Bath & North East Somerset Council		
MEETING:	**Cabinet**	
MEETING DATE:	**11th October 2017**	
TITLE:	**Treasury Management Monitoring Report to 30th June 2017**	EXECUTIVE FORWARD PLAN REFERENCE: E 2983
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
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Appendix 3 – Average monthly rate of return for 1st 3 months of 2017/18
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1 THE ISSUE

1.1 In February 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan 2017/18 for the first three months of 2017/18.

2 RECOMMENDATION

The Cabinet agrees that:

2.1 the Treasury Management Report to 30th June 2017, prepared in accordance with the CIPFA Treasury Code of Practice, is noted

2.2 the Treasury Management Indicators to 30th June 2017 are noted.

3 RESOURCE IMPLICATIONS

3.1 The financial implications are contained within the body of the report.

4 STATUTORY CONSIDERATIONS AND BASIS FOR PROPOSAL

4.1 This report is for information only.

5 THE REPORT

Summary

5.1 The average rate of investment return for the first three months of 2017/18 is 0.28%, which is 0.12% above the benchmark rate.

5.2 The Council's Prudential Indicators for 2017/18 were agreed by Council in February 2017 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

5.3 The Council's investment position as at 30th June 2017 is given in **Appendix 2**. The balance of deposits as at 31st March 2017 and 30th June 2017 are also set out in the pie charts in this appendix.

5.4 The Council was the accountable body for the West of England Revolving Investment Fund (RIF) and received grant funding of £57 million at the end of the 2011/12 financial year. This function has now transferred to the West of England Combined Authority (WECA) and balances transferred over as investments reached maturity in this quarter, with the exception of £5.0 million representing one investment yet to reach maturity. These funds are invested separately from the Council's cash balances and are therefore excluded from all figures given in this report.

5.5 The Council has also ceased to act as Accountable Body for the West of England Local Enterprise Partnership (WoE LEP). In 2016/17 42.407m of Local Growth Fund (LGF) grant was received from Central Government following submission of its Strategic Economic Plan. This sum, prior to distribution, was being invested in line with the Council's overall Treasury Management Strategy, with the interest earmarked to fund support and governance costs. The balances related to the LGF are included in the figures given in this report, albeit these were reduced to zero over the first quarter, with the final unallocated grant balance of £1.8m paid to WECA on 29th June 2017.

5.6 Gross interest earned on investments for the first three months totalled £38k. Net interest, after deduction of amounts due to Local Growth Fund and other internal balances, is £26k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.28%, which was 0.12% above the benchmark rate of average 7 day LIBID +0.05% (0.16%).

Summary of Borrowings

5.7 The Council's external borrowing as at 30th June 2017 totalled £158.5 million and is detailed in Appendix 4. £18.5m of new PWLB annuity borrowing was arranged during the quarter to the fund the acquisition of investment property. Further funds of £16.0m were borrowed for 12 months for cashflow, (as per 5.8 below), £6m at 0.49% with 0.1% brokerage fee and £10m direct at 0.55%.

5.8 The Council's Capital Financing Requirement (CFR) as at 31st March 2017 was £200.1 million with a projected total of £338 million by the end of 2017/18 based on the capital programme approved at February 2017 Council. This represents the Council's underlying need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

5.9 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2017 apportioned to Bath & North East Somerset Council is £12.86m. Since this borrowing is managed by an external body and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 5.7.

5.10 The borrowing portfolio as at 30th June 2017 is shown in **Appendix 4**.

Strategic & Tactical Decisions

5.11 As shown in the charts at **Appendix 2**, The Council mainly uses AAA rated Money Market funds to maintain very short term liquidity. The Council has £14.3M invested in Money Market Funds as at 30th June 2017. The investment portfolio also includes investments with Local Authorities and very highly rated Foreign Banks.

5.12 The Council does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Council's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

5.13 The Council's average investment return is broadly in line to the budgeted level of 0.30%.

Future Strategic & Tactical Issues

5.14 Our treasury management advisors economic and market review for the first quarter 2016/17 is included in **Appendix 5**.

5.15 The Bank of England base rate was reduced to 0.25% on 4th August 2016. In the opinion of the Council's treasury advisors there is unlikely to be a rate rise until Q3 2020, with the risks to this forecast remain weighted to the downside. In their June "Economic and Interest Rate Forecast Report" their view is the UK is heading for a soft patch or recession, but the likely depth of this should be more limited than the last as the global backdrop, whilst moribund, is not as desperate as at the end of the last decade.

