NEATH PORT TALBOT COUNTY BOROUGH COUNCIL

CABINET

REPORT OF THE DIRECTOR OF FINANCE & CORPORATE SERVICES

22nd NOVEMBER 2017

MATTERS FOR DECISION

WARDS AFFECTED - ALL

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2017/18

1. Purpose of the Report

1.1 To review treasury management activities for the 6 month period to 30th September 2017.

2. Background

2.1 The Council operates a cash balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 As a consequence treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

3. Introduction

3.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was adopted by this Council at the Council meeting in 28th February 2013.

3.2 The primary requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices set out in the manner in which the Council will seek to achieve those policies and objectives.

(iii) Receipt by the full Council of an Annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.

(iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(v) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated bodies are the Audit and Policy and Resources Committees.

Scheme of Delegation

Area of Responsibility	Council/ Committee	Frequency
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Cabinet for approval by Full Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Cabinet	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Cabinet for approval by Full Council	Periodically
Annual Treasury Outturn Report	Policy and Resources Cabinet Board	Annually by 30th September after the end of the year
Treasury Management Monitoring and Performance Reports	Policy and Resources Cabinet Board and Scrutiny and Audit Committee	6 Weekly Quarterly
Treasury Management Practices	Cabinet for approval by Full Council	Annually
Scrutiny of Treasury Management Strategy	Policy and Resources Scrutiny and Audit Committee	Annually

3.3 This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for 2017/18;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;

- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2017/18;
- A review of the Council's borrowing strategy for 2017/18;
- A review of any debt rescheduling undertaken during 2017/18;
- A review of compliance with Treasury and Prudential Limits for 2017/18.
- Revised Treasury and Prudential Limits for 2017/18 to 2019/20.

3.4 There have been no changes to the approved Treasury Management and Investment Strategies for the 6 months up to 30th September 2017.

4. Economic update

4.1 After the UK economy surprised us with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.2% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure.

However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action.

Subsequently at its next meeting on the 2 November 2017 the MPC voted 7 to 2 in favour of increasing the Bank Base Rate from 0.25% to 0.5%, the first increase in a decade. They also gave forward guidance that they expected to increase Bank Rate only twice more in the next 2 years to reach 1% by 2020. This has been seen as a very relaxed rate of increase prediction in line with previous statements that the rate will only go up very gradually and to a limited extent. The quarterly Inflation Report was notable downbeat about economic growth based on the trend that the economy has now fallen from 2.2% to only 1.5% and that inflation (CPI) is likely to peak shortly at 3.2% before falling.

4.2 Interest rate forecasts

The Council’s Treasury Advisor, Link Asset Services, has recently provided the following updated forecasts: This shows a projected increase in the bank rate by another 0.25% in the final quarters of 2018 and 2019 to 0.75% and 1.00% respectively. The table also shows projected changes in short term investment lending rates and longer term borrowing rates.

	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.25	1.25	1.25
3 month LIBID	0.40	0.40	0.40	0.40	0.40	0.60	0.60	0.60	0.70	0.90	0.90	1.00	1.20	1.20	1.20
6 month LIBID	0.45	0.50	0.50	0.50	0.60	0.80	0.80	0.80	0.90	1.00	1.00	1.10	1.30	1.30	1.40
12 month LIBID	0.65	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.10	1.30	1.30	1.40	1.50	1.50	1.60
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.10	2.10	2.20	2.30	2.30
10 yr PWLB	2.10	2.10	2.20	2.30	2.40	2.40	2.50	2.60	2.60	2.70	2.70	2.80	2.90	2.90	3.00
25 yr PWLB	2.70	2.80	2.90	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.40	3.50	3.50	3.60	3.60
50 yr PWLB	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40	3.40

Link Asset Services advise that forecasting remains difficult with so many external influences weighing on the UK. This is due to the uncertainties arising from trading arrangements following Brexit, growth in the UK economy, wage demands etc. They also advise that the growth in the US economy is likely to be faster than that in the UK and this will need to be monitored closely.

