Meeting: **Audit Committee** **Date: 22nd May 2018**

Wards Affected: All Wards in Torbay

Report Title: Treasury Management Outturn 2017/18

Is the decision a key decision? No

When does the decision need to be implemented?

Executive Lead Contact Details: Mayor Gordon Oliver, 01803 207001, gordon.oliver@torbay.gov.uk

Supporting Officer Contact Details: Pete Truman, Principal Accountant, 01803 207302, pete.truman@torbay.gov.uk

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1. Proposal and Introduction

1.1 This report informs Members of the performance of the Treasury Management function in supporting the provision of Council services in 2017/18 through management of cash flow, debt and investment operations and the effective control of the associated risks.

1.2 The headline points of the report are:

- New borrowing of £124 million taken to fund the Capital Investment Fund
- Reduction in the overall average borrowing rate to 3.40%
- Annual investment rate achieved exceeded the market benchmark
  Increased investment in the CCLA Local Authorities Property Fund

2. Reason for Proposal

2.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual outturn report reviewing treasury management activities and the actual prudential and treasury indicators for 2017/18.

2.2 This report also meets the requirements of the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code). Both Codes were revised in December 2017 but full implementation is not required for the 2017/18 financial year.

3. Recommendation(s) / Proposed Decision

3.1 That the Treasury Management decisions made during 2017/18, as detailed in the submitted report be noted; and

3.2 That the performance against the approved Prudential and Treasury Indicators as set out in Appendix 1 to this report be noted.

4. **Background Information**

4.1 Treasury management is defined by the 2011 Code of practice as:

"The management of the authority's investments and cash flows, it's 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".

4.2 During 2017/18 the minimum reporting requirements were that full Council should receive the following reports:

- An annual treasury strategy in advance of the year (Council 9th February 2017)
- A mid-year review report (Council 19th October 2017)
- An annual report following the year describing the activity compared to the strategy (this report)

4.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the policies previously approved by Members.

4.4 The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the above strategy and mid-year treasury management reports by the Audit Committee before they were reported to full Council. Member training on treasury management issues was undertaken in July 2015 in order to support members' scrutiny role.

4.6 Treasury Management strategies were planned and implemented in conjunction with the Council's appointed advisors, Link Asset Services although the Council officers were the final arbiters of the recommended approach.

4.7 This report covers:

- The Economy and Interest rates
- Treasury Position at year end;
- The Strategy for 2017/18;
- Borrowing Outturn for 2017/18;
- Investment Outturn for 2017/18;
- Revenue Budget Performance;
- Reporting Arrangements and Management Evaluation

- Loans to Organisations
- Prudential and Treasury Indicators (Appendix1)

5. The Economy and Interest Rates

5.1 A commentary provided by Link Asset Services is presented at Appendix 2 to the report.

6. Overall Treasury Position as at 31 March 2018

6.1 At the beginning and the end of 2017/18 the Council's treasury position was as follows:

TABLE 1	31 March 2017 Principal	Rate/ Return	Average Life yrs	31 March 2018 Principal	Rate/ Return	Average Life yrs
Borrowing	*£153.1m*	*4.17%*	*26.3 years*	*£272.4m*	*3.40%*	*31.0 years*
Other long term liabilities	*£19.6m*	*5.14%*	*18.9 years*	*£18.9m*	*5.14%*	*17.9years*
Total debt	***£172.7m***	***4.25%***	***25.5 years***	***£291.3m***	***4.04%***	***30.2 years***
CFR	***£174.3m***			***£279.5m***		
Over*/(under) borrowing	*£(1.6)m*			*£11.8m*		
Total investments	***£41.7m***	***0.91%***		***£64.7m***	***0.83%***	
Net debt	£131.0m	3.24%		£226.6m	3.16%	

*A purchase from the Investment Fund was completed in April 2018 for £11M.

7. The Strategy for 2017/18

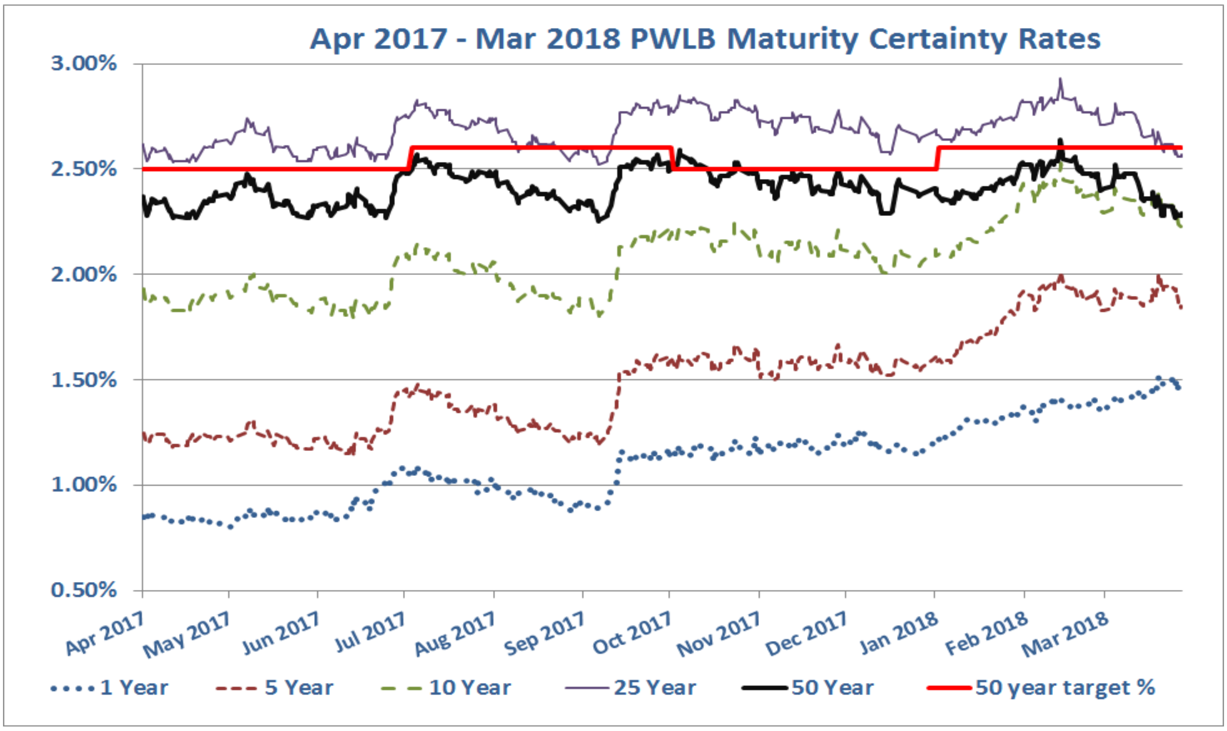
7.1 The 2017/18 approved strategy earmarked the use of existing cash resources to initially fund planned capital expenditure (internal borrowing) in order to delay the additional cost of borrowing to the General Fund until income streams were realised.

7.2 Due regard was given to the potential for changes in rate forecasts and in the event of sharp rises the CFO had sufficient powers to vary the strategy and take a greater proportion of the borrowing requirement earlier to protect the affordability of capital schemes over the longer term.

7.3 Core cash levels were already locked into longer term, higher yielding investments from previous strategy decisions. Remaining cash levels were to be kept available for the internal borrowing strategy in para 7.1 and mainly limited to short term liquidity instruments.

8. Borrowing Outturn 2017/18

8.1 The graph below shows the movement in PWLB borrowing rates for a selection of maturities over the year. The 25 and 50 year maturities were volatile through the year without any consistent trend. Shorter term rates were on a rising trend peaking in February March 2018.



8.2 2017/18 was an unprecedented year in terms of borrowing activity for Torbay Council. The ambitious Capital Plan, in particular a number of Investment Fund acquisitions (£99 million) gave rise to a significant capital Financing Requirement. A number of loans were taken from the Public Works Loan Board (PWLB) throughout the year and £4.5 million of maturities were repaid, as summarised below:

New Loans in year	£124 million
Average rate of new loans	2.45%
Average term of new loans	37 years
Maturities repaid	£4.5 million

8.3 Maturities were weighted towards the longer end to take of advantages in the yield curve and provide potential opportunities for debt rescheduling in the future when rate levels eventually rise.

