NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

CABINET – TUESDAY, 12 JUNE 2018

Title of report	**TREASURY MANAGEMENT STEWARDSHIP REPORT 2017/18**
Key Decision	a) Financial Yes b) Community Yes
Contacts	Councillor Nick Rushton 01530 412059 nicholas.rushton@nwleicestershire.gov.uk Strategic Director of Housing and Customer Services 01530 454819 glyn.jones@nwleicestershire.gov.uk Head of Finance 01530 454707 tracy.bingham@nwleicestershire.gov.uk
Purpose of report	To inform Members of the Council's Treasury Management activity undertaken for the financial year 2017/18.
Reason for Decision	These are statutory requirements
Council Priorities	Value for Money
Implications:	
Financial/Staff	Interest earned on balances and interest paid on external debt, impact on the resources available to the Council.
Link to relevant CAT	Could impact upon all Corporate Action Teams.
Risk Management	Borrowing and investment both carry an element of risk. This risk is mitigated through the adoption of the Treasury and Investment Strategies, compliance with the CIPFA code of Treasury Management and the retention of Treasury Management Advisors (Arlingclose) to proffer expert advice.
Equalities Impact Screening	Not required.
Human Rights	No implications.
Transformational Government	No implications.
Comments of Head of Paid Service	Report is satisfactory
Comments of Section 151 Officer	Report is satisfactory

Comments of Monitoring Officer	Report is satisfactory
Consultees	None
Background papers	Treasury Management Strategy Statement 2017/18 – Council Meeting 23 February 2017; Treasury Management Activity Report – April to August 2017 – Audit & Governance Committee 27 September 2017; Treasury Management Activity Report – April to October 2017 – Audit & Governance Committee 6 December 2017; Treasury Management Activity Report – April to February 2018 – Audit & Governance Committee 21 March 2018; Budget and Council Tax Report 2018/19 – Council meeting 27 February 2018
Recommendations	**THAT MEMBERS APPROVE THIS REPORT.**

1.0 BACKGROUND

1.1 Treasury Management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the code"), which requires local authorities to produce Prudential Indicators and a Treasury Management Strategy Statement annually on the likely financing and Investment activity.

1.2 This report fulfils the council's legal obligation under the Local Government Act 2003, to have regard to both the CIPFA Code and the MHCLG Investment Guidance

1.3 CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The revised Prudential Code introduced the requirement for a capital strategy which provides a high level, long-term context of capital expenditure and investment decisions.

1.4 A capital strategy was presented to members as part of the Budget and Council tax report to council on 27 February 2018.

1.5 The council's current Treasury Management Strategy Statement, including the Borrowing Strategy, Debt Rescheduling Strategy, Annual Investment Policy and Strategy, Interest Apportionment Policy, Prudential Indicators and Annual Minimum Revenue Position Statement were approved by Council on 23 February 2017.

1.6 When investing or borrowing, the council is exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risks are therefore central to the council's treasury management strategy.

1.7 As a result of the second 'Markets in Financial Instruments Directive' (MiFID II), from 3 January 2018 all local authorities were automatically treated as retail clients for the purpose of investing, but could opt-up to Professional client status if certain criteria was met, including maintaining an investment balance of at least £10m and that persons making investment decisions have the expertise and knowledge to understand the risks involved – as presented to Council on 27 February 2018 in the Treasury Management Strategy Statement.

2.0 THE U.K. ECONOMY AND OTHER FACTORS.

2.1 An economic update and Interest rate forecast has been provided by our Treasury Advisers (Arlingclose Ltd) and summarised below. A full update can be found at Appendix A

- CPI rose to 3.1% in November 2017 before falling back to 2.7% in February 2018
- The unemployment rate fell back to 4.3% in January 2018
- The Bank of England increased the bank rate by 0.25% to 0.5%. This was the first increase in 10 years
- UK economy grew by 1.8% in the calendar year of 2017

3.0 THE COUNCIL'S TREASURY POSITION.

3.1 The council's current strategy is to use internal borrowing to reduce risk and keep interest costs low. The treasury management change over the financial year is shown below.

