Bath & North East Somerset Council		
MEETING:	**Cabinet**	
MEETING DATE:	**6th February 2019**	
TITLE:	**Treasury Management Monitoring Report to 31st December 2018**	EXECUTIVE FORWARD PLAN REFERENCE: E 3117
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council's Investment Position at 31st December 2018
Appendix 3 – Average monthly rate of return for 9 months of 2018/19
Appendix 4 – The Council's External Borrowing Position at 31st December 2018
Appendix 5 – Arlingclose's Economic & Market Review Q3 of 2018/19
Appendix 6 – Interest & Capital Financing Budget Monitoring 2018/19
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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 2018/19 for nine months of 2018/19.

2 RECOMMENDATION

The Cabinet agrees that:

2.1 The Treasury Management Report to 31st December 2018, prepared in accordance with the CIPFA Treasury Code of Practice, is noted

2.2 The Treasury Management Indicators to 31st December 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 six months of 2018/19 is 0.68%, which is 0.15% 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 31st December 2018 is given in **Appendix 2**. The balance of deposits as at 30th September 2018 and 31st December 2018 are also set out in the pie charts in this appendix.

5.4 Gross interest earned on investments for nine months totalled £212k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.68%, which was 0.15% above the benchmark rate of average 7 day LIBID +0.05% (0.53%).

Summary of Borrowings

5.5 The Council's external borrowing as at 31st December 2018 totalled £206.7 million and is detailed in Appendix 4. PWLB annuity borrowing for £25 million was arranged during the quarter in response to a reduction in borrowing rates arising from the political and economic uncertainty being experienced in the UK and Europe.

5.6 The Council's Capital Financing Requirement (CFR) as at 31st 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. A review of the Capital Programme has taken place that will result in a reduction in the Council's borrowing requirement. This will be updated within the Council's revised Prudential Indicators and CFR as part of budget setting for 2019/20

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 31st 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 5.5.

5.8 The borrowing portfolio as at 31st December 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 £26.3 million invested in Money Market Funds as at 31st December 2018. The investment portfolio also included investments with 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 slightly above the budgeted level of 0.45%.

Future Strategic & Tactical Issues

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

5.13 The rise in quarterly GDP growth to 0.6% in the third calendar quarter from 0.4% in the second was due to weather-related factors boosting overall household consumption and construction activity over the summer. At 1.5%, annual GDP growth continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since.

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 showing interest and capital financing and the forecast year end position based on the period April to December is included in **Appendix 6**. The current forecast is for an underspend of £495k, mainly related to the re-phasing of capital spend, as reported in the 2017/18 outturn report, leading to lower than forecast borrowing costs and minimum revenue provision (MRP) requirement. This is partly offset by lower internal income related to service charges for funding debt costs in relation to the re-phased capital projects.

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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Background papers	*2018/19 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.

	2018/19 Prudential Indicator	**Actual as at 31st December 2018**
	£'000	£'000
Borrowing	434,000	206,736
Other long term liabilities	2,000	0
Cumulative Total	**436,000**	**206,736**

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.

	2018/19 Prudential Indicator	**Actual as at 31st December 2018**
	£'000	£'000
Borrowing	403,000	206,736
Other long term liabilities	2,000	0
Cumulative Total	**405,000**	**206,736**

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.

	2018/19 Prudential Indicator	**Actual as at 31st December 2018**
	£'000	£'000
Fixed interest rate exposure	**403,000**	**186,736***

* 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.

	2018/19 Prudential Indicator	**Actual as at 31st December 2018**
	£'000	£'000
Variable interest rate exposure	**246,000**	**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.

	2018/19 Prudential Indicator	**Actual as at 31st December 2018**
	£'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 2018**
	%	%	%
Under 12 months	50	Nil	9.7*
12 months and within 24 months	75	Nil	4.8
24 months and within 5 years	75	Nil	0
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	85.5

* 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**.

	2018/19 Prudential Indicator	**Actual as at 31st December 2018**
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AA+**

APPENDIX 2

The Council's Investment position at 31st December 2018
The term of investments is as follows:

Term Remaining as at 31st December 2018	**Balance at 31st December 2018**
	£'000's
Notice (instant access funds)	28,200
Up to 1 month	
1 month to 3 months	10,000
Over 3 months	15,000
Total	**53,200**

The investment figure of £53.2 million is made up as follows:

	Balance at 31st December 2018
	£'000's
B&NES Council	48,838
Schools	4,362
Total	**53,200**

The Council had a total average net positive balance of £41.3m during the period April 2018 to December 2018.

