
Report To:	Policy & Resources Committee	Date:	13 November 2018
Report By:	Chief Financial Officer	Report No:	FIN/108/18/AP/KJ
Contact Officer:	Alan Puckrin	Contact No:	01475 712223
Subject:	TREASURY MANAGEMENT – MID-YEAR REPORT 2018/19		

1.0 PURPOSE

- 1.1 The purpose of this report is to advise members of the operation of the treasury function and its activities for the first six months of 2018/19 as required under the terms of Treasury Management Practice 6 ("TMP6") on "Reporting Requirements and Management Information Arrangements".

2.0 SUMMARY

- 2.1 As at 30 September 2018, the Council had gross external debt (including PPP) of £260,107,373 and investments of £22,037,319. This compares to gross external debt (including PPP) of £271,348,549 and investments of £33,445,618 at 31 March 2018. The significant movements are largely due to £10,000,000 of PWLB borrowing maturing and being repaid from investments.
- 2.2 The Council is projected to be underborrowed by £36,307,000 compared to its Capital Financing Requirement as at 31 March 2019. This is a decrease in projected underborrowing of £8,128,000 from the estimate of £44,435,000 in the 2018/19 Treasury Management Strategy. The under borrowing position means that the Council is using funds it currently has (such as reserves) to cash flow capital expenditure rather than bringing in new funds from borrowing.
- 2.3 The Council undertook £5m of 3-month temporary borrowing at 0.70% from another Scottish local authority during the period in order to provide additional short-term liquid funds. This temporary borrowing has now been repaid. The projection for the remainder of the year includes £10,000,000 of borrowing that will only be undertaken if the funds are required and it is prudent to borrow. Any borrowing undertaken will be reported to Committee.
- 2.4 The average rate of return achieved on investments during the first six months of 2018/19 was 0.72% which exceeds the benchmark return rate for the period of 0.61% by 0.11% and resulted in £18,000 of additional interest on investments for the Council.
- 2.5 During the first six months of 2018/19 the Council did not undertake any debt restructuring and operated within the required treasury limits and Prudential Indicators for the year set out in the Council's Treasury Policy Statement, annual Treasury Strategy Statement, and the Treasury Management Practices.

3.0 RECOMMENDATIONS

- 3.1 It is recommended that the Committee notes the contents of the Mid-Year Report on Treasury Management for 2018/19 and the ongoing work to ensure the delivery of financial benefits for the Council.
- 3.2 It is recommended that the Mid-Year Report be remitted to the Inverclyde Council for approval.

Alan Puckrin
Chief Financial Officer

4.0 BACKGROUND

- 4.1 The Council is required by the CIPFA Code of Practice on Treasury Management 2011 and the CIPFA Prudential Code for Capital Finance in Local Authorities to produce a mid-year treasury management review of activities and prudential and treasury indicators for 2018/19.
- 4.2 Treasury Management in this context is defined as: "The management of the local authority's 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."
- 4.3 A glossary of treasury management terms is attached as Appendix 1.

5.0 MID-YEAR REVIEW

- 5.1 The treasury management issues arising during the first six months of 2018/19 were:
 - a. The Council's debt (including PPP) has reduced during the period by £11.242m due to repaying maturing debt/liabilities without undertaking new borrowing.
 - b. The Council's investments have reduced by £11.409m due to using investments to repay debt and from regular cash flow movements.
 - c. As at 31 March 2018 the Council had under borrowed against its capital financing requirement by £36.995m. The latest projection is for the under borrowing to reduce to £36.307m as at 31 March 2019. Under borrowing means that the Council is using funds it currently has to cash flow capital expenditure rather than bringing in funds from borrowing. The projected level of under borrowing is considered manageable but the position is kept under review in light of Council capital financing and other funding requirements.
 - d. There remains ongoing volatility in the financial markets and economic uncertainty in the UK and around the world, impacting on rates for new borrowing and investments. In August 2018 the Bank of England increased the UK Bank Rate from 0.50% to 0.75%, the highest that the rate has been since 2009. There remains uncertainty over when the next increase will take place and the timing and pace of any movements after that.
 - e. The Council's treasury advisers are forecasting no change to the Bank Rate until an increase to 1.00% in Quarter 3 of 2019.
 - f. During the period PWLB rates for new borrowing had been expected to see slight increases of up to 0.10%. Rates increased by between 0.07% for shorter periods and 0.27% for longer borrowing. The volatility during the 6-month period resulted in spreads between the high and low rates for some loan periods of up to 0.39% (e.g. a longer-term new borrowing rate of 2.25% was at 2.64% during the period).
 - g. The Council's treasury advisers expect PWLB rates to rise very gently during the rest of the year but the extent and speed of increase will depend on economic factors affecting the UK and global markets.
 - h. The Council undertook £5m of 3-month temporary borrowing at 0.70% from another Scottish local authority during the period in order to provide additional short-term liquid funds. This temporary borrowing has now been repaid. The projection for the remainder of the year includes £10,000,000 of borrowing that will only be undertaken if the funds are required and it is prudent to borrow. Any borrowing undertaken will be reported to Committee.
 - i. The Council did not undertake any debt restructuring during the first six months of 2018/19 and remained within its Prudential Indicator and Treasury Management limits.
 - j. Investment returns were expected to remain relatively low but were affected by the possibility of Bank Rate increases during the period and the actual increase in August.
 - k. The Council's investments earned a rate of return of 0.72% during the period and outperformed the benchmark return of 0.61% resulting in additional income to the Council of £18,000.