	Balance at 01/04/2017 £m	**Net Movement £m**	**Balance at 31/03/2018 £m**
Long term borrowing - HRA	£75.1	-£1.1	£74.0
Long term borrowing – General Fund	£8.4	£0.0	£8.4
Other long-term liabilities - HBBC	£0.1	-£0.0	£0.1
Total Borrowing	**£83.5**	**-£1.1**	**£82.5**
Long term investments – greater than 1 year	£12.0	£0.0	£12.0
Short term investments – less than 1 year	£24.3	£5.0	£29.3
Pooled funds and externally managed investments*	£3.1	-£0.5	£2.6
Total Investments	**£39.4**	**£4.5**	**£43.9**
Net debt	**£44.1**	**-£5.6**	**£38.5**

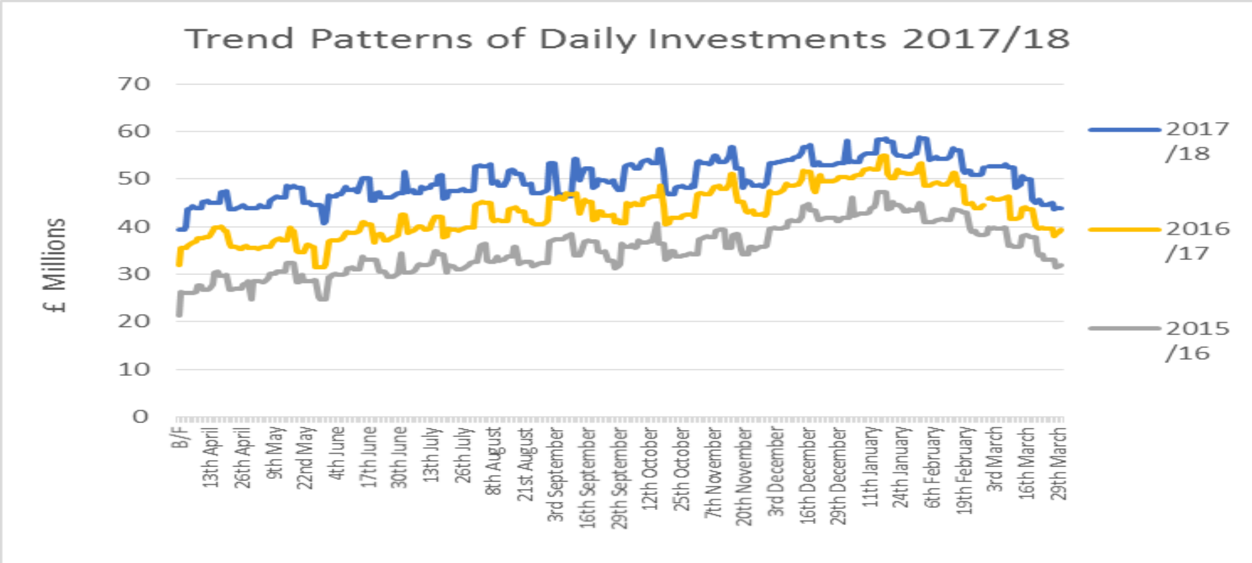
*Represents investments held in Money Market Funds

3.2 The annual repayments on two PWLB annuity loans taken out as part of the self-financing system of Council Housing in 2011/2012, is shown in the Net Movement column.

3.3 In 2017/18, the capacity for investment has increased by £4.5m. This can be affected by various factors including: increased income, contributions to/from reserves, setting aside expenditure to repay borrowing (MRP), fortuitous income, cash flow timing of receipts and payments and internal borrowing.

3.4 In 2017/18, some of the highlights that have impacted on the capacity are: sales of assets – circa £1.8m; MRP £0.55m; increased income from various activities across the council including circa £145k from recycling income and circa £90k from investment income.

3.5 The pattern of investments per day is shown in the table below, illustrating the cash flow trends throughout the year



4.0 BORROWING ACTIVITY.

4.1 The council's Borrowing Strategy 2017/18, incorporates a prudent and pragmatic approach to borrowing to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the council's Prudential Indicators.

4.2 None of the loans that matured in 2017/18 required replacement.

4.3 The council has not undertaken any new long-term borrowing during the year. Interest payments totalling £2.76m were made in respect of existing debt.

