Treasury Management Strategy Statement and Annual Investment Strategy Update 2018/19

The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved by Council on 8 March 2018.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

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

Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2018-19 Original Programme £'000	2018-19 Latest Approved £'000	Position As At 30-09-18 £'000	2018-19 Forecast Outturn £'000
General Fund	4,065	4,702	1,254	4,123
Housing Revenue Account (HRA)	9,220	7,450	1,318	5,943
Total	**13,285**	**12,152**	**2,572**	**10,066**

Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure.

Capital Expenditure	2018-19 Original Programme £'000	2018-19 Latest Approved £'000	Position As At 30-09-18 £'000	2018-19 Forecast Outturn £'000
General Fund	4,065	4,702	1,254	4,123
HRA	9,220	7,450	1,318	5,943
Total spend	**13,285**	**12,152**	**2,572**	**10,066**
Financed by:				
Capital receipts	1,821	1,208	75	606
Capital grants and Contributions	1,556	1,620	490	1,435
Major Repairs Reserve	8,100	6,846	1,306	5,639
Direct Revenue Funding	100	770	403	748
Total financing	**11,577**	**10,444**	**2,274**	**8,428**
Borrowing need	**1,708**	**1,708**	**298**	**1,638**

The borrowing need shown in the above table is the Council's purchase of an additional equity stake in Welland Homes and the loans made to Welland Homes. This capital expenditure has not been financed and therefore creates a borrowing requirement. Rather than take out external borrowing, the Council is utilising its cash balances and internally borrowing to finance the capital expenditure.

Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary.

The following table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose.

It also shows the expected debt position over the period. This is termed the Operational Boundary.

	2018-19 Original Estimate For Year End £'000	2018-19 Latest Approved For Year End £'000	Position As At 30-09-18 £'000	2018-19 Forecast Outturn For Year End £'000
Prudential Indicator – CFR				
CFR – non housing	5,555	5,555	4,145	5,485
CFR – housing	68,439	68,439	68,439	68,439
Total CFR	**73,994**	**73,994**	**72,584**	**73,924**
Net movement in CFR	**1,708**	**1,708**	**298**	**1,638**
Prudential Indicator – External Debt / Operational Boundary				
Borrowing	67,456	67,456	67,456	67,456
Other long term liabilities	0	0	0	0
Total debt 31 March	**67,456**	**67,456**	**67,456**	**67,456**

Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2018-19 Original Estimate For Year End £'000	2018-19 Revised Estimate For Year End £'000	Position As At 30/09/18 £'000	2018-19 Forecast Outturn For Year End £'000
Gross borrowing	67,456	67,456	67,456	67,456
Less investments	(31,180)	(36,000)	(45,600)	(36,000)
Net borrowing	**36,276**	**31,456**	**21,856**	**31,456**
CFR (year-end position)	**73,994**	**73,994**	**72,584**	**73,924**

The Executive Director Commercialisation (Section 151 Officer) reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2018-19 Original Estimate For Year End £'000	Position As At 30/09/18 £'000	2018-19 Revised Estimate For Year End £'000
Borrowing	89,456	89,456	89,456
Other long term liabilities	1,000	1,000	1,000
Total	**90,456**	**90,456**	**90,456**

The limit of £1m for long term liabilities shown above provides headroom for the Council to take out finance leases for capital assets rather than outright purchase. Prior to taking out a finance lease, a full option appraisal would be carried out to ensure it is the most cost effective way of financing the capital expenditure.

Investment Portfolio 2018/19

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk policy. As set out in Appendix A, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% bank rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

APPENDIX B

The Council held £43.777m of investments and £1.827m of loans to Welland Homes as at 30 September 2018 (£36.540m and £1.529m as at 31 March 2018). The investment portfolio yield for the first six months of the year is 0.84% against a benchmark of 0.61% (average 3 month LIBID). Deposits held excluding accrued interest were as follows:

Institution	Investment Type	Start Date	Maturity Date	Rate/ Return %	As at 31-03-18 £'000	As at 30-09-18 £'000
UK Municipal Bonds Agency	Equity	n/a	n/a	n/a	50	50
Welland Homes	Equity	n/a	n/a	n/a	877	877
Lloyds Bank Current Account	Instant Access	n/a	n/a	0.65	0	85
Svenska Handelsbanken	Instant Access	n/a	n/a	0.67	513	1,965
CCLA Money Market Fund	Instant Access	n/a	n/a	0.69	2,600	2,800
Royal Bank of Scotland (BBB+)	Certificate of Deposit	13/04/17	13/04/18	0.70	5,000	0
Qatar National Bank	Time Deposit	18/04/17	18/04/18	0.83	1,000	0
Coventry Building Society (A)	Time Deposit	03/11/17	03/05/18	0.54	4,000	0
Telford & Wrekin Council	Time Deposit	19/03/18	21/05/18	0.85	3,000	0
First Abu Dhabi Bank (AA-)	Time Deposit	01/06/17	01/06/18	0.60	5,000	0
Lloyds Bank (A)	Time Deposit	21/11/17	20/11/18	0.90	2,500	2,500
London Borough of Enfield	Time Deposit	02/02/18	01/02/19	0.78	5,000	5,000
Oadby & Wigston Borough Council	Time Deposit	14/02/18	13/02/19	0.78	3,000	3,000
Cambridgeshire County Council	Time Deposit	28/02/18	27/02/19	1.00	4,000	4,000
Ards & North Down Borough Council	Time Deposit	03/05/18	05/11/18	0.75	0	1,000
Goldman Sachs International Bank (A)	Time Deposit	03/05/18	02/11/18	0.79	0	2,000
National Bank of Canada (A+)	Time Deposit	14/05/18	14/11/18	0.70	0	2,500
Australia & New Zealand Bank (AA-)	Time Deposit	18/06/18	18/03/19	0.82	0	2,500
National Westminster Bank (A-)	Certificate of Deposit	19/06/18	19/06/19	0.93	0	2,500
Standard Chartered (A+)	Certificate of Deposit	16/07/18	16/01/19	0.83	0	3,000
Birmingham City Council	Time Deposit	22/08/18	22/11/18	0.82	0	5,000
Lancashire County Council	Time Deposit	03/09/18	02/09/19	1.10	0	3,000
Boston Borough Council	Time Deposit	06/09/18	05/10/18	1.00	0	2,000
TOTAL					**36,540**	**43,777**

In addition to the investments listed, the Council has issued two loans to Welland Homes which are classified as Long Term Debtors. The balance and details of these loans as at 30 September 2018 are as follows:

Loan 1 - £1,341,643 @ 3.5% repayable on 17/03/47.
Loan 2 - £485,240 @ 5.5%. This is a development loan and once the development has been completed the rate reduces to 3.5% in accordance with the loan agreement.

The Executive Director Commercialisation (Section 151 Officer) confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19.

The Council's budgeted investment return for 2018/19 is £258,000 (GF £196,000, HRA £62,000) and performance for the year to date is £184,510 (GF £129,175, HRA £55,335). Expectation is that the outturn for investment returns will be approximately £375,000 (GF £266,200, HRA £108,800).

The increased levels of investment interest achieved can be attributed to higher levels of investment balances being held and also higher than anticipated interest rate levels in the market, in particular the inter-authority rates which are now higher than those offered by financial institutions.

The Council monitors risk of its investment portfolio against the Link Asset Services counterparty risk matrix. This matrix gives recommended maximum investment durations for each financial institution based on the ratings allocated by the major credit rating agency's and also takes into account credit default swap prices.

