APPENDIX A

SELBY
DISTRICT COUNCIL

Report Reference Number: E/18/28

To:	**Executive**
Date:	**Thursday 8th November 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 Q2 2018/19

Summary:

This report reviews the Council's borrowing and investment activity (Treasury Management) for the period 1st April to 30th September 2018 (Q2) and presents performance against the Prudential Indicators.

Investments – On average the Council's investments totalled £63.6m over the quarter at an average rate of 0.73% and earned interest of £231k (£162k allocated to the General Fund; £69k allocated to the HRA) which was £111k 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 £432k (£302k GF, £130K HRA), a budget surplus of £190k. It is proposed that any amount allocated to the GF above £300k is transferred to the contingency reserve, in line with the approved Medium Term Financial Strategy.

Borrowing – Long-term borrowing totalled £59.3m at 30th September 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, and has not undertaken any during 2018/19.

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

Following approval to invest £5m between two property funds, the

Treasury team have been progressing the application process for SDC, including requirements under MiFID II. It is anticipated that units will be purchased in the October trading window. Returns achieved against Property Fund investments will be allocated against the GF savings target. Entry fees will be treated as revenue expenses and offset against returns in year one.

Recommendations:

i. Councillors endorse the actions of officers on the Council's treasury activities for Q2 2018/19 and approve the report.

ii. Note that investment income allocated to the General Fund, over the £300k threshold is to be transferred to Contingency Reserve.

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.

1. Introduction and background

1.1 This is the second monitoring report for treasury management in 2018/19 and covers the period 1 April to 30 September 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 The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track and Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019. Investment income forecasts have therefore been adjusted to reflect a stable rate for the remainder of 2018/19.

2.2 The Council's treasury advisors Link Asset Services – Treasury Solutions summarised the key points associated with economic activity in Q2 2018/19 up to 30 September 2018:

- The economy gathered some momentum;
- A tight labour market put upward pressure on wage growth;
- Consumer price inflation rose unexpectedly;
- Another hike from the MPC in August, but some dovish signals;
- Better public finance figures provided some breathing room for the Chancellor;
- Brexit negotiations remained at an impasse;
- UK equities underperformed.

2.3 Deposit rates at the start of 2018/19 have gradually increased, as the rate increases in Q3 17/18 and Q2 18/19 have filtered through into investments placed by the pooled Treasury Fund. Current forecasts suggest there will be no further increase until Q2 19/20, and therefore Treasury investment income has been forecast in line with expectations.

Interest Rate Forecasts

2.4 The interest rate forecasts from Link Treasury advisors are as follows;

Table 2: Forecast for Interest Rates

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

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 Q2 2018/19 was as follows:-

- Balance invested at 30 September 2018 £68.04m
- Average Daily Balance Q2 18/19 £63.6m
- Average Interest Rate Achieved Q2 18/19 0.69%

2.12 The average return to Q2 2018/19 of 0.69% compares with the average benchmark returns as follows:

- 7 day 0.44%
- 1 month 0.47%
- 3 months 0.61%
- 6 months 0.71%
- 12 months 0.94%

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 £5.54m as at 30 September 2018. This means that capital borrowing is currently in excess of the Council's underlying need to borrow. The slight increase 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 have 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, which completed during Q2 18/19. The second in Selby, which is currently being progressed by Legal and the Project Team, it is expected this will compete towards the end of Q3 18/19. Business cases are currently being developed for the on-going use of the buildings, which means that costs relating to managing the properties, such as Business Rates, security etc. will need to be funded through in-year savings.

Property Funds

2.23 On 6th September 2018, The Executive approved exemption of the Council's procurement rules to invest £5m in Property funds, which have been selected through a procurement exercise carried out by the NYCC Treasury Team, in conjunction with the Council's joint treasury advisors, Link, who were commissioned to support the selection process.

2.24 Throughout September, the Treasury team have progressed the necessary application process to buy into the secondary market of Blackrock and Threadneedle Funds, to place £2.5m per fund, direct investment on behalf of SDC. This included application under Mifid II regulations as the holdings will be wholly owned by SDC.

2.25 Current returns will be monitored once the units have been purchased, but based on historical performance, it is anticipated that returns will be in the region of 4.86%, total return (5.07% Income, -0.21% Capital), roughly 4% above forecast income from Treasury cash deposits. However, as the fund returns are linked to capital value, it has been proposed to create a dedicated reserve to ensure that The Council has the capacity to withstand any losses due to market fluctuations.

2.26 It has been proposed that The Council funds would be required for up to 5 years as an initial investment horizon, however as referenced above it is recognised that the Property Market values can decrease as well as increase, and so the duration of the investment will be kept under review to help minimise the risk of losses in capital value.

3. Alternative Options Considered

3.1 Not Applicable

4.0 Implications

4.1 Legal Implications

There are no legal issues as a result of this report.

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 circa £200k 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 expected to be £107k on the secondary market, which includes frees from the Broker and Link. These will 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.

6. Background Documents

Finance Treasury Management Files

Contact Details
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Appendices: