Agenda item 10

Cabinet – 12 December 2018

Treasury Management Mid-Year Position Statement 2018/19

Portfolio: Councillor Bird, Leader of the Council

Related portfolios: N/A

Service: Finance

Wards: All

Key decision: No

Forward plan: No

1. Summary

1.1. This report sets out the council's mid-year position statement for treasury management activities (**Appendix A**).

2. Recommendations

2.1. To note and forward to Council, for consideration and noting (and in line with the requirements of the Treasury Management Code of Practice (2017)), the mid-year position statement for treasury management activities 2018/19 including prudential and local indicators (**Appendix A**).

3. Report Detail

Treasury Management Midyear review

3.1 Table 1 shows borrowing and investments held at 31 March 2018 and 30 September 2018. The table shows that net borrowing between this period has increased by £4.996m. PWLB loans have increased to fund capital expenditure previously funded from internal borrowing. Private loans have decreased due to the early repayment of a loan in order to make savings. Other loans have reduced due to the repayment of loan maturities taken out to meet the cash flow requirements for the upfront pension payment made in April 2016.

A forecast borrowing position for the year end has also been provided which assumes a further £10m reduction in overall borrowing levels linked to the assumed repayment of loan maturities that come due between October 2018 and March 2019.

The investment balance for the period to 30 September 2018 has also increased by £40.546m; this is in line with the budgeted assumptions for the year which included a plan to ensure that cash balances were maintained at an appropriate and robust level in line with expected cashflows projected for the year. This is also linked to the cashflow profile for local authorities where a large proportion if income is normally received at the start of the year (with upfront payment of grants / council tax / business rates etc), with corresponding expenditure normally being spread across the year.

The forecast investment position for the year end shows that investment balances are expected to decrease as we approach 31 March 2019 and payments on capital schemes are made and less income is profiled to be raised, and therefore collected, during the period.

Table 1					
Borrowing	**31-Mar-18 £m**	**30-Sep-18 £m**	**Change in year to date £m**	**Forecast Position 31-Mar-19 £m**	**Forecast Change 31-Mar-18 to 31-Mar-19 £m**
PWLB	113.492	155.492	42.000	175.492	62.000
Private Loans	102.000	95.000	(7.000)	95.000	(7.000)
Other Loans	103.826	73.822	(30.004)	43.822	(60.004)
Total Borrowing	**319.318**	**324.314**	**4.996**	**314.314**	**(5.004)**
Investments	**31-Mar-18 £m**	**30-Sep-18 £m**	**Change in year £m**	**Forecast Position 31-Mar-19 £m**	**Forecast Change 31-Mar-18 to 31-Mar-19 £m**
At-call	15.394	19.940	4.546	20.000	4.606
Short term	99.500	140.500	41.000	73.606	(25.894)
Long term	14.000	9.000	(5.000)	15.000	1.000
Property funds	20.000	20.000	0.000	20.000	0.000
Total Investments	**148.894**	**189.440**	**40.546**	**128.606**	**(20.288)**
Net Position (Borrowing less Investment)	**170.424**	**134.874**	**(35.550)**	**185.708**	**15.284**

Capital Financing

3.2 Table 2 below shows the midyear revenue outturn forecast for treasury management capital financing. The net forecast underspend of £898k has been assumed to be transferred to reserves (investment returns line). This is in the main attributable to the forecast overachievement of investment income returns of (£0.799m) due to ongoing proactive management of cash flow, and the identification of appropriate counterparty investment options. There is a further £146k underspend on interest payable costs due to partial delivery of the rescheduling saving. Notable current overspends include a £60k forecast overspend on bank charges, which is an ongoing pressure from 2017/18 and is undergoing further investigation. There is also a £87k forecast underachievement of airport dividends.