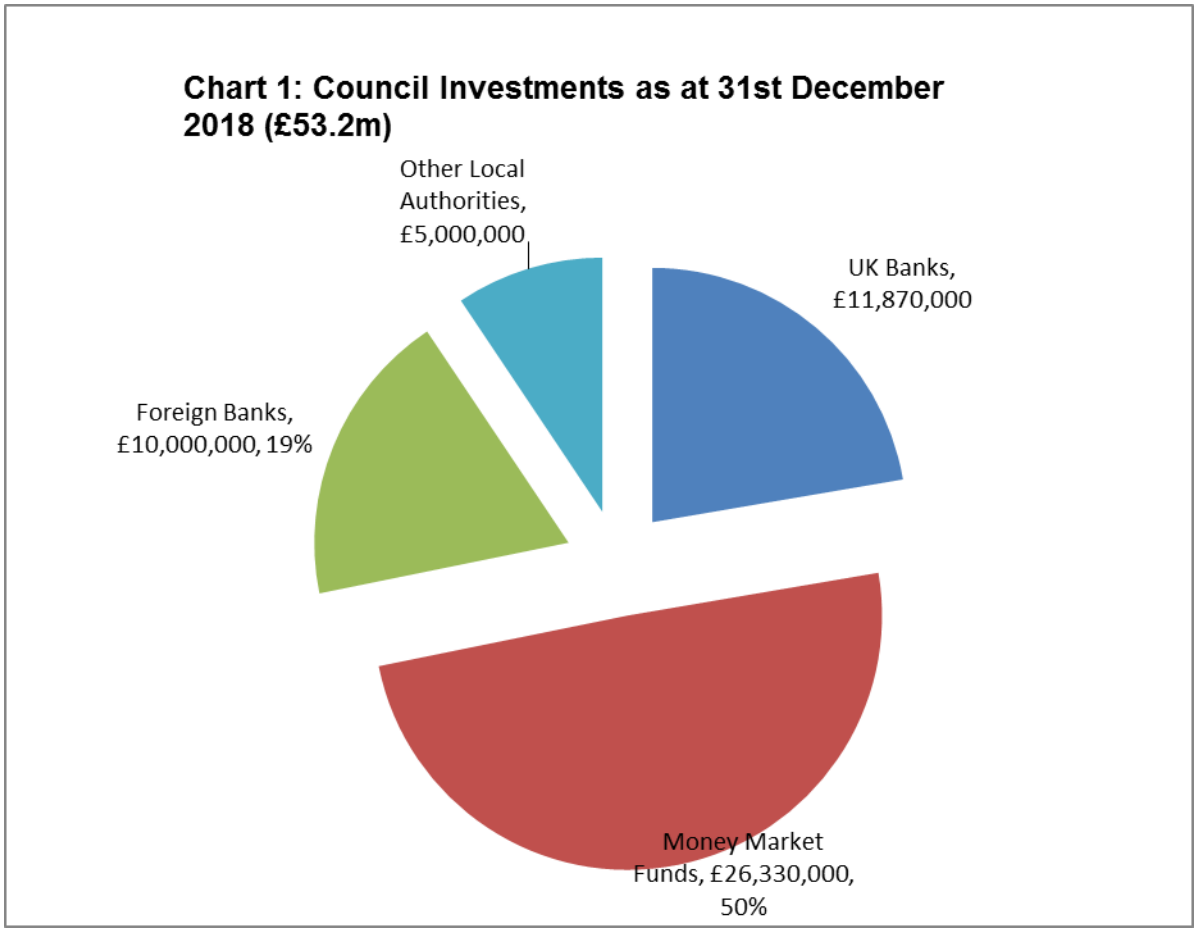


Chart 1: Council Investments as at 31st December 2018 (£53.2m)
Other Local Authorities, £5,000,000
UK Banks, £11,870,000
Foreign Banks, £10,000,000, 19%
Money Market Funds, £26,330,000, 50%

