MEETING:	**AUDIT AND GOVERNANCE COMMITTEE**
DATE:	**28 SEPTEMBER 2017**
TITLE:	**TREASURY MANAGEMENT 2017/18 – MID YEAR REVIEW**
PURPOSE:	**CIPFA's Code of Practice recommends that a report on the Council's actual Treasury Management during the current financial year is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
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EXECUTIVE SUMMARY

During the five month period between 1 April and 31 August 2017, the Council's borrowing remained well within the limits originally set. There were no new defaults by banks in which the Council deposited money.

1. INTRODUCTION

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that Authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). This report provides a mid-year update.

The Council's Treasury Management Strategy for 2017/18 was approved by full Council on 2 March 2017 which can be accessed on https://democracy.cyngor.gwynedd.gov.uk/ielistdocuments.aspx?cid=130&mid=1657&ver=4

The Council has borrowed and invested substantial sums of money and is therefore 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 risk are therefore central to the Council's treasury management strategy. This report covers treasury activity and the associated monitoring and control of risk.

2. EXTERNAL CONTEXT

UK Consumer Price Inflation (CPI) index rose over the first quarter of 2017/18 and the data print for May showed CPI at 2.9%, its highest since June 2013. The effect of the fall in fuel prices was offset by rises in a number of other categories in the CPI 'basket' as the fall in the value of sterling following June 2016's referendum result continued to feed through into higher import prices.

Prime Minister Theresa May called an unscheduled General Election in June, to resolve uncertainty and in the hope of gaining an enhanced mandate to enter the forthcoming Brexit negotiations. The surprise result has led to a minority Conservative government in an arrangement with the Democratic Unionist Party. This political impasse clearly results in an enhanced level of political uncertainty, however the potential for a so-called hard Brexit is now diminished, reducing the associated economic headwinds for the UK economy from a 'no deal' or otherwise unfavourable trade agreement.

The reaction from the markets on the election's outcome has been fairly muted, business confidence now hinges on the progress (or not) on Brexit negotiations, whether new trade treaties and arrangements are successfully concluded and whether or not the UK continues to remain part of the EU customs union post the country's exit from the EU.

In the face of this uncertainty, Arlingclose expects the Bank of England will look through periods of high inflation and maintain its low-for-longer stance on policy interest rates for an extended period.

There were a few credit rating changes during the period. Moody's downgraded Standard Chartered Bank's long-term rating to A1 from Aa3 on the expectation that the bank's profitability will be lower following management's efforts to de-risk their balance sheet. The agency also affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1

3. LOCAL CONTEXT

At 31/3/2017 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £173.5m, while usable reserves and working capital which are the underlying resources available for investment were £68.5m. The Council had £111m of borrowing and £29m of investments.

The Council's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position as at 31st August 2017 and the change in the quarter is show in the table below.

	31.3.17 Balance £m	5 month Movement £m	31.8.17 Balance £m	31.8.17 Rate %
Long-term borrowing	108	0	108	5.8
Short-term borrowing	3	(2)	1	10.6
Total borrowing	**111**	**(2)**	**109**	**5.7**
Long-term investments	2	0	2	1.8
Short-term investments	26	5	31	0.4
Cash and cash equivalents	1	17	18	0.3
Total investments	**29**	**22**	**51**	**0.4**

4. BORROWING STRATEGY

At 31/8/2017 the Council held £109.7m of loans, (a decrease of £2.2m on 31/3/2017), as part of its strategy for funding previous years' capital programmes.

The Council does not expect to borrow in 2017/18.

Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained, and are likely to remain, lower than long-term rates, the Council determined it was more cost effective in the short-term to use internal resources instead.

The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the Council with this 'cost of carry' and breakeven analysis which did not indicate any value in borrowing in advance for future years' planned expenditure.

Borrowing Position at at 31.08.17

	31.3.17 Balance £m	5 months Movement £m	31.8.17 Balance £m	31.8.17 Rate %
Public Works Loan Board	95	(2)	93	5.8
Bank (fixed-term)	16	0	16	4.2
Total borrowing	**111**	**(2)**	**109**	**5.5**

PWLB Certainty Rate and Project Rate Update

The Council qualified for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a 12 month period from 1 November 2016. In September 2017 the Council submitted its application to the Treasury to access this reduced rate for a further 12 month period from 1 November 2017.

Debt Rescheduling

The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

Changes in the debt portfolio over the period have achieved a reduction in the level of borrowing as well as a reduction in credit risk by repaying loans from investment balances.

5. INVESTMENT ACTIVITY

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held.

The Welsh Government's Investment Guidance gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the 5 months, the Council's investment balance ranged between £68.5 and £31.6 million due to timing differences between income and expenditure. The investment position during the period is shown in the table below.

	31.3.17 Balance £m	5 month Movement £m	31.8.17 Balance £m
Banks & building societies (unsecured)	21.3	(8.1)	13.2
Covered bonds (secured)	2.2	0	2.2
Government (incl. local authorities)	6.0	11.0	17.0
Money Market Funds	0.0	18.2	18.2
Total investments	**29.5**	**21.1**	**50.6**

Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2017/18.

