CITY OF YORK COUNCIL

Executive **12 July 2018**

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

Treasury Management Annual Report and Review of Prudential Indicators 2017/18

Summary

1. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2017/18. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

2. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

3. This report also confirms that the Council has complied with the requirement under the Code to give prior scrutiny to treasury management reports by Audit & Governance Committee.

Recommendations

4. The Executive is asked to:

    1) Note the 2017/18 performance of treasury management activity and prudential indicators outlined in annex A and
    2) Recommend to full council the increase in borrowing limit set out in paragraph 13 to 15

    Reason: to ensure the continued performance of the treasury management function can be monitored and to comply with statutory requirements.

Background and analysis

The Economy and Interest Rates

5. During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year which meant growth was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. The services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up modestly in the second half of 2017 and market expectations rose significantly that the Monetary Policy Committee (MPC) would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14th September indicated that the MPC was likely to raise Bank Rate very soon. The 2nd November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.5%.

6. The 8th February MPC meeting minutes then revealed another sharp hardening in MPC, warning on a more imminent and faster pace of increases in Bank Rate than had previously been expected. Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017/18 and resulted in investment rates from 3 to 12 months increasing sharply during the spring quarter.

7. Public Works Loans Board (PWLB) borrowing rates increased correspondingly to the above developments with the shorted term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year (within 25 bps for much of the year) compared to US treasuries. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 years rather than longer term yields.

8. The major UK landmark event of the year was the inconclusive result of the general election on 8th June. However this had relatively little impact on financial markets.

Overall treasury position as at 31 March 2018

9. The Council's year end treasury debt and investment position for 2017/18 compared to 2016/17 is summarised in the table below:

Debt	31/03/2018 £m	Rate %	31/03/2017 £m	Rate %
General Fund debt	118.0	4.24	122.3	4.23
Housing Revenue Account (HRA) debt	139.0	3.34	139.0	3.34
PFI	61.2	n/a	4.56	n/a
Total debt	318.2	3.75	265.9	3.76
Investments				
Councils investment balance	75.7	0.41	91.6	0.49

Table 1 summary of year end treasury position as at 31 March 2018

The Strategy for 2017/18

10. The expectation for interest rates within the treasury management strategy for 2017/18 anticipated that Bank Rate would not start rising from 0.25% until quarter 2 2019 and then only increase once more before 31st March 2020. There would also be gradual rises in medium and longer term fixed borrowing rates during 2017/18 and the two subsequent financial years. Variable, or short terms rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

11. In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

12. During 2017/18 longer term PWLB rates were volatile but with little overall direction whereas shorter term PWLB rates were on a rising trend during the second half of the year.

13. When approving the Treasury Management Strategy in February 2017, the Council approved an authorised borrowing limit of £393.5mm for 2017/18, which included £30m for other long-term liabilities, including PFI/PPP projects. Under Section 3 (1) of the Local Government Act 2003, the authorised borrowing limit is a statutory borrowing limit for the Council and any changes/increases need to be approved by Full Council.

14. During 2017/18, the Council has taken on the debt liability for the Allerton Waste PPP project and this has seen an increase in the other long-term liabilities element of the Council's borrowing requirement of £56.6m Although the Council has not physically borrowed to cover the project, the liability of the Council has increased to reflect future contractual repayments and the Authorised Borrowing Limit for 2017/18 (and subsequent years) will need to be amended to take into account the additional liability.

15. Members are therefore requested to approve a retrospective increase in the Authorised Borrowing Limit for 2017/18 of £441.4m, with the limit for 2018/19 and future years also being increased to £480.3m. The previously approved limit for 2018/19 was £423.0m

Borrowing requirement and debt

16. The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2018 Actual £m	31 March 2018 Budget £m	31 March 2017 Actual £m
CFR General Fund	201.1	208.6	179.3
CFR HRA	139.0	140.3	139.0
PFI	61.2	4.56	4.56
Total CFR	401.3	353.5	322.9

Table 2 capital financing requirement

Borrowing outturn for 2017/18

17. The Council continues to make efficient use of its strong cash balance position to support its current capital expenditure requirements. Two new loans were taken during the year. Both are ten year fixed rate loans from West Yorkshire Combined Authority at 0% interest and both are repayable on the 28th February 2027. £618,598 was taken on 1st September 2017 and £104,141 was taken on 2nd February 2018. No repayments are due during the term of the loan. The purpose of the loans is to help to fund York Central infrastructure projects. Members are reminded that these are instalments of a total £2.55m loan agreed by Executive on the 14th July 2016.

18. Two PWLB loans totalling £5m were repaid during the year. On 10th September 2017 a £3m PWLB loan was repaid which had an interest rate of 2.95% and on 5th November 2017 a £2m PWLB loan was repaid which

had an interest rate of 3.87%, taking the Councils long-term borrowing figure to £257m. The weighted average interest rate for the repaid loans was 3.4%.

19. No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Investment rates in 2017/18

20. Investment rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25% and reached a peak at the end of March. Bank Rate was duly raised form 0.25% to 0.5% on 2nd November 2017 and remained at that level for the rest of the year. However, further increases are expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England. This facility ended on 28th February 2018.

Investment outturn for 2017/18

21. The Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 25th February 2017. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.). The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

22. The Council maintained an average investment balance of £111.11m compared to £108.55m in 2016/17. The surplus funds earned an average rate of return of 0.41% in 2017/18 compared to 0.49% in 2016/17. There has been a gradual increase in cash balances over recent years to due the level of developer's contributions held pending investment through the capital programme, along with the continued early receipt of grant funding from Government in advance of spending. These balances are therefore not available in the longer term and will start to decrease as capital investment is made in a range of projects, as outlined in the Capital Strategy approved by Council in February 2018.

23. The comparable performance indicator for the Councils investment performance is the average London Inter Bank Bid Rate (LIBID) which represents the average interest rate at which major London banks borrow

from other banks. Table 3 shows the rates for financial year 2017/18 and shows that for all cash holdings the rate of return exceeds the levels of the usual 7 day and 3 month benchmarks.

Benchmark	Benchmark Return	Council Performance
7 day	0.21	0.41
3 month	0.28	0.41

Table 3 – LIBID vs. CYC comparison

24. This compares with a budget assumption of average investment balances between a low point of £35m and high point of £96m at an average 0.25% investment return

Other issues

25. In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code.

26. A particular focus of these revised codes was how to deal with investments which are not treasury type investments eg by investing in purchasing property in order to generate income for the council at a much higher level than can be achieved by treasury investments. One recommendation was that councils should produce a new report to members to give a high level summary of the overall capital strategy and to enable members to see how the cash resources of the council have been apportioned between treasury and non treasury investments. Officers will report to members when the implications of these new codes have been assessed as to the likely impact.

27. The EU set the date of 3rd January 2018 for the introduction of regulation under Markets in Financial Instruments Directive II (MiFID II). These regulations govern the relationship that financial institutions conducting lending and borrowing transactions will have with councils from that date. This has had little effect on the council, apart from having to fill in forms sent by each institution we deal with and for each type of investment instrument we use, apart from for cash deposits with banks and building societies.

Consultation

28. The report has been reviewed and scrutinised by Audit and Governance Committee on 27th June 2018.

Options

29. Not applicable.

Council Plan

30. Effective treasury management ensures the Council has sufficient liquidity to operate, safeguards investments, maximises return on those investments and minimises the cost of debt. This allows more resources to be allocated for delivering the Council's priorities as set out in the Council Plan.

Implications

31. This report has the following implications:

- **Financial** are contained throughout the main body of the report.
- **Human Resources (HR)** There are no HR implications.
- **One Planet Council / Equalities** There are no One Planet Council or equalities implications.
- **Legal** Treasury management activities have to conform to the Local Government Act 2003, which specifies that the Council is required to adopt the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice.
- **Crime and Disorder** There are no crime and disorder implications.
- **Information Technology (IT)** There are no IT implications.
- **Property** There are no property implications.
- **Other** There are no other implications.

Risk Management

32. The treasury function is a high-risk area due to the large value transactions that take place. As a result, there are strict procedures set out as part of the treasury management practices statement. The scrutiny of this and other monitoring reports is carried out by Audit and Governance Committee as part of the Council's system of internal control.

Contact Details

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Wards Affected: List wards or tick box to indicate all **All** ✓

For further information please contact the author of the report

Background Papers:
None

Annexes:
Annex A: Prudential Indicators 2017/18

List of Abbreviations Used in this Report

CIPFA - Chartered Institute of Public Finance & Accountancy
MRP - Minimum Revenue Provision
CFR - Capital Financing Requirement
MPC - Monetary Policy Committee
PWLB - Public Works Loan Board
CLG – (Department for) Communities and Local Government
LIBID – The London Interbank Bid Rate