Inverclyde council

AGENDA ITEM NO: 11

Report To:	**Inverclyde Council**	**Date:**	**1 December 2016**
Report By:	**Corporate Director Environment, Regeneration & Resources**	**Report No:**	**RMcG/LP/150/16**
Contact Officer:	**Rona McGhee**	**Contact No:**	**01475 712113**
Subject:	**Treasury Management – Mid-Year Report 2016/17: Remit from Policy & Resources Committee**		

1.0 PURPOSE

1.1 The purpose of this report is to request the Council to consider a remit from the Policy & Resources committee.

2.0 SUMMARY

2.1 The Policy & Resources Committee to its meeting on 15 November 2016 consider a report by the Chief Financial Officer on the operation of the treasury function and its activities for the first six months of 2016/17 as required under the terms of Treasury Management Practice 6 ("TMP6") on "Reporting Requirements on Management Information Arrangements".

2.2 A copy of the report to the Policy & Resources Committee is attached as Appendix 1.

2.3 The Policy & Resources Committee decided:
(1) that the contents of the Mid-Year Report on Treasury Management for 2016/17 and the ongoing work to ensure the delivery of financial benefits for the Council be noted; and
(2) that the Mid-Year Report be remitted to the Inverclyde Council for approval.

3.0 RECOMMENDATION

3.1 The Committee is asked to approve the Treasury Management Mid-Year Report 2016/17.

Rona McGhee
Head of Legal & Property Services

Inverclyde council

APPENDIX 1
AGENDA ITEM NO. 11

Report To:	**Policy & Resources Committee**	**Date:**	**15 November 2016**
Report By:	**Chief Financial Officer**	**Report No:**	**FIN/106/16/AP/KJ**
Contact Officer:	**Alan Puckrin**	**Contact No:**	**01475 712223**
Subject:	**TREASURY MANAGEMENT – MID-YEAR REPORT 2016/17**		

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 2016/17 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 2016 the Council had gross external debt (including PPP) of £274,977,928 and investments of £43,725,926. This compares to gross external debt (including PPP) of £280,951,047 and investments of £51,529,212 at 31 March 2016.

2.2 The Council is projected to be underborrowed by £34,073,000 compared to its Capital Financing Requirement as at 31 March 2017. This is a reduction in projected underborrowing of £1,826,000 from the estimate of £35,899,000 in the 2016/17 Treasury Management Strategy. The Council has undertaken no borrowing so far in 2016/17 and no borrowing is projected for the remainder of the year.

2.3 The average rate of return achieved on investments during the first six months of 2016/17 was 0.75% which exceeds the benchmark return rate for the year of 0.38% by 0.37% and resulted in £87,000 of additional interest on investments for the Council.

2.4 During the first six months of 2016/17 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 2016/17 and the ongoing work to ensure the delivery of financial benefits for the Council.

3.2 It is also recommended that the Mid-Year Report be remitted to the Full 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 2016/17.

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 2016/17 were:

a. The Council’s debt (including PPP) has reduced during the period by £5.973m due to repaying maturing debt without undertaking new borrowing.
b. The Council’s investments have reduced by £7.803m due to repaying debt from existing funds and regular cash flow movements.
c. As at 31 March 2016 the Council had under borrowed against its capital financing requirement by £21.210m. The latest projection is for the under borrowing to increase to £34.073m at 31 March 2017. Under borrowing means that the Council is using funds it currently has to cash flow capital expenditure rather than bringing in new 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. The outcome of the EU Referendum has resulted in increased and ongoing volatility in the financial markets and economic uncertainty in the UK and around the world. As well as large falls in exchange rates for the pound, PWLB borrowing rates fell to unprecedented levels, the Bank of England increased stimulus to the economy (through further Quantitative Easing), and cut the UK Bank Rate from the record low of 0.50% (set in March 2009) down to 0.25%.
e. The Council’s treasury advisers are forecasting a further cut in the Bank Rate to 0.10% in Quarter 4 of 2016 although this will depend on the economic conditions and outlook.
f. During the period PWLB rates for new borrowing had been expected to increase by between 0.10% and 0.30% but the uncertainty following the EU Referendum led to rates falling by between 0.30% and 0.88%. The volatility during the 6-month period resulted in spreads between the high and low rates for some loan periods of up to 1.22% (e.g. a new borrowing rate that reached 3.09% later fell to a low of 1.87%).
g. The Council’s treasury advisers expect PWLB rates to rise 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. No borrowing has been undertaken during 2016/17 to date and no borrowing is projected for the rest of the year.
i. The Council did not undertake any debt restructuring during the first six months of 2016/17 and remained within its Prudential Indicator and Treasury Management limits.
j. Two of the Council’s LOBO loans had their “lender option” feature removed by the lender (as they did with many of their clients) and so these market loans have become fixed rate loans at their existing interest rates.
k. Investment returns were expected to remain relatively low and this was indeed the position during the period, with rates falling further after the Bank Rate cut in August (as did the rates on the Council’s Deposit and Notice Accounts).
l. The Council’s investments earned a rate of return of 0.75% during the period and outperformed the benchmark return of 0.38% resulting in additional income to the Council of £87,000.

m./

m. 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.
n. The Council's investment performance is due to undertaking fixed term investments and placing funds in notice accounts 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.