5.16 The benefits of the Council's current policy of internal borrowing are monitored regularly against the likelihood that long term borrowing rates are forecast to rise in future years. The focus remains on the rate of increase and the medium-term peak.

5.17 The borrowing that has taken place in 2017/18 is therefore likely to be driven by a need to maintain an appropriate working cash balance rather than any immediate changes to interest rates.

Budget Implications

5.18 A breakdown of the revenue budget for interest and capital financing and the forecast year end position based on the period April to June is included in **Appendix 6**. This is currently forecast to be on target for 2017/18.

5.19 This position will be kept under review during the remainder of the year, taking into account the Council's cash-flow position and the timing of any new borrowing required.

6 RATIONALE

6.1 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

7 OTHER OPTIONS CONSIDERED

7.1 None.

8 CONSULTATION

8.1 Consultation has been carried out with the Cabinet Member for Finance & Efficiency, Section 151 Finance Officer and Monitoring Officer.

8.2 Consultation was carried out via e-mail.

9 RISK MANAGEMENT

9.1 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

9.2 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

9.3 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year.

Contact person	*Gary Adams - 01225 477107 ; Giles Oliver - 01225 477209 Gary_Adams@bathnes.gov.uk ; Giles Oliver@bathnes.gov.uk*
Background papers	*2017/18 Treasury Management & Investment Strategy*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2017/18 Prudential Indicator	**Actual as at 30th June 2017**
	£'000	£'000
Borrowing	338,000	158,504
Other long term liabilities	2,000	0
Cumulative Total	**340,000**	**158,504**

2. Operational limit for external debt
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2017/18 Prudential Indicator	**Actual as at 30th June 2017**
	£'000	£'000
Borrowing	306,000	158,504
Other long term liabilities	2,000	0
Cumulative Total	**308,000**	**158,504**

3. Upper limit for fixed interest rate exposure
This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2017/1 Prudential Indicator	**Actual as at 30th June 2017**
	£'000	£'000
Fixed interest rate exposure	**306,000**	**138,504***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the Lender exercise this option to increase the rate).

4. Upper limit for variable interest rate exposure
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2017/18 Prudential Indicator	**Actual as at 30th June 2017**
	£'000	£'000
Variable interest rate exposure	**206,000**	**20,000**

5. Upper limit for total principal sums invested for over 364 days
This is the maximum amount of total investments which can be over 364 days. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

	2017/18 Prudential Indicator	Actual as at 30th June 2017
	£'000	£'000
Investments over 364 days	**50,000**	**0**

6. Maturity Structure of borrowing
This indicator is set to control the Council's e4xposure to refinancing risk.

	Upper Limit	Lower Limit	Actual as at 30th June 2017
	%	%	%
Under 12 months	50	Nil	25*
12 months and within 24 months	75	Nil	0
24 months and within 5 years	75	Nil	6
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	69

* The CIPFA Treasury management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date (which are at 6 monthly intervals for the £20m of LOBO's). However, the Council would only consider repaying these loans if the Lenders exercised their options to alter the interest rate.

7. Average Credit Rating
The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**.

	2017/18 Prudential Indicator	Actual as at 30th June 2017
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AAA-**

APPENDIX 2

The Council's Investment position at 30th June 2017
The term of investments, from the original date of the deal, are as follows:

As per Weekly	**Balance at 30th June 2017**
	£'000's
Notice (instant access funds)	18,680
Up to 1 month	-
1 month to 3 months	5,000
Over 3 months	5,000
Total	**28,680**

The investment figure of £28.7 million is made up as follows:

	Balance at 30th June 2017
	£'000's
B&NES Council	24,012
Schools	4,668
Total	**28,680**

The Council had a total average net positive balance of £37.107m during the period April 2017 to June 2017.

Chart 1: Council Investments as at 30th June 2017 (£28.7m)