- l. All investments were in accordance with the Council's investment policy and no institutions with which investments were made had any difficulty in repaying those investments and interest in full during the period.
- m. The Council's investment performance is due to undertaking fixed term investments at interest rates that were above the benchmark with counterparties that have high creditworthiness (the Bank of Scotland and Santander UK) and in accordance with the Council's investment strategy. The outturn is reduced due to using investments to repay maturing debt and thereby saving the Council the cost of borrowing at rates higher than being earned from using investment funds.

5.2 In addition:

- a. On 8 August 2017 the Policy & Resources Committee approved an investment in an ethical investment organisation and to waive any interest due on the investment. The £50,000 invested with Shared Interest Society Limited is part of the investment balances included in this report.
- b. The Council's contract with the Bank of Scotland for banking services is for 5 years from 1 April 2012 until 31 March 2017 with an option to extend for a further two 1 year periods until 31 March 2019. Both of these options have now been exercised. The Council will issue tenders for banking services for the 5 year period from 1 April 2019 to 31 March 2024 and with an option to extend for a further two 1 year periods until 31 March 2026.
- c. The Council's current contract with its treasury advisers ends on 30 June 2019. The Council will issue tenders for treasury management advisers services for the three year period from 1 July 2019 with an optional one year extension until 30 June 2023.

5.3 The Council's debt position was as follows:

	At 31 March 2018	At 30 September 2018
	£	£
Total Excluding PPP	207,389,549	196,938,373
PPP Debt	63,959,000	63,169,000
Total Including PPP	271,348,549	260,107,373

Further detail is given in the following table:

	At 31 March 2018		At 30 September 2018		Movement In Period
	Principal	Rate	Principal	Rate	Principal
	£000		£000		£000
Fixed Rate Funding:					
- PWLB	104,714		94,288		(10,426)
- Market *	71,000		71,000		See * Below
	175,714	4.04%	165,288	4.06%	(10,426)
Variable Rate Funding:					
- PWLB	0		0		0
- Market *	31,400		31,400		See * Below
- Temporary #	276		250		(26)
	31,676	4.94%	31,650	4.94%	(26)
Total Debt (Excl PPP)	207,390	4.18%	196,938	4.20%	(10,452)
PPP Debt	63,959		63,169		(790)
Total Debt (Incl PPP)	271,349		260,107		(11,242)

* - Market Loans are shown as variable when they have less than 1 year to go until their next call date. The total value of Market Loans has not changed between financial years, just the split between fixed and variable.

- Temporary Loans include funds held by the Council on behalf of the Common Good and Trust Funds that are treated as borrowing for Treasury Management purposes.

5.4 The Council's investment position was as follows:

	At 31 March 2018		At 30 September 2018		Movement In Period
	Principal	Return	Principal	Return	Principal
	£000		£000		£000
Investments:					
- Fixed Term Deposits	11,500	0.77%	16,500	0.88%	5,000
- Notice Accounts	15,000	0.70%	0	-	(15,000)
- Shared Interest Society Limited	50	-	50	-	0
- Deposit Accounts	6,896	0.50%	5,487	0.75%	(1,409)
Totals	33,446	0.68%	22,037	0.84%	(11,409)

Maximum level of investments in Period: £42,440,119 on 18 July 2018

Minimum level of investments in Period: £21,955,819 on 27 July 2018

Daily average for the period: £32,340,508

5.5 2018/19 Latest Projection Compared to Estimates in 2018/19 Strategy

The latest 2018/19 projection compared to the estimates in the 2018/19 strategy:

	2018/19 Estimate	2018/19 Latest Projection
	£000	£000
<u>Borrowing Requirement</u>		
New borrowing	0	0
Alternative financing requirements	0	0
Replacement borrowing	10,000	10,000
TOTAL	10,000	10,000
<u>Prudential/Treasury Management Indicators</u>		
	£000	£000
Gross external debt including PPP (As at 31 March 2019)	269,307	269,325
Capital financing requirement (As at 31 March 2019)	313,742	305,632
(Under)/over borrowing against CFR	(44,435)	(36,307)
	£000	£000
Gross Capital Expenditure	25,850	27,960
Ratio of financing costs (including PPP) to net revenue stream	14.26%	14.14%
Ratio of net debt (debt and PPP less investments) to net revenue stream	128.6%	129.4%

5.6 2018/19 Mid-Year Position Compared to Limits in 2018/19 Strategy

The 2018/19 mid-year position compared to limits in the 2018/19 strategy:

Prudential/Treasury Management Indicators

Authorised limit for external debt

- Borrowing
- Other long term liabilities

Operational boundary for external debt

- Borrowing
- Other long term liabilities

Upper limit on sums invested for periods longer than 365 days (Actual is maximum in period)

Upper limits on Fixed/Variable borrowing maturing in each period (LOBOs included based on call dates and not maturity dates) at 31 March 2019

- Under 12 months
- 12 months and within 24 months
- 24 months and within 5 years
- 5 years and within 10 years
- 10 years and within 30 years
- 30 years and within 50 years
- 50 years and within 70 years

Council Policy Limits

Maximum Percentage of Debt Repayable In Year

Maximum Proportion of Debt At Variable Rates

Maximum Percentage of Debt Restructured In Year

2018/19 Limits		2018/19 Mid-Year Actual Position	
£000		£000	
250,000		196,938	
64,000		63,169	
314,000		260,107	
£000		£000	
230,000		196,938	
64,000		63,169	
294,000		260,107	
£000		£000	
10,000		0	
Fixed	Var.	Fixed	Var.
45%	35%	2.6%	16.1%
45%	35%	23.4%	-
45%	35%	8.9%	-
45%	35%	4.5%	-
45%	35%	3.9%	-
45%	35%	20.3%	-
45%	35%	20.3%	-
25%		20.3%	
45%		16.1%	
30%		0.0%	

The forecast Investment Balances for 2018/19 required under Investment Regulation 31 and the actual position at 30 September 2018 is shown in Appendix 2. An analysis of the cash balances managed in-house is shown in Appendix 3.

5.7 The forecast from the Treasury Advisors in the 2018/19 Strategy for the Bank Rate as at 31 March and the latest forecast for the Bank Rate are:

	Forecast Per 2018/19 Strategy	Latest Forecast
2018/19	1.00%	0.75%
2019/20	1.25%	1.00%
2020/21	1.50%	1.50%

- 5.8 The Council's investment policy for the year is governed by Scottish Government Investment Regulations, which was implemented in the annual investment strategy approved by the Council on 12 April 2018. This policy sets out the approach for choosing investment categories and counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data such as rating outlooks, credit default swaps, bank share prices etc.
- 5.9 All investments were in accordance with the policy and no institutions with which investments were made had any difficulty in repaying investments and interest in full during the period.

The result of the investment strategy undertaken by the Council in the first six months of 2018/19 is as follows:

Average Investment	Rate of Return (gross of fees)	Benchmark Return (3 month LIBID uncompounded)
£32,340,508	0.72%	0.61%

The Council have outperformed the benchmark by 0.11% resulting in additional income to the Council of £18,000. Opportunities for the Council to out-perform the benchmark rate are becoming fewer due to more standardisation of rates and periods offered.

6.0 IMPLICATIONS

Legal

- 6.1 None. Any borrowing or lending is done under the Council's legal powers.

Finance: Through the achievement of exceeding the investment benchmark return rate, the Council has benefited from additional returns of £18,000. The Council utilises Treasury Management as part of the overall Financial Strategy. Officers will continue to investigate borrowing and investment opportunities to bring financial benefits to the Council, all within the Treasury Management Policy.

Human Resources

- 6.2 None.

Equalities

- 6.3 None.

Repopulation

- 6.4 None.

7.0 CONSULTATIONS

- 7.1 This report has been produced based on advice from the Council's treasury advisers (Link Treasury Services Limited).