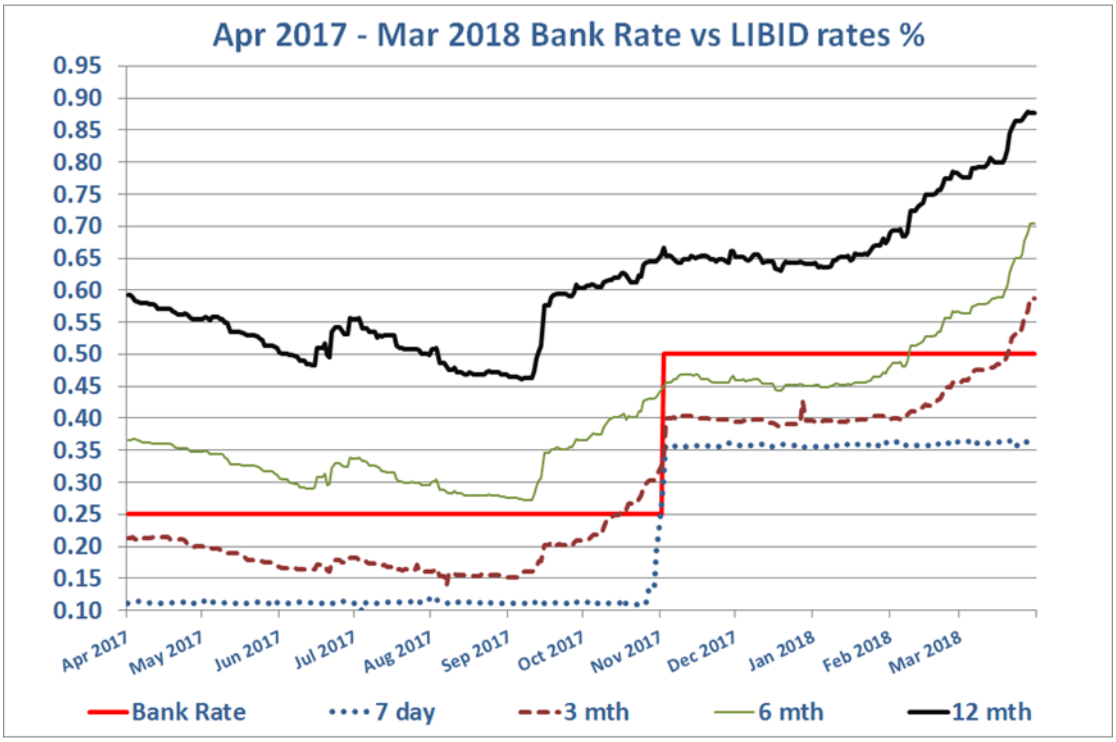
8.4 In line with the strategy borrowing amounts were sufficient to cover funding needs after applying available internal cash to capital expenditure. Timing of borrowing was generally delayed until certainty of outlay (i.e. exchange of contracts on Investment Fund acquisitions)

8.5 These measures were balanced by some defensive funding to protect against volatility in the markets and risks of sharp rises in borrowing rates. At year-end there was an over-borrowed position of £11.8 million to the Capital Financing Requirement pending potential capital spending in the new financial year.

8.6 As a result of the new loans the borrowing portfolio (excluding other long term liabilities) has increased to £272.4million and the average rate of interest paid across all loans in 2017/18 was 3.65%.

9. Investment Outturn 2017/18

9.1 The movement in key market investment rates during 2016/17 are illustrated in the table below.



9.2 Investments rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March. Bank Rate was duly raised from 0.25% to 0.50% on 2nd November 2017 and remained at that level for the rest of the year. However, further increases are expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on 28th February 2018.

9.3 In line with the primary strategy investments were limited to short term instruments with wide use made of Money market Funds. Deposits of 3 to 6 months were also transacted to provide some uplift to the overall return on short term funds.

9.4 Cash levels were boosted by a raft of PWLB borrowing in November and the Chief Finance Officer took advantage of this position to place a further £2M of strategic funds into the CCLA Local Authorities Property Fund at the end of January 2018. This represented a forward investment of an element of the core cash allocation, ahead of existing deals maturing later in 2018.

9.5 ***Performance Analysis*** - Detailed below is the result of the investments undertaken by in 2017/18. The Council's investment returns remain well in excess of the market benchmark while still maintaining availability of funds for internal borrowing

	Average Investment Principal	Rate of Return (gross of fees)	Rate of Return (net of fees)	Capita Benchmarking Club*		Market Benchmark/ Target Return
				Peer LA Comparison	English Unitaries	
Internally Managed	£63.5M	0.52%	Na	0.59%	0.58%	0.21%
CCLA Property Fund	£3.3M	4.82%	4.23%			
Combined	£66.8M	0.74%	0.71%			0.21%

* As at December 2017. Year end results not available at time of report.

9.12 In interest terms, the treasury strategy and decisions implemented contributed an additional £330,000 (after fees) to the General Fund over and above what would have been attained from the benchmark return.

9.13 A list of those institutions with which the in-house team invested funds during the year is provided at Appendix 3. No institutions with which investments were made showed any difficulty in repaying investments and interest in full during the year.

10 Revenue Budget Performance

10.1 The effect of the decisions outlined in this report on the approved revenue budget is outlined in the table below. The changes in interest paid and MRP directly relate to purchases of investment properties later in the financial year which provide an income stream to the Council.

	Revised Budget 2017/18	Actual 2017/18	Variation
	£M	**£M**	**£M**
Investment Income	(0.4)	(0.5)	(0.1)
Interest Paid on Borrowing	7.5	7.9	0.4
Net Position (Interest)	**7.1**	**7.4**	**0.3**
Minimum Revenue Provision (MRP)	3.1	3.2	0.1
MRP re: PFI	0.6	0.6	0
Net Position (Other)	**3.7**	**3.8**	**0.1**
Net Position Overall	**10.8**	**11.2**	**0.4**

10.2 The position was regularly reported to OSB and Council throughout the year as part of the budget monitoring reports to Members

11 Reporting Arrangements and Management Evaluation

11.1 The management and evaluation arrangements identified in the annual strategy and followed for 2017/18 were as follows:

- Monthly monitoring report to Executive Lead for Finance, Chief Finance Officer and Group Leaders
- Regular meeting of the Treasury Manager and Finance Manager to review previous months performance and plan following months activities
- Regular meetings with the Council's treasury advisors
- Regular meetings with the Council's appointed Fund Manager
- Membership and participation in Link Asset Services Investment Benchmarking Club

12 Loans to Organisations

12.1 The Council has provided loans or loan facilities to the following organisations. These are policy decisions and not part of the treasury management strategy except for identifying any impact on cash balances:

Value of loan 31st March 2017 £000s	Organisation	Value of loan 31st March 2018 £000's	Due within one year £000's	Due in excess of one year £000's	Years on loan
1,464	Torbay Economic Development Company	1,445	51	1,394	**25**
945	Torbay Coast & Countryside Trust	916	17	899	**45**
67	Academy Schools	0	0	0	**-**
7	Babbacombe Cliff Railway	0	0	0	**-**
32	Sports Clubs	30	2	28	**various**
-	Care Home Provider	1,217	101	1,116	**25**
-	South Devon College	3,880	160	3,720	**25**
-	Parkwood Leisure	515	0	515	**12**
2,515		**8,003**	**331**	**7,672**	

12.2 The current overall rate of interest on these loans is around 3.5%.

Appendices

Appendix 1: Prudential and Treasury Indicators 2017/18
Appendix 2: The Economy and Interest Rates
Appendix 3: Counterparties with which funds have been deposited in 2017/18

Background Documents

Treasury Management Strategy 2017/18

Appendix 1

Prudential and Treasury Indicators 2017/18

Capital Expenditure and Financing 2017/18

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need (though the timing of borrowing may be delayed through the application of cash balances held by the Council).