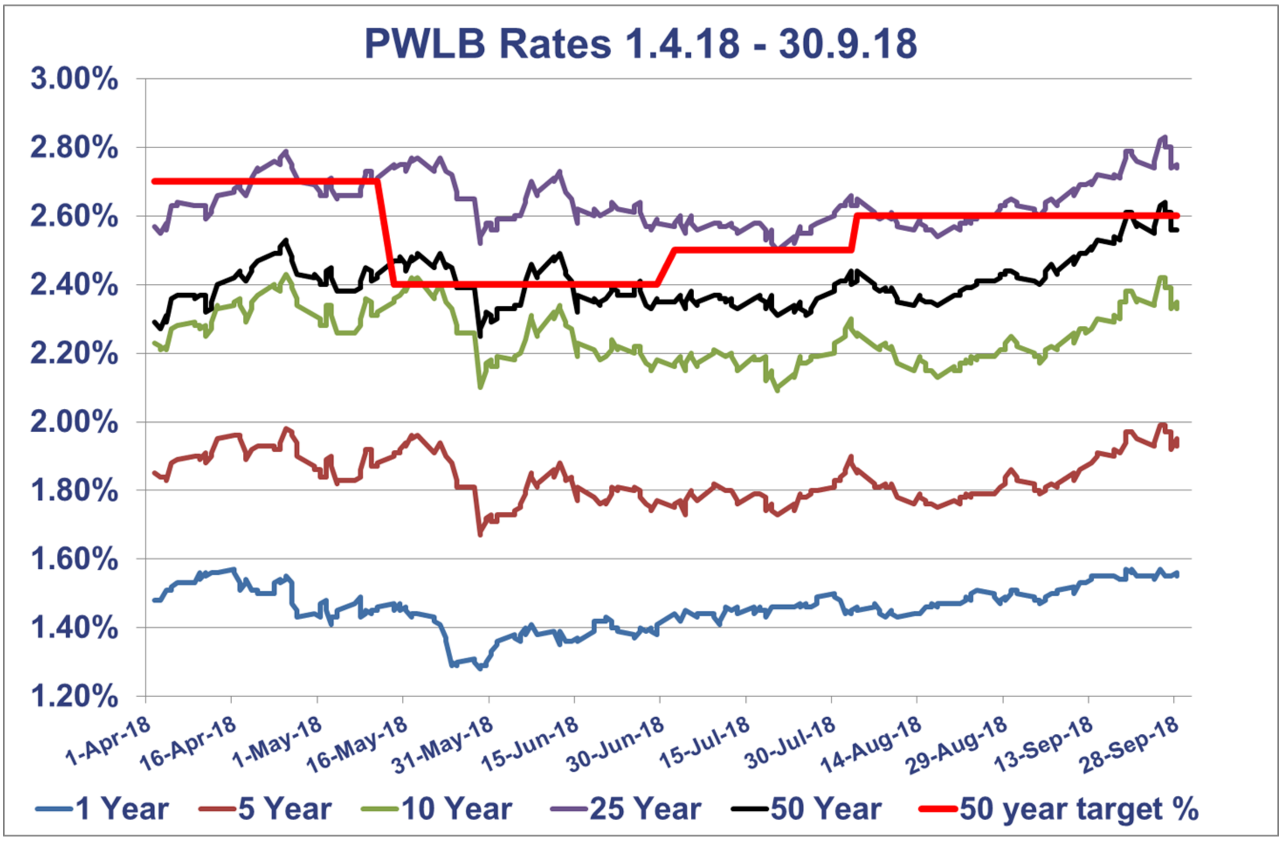
Investment Counterparty Criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

Borrowing

The Council's projected capital financing requirement (CFR) for the end of 2018/19 is £73.924m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council has borrowings of £67.456m in respect of the Housing Revenue Account self-financing settlement.

The following graph shows the movement in PWLB rates for the first six months of the year to 30 September 2018:



Debt Rescheduling

The majority of the Councils debt was taken out in March 2012 as part of the HRA Financing Reforms. Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

OTHER

UK Banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1 January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

IFRS9 accounting standard

This accounting standard came into effect from 1 April 2018. It means that the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact onto the Surplus or Deficit on the Provision of Services, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but more specialist types of investments, (e.g. pooled funds, third party loans, commercial investments), are likely to be impacted.

Changes in risk policy

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk policy e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk policy should be brought to members' attention in treasury management update reports.

There has been no change in risk policy to report.

UK Municipal Bonds Agency Update

The UK Municipal Bonds Agency is owned by councils and the Local Government Association. South Holland DC has a £50,000 equity stake in the company.

Its aim is to offer lower cost borrowing to councils and to secure a sustainable alternative to the Public Works Loan Board for council borrowing.