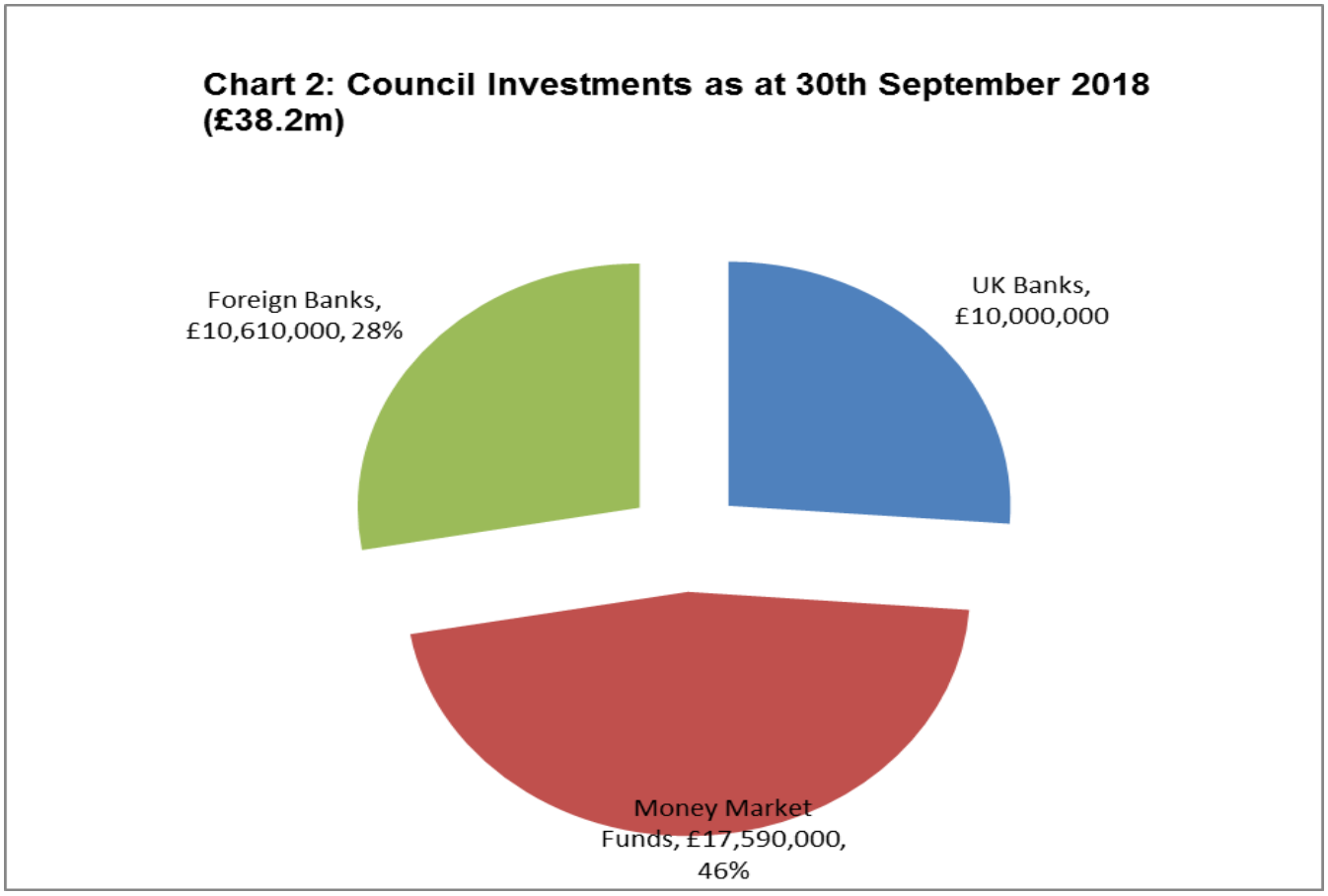


Chart 2: Council Investments as at 30th September 2018 (£38.2m)
Foreign Banks, £10,610,000, 28%
UK Banks, £10,000,000
Money Market Funds, £17,590,000, 46%

Chart 3: Council Investments per lowest equivalent Long Term credit rating (£53.2m) 31th December 2018