4.4 The council's cash flow remained positive and did not require and temporary loans during the year.

4.5 The council had approximately £5.5m of internal debt at 31 March 2018. This is the cumulative value of internal cash balances used to finance new capital expenditure instead of financing through unsupported borrowing. This is currently judged to be the most cost effective means of funding the capital programme.

4.6 The estimated Minimum Revenue Provision (MRP) is intended to ensure that the capital financing debt is paid off over the longer term. The MRP charge made to General Fund revenue account for 2017/18 is £0.55m. For housing, MRP is classed as the principal repayments made in respect of the two PWLB annuity loans taken out as part of the housing self-financing in 2011/12. In 2017/18, this repayment was £1.08m.

5.0 DEBT RESCHEDULING ACTIVITY.

5.1 The council's Debt Rescheduling Strategy 2017/18, establishes a flexible approach where the rationale for rescheduling could be one or more of the following:

- Savings in interest costs with minimal risk.
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio.
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

5.2 No opportunities for debt rescheduling were identified which conformed to the above rationale. Accordingly, the council has undertaken no debt rescheduling activity during the year.

5.3 The council's portfolio of thirteen loans - ten PWLB loans and three market loans continue to be monitored for debt rescheduling opportunities.

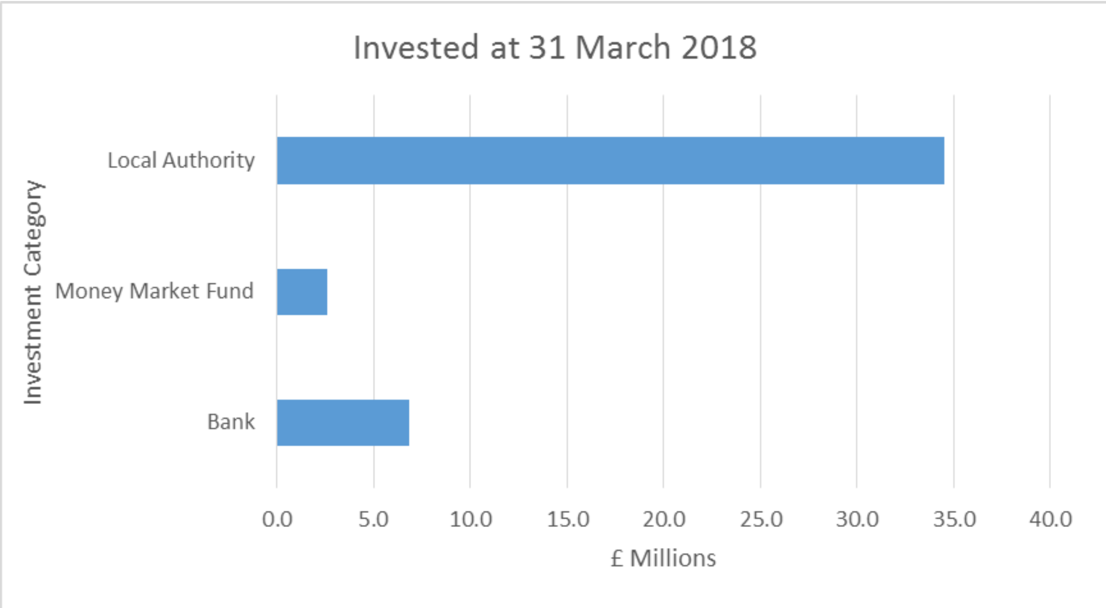
6.0 INVESTMENT ACTIVITY.

6.1 The main objective of the council's Investment Policy and Strategy 2017/18 is to invest its surplus funds prudently.

6.2 The council's investment priorities (S.L.Y.) are:

- **s**ecurity of the invested capital;
- sufficient **l**iquidity to permit investments; and,
- Optimum **y**ield which is commensurate with security and liquidity.

6.3 To lower the inherent investment risk, the council has minimised the use of banks and increased the use of other Local Authorities as investment counterparties. A range of lengths of investment, from overnight investments to short and long fixed term, from 32 days to 3 years, are currently utilised to ensure that the principles of security, liquidity and yield are followed. The table below shows the range of counterparties used by the council and the values invested at 31 March 2018.



