POLICY RESOURCES & GRWOTH COMMITTEE	Agenda Item 28 Brighton & Hove City Council

Subject:		**Treasury Management Strategy Statement 2018/19 - End of Year Review**	
Date of Meeting:		**18 July 2019**	
Report of:		**Executive Director for Finance & Resources**	
Contact Officer:			
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Ward(s) affected:		**(All Wards);**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2018/19 Treasury Management Strategy Statement (TMSS) and Treasury Management Practices (TMPs) were approved by the Policy, Resources & Growth Committee on 29 March 2018. The TMSS sets out the role of Treasury Management, whilst the TMPs and accompanying schedules identify the practices and procedures that will be followed to achieve the aims of the TMSS and that underpin the council's Treasury Management function.

1.2 The TMSS includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash balances and was approved by Full Council on 19 April 2018.

1.3 Much of the detail within treasury management is described using technical language. To aid readers, a glossary of the main terms used in this report is included at **Appendix 1**.

2. RECOMMENDATIONS:

2.1 That Policy, Resources & Growth Committee (PR&G) notes the key actions taken during the second half of 2018/19 to meet the TMSS and practices (including the investment strategy) as set out in this report.

2.2 That PR&G notes the reported compliance with the AIS for the six month period up to the end of March 2019.

2.3 That PR&G notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised borrowing limit and operational boundary have not been exceeded.

2.4 That PR&G notes the offer of training for committee members in order to support strong democratic oversight over the performance of the council's treasury management function.

3. CONTEXT/ BACKGROUND INFORMATION

Introduction

3.1 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available (i.e. liquid) when it is needed. Effective cash flow planning enables surplus monies to be invested in counterparties or instruments commensurate with the council's risk appetite, providing adequate liquidity is maintained.

3.2 The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn on may be restructured to meet council risk or cost objectives.

3.3 The contribution the treasury management function makes to the authority is therefore critical, as the balance of debt and investment operations ensure liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue spending or for larger capital projects. The treasury operations also therefore influence the interest costs of debt and the investment income arising from cash deposits which has implications for the council's budget.

3.4 Since cash balances generally result from holding earmarked and committed reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund.

3.5 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

3.6 The Chartered Institute of Public Finance & Accountancy (CIPFA) defines treasury management as:

"The management of the local authority's borrowing, investments and cash flows, its 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."

3.7 Revised reporting was introduced the 2019/20 reporting cycle due to revisions of the Ministry for Housing Communities & Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a 'Capital Strategy', to provide a longer-term focus to the capital investment plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011.

3.8 The capital strategy report, should demonstrate that the authority:

- takes capital expenditure and investment decisions in line with service objectives;
- takes account of stewardship, value for money, prudence and affordability;
- sets out the long term context in which capital expenditure and investment decisions are made;
- gives due consideration to both risk and reward and the impact on the achievement of priority outcomes.

The aim of the Capital Strategy is to ensure that all members on the full Council understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. The first Capital Strategy for this authority was approved by full Council at its February 2019 meeting.

A key element of the Treasury Management Policy & Strategy concerns prudential indicators. These require the council to set limits on external debt and borrowing activity. These are set in the context of capital financing requirements but, more importantly, in the context of overall affordability. Anything borrowed must ultimately be repaid. All councils are required to set aside Minimum Revenue Provision (MRP) for debt but must also consider whether repayments will be affordable both now and in the longer term when resources may be predicted to reduce. Financing costs (principal and interest repayments) must also be budgeted for and any increase in repayments may therefore reduce the resources available for providing other essential services.

Economic Background

3.9 The council's treasury advisors, Link Asset Services, provide their assessment of the UK and global economic landscapes over 2018/19 (**Appendix 2**).

3.10 The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75% early in the financial year. UK GDP growth was weak in the first few months of 2018 resulting in the expectation for the timing of this increase being pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the Monetary Policy Committee (MPC) would raise Bank Rate in August. This increase to 0.75% was confirmed at the MPC meeting on 1 August 2018.