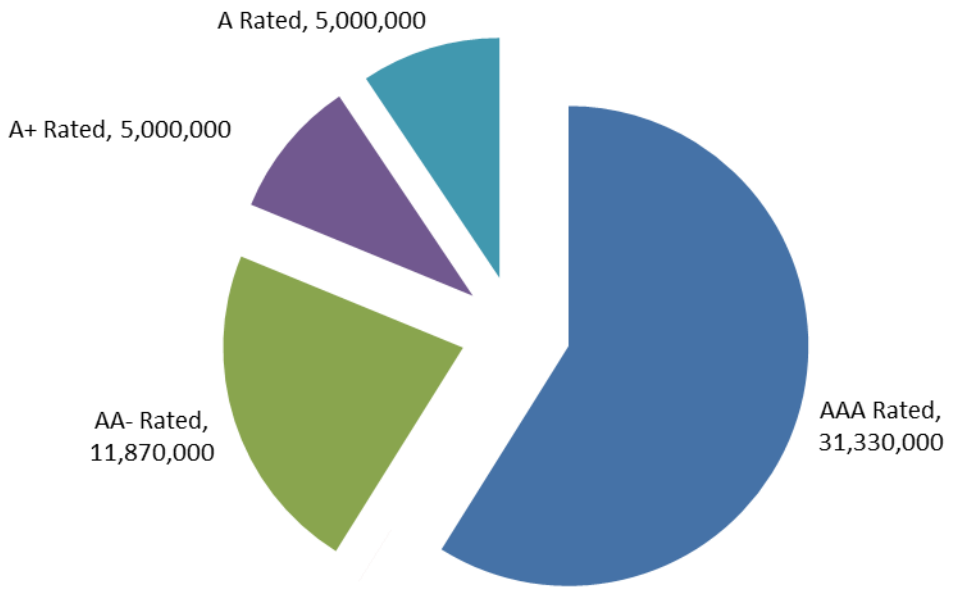
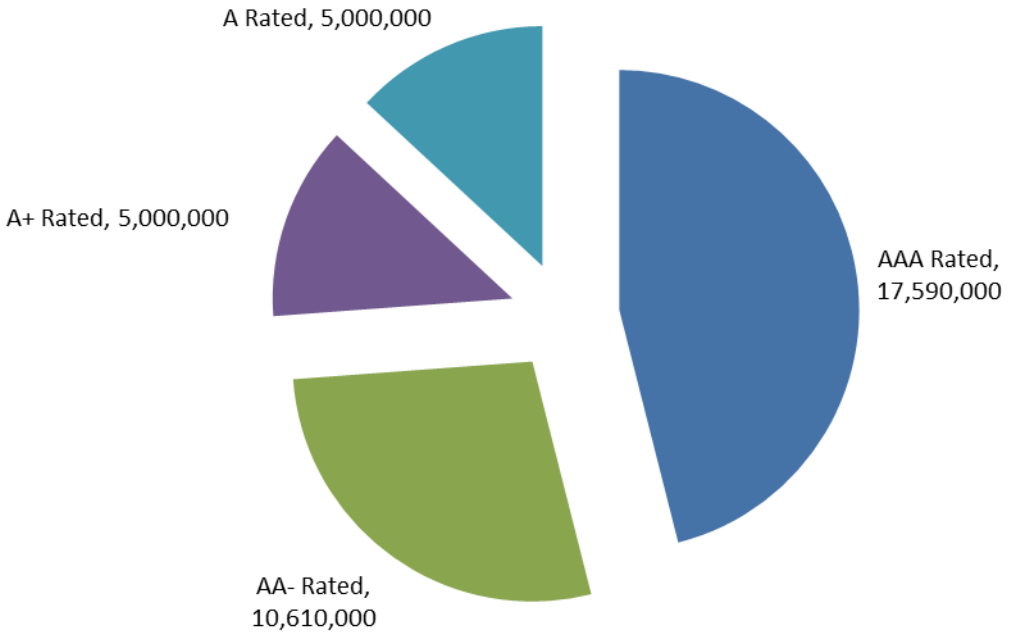


Chart 4: Council Investments per lowest equivalent Long Term credit rating (£38.2m) 30th September 2018



APPENDIX 3

Average rate of return on investments for 2018/19.

	April %	**May %**	**June %**	**July %**	**Aug %**	**Sep %**
Average rate of interest earned	0.50%	0.60%	0.61%	0.60%	0.71%	0.74%
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.41%	0.41%	0.41%	0.41%	0.63%	0.64%
Performance against Benchmark %	+ 0.09%	+ 0.19%	+ 0.20%	+ 0.19%	+ 0.08%	+ 0.10%

	Oct %	**Nov %**	**Dec %**	**Average for Period**
Average rate of interest earned	0.75%	0.82%	0.80%	**0.68%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.63%	0.58%	0.59%	**0.53%**
Performance against Benchmark %	+ 0.12%	+ 0.14%	+ 0.21%	**+ 0.15%**