6.4 The counterparties that the council currently use all meet the criteria set out in the Treasury Management Strategy Statement 2017/18 and are monitored by the Treasury Management Advisors. A detailed list of the counterparties used and amounts currently invested can be seen in Appendix B.

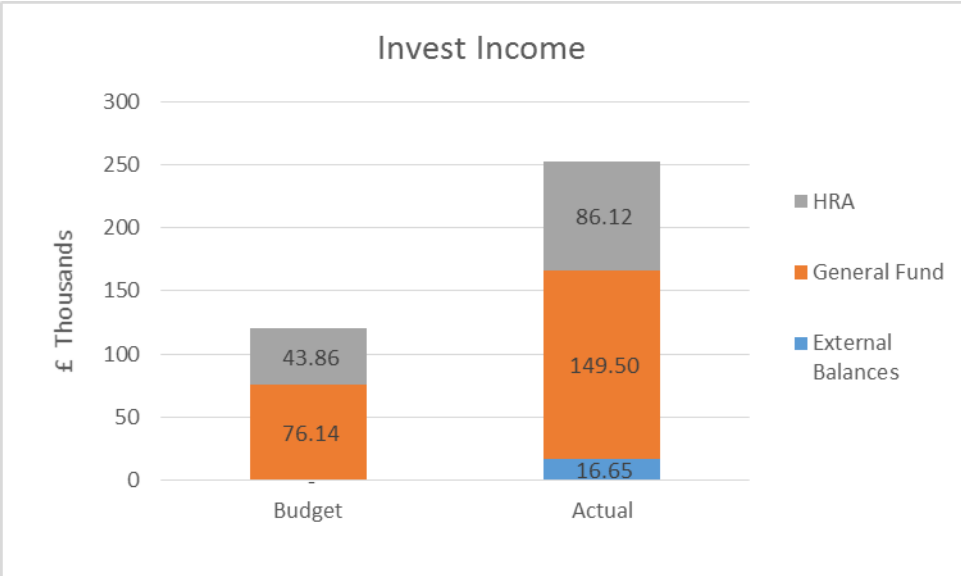
6.5 The average rate of return on the council's investment balances for the year was 0.487%. For comparison purposes, the benchmark return (average 7-day London Interbank Bid Rate or LIBID rate) on 29 March 2018 was 0.21% and the average 7 day London Interbank Offered Rate (LIBOR) rate was 0.34%. This shows that we are achieving a good rate of return against benchmark.

6.6 Paragraph 6.5 above explains that the current average rate of return of 0.48% has been achieved. The graph at Appendix C shows the average rate per counterparty to illustrate the range and movement of interest rates over the year.

6.7 The council budgeted to achieve £120,000 of income from its investment activity in 2017/18. Investment activity for the year achieved £252,272 in interest. This is a slight increase of £2,881 from the revised forecast outturn of £249,391 presented to Members in the Treasury Management Activity Report April 2017 to February 2018.

6.8 Of this total, an element is applied to balances held on external income. This external income largely represents balances from S106 contributions that have not yet been spent.

6.9 The budgeted and projected levels of investment income is represented in the table below.



6.10 There was one breach of investment limits in the year reported to Audit and Governance committee on 21 March 2018.

6.11 On 1st February 2018, the counterparty limit for our banking provider (Lloyds) was breached by £1.4m. An unexpected credit into the bank account for £1.7m was made late in the day. This is not something the Council could have taken action to avoid.

7.0 SUMMARY

7.1 For the financial year 2017/18, the council can confirm that it has complied with its Prudential Indicators, which were approved as part of the council's Treasury Management Strategy Statement.

7.2 The council can confirm that during the financial year, other than the breach of prescribed limit detailed in paragraph 6.11, it has complied with its Treasury Management Practices.

APPENDIX A

Economic information provided by Treasury Management Advisors

External Context *(based on data as at 09/04/18)*

Economic commentary

2017-18 was characterised by the push-pull from expectations of tapering of Quantitative Easing (QE) and the potential for increased policy rates in the US and Europe and from geopolitical tensions, which also had an impact.

