Bath & North East Somerset Council		
MEETING:	**Cabinet**	
MEETING DATE:	**7 February 2018**	
TITLE:	**Treasury Management Monitoring Report to 31st December 2017**	EXECUTIVE FORWARD PLAN REFE RENCE: E 2984
WARD:	All	
AN OPEN PUBLIC ITEM		

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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 nine months of 2017/18.

2 RECOMMENDATION

The Council agrees that:

2.1 the Treasury Management Report to 31st December 2017, prepared in accordance with the CIPFA Treasury Code of Practice, is noted

2.2 the Treasury Management Indicators to 31st December 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 nine months of 2017/18 is 0.27%, which is 0.06% 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 31st December 2017 is given in **Appendix 2**. The balance of deposits as at 30th September 2017 and 31st December 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 Local Growth Fund. This function has now transferred to the West of England Combined Authority (WECA) and all balances also transferred.

5.5 Gross interest earned on investments for the first nine months totalled £67k. Net interest, after deduction of amounts due to Schools, Local Growth Fund and other internal balances, is £55k. This level of interest reflects the policy of using cash balances to minimise borrowing costs and reduce exposure to investment counterparty risk.

5.6 **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.27%, which was 0.06% above the benchmark rate of average 7 day LIBID +0.05% (0.21%). Performance from Money Market Funds in November and December lagged behind the benchmark due to proportion of these funds invested at fixed rates prior to interest rate (see 5.16).

Summary of Borrowings

5.7 The Council's external borrowing as at 31st December 2017 totalled £176.9million and is detailed in Appendix 4. £10million of new PWLB annuity borrowing was arranged during the quarter to maintain appropriate cashflow balances

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 The CFR represents the underlying need to borrow and the difference from the current borrowing of £176.9 million, represents re-investment internal balances of reserves, reducing the in-year borrowing costs in excess of the potential investment returns. Therefore, in-year use of reserves will lead to higher borrowing.

5.10 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 5.6.

5.11 The borrowing portfolio as at 31st December 2017 is shown in **Appendix 4**.

Strategic & Tactical Decisions

5.12 As shown in the charts at **Appendix 2**, the investment portfolio has been mainly diversified across Money Market Funds, investments with Local Authorities and highly rated Foreign Banks. The Council uses AAA rated Money Market funds to maintain very short term liquidity and had £22.6m invested as at 31st December 2017.

5.13 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.

5.14 The Council's current average investment return is in broadly line with the budgeted level of 0.30%.

Future Strategic & Tactical Issues

5.15 Our treasury management advisors economic and market review for the second quarter 2017/18 is included in **Appendix 5**.

5.16 The Bank of England base rate was increased to 0.5% on 2nd November 2017. The minutes of the MPC meeting indicated that all members agree that any future increases in Bank Rate would be expected to be at a gradual pace and to a limited extent. The rate was held at 0.5% at the December meeting.

5.17 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.

5.18 From 3rd January 2018, the second Markets in Financial Instruments Directive (MiFID II), resulted the Council "opting" up to professional status to continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. A criteria of this will be to have an investment balance of at least £10 million at all times. Further details are provided in Appendix 5

Budget Implications

5.19 A breakdown of the revenue budget for interest and capital financing and the forecast year end position based on the period April to December is included in **Appendix 6** and shows that the forecast is on target

5.20 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 Community Resources, 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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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 31st December 2017
	£'000	£'000
Borrowing	338,000	176,919
Other long term liabilities	2,000	0
Cumulative Total	**340,000**	**176,919**

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 31st December 2017
	£'000	£'000
Borrowing	306,000	176,919
Other long term liabilities	2,000	0
Cumulative Total	**308,000**	**176,919**

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.

