SELBY DISTRICT COUNCIL

Report Reference Number: E/18/20

To:	**Executive**
Date:	**6th September 2018**
Status:	**Non Key Decision**
Ward(s) Affected:	**All**
Author:	**John Raine, Head of Technical Finance**
Lead Executive Member:	**Councillor Cliff Lunn, Lead Executive Member for Finance and Resources**
Lead Officer:	**Karen Iveson, Chief Finance Officer**

Title: **Treasury Management – Quarterly Update Q1 2018/19**

Summary:

This report reviews the Council's borrowing and investment activity (Treasury Management) for the period 1st April to 30th June 2018 (Q1) and presents performance against the Prudential Indicators.

Investments – On average the Council's investments totalled £60.6m over the quarter at an average rate of 0.66% and earned interest of £98.8k (£68k allocated to the General Fund; £31k allocated to the HRA) which was £30k above the year to date budget. Whilst cash balances are expected to reduce over the year, the bank rate increased on 2nd August 2018 meaning forecast returns could be in the region of £360k, a budget surplus of £120k.

Borrowing – Long-term borrowing totalled £59.3m at 30th June 2018, (£1.6m relating to the General Fund; £57.7m relating to the HRA), Interest payments of £2.5m are forecast for 2018/19, a saving of £0.3m against budget. The Council had no short term borrowing in place as at 31 March 2018.

Prudential Indicators – the Council's affordable limits for borrowing were not breached during this period.

The report also sets out an approach to investment in property funds and seeks approval of the procurement of investment of £5m in two selected funds.

Recommendations:

i. **Councillors endorse the actions of officers on the Council's treasury activities for Q1 2018/19 and approve the report.**
ii. **The Executive approve the exemption to the Council's procurement rules for the investment of £5m in property funds as set out in this report.**

Reasons for recommendation

To comply with the Treasury Management Code of Practice, the Executive is required to receive and review regular treasury management monitoring reports.
In relation to investment in property funds, the Council's treasury team has been through an equivalent procurement process for North Yorkshire County Council to select suitable funds for investment by Selby District Council.

1. Introduction and background

1.1 This is the first monitoring report for treasury management in 2018/19 and covers the period 1 April to 30 June 2018. During this period the Council complied with its legislative and regulatory requirements.

1.2 Treasury management in Local Government is governed by the CIPFA "Code of Practice on Treasury Management in the Public Services" and in this context is the management of the Council's cash flows, its banking and its capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. This Council has adopted the Code and complies with its requirements.

1.3 The Council's Treasury Strategy, including the Annual Investment Strategy and Prudential Indicators was approved by Council on 22 February 2018.

1.4 The two key budgets related to the Council's treasury management activities are the amount of interest earned on investments £240k (£165k General Fund, £75k HRA) and the amount of interest paid on borrowing £2.729m (£75k General Fund, £2.787m HRA).

2. The Report

Interest Rates and Market Conditions

2.1 Following the Monetary Policy Committee announcing a Bank of England increase, interest rates increased from 0.25% to 0.50% in Q3 2017/18. Q4 17/18 saw a gradual improvement in returns as the increase was reflected in market rates, resulting in the current average rate on investments achieving 0.66% in the first quarter of 18/19. On 2nd August 2018 a further increase has been announced to 0.75%, which is earlier than previously anticipated. Forecast investment income has therefore been adjusted to reflect the earlier rise in rates.

2.2 The Council's treasury advisors Link Asset Services – Treasury Solutions summarised the key points associated with economic activity in Q1 2018/19 up to 30 June 2018:

- The economy showed signs of regaining momentum after the slowdown in the first quarter of 2018;
- Employment growth rose strongly but wage growth softened;
- Consumer price inflation eased further;
- Public sector borrowing was lower than expected;
- Progress on Brexit negotiations stalled.

2.3 Deposit rates at the start of 2018/19 have gradually increased, as the rate increase in Q3 17/18 has filtered through into various deposits. Following the recent announcement of a further 0.25% increase, it is expected that rates achieved on investment will continue to steadily improve over the financial year.

Interest Rate Forecasts

2.4 The interest rate forecasts from Link Treasury advisors are as follows; which reflect the latest base rate rise:

Table 2: Forecast for Interest Rates

	Forecast	**Forecast**	**Forecast**	**Forecast**
	Q1 2018/19	**Q2 2018/19**	**Q3 2018/19**	**Q4 2018/19**
Bank Rate	0.50	0.75	0.75	0.75
5 Yr PWLB	2.00	2.00	2.00	2.10
25 Yr PWLB	2.80	2.40	2.50	2.50
50 yr PWLB	2.50	2.60	2.70	2.80

Annual Investment Strategy

2.7 The Annual Investment Strategy outlines the Council's investment priorities which are consistent with those recommended by DCLG and CIPFA:

- Security of Capital and
- Liquidity of its investments

2.8 The Investment of cash balances of the Council are managed as part of the investment pool operated by North Yorkshire County Council (NYCC). In order to facilitate this pooling, The Councils Annual Investment strategy and Lending List has been aligned to that of NYCC.

