Agenda Item No. 4

THE VALE OF GLAMORGAN COUNCIL

CORPORATE PERFORMANCE AND RESOURCES SCRUTINY COMMITTEE: 14 DECEMBER 2017

REFERENCE FROM CABINET: 20 NOVEMBER 2017

C138 TREASURY MANAGEMENT (L) (SCRUTINY COMMITTEE – CORPORATE PERFORMANCE AND RESOURCES) -

Cabinet was provided with a mid-year report on the Authority's treasury management operations for the period 1 April, 2017 to 30 September, 2017.

The Authority's existing borrowing strategy estimated that it would borrow £14,769k of new loans to support the capital programme for 2017/2018. The sum would fluctuate dependent on the delivery of the Capital Programme, particularly WHQS. Given the current and projected level of Council reserves it was likely that the sum required would be internally borrowed during 2017/18.

Council officers in conjunction with the Treasury Advisors had and would continue to monitor the prevailing interest rates and the market forecasts and adopt a pragmatic approach to changing circumstances in respect of its borrowing needs.

The Head of Finance (Section 151 Officer) was pleased to report that all treasury management activity undertaken during the period complied with the approved strategy, the CIPFA Code of Practice and the relevant legislative provisions.

The following tables summarised the treasury management transactions undertaken by the Authority during the first half of this financial year. All activities were in accordance with the Authority’s approved Strategy on Treasury Management. The following table set out the monies borrowed / repaid during the period.

Loan Type	Opening Balance	Received	Repaid	Closing Balance
	01/04/2017			**30/09/2017**
	£'000	**£'000**	**£'000**	**£'000**
PWLB	148,999	0	(1,138)	147,861
Other Long Term Loans	6,000	0	0	6,000
Temporary Loans	100	0	0	100
WG Loans	2,100	0	0	2,100
Totals	**157,199**	**0**	**(1,138)**	**156,061**

- Loans borrowed from the PWLB were intended to assist Local Authorities in meeting their longer term borrowing requirements. The above loans were all at fixed rates of interest. The rate paid on each loan was largely dependent upon the original duration of the loan and date taken out. The loans taken out for the HRAS buyout were at a predetermined range of rates specified by HM Treasury.

- Other long term loans represented those non-PWLB loans that were repayable at least 1 year or more from the date they were advanced. The bulk of this debt was represented by two market loans of £2,000,000 and £4,000,000.

- Temporary Loans represented those loans that were borrowed for a period of less than 1 year. They were borrowed on 7 day notice.

- WG Loan was an interest free loan provided by Welsh Government to progress the Barry Island Link Road Scheme.

External interest at an average rate of 4.72% and amounting to £3,705,836 had been paid on the loans during the first 6 months of 2017/2018.

As at 30 September, 2017 it was estimated that the Authority had internally borrowed in excess of £39million to finance the capital programme. Interest had been charged at the average 3 month LIBID rate which for 2017-18 to date equated to 0.38% .This was a far cheaper alternative to borrowing externally and was affordable given the projected level of reserves. The estimated total interest to be charged to revenue for internal borrowing for 2017-2018 was £150,030.

Pooling the interest charges for external and internal borrowing, the average rate charged to the Council to deliver the capital programme was estimated to be 3.99%.

The Authority had made the following investments for the period 1 April, 2017 to 30 September, 2017 as set out below:-

Borrowing Institution	**Opening Balance**	**Invested**	**Returned**	**Closing Balance**
	01/04/2017			**30/09/2017**
	£’000	£’000	£’000	£’000
UK Local Authorities	65,500	69,000	(87,500)	47,000
Debt Management Office	4,250	904,300	(888,150)	20,400
Totals	**69,750**	**973,300**	**(975,650)**	**67,400**

Interest, at an average rate of 0.30% and amounting to £62,176 had been received from the investments for the first 6 months of 2017/2018.