5.0 The Council's Capital Position (Prudential Indicators)

5.1 This part of the report updates:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

The Council's Capital Expenditure and Financing 2017/18

	2016/17 Actual £'000	2017/18 Original Estimate £'000	2017/18 Current Estimate £'000
Capital expenditure	53,758	59,273	76,366
Resourced by:			
• Capital receipts	1,412	1,300	1,300
• Capital grants & contributions	19,870	29,792	37,827
• Capital reserves + DRF	2,441	1,721	67
Capital Expenditure to be financed from borrowing	**30,035**	**26,460**	**37,172**

5.2 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

5.3 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

5.4 Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments.

External debt can also be borrowed or repaid at any time, but this does not change the CFR.

5.5 The total CFR can also be reduced by:

- The application of additional capital financing resources (such as unapplied capital receipts); or
- Charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

5.6 The Council's 2017/18 MRP Policy (as required by CIPFA Code of Practice on Treasury Management) was approved by Council as part of the Treasury Management Strategy Report for 2017/18 on 1st February 2017.

5.7 The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR	**2016/17 Actual £'000**	**2017/18 Original Estimate £'000**	**2017/18 Current Estimate £'000**
Opening balance	270,244	287,793	292,826
Add unfinanced capital expenditure (Section 5.1)	30,035	26,460	37,172
Less MRP/Set aside receipts	(7,453)	(8,174)	(8,179)
Closing balance	**292,826**	**306,079**	**321,819**

5.8 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

5.9 Net borrowing and the CFR – in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2017/18. The following table highlights the Council's net borrowing position against the CFR. This shows the Council is complying with this prudential indicator as projected net borrowing is less than the CFR i.e. £195.654m compared to £321.819m.

	2016/17 Actual £'000	**2017/18 Original Estimate £'000**	**2017/18 Current Estimate £'000**
External Debt (Gross)	250,140	260,656	255,654
Less Investments	(70,820)	(60,000)	(60,000)
Net Borrowing Position	179,320	200,656	195,654
CFR	292,826	306,079	321,819

5.10 The authorised limit – the authorised limit is the "affordable borrowing limit" required by Section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level.

5.11 The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

	2016/17 Actual £'000	**2017/18 Original Estimate £'000**	**2017/18 Current Estimate £'000**
Authorised Limit	343,791	355,237	347,607
Operational Boundary	323,791	335,237	327,607
Gross Borrowing *	265,420	260,656	255,654

* Total maximum long term and short term

This report confirms that during the first 6 months of 2017/18 Council has maintained gross borrowing within the Authorised Limit.

6. Investment Portfolio 2017/18

6.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. It is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates remain very low and in line with the 0.25% Bank Rate (since 4th August 2016) but subsequently increased to 0.5% on 2 November 2017.

The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low. The following projected change in the bank base rate has been received from the Council's Treasury Advisors following the interest rate increase of 2 November 2017.

RATE	**Projected 7 Nov**	**Projected previously**
Q3 2017	0.50%	0.25%
Q1 2018	0.50%	0.25%
Q1 2019	0.75%	0.25%
Q1 2020	1.00%	0.75%
Q1 2021	1.25%	N/A

6.2 It is confirmed that the approved limits within the Annual Investment Strategy have not been breached during the first six months of 2017/18.

6.3 The Council's budgeted investment return for 2017/18 has been set at £504k which is a reflection of the low level of returns anticipated on investments.

6.4 The Treasury Management Strategy Statement (TMSS) for 2017/18, which includes the Annual Investment Strategy, sets out the Council's investment priorities as being:

- Security of Capital
- Liquidity

6.5 There has been no change in the Council's Investment Strategy aims from those approved on 1st February 2017. The aim continues to be to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate, it is considered appropriate to keep an adequate level of investments which can be instantly accessed to cover short term cash flow needs. The Council also seeks out value where available in significantly higher rates in periods up to 12 months with approved institutions that meet the Council's stringent credit rating assessment.

6.6 Investment rates available have continued at historically low levels but have now slightly increased following the end of the first half year to 30 September 2017 and the increase in the Bank Base Rate on 2 November 2017. The average level of funds available for investment purposes during the period was affected by the timing of precept payments, receipt of grants and progress on the Capital Programme.