	2017/18 Prudential Indicator	Actual as at 31st December 2017
	£'000	£'000
Fixed interest rate exposure	**306,000**	**156,919(*)**

* 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 31st December 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 31st December 2017**
	£'000	£'000
Investments over 364 days	**50,000**	**0**

6. Maturity Structure of borrowing

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

	Upper Limit	**Lower Limit**	**Actual as at 31st December 2017**
	%	%	%
Under 12 months	50	Nil	13.2*
12 months and within 24 months	75	Nil	0
24 months and within 5 years	75	Nil	5.9
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	80.9

* 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 31st December 2017**
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AAA-**

APPENDIX 2

The Council's Investment position at 31st December 2017
The term of investments, from the original date of the deal, are as follows:

As per Weekly	**Balance at 31st December 2017**
	£'000's
Notice (instant access funds)	24,310
1 month to 3 months	0
Over 3 months	5,000
Total	**29,310**

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

	Balance at 31st December 2017
	£'000's
B&NES Council	24,786
Schools	4,524
Total	**29,310**

The Council had a total average net positive balance of £33.130m during the period April 2017 to December 2017.

Chart 1: Council Investments as at 31st December 2017 (£29.31m)

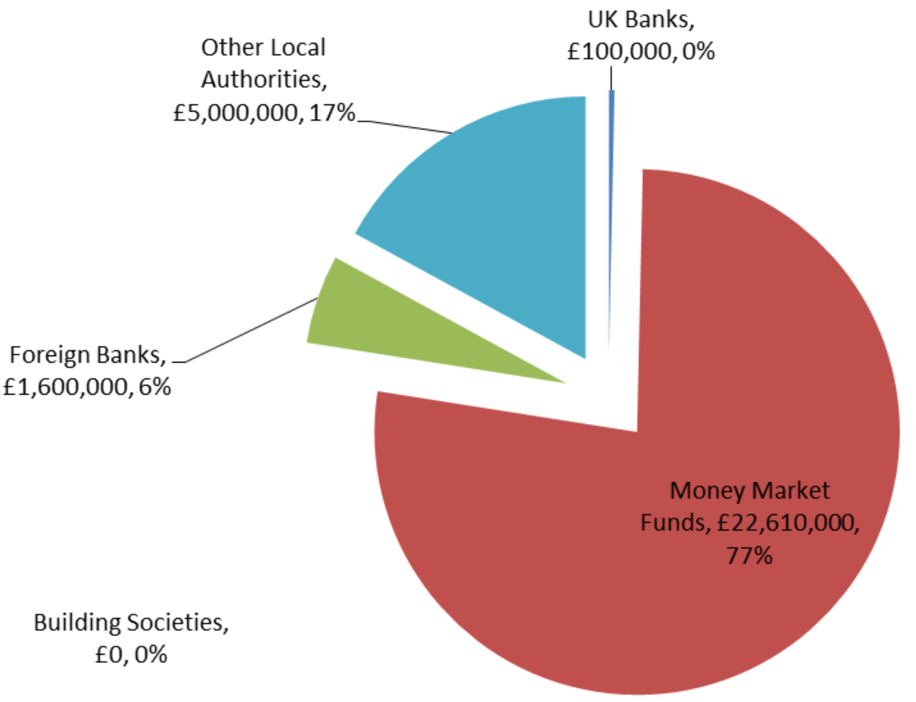
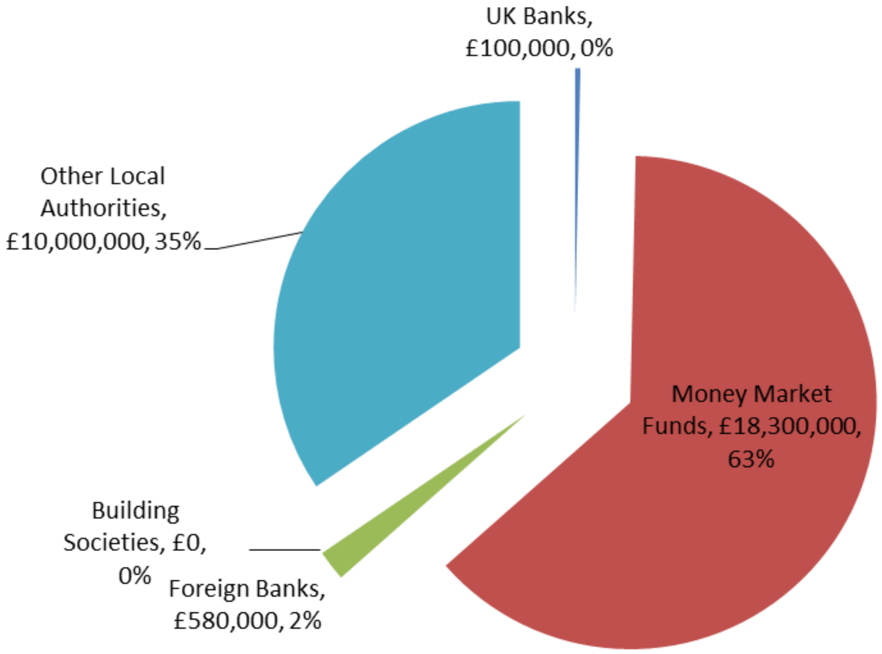