The UK economy showed signs of slowing with latest estimates showing GDP, helped by an improving global economy, grew by 1.8% in calendar 2017, the same level as in 2016. This was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, but it also reflected the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

The inflationary impact of rising import prices, a consequence of the fall in sterling associated with the EU referendum result, resulted in year-on-year CPI rising to 3.1% in November before falling back to 2.7% in February 2018. Consumers felt the squeeze as real average earnings growth, i.e. after inflation, turned negative before slowly recovering. The labour market showed resilience as the unemployment rate fell back to 4.3% in January 2018. The inherent weakness in UK business investment was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit, the UK and the EU only reaching an agreement in March 2018 on a transition which will now be span Q2 2019 to Q4 2020. The Withdrawal Treaty is yet to be ratified by the UK parliament and those of the other 27 EU member states and new international trading arrangements are yet to be negotiated and agreed.

The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February *Inflation Report* indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening. Although in March two MPC members voted to increase policy rates immediately and the MPC itself stopped short of committing itself to the timing of the next increase in rates, the minutes of the meeting suggested that an increase in May 2018 was highly likely.

In contrast, economic activity in the Eurozone gained momentum and although the European Central Bank removed reference to an 'easing bias' in its market communications and had yet to confirm its QE intention when asset purchases end in September 2018, the central bank appeared some way off normalising interest rates. The US economy grew steadily and, with its policy objectives of price stability and maximising employment remaining on track, the Federal Reserve Open Market Committee (FOMC) increased interest rates in December 2017 by 0.25% and again in March, raising the policy rate target range to 1.50% - 1.75%. The Fed is expected to deliver two more increases in 2018 and a further two in 2019. However, the imposition of tariffs on a broadening range of goods initiated by the US, which has led to retaliation by China, could escalate into a deep-rooted trade war having broader economic consequences including inflation rising rapidly, warranting more interest rate hikes.

Financial markets: The increase in Bank Rate resulted in higher money markets rates: 1-month, 3-month and 12-month LIBID rates averaged 0.32%, 0.39% and 0.69% and at 31st March 2018 were 0.43%, 0.72% and 1.12% respectively.

Gilt yields displayed significant volatility over the twelve-month period with the change in sentiment in the Bank of England's outlook for interest rates. The yield on the 5-year gilts which had fallen to 0.35% in mid-June rose to 1.65% by the end of March. 10-year gilt yields also rose from their lows of 0.93% in June to 1.65% by mid-February before falling back to 1.35% at year-end. 20-year gilt yields followed an even more erratic path with lows of 1.62% in June, and highs of 2.03% in February, only to plummet back down to 1.70% by the end of the financial year.

The FTSE 100 had a strong finish to calendar 2017, reaching yet another record high of 7688, before plummeting below 7000 at the beginning of 2018 in the global equity correction and sell-off.

Credit background:

Credit Metrics

In the first quarter of the financial year, UK bank credit default swaps reached three-year lows on the announcement that the Funding for Lending Scheme, which gave banks access to cheaper funding, was being extended to 2018. For the rest of the year, CDS prices remained broadly flat.

The rules for UK banks' ring-fencing were finalised by the Prudential Regulation Authority and banks began the complex implementation process ahead of the statutory deadline of 1st January 2019. As there was some uncertainty surrounding which banking entities the Authority would will be dealing with once ring-fencing was implemented and what the balance sheets of the ring-fenced and non ring-fenced entities would look would actually look like, in May 2017 Arlingclose advised adjusting downwards the maturity limit for unsecured investments to a maximum of 6 months. The rating agencies had slightly varying views on the creditworthiness of the restructured entities.

Barclays was the first to complete its ring-fence restructure over the 2018 Easter weekend; wholesale deposits including local authority deposits will henceforth be accepted by Barclays Bank plc (branded Barclays International), which is the non ring-fenced bank.

Money Market Fund regulation: The new EU regulations for Money Market Funds (MMFs) were finally approved and published in July and existing funds will have to be compliant by no later than 21st January 2019. The key features include Low Volatility Net Asset Value (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing NAV, providing they meet strict new criteria and minimum liquidity requirements. MMFs will not be prohibited from having an external fund rating (as had been suggested in draft regulations). Arlingclose expects most of the short-term MMFs it recommends to convert to the LVNAV structure and awaits confirmation from each fund.