As could be seen from the table above the Authority had invested only with UK Local Authorities and the Debt Management Office (DMO). This strategy was considered prudent considering the continuing pressures in the financial markets and the pending re-organisation of the larger UK banks .The Head of Finance (Section 151 Officer) would always have regard to the security and liquidity of the investments before seeking the highest rate of return, or yield.

The Council would continue working with the Investment Adviser to consider other Investment tools such as Treasury Bills to increase return without otherwise compromising security.

In light of the very low level of short term investment interest rates available, internal funds had continued to be used to finance capital expenditure. Given the level of borrowing in the Capital Programme and planned use of the Council's reserves, borrowing arrangements would need to be kept under review.

The Authority measured its exposure to treasury management risks using the following indicators:

Interest Rate Exposure - This indicator was set to control the Authority's exposure to interest rate risk. The exposure to fixed and variable rate interest rates, expressed as an amount of net principal borrowed were:

	Limit	Actual	Met
Upper limit on fixed rate exposures	190.400M	157.199	✓
Upper limit on variable rate exposures	0m	0m	✓

Fixed rate investments and borrowings were those where the rate of interest was fixed for the whole financial year. Instruments that either matured during the financial year or had a floating interest rate were classed as variable rate.

Maturity Structure of Borrowing - This indicator was set to control the Authority's exposure to refinancing risk. The maturity date of borrowing was the earliest date on which the lender could demand repayment. The maturity structure of fixed rate borrowing as at 30 September, 2017 was:

	Upper Limit	Lower Limit	Actual	Met
Under 12 months	20%	0%	0.10%	✓
12 months and within 24 months	20%	0%	0.47%	✓
24 months and within five years	30%	0%	7.76%	✓
Five years and within 10 years	40%	0%	27.07%	✓
10 years and above	100%	0%	64.60%	✓

Principal Sums Invested for Periods Longer than 364 Days - This indicator was to control the Council's exposure to the risk of incurring losses by seeking early repayment of its long term investments. The total principal sums invested to final maturities beyond the period end were:

	2017/18	2018/19	2019/20
Limit on principal invested beyond year end	£10M	£5M	£5M
Actual principal invested beyond year end	0	0	0
Within limit?	✓	✓	✓

This was a matter for Executive decision

Cabinet, having considered the report and all the issues and implications contained therein

RESOLVED –

(1) T H A T the Treasury Management mid-year report for the period 1 April, 2017 to 30 September, 2017 be noted.

(2) T H A T the latest Treasury Management Indicators be noted.

(3) T H A T the report be forwarded to the next Corporate Performance and Resources Scrutiny Committee for consideration alongside relevant reports relating to Initial Revenue and Capital Budgets for 2018/19.

<u>Reasons for decisions</u>

(1) To present the Treasury Management mid-year report as required by the CIPFA Treasury Management in the Public Services: Code of Practice.

(2) To present an update of the Treasury Management Indicators which were included in the treasury management strategy.

(3) To present the report to the next Scrutiny Committee (Corporate Resources) for consideration.

Attached as Appendix – Report to Cabinet – 20 NOVEMBER 2017

The Vale of Glamorgan Council

Cabinet Meeting: 20 November, 2017

Report of the Leader

Treasury Management

Purpose of the Report

1. To provide a mid year report on the Authority's treasury management operations for the period 1st April 2017 to 30th September 2017 which is a requirement of the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice.

Recommendations

1. That the Treasury Management mid year report for the period 1st April 2017 to 30th September 2017 be noted.
2. The latest Treasury Management Indicators are noted.
3. That this report be forwarded to the next Corporate Performance and Resources Scrutiny Committee for consideration alongside relevant reports relating to Initial Revenue and Capital Budgets for 2018/19.

Reasons for the Recommendations

1. To present the Treasury Management mid year report as required by the CIPFA Treasury Management in the Public Services: Code of Practice.
2. To present an update of the Treasury Management Indicators which are included in the treasury management strategy.
3. To present this report to the next Scrutiny Committee (Corporate Resources) for consideration.