2.9 NYCC continues to invest in only highly credit rated institutions using the Link suggested creditworthiness matrices which take information from all the credit ratings agencies. Officers can confirm that the Council has not breached its approved investment limits during the year.

2.10 In light of an anticipated growth in the investment pool held by NYCC due to an increase in client funds, a review of the current counterparty list has been carried out, with recommendations to standardise limits within various institution groups, remove un-utilised institutions and add new institutions which hold the recommended rating and attractive rates. This review will not change the risk profile of the overall fund.

2.11 The Council's investment activity in the NYCC investment pool up to Q1 2018/19 was as follows:-

- Balance invested at 30 June 2018 £58.1m
- Average Daily Balance Q1 18/19 £60.6m
- Average Interest Rate Achieved Q1 18/19 0.66%

2.12 The average return to Q1 2018/19 of 0.66% compares with the average benchmark returns as follows:

- 7 day 0.36%
- 1 month 0.38%
- 3 months 0.55%
- 6 months 0.67%
- 12 months 0.84%

Borrowing

2.13 It is a statutory duty for the Council to determine and keep under review its "Affordable Borrowing Limits". The Council's approved Prudential Indicators (affordable limits) were outlined in the Treasury Management Strategy Statement (TMSS). A list of the limits is shown at Appendix A. Officers can confirm that the Prudential Indicators were not breached during the year.

2.14 The TMSS indicated that there was no requirement to take long term borrowing during 2018/19 to support the budgeted capital programme. However, the borrowing requirement is largely dependent on the Housing Development Programme and whilst it is expected that this will be funded by internal borrowing, this will continue to be reviewed.

2.15 The Council approved an Authorised Borrowing Limit of £84m (£83m debt and £1m Leases) and an Operational Borrowing Limit of £79m (£78m debt and £1m Leases) for 2018/19.

2.16 The strategy, in relation to capital financing, is to continue the voluntary set aside of Minimum Revenue Provision (MRP) payments from the HRA in relation to self-financing debt in order to create capacity to internally borrow to support the Housing Delivery Programme. £1.26m is budgeted for 2018/19.

2.17 As a result, the Council was in an over-borrowed position of £6.8m as at 30 June 2018. This means that capital borrowing is currently in excess of the Council's underlying need to borrow. The increase of £1m compared to the year-end position is a result of the in-year HRA self-financing set aside and timing of new capital expenditure which will increase as the year progresses, reducing the over-borrowed position.

2.18 The 2018/19 Treasury Management Strategy forecasts an under-borrowed position by the end of 18/19, rising to £14.5m by the end of 20/21 as loans are made to support the Housing Trust, and HRA Housing Investment Programme. Plans to undertake any additional long term borrowing in the short/medium term will be kept under review as the Extended Housing Delivery Programme progresses and while borrowing rates remain low.

Capital Strategy

2.19 The Capital Strategy was included as part of the Council's Annual Treasury Management and Investment Strategy 2018/19, approved in February 2018. The Capital Strategy sets out how capital expenditure, capital financing and treasury management contribute to the provision of Corporate and service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. It sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

2.20 Alternative non-treasury investments are considered as part of the Capital Strategy. Given the technical nature of potential alternative investments and strong linkages to the Council's Treasury Management function, appropriate governance and decision making arrangements are needed to ensure robust due diligence in order to make recommendations for implementation. As a result, all investments are subject to consideration and where necessary recommendations of the Executive.

2.21 Options for alternative investments currently being explored are Commercial Property investments, which will be subject to individual business case approval, and Property Funds.

Commercial Property Investments

2.22 To date there has been two successful bids on Commercial Properties, one in Selby town and one in Tadcaster, both buildings are ex-Natwest Bank Properties. The first successful bid was placed for the Tadcaster property, completion is due towards late August. The second in Selby, which is currently being progressed by Legal and the Project Team.

Property Funds

2.23 In August 2017 NYCC's approach to commercial investment was reviewed and consequently, Property Funds (pooled investment vehicles investing in diversified UK commercial property), were added to the schedule of Non Specified Investments as part of the 2018/19 Annual Treasury Management Strategy which was subsequently adopted by Selby District Council in March 2018 as part of our Treasury Management Strategy.

