Rotherham Metropolitan Borough Council

Public Report

Summary Sheet

Council Report
Audit Committee

Title
Mid-Year Treasury Management and Prudential Indicators Monitoring Report – 2017/18

Is this a Key Decision and has it been included on the Forward Plan?
No

Strategic Director Approving Submission of the Report
Judith Badger – Strategic Director for Finance & Customer Services

Report Author(s)
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Ward(s) Affected
All

Executive Summary

1. Mid-Year Treasury Review

The regulatory framework of treasury management requires that the Council receive a mid-year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report.

This report meets the first of those requirements. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs).

It is also a requirement that any proposed changes to the 2017/18 prudential indicators are approved by Full Council.

The monitoring as set out in the Appendix to the report is structured to highlight the key changes to the Council's capital activity (the PIs) and the actual and proposed treasury management activity (borrowing and investment).

The key messages for Members are:

a. Investments - the primary governing principle remains **security** over return and the criteria for selecting counterparties continues to reflect this.

b. Borrowing - overall this will remain fairly constant over the period covered by this report and the Council will maintain its strategy of being significantly under-borrowed against the capital financing requirement, as the most cost effective approach in the current financial climate. The Council's existing treasury management strategy provides for the Council to take out £30m of new borrowing per annum over the next 4 years to reduce the amount of under-borrowing over time. This position will remain under review and an update of the strategy will be presented to Members within the Budget and Council Tax 2018/19 report to Budget Council in February 2018.

c. Governance - strategies and monitoring are undertaken by Audit Committee

Recommendation

Audit Committee is asked to note the contents of the report

List of Appendices Included
Appendix – Mid-Year Treasury Management and Prudential Indicators Monitoring Report – 2017/18.

Background Papers
Budget and Council Tax 2017/18 report to Council 8th March 2017

Consideration by any other Council Committee, Scrutiny or Advisory Panel
No

Council Approval Required
No

Exempt from the Press and Public
No

Mid-Year Treasury Management and Prudential Indicators Monitoring Report – 2017/18

1. Recommendation

Audit Committee is asked to note the contents of the report

2. Background

2.1 **Mid-Year Treasury Review** – Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid-year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

2.2 This review as fully set out in the Appendix meets that revised requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Strategy and PIs were previously reported to Audit Committee and Cabinet and Commissioners Decision Making meeting in February 2017 and approved by Council on 8 March 2017.

3. Key Issues

3.1 **Mid-Year Treasury Review** – The review as set out in the Appendix keeps Members up to date and informs on performance against the plan.

3.2 The key messages for Members are:

a. a. Investments - the primary governing principle remains security over return and the criteria for selecting counterparties continues to reflect this.

b. Borrowing - overall this will remain fairly constant over the period covered by this report and the Council will maintain its strategy of being significantly under-borrowed against the capital financing requirement, as the most cost effective approach in the current financial climate. The Council's existing treasury management strategy provides for the Council to take out £30m of new borrowing per annum over the next 4 years to reduce the amount of under-borrowing over time. This position will remain under review and an update of the strategy will be presented to Members within the Budget and Council Tax 2018/19 report to Budget Council in February 2018.

c. Governance - strategies and monitoring are undertaken by Audit Committee

4. Options considered and recommended proposal

4.1 **Mid-Year Treasury Review** – The review as set out in the Appendix indicates performance is in line with the plan and no proposals to vary the approach for the remainder of the year are proposed. However, a change is proposed for the Council's future strategy with regard to the limit of investment in Money Market Funds. This is described in the Investment Strategy outlined in Paragraph 5 of the Appendix to this report.

5. Consultation

5.1 The continuing approach to treasury management has been discussed with the Council's External Treasury Management Advisers Capita Asset Services, who have confirmed this is a prudent approach given current market conditions.

6. Timetable and Accountability for Implementing this Decision

6.1 The report is for Audit Committee information and noting.

7. Financial and Procurement Implications

7.1 Treasury Management forms an integral part of the Council's overall financial arrangements.

7.2 The assumptions supporting the capital financing budget for 2017/18 and for future years covered by the Council's MTFS were reviewed in light of economic and financial conditions and the capital programme.

7.3 The current strategy is to maintain the Council's position of being significantly under-borrowed against the Capital Financing Requirement and to optimise cash-flows by using short-term loans rather than taking out new longer term debt. This strategy takes advantage of the low interest rates currently available for short term loans and generates savings against the 2017/18 budget which are reflected in the financial monitoring reports.

8. Legal Implications

8.1 It is a requirement that changes to the Council's prudential indicators and approved by Full Council

9. Human Resources Implications

9.1 There are no Human Resource implications arising from the report.

10. Implications for Children and Young People and Vulnerable Adults

10.1 There are no implications arising from the proposals to Children and Young People and Vulnerable Adults.

11. Equalities and Human Rights Implications

11.1 There are no implications arising from this report to Equalities and Human Rights.

12. Implications for Partners and Other Directorates

12.1 There are no implications arising from this report to Partners or other directorates.

13. Risks and Mitigation

13.1 Regular monitoring of treasury activity ensures that risks and uncertainties are addressed at an early stage and hence kept to a minimum.

14. Accountable Officer(s)

Graham Saxton (Assistant Director, Financial Services)

Approvals Obtained from:-

Strategic Director for Finance & Customer Services: - Judith Badger

Appendix

Mid-Year Prudential Indicators and Treasury Management Monitoring

1. Introduction and Background

1.1 Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid-year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

1.2 This report meets that revised requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Strategy and PIs for 2017/18 were previously reported to Audit Committee and Commissioners Decision Making meeting in February 2017 and approved by Council on 8 March 2017.

1.3 The Council's revised capital expenditure plans and the impact of these revised plans on its financing are set out below in Sections 2.2 and 2.3 respectively. The Council's capital spending plans provide a framework for the subsequent treasury management activity. Section 3 onwards sets out the impact of the revised plans on the Council's treasury management indicators.

1.4 The underlying purpose of the report supports the objective in the revised CIPFA Code of Practice on Treasury Management and the Communities & Local Government Investment Guidance. This states that Members receive and adequately scrutinise the treasury management service.

1.5 The underlying economic and financial environment remains difficult for the Council, foremost being the improving, but still challenging, concerns over investment counterparty risk. This background encourages the Council to continue maintaining investments short term and with high quality counterparties. The downside of such a policy is that investment returns remain low.

1.6 The Strategic Director for Finance & Customer Services can report that the basis of the treasury management strategy, the investment strategy and the PIs are not materially changed from that set out in the approved Treasury Management Strategy (March 2017).

2. Key Prudential Indicators

2.1. This part of the report is structured to update:

- The Council's latest capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

2.2 Capital Expenditure (PI)

2.2.1 This table shows the forecast estimates for capital expenditure as reported in the September Financial Monitoring Report presented to the Cabinet and Commissioners' Decision Making meeting held on the 13 November 2017. This position reflects slippage on the capital programme for 2016/17 which is now rolled into 2017/18, as reported in the financial outturn report to Cabinet in July 2017, and new scheme approvals during the year.

Capital Expenditure by Service	2017/18 Original Estimate £m	Current Estimate £m
Children & Young People Services	10.464	8.150
Regeneration & Environment	25.293	32.628
Adult Care & Housing – Non-HRA	3.489	2.385
Finance & Customer Services	3.636	3.270
Total Non-HRA	**42.882**	**46.433**
Adult Care & Housing – HRA	26.756	35.352
Total HRA	**26.756**	**35.352**
Total	**69.638**	**81.785**

2.3 Impact of Capital Expenditure Plans

2.3.1 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the expected financing arrangements of this capital expenditure.

Capital Expenditure	2017/18 Original Estimate £m	Current Estimate £m
Total spend	69.638	81.785
Financed by:		
Capital receipts	10.134	12.663
Capital grants, capital contributions & other sources of capital funding	42.085	48.754
Borrowing Need	17.419	20.368
Total Financing	**69.638**	**81.785**
Unsupported Borrowing	17.419	20.368
Borrowing Need	**17.419**	**20.368**

The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision (MRP). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

2.3.2 The increase in borrowing need for 2017/18 (£2.949m) reflects the re-profiling of capital expenditure & financing and new approvals since the original estimate was approved.

2.3.3 **Changes to the Capital Financing Requirement (PI), External Debt and the Operational Boundary (PI)**

The table below shows the CFR, which is the underlying external need to borrow for a capital purpose. It also shows the expected debt position over the period. This expected debt position has previously also been used as the basis for the Operational Boundary PI. This was set at the beginning of the financial year at £659.331m. During 2016/17 there were periods where the actual position was above the Operational Boundary, but this is acceptable practice. It is the Authorised Limit which the Council must not breach. For the 2018/19 strategy it is proposed to review whether the level of the Operational Boundary needs to be set closer to the authorised limit in order to improve the effectiveness of this particular indicator.

2.3.4 In addition to showing the underlying need to borrow, the Council's CFR has since 2009/10, also included other long term liabilities which have been brought on balance sheet, for example, PFI schemes and finance lease assets. No borrowing is actually required against these schemes as a borrowing facility is already included in the contract and there has been no change in the borrowing need resulting from these requirements.

2.3.5 The current CFR estimate for 2017/18 is £809.488m and this figure represents an increase of £16.949m when compared to the 2016/17 year-end position of £792.538m. The increase is due to:

- The estimated borrowing need for the year £20.241m net of the Minimum Revenue Provision charge for the year (£0.526m)
- The repayments of borrowing contained within PFI and similar schemes (£2.766m).

RMBC	2017/18 Original Estimate £m	Current Estimate £m
CFR – Non Housing	374.101	372.575
CFR – Housing	304.125	304.125
Total CFR excluding PFI, finance leases and similar arrangements	678.226	676.700
Net movement in CFR	**17.002**	**19.715**
Cumulative adjustment for PFI, finance leases and similar arrangements	132.789	132.789
Net movement in CFR	**-2.766**	**-2.770**
Total CFR including PFI, finance leases and similar arrangements	811.015	809.488
Net movement in overall CFR	**14.236**	**16.945**
Borrowing	523.776	523.776
Other long term liabilities*	132.789	132.789
Total Debt 31 March	**656.565**	**656.565**

* Includes on balance sheet PFI schemes, finance leases and similar arrangements, etc.

Former SYCC Operational Boundary for External Debt	2017/18 Original Estimate £m	2017/18 Current Estimate £m
Borrowing	76.709	76.709
Other long term liabilities	0	0
Total Debt 31 March	76.709	76.709

3. Limits to Borrowing Activity

3.1 The first key control over the treasury activity is a PI to ensure that over the medium term, gross and net borrowing will only be for a capital purpose. Gross and net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which would only be adhered to if this proves prudent to do so.

RMBC	2017/18 Original Estimate £m	Current Position £m
Gross Borrowing	523.776	567.866
Plus Other Long Term liabilities*	132.789	132.789
Total Gross Borrowing	**656.565**	**700.655**
CFR*	811.015	809.488
Total Gross Borrowing	656.565	700.655
Less Investments	0	(38.000)
Net Borrowing	**656.565**	**662.655**
CFR*	**811.015**	**809.488**

* Includes on balance sheet PFI schemes, finance leases and similar arrangements, etc.

3.2 The Strategic Director for Finance & Customer Services reports that no difficulties are envisaged for the current or future years in complying with this PI.

3.3 A further PI controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt (RMBC)	2017/18 Original Indicator £m	Current Position £m
Borrowing	709.184	567.866
Other long term liabilities*	135.555	132.789
Total	**844.739**	**700.655**

* Includes on balance sheet PFI schemes, finance leases and similar arrangements, etc.

Former SYCC - Authorised Limit for External Debt	2017/18 Original Estimate £m	Current Position £m
Borrowing	76.709	76.709
Other long term liabilities	0	0
Total	76.709	76.709

4. Treasury Strategy 2017/18 – 2019/20

4.1 Debt Activity during 2017/18

4.1.1 The expected borrowing need is set out below:

RMBC	2017/18 Original Estimate £m	Current Position £m
CFR	811.015	809.488
Less Other Long Term Liabilities*	132.789	132.789
Net Adjusted CFR (y/e position)	**678.226**	**676.699**
Borrowed at 30/09/17	523.776	567.866
Invested at 30/09/17		(38,000)
Under borrowing at 30/09/17	**154.450**	**146.833**
Borrowed at 30/09/17	523.776	
Estimated additional borrowing to be taken October to March 2018	0.000	
Total Borrowing	**523.776**	
Under borrowing at 31/03/18	**154.450**	

* Includes on balance sheet PFI schemes, finance leases and similar arrangements, etc.

4.1.2 The Council is currently significantly under-borrowed, the delay in borrowing reduces the cost of carrying borrowed monies when yields on investments are low relative to the borrowing rates. Based on current borrowing rates and investment returns the differential is around 2% and if the Council was fully borrowed the additional cost per year would amount to over £2.5m. The delay in taking out new long-term borrowing does give rise to an element of interest rate risk, as longer term borrowing rates may rise, but this position is being closely monitored and the overall position carefully managed.

4.1.3 During the six months to 30 September 2017 the Council has borrowed the following amounts shown in the table below. The borrowing taken highlights the Council's current position of utilising low rate short term deals to generate significant interest savings. The following deals were required for a combination of debt refinancing, pension fund payments profile and cashflow management.

Principal	Type	Term	Interest Rate
£10,000,000	Temp	3 Months	0.43%
£10,000,000	Temp	3 Months	0.43%
£3,000,000	Temp	3 Months	0.40%
£10,000,000	Temp	3 Months	0.34%
£10,000,000	Temp	3 Months	0.21%
£20,000,000	Temp	3 Months	0.23%
£10,000,000	Temp	3 Months	0.31%
£20,000,000	Temp	3 Months	0.22%
£10,000,000	Temp	3 Months	0.25%

4.1.4 During the six months to 30 September 2017, the Council has repaid the following amounts:

Lender	Principal	Type	Interest Rate
PWLB	£1,000,000	Fixed rate (EIP)	3.46%
PWLB	£65,000	Fixed rate (EIP)	1.89%
PWLB	£83,491	Fixed rate (Annuity)	Various
PWLB	£10,000,000	Fixed rate	9.38%
Local Authority	£5,000,000	Temp	0.40%
Local Authority	£10,000,000	Temp	0.30%
Local Authority	£5,000,000	Temp	0.32%
Local Authority	£10,000,000	Temp	0.35%
Local Authority	£10,000,000	Temp	0.43%
Local Authority	£10,000,000	Temp	0.43%
Local Authority	£3,000,000	Temp	0.40%
Local Authority	£10,000,000	Temp	0.34%

Local Authority	£10,000,000	Temp	0.21%
Local Authority	£20,000,000	Temp	0.23%
Local Authority	£10,000,000	Temp	0.31%
Local Authority	£20,000,000	Temp	0.22%

One Equal Instalment of Principal (EIP) loan for £20m is being repaid in equal half yearly instalments of £1m over its 10 year term. A second EIP loan for £1.3m is being repaid in equal half yearly instalments of £65,000 over its 10 year term. There are 5 Annuity loans on which variable amounts of principal are repaid each six months.

5. Investment Strategy 2017/18 – 2019/20

5.1 Key Objectives

The primary objective of the Council's investment strategy is safeguarding the repayment of the principal and interest of its investments on time – the investment return being a secondary objective. The current difficult economic and financial climate has heightened the Council's over-riding risk consideration with regard to "Counterparty Risk". As a result of these underlying market concerns officers continue to implement an operational investment strategy which maintains the tight controls already in place in the approved investment strategy.

5.1.1 There is one proposed future change to the existing criteria and that is for the use of Money Market Funds (MMF's). The existing strategy limits the Council to investing a maximum of 20% of the total investment portfolio with MMF's, and those funds must be AAA rated.

5.1.2 This strategy was suitable for a time when the Council had a greater level of day to day cash flows, a larger investment portfolio, and was able to deposit cash across its two main investment options with a competitive return, the Debt Management Office at 0.25%, and Handelsbanken at 0.40%.

5.1.3 However the Council is currently operating a strategy, whereby it is utilising the low rates available in the short term inter-local authority lending market to hold a position of being under borrowed, with the vision of not entering into any long term borrowing until required. This means that the Council has less day to day cash to invest. In addition the interest rates on the Council's two main investment options have now significantly reduced due the uncertain economic climate. Prior to the recent increase in the Bank of England base rate, the Debt Management Office rate was 0.10%, and Handelsbanken was 0.20%.

5.1.4 Given this position the Council would now see a greater return on its investments by making stronger use of MMF's, which had comparable investment returns of anywhere from 0.22% to 0.30%, and above. The process for using MMF's is very efficient and effective, with the added benefit that the funds the Council can access are all AAA rated. To enable the Councils Treasury Management Team to make best use of this market, in the most efficient and cost effective way the following change is proposed to the Treasury Management Strategy.

Existing Rule:

- Money Market Funds – AAA – restricted to a maximum of 20% of the investment portfolio

New Rule:

- Money Market Funds – AAA – restricted to a maximum investment of £10m per fund

5.2 **Current Investment Position**

The Council held £38.000m of investments at 30 September 2017, and the constituent parts of the investment position are:

Sector	Country	Up to 1 year £m	1 - 2 years £m	2 – 3 years £m
Banks	UK	6.000	0	0
DMO	UK	32.000	0	0
Local Authorities	UK	0	0	0
Total		**38.000**	**0**	**0**

One 'call' account with the top rated bank Handlesbanken is operated. This bank meets the Council's highest investment criteria.

This enables the Council to minimise the risk of having to leave unexpected receipts with the Council's current bankers, it allows immediate access to a small amount of funds to cover or part cover any short-term borrowing requirements and based on current rates there is a small benefit of approx. 0.10% over the rate achievable from the Debt Management Office.

5.3 **Risk Benchmarking**

A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are requirements to Member reporting and the following reports the current position against the benchmarks.

5.3.1 **Security** – The Council monitors its investments against historic levels of default by continually assessing these against the minimum criteria used in the investment strategy. The Council's approach to risk, the choice of counterparty criteria and length of investment ensures any risk of default is minimal when viewed against these historic default levels.

5.3.2 **Liquidity** – In respect of this area the Council set liquidity facilities/benchmarks to maintain:

- Bank overdraft – on a day-to-day basis the Council works to an agreed overdraft limit of £100,000 with the Council's bankers. Whilst a short-term increase could be negotiated less expensive short-term borrowing is accessed through the financial markets to remain within the agreed overdraft.
- Liquid short-term deposits of at least £3m available within a week's notice.

The Strategic Director for Finance & Customer Services can report that liquidity arrangements were adequate during the year to date.

5.3.3 **Yield –** a local measure for investment yield benchmark is internal returns above the 7 day LIBID rate

The Strategic Director for Finance & Customer Services can report that the return to date averages 0.15%, against a 7 day LIBID to the end of September 2017 of 0.11%. This is reflective of the Council's current approach to risk whereby security has been maximised by using the Debt Management Office and highly rated banks.

It is important to recognise that based on the Council's current average cash investments of £38m the difference in return at the benchmark when compared to the return achieved at the current rate would be £53.2k. This increase in return has to be measured against the additional risk of placing cash elsewhere.

6. Revisions to the Investment Strategy

6.1 The counterparty criteria are continually under regular review but in the light of the current market conditions no recommendations are being put to Members to revise the Investment Strategy.

7. Treasury Management Prudential Indicators

7.1 Actual and estimates of the ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream.

	2017/18 Original Indicator %	2017/18 Current Position %
Non-HRA	7.01	6.02
HRA	16.37	15.57

7.2 The revised non HRA indicator reflects the impact of the restructured debt and borrowing being at rates less than originally anticipated for 2017/18. The HRA indicator has also decreased due to the HRA's internal borrowing, which is calculated using the Council's overall average rate of interest, now being at a lower rate than had been assumed in the original indicator.

7.3 **Prudential indicator limits based on debt net of investments**

- **Upper Limits On Fixed Rate Exposure** – This indicator covers a maximum limit on fixed interest rates.

- **Upper Limits On Variable Rate Exposure** – Similar to the previous indicator this identifies a maximum limit for variable interest rates based upon the debt position net of investments.

RMBC	2017/18 Original Indicator	Current Position
Limits on fixed interest rates based on net debt	100%	74.76%
Limits on variable interest rates based on net debt	30%	25.24%

7.4 **Maturity Structures Of Borrowing**

These gross limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing.

The current position shown below reflects the next call dates on those Council's LOBO loans (£62m) that are not callable in 2017/18 and thus are regarded as fixed rate. The actual maturity date for most of these loans is greater than 50 years. This approach gives a better indication of risk and whilst there is a possibility that a loan is called with an increase in interest payable the likelihood of any LOBO loans being called in the current climate is assessed as zero for the next three years.

RMBC	2017/18 Original Indicator		Current Position	
	Lower	Upper	%	£m
Under 12 months	0%	35%	27.55%	111.540
12 months to 2 years	0%	35%	8.65%	35.000
2 years to 5 years	0%	45%	13.96%	56.515
5 years to 10 years	0%	45%	1.24%	5.000
10 years to 20 years	0%	45%	10.73%	43.455
20 years to 30 years	0%	50%	1.24%	5.000
30 years to 40 years	0%	50%	18.86%	76.336
40 years to 50 years	0%	55%	10.37%	42.000
50 years and above	0%	60%	7.41%	30.000

The former SYCC account is due to be wound up by the end of 2020/21 and the maturity structure is now largely fixed as the need and indeed opportunities to re-finance within the remaining 5 years will be limited. As a result future limits are currently set in line with the on-going maturity profile.

Former SYCC	2017/18 Original Indicator		Current Position	
	Lower	Upper	%	£m
Under 12 months	0%	60%	52.82%	40.520
12 months to 2 years	0%	75%	21.51%	16.5
2 years to 5 years	0%	100%	25.67%	19.689

7.5 **Total Principal Funds Invested**

These limits are set to reduce the need for the early sale of an investment, and show limits to be placed on investments with final maturities beyond each year-end.

The Council currently has no sums invested for periods exceeding 364 days due to market conditions. To allow for any changes in those conditions the indicator has been left unchanged. This also excludes any Icelandic investments that are due to be recovered after more than 364 days.

RMBC	2017/18 Original Indicator £m	Current Position £m
Maximum principal sums invested > 364 days	10	0
Cash deposits	10	0

7.6 **Treasury Management Advisers**

The Council is in its second year of a three year contract with Capita Asset Services Treasury Solutions (CAS) for the provision of treasury management and asset finance services. This began on 7 October 2016.