Table 2: Service Description	Full Year Forecast £m	Annual Budget £m	Forecast Variance £m	Action Plan Items £m	Transfer to / (from) reserves £m	Net Forecast Variance £m
Interest Payable	13.367	10.276	3.091	0.000	(3.237)	(0.146)
Investment Returns	(2.323)	(1.524)	(0.799)	0.000	0.898	0.099
Allocation of interest on Internal balances	0.290	0.398	(0.108)	0.000	0.000	(0.108)
Other Local Authority Debt	2.000	1.990	0.010	0.000	0.000	0.010
Treasury management Costs	0.013	0.013	0.000	0.000	0.000	0.000
Bank Charges	0.120	0.060	0.060	0.000	0.000	0.060
Birmingham Airport	(1.474)	(1.640)	0.166	0.000	(0.080)	0.086
Mortgages	(0.001)	0.000	(0.001)	0.000	0.000	(0.001)
Depreciation	(24.288)	(24.288)	0.000	0.000	0.000	0.000
Minimum Revenue Provision	9.093	9.093	0.00	0.000	0.000	0.000
Total	(3.203)	(5.622)	2.419	0.000	(2.419)	0.000

Economic Context

3.3 The outcome of the EU referendum in June 2016 resulted in a gloomy outlook and economic forecasts from the Bank of England based around an expectation of a major slowdown in UK GDP growth, particularly during the second half of 2016, which was expected to push back the first increase in Bank Rate for at least three years. Consequently, the Bank responded in August 2016 by cutting Bank Rate by 0.25% to 0.25% and making available over £100bn of cheap financing to the banking sector up to February 2018. Both measures were intended to stimulate growth in the economy.

During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year; quarter 1 came in at +0.3% (+1.7% year on year) and quarter 2 was +0.3% (+1.5% year on year), which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up in quarter 3 to 0.5% before dipping slightly to 0.4% in quarter 4.

As such, market expectations during the autumn rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The MPC meeting of 14 September provided a shock to the markets with a sharp increase in tone in the minutes where the MPC considerably hardened their wording in terms of needing to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered on this warning by withdrawing the 0.25% emergency rate cut which had been implemented in August 2016. Market debate then moved on as to whether this would be a one and done move for maybe a year or more by the MPC, or the first of a series of increases in Bank Rate over the next 2-3 years. The MPC minutes from that meeting were viewed as being dovish, i.e. there was now little pressure to raise rates by much over that time period. In particular, the GDP growth forecasts were pessimistically weak while there was little evidence of building pressure on wage increases despite remarkably low unemployment. The MPC forecast that CPI would peak at about 3.1% and chose to look through that breaching of its 2% target as this was a one off result of the devaluation of sterling caused by the result of the EU referendum. The inflation forecast showed that the MPC expected inflation to come down to near the 2% target over the two to three year time horizon. So this all seemed to add up to cooling expectations of much further action to raise Bank Rate over the next two years.

However, GDP growth in the second half of 2017 came in stronger than expected, while in the new year there was evidence that wage increases had started to rise. The 8 February MPC meeting minutes therefore revealed another sharp hardening in MPC warnings focusing on a reduction in spare capacity in the economy, weak increases in productivity, higher GDP growth forecasts and a shift of their time horizon to focus on the 18 – 24 month period for seeing inflation come down to 2% (CPI inflation ended the year at 2.7% but was forecast to still be just over 2% within two years). This then led to the MPC agreeing to another Bank Rate increase in May 2018, with the market also bringing forward its expectations around the timing of subsequent increases in the Bank Rate. This shift in market expectations resulted in investment rates from 3 – 12 months increasing sharply during the first half of 2018.

Performance

3.4 The treasury management function regularly compares its performance against that of statistical neighbours, and this is reported to the treasury management panel and to members via the treasury management annual report.

3.5 The prudential and local indicators as at 30 September 2018 are shown in **Appendix A.** All indicators are currently being met.

The targets that these prudential indicators are monitored against have been taken from the Treasury Management and Investment Strategy for 2018/19 Onwards, which was approved by Council in February 2018.

4. Council Corporate Plan priorities

4.1 Sound financial management of the council’s cash balances supports the delivery of council priorities within the available resources

5. Risk Management

5.1 Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. It is recognised that the management of risk is as important as maximisation of performance and it is essential that the council has the right balance of risk and reward when making investment decisions. This is supported by treasury management policies which seek to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council.

6. Financial Implications

6.1 Treasury management activity forms part of the council's financial framework and supports delivery of the medium term financial strategy. The review of treasury management performance and activity is reviewed through both the treasury management annual report and the mid-year performance review report.

7. Legal Implications

7.1 The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original treasury management code in 1992 and further revisions to the Code in 2002, 2010 and 2017.