Investment performance to the 30th September 2017

6.7 The Council held £72m of investments as at 30th September 2017 (£70.820m at 31 March 2017) and the investment portfolio yield for the first six months of the year is 0.69% against a benchmark 0.18%. The Council has outperformed the benchmark by 51 basis points. The benchmark for funds managed in-house is the 3 month LIBID uncompounded rate which is the most realistic comparison rate as advised by our treasury management consultants.

6.8 A full list of investments held as at 30th September 2017 is provided in Appendix 1.

Investment counterparty criteria and proposed amendments

6.9 The current investment counterparty criteria approved by Members earlier this year are detailed in Appendix 3 of this report.

6.10 The Current Investment Policy to allow for a maximum investment of £20m with F1 rated institutions. Currently classified as F1 by the Fitch credit reference agency are banks such as Lloyds Bank, Barclays Bank and Santander UK plc.

7. Borrowing

7.1 The Council's agreed Strategy in relation to borrowing is set out in the Treasury Management Strategy Report as approved by Council. This strategy outlined that consideration would be given to entering into new external borrowing if PWLB (or money market) rates became more favourable.

7.2 During 2017/18 the Council has, to date, entered into the following new loan arrangement with the PWLB:

Date	Amount of Loan £'000	Type	Interest Rate %	Term of Loan
15/8/17	10,000	Maturity Loan	2.33	48.5

The loans are used to fund capital expenditure on assets including the 21st Century Schools Programme, Street Lighting and Regeneration.

Given the projected increases in interest rates and the need to ensure adequate cash flows in place for the Council to meet its capital programme requirements consideration is being given to take out additional new loans.

Borrowing in advance of need

7.3 The Council has not borrowed in advance of need during the six month period ended 30th September 2017. Members should note that the total external debt projection for 31st March 2018 is as follows:

	£'000
Public Works Loans Board (PWLB)	193,154
Market Loans	62,500
Total	**255,654**

8. Debt Rescheduling

8.1 Debt rescheduling opportunities have been non-existent during 2017/18 due to the penalties involved in entering into such arrangements.

9. Compliance with Treasury and Prudential Limits

9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's original approved Treasury and Prudential Indicators (affordability) limits were included in the approved Treasury Management Strategy Statement as reported to Council on 1st February 2017.

9.2 During the financial year to date, the Council has operated within the Treasury Limits and Prudential Indicators set out in the Treasury Management Strategy Statement and in compliance with the Treasury Management Practices. The Prudential and Treasury Indicators for 2017/18 onwards have been revised and are presented in Appendix 2.

10. Equality Impact Assessment

There is no requirement for an equality impact assessment under the Equality Act 2010 in relation to this report as there is no direct service provided.

11. Risk Management

There are several risks associated with the treasury management activities. These include interest rate fluctuations, counter party investment, international economic and political etc. The treasury management strategy is included within the Council's Corporate Risk Register.

12. Consultation

There is no requirement under the Constitution for external consultation on this item.

13. Recommendation

It is recommended that Members note the Treasury Management activities to date this financial year, and how they relate to the proposed activities within the original 2017/18 Treasury Management Strategy and Annual Investment Strategy Statements.

14. Reason for Proposed Decision

To comply with requirements of the Code of Practice on Treasury Management.

Appendices
Appendix 1 – Investment Position as at 30th September 2017
Appendix 2 – Prudential Indicators
Appendix 3 – Specified Investments - Current Criteria

List of Background Papers
Link Asset Service Mid-Year Reporting Template
Investment and Loan Records 2017/18

