

## Bath & North East Somerset Council

MEETING:	<b>Cabinet</b>	
MEETING DATE:	<b>5<sup>th</sup> September 2018</b>	
TITLE:	<b>Treasury Management Monitoring Report to 30<sup>th</sup> June 2018</b>	EXECUTIVE FORWARD PLAN REFERENCE:  <b>E 3089</b>
WARD:	All	
<b>AN OPEN PUBLIC ITEM</b>		
<b>List of attachments to this report:</b>  <b>Appendix 1</b> – Performance Against Prudential Indicators <b>Appendix 2</b> – The Council’s Investment Position at 30 <sup>th</sup> June 2018 <b>Appendix 3</b> – Average monthly rate of return for 1 <sup>st</sup> 3 months of 2018/19 <b>Appendix 4</b> – The Council’s External Borrowing Position at 30 <sup>th</sup> June 2018 <b>Appendix 5</b> – Arlingclose’s Economic & Market Review Q1 of 2018/19 <b>Appendix 6</b> – Interest & Capital Financing Budget Monitoring 2018/19 <b>Appendix 7</b> – Summary Guide to Credit Ratings		

### 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 2018/19 for the first three months of 2018/19.

### 2 RECOMMENDATION

The Cabinet agrees that:

- 2.1 the Treasury Management Report to 30<sup>th</sup> June 2018, prepared in accordance with the CIPFA Treasury Code of Practice, is noted
- 2.2 the Treasury Management Indicators to 30<sup>th</sup> June 2018 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 2018/19 is 0.57%, which is 0.16% above the benchmark rate.

5.2 The Council's Prudential Indicators for 2018/19 were agreed by Council in February 2018 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 30<sup>th</sup> June 2018 is given in **Appendix 2**. The balance of deposits as at 31<sup>st</sup> March 2018 and 30<sup>th</sup> June 2018 are also set out in the pie charts in this appendix.

5.4 Gross interest earned on investments for the first three months totalled £52k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.57%, which was 0.16% above the benchmark rate of average 7 day LIBID +0.05% (0.41%).

### Summary of Borrowings

5.5 The Council's external borrowing as at 30<sup>th</sup> June 2018 totalled £175.7 million and is detailed in Appendix 4. £16.8m of loans matured during the quarter, and the cash flow position of the Council didn't require immediate replacement of this borrowing.

5.6 The Council's Capital Financing Requirement (CFR) as at 31<sup>st</sup> March 2018 was £247.1 million with a projected total of £434 million by the end of 2018/19 based on the capital programme approved at February 2018 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.

5.7 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 31<sup>st</sup> March 2018 apportioned to Bath & North East Somerset Council is £12.3m. 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 5.6.

5.8 The borrowing portfolio as at 30<sup>th</sup> June 2018 is shown in **Appendix 4**.

### Strategic & Tactical Decisions

5.9 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 had £18.2M invested

in Money Market Funds as at 30<sup>th</sup> June 2018. The investment portfolio also included investments with Local Authorities, UK banks and very highly rated Foreign Banks.

5.10 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.

5.11 The Council's average investment return is broadly in line with the budgeted level of 0.45%.

### **Future Strategic & Tactical Issues**

5.12 Our treasury management advisors economic and market review for the first quarter 2018/19 is included in **Appendix 5**.

5.13 The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates raised expectations of a rate hike at the August meeting. This was subsequently confirmed at its meeting on the 2nd August, where the rate was increased by a quarter of a percentage point, from 0.50% to 0.75%, the highest level since March 2009. The Bank of England cited very limited slack in the UK economy and a tightening in the labour market as the main reasons for the increase.

5.14 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.

5.15 The borrowing forecast to take place in 2018/19 is likely to be driven by a need to maintain an appropriate working cash balance rather than any immediate changes to interest rates.

### **Budget Implications**

5.16 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 2018/19.

5.17 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.