8. Property implications

8.1 None directly relating to this report.

9. Health and wellbeing implications

9.1 None directly relating to this report.

10. Staffing implications

10.1 None directly relating to this report.

11. Reducing inequalities

11.1 None directly relating to this report.

12. Consultation

12.1 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the S151 Officer, Head of Finance (Deputy S151 Officer) and Senior Finance Manager.

13. Background papers

- Various financial working papers
- Annual review of treasury management policy statement 2017/18 – Cabinet 20/11/17
- Corporate budget plan and treasury management and investment strategy 2018/19 – Council 28/02/18

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James Walsh
Executive Director

3 December 2018

Councillor Bird
Portfolio holder

3 December 2018

APPENDIX A

Prudential Indicators as at 30th September 2018

<table>
<tr><th colspan="2" rowspan="2">Prudential Indicator</th><th rowspan="2">Actual
2017/18
£m</th><th rowspan="2">Target
2018/19
£m</th><th rowspan="2">Forecast Position at
31-Mar-19
£m</th><th colspan="2">Variance to target</th></tr>
<tr><th>Numerical Variance</th><th>% Variance</th></tr>
<tr><td>PrI 1</td><td>Capital Expenditure</td><td>75.49</td><td>110.04</td><td>104.55</td><td>-5.49</td><td>-5%</td></tr>
<tr><td colspan="7">This indicator is required to inform the council of capital spending plans it is the duty of a local authority to determine and keep under review the amount that it can afford to allocate to capital expenditure. Capital expenditure may be funded by grant, capital receipts and borrowing. The forecast variance to target for 2018/19 is due to re profiling of capital schemes.</td></tr>
<tr><td>PrI 2</td><td>Ratio of financing costs to net revenue stream</td><td>8.75%</td><td>4.50%</td><td>4.50%</td><td>0.00</td><td>0%</td></tr>
<tr><td colspan="3">Financing costs - Divided by
(Interest charged on loans Less Interest earned on investments)</td><td colspan="2">Budget requirement
(Revenue Support Grant + NNDR +Council Tax)</td><td colspan="2">The ratio of financing costs to net revenue stream (General Fund) as a %</td></tr>
<tr><td>PrI 3</td><td>Estimates of the incremental impact of new capital investment decisions on Council Tax</td><td>£12.90</td><td>£24.14</td><td>£24.14</td><td>0.00</td><td>0%</td></tr>
<tr><td colspan="7">This is a notional amount indicating the amount of council tax band D that is affected by the capital programme in the budget report compared to existing approved commitments and current plans.</td></tr>
<tr><td>PrI 4</td><td>Capital Financing Requirement</td><td>351.59</td><td>367.66</td><td>367.66</td><td>N/A</td><td>N/A</td></tr>
<tr><td colspan="7">This represents the underlying level of borrowing needed to finance historic and future capital expenditure. It is updated at end of the financial year.</td></tr>
<tr><td>PrI 5</td><td>Authorised Limit for external debt</td><td>362.39</td><td>442.09</td><td>442.09</td><td>0</td><td>0%</td></tr>
<tr><td colspan="7">The council may not breach the limit it sets, so it is important to allow prudent room for uncertain cash flow movements and borrowing in advance of future need.</td></tr>
<tr><td>PrI 6</td><td>Operational Limit for external debt</td><td>329.45</td><td>401.90</td><td>401.90</td><td>0</td><td>0%</td></tr>
<tr><td colspan="7">This has been set at the level of the capital financing requirement less the CFR items relating PFI and finance leases.</td></tr>
<tr><td>PrI 7</td><td>Gross Borrowing exceeds capital financing requirement</td><td>No</td><td>No</td><td>No</td><td colspan="2"></td></tr>
<tr><td colspan="7">The CFR represents the underlying level of borrowing needed to finance historic capital expenditure. Actual net borrowing should be lower than this because of strong positive cash flow and balances. It would be a cause for concern if net borrowing exceeded CFR.</td></tr>
</table>

PrI 8	**Authority has adopted CIPFA Code of Practice for Treasury Management**	**Yes**	**Yes**	**Yes**	
To ensure that treasury management activity is carried out within best professional practice.					
PrI 9	**Total principle sums invested for longer than 364 days must not exceed**	**14.0**	**25.0**	**9.0**	
The council is at risk when lending temporarily surplus cash. The risk is limited by investing surplus cash in specified investments and by applying lending limits and high credit worthiness. These are kept under constant review.					