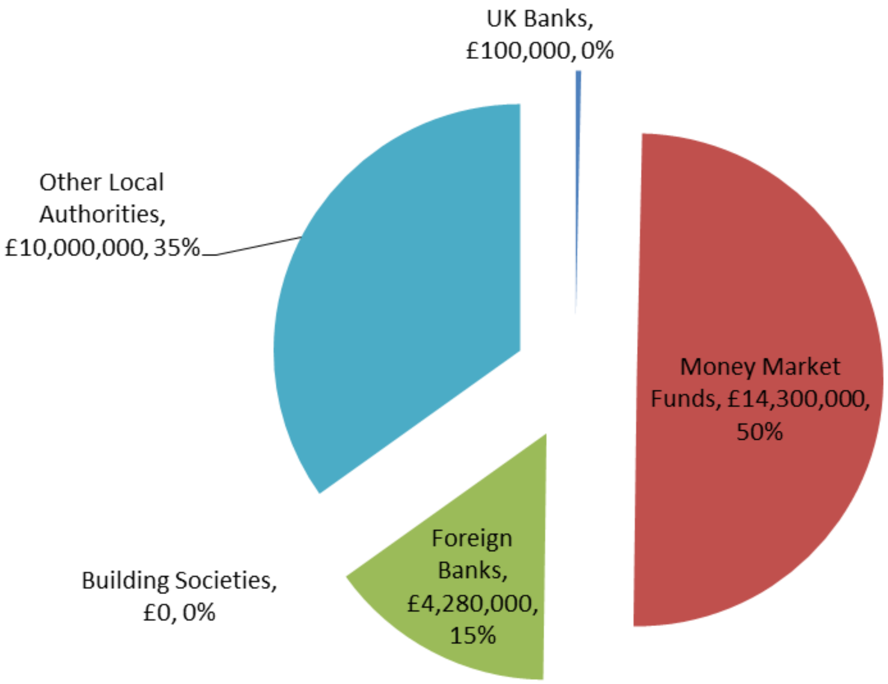


Chart 2: Council Investments as at 31st March 2017 (£38.9m)

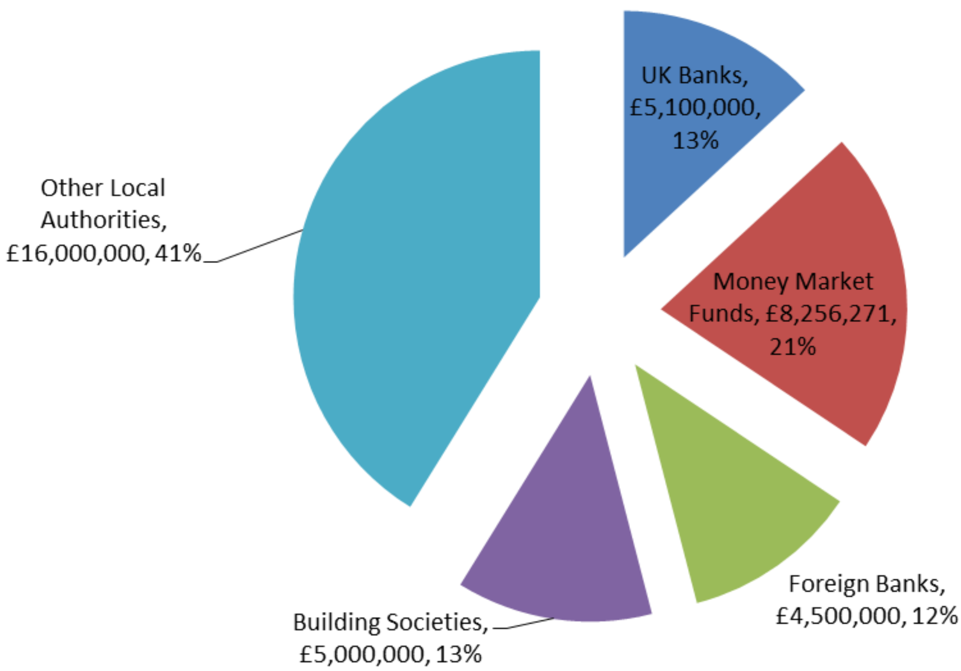


Chart 3: Council Investments per lowest equivalent Long Term credit rating (£28.7m) 30th June 2017