Credit Rating developments

The most significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities.

Changes to credit ratings included Moody's downgrade of Standard Chartered Bank's long-term rating to A1 from Aa3 and the placing of UK banks' long-term ratings on review to reflect the impending ring-fencing of retail activity from investment banking (Barclays, HSBC and RBS were on review for downgrade; Lloyds Bank, Bank of Scotland and National Westminster Bank were placed on review for upgrade).

Standard & Poor's (S&P) revised upwards the outlook of various UK banks and building societies to positive or stable and simultaneously affirmed their long and short-term ratings, reflecting the institutions' resilience, progress in meeting regulatory capital requirements and being better positioned to deal with uncertainties and potential turbulence in the run-up to the UK's exit from the EU in March 2019. The agency upgraded Barclays Bank's long-term rating to A from A- after the bank announced its plans for its entities post ring-fencing.

Fitch revised the outlook on Nationwide Building Society to negative and later downgraded the institution's long-term ratings due to its reducing buffer of junior debt. S&P revised the society's outlook from positive to stable.

Other developments:

In February, Arlingclose advised against lending to Northamptonshire County Council (NCC). NCC issued a section 114 notice in the light of severe financial challenge and the risk that it would not be in a position to deliver a balanced budget.

Local Authority Regulatory Changes

Revised CIPFA Codes: CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code are incorporated into Treasury Management Strategies and monitoring reports.

The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. Where this strategy is produced and approved by full Council, the determination of the Treasury Management Strategy can be delegated to a committee. The Code also expands on the process and governance issues of capital expenditure and investment decisions.

A capital strategy was presented to members as part of the Budget and Council Tax report to Council on 27 February 2018

In the 2017 Treasury Management Code the definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is be identified and reported.

MHCLG Investment Guidance and Minimum Revenue Provision (MRP): In February 2018 the MHCLG (Ministry of Housing, Communities and Local Government) published revised Guidance on Local Government and Investments and Statutory Guidance on Minimum Revenue Provision (MRP).

Changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income return and a new category called "loans" (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate). The Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and also specifies additional indicators. Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

The definition of prudent MRP has been changed to "put aside revenue over time to cover the CFR"; it cannot be a negative charge and can only be zero if the CFR is nil or negative. Guidance on asset lives has been updated, applying to any calculation using asset lives. Any change in MRP policy cannot create an overpayment; the new policy must be applied to the outstanding CFR going forward only.