8.0 LIST OF BACKGROUND PAPERS

- 8.1 CIPFA - Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – 2017 Edition
Inverclyde Council – Treasury Management Strategy and Annual Investment Strategy 2018/19-2021/22.

TREASURY MANAGEMENT
GLOSSARY OF TERMS

Authorised Limit for External Debt

This is a limit for total Council external debt as set by the Council based on debt levels and plans.

Bank of England

The central bank for the UK with ultimate responsibility for setting interest rates (which it does through the Monetary Policy Committee or “MPC”).

Bank Rate

The interest rate for the UK as set each month by the Monetary Policy Committee (“MPC”) of the Bank of England. This was previously referred to as the “Base Rate”.

Call Date

A date on which a lender for a LOBO loan can seek to apply an amended interest rate to the loan. The term “call date” is also used in relation to some types of investments with a maturity date where the investments can be redeemed on call dates prior to the maturity date.

Capital Expenditure

Expenditure on or for the creation of fixed assets that meets the definition of Capital Expenditure under the accounting rules as set-out in the Code of Practice on Local Authority Accounting in the United Kingdom and for which the Council are able to borrow.

Capital Financing Requirement

The Capital Financing Requirement (sometimes referred to as the “CFR”) is a Prudential Indicator that can be derived from the information in the Council’s Balance Sheet. It generally represents the underlying need to borrow for capital expenditure (including PPP schemes).

CIPFA

CIPFA is the Chartered Institute of Public Finance and Accountancy who produce guidance, codes of practice, and policy documents for Councils.

Counterparty

Another organisation involved in a deal i.e. if the Council enters a deal with a bank then the bank would be referred to as the “Counterparty”.

Credit Ratings

Credit ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an opinion on the relative ability of a financial institution to meet its financial commitments. Credit ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

The highest credit rating is AAA.

European Central Bank

Sometimes referred to as “the ECB”, the European Central Bank is the central bank for the Eurozone and is the equivalent of the Bank of England. The European Central Bank sets interest rates for the Eurozone.

Eurozone

This is the name given to the group of 19 countries in Europe that have the Euro as their currency and that participate in a monetary union. Interest rates in the Eurozone are set by the European Central Bank. The Eurozone is comprised of: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Federal Reserve

Sometimes referred to as “the Fed”, the Federal Reserve is the central bank for the US and is the equivalent of the Bank of England. The Federal Reserve sets interest rates for the US.

Fixed Term Deposit

A Fixed Term Deposit or Fixed Term Investment is an investment with a named bank or financial institution which matures on a set date and which is repaid with interest on the maturity date. Fixed Term Deposits cannot be traded and cannot be terminated before the maturity date without the payment of a penalty (if at all).

Gilt Yields

A gilt yield is the effective rate of return that someone buying a gilt at the current market price will receive on that gilt. Since the market price of a gilt can vary at any time, the yield will also vary.

Gilts

Gilts are bonds (i.e. debt certificates) that are issued (i.e. sold) by the UK Government. When they issue gilts the Government sets the interest rate that applies to the gilt, sets when they will repay the value of the gilt, and it agrees to make interest payments at regular intervals until the gilt is repaid or redeemed. Gilts are traded in the financial markets with the price varying depending on the interest rate applicable to the gilt, when the gilt will be repaid (i.e. when it will mature), on Bank Rate expectations, and on market conditions.

Gross Domestic Product

Gross Domestic Product (“GDP”) is a measure of the output of goods and services from an economy.

Growth

Positive growth in an economy is an increase in the amount of goods and services produced by that economy over time. Negative growth in an economy is a reduction in the amount of goods and services produced by that economy over time.

Inflation

Inflation is the term used for an increase in prices over time. It can be measured in various ways including using the Consumer Prices Index (“CPI”) or the Retail Prices Index (“RPI”).

Investment Regulations

The Local Government in Scotland Act 2003 allows the Scottish Ministers to introduce Regulations to extend and govern the rules under which Scottish Councils may invest funds. The Local Government Investments (Scotland) Regulations 2010 came into effect on 1 April 2010.

LIBID

This is the London Interbank Bid Rate – an interest rate that is used between banks when they wish to attract deposits from each other.

LIBOR

This is the London Interbank Offering Rate – an interest rate that is used as a base for setting interest rates for deals between banks.

LOBO

This is a form of market loan that the Council has with some lenders. The term is short for the phrase “Lender Option/Borrower Option”.

MPC

The MPC or Monetary Policy Committee is a committee of the Bank of England that meets regularly during the year (in meetings over 2 days) to set the Bank Rate for the UK.