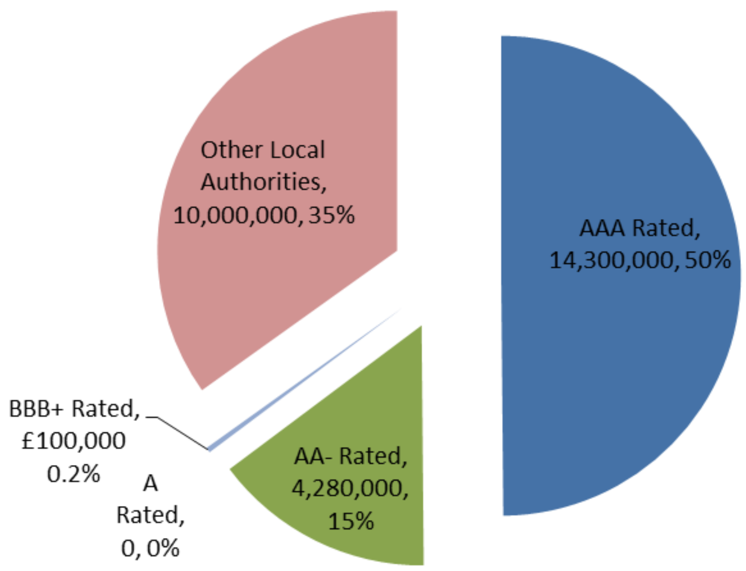
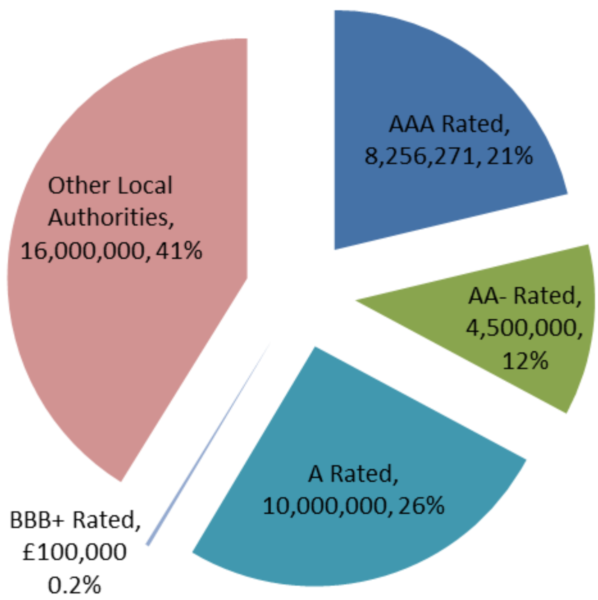


Chart 4: Council Investments per lowest equivalent Long Term credit rating (£38.9m) 31st March 2017



APPENDIX 3

Average rate of return on investments for 2017/18.

	April %	May %	June %	Average for Period
Average rate of interest earned	0.34%	0.24%	0.24%	**0.28%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.16%	0.16%	0.16%	**0.16%**
Performance against Benchmark %	+0.18%	+0.08%	+0.08%	**+0.12%**

APPENDIX 4

Councils External Borrowing at 30th June 2017

	Amount (£)	Start Date	Maturity Date	Interest Rate
LONG TERM				
PWLB	10,000,000	15/10/04	15/10/34	4.75%
PWLB	5,000,000	12/05/10	15/08/35	4.55%
PWLB	5,000,000	12/05/10	15/02/60	4.53%
PWLB	5,000,000	05/08/11	15/02/31	4.86%
PWLB	10,000,000	05/08/11	15/08/29	4.80%
PWLB	15,000,000	05/08/11	15/02/61	4.96%
PWLB	5,300,000	29/01/15	08/04/34	2.62%
PWLB	5,000,000	29/01/15	08/10/64	2.92%
PWLB	19,704,175	20/06/16	20/06/41	2.36%
PWLB	10,000,000	24/02/17	15/02/41	2.28%
PWLB	10,000,000	04/04/17	15/02/42	2.26%
PWLB	8,500,000	08/05/17	15/02/42	2.25%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
Eurohypo Bank*	10,000,000	27/04/05	27/04/55	4.50%
Gloucestershire County Council	5,000,000	25/11/14	19/12/19	2.05%
Gloucestershire County Council	5,000,000	19/12/14	19/12/19	2.05%
Total	**138,504,175**			
TEMPORARY				
East Dorset DC	2,000,000	20/03/17	19/03/18	0.50%
Christchurch Borough Council	2,000,000	20/03/17	19/03/18	0.50%
Tameside Metropolitan	6,000,000	25/04/17	20/04/18	0.49%
West of England Combined Authority	10,000,000	25/04/17	24/04/18	0.55%
TOTAL	**158,504,175**			

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals. Should the lender use the option to change the rate, then at this point the borrower has the option to repay the loan without penalty.

APPENDIX 5

Economic and market review for April to June 2017 (provided by Arlingclose)

Commodity prices slid back during the quarter with oil falling below $50 a barrel. The primary factor in the oil price fall was oversupply and a lack of belief in OPEC's (Organisation of Petroleum Exporting Countries) ability to deliver on agreed production caps of members.