Counterparty credit quality was assessed and monitored with reference to credit ratings (the Council's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A- across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

Performance Report

The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in the table below.

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/17	4.22	AA-	3.27	AA
30/06/17	4.07	AA-	3.30	AA

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Investments were made with banks and building societies and included call accounts, fixed-rate term deposits and certificates of deposit, Money Market Funds and covered bonds.

The average cash balances were £36.5m during the five months. The UK Bank Rate had been maintained at 0.25% since August 2016.

The Council's budgeted investment income for the year is estimated at £0.17m. based on an investment outturn of 0.5% for the whole year.

Compliance Report

The Head of Finance confirms compliance with its Prudential Indicators for 2017/18, which were set in March 2017 as part of the Council's Treasury Management Strategy Statement.

Debt Limits

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

	5 month Maximum	31.8.17 Actual	2017/18 Operational Boundary	2017/18 Authorised Limit	Complied
Borrowing	109m	106.5m	180m	190m	✓
PFI & finance leases	4.0m	4.0m	**0**	**0**	✓
Total debt	**113m**	**113m**	**180m**	**190m**	✓

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

The Head of Finance is pleased to report that all treasury management activities undertaken during the five months to 31 August 2017 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating or credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual
Portfolio average credit score	6.0	3.30

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2016/17	**2017/18**	**2018/19**
Upper limit on fixed interest rate exposure	100%	100%	100%
Actual	100%		
Upper limit on variable interest rate exposure	50%	50%	50%
Actual	0%		

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	**Lower**	**Actual**
Under 12 months	25%	0%	0%
12 months and within 24 months	25%	0%	0.3%
24 months and within 5 years	50%	0%	4.9%
5 years and within 10 years	75%	0%	16.3%
10 years and within 20 years	100%	0%	25.5%
20 years and within 30 years	100%	0%	12.7%
30 years and within 40 years	100%	0%	16.6%
40 years and within 50 years	100%	0%	8.7%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2017/18	**2018/19**	**2019/20**
Limit on principal invested beyond year end	£40m	£20m	£10m
Actual	£2.18m	£2.18m	£2.18m

7. Investment Training

During the period officers have attended investment training with Arlingclose and CIPFA relevant to their roles.

8. Outlook for the Remainder of 2017/18

UK GDP growth is forecast to be around 1.6% for 2017 and 1.4% in 2018. Subdued consumer spending will be the main driver behind this period of weaker growth, along with muted business investment due to Brexit-related uncertainty.

Arlingclose's central case for the path of Bank Rate over the next three years remains at 0.25%. Arlingclose believes that the high inflation reflects the impact of sterling's weakness on imports, and in the face of weaker growth prospects, will be looked through by Bank of England policymakers. The likely path for Bank Rate is for it to remain flat at 0.25%. However, there is downside risk for rates to be cut to 0.00% in the short-term and medium-term, and scope for rates to be increased from 2019 onwards, albeit modestly to 0.50%.

	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Downside risk	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

Arlingclose believes that the Government and the Bank of England have both the tools and the willingness to use them to prevent any immediate market-wide problems leading to bank insolvencies. The cautious approach to credit advice means that the banks currently on the Authority's counterparty list have sufficient equity buffers to deal with any localised problems in the short term.

Appendix 1

Prudential Indicators 2017/18

The Local Government Act 2003 requires the Council to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Council's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate* £m
General Fund Expenditure	**29.3**	**25.5**	**10.3**	**6.7**
Capital Receipts	0.8	1.3	0.0	0.0
Government Grants	11.5	6.7	2.5	2.5
Revenue	2.9	8.9	3.5	0.0
Borrowing	14.1	8.6	4.3	4.2
Total Financing	**29.3**	**25.5**	**10.3**	**6.7**

* The estimate for 2018/19 does not include new schemes as they have not yet been approved.

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate* £m
General Fund	**177.0**	**179.6**	**176.4**	**173.0**

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31/03/17 Actual £m	31/08/17 Actual £m	31/03/18 Estimate £m	31/03/19 Estimate £m	31/03/20 Estimate* £m
Borrowing	113.4	106.8	106.8	106.8	106.1
Finance leases	2.3	2.5	2.3	2.2	2.1
Total Debt	**115.7**	**109.3**	**109.1**	**109.0**	**108.2**

Total debt is expected to remain below the CFR during the forecast period.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Borrowing	175	180	190	190
Other long-term liabilities	0	0	0	0
Total Debt	**175**	**180**	**190**	**190**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Borrowing	195	190	200	200
Other long-term liabilities	0	0	0	0
Total Debt	**195**	**190**	**200**	**200**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2016/17 Actual %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
General Fund	5.02	5.78	5.81	6.07

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
General Fund - increase in annual Band D Council Tax	0	0	0

Adoption of the CIPFA Treasury Management Code: The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in March 2011.