Operational Boundary

This is a level of debt set by the Council at lower than the Authorised Limit and which Council debt levels should not normally exceed during normal operations.

Prudential Code

Councils are required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements include the production of Prudential Indicators. The Prudential Code was last revised in December 2017.

Prudential Indicators

Indicators set-out in the Prudential Code that will help Councils to meet requirements in relation to borrowing limits or which will help Councils demonstrate affordability and prudence with regard to their prudential capital expenditure.

PWLB

The Public Works Loan Board is a government agency and part of the Debt Management Office. The PWLB provides loans to local authorities and other specified bodies.

PWLB Certainty Rates

In the Budget in March 2012, the Chancellor of the Exchequer announced that local authorities that provide information on their long-term borrowing and capital spending plans would be eligible for a 0.20% discount rate for new PWLB borrowing. The PWLB Certainty Rates came into effect on 1 November 2012.

PWLB Rates

These are the interest rates chargeable by the Public Works Loan Board for loans. The rates for fixed rate loans are determined by the day on which the loan is agreed. The rates to be charged by the PWLB for loans are set each day based on gilt yields at the start of business each day and then updated at least once during the day.

Quantitative Easing

This is the creation of money by a central bank (such as the Bank of England) in order to purchase assets from banks and companies and boost the supply of money in an economy.

Spread

For interest rates the spread is the difference between the highest and lowest rate for that interest rate over a period.

Treasury Management Code

This is the "Treasury Management in the Public Services: Code of Practice" and is a code of practice for Council treasury management activities. It is produced by CIPFA and was last revised in December 2017.

Treasury Management Indicators

These are Prudential Indicators specifically relating to Treasury Management issues.

Treasury Management Practices (TMPs)

This is a Council document that sets out Council policies and procedures for treasury management as required by the Treasury Management Code. The Council also agrees an annual treasury management strategy that is submitted to Committee in accordance with the Treasury Management Practices.

Yield

The yield is the effective rate of return on an investment.

**FORECAST OF INVESTMENT BALANCES
ESTIMATE FOR 2018/19 AND ACTUAL AT 30 SEPTEMBER 2018**

Investment Regulation 31 requires the Council to provide forecasts for the level of investments. The estimate for 2018/19 and the actual as at 30 September 2018 are:

	2018/19	2018/19
	Estimate For Year	Actual For 1 April 2018 To 30 September 2018
	£000	£000
Cash balances managed in-house		
- At Start of Year	40,000	33,396
- At End of Year/Period	25,618	21,987
- Change in Year/Period	(14,382)	(11,409)
- Average daily cash balances	32,809	32,291
Holdings of shares, bonds, units (includes local authority owned company)		
- At Start of Year	2	2
- Purchases	0	0
- Sales	0	0
- At End of Year/Period	2	2
Loans to local authority company or other entity to deliver services		
- At Start of Year	524	524
- Advances	0	0
- Repayments	41	19
- At End of Year/Period	483	505
Loans made to third parties #		
- At Start of Year	2,143	2,219
- Advances	0	17
- Repayments	23	96
- At End of Year/Period	2,120	2,140
Total of all investments		
- At Start of Year	42,669	36,141
- At End of Year/Period	28,223	24,634
- Change in Year/Period	(14,446)	(11,507)

- This includes the £50,000 investment made with the Shared Interest Society Limited in August 2017.

**CASH BALANCES MANAGED IN-HOUSE
ACTUAL AS AT 31 MARCH 2018 AND 30 SEPTEMBER 2018**

The following is an analysis of cash balances managed in-house as at 31 March 2018 and at 30 September 2018:

	As At 31 March 2018	As At 30 September 2018
	£	£
<u>Fixed Term Deposits</u>		
Bank of Scotland	8,000,000	13,000,000
Santander UK	3,500,000	3,500,000
	11,500,000	16,500,000
Average Interest Rate	0.77%	0.88%
<u>Notice Accounts</u>		
Bank of Scotland	15,000,000	0
Santander UK	317	318
	15,000,317	318
Average Interest Rate	0.70%	0.60%
<u>Ethical Investment Organisation</u>		
Shared Interest Society Limited	50,000	50,000
	50,000	50,000
Average Interest Rate	-	-
<u>Deposit Accounts</u>		
Bank of Scotland	6,894,800	5,486,500
Santander UK	501	501
	6,895,301	5,487,001
Average Interest Rate	0.50%	0.75%
TOTAL	33,445,618	22,037,319
Average Interest Rate	0.68%	0.84%