Chart 2: Council Investments as at 30th September 2017 (£28.980m)



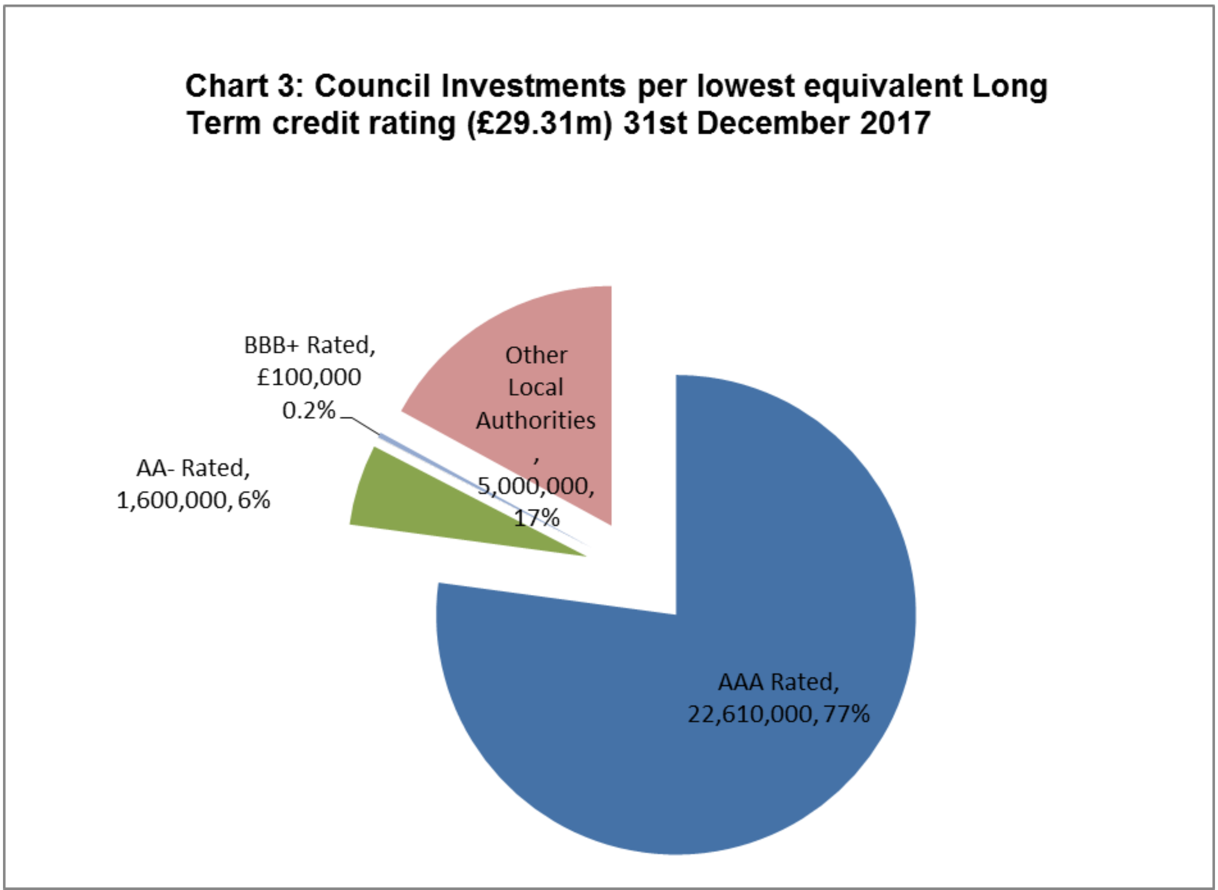


Chart 3: Council Investments per lowest equivalent Long Term credit rating (£29.31m) 31st December 2017
BBB+ Rated, £100,000 0.2%
Other Local Authorities , 5,000,000, 17%
AA- Rated, 1,600,000, 6%
AAA Rated, 22,610,000, 77%