Prudential Indicator continued		**Upper Limit**	**Lower Limit**	**Actual 2017/18**	**Forecast Position at 31-Mar-19**
PrI 10	Fixed Interest Rate Exposure	95.00%	40.00%	**93.85%**	**93.94%**
PrI 11	Variable Interest Rate Exposure	45.00%	0.00%	**6.15%**	**6.06%**
PrI 12	***Maturity Structure of Borrowing***				
	Under 12 months	25.00%	0.00%	**26.22%**	**16.73%**
	12 months and within 24 months	25.00%	0.00%	**12.31%**	**12.12%**
	24 months and within 5 years	40.00%	0.00%	**21.03%**	**21.62%**
	5 years and within 10 years	50.00%	5.00%	**11.34%**	**11.17%**
	10 years and above	85.00%	30.00%	**29.10%**	**38.37%**

Local Indicators as at 30th September 2018

Local Indicators		Actual 2017/18	Target 2018/19	Forecast Position as at 31-Mar-19	Variance to target		Met
					Numerical Variance	% Variance	
L1	**Full compliance with prudential code**	**Yes**	Yes	**Yes**	-	-	Y
L2	**Average length of debt**	**13.14**	Lower Limit 15 years, Upper limit 25 years	**15.46**	-	-	Y
This is a maturity measure and ideally should relate to the average lifespan of assets.							
L3a	**Financing costs as a % of council tax requirement**	**7.61%**	7.67%	**7.63%**	- 0.04	- 0.52%	Y
L3b	**Financing costs as a % of tax revenues**	**4.57%**	12.50%	**4.73%**	- 7.77	- 62.16%	Y
These are a variation to PrI 3 excluding investment income and including MRP (amount set aside to repay debt costs). The target figure of 12.5% represents a upper limit of affordable net borrowing costs as a percentage of tax revenues for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favorable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.							
L4	**Net actual debt vs. operational debt**	**99.66%**	85.00%	**82.14%**	-2.86	-3.37%	Y
This assists the monitoring of the authority's debt position.							
L5	**Average interest rate of external debt outstanding excluding OLA**	**3.26%**	3.76	3.38%	- 0.38	- 10.11%	Y
L6	**Average interest rate of external debt outstanding including OLA**	**3.42%**	3.91%	3.53%	- 0.38	- 9.72%	Y
The measure should be as low as possible. Other Local Authority debt (OLA) is managed on our behalf by Dudley council.							
L7	**Gearing effect of 1% increase in interest rate**	**3.47%**	5.00%	**3.61%**	**0.06% increase. This would increase the average interest rate payable from 3.53% shown in L6 to 3.61%**		Y
This relates risk management principles to the monitoring of the TM strategy. It measures the effect of a change in interest rates and the effect it may have on the capital financing costs.							
L8	**Average interest rate received on STI vs. 7 day LIBID rate**	**0.76%**	0.50%	**0.76%**	0.26	52.00%	Y
The council aims to be gain interest on surplus funds higher than the 7 day LIBID rate. This measures performance in a changing economic context.							

L9a	**AT call investments**	**0.23%**	0.20%	**0.34%**	0.14	70%	Y
L9b	**Short Term Investments**	**1.06%**	0.70%	**1.06%**	0.36	51.43%	Y
L9c	**Long Term Investments**	**1.85%**	1.05%	**1.82%**	0.77	73.33%	Y
L10	**Average interest rate on all ST investments (ST and AT call)**	**0.65%**	0.65%	**1.02%**	0.37	56.92%	Y
L11	**Average rate on all investments**	**1.32%**	1.00%	**1.24%**	0.24	24.00%	Y
As L10, but includes investments longer than 364 days. All of the 7 indicators within L8-L11 are currently being exceeded. This is in the main due to the ongoing negotiations being undertaken by the service to secure favourable rates when considering investment options, and through the review and identification of new and appropriate opportunities for investment.							
L12	**% daily bank balances within target range**	**100%**	99%	**100%**	1.00	1.01%	Y
This measures how good our daily cash flow prediction is. A figure of 98% and above indicates a high level of accuracy.							