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<b>Background papers</b>	<i>2018/19 Treasury Management &amp; Investment Strategy</i>
<b>Please contact the report author if you need to access this report in an alternative format</b>	

## 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.

	<b>2018/19 Prudential Indicator</b>	<b>Actual as at 30<sup>th</sup> June 2018</b>
	£'000	£'000
Borrowing	434,000	175,721
Other long term liabilities	2,000	0
<b>Cumulative Total</b>	<b>436,000</b>	<b>175,721</b>

#### 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.

	<b>2018/19 Prudential Indicator</b>	<b>Actual as at 30<sup>th</sup> June 2018</b>
	£'000	£'000
Borrowing	403,000	175,721
Other long term liabilities	2,000	0
<b>Cumulative Total</b>	<b>405,000</b>	<b>175,721</b>

#### 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.

	<b>2018/19 Prudential Indicator</b>	<b>Actual as at 30<sup>th</sup> June 2018</b>
	£'000	£'000
<b>Fixed interest rate exposure</b>	<b>403,000</b>	<b>155,721*</b>

\* 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.

	<b>2018/19 Prudential Indicator</b>	<b>Actual as at 30<sup>th</sup> June 2018</b>
	£'000	£'000
<b>Variable interest rate exposure</b>	<b>246,000</b>	<b>20,000</b>

## 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.

	<b>2018/19 Prudential Indicator</b>	<b>Actual as at 30<sup>th</sup> June 2018</b>
	£'000	£'000
<b>Investments over 364 days</b>	<b>50,000</b>	<b>0</b>

## 6. Maturity Structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk.

	<b>Upper Limit</b>	<b>Lower Limit</b>	<b>Actual as at 30<sup>th</sup> June 2018</b>
	%	%	%
Under 12 months	50	Nil	12.8*
12 months and within 24 months	75	Nil	5.7
24 months and within 5 years	75	Nil	0
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	81.5

\* 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**.

	<b>2018/19 Prudential Indicator</b>	<b>Actual as at 30<sup>th</sup> June 2018</b>
	Rating	Rating
<b>Minimum Portfolio Average Credit Rating</b>	<b>A-</b>	<b>AA+</b>

## APPENDIX 2

### The Council's Investment position at 30<sup>th</sup> June 2018

The term of investments is as follows:

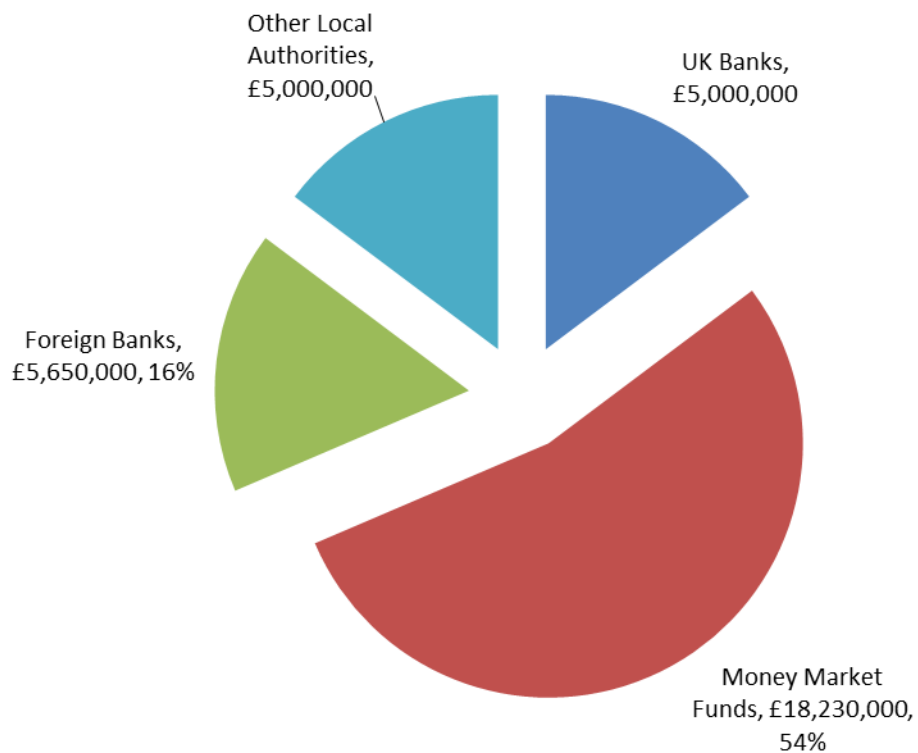
<b>Term Remaining as at 30<sup>th</sup> June 2018</b>	<b>Balance at 30<sup>th</sup> June 2018</b>
	£'000's
Notice (instant access funds)	18,880
Up to 1 month	10,000
1 month to 3 months	0
Over 3 months	5,000
<b>Total</b>	<b>33,880</b>

