

Cheltenham Borough Council
Cabinet – 4th December 2018
Council – 10th December 2018
Treasury Mid-Term Report 2018/19

Accountable member	Finance, Rowena Hay
Accountable officer	Section 151 Officer, Paul Jones
Accountable scrutiny	Treasury Management Panel
Ward(s) affected	None
Key Decision	Yes
Executive summary	The Treasury Management Strategy for 2018/19 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's <i>Treasury Management in the Public Services: Code of Practice</i> (the CIPFA Code) which requires the council to approve treasury management semi-annual and annual reports.
Consultation	The Treasury Management Panel considered this report on 19th November 2018 and recommended this on to Cabinet and Council.
Recommendations	Cabinet and Council : 1. Note the contents of the summary report of the treasury management activity during the first six months of 2018/19.

Financial implications	All financial implications are detailed throughout the report Contact officer: Andrew Sherbourne, andrew.sherbourne@cheltenham.gov.uk, 01242 264337
Legal implications	None specific arising from the report recommendations. Contact officer: Peter Lewis, peter.lewis@tewkesbury.gov.uk, 01242 264216
HR implications (including learning and organisational development)	No direct HR implications arising from this report Contact officer: Julie McCarthy, julie.mccarthy@cheltenham.gov.uk. 01242 264355
Key risks	see appendix 2

Corporate and community plan Implications	None
Environmental and climate change implications	None

1. Background

- 1.1 In February 2011 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires members to approve the treasury management semi-annual and annual reports.
- 1.2 The Council's treasury management strategy for 2018/19 was approved at a meeting on 19th February 2018. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the council's treasury management strategy.
- 1.3 Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. Also in England the Ministry for Housing Communities and Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018.
- 1.4 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full council covering capital expenditure and financing, treasury management and non-treasury investments. The council will be updating its Capital Strategy later in 2018/19 for approval by full council in February 2019.

2. Economic update for the first six months

The following key points have been provided by the councils Treasury Advisors, Arlingclose.

- 2.1 Oil prices rose by 23% over the six months to around 82\$/barrel. UK Consumer Price Inflation (CPI) for August rose to 2.7% year on year, above the predicted forecast of the Bank of England's Inflation Report for August, as the effects of sterling's large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages. However real wages (adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.
- 2.2 The Rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the

weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year on year GDP growth at 1.2% also remains below trend. The Bank of England made no changes to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

- 2.3** Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in each of June and September by 0.25% to the current 2%-2.25%. Markets now expect one further rise in 2018. The escalating trade war between the US and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019.
- 2.4** The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29th March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

3. Treasury Management Summary position 1/4/2018 to 30/9/2018

- 3.1** On the 31st March 2018, the Council had net borrowing of £53.569m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.18 Actual £m
General Fund CFR	42.651
HRA CFR	44.750
Total CFR	87.401
Less: Usable reserves	32.118
Less: Working capital	1.714
Net borrowing	53.569

- 3.2** The Council's current strategy has been to fund a number of capital asset purchases with the use of temporary borrowing and then take long term borrowing from the Public Works Loan Board (PWLb). At the back end of September the Council took out 38 Maturity loans with the PWLB for £43.083m to fund the purchase of several commercial properties within the Borough. The loans were taken out over 3yrs to 40yrs with the average rate of 2.57%. This has saved £940k in interest over the life of the borrowing when compared to the original business cases.
- 3.3** As at 31st March 2018 the Council held loans of £72.086m but has significantly

borrowed more as mentioned in paragraph 3.2, taking the balance to £139.125m as at 30th September 2018. £20m was taken on a temporary basis to fund the purchase of an asset before taking out the PWLB loan. This was repaid in mid-October 2018. The weighted average interest rate on these loans is 2.70% down from 3.42% in March 2018. Borrowing costs have risen to align with the additional borrowing. The costs are likely to rise from £2.424m to £3.065m, an increase of £641k; however these additional costs will be met in full from additional rental income from the commercial properties purchased this year and surplus investment income as detailed in paragraph 4.3.

Table 2: Treasury Management Summary

	31.3.18 Balance £m	Movement £m	30.9.18 Balance £m	30.9.18 Rate %
Long-term borrowing	64.286	41.839	106.125	3.31
Short-term borrowing	7.80	25.20	33.00	0.73
Total borrowing	72.086	67.039	139.125	2.70
Long-term investments	4.00	4.00	8.00	4.67
Short-term investments	11.00	35.20	46.20	0.74
Cash and cash equivalents	2.243	8.033	10.276	0.53
Icelandic	0.435	(0.007)	0.428	-
Total investments	17.678	47.226	64.904	1.95
Net borrowing	54.408	19.813	74.221	

4. Investments

- 4.1** The Council holds significant invested funds, representing income received in advance of expenditure plus balances, reserves held and money borrowed in advance of need. During the six month period the council's investment balance ranged between £16.625m and £65.234m due to timing differences between income and expenditure. The investment position is shown in table 3 below.

Table 3: Treasury Investment Position

	31.3.18 Balance £m	Net Movement £m	30.9.18 Balance £m	30.9.18 Rate of Return %
Banks & Building Societies (unsecured)	9.000	(1.000)	8.000	0.75
Local Authorities	3.000	36.000	39.000	0.76
Money Market Funds/ Call Accounts	1.946	8.330	10.276	0.53
CCLA Property Fund	3.000	-	3.000	4.08
Schroders Maximiser Fund	-	2.000	2.000	8.86
CCLA Diversified Income Fund	-	2.000	2.000	3.20
Total Investments	16.946	47.330	64.276	

- 4.2** Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking optimum rate of return, or yield. All investments made to date in this financial year have been in line with the approved lending list set in February 2018.
- 4.3** In February 2018 the Council's Investment income for 2018/19 was budgeted to be £328,200. The average cash balances representing the council's reserves and working balances, was £25.154m during the period this report covers. The Council anticipates an investment outturn of £477,700 at a rate of return of 2.03% for this financial year. Estimated surplus for investment income is £149.5k for the financial year.
- 4.4** Net loans and investments are estimated to be £593,500 over the original budget but after aligning budgets with the business cases for the commercial properties purchased the estimated year end will come in on budget.
- 4.5** The Housing Revenue Account (HRA) has benefited by holding higher reserves and balances at the start of the financial year plus the higher interest rate returns achieved has seen their investment interest increase by £116k. The 2018/19 budget has been updated to show this change.

5. Outlook for the remainder of 2018/19

- 5.1** Having raised policy rates in August 2018 to 0.75%, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon.
- 5.2** The MPC has a definite bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that (a) ultra-low interest rates result in other economic problems, and that (b) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise and cuts are required.
- 5.3** Arlingclose's central case is for Bank Rate to rise twice in 2019. The risks are weighted to the downside.

	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Downside risk	0.00	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

6.1 Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the first six months complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 4 below.

Table 4: Debt Limits

	30.9.18 Actual £m	2018/19 Operational Boundary	2018/19 Authorised Limit	Complied? Yes/No
Borrowing	139.25	175.00	185.00	Yes
Total debt	139.25	175.00	185.00	

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

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Appendices	Risk Appendix 1
Background information	Treasury Management Strategy, Council 19th February 2018