CITY OF YORK COUNCIL

Executive **29 November 2018**

Report of the Deputy Chief Executive and Director of Customer & Corporate Services

Portfolio of the Executive Leader (incorporating Finance & Performance)

Treasury Management Mid Year Review and Prudential Indicators 2018/19

Summary

1. The Council is required through legislation to provide members with a mid year update on treasury management activities. This report provides an update on activity for the period 1 April 2018 to 30 September 2018.

Recommendations

2. Members are required, in accordance with the Local Government Act 2003 (revised), to:
   - Note the Treasury Management activities to date in 2018/19
   - Note the Prudential Indicators set out at Annex A and note the compliance with all indicators.

Reason: to ensure the continued performance of the Council's Treasury Management function.

Background

3. In December 2017 the Chartered Institute of Public Finance & Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. As from 2019/20 all local authorities will be required to prepare a Capital Strategy which is intended to provide the following:
   - A high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
   - An overview of how the associated risk is managed
   - The implications for future financial sustainability

4. A report setting out our Capital Strategy will be taken to full council alongside the usual suite of budget reports in February 2019.

5. The Treasury Management function is responsible for the effective management of the Council's investments, cash flows, banking, and money market transactions. It also considers the effective control of the risks associated with those activities and ensures optimum performance within those risk parameters.

6. This mid year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management and covers the following:
   - An economic update for the first part of the 2018/19 financial year;
   - A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
   - The prudential indicators;
   - A review of the Council's investment portfolio;
   - A review of the Council's borrowing strategy;
   - A review of compliance with the Treasury and Prudential Limits.

Economic Background and Analysis

7. 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%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

8. Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. 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. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

9. As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible

growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.) Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

Interest Rate Forecast

10. Table 1 is Link Asset Services Interest Rate forecast for both the bank rate and long term Public Works Loans Board borrowing rates (note all figures are percentages):

	Dec 18	Mar 19	Jun 19	Sep 19	Dec 19	Mar 20	Jun 20	Sep 20	Dec 20	Mar 21
Bank Rate	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.25	1.50	1.50
5 Yr PWLB rate	2.00	2.10	2.20	2.20	2.30	2.30	2.40	2.50	2.50	2.60
10 Yr PWLB rate	2.50	2.50	2.60	2.70	2.70	2.80	2.90	2.90	3.00	3.10
25 Yr PWLB rate	2.90	3.00	3.10	3.10	3.20	3.30	3.30	3.40	3.50	3.50
50 Yr PWLB rate	2.70	2.80	2.90	2.90	3.00	3.10	3.10	3.20	3.30	3.30

Table 1: Link Asset Services Interest Rate Forecast (%)

11. The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC

came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%.

Annual Investment Strategy Update

12. The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved by Council on 22 February 2018. There are no policy changes to the TMSS and the details in this report do not amend the TMSS.

13. The Council's Annual Investment Strategy, which is incorporated in the Strategy, outlines the Council's investment priorities as follows:
    - security of capital
    - liquidity
    - yield

14. The Council continues to aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity and the Councils risk appetite.

Investment Portfolio

15. The average level of cash balances available for investment purposes in the first 6 months of 2018/19 was £92.174m (£114.243m for the same 6 month period in 17/18). The level of cash balances available is largely dependent on the timing of the Council's cash flow as a result of precept payments, receipt of grants, receipt of developers contributions, borrowing for capital purposes, payments to its suppliers of goods and services and spend progress on the Capital Programme. These funds are therefore only available on a temporary basis depending on cash flow movement.

16. The average level of cash balances has decreased compared to a year ago due to a number of factors. These include a number of delayed capital schemes now-progressing.

17. The Council continues to use cash balances instead of taking long term debt to finance the Councils capital programme. This strategy remains a prudent one as investment rates continue to be lower than borrowing rates when viewed on a short term projection but the potential to secure long term funding is kept under review to ensure this remains the most effective use of cash balances, given long term rates are currently at attractive levels. As cash balances are set to decrease in the short to medium term, due to previously agreed capital schemes progressing and new schemes being added to the capital programme, consideration is

being given to long term debt in order to finance the Councils capital programme.