Background

2. On 7th March 2012, Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Authority to approve a treasury management strategy before the start of each financial year, a mid year report and an annual report after the end of each financial year.
3. In addition, Welsh Government Guidance on Local Government Investments recommends that local authorities consider and amend where necessary their

investment strategies in light of changing internal or external circumstances. This report therefore meets the requirements of both sets of guidance.

Relevant Issues and Options

Treasury Management Strategy 2017-2018

4. Council approved the 2017/2018 treasury management strategy at its meeting on 1st March 2017.

5. The Authority's investment strategy is to secure the best return on its investments whilst having regard to capital security within the parameters laid down.

6. The Authority's existing borrowing strategy estimated that it will borrow £14,769k of new loans to support the capital programme for 2017/2018. The sum will fluctuate dependent on the delivery of the Capital Programme, particularly WHQS. Given the current and projected level of Council reserves it is likely that the sum required will be internally borrowed during 2017/18.

7. Council officers in conjunction with the Treasury Advisors have and will continue to monitor the prevailing interest rates and the market forecasts and adopt a pragmatic approach to changing circumstances in respect of its borrowing needs.

8. The Head of Finance (Section 151 Officer) is pleased to report that all treasury management activity undertaken during the period complied with the approved strategy, the CIPFA Code of Practice and the relevant legislative provisions.

Interest Rates / Economic review

9. This section of the report has been provided by the Council's Treasury Advisors:-

10. UK Consumer Price Inflation (CPI) index rose with the data print for August showing CPI at 2.9%, its highest since June 2013 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. The new inflation measure CPIH, which includes owner occupiers’ housing costs, was at 2.7%.

11. The unemployment rate fell to 4.3%, its lowest since May 1975, but the squeeze on consumers intensified as average earnings grew at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar 2017.

12. The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth. Although at September’s meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months".

13. In contrast, near term global growth prospects improved. The US Federal Reserve increased its target range of official interest rates in June for the second time in 2017 by 25bps (basis points) to between 1% and 1.25% and, despite US inflation hitting a soft patch with core CPI at 1.7%, a further similar increase is expected in its December 2017 meeting. The US Federal Reserve also confirmed that it would be

starting a reversal of its vast Quantitative Easing programme and reduce the $4.2 trillion of bonds it acquired by initially cutting the amount it reinvests by $10bn a month.

External Context

14. Geopolitical tensions escalated in August as the US and North Korea exchanged escalating verbal threats over reports about enhancements in North Korea's missile programme. These tensions helped wipe off nearly $1 trillion from global equity markets but benefited safe-haven assets such as gold, the US dollar and the Japanese yen.

15. Prime Minister Theresa May called an unscheduled General Election in June, to resolve uncertainty but the result has led to an enhanced level of political uncertainty. Although the potential for a so-called hard Brexit is diminished, lack of clarity over future trading partnerships, in particular future customs agreements with the rest of the EU block, is denting business sentiment and investment. The reaction from the markets on the UK election's outcome was fairly muted, business confidence now hinges on the progress (or not) on Brexit negotiations, the ultimate 'divorce bill' for the exit and whether new trade treaties and customs arrangements are successfully concluded to the UK's benefit.

Financial Markets

16. Gilt yields displayed significant volatility over the six-month period with the appearing change in sentiment in the Bank of England's outlook for interest rates, the push-pull from expectations of tapering of Quantitative Easing (QE) in the US and Europe and from geopolitical tensions, which also had an impact. The yield on the 5-year gilts fell to 0.35% in mid-June, but then rose to 0.80% by the end of September. The 10-year gilts similarly rose from their lows of 0.93% to 1.38% at the end of the quarter, and those on 20-year gilts from 1.62% to 1.94%.

17. The FTSE 100 nevertheless reached a record high of 7548 in May but dropped back to 7377 at the end of September. Money markets rates have remained low: 1-month, 3-month and 12-month LIBID rates have averaged 0.25%, 0.30% and 0.65% over the period from January to 21st September

18. Within the next year ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented. Until the new structures are finally determined and published, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain.