The investment figure of £33.9 million is made up as follows:

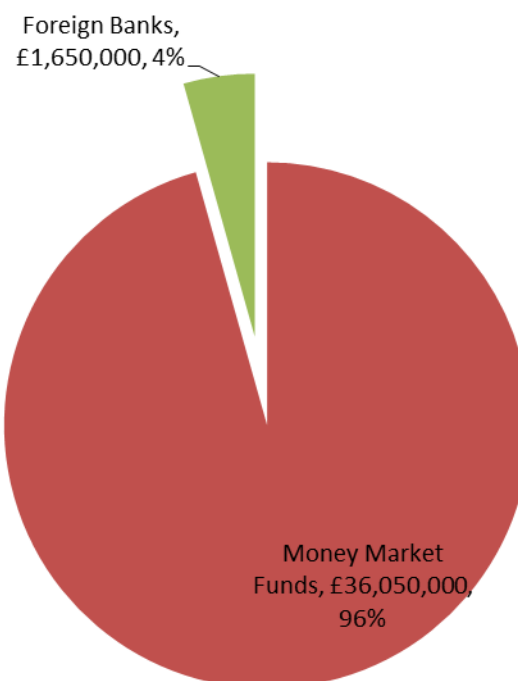
	<b>Balance at 30<sup>th</sup> June 2018</b>
	£'000's
B&NES Council	29,238
Schools	4,642
<b>Total</b>	<b>33,880</b>

The Council had a total average net positive balance of £36.817m during the period April 2018 to June 2018.

