Leicestershire County Council

CABINET – 14 SEPTEMBER 2018

ANNUAL TREASURY MANAGEMENT REPORT 2017/18

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PART A

Purpose of the Report

1. The purpose of this report is to advise the Cabinet of the action taken and the performance achieved in respect of the treasury management activities of the Council in 2017/18.

Recommendation

2. The Cabinet is asked to note this report.

Reason for Recommendation

3. The Authority's full adoption of the CIPFA Code of Practice for treasury management requires an annual report on Treasury Management activity and performance to be considered by both the Cabinet and the Corporate Governance Committee before the end of September each year.

Timetable for Decisions (including Scrutiny)

4. Under the CIPFA Code of Practice it is necessary to report on treasury management activities undertaken in 2017/18 by the end of September 2018

5. The Corporate Governance Committee considered the matter on 25 July 2018, and noted the report.

Policy Framework and Previous Decisions

6. The Authority adopted the revised CIPFA Code of Practice for treasury management in February 2010. Treasury management issues are now reported to either the Corporate Governance Committee or the Cabinet. Approval of the annual treasury management strategy remains the responsibility of the County Council which it considers as part of the MTFS each year.

Resource Implications

7. Treasury management is an integral part of the County Council's finances. Interest generated by treasury management activities of £1.5m was earned in 2017/18 and interest paid on external debt was £15.3m.

Circulation under the local Issues Alert Procedure

8. None

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PART B

Background

9. The term treasury management is defined as:-

   "The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

10. The Director of Corporate Resources is responsible for carrying out treasury management on behalf of the County Council, under guidelines agreed annually by the County Council.

Treasury Management 2017/18

11. The Treasury Management Policy Statement for 2017/18 was agreed by the County Council on 22nd February 2017, in relation to the sources and methods of borrowing and approved organisations for lending temporarily surplus funds.

12. The criteria for lending to Banks are still derived from the list of approved counter parties provided by the County Council's advisors, Link Asset Services. The list is amended to reduce the risk to the County Council by removing the lowest rated counterparties and reducing the maximum loan duration.

13. For local authority lending the policy is unchanged with no loans permitted in excess of 12 months duration or £10 million in value. During May, Moody's, one of the world's best known credit rating agencies, re-affirmed its view that the UK local government sector has a high credit quality. The implication being that the sector continues to be a good risk for lenders.

14. During the year there were no divergences from the agreed policy.

15. In 2016 it was agreed that any counterparty that was downgraded whilst a loan was active, and where the unexpired period of the loan, or the amount on loan, would then breach the limit at which a new loan could be made to that counterparty, this would be included in the quarterly treasury management report to this Committee. There were no such incidents during 2017/18.

16. Following the November 2017 increase in UK base lending rates to 0.5% the impact on short-dated investments in Money Market Funds improved marginally over time, but took in excess of 4 months to achieve parity with base rates. However, the medium to longer term rates included the impact of the rate increase immediately and also priced in expectation for future base rate rises which created opportunities to improve returns.

17. At the February 2018 Bank of England (BoE) Monetary Policy Committee meeting, market guidance from the BoE left no doubt that rates would rise again as soon as May 2018 and this impacted on higher rates across the yield curve. The premium for lending long to highly rated UK financial institutions continued to out-weigh the risk of a rate increase, so investments for periods of 6 months and 12 months were made during the quarter. Despite predictions, as the May BoE meeting neared, inflation fell

to 2.2% and the poor quarter one GDP figure of 0.1%, which was below trend, saw rates remain on hold. With rates on hold for a further quarter at least the decision to lend into the longer end of the yield curve will be advantageous.

18. On the debt portfolio, no new loans were taken. A total of £10m was repaid in the year, as well as a short dated maturing PWLB loan of £7.5m, £0.5m in respect of three Equal Instalments of Principal loans, and a £2m external market loan, thereby reducing the overall balance of the loan portfolio, but marginally increasing the average ‘Pool’ rate.

19. The Authority has not raised any external loans since August 2010 and external debt is around £100m lower than it was at its peak in November 2006. There are no current plans to raise any further external debt, and opportunities to reduce it will be considered if they are cost effective.

Position at 31st March 2018

20. The Council’s external debt position at the beginning and end of the year was as follows:-

	31st March 2017			31st March 2018		
	Principal	Average Rate	Average Life	Principal	Average Rate	Average Life
Fixed Rate Funding						
- PWLB	£169.1m	6.61%	33 yrs	£161.1m	6.77%	32 yrs
-Market	£ 2.0m	8.12%	1 yr	£ 0.0m	n/a	n/a
Variable Rate Funding:						
- Market (1)	£103.5 m	4.37%	1 yr	£103.5 m	4.37%	1 yr
Total Debt	£274.6m	5.78%	20 yrs	£264.6m	5.83%	20 yrs

(1) The lenders all have an option to increase the rates payable on these loans on certain pre-set dates, and if they exercise this option we can either repay or accept the higher rate. The average life is based on the next option date.

21. The position in respect of investments varies throughout the year as it depends on large inflows and outflows of cash. Over the course of the year the loan portfolio (which includes cash managed on behalf of schools with devolved banking arrangements) varied between £187m and £268m, and averaged £220m. Investments as at 31 March 2018 were £206m.

Debt Transactions

22. The Council began the financial year £6.9m over-borrowed compared with the amount required to fund the historic capital programme - the Capital Financing Requirement.

23. The major reason for this is that there has been no requirement to borrow to fund the capital programme (which leads to debt financing costs that fall on the revenue budget), and also the Governments change a number of years ago to award grants to fund the capital programme rather than the previous approach of supporting borrowing. Given the large penalties that would currently be incurred by prematurely repaying existing debt, there is little that can be done to reduce the likelihood of the position increasing unless long-term interest rates rise significantly.

24. At the end of the financial year, after the repayment of debt and setting aside funding for the Minimum Revenue Provision (MRP) - a charge (c. £11m) that is intended to ensure that loans raised to finance capital expenditure are paid off over the longer term – the Council was £7.7m over-borrowed.

25. The lack of opportunity to reduce the debt portfolio because of historic stagnant interest rates makes the punitive redemption costs prohibitive. The debt portfolio stands at £264.6m and the average pool rate 5.83%.

26. The action taken on the debt portfolio marginally increased the average rate of external debt over the course of the year as the interest rate on the largest maturing loan (£7.5m) was at a lower rate (3.16%) than the portfolio average.

Investments

27. The loan portfolio produced an average return of 0.60% in 2017/18, compared to an average base rate of 0.35% and the average 7 day LIBID (London Interbank Bid Rate) index (representative of what could be achieved if only short-term loans within the money market were made) of 0.23%.

28. The loan portfolio has outperformed both the average base rate and the local authority 7 day deposit rate in every one of the last 23 years, which is when the figures started to be produced. The level of the out performance is flattered somewhat by the significant over performance achieved both during and in the immediate aftermath of the credit crunch. The average rate of interest earned on the portfolio in the last 23 years is 3.97%, and this compares to an average base rate and the average LIBID index which have both produced a return of 3.32%.

29. The variability of balances makes it difficult to calculate the excess interest that the over performance has achieved over the whole of the 20+ year period for which performance records are available, but it is estimated to be at least £28m. Almost half of this added value came in the five financial years from 2008 to 2013, which can be categorised as the start of the financial crisis and a period in which a number of loans placed during the financial crisis were earning interest at rates that (relative to base rates) were extraordinary.

Summary

30. Treasury Management is an integral part of the Council's overall finances and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium / long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in significant savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.

31. The loan portfolio has produced an exceptional level of over performance in the period in which performance figures have been calculated. Adding significant value in a period of extremely low interest rates is very difficult. Ironically a period in which there begins to be differentiation in expectations for both the pace and extent of future base rate rises will make the cash sums that can be gained larger, whilst also giving a higher level of risk that the decisions taken might be wrong. Such a period has intermittently seemed to get closer in recent years, only to be consistently put back.

Equality and Human Rights Implications

32. None.

Background Papers

Report to County Council on 22nd February 2017 – 'Medium Term Financial Plan':
http://politics.leics.gov.uk/documents/s126527/MTFS%202017%20-2021.pdf

Appendix K 'Treasury Management Strategy Statement and Annual Investment Strategy 2017/18'
http://politics.leics.gov.uk/documents/s126539/Appendix%20L%20-%20Treas%20Man%20Strat.pdf