19. The new EU regulations for Money Market Funds were finally approved and published in July and existing funds will have to be compliant by no later than 21st January 2019. The key features include Low Volatility Net Asset Value (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing NAV, providing they meet strict new criteria and minimum liquidity requirements.

Regulatory Updates

20. MiFID II: Local authorities are currently treated by regulated financial services firms as professional clients who can "opt down" to be treated as retail clients instead. However, from 3rd January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can "opt up" to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing

designated investments. In order to opt up to professional, the authority must have an investment balance of at least £10 million and the person authorised to make investment decisions on behalf of the authority must have at least one year's relevant professional experience. In addition, the firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

21. The main additional protection for retail clients is a duty on the firm to ensure that the investment is "suitable" for the client. However, local authorities are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service whether they are retail or professional clients. It is also likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Authority has declined to opt down to retail client status in the past as the costs were thought to outweigh the benefits.

22. The Authority meets the conditions to opt up to professional status and intends to do so in order to maintain their current MiFID status.

CIPFA Consultation on Prudential and Treasury Management Codes

23. In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes and after reviewing responses launched a further consultation on changes to the codes in August with a deadline for responses of 30th September 2017.

24. The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to Full Council which will cover the basics of the capital programme and treasury management. The prudential indicators for capital expenditure and the authorised borrowing limit would be included in this report but other indicators may be delegated to another committee. There are plans to drop certain prudential indicators, however local indicators are recommended for ring fenced funds (including the HRA) and for group accounts. Other proposed changes include applying the principles of the Code to subsidiaries.

25. Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of "investments" as well as loans made or shares brought for service purposes. Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee rather than needing approval of full Council. There are also plans to drop or alter some of the current treasury management indicators.

26. CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year. The Department of Communities and Local Government (DCLG) and CIPFA wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical. It is understood that DCLG will be revising its Investment Guidance (and its MRP guidance) for local authorities in England; however there have been no discussions with the devolved administrations yet.

Interim Report

27. The following tables summarise the treasury management transactions undertaken by the Authority during the first half of this financial year. All activities were in accordance with the Authority's approved Strategy on Treasury Management. The following table sets out the monies borrowed / repaid during the period.

Loan Type	Opening Balance 01/04/2017 £'000	Received £'000	Repaid £'000	Closing Balance 30/09/2017 £'000
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Totals	**157,199**	**0**	**(1,138)**	**156,061**

- Loans borrowed from the PWLB are intended to assist Local Authorities in meeting their longer term borrowing requirements. The above loans are all at fixed rates of interest. The rate paid on each loan is largely dependent upon the original duration of the loan and date taken out. The loans taken out for the HRAS buyout were at a predetermined range of rates specified by HM Treasury.
- Other long term loans represent those non-PWLB loans that are repayable at least 1 year or more from the date they are advanced. The bulk of this debt is represented by two market loans of £2,000,000 and £4,000,000.
- Temporary Loans represent those loans that are borrowed for a period of less than 1 year. They are borrowed on 7 day notice.
- WG Loan is an interest free loan provided by WG to progress the Barry Island Link Road Scheme.

28. The Council reviews opportunities for refinancing and rescheduling debt in consultation with Arlingclose Ltd. each year as part of the annual treasury management strategy review.

29. External interest at an average rate of 4.72% and amounting to £3,705,836 has been paid on these loans during the first 6 months of 2017/2018.

30. As at the 30th September 2017 it is estimated that the Authority has internally borrowed in excess of £39million to finance the capital programme. Interest has been charged at the average 3 month LIBID rate which for 2017-18 to date equates to 0.38% .This was a far cheaper alternative to borrowing externally and was affordable given the projected level of reserves. The estimated total interest to be charged to revenue for internal borrowing for 2017-2018 is £150,030.