3.11 It was not expected that the MPC would raise the Bank Rate again during 2018/19 in view of the fact that the UK was entering into a period of major uncertainty with Brexit due in March 2019. Value was therefore sought by placing longer term investments after 1 August where cash balances were sufficient to allow this.

3.12 Both Brexit uncertainty and trade negotiations between the US and China dominated economic and financial news in 2018/19, causing volatility across financial markets for much of the financial year.

Treasury Management Strategy

3.13 A summary of the action taken in the 6 months to March 2019 is provided in Appendix 1 to this report and further information on borrowing and investment performance is shown in the March 2019 Treasury Management statistics at **Appendix 3**. The main points are:

- The council repaid £30m of LOBO loans held with the Royal Bank of Scotland (RBS) during October 2018;
- The council entered into £26.0m of new borrowing March 2019 to replace the RBS borrowing:
    - £16.0m was to replace the Housing Revenue Account (HRA – the ring-fenced account that covers the council's housing stock) element of the RBS loans;
    - £10.0m was to replace the General Fund element of the RBS loans.
- The highest risk indicator during the period was 0.021% which is below the maximum benchmark of 0.050%;
- The return on investments has exceeded the target benchmark rates in two of the 6 months ;
- The two borrowing limits approved by full Council have not been exceeded.

3.14 Treasury management activity for the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Oct 2018 to 31 Mar 2019			
	Fixed deposits	Money market funds	Total	
Up to 1 week	-	£279.8m	£279.8m	83%
Between 1 week & 1 month	-	-	-	0%
Between 1 month & 3 months	£16.5m	-	£16.5m	5%
Over 3 months	£41.0m	-	£41.0m	12%
	£57.5m	**£279.8m**	**£337.3m**	**100%**

Budget versus Outturn 2018/19

3.15 The following table summarises the performance achieved on investments compared to the budgeted position and approved benchmark for the whole year.

	In-house Investments		Aberdeen Short dated fund (net of fees)	
	Average Balance	Average rate	Average Balance	Average rate
Budget 2018/19	£70.0m	0.90%	£25.7m	0.70%*
Actual 2018/19	£155.2m	0.81%	£10.0m	0.73%*
Benchmark Rate**		0.73%		0.66%

* *net of fees*
*** Aberdeen Short Dated Fund Benchmark rate is set at 105% of 7 Day LIBID, whereas in-house benchmark rate was set at 7 Day LIBID +0.10% for 2018/19*

3.16 The Financing Costs budget variance in 2018/19 was £0.534m underspent. The key variance is an over-achievement of investment income (£0.435m) as a result of higher balances which offsets a minor loss as a result of the average rate achieved on investments being lower than budgeted for. The higher investment balances were as a result of:

- delay and re-profiling of capital expenditure and major projects (so balances have not been drawn down as quickly as expected);
- capital receipts within the balances that have not yet been applied (such as Kings House & capital Education grant).

3.17 The remaining underspend was due to higher recharges to services for borrowing than anticipated (£0.065m), and a part year net saving as a result of the debt restructure outlined in paragraphs 3.17 & 3.18 (£0.034m). Of the total £0.534m under spend, £0.190m was taken to the earmarked financing costs reserve to smooth short term pressures expected as a result of the gap between investment rates and borrowing rates.

