South Cambridgeshire District Council

REPORT TO:	Audit and Corporate Governance Committee	26 March 2019
LEAD OFFICER:	Bob Palmer, Interim Executive Director of Corporate Services	

HALF-YEAR TREASURY MANAGEMENT REPORT 2018/19

1. Executive Summary

1.1 The Council has adopted The Chartered Institute of Public Finance (CIPFA) Code of Practice on Treasury Management (Revised 2017).

1.2 The Code requires as a minimum receipt by full Council of an Annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a half year report and an annual report (stewardship report) covering activities in the previous year. In this council, the receipt of the annual report and the half year report is delegated to the Audit and Corporate Governance Committee.

1.3 This half year report has been prepared in accordance with CIPFA's Code of Practice on Treasury Management and covers the following:-

- The Council's capital expenditure (prudential indicators);
- A review of compliance with treasury and prudential limits for 2018/19;
- A review of the council's borrowing strategy for 2018/19;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the council's investment portfolio for 2018/19; and
- An update on interest rate forecasts following economic news in the first half of the 2018/19 financial year.

2 Recommendations

2.1 The committee is asked to consider and comment on the council's mid-year position.

3 Background

3.1 The council is required to comply with the CIPFA Prudential Code (December 2017 edition) and the CIPFA Treasury Management Code of Practice (revised December 2017). The council is required to set prudential and treasury indicators, including an authorised limit for borrowing, for a three-year period and should ensure that it's capital plans are affordable, prudent and sustainable.

3.2 The council is currently supported in its treasury management functions by specialist advisors who are Link Asset Services. Link's services include the provision of advice to the council on developments and best practice in this area and provide information on the creditworthiness of potential counterparties, deposits, borrowing, interest rates and the economy.

4 The council's capital expenditure and financing 2018/19 to 2021/22

4.1 The council undertakes capital expenditure on long-term assets. These activities may either be:-

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, developer contributions, revenue contributions, reserves etc.), which has no resultant impact on the council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply other resources, the funding of capital expenditure will give rise to a borrowing need.

4.2 Details of capital expenditure forms one of the required prudential indicators. The table below shows the proposed capital expenditure and how it will be financed. It also includes any re-phasing during 2018/19 and is in line with the agreed capital plan.

	2018/19 Original Estimate £'000	2018/19 Revised Estimate £'000	2018/19 Variance £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
General Fund (GF) capital expenditure	4,827	4,051	(776)	23,854	27,895
Housing Revenue Account (HRA) capital expenditure	22,873	18,637	(4,236)	27,031	35,851
3rd party loans - Ermine St Housing	15,000	28,055	13,055	12,507	12,689
3rd party loans - Other	1,850	2,400	550	0	0
Total capital expenditure	**44,550**	**53,143**	**8,593**	**63,392**	**76,435**
Financed by:					
Capital receipts	8,644	4,718	(3,926)	6,860	8,822
Capital grants	4,898	4,338	(560)	3,688	10,033
HRA capital reserve	9,902	6,727	(3,175)	6,689	6,868
Revenue contributions	2,961	5,138	2,177	13,041	12,622
Earmarked reserves	960	922	(38)	607	5,187
Total available resources for financing capital expenditure	**27,365**	**21,843**	**5,522**	**30,885**	**43,532**
Un-financed capital expenditure	**17,185**	**31,300**	**14,115**	**32,507**	**32,903**

5 The council's prudential and treasury management indicators

5.1 The table below shows the Capital Financing Requirement (CFR), which is the underlying need to incur borrowing for a capital purpose. It also shows the expected debt position over the period.

	2018/19 Original Estimate £'000	2018/19 Revised Estimate £'000	2018/19 Variance £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Capital Financing Requirement (CFR) as at 1st April					
- General Fund	56,338	63,255	14,115	95,006	126,896
- HRA	204,429	204,429	0	204,429	204,429
Total CFR	**260,766**	**267,684**	**14,115**	**299,435**	**331,325**
Movement in CFR	**12,928**	**30,583**	**14,115**	**31,751**	**31,890**

5.2 A further prudential indicator controls the overall level of borrowing. This is the authorised limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by members.

5.3 The table below shows the council's current outstanding external debt and headroom (the amount of additional borrowing that is possible without breaching the authorised limit).

	30 September 2018 Principal £'000
Authorised external borrowing limit (A) – Treasury Management Strategy Statement 2018/19	**222,000**
2012 Borrowing for HRA self-financing (B)	205,123
Headroom as at 1 April 2018 (A minus B)	16,877
2018/19 borrowing up to 30 September 2018	8,600
Current headroom	**8,277**

5.4 During the period the council has operated within the authorised and operational borrowing limits contained within the prudential indicators set out in the council's Treasury Management Strategy Statement. The anticipated prudential and treasury indicators are shown in Appendix A.

6 Borrowing

6.1 The council is permitted to borrow under the Prudential Framework, introduced with effect from 1 April 2004.

6.2 At present, debt held by the authority consists of 41 maturity loans with the Public Works Loans Board (PWLB) totaling £205,123,000 and 3 short term loans for cash flow purposes with other public bodies totaling £8,600,000.

6.3 The council's current capital plan requires external borrowing to support lending to Ermine Street Housing Limited. The requirement for this borrowing will be kept under review, with particular consideration of the council's cash balances and cash flow forecasts.

6.4 The provision for the repayment of debt is known as the Minimum Revenue Provision (MRP). Regulations require the authority to determine annually a policy by which MRP will be determined. This policy was agreed by Council on 22 February 2018.

6.5 In the event that external borrowing is undertaken, the council is able, as an eligible local authority, to access funds at the PWLB Certainty Rate (a 0.20% discount on loans, until 31 October 2019 at least (with the date agreed annually).

7 Investment portfolio

7.1 The council takes a cautious approach within its Treasury Management Strategy Statement, and the detailed counterparty list with limits is shown within Appendix B.

7.2 The average rate of return for the 6 months to 30 September 2018 for loans to Ermine Street Housing was 3.78% (2017/18 3.73%). The average rate for all other deposits was 0.89% (2017/18 0.81%). Net investment interest for the year was included in the council budget estimates as £1,702,000 with an estimated £571,240 payable to the Housing Revenue Account. An overachievement of £173,100 net interest is forecast in the year due to higher balance levels and longer periods of investment, predominantly with Ermine Street Housing.

7.3 The council's investments at 30 September 2018 are shown below.

	31-Mar-18 £'000	30-Sep-18 £'000
Local authorities	4,000	16,500
Ermine Street Housing Ltd	35,506	49,084
Clearing banks	20,500	27,000
Other banks	5,000	5,000
Housing Associations	5,000	5,000
Money Market Funds	3,425	1,615
Building Societies with assets:		
- Greater than £10bn	8,000	9,000
- Between £5bn and £10bn	0	0
- Between £1.5bn and £5bn	0	0
Shares	50	50
Total	**81,481**	**113,249**

8 Interest rates

8.1 Link Asset Services is the council's independent treasury advisor. In support of effective forecasting the council needs to be aware of the potential influence of interest rates on treasury management issues for the council. Link's opinion on interest rates is presented in Appendix C.

9 Implications

Financial Implications

The prudential and treasury indicators have been amended to take account of known financial activities.

Risk management

Treasury risks are managed through compliance with the investment strategy and consideration of Security, Liquidity and Yield, in that order, when assessing potential treasury investments.

10 Consultation responses

None required.

11. Background papers

No background papers were used in the preparation of this report.

12. Appendices

12.1 Appendix A – Prudential and treasury management indicators
Appendix B – The council's current counterparty list
Appendix C – Link's opinion on UK forecast interest rates
Appendix D – Glossary of Terms and Abbreviations

Background Papers

Where the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 require documents to be open to inspection by members of the public, they must be available for inspection: -

(a) at all reasonable hours at the offices of South Cambridgeshire District Council;
(b) on the Council's website; and
(c) in the case of documents to be available for inspection pursuant to regulation 15, on payment of a reasonable fee required by the Council by the person seeking to inspect the documents at the offices of South Cambridgeshire District Council.

Report Author: Carolyn Ryba, Head of Finance
Telephone: (01954) 713072

Appendix A

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

£'000	2018/19 Original estimate	2018/19 Revised Estimate	2019/20 Estimate	2020/21 Estimate
PRUDENTIAL INDICATORS				
Capital expenditure				
General Fund	4,827	4,051	23,854	27,895
HRA	22,873	18,637	27,031	35,851
Third party loans – ESH	15,000	28,055	12,507	12,689
Third party loans - Other	1,850	2,400	0	0
Total capital expenditure	**44,550**	**53,143**	**63,392**	**76,435**
Capital Financing Requirement (CFR) as at 31 March				
- General Fund	56,338	63,255	95,006	126,896
- HRA	204,429	204,429	204,429	204,429
Total	**260,766**	**267,684**	**299,435**	**331,325**
Change in CFR	**12,928**	**30,583**	**31,751**	**31,890**
Deposits at 31 March	**85,000**	**85,000**	**70,000**	**60,000**
External Gross Debt	**205,123**	**205,123**	**237,630**	**270,319**
Ratio of financing costs to net revenue stream				
- General Fund	**-4%**	**-2%**	**-2%**	**-1%**
- HRA	**22%**	**24%**	**24%**	**24%**

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

£'000	2018/19 Original estimate	2018/19 Revised estimate	2019/20 Estimate	2020/21 Estimate
TREASURY INDICATORS				
Authorised limit				
for borrowing	222,000	277,684	309,435	341,325
for other long-term liabilities	0	0	0	0
Total	**222,000**	**277,684**	**309,435**	**341,325**
HRA	205,123	205,123	205,123	205,123
Operational boundary				
for borrowing	222,000	272,684	304,435	336,325
for other long-term liabilities	0	0	0	0
Total	**222,000**	**272,684**	**304,435**	**336,325**
Upper limit for total principal sums deposited for over 364 days	**70,000**	**70,000**	**80,000**	**95,000**
Limits for exposure to fixed and variable rate borrowing (borrowing less investments)				
Fixed rate borrowing / deposits	178%	178%	176%	176%
Variable rate borrowing / deposits	-68%	-68%	-71%	-71%
Maturity structure of new fixed rate borrowing		Upper Limit	Lower Limit	
10 years and above		100%	0%	

Appendix B

Current Counterparty List

The full listing of approved counterparties is shown below, showing the category under which the counterparty has been approved, the appropriate deposit limit and current duration limits. These counterparties have also been shown under Specified and Non-Specified Investments (in line with MHCLG Guidance).

Name	Council's Current Deposit Period	Category	Limit (£)
Specified Investments: -			
All UK Local Authorities	N/A	Local Authority	10m
All UK Police Authorities	N/A	Police Authority	10m
All UK Fire Authorities	N/A	Fire Authority	10m
Debt Management Account Deposit Facility	N/A	DMADF	Unlimited
Barclays Bank Plc	Using Link Asset Services Credit Criteria	UK Bank	10m
HSBC Bank Plc	Using Link Asset Services Credit Criteria	UK Bank	10m
Lloyds Bank Plc	Using Link Asset Services Credit Criteria	UK Bank	10m
Santander UK Plc	Using Link Asset Services Credit Criteria	UK Bank	10m
Other UK Retail & Clearing Banks	Using Link Asset Services Credit Criteria	UK Banks	10m
Subsidiaries of UK Banks (provided the subsidiaries are UK-incorporated deposit takers under the Financial Services and Markets Act 2000 and provided loans are for a maximum period of three months)	Using Link Asset Services Credit Criteria	UK Banks	3m
Places for People Homes Ltd	Using Link Asset Services Credit Criteria	Registered Housing Association	5m
Close Brothers Ltd	Using Link Asset Services Credit Criteria	UK Retail Bank	5m

Name	Council's Current Deposit Period	Category	Limit (£)
Money Market Funds: HSBC GLF MMF Aberdeen Standard Life Deutsche GLS Barclays Call Account	Liquid Rolling Balance	Financial Instrument	10m (per fund)

Name	Council's Current Deposit Period	Society Asset Value (£'m) – as at 1st May 2018	Limit (£)
Other Specified Investments - UK Building Societies: -			
Nationwide Building Society	Using Link Asset Services Credit Criteria	221,670	Assets greater than £10,000m **Limit - £10m** Assets between £10,000m and £5,000m **Limit - £5m** Assets between £5,000m and £1,500m **Limit - £3m**
Yorkshire Building Society		42,047	
Coventry Building Society		42,573	
Skipton Building Society		21,024	
Leeds Building Society		18,484	
Principality Building Society		9,263	
Nottingham Building Society		3,988 (Jun 2018)	
Name	**Council's Current Deposit Period**	**Category**	**Limit (£)**
Non-Specified Investments: -			
All UK Local Authorities – longer term limit	Over 1 year and up to 5 years	Local Authority	10m per single counterparty
CCLA Local Authorities' Property Fund	Minimum of 5 years	Pooled UK Property Fund	Up to 10m
South Cambs Ltd - Housing Co.	Up to 5 years	Loan	107m
UK Municipal Bonds Agency	N/A	Share Capital	0.050m

Appendix C

Link's opinion on UK forecast interest rates
The Council's treasury advisor, Link Asset Services, has provided the following forecast:

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%

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%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. We do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. This is likely to lead to friction with the EU when setting the target for the fiscal deficit in the national budget. Unsurprisingly, investors have taken a dim view of this and so Italian bond yields have been rising.
- Austria, the Czech Republic and Hungary now form a strongly anti-immigration bloc within the EU while Italy, this year, has also elected a strongly anti-immigration

government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position as a result of the rise of the anti-immigration AfD party. To compound this, the result of the Swedish general election in September 2018 has left an anti-immigration party potentially holding the balance of power in forming a coalition government. The challenges from these political developments could put considerable pressure on the cohesion of the EU and could spill over into impacting the euro, EU financial policy and financial markets.

- The imposition of trade tariffs by President Trump could negatively impact world growth. President Trump's specific actions against Turkey pose a particular risk to its economy which could, in turn, negatively impact Spanish and French banks which have significant exposures to loans to Turkey.
- Weak capitalisation of some European banks.
- Rising interest rates in the US could negatively impact emerging countries which have borrowed heavily in dollar denominated debt, so causing an investor flight to safe havens e.g. UK gilts.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- President Trump's fiscal plans to stimulate economic expansion causing a significant increase in inflation in the US and causing further sell offs of government bonds in major western countries.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Appendix D

Treasury Management – Glossary of Terms and Abbreviations

Term	**Definition**
Authorised Limit for External Borrowing	Represents a control on the maximum level of borrowing
Capital Expenditure	Expenditure capitalised in accordance with regulations i.e. material expenditure either by Government Directive or on capital assets, such as land and buildings, owned by the Council (as opposed to revenue expenditure which is on day to day items including employees' pay, premises costs and supplies and services)
Capital Financing Requirement	A measure of the Council's underlying borrowing need i.e. it represents the total historical outstanding capital expenditure which has not been paid for from either revenue or capital resources
Certificates of Deposit (CDs)	Low risk certificates issued by banks which offer a higher rate of return
CIPFA	Chartered Institute of Public Finance and Accountancy
Corporate Bonds	Financial instruments issued by corporations
Counterparties	Financial Institutions with which funds may be placed
Credit Risk	Risk of borrower defaulting on any type of debt by failing to make payments which it is obligated to do
MHCLG	Ministry for Housing, Communities & Local Government (formerly the Department for Communities & Local Government, DCLG)
Enhanced Cash Funds	Higher yielding funds typically for investments exceeding 3 months
Eurocurrency	Currency deposited by national governments or corporations in banks outside of their home market
External Gross Debt	Long-term liabilities including Private Finance Initiatives and Finance Leases
Government CNAV	Highly liquid sovereign stock based on a Constant Net Asset Value (CNAV)
HRA	Housing Revenue Account - a 'ring-fenced' account for local authority housing account where a council acts as landlord
HRA Self-Financing	The funding regime for the HRA introduced in place of the previous annual subsidy system
London Interbank Offered Rate (LIBOR)	A benchmark rate that some of the leading banks charge each other for short-term loans
London Interbank Bid Rate (LIBID)	The average interest rate which major London banks borrow Eurocurrency deposits from other banks
Liquidity	A measure of how readily available a deposit is
MPC	Monetary Policy Committee - The Bank of England Committee responsible for setting the UK's bank base rate
Low Volatility Net Asset Value (LVNAV)	Highly liquid sovereign stock based on a Constant Net Asset Value (CNAV)
Non-Ring-Fenced Bank (NRFB)	Government & Bank of England rules will apply to all UK Banks which have to split their business into 'core' retail and investment units known as Ring and Non-Ring-Fenced Banks for the 1st January 2019 deadline

Term	Definition
Non-Specified Investments	These are investments that do not meet the conditions laid down for Specified Investments and potentially carry additional risk, e.g. lending for periods beyond 1 year
Operational Boundary	Limit which external borrowing is not normally expected to exceed
PWLB	Public Works Loans Board - an Executive Government Agency of HM Treasury from which local authorities & other prescribed bodies may borrow at favourable interest rates
Ring Fenced Bank (RFB)	Government & Bank of England rules will apply to all UK Banks which have to split their business into ‘core’ retail and investment units known as Ring and Non-Ring-Fenced Banks for the 1st January 2019 deadline
Security	A measure of the creditworthiness of a counter-party
Specified Investments	Those investments identified as offering high security and liquidity. They are also sterling denominated, with maturities up to a maximum of 1 year, meeting the minimum ‘high’ credit rating criteria where applicable
Supranational Bonds	Multi-lateral Development Bank Bond
UK Government Gilts	Longer-term Government securities with maturities over 6 months and up to 30 years
Variable Net Asset Value (VNAV)	MMFs values based on daily market fluctuations to 2 decimal places known as mark-to-market prices
UK Government Treasury Bills	Short-term securities with a maximum maturity of 6 months issued by HM Treasury
Weighted Average Life (WAL)	Weighted average length of time of unpaid principal
Weighted Average Maturity (WAM)	Weighted average amount of time to maturity
Yield	Interest, or rate of return, on an investment