18. Investment return (calculated as the amount of interest earned against the average cash balance for the period) during the first six months of 2018/19 is shown in table 2:

	2017/18 (full year)	**2018/19 (part year to date)**
Average CYC Rate of Return	0.41	0.65
Benchmarks		
Bank of England Base Rate	0.25	0.75
Average 7 Day LIBID	0.21	0.44
Average 1 Month LIBID	0.28	0.47

Table 2: CYCs investment rate of return performance vs. benchmarks

19. The average rate of return achieved to date in 2018/19 has increased compared to the average seen in 2017/18, due to the increase in Bank Rate.

20. It remains a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates continue to be very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

21. Figure 1 shows the interest rates available on the market based on LIBID rates between 7 days and 1 year and also the rate of return that the Council has achieved for the first six months of 2018/19. It shows that favourable / competitive interest rates have been obtained for investments whilst ensuring the required liquidity and security of funds for the Council.

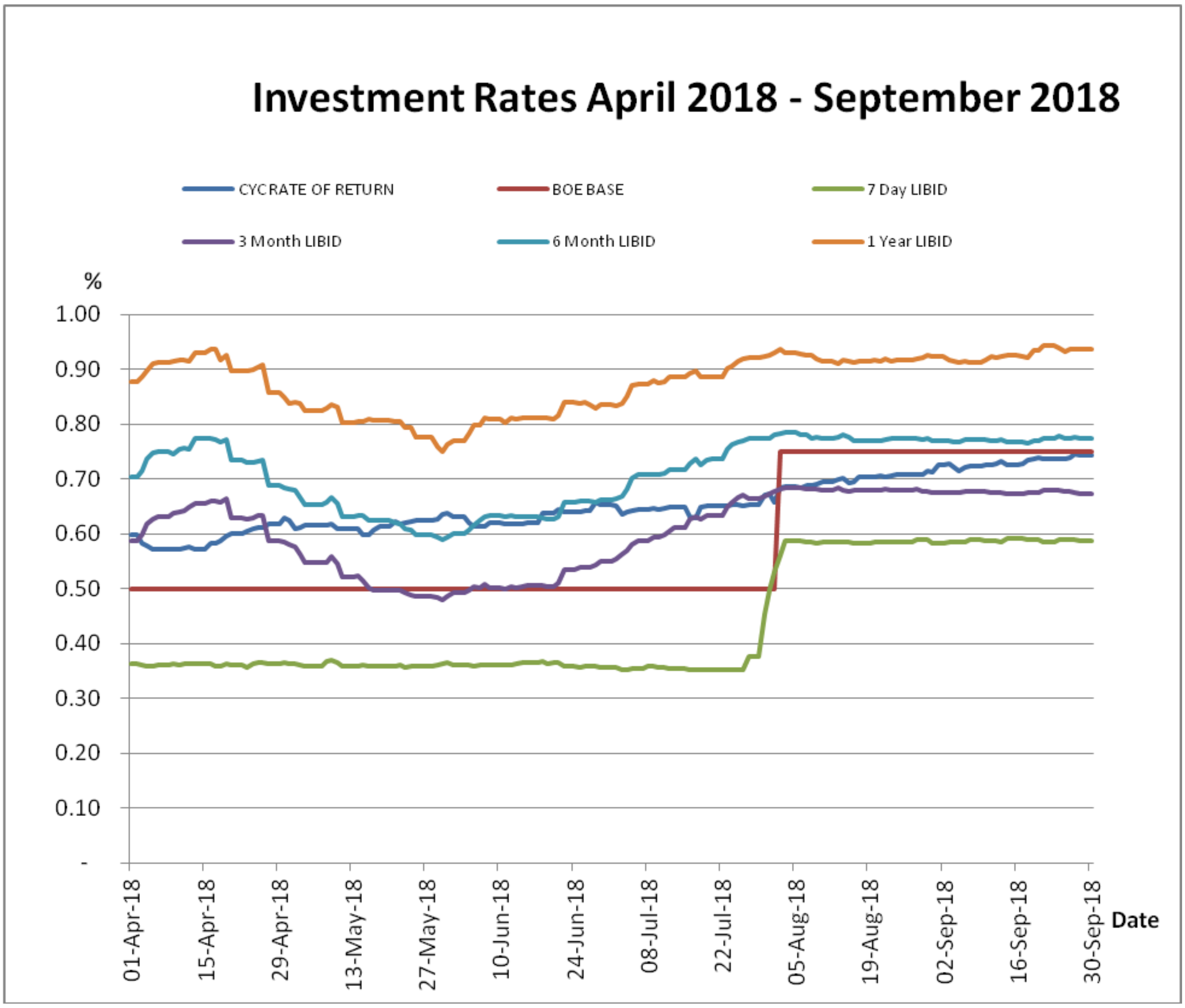

Figure 1 CYC Investments vs Money Market Rates up to 30th September 2018

22. Figure 2 shows the investments portfolio split by deposits in short term call accounts, fixed term investments and money market funds (MMFs).

23. All of the money market funds have an AAA credit rating, the notice call accounts are all AA or A+ rated and the fixed terms investments are A+ or A rated.

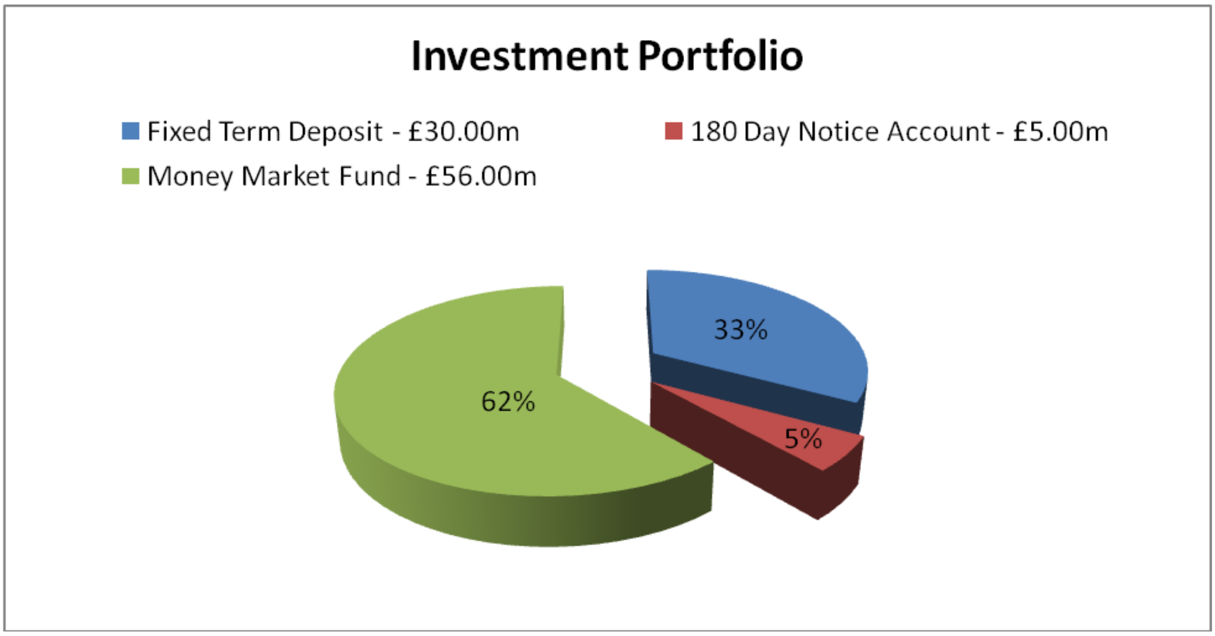

Figure 2 Investment Portfolio by type at 30th September 2018

Borrowing Portfolio

24. The Council undertakes long term borrowing in accordance with the investment requirements of the capital programme and all borrowing is therefore secured for the purpose of its asset base.