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Appendix 1

Investment Position as at 30th September 2017

Borrower	Maturity	Rate %	Total £'000
Banks and Building Societies			
Lloyds Banking Group	15-Nov-17	0.55	3,000
Lloyds Banking Group	19-Oct-17	0.55	1,000
Goldman Sachs	185 day notice	0.85	5,000
Goldman Sachs	185 day notice	0.75	5,000
Goldman Sachs	185 day notice	0.70	2,000
Goldman Sachs	185 day notice	0.88	3,000
Santander Bank	182 day notice	0.55	10,000
Santander Bank	Instant Access	0.25	5,000
Skipton Building Society	11-Jan-18	0.53	5,000
Skipton Building Society	27-Oct-17	0.15	1,000
Skipton Building Society	27-Oct-17	0.17	4,000
Skipton Building Society	27-Oct-17	0.15	5,000
Other Local Authorities			
Blaenau Gwent CBC	16-Nov-17	0.38	2,000
Eastbourne BC	19-Jun-18	2.20	4,000
Leeds City Council	1 day notice	0.22	6,000
Middlesborough BC	02-Oct-17	0.17	5,000
Peterborough City Council	04-Dec-18	2.10	2,000
Peterborough City Council	06-Dec-18	2.10	2,000
Peterborough City Council	18-Dec-18	2.10	2,000
Total			**72,000**

Appendix 2

PRUDENTIAL INDICATORS

PRUDENTIAL INDICATORS	**2016/17 Actual**	**2017/18 Original Estimate**	**2017/18 Revised Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure	53,758	59,273	76,366	34,887	14,990
Capital Financing Requirement as at 31st March	292,826	306,079	321,819	333,392	333,467
Ratio of financing costs to net revenue stream	% 6.20	% 6.62	% 6.63	% 6.72	% 7.07
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in council tax (Band D) per annum	23.27	24.46	30.32	14.51	17.56

Appendix 2

PRUDENTIAL INDICATORS

TREASURY MANAGEMENT INDICATORS	**2016/17 Actual**	**2017/18 Original Estimate**	**2017/18 Revised Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Authorised Limit for External Debt:					
Borrowing and other long term liabilities	343,791	355,237	347,607	342,423	339,456
Operational Boundary for External Debt:					
Borrowing and other long term liabilities	323,791	335,237	327,607	322,423	319,456
External Debt (Gross)	250,140	260,656	255,654	260,470	257,503
Less Investments	(70,820)	(60,000)	(60,000)	(60,000)	(60,000)
Net Borrowing Position	**179,320**	**200,656**	**195,654**	**200,470**	**197,503**

Appendix 2

PRUDENTIAL INDICATORS

	2017/18 to 2019/20 limit
	£'000
Upper Limit on Fixed Interest Rate Exposure	347,607
Lower Limit on Fixed Interest Rate Exposure	
Upper Limit on Variable Rate Exposure	173,804
Lower Limit on Variable Rate Exposure	
Upper Limit for Total Principal Sums Invested for Over 364 Days (per maturity date)	£25m

Maturity Structure of Fixed Rate Borrowing During 2016/17	2016/17 Actual	2017/18 Estimate		
	%	%	Upper Limit %	Lower Limit %
Under 12 months	6	2	15	0
12 months to 2 years	2	6	15	0
2 to 5 years	7	5	40	0
5 to 10 years	7	3	60	0
10 years and above	78	84	100	15

Appendix 3

Specified Investments Criteria

	Minimum 'High' Credit Criteria	Funds Managed	Max Amount	Max Duration
Term deposits				
Term deposits - Debt Management Office	N/A	In-house	Unlimited	1 year
Term deposits – local, police and fire authorities	N/A	In-house	£10m	1 year
Term deposits – Nationalised & Part Nationalised UK banks/Building Societies	Fitch short-term rating F1+, F1	In-house	£20m	1 year
Term deposits – UK banks/Building Societies	Fitch short-term rating F1+	In-house	£20m	1 year
Term deposits – UK banks/Building Societies	Fitch short-term rating F1	In-house	£15m	6 months or 185 days
Callable deposits				
Callable deposits – Debt Management Agency deposit facility	N/A	In-house	Unlimited	
Callable deposits – Nationalised & Part Nationalised UK banks/Building Societies	Fitch short-term rating F1+, F1	In-house	£20m	
Callable deposits – Nationalised & Part Nationalised UK banks/Building Societies	Fitch short-term rating F2	In-house	£10m	
Callable deposits - UK banks/Building Societies	Fitch short-term rating F1+ or F1	In-house	£15m *	
Term deposits – non UK banks	Fitch short-term rating F1+	In-house	£5m	6 months or 185 days

* Where necessary this limit may be temporarily exceeded with the Authority's bankers only.