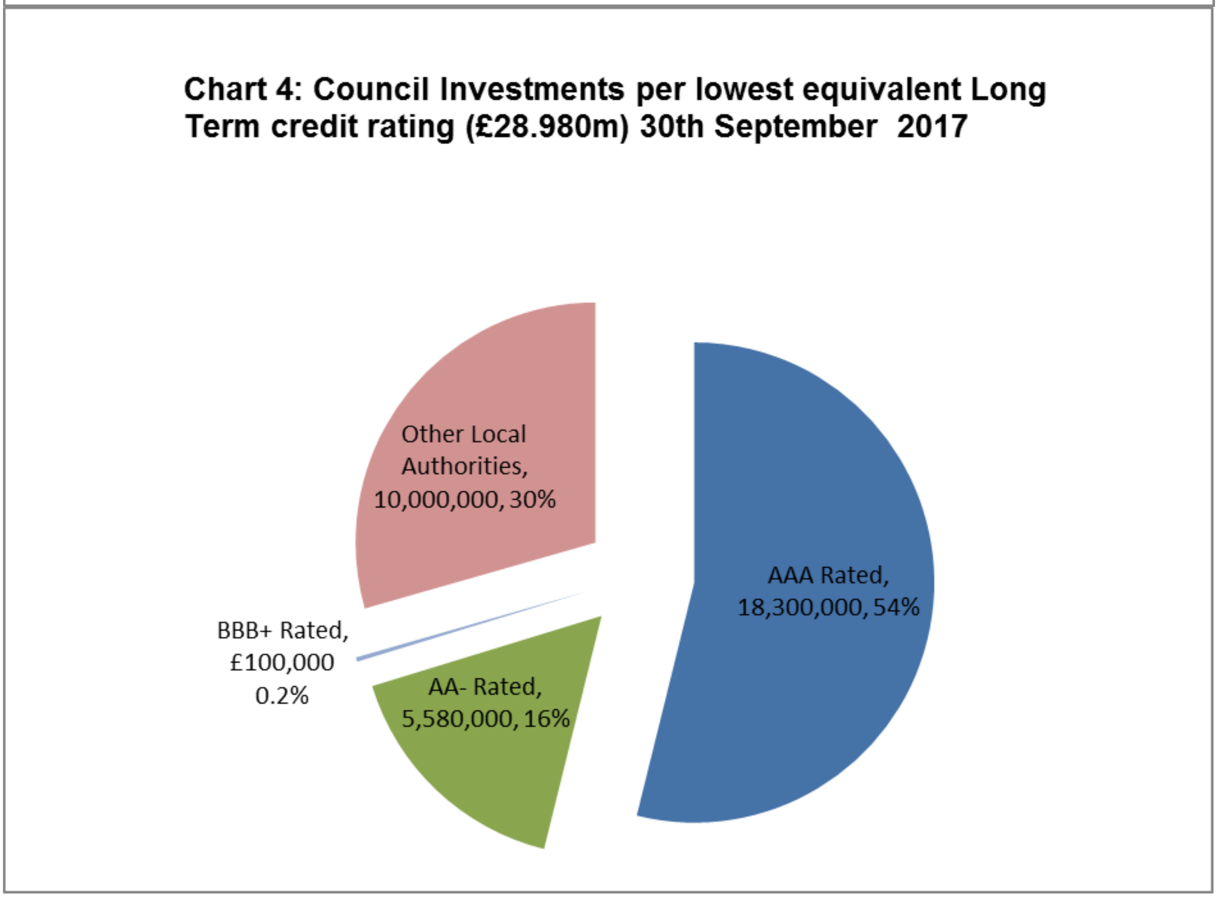


Chart 4: Council Investments per lowest equivalent Long Term credit rating (£28.980m) 30th September 2017
Other Local Authorities, 10,000,000, 30%
AAA Rated, 18,300,000, 54%
BBB+ Rated, £100,000 0.2%
AA- Rated, 5,580,000, 16%

APPENDIX 3

Average rate of return on investments for 2017/18

	April %	May %	June %	July %	Aug %	Sept %
Average rate of interest earned	0.34%	0.24%	0.24%	0.22%	0.24%	0.24%
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.16%	0.16%	0.16%	0.16%	0.16%	0.16%
Difference %	0.18%	0.08%	0.08%	0.06%	0.08%	0.08%

(Cont)	Oct %	Nov %	Dec %	Average for Period
Average rate of interest earned	0.26%	0.33%	0.34%	**0.27%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.17%	0.40%	0.41%	**0.21%**
Difference %	0.09%	-0.07%	-0.07%	**+0.06%**

APPENDIX 4

Councils External Borrowing at 31st December 2017

LONG TERM	Amount	Start	Maturity Date	Interest Rate
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	19,102,011	20/06/16	20/06/41	2.36%
PWLB	9,828,688	24/02/17	16/02/40	2.28%
PWLB	9,850,109	04/04/17	15/02/42	2.26%
PWLB	8,372,424	08/05/17	15/02/42	2.25%
PWLB	6,965,920	10/08/17	10/04/67	2.64%
PWLB	10,000,000	13/12/17	10/10/42	2.35%
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 CC	5,000,000	25/11/14	19/12/19	2.05%
Gloucestershire CC	5,000,000	19/12/14	19/12/19	2.05%
Sub Total	**154,419,152**			
TEMPORARY				
East Dorset DC	2,000,000	20/03/17	19/03/18	0.50%
Christchurch BC	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%
PCC For Hampshire	2,500,000	28/07/17	27/07/18	0.41%
Sub Total	**22,500,000**			
Total	**176,919,152**			

*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 31st December 2017 (provided by Council's Treasury Advisors Arlingclose)