APPENDIX 4
Councils External Borrowing at 31st December 2018

Borrowing	Amount (£)	Start	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	18,485,552	20/06/16	20/06/41	2.36%
PWLB	9,480,184	24/02/17	16/02/40	2.28%
PWLB	9,545,227	04/04/17	16/02/43	2.26%
PWLB	8,112,949	08/05/17	15/02/42	2.25%
PWLB	6,896,403	10/08/17	10/04/67	2.64%
PWLB	9,702,041	13/12/17	10/10/42	2.35%
PWLB	9,708,599	06/03/18	10/10/42	2.52%
PWLB	9,777,159	06/03/18	10/10/47	2.62%
PWLB	10,000,000	10/09/18	20/07/43	2.42%
PWLB	9,852,481	06/12/18	20/06/43	2.38%
PWLB	9,950,587	12/12/18	20/06/68	2.59%
PWLB	4,924,955	13/12/18	20/06/43	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 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%
Overall Total	**206,736,137**			

*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 December 2018
(Draft to be finalised by AC)

Economic background:
After rising to over $80/barrel around the middle of the year, oil prices fell back sharply by 25% to just over $60 in December. UK Consumer Price Inflation (CPI) for November was up 2.3% year/year, in line with the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for the three months to October 2018 showed the unemployment rate remained at 4.1% while the employment rate of 75.7% was the joint-highest estimate since comparable estimates began in 1971. The 3 month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level likely to only have a modest impact on consumer spending.

The rise in quarterly GDP growth to 0.6% in the third calendar quarter from 0.4% in the second was due to weather-related factors boosting overall household consumption and construction activity over the summer. At 1.5%, annual GDP growth continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in November while lowering its forecast of rate rises in 2019 to two from the three previously projected.

A temporary truce in the ongoing trade war between the US and China was announced as the leaders of both countries agreed to halt new trade tariffs for 90 days to allow talks to continue. Tariffs already imposed will remain in place. The fallout continues to impact on economic growth and stock market volatility.

With less than three months until Article 50 expires on 29th March 2019, the deal Theresa May secured from the EU, together with the controversial Northern Ireland 'backstop', was brought in front of MPs in December to debate and ultimately vote on. Due to the level of opposition to the deal, the vote was subsequently delayed so Mrs May could seek clarification from the EU on how the withdrawal agreement could be ratified. EU leaders have been clear, however, that the terms of the deal are not up for further negotiation. The ongoing uncertainty continues to weigh on sterling and UK markets.

Financial markets:
Investors wrestled with a range of global concerns: an economic slowdown in China, rising trade tensions between the US and China, a sharply lower oi price, slowing Euro area output and, of course, the ongoing uncertainty surrounding Brexit. December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. But spreads on corporate bonds also widened reflecting concerns about tougher economic conditions ahead and the abilities of corporates to service their debt obligations.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising to 1.30% in October, gilts regained their safe-haven status in December - the 5-year benchmark gilt yield fell as

low as 0.82% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.59% to 1.06% and from 2.05% to 1.62%. The higher Bank Rate continued to push up money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.58%, 0.76% and 1.03% respectively over the period.

Credit background:
Credit Default Swap (CDS) spreads drifted up over the period, reflecting the ongoing uncertainty around Brexit but continuing to remain low in historical terms. The spread on non-ringfenced bank NatWest Markets plc rose sharply to around 129bps while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 44bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 44 and 94 bps at the end of the period.
The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) is complete and the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) continues prior to starting trading as separate entities from 1st January 2019.

The Bank of England released its latest report on bank stress testing, illustrating that all entities tested were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

There were minimal credit rating changes during the period. Moody's revised the outlook on Nationwide Building Society to negative from stable as it believes Nationwide may become more reliant on retail deposit funding going forward, reducing the volume of wholesale deposits and senior debt available to a level where only a two-notch uplift is warranted rather than the current three notches.

Our treasury advisor Arlingclose will continue to provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in. Arlingclose's creditworthiness advice will continue to include unsecured bank deposits and CDs but not senior unsecured bonds issued by commercial banks.

APPENDIX 6

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

April to December 2018	YEAR END FORECAST			ADV/FAV
	Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	
Interest & Capital Financing				
- Debt Costs	7,647	7,167	(480)	FAV
- Internal Repayment of Loan Charges	(9,245)	(8,295)	950	ADV
- Ex Avon Debt Costs	1,140	1,140	0	
- Minimum Revenue Provision (MRP)	6,230	5,270	(960)	FAV
- Interest on Balances	(304)	(309)	(5)	FAV
Sub Total - Capital Financing	**5,468**	**4,973**	**(495)**	**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 - indicates an issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.