**Chart 1: Council Investments as at 30th June 2018  
(£33.9m)**

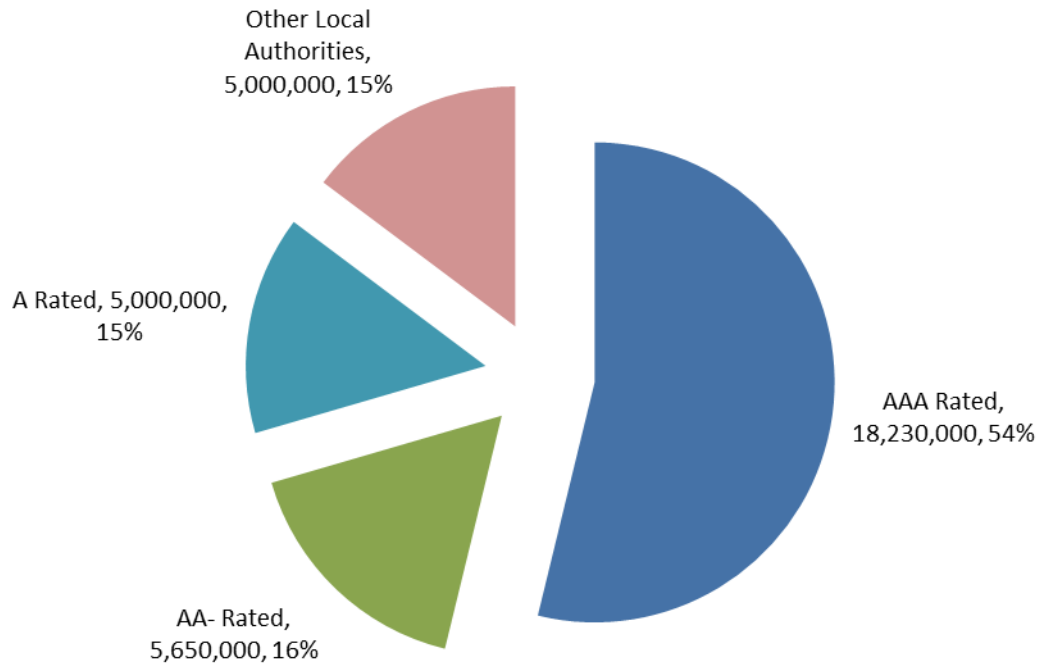


**Chart 2: Council Investments as at 31st March 2018  
(£37.7m)**

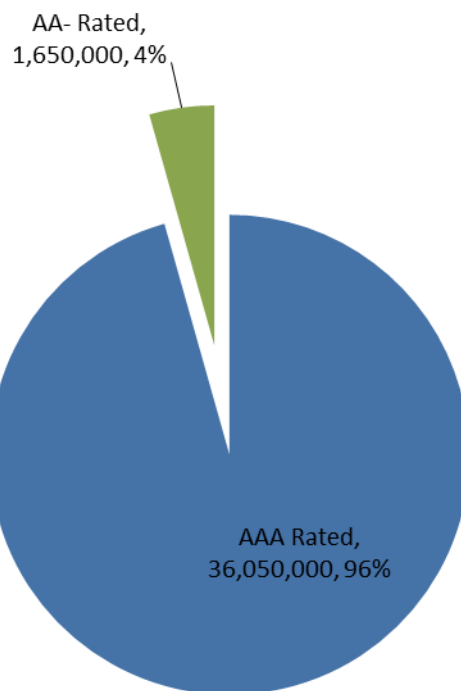




**Chart 3: Council Investments per lowest equivalent Long Term credit rating (£33.9m) 30th June 2018**



**Chart 4: Council Investments per lowest equivalent Long Term credit rating (£37.7m) 31st March 2018**



**APPENDIX 3****Average rate of return on investments for 2018/19.**

	<b>April %</b>	<b>May %</b>	<b>June %</b>	<b>Average for Period</b>
<b>Average rate of interest earned</b>	0.50%	0.60%	0.61%	<b>0.57%</b>
<b>Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)</b>	0.41%	0.41%	0.41%	<b>0.41%</b>
<b>Performance against Benchmark %</b>	+0.09%	+0.19%	+0.20%	<b>+0.16%</b>

**APPENDIX 4**  
**Councils External Borrowing at 30<sup>th</sup> June 2018**

<b>Borrowing</b>	<b>Amount (£)</b>	<b>Start</b>	<b>Maturity DaBte</b>	<b>Interest Rate</b>
<b>LONG TERM</b>				
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	18,795,590	20/06/16	20/06/41	2.36%
PWLB	9,655,424	24/02/17	16/02/40	2.28%
PWLB	9,698,525	04/04/17	16/02/43	2.26%
PWLB	8,243,412	08/05/17	15/02/42	2.25%
PWLB	6,931,389	10/08/17	10/04/67	2.64%
PWLB	9,851,890	13/12/17	10/10/42	2.35%
PWLB	9,855,212	06/03/18	10/10/42	2.52%
PWLB	9,889,305	06/03/18	10/10/47	2.62%
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 C C	5,000,000	25/11/14	19/12/19	2.05%
Gloucestershire C C	5,000,000	19/12/14	19/12/19	2.05%
<b>Sub Total</b>	<b>173,220,746</b>			
<b>TEMPORARY</b>				
PCC for Hampshire	2,500,000	28/07/17	27/07/18	0.41%
<b>Sub Total</b>	<b>2,500,000</b>			
<b>Overall Total</b>	<b>175,720,746</b>			

\*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 2018** **(provided by Council's Treasury Advisors Arlingclose)**

#### **External Context**

Commodity prices fell during the quarter, although oil prices rose, peaking at \$75 a barrel before falling slightly to just over \$73. The primary factor in the oil price's recent fall was the OPEC's (Organisation of Petroleum Exporting Countries) announcement that a deal had been reached with non-OPEC nations to increase nominal production by 1 million barrels a day.