Economic backdrop: The significant economic event was the increase in the Bank Rate in November by 0.25% to 0.50%, making it the first increase by the Bank of England's MPC to rates since July 2007. The vote to increase Bank Rate was 7-2, reflecting the MPC's growing concern that rising inflation had finally outweighed the risks to growth and largely to meet expectations the Bank itself created. The Bank has reiterated that it expects any future increases in Bank Rate to be at a gradual pace and limited in extent.

Commodity prices rose over the period with oil increasing to around $67 a barrel from a low of $42 in June. UK Consumer Price Inflation (CPI) index continued to rise with the data print for November showing CPI at 3.1%, its highest since March 2012 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. The new inflation measure CPIH, which includes owner occupiers' housing costs, was at 2.8%.

The number of unemployed in the economy continued to decrease, although the unemployment rate remained at 4.3%. Consumers' wages continued to shrink, in real terms, given average earnings growth remained subdued at 2.5%, a good deal below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q2 and Q3 GDP growth of 0.3% and 0.4% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings remaining relatively low and real wage growth negative, there are concerns that these will be a constraint on future economic activity.

In contrast, near-term global growth prospects improved. The US economy grew steadily and inflation increased to 2.2%. As was expected, the Federal Reserve increased its target range of official interest rates in December for the third time in 2017 by 25 basis points to between 1.25% and 1.50%. The Fed is expected to deliver three more increases in 2018 and a further two in 2019. The central bank's growth forecasts were revised up based on the newly-passed personal and corporate tax rate cuts proposed by Donald Trump.