5.2 The UK Government are continuing with proposals to sell their remaining shares in the Lloyds Banking Group which includes the Bank of Scotland who are the Council's bankers and with whom the Council has regularly undertaken fixed term deposits. On 7 October the UK Government announced that they would put in place a further trading plan for the sale of these shares over a period of up to 12 months. The removal of government ownership does not affect the strength or stability of the Bank but may cause the Council to reduce the maximum period for investments with the Bank under the Investment Strategy and affect the likely return on any fixed term funds invested with the Bank in future.

The Council's current 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. It is proposed initially to exercise the option for the first of the 1 year periods to extend the service until 31 March 2018.

5.3 The Council's debt position was as follows:

	At 31 March 2016	At 30 September 2016
	£	£
Total Excluding PPP	213,224,047	208,204,928
PPP Debt	67,727,000	66,773,000
Total Including PPP	280,951,047	274,977,928

Further detail is given in the following table:

	At 31 March 2016		At 30 September 2016		Movement In Period
	Principal	Rate	Principal	Rate	Principal
	£000		£000		£000
Fixed Rate Funding:					
- PWLB	110,684		105,245		(5,439)
- Market *	71,000		55,000		See * Below
	181,684	4.05%	160,245	3.98%	(5,439)
Variable Rate Funding:					
- PWLB	0		0		0
- Market *	31,400		47,400		See * Below
- Temporary #	140		560		420
	31,540	4.96%	47,960	4.86%	420
Total Debt (Excl PPP)	213,224	4.18%	208,205	4.18%	(5,019)
PPP Debt	67,727		66,773		(954)
Total Debt (Incl PPP)	280,951		274,978		(5,973)

* - 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 have increased due to Scottish Government requirements that, from 1 April 2016, funds held by the Council on behalf of the Common Good and Trust Funds are to be treated as borrowing for Treasury Management purposes.

5.4 The Council's investment position was as follows:

	At 31 March 2016		At 30 September 2016		Movement In Period
	Principal	Return	Principal	Return	Principal
	£000		£000		£000
Investments:					
- Fixed Term Deposits	25,500	0.85%	24,000	0.74%	(1,500)
- Notice Accounts (95 Day and 120 Day)	14,529	0.95%	14,572	0.70%	43
- Deposit Accounts	11,500	0.50%	5,154	0.25%	(6,346)
Totals	51,529	0.80%	43,726	0.67%	(7,803)

Maximum level of investments in Period: £53,962,026 on 16 September 2016
Minimum level of investments in Period: £41,178,926 on 27 September 2016
Daily average for the period: £47,044,665

5.5 <u>2016/17 Latest Projection Compared to Estimates in 2016/17 Strategy</u>
The latest 2016/17 projection compared to the estimates in the 2016/17 strategy:

	2016/17 Estimate	2016/17 Latest Projection
<u>Borrowing Requirement</u>	£000	£000
New borrowing	0	0
Alternative financing requirements	0	0
Replacement borrowing	5,000	0
TOTAL	5,000	0
<u>Prudential/Treasury Management Indicators</u>	£000	£000
Gross external debt including PPP (As at 31 March 2017)	278,842	273,935
Capital financing requirement (As at 31 March 2017)	314,741	308,008
(Under)/over borrowing against CFR	(35,899)	(34,073)
Net external borrowing and capital financing requirement (As at 31 March 2017)	£000 (66,464)	£000 (66,886)
Capital expenditure	£000	£000
• Capital Programme	33,632	29,539
• PPP Schools/Finance Leases (incl. accounting adjustments)	(1,908)	(1,908)
Total	31,724	27,631
Ratio of financing costs (including PPP/ Finance Leases) to net revenue stream	13.38%	13.23%
Incremental impact of capital investment decisions - incremental increase in council tax (band D) per annum (use of capital receipts and prudential borrowing for capital expenditure)	£2.61	£2.03

5.6 <u>2016/17 Mid-Year Position Compared to Limits in 2016/17 Strategy</u>
The 2016/17 mid-year position compared to limits in the 2016/17 strategy:

	2016/17 Limits	2016/17 Mid-Year Actual Position
<u>Prudential/Treasury Management Indicators</u> Authorised limit for external debt	£000	£000
• Borrowing	229,000	208,205
• Other long term liabilities	68,000	66,773
	297,000	274,978
Operational boundary for external debt	£000	£000
• Borrowing	219,000	208,205
• Other long term liabilities	68,000	66,773
	287,000	274,978
Upper limit for fixed interest rate exposure	130%	97%
Upper limit for variable rate exposure	40%	3%
Upper limit on sums invested for periods longer than 364 days (Actual is maximum in period)	£000 10,000	£000 0
Limits on fixed rate borrowing maturing in each period (LOBOs included based on call dates and not maturity dates) at 31 March 2017		
• Under 12 months	45%	0.3%
• 12 months and within 24 months	45%	15.9%
• 24 months and within 5 years	45%	12.6%
• 5 years and within 10 years	45%	15.7%
• 10 years and within 30 years	45%	5.5%
• 30 years and within 50 years	45%	25.0%
• 50 years and within 70 years	45%	25.0%
<u>Council Policy Limits</u> Maximum Percentage of Debt Repayable In Year	25%	19.2%
Maximum Proportion of Debt At Variable Rates	45%	23.0%
Maximum Percentage of Debt Restructured In Year	30%	0.0%

The forecast Investment Balances for 2016/17 required under Investment Regulation 31 and the actual position at 30 September 2016 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 2016/17 Strategy for the Bank Rate as at 31 March and the latest forecast for the Bank Rate are:

	Forecast Per 2016/17 Strategy	Latest Forecast
2016/17	0.75%	0.10%
2017/18	1.25%	0.10%
2018/19	1.75%	0.25%

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 7 April 2016. 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 2016/17 is as follows:

Average Investment	Rate of Return (gross of fees)	Benchmark Return (3 month LIBID uncompounded)
£47,044,665	0.75%	0.38%

The Council have outperformed the benchmark by 0.37% resulting in additional income to the Council of £87,000. 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

6.2 Through the achievement of exceeding the investment benchmark return rate, the Council has benefited from additional returns of £87,000. 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

6.3 None

Equalities

6.4 None

Repopulation

6.5 None

7.0 CONSULTATIONS

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

8.0 LIST OF BACKGROUND PAPERS

8.1 CIPFA - Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – 2011 Edition
Inverclyde Council – Treasury Management Strategy 2016/17.

Appendix 1

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.

Incremental Impact of Capital Investment Decisions
These are Prudential Indicators that reflect the impact on Council Tax of movements in projected and estimated capital expenditure within and between financial years.

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 November 2011.

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 November 2011.

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.

Finance Services
Inverclyde Council
October 2016.

Appendix 2

FORECAST OF INVESTMENT BALANCES
ESTIMATE FOR 2016/17 AND ACTUAL AT 30 SEPTEMBER 2016

Investment Regulation 31 requires the Council to provide forecasts for the level of investments. The estimate for 2016/17 and the actual as at 30 September 2016 are:

	2016/17	**2016/17**
	Estimate For Year	**Actual For 1 April 2016 To 30 September 2016**
	£000	£000
Cash balances managed in-house		
- At Start of Year	50,124	51,529
- At End of Year/Period	30,565	43,726
- Change in Year/Period	(19,559)	(7,803)
- Average daily cash balances	40,345	47,045
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	600	602
- Advances	0	0
- Repayments	35	16
- At End of Year/Period	565	586
Loans made to third parties		
- At Start of Year	2,212	2,212
- Advances	3	0
- Repayments	28	27
- At End of Year/Period	2,187	2,185
Total of all investments		
- At Start of Year	52,938	54,345
- At End of Year/Period	33,319	46,499
- Change in Year/Period	(19,619)	(7,846)

CASH BALANCES MANAGED IN-HOUSE
ACTUAL AS AT 1 APRIL 2016 AND 30 SEPTEMBER 2016

The following is an analysis of cash balances managed in-house as at 1 April 2016 and at 30 September 2016:

	As At 1 April 2016	**As At 30 September 2016**
	£	£
Fixed Term Deposits		
Bank of Scotland	25,500,000	24,000,000
	25,500,000	24,000,000
Average Interest Rate	0.85%	0.74%
Notice Accounts (95 Day and 120 Day)		
Santander UK	14,528,714	14,572,027
	14,528,714	14,572,027
Average Interest Rate	0.95%	0.70%
Deposit Accounts		
Bank of Scotland	11,500,000	5,153,400
Santander UK	498	499
	11,500,498	5,153,899
Average Interest Rate	0.50%	0.25%
TOTAL	51,529,212	43,725,926
Average Interest Rate	0.80%	0.67%