UK Consumer Price Inflation (CPI) index rose over the quarter and the data print for May showed CPI at 2.9%, its highest since June 2013. The effect of the fall in fuel prices was offset by rises in a number of other categories in the CPI 'basket' as the fall in the value of sterling following June 2016's referendum result continued to feed through into higher import prices. The most recent labour market data for April 2017 showed that the unemployment rate at 4.6% remained at its lowest since July 1975 but that the squeeze on real wages (i.e. after inflation) is intensifying and resulting in negative real wage growth. Q1 GDP data released in April and revised in May showed economic activity growing at a much slower pace of 0.2%. However recent surveys indicate that the slowdown in the first quarter is being viewed as an anomaly and that Q2 GDP could rebound. Understandably, the Bank of England made no change to monetary policy at its meeting on 15th June.

Having raised rates in March, the US Federal Reserve made no change to monetary policy at the conclusion of its meeting in May. The recent weakness witnessed in the first print of Q1 US GDP was noted in the accompanying statement but the Fed viewed this as a transitory issue and was of the view that the GDP path and household spending would recover during 2017. The US Federal Reserve then 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 a further similar increase is expected during the second half of 2017.

Prime Minister Theresa May called an unscheduled General Election in June, to resolve uncertainty and in the hope of gaining an enhanced mandate to enter the forthcoming Brexit negotiations. The surprise result has led to a minority Conservative government in a confidence and supply arrangement with the Democratic Unionist Party. This political impasse clearly results in an enhanced level of political uncertainty, however the potential for a so-called hard Brexit is now diminished, reducing the associated economic headwinds for the UK economy from a 'no deal' or otherwise unfavourable trade agreement.

The reaction from the markets on the election's outcome has been fairly muted, business confidence now hinges on the progress (or not) on Brexit negotiations, whether new trade treaties and arrangements are successfully concluded and whether or not the UK continues to remain part of the EU customs union post the country's exit from the EU.

In the face of this uncertainty, Arlingclose expects the Bank of England will look through periods of high inflation and maintain its low-for-longer stance on policy interest rates for an extended period.

In financial markets, gilt yields displayed some volatility with a marked uptick in late June. This was largely due to the expectation of tapering of Quantitative Easing (QE) in the US and Europe, which also had an impact on gilts. The yield on the 5 year benchmark gilt rose from 0.56% to 0.69% during the quarter, that on the 10-year gilt rose from 1.06% to 1.26% and the yield on the 20-year gilt rose from 1.65% to 1.78%.

The FTSE 100 reached a record high of 7548 in May but dropped off slightly towards the end of the quarter. The FTSE-250 and FTSE All Share indices also rose, the All Share index closing at 4002 at the end of June. Money markets rates have remained low: 1-month, 3-month and 12-month LIBID rates have averaged 0.25%, 0.33% and 0.66% in the quarter respectively.

Counterparty Update

UK bank credit default swaps have continued their downward trend, reaching three year lows by the end of June. Bank share prices have not moved in any particular pattern. There were a few credit rating changes during the quarter. Moody's downgraded Standard Chartered Bank's long-term rating to A1 from Aa3 on the expectation that the bank's profitability will be lower following management's efforts to de-risk their balance sheet. The agency also affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1. Moody's downgraded the major Canadian banks' long-term ratings on the agency's expectation of a more challenging operating environment for the banks for the remainder of 2017 and beyond, that could lead to a deterioration in the banks' asset quality and increase their sensitivity to external shocks. Moody's downgraded the ratings of the large Australian banks to Aa3 from Aa2 reflecting the agency's view of the rising risks from the banks' exposure to the Australian housing market and the elevated proportion of lending to residential property investors.

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 within the next year. In May, following Arlingclose's advice, the Authority reduced the maximum duration of its deposits at Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months as there is some uncertainty surrounding which banking entities the Authority will be dealing with once ring-fencing is implemented. Even where there has been a level of clarity provided regarding where local authority customers will sit within the proposed new legal structures of the banks, it is not yet known what the balance sheet structures of those banks will be.

S&P also revised Nordea Banks outlook to stable from negative, whilst affirming their long-term rating at AA-. The outlook revision reflects Nordea's geographic diversification and strong financials.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2017/18 (Apr to June)

April to June 2017	**YEAR END FORECAST** Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	**ADV/FAV**
Interest & Capital Financing				
- Debt Costs	6,194	6194	0	
- Internal Repayment of Loan Charges	-8,391	-8,391	0	
- Ex Avon Debt Costs	1,190	1,190	0	
- Minimum Revenue Provision (MRP)	5,278	5,278	0	
- Interest on Balances	-141	-141	0	
Sub Total - Capital Financing	**4,130**	**4,130**	**0**	

APPENDIX 7

Summary Guide to Credit Ratings

Rating	**Details**
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.