In the face of a struggling economy and Brexit-related uncertainty, Arlingclose expects the Bank of England to take a very measured approach to any monetary policy tightening. Any increases will be gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy through the Brexit transition.

Financial markets: Gilt yields were broadly stable over the quarter as much of the uncertainty which plagued the first half of the year dissipated. The yield on the 5-year gilts fell slightly to 0.72% at the end of the quarter, down from 0.80% in September. The 10-year gilts similarly fell from 1.38% to 1.19% at the end of the quarter and the 20-year gilts from 1.94% to 1.73%.

The FTSE 100 continued to climb, reaching yet another record high of 7688 at the end of calendar year. Money markets rates, unsurprisingly, have increased over the quarter: 1-month, 3-month and 12-month LIBID rates have averaged 0.43%, 0.47% and 0.76% over the period October-December.

Credit background: UK bank credit default swaps have remained broadly stable throughout the quarter. Bank share prices have not moved in any pattern.

Much of the activity by credit rating agencies during the quarter has related to the upcoming UK bank ringfencing which will take effect in 2018. Ringfencing requires the larger UK banks to separate their core retail banking activity from the rest of their business, resulting in two separate banks. In general, the agencies expect to give the ringfenced "retail" bank a higher credit rating than the non-ringfenced "investment" bank. In practice, this will only affect Barclays, HSBC, Lloyds and RBS as other UK banks and building societies either only conduct retail banking activities or have less than £25 billion of deposits covered by the Financial Services Compensation Scheme.

Barclays Bank plc was upgraded to A from A- by Standard & Poor's (S&P), after the bank announced its plans for its ringfenced bank, Barclays Bank UK plc, and the non-ringfenced bank, Barclays Bank plc. S&P also assigned preliminary ratings of 'A/A-1' to Barclays Bank UK plc.

In November S&P revised upwards the outlook of various UK banks and building societies to positive or stable and simultaneously affirmed their long and short-term ratings. These reflect the agency's view that the institutions now show increased resilience, have made substantial progress in meeting regulatory capital requirements and are now better positioned to deal with uncertainties and potential turbulence in the run-up to the UK's exit from the EU in March 2019.

There have been no changes to Arlingclose's investment advice regarding banks and building societies during the quarter.

Regulatory Updates

MiFID II: As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities will be treated as retail clients but can "opt up" to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Authority has met the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. The Authority will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

CIPFA Codes: CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The Authority is currently considering the changes from the 2011 Code for incorporation into future Treasury Management Strategies and monitoring reports.

The 2017 Prudential Code introduces the requirement for a Capital Strategy which sets out the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. Where this strategy is produced, it must be approved by full Council, and the determination of the Treasury Management Strategy can then be delegated to a committee.

In the 2017 Treasury Management Code the definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy.

DCLG Consultations on Investment Guidance and Minimum Revenue Provision (MRP): In November the DCLG consulted on proposed changes to its Guidance on Local Government Investments and Statutory Guidance on Minimum Revenue Provision (MRP) with a deadline for responses of 22nd December.

Proposed changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income return and a new category called "loans" (e.g temporary transfer of cash to a third party, joint venture, subsidiary or associate). The draft Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and also specifies additional indicators. Investment strategies should detail the extent to which core expenditure is reliant on investment income and a contingency plan should yields on investments fall.

There is a proposed change to the basis of prudent MRP to "cover the gap between the Capital Financing Requirement (CFR) and grant income/capital receipts"; it cannot be a negative charge and can only be zero if the CFR is nil or negative. Guidance on asset lives has been updated, applying to any calculation using asset lives. Any change in MRP policy cannot create an overpayment; the new policy must be applied to the outstanding CFR going forward only.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2017/18 (April to December)

April to December 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	6,044	(150)	FAV
- 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	5,078	(200)	FAV
- Interest on Balances	-141	-121	20	ADV
Sub Total - Capital Financing	**4,130**	**3,800**	**(330)**	**FAV**

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.