25. The level of borrowing taken by the Council is determined by the Capital Financing Requirement (the Councils underlying need to borrow for capital expenditure purposes). Borrowing needs to be affordable, sustainable and prudent.

26. Under regulation, the Council can borrow in advance of need and Markets are therefore constantly monitored and analysed to ensure that advantage is taken of favourable rates and the increased borrowing requirement is not as dependant on interest rates in any one year.

27. On the reverse side, the Council's level of borrowing can also be below the Capital Financing Requirement. This would mean that instead of increasing the Council's level of borrowing, surplus funds held for investment purposes would be utilised. In the current interest rate environment, where investment rates on holding investments are significantly below borrowing rates, consideration is given to the value of taking borrowing or whether it is better for the council to keep investment balances lower.

28. The finance team continues to closely monitor the opportunities that arise and receive daily updates from Link Asset Services in respect of borrowing timings and amounts. One new loan has been taken during

the first six months of 2018/19 on 13th April 18 from West Yorkshire Combined Authority at 0% interest, repayable on the 28th February 2027. No repayments are due during the term of the loan. The purpose of the loan is to help to fund York Central infrastructure projects. Members are reminded that this is a further instalment of a total £2.550m loan agreed by Executive on the 14th July 2016.

29. One loan has been redeemed prematurely. The Council was approached by the provider of one of its LOBO loans who advised they would be willing to negotiate a reduced premium to redeem the loan early. The Council asked its treasury management advisers to review the proposal and they highlighted that, given our strong cash position, it would be financially advantageous to accept the offer. The £5m loan was redeemed on the 12th October and, based on the loan not being refinanced, the saving to the treasury budget is £51k in 2018/19 and £111k in 2019/20 although this gradually reduces over the remaining life of the loan. The average saving generated is £29k pa. The net benefit over the remaining 42 years of the original loan period would be £1.242m in cash terms, and £738k on a net present value basis, split between GF and HRA.

30. The TMSS allows us to repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

31. The Councils long-term borrowing started the year at a level of £257.059m. On 12th October 2018 a £5m RBS LOBO loan was repaid taking the Councils long-term borrowing figure to £252.465m. The Housing Revenue Account settlement debt amounts is 48% of the borrowing portfolio (£121.550m) and the General Fund debt is 52% (£130.915m).

32. Figure 3 illustrates the 2018/19 maturity profile of the Council’s debt portfolio at 12th October 2018. The maturity profile shows that there is no large concentration of loan maturity in any one year, thereby spreading the interest rate risk dependency.

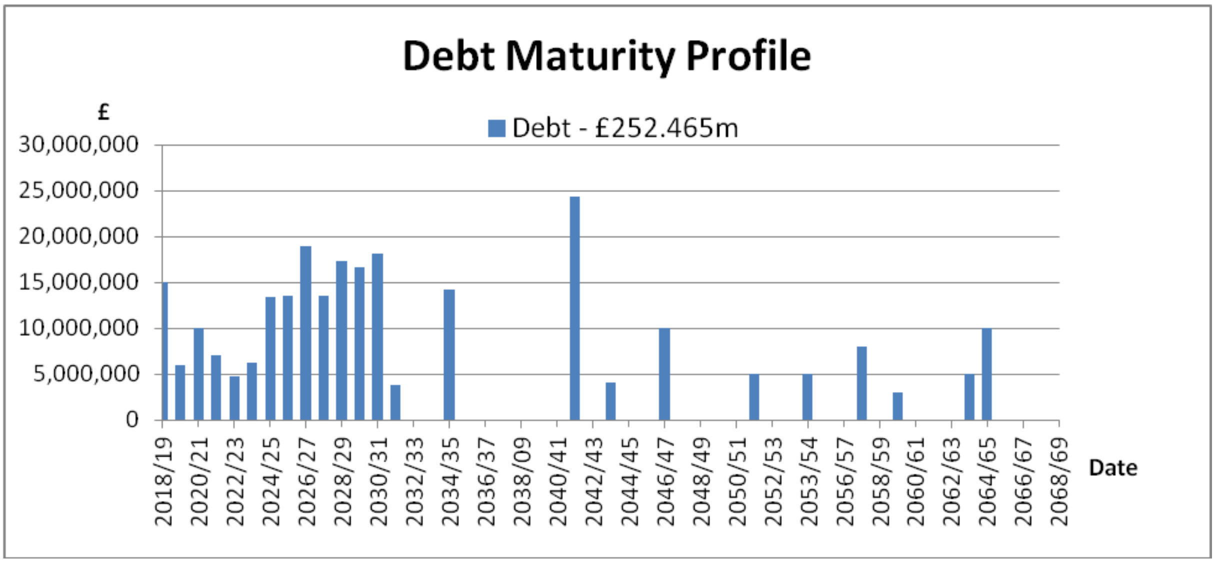

Figure 3 – Debt Maturity Profile 18/19 at 12th October 2018 [after RBS lobo repayment.]

33. Table 3 shows PWLB Certainty borrowing rates available for selected loan durations. There have been fluctuations in the rates with an average trend upwards to 30th September 2018.

	PWLB Certainty borrowing rates by duration of loan				
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Yr High	1.57%	1.99%	2.43%	2.83%	2.64%
Yr Low	1.28%	1.67%	2.09%	2.50%	2.25%
Yr Avg	1.46%	1.84%	2.25%	2.64%	2.41%
Spread	0.29%	0.32%	0.34%	0.33%	0.39%

Table 3 – PWLB Borrowing Rates (%) – to 30th September 2018

Compliance with Prudential Indicators

34. The Prudential Indicators for 2018/19 included in the Treasury Management Strategy Statement are based on the requirements of the Council’s capital programme and approved at Budget Council on 22 February 2018.

35. It is a statutory duty for the Council to determine and keep under review the “Affordable Borrowing Limits” included in the Prudential Indicators. The monitoring of the Prudential Indicators is attached at Annex A.

During the financial year 2018/19 to date the Council has operated within the treasury limits and Prudential Indicators set out.

Consultation and Options

36. The report shows the six month position of the treasury management portfolio in 2018/19. The treasury management budget was set in light of the council's expenditure plans and the wider economic market conditions, based on advice from Link Asset Services. It is a statutory requirement to provide the information detailed in the report.

Council Plan

37. The treasury management function aims to achieve the optimum return on investments commensurate with the proper levels of security, and to minimise the interest payable by the Council on its debt structure. It thereby contributes to all Council Plan priorities.

Financial implications

38. The financial implications are in the body of the report.

Legal Implications

39. Treasury Management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

Other Implications

40. There are no crime and disorder, information technology, property, equalities, human resources or other implications as a result of this report.

Risk Management

41. The Treasury Management function is a high-risk area because of the level of large money transactions that take place. As a result of this there are procedures set out for day to day treasury management operations that aim to reduce the risk associated with high volume high

value transactions. These are detailed in the Treasury Management Strategy Statement at the start of each financial year.

Contact Details

Authors:	**Cabinet Member & Chief Officer Responsible for the report:**			
Debbie Mitchell Corporate Finance Manager 01904 554161 Sarah Kirby Principal Accountant 01904 551635	Ian Floyd Deputy Chief Executive & Director of Customer & Corporate Services			
	Report Approved	√	**Date**	5/11/18
Wards Affected: All				
For further information please contact the author of the report				

Specialist Implications**:**
Legal – Not Applicable
Property – Not Applicable
Information Technology – Not Applicable

Annexes
Annex A – Prudential Indicators 2018/19