31. Pooling the interest charges for external and internal borrowing, the average rate charged to the Council to deliver the capital programme is estimated to be 3.99%

32. The Authority has made the following investments for the period 1st April 2017 to 30th September 2017 as set out below:-

Borrowing Institution	**Opening Balance 01/04/2017**	**Invested**	**Returned**	**Closing Balance 30/09/2017**
	£'000	£'000	£'000	£'000
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Debt Management Office	4,250	904,300	(888,150)	20,400
Totals	**69,750**	**973,300**	**(975,650)**	**67,400**

33. Interest, at an average rate of 0.30% and amounting to £62,176 has been received from these investments for the first 6 months of 2017/2018.

Investment Strategy

34. As can be seen from the table above the Authority has invested only with UK Local Authorities and the Debt Management Office (DMO). This strategy is considered prudent considering the continuing pressures in the financial markets and the pending re-organisation of the larger UK banks .The Head of Finance (Section 151 Officer) will always have regard to the security and liquidity of the investments before seeking the highest rate of return, or yield.

35. The Council will continue working with the Investment Adviser to consider other Investment tools such as Treasury Bills to increase return without otherwise compromising security.

Debt Management Strategy

36. In light of the very low level of short term investment interest rates currently available, internal funds have continued to be used to finance capital expenditure to date. Given the level of borrowing in the Capital Programme and planned use of the Council's reserves, borrowing arrangements will need to be kept under review.

Treasury Management Indicators

37. The Authority measures its exposure to treasury management risks using the following indicators. Cabinet is asked to note the following indicators as at 30th September 2017.

Interest Rate Exposure

- This indicator is set to control the Authority's exposure to interest rate risk. The exposures to fixed and variable rate interest rates, expressed as an amount of net principal borrowed were:

	Limit	**Actual**	**Met**
Upper limit on fixed rate exposures	190.400M	157.199	✓
Upper limit on variable rate exposures	0m	0m	✓

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that either mature during the financial year or have a floating interest rate are classed as variable rate.

Maturity Structure of Borrowing

- This indicator is set to control the Authority's exposure to refinancing risk. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The maturity structure of fixed rate borrowing as at 30th September 2017 was:

	Upper Limit	Lower Limit	Actual	Met
Under 12 months	20%	0%	0.10%	✓
12 months and within 24 months	20%	0%	0.47%	✓
24 months and within five years	30%	0%	7.76%	✓
Five years and within 10 years	40%	0%	27.07%	✓
10 years and above	100%	0%	64.60%	✓

Principal Sums Invested for Periods Longer than 364 Days

- This indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its long term investments. The total principal sums invested to final maturities beyond the period end were:

	2017/18	2018/19	2019/20
Limit on principal invested beyond year end	£10M	£5M	£5M
Actual principal invested beyond year end	0	0	0
Within limit?	✓	✓	✓

Resource Implications (Financial and Employment)

38. Money is borrowed for capital purposes and interest is charged to revenue accounts.

Sustainability and Climate Change Implications

39. There are no direct implications arising from the report.

Legal Implications (to Include Human Rights Implications)

40. Compliance with the Local Government Act 2003 and CIPFA's "Code of Practice for Treasury Management in the Public Services" is mandatory.

Crime and Disorder Implications

41. There are no crime and disorder implications resulting from this report.

Equal Opportunities Implications (to include Welsh Language issues)

42. There are no equality implications resulting from this report.

Corporate/Service Objectives

43. This meets the objective to provide effective treasury management. This is linked to the corporate objectives generally in that any savings made can be used to assist other services in meeting their objectives.

Policy Framework and Budget

44. This is a matter for Executive decision by Cabinet.

Consultation (including Ward Member Consultation)

45. None.

Relevant Scrutiny Committee

46. Corporate Performance and Resources

Background Papers

CIPFA's "Code of Practice for Treasury Management in the Public Services", "The Prudential Code" and WG guidance on local authority investments.

Contact Officer

Principal Accountant.

Responsible Officer:

Carys Lord
Section 151 Officer