UK Consumer Price Inflation (CPI) index fell over the quarter and the data released for May showed CPI at 2.4%, a 12-month low. The most recent labour market data for April 2018 showed the unemployment rate at 4.2%, a low last seen in 1975. However real wages (i.e. adjusted for inflation) grew only by 0.4%, a marginal increase unlikely to have had much effect for households. Q1 GDP data released in April and revised in May showed economic activity slowing to 0.1%. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates have raised expectations of a rate hike at the August meeting.

Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in June by 0.25% to between 1.75% and 2% and markets now expect two further rises in 2018.

Fears rose of a global trade war on the announcement of the Trump Administration implementing tariffs on \$200bn of imports, notably steel, aluminium, food and chemicals. Canada, the EU and China contemplated announced retaliatory tariffs as did Mexico. Many of these have since been instituted in early July. The announcements sparked a sell-off in global equity markets, with the major equity global indices falling.

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 a vote of 319 to 303, after the government gave assurances that Parliament would have a meaningful vote in the event of a no-deal Brexit. Very little progress was made in negotiating future trading arrangements, extending the period of uncertainty.

#### **Financial markets:**

Gilt yields displayed marked volatility during the quarter, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven UK, German and US government bonds. The yield on the 5-year benchmark gilt fell from 1.13% to 1.04% during the quarter, the 10-year gilt fell from 1.36% to 1.28% and the yield on the 20-year gilt rose marginally from 1.71% to 1.72%. Money markets rates remained low: 1-month, 3-month and 12-month LIBID rates averaged 0.38%, 0.55% and 0.84% in the quarter respectively.

### **Credit background:**

UK bank credit default swaps rose marginally over the quarter but the overall level was still low against historic averages.

There were a few credit rating changes during the quarter. Moody's downgraded Barclays Bank Plc's long-term rating to A2 from A1 after the banking group completed its restructure to be compliant with UK bank ring-fencing which comes into effect in 2019. The agency also downgraded Royal Bank of Scotland plc's (RBS plc) long-term ratings to Baa2 from A3 on its view that the credit metrics of RBS plc, which will become the non-ring-fenced NatWest Markets plc, will become weaker and less diversified and the main functions of the bank would be in higher risk activities. Moody's and Fitch also upgraded long-term ratings of NatWest Bank and Ulster Bank as under ring-fencing their credit profiles are expected to improve. The Authority had suspended RBS as an investment counterparty ahead of the downgrade as it no longer met the Authority's higher credit rating threshold of A- in its 2018/19 strategy. S&P revised the Royal Bank of Canada's outlook to stable from negative whilst affirming the long-term rating at AA- and Fitch revised the Commonwealth Bank of Australia's outlook to negative from stable, whilst affirming the bank's long-term rating at AA-.

## APPENDIX 6

### Interest & Capital Financing Costs – Budget Monitoring 2018/19 (Apr to June)

April to June 2018	YEAR END FORECAST			ADV/FAV
	Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	
<b>Interest &amp; Capital Financing</b>				
- Debt Costs	7,647	7,647	0	
- Internal Repayment of Loan Charges	(9,245)	(9,245)	0	
- Ex Avon Debt Costs	1,140	1,140	0	
- Minimum Revenue Provision (MRP)	6,230	6,230	0	
- Interest on Balances	(304)	(304)	0	
<b>Sub Total - Capital Financing</b>	<b>5,468</b>	<b>5,468</b>	<b>0</b>	

## 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 an issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.