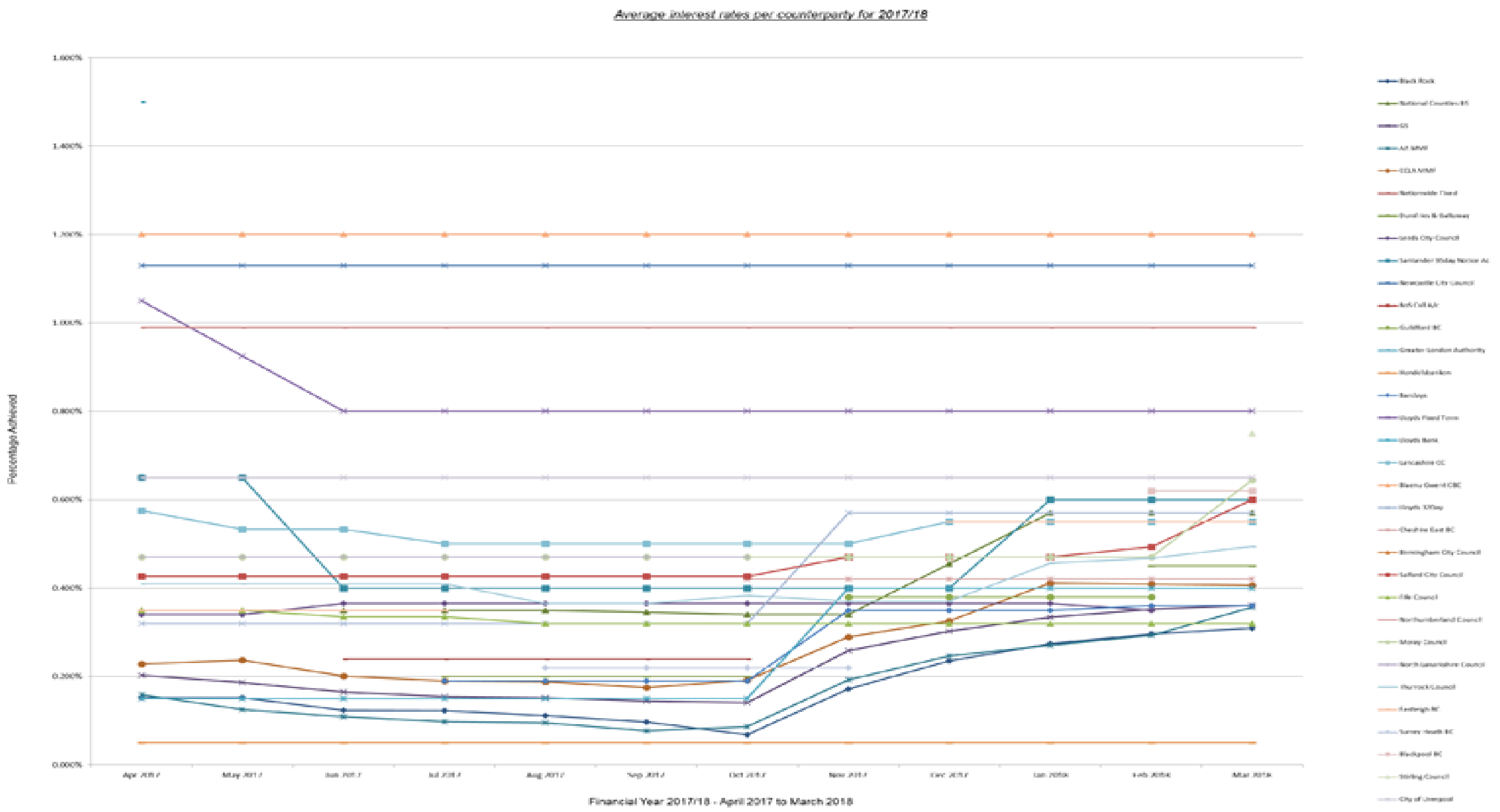
MiFID II: As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Authority has met the conditions to opt up to professional status and has done so in order to maintain its former MiFID II status prior to January 2018. The Authority will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

Appendix B

Counterparty	Investment Category	Total Length of Investment (days)	Rate %	£m
BoS Call A/c	Bank	1	0.40	1.5
Lloyds Bank	Bank	1	0.40	0.6
AAM MMF	MMF	1	0.35	1.6
CCLA MMF	MMF	1	0.41	1.0
Lloyds 32day Notice Account	Bank	32	0.57	0.3
Barclays Treasury Direct - Fixed Term	Bank	89	0.36	1.5
Thurrock Council	LA	90	0.50	1.0
Thurrock Council	LA	91	0.60	1.0
Dumfries & Galloway Council	LA	91	0.45	1.5
Santander 95 Day Notice Account	Bank	95	0.60	1.5
Blackpool Borough Council	LA	120	0.62	2.0
Eastleigh Borough Council	LA	182	0.55	1.0
Stirling Council	LA	185	0.75	1.5
Thurrock Council	LA	213	0.42	2.0
Cheshire East Borough Council	LA	214	0.42	5.0
Moray Council	LA	275	0.82	2.5
Leeds City Council	LA	276	0.60	3.0
Thurrock Council	LA	312	0.63	1.0
Salford City Council	LA	321	0.60	1.0
Lloyds Fixed Term Deposit	Bank	364	0.80	1.5
The City of Liverpool	LA	640	0.65	2.0
Lancashire County Council (LT)	LA	730	0.55	2.0
Newcastle City Council	LA	1093	1.13	2.5
Northumberland County Council	LA	1096	0.99	3.0
Blaenau Gwent County Borough Council	LA	1099	1.20	2.5
TOTALS				**43.9**

APPENDIX C



Average interest rates per counterparty for 2017/18
1.600%
1.400%
1.200%
1.000%
0.800%
0.600%
0.400%
0.200%
0.000%
Percentage Achieved
Financial Year 2017/18 - April 2017 to March 2018