Summary of Treasury Activity October 2018 to March 2019

3.18 The following table summarises the treasury activity in the half year to March 2019 compared to the corresponding period in the previous year:

October to March	2016/17	2017/18	2018/19
Long-term borrowing raised (General Fund)	-	-	(£10.0m)
Long-term borrowing raised (HRA)	-	(£4.0m)	(£16.0m)
Long-term borrowing repaid (General Fund)	£0.5m	£1.0m	£14.9m
Long-term borrowing repaid (HRA)	-	£0.5m	£16.6m
Short-term borrowing (raised)/repaid	£1.0m	(£0.5m)	(£6.0m)
Investments made	£292.0m	£337.7m	£337.3m
Investments maturing	(£306.2m)	(£322.9m)	(£352.8m)

3.19 The following table summarises how the day-to-day cash flows in the second half-year have been funded compared to the same period in the previous year:

October to March	2016/17	2017/18	2018/19
Net cash flow (shortage)/surplus	**(£12.9m)**	**£12.1m**	**(£20.3m)**
Represented by:			
Increase/(reduction) in long-term borrowing	(£0.5m)	£2.5m	(£5.5m)
Increase/(reduction) in short-term borrowing*	(£1.0m)	£0.5m	£6.0m
Reduction/(increase) in investments	£14.2m	(£14.8m)	£15.5m
Reduction/(increase) in bank balance	£0.2m	(£0.3m)	£4.3m

*South Downs National Park external investments plus temporary borrowing

Security of Investments

3.20 A summary of investments made by the in-house team and outstanding as at 31 March 2019 in the table below shows that investments continue to be held in good quality, short term instruments.

'AAA' rated money market funds	£44.70m	29%
'AA' rated institutions	£36.00m	24%
'A' rated institutions	£70.50m	47%
'BBB' rated institutions	£0.00m	0%
Total	**£151.20m**	**100%**

Period – less than one week	£49.70m	34%
Period – between one week and one month	£15.00m	10%
Period – between one month and three months	£21.00m	14%
Period – between three months and 1 year	£60.50m	42%
Total	**£151.20m**	**100%**

Risk

3.21 As part of the investment strategy for 2018/19 the Council agreed a maximum risk benchmark of 0.050% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures the risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.015% and 0.021% between October 2018 and March 2019. It should be remembered however that the benchmark is an ‘average risk of default’ measure, and does not constitute an expectation of loss against a particular investment.

3.22 The treasury management service is subject to a detailed audit on a regular basis. This includes the testing of the control environment and the management of risk. A substantial level of assurance was provided during the most recent audit (October 2017).

Compliance with the Annual Investment Strategy

3.23 During the reporting period, the information in this report provides assurance that the Annual Investment Strategy has been complied with in full.

Borrowing Strategy

3.24 The General Fund has been maintaining an under-borrowed position in response to the current economic climate. This is a prudent strategy as investment returns are low and counterparty risk is still an issue that needs to be considered. The Council’s investment balances have been increasing over 2017/18 & 2018/19, primarily as a result of receiving one off and unapplied capital funding. As a result, no new borrowing to support the General Fund capital programme was undertaken in 2018/19.

3.25 The HRA operates a fully funded Capital Financing Requirement. Over 2016/17 and 2017/18 the HRA has applied £16.3m of borrowing to fund its capital programme. Of this, it borrowed £14m externally from the PWLB and the remaining £2.3m was borrowed from the General Fund in order to reduce the HRA’s interest rate and to minimise counterparty risk at a time when General Fund investment balances were increasing. The HRA’s underlying borrowing need increased marginally in 2018/19 as a result of transferring land and properties from the General Fund. The internal short term loan to the HRA increased to £4.5m to support this transfer and replace the PWLB debt maturities in the year.

3.26 A restructuring opportunity arose in October 2018, with one of the council’s market lenders (RBS) offering to allow the council to repay £30m Lender Option Borrower Option (LOBO) loans on more attractive terms. There has been an increase in the council’s cash balances during the last two years and the loan repayment was therefore initially funded through using cash within the investment portfolio and some short term borrowing to support short term cash flow.

3.27 Replacements loans of £26m were undertaken during March 2019. Officers took advantage of a dip in interest rates which resulted from investor uncertainty in the lead up to 29 March 2019; the date that it was expected that the UK would withdraw from the European Union. The replacement loans were modelled to restructure and smooth the council's debt maturity profile and reduce the cost of borrowing to the council. The total savings achieved were £0.304m per annum. The below table summarised the annual full year impact on revenue for the HRA and General Fund on restructuring this debt.