The actual capital expenditure forms one of the required prudential indicators and is shown in the table below.

	2016/17 Actual £m	2017/18 Revised Budget £m	2017/18 Actual £m
Total capital expenditure	37	135	121

Capital Financing Requirement

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's net debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2017/18 unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been financed by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively the reserving of funds for repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. The Council's 2017/18 MRP Policy (as required by MHCLG Guidance) was approved as part of the revised Treasury Management Strategy Report for 2017/18 on 19th October 2017.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's CFR for the year represents a key prudential indicator analysed below. This includes PFI schemes on the balance sheet, which increase the Council's long term liabilities. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m)	31 March 2017 Actual	31 March 2018 Revised Indicator	31 March 2018 Actual
CFR at Year End	174.3	288	280

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit presented at Appendix 1 to this report.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2017/18 plus the expected changes to the CFR over the subsequent two years. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

CFR (£m)	31 March 2017 Actual	31 March 2018 Actual
Opening balance	151.1	174.3
Capital expenditure in year funded from borrowing	26.6	109.0
Minimum Revenue Provision	(3.4)	(3.8)
CFR at Year End	**174.3**	**279.5**
Net borrowing position	**131.0**	**226.6**

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2017/18 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached. Borrowing levels were maintained well below the operational boundary throughout the year.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term liabilities net of investment income) against the net revenue stream.

	2017/18
Authorised limit	£330m
Maximum gross borrowing position	£272.5m
Operational boundary	£310m
Average gross borrowing position	£215.4m
Financing costs as a proportion of net revenue stream	10.1%

Treasury Indicators:

Maturity Structure of the fixed rate borrowing portfolio - This indicator assists Authorities avoid large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time.

	31 March 2018 Actual	**31 March 2018 Proportion**	**2017/18 Original Limits Lower-Upper**
Up to 10 years	£34M	12%	5% - 50%
10 to 20 years	£51M	19%	5% - 50%
20 to 30 years	£30M	11%	10% - 60%
30 to 40 years	£58M	21%	10% - 50%
Over 40 years	£99M	36%	0% - 50%

Principal sums invested for over 364 days - The purpose of this indicator is to contain the Council's exposure to the possibility of losses that might arise as a result of it having to seek early repayment or redemption of principal sums invested. The Actual figure reflects investment in the CCLA Property Fund

	2017/18 Limit	2016/17 Actual
Investments of 1 year and over	£35m	£5m

Exposure to Fixed and Variable Rates - The Prudential Code requires the Council to set upper limits on its exposure to the effects of changes on interest rates. The exposure to fixed and variable rates was as follows:

	31 March 2017 Actual %	2017/18 Upper Limits %	31 March 2018 Actual %
Limits on fixed interest rates: • Debt only • Investments only	100 53	100 80	100 34
Limits on variable interest rates • Debt only • Investments only	0 47	30 85	0 66

Appendix 2

The Economy and Interest Rates

By Link Asset Services April 2018

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 which meant that growth 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 modestly in the second half of 2017. Consequently, market expectations during the autumn, rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.
The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected.
Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and resulted in **investment rates** from 3 – 12 months increasing sharply during the spring quarter.

PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to **US treasuries**. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 year, rather than longer term yields.

The major UK landmark event of the year was the inconclusive result of the **general election** on 8 June. However, this had relatively little impact on financial markets

Appendix 3

Counterparties with which funds were deposited (April 2017 – March 2018)

Banks and Building Societies

Goldman Sachs International Bank
Lloyds Bank
National Westminster Bank
Santander UK
Svenska Handelsbanken

Local Authorities

Lancashire County Council
Nottinghamshire Police and Crime Commissioner
Newcastle City Council
Leeds City Council
London Borough of Barking and Dagenham
Monmouthshire County Council

Other Approved Institutions

Public Sector Deposit Fund
Goldman Sachs Sterling Reserve Fund
Aberdeen Asset Management Ltd
Funding Circle
CCLA Local Authorities Property Fund