2.24 The County Council, through its in-house treasury team (led by the Assistant Director NYCC/Selby's CFO) has undertaken a procurement process to select one or more property fund managers. The County Council's (and Selby's) treasury management advisors, Link, were commissioned to support the selection process.

2.25 NYCC's approved Investment strategy provides for up to 20% (max £20m) to be invested for a period of up to 5 years in Property Funds and the County Council is now pursuing an initial £6m investment in two property funds. A full EU compliant procurement process could then be considered to extend investment in the future.

2.26 This is now an opportune time for Selby District Council to consider it's appetite for investment in Property Funds and it is proposed that the Chief Finance Officer, with the necessary support from the County Council's treasury team and Link, seek to invest £5m in the two property funds selected through the NYCC procurement process.

2.27 In endorsing this approach the Executive are advised that £5m represents a reasonable proportion of Selby's cash balances (circa 10%) and cash flow forecasts suggest that these funds are available for at least 5 years. It is also important to note that the value of property can go down as well as up – the funds selected have a good mix of properties within their portfolio in order to mitigate downturns in the market but this cannot be guaranteed.

2.28 The funds selected are capital funds, which means that when cash is withdrawn from the fund it is received as a capital receipt – accordingly it is proposed that the investments are cash backed through a dedicated reserve financed from balances within the Special Projects Reserve not yet allocated to the Programme for Growth.

3. Alternative Options Considered

3.1 The Council has access to a range of investments through the pooled arrangements in place through North Yorkshire County Council.

4.0 Implications

4.1 Legal Implications

4.1.1 The proposal to invest in property funds by applying the process undertaken by NYCC is a departure from Selby's own procurement rules but given the process was undertaken by the same team that manages Selby's investments, supported by the same treasury advisors, and Selby has the same investment strategy as NYCC, it is unlikely that a different conclusion would be reached from another procurement exercise and consequently an exemption to Selby's rules is sought.

4.1.2 In order to apply to invest in property funds the Council must qualify under the Markets in Financial Instruments Directive (MIFID II) which is EU legislation that regulates firms that provide services to clients.

4.2 Financial Implications

4.2.1 The Councils investment income during the year has been highlighted through in-year monitoring and is reported in the surplus outturn position for the General Fund and HRA.

4.2.2 Going forward investment in property funds will generate a revenue income for the Council – based on past performance (which is no guarantee of future performance) return of 4-5% could be achieved which would give annual income of around £200k - £250k based on £5m invested. The funds will be established and monitored through our existing treasury arrangements but given the specialist nature of these investments an additional fee of 1% of revenue returns (£2k based on estimated returns) will be charged by NYCC plus a one off fee of £3.5k.

4.2.3 Fund entry fees are subject to confirmation but could be in the region of £120k - £150k on the secondary market and £300-500k on the primary market. It is proposed that these be funded from the Programme for Growth (Commercial Property Acquisition Fund).

5. Conclusion

5.1 The impact of the economy, and the turmoil in the financial markets, continues to have an impact on the Council's investment returns. Forecasts predict steady growth in bank rates over the long term over and above the 0.50% increase over the last 12months. Whilst returns remain relatively modest, rate increases earlier than forecast and better than expected cash flows, largely as a result of the timing of collection fund cash-flows has resulted in a positive outlook for 2018/19 in performance against budget.

5.2 The Council's debt position is in line with expectations set out in the Strategy, with no immediate changes on the horizon. However, as the Housing Delivery programme progresses and interest rates begin to rise, opportunities to optimise the Council's debt portfolio will be kept under review.

5.3 The Council operated within approved Strategy Indicators for the quarter, with no breaches on authorised limits. The Prudential Indicators are reviewed annually as part of the Treasury Strategy to ensure approved boundaries remain appropriate; activities to date during 18/19 have not highlighted any concerns.

5.4 The approach to investment in property funds set out in the report enables Selby to apply the procurement process undertaken by the County Council's treasury team and achieve an improved return on the funds invested. In approving such an investment the Executive must keep in mind that property investment is not without risk and property values can go down as well as up and revenue returns cannot be guaranteed. However, the funds selected have a diversified portfolio and a strong track record of managing risk and volatility in property values over the long term.

6. Background Documents

Finance Treasury Management Files

Contact Details
Michelle Oates
Senior Accountant – Capital & Treasury
North Yorkshire County Council
moates@selby.gov.uk

Karen Iveson
Chief Finance Officer
kiveson@selby.gov.uk

Appendices:
Appendix A – Prudential Indicators as at 30 June 2018