	General Fund	**HRA**
Annual Interest from RBS Loans (Average Rate 4.26%)	(£0.593m)	(£0.684m)
Interest on replacement loans (Average Rate 2.09%)	£0.209m	£0.334m
Annual write down of Premium payable	£0.101m	£0.116m
Reduction in investment income	£0.154m	£0.059m
Total net cost/(saving)	**(£0.129m)**	**(£0.175m)**

3.28 The treasury management team, along with the its advisors, monitor interest rates and will seek to externalise the HRA's borrowing from the General Fund at a time which would be optimal for both the HRA and the General Fund. The Treasury Team are also exploring alternative borrowing sources, such as forward market borrowing for future capital investment plans.

3.29 A summary of the council's debt portfolio is included in **Appendix 4**.

Treasury Advisors

3.30 The council's contract with Link Asset Services has been extended for one year until December 2019 using a procurement framework.

3.31 Officers recognise that responsibility for decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

Capital Strategy

3.32 New requirements to produce a Capital Strategy were introduced within an update to the Ministry of Housing, Communities and Local Government's (MHCLG) Investment Guidance, and revisions to CIPFA's Treasury Management Code. The aim of the strategy is to ensure that all members understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

3.33 The 2019/20 Capital Strategy was presented to Budget Council as part of the Budget Report in February 2019. Officers have since met with representatives from MHCLG to discuss the impact and future direction of the council's Capital Strategy to ensure it delivers on its original aims.

Member Training

3.34 It is a requirement of CIPFA's Treasury Management code to ensure members that are responsible for decision making and scrutiny of the authority's TMSS are adequately trained to undertake their roles in this area.

3.35 Treasury Management training will be offered to all members, but will be particularly relevant for members of PRG and the Audit & Standards committee. This training will be offered before the 2020/21 TMSS & Annual Investment Strategy is presented to PRG and Council.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report sets out action taken in the 6 months to March 2019. Treasury management actions have been carried out within the parameters of the AIS, TMSS, and Prudential Indicators. Therefore no alternative options have been considered.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted over the content of this report. No other consultation has been undertaken.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as "best and proper practice" under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year's performance. This report fulfils this requirement.

7. FINANCIAL & OTHER IMPLICATIONS:

<u>Financial Implications:</u>

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraph 3.7.

Finance Officer Consulted: James Hengeveld Date: 16/06/19

<u>Legal Implications:</u>

7.2 The TMPS and associated actions are carried out using powers given to the council by Part 1 of the Local Government Act 2003. These include the power for a local authority to invest for the purposes of the prudent management of its financial affairs (section 12).

7.3 Regulations made under the 2003 Act (the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003/3146) require local authorities to have regard to specified guidance notes when exercising their functions under Chapter 1 of Part 1 of the 2003 Act.

7.4 The activities outlined in the report are considered to be compliant with the 2003 Act and with specified guidance.

Lawyer Consulted: *Victoria Simpson* *Date: 19/06/19*

Equalities, Sustainability and other significant implications:

7.5 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. Glossary of terms
2. The Economy & Interest Rates – Link Asset Services
3. March 2019 Treasury Management Statistics
4. A summary of the action taken in the period October 2018 to March 2019

Documents in Members' Rooms

None.

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations.

2. The Treasury Management Policy Statement, Treasury Management Practices and associated schedules 2018/19 approved by Policy & Resources on 29 March 2018.

3. The Annual Investment Strategy 2018/19 approved by full Council on 19 April 2018.

4. Treasury Management Policy Statement 2018/19 (including Annual Investment Strategy 2018/19) – Mid-Year Review approved by Policy & Resources Committee on 6 December 2018.

5. Papers held within Finance, Finance & Resources Directorate.

6. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2017.