Renfrewshire Council

To: **Finance Resources and Customer Services Policy Board**

On: **8 November 2017**

Report by: **Director of Finance and Resources**

Heading: **Treasury Management Mid-year Review 2017-2018**

1. Summary

1.1 This mid-year report has been prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services Code of Practice (revised November 2009) which was adopted by Council on 3 March 2010. The report covers the following:

- an economic update for the first six months of 2017-2018;
- a review of the Treasury Management Strategy Statement 2017-2018, incorporating the annual investment strategy;
- a review of the Council's investment portfolio for 2017-2018;
- a review of the Council's borrowing strategy for 2017-2018; and
- a review of compliance with treasury management indicators for 2017-2018.

2. Recommendations

2.1 It is recommended that Members note the treasury management activity for the period 1 April 2017 to 13 October 2017.

3. Economic update

3.1 **External economic review for the period April to October 2017**
The following paragraphs outline a review of the economy over the first half of 2017-2018.

3.2 UK Consumer Price Inflation (CPI) index rose in August showing CPI at 2.9%, its highest since June 2013 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 2.7%. The unemployment rate fell to 4.3%, its lowest since May 1975, but the squeeze on consumers intensified as average earnings grew at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar year 2017.

3.3 The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth. Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric to imply an increased likelihood of a rise in Bank Rate in "the coming months".

3.4 Following an unscheduled General Election in June, the result has led to an enhanced level of political uncertainty. Although the potential for a hard Brexit is diminished, lack of clarity over future trading partnerships, in particular future customs agreements with the rest of the EU block, is denting business sentiment and investment. The reaction from the markets on the UK election's outcome was fairly muted, business confidence now hinges on the progress on Brexit negotiations, the ultimate 'divorce bill' for the exit and whether new trade treaties and customs arrangements are successfully concluded to the UK's benefit.

3.5 In the face of a struggling economy and Brexit-related uncertainty, the Council's treasury advisers (Arlingclose) expect the Bank of England to take only a very measured approach to any monetary policy tightening, with any increase being gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy throughout the Brexit transition.

3.6 **Financial markets:** Gilt yields displayed significant volatility over the six-month period with the appearing change in sentiment in the Bank of England's outlook for interest rates, the expectations of tapering of Quantitative Easing (QE) in the US and Europe and from geopolitical tensions also had an impact.

3.7 The FTSE 100 nevertheless reached a record high of 7548 in May but dropped back to 7377 at the end of September. Money markets rates

have remained low: 1-month, 3-month and 12-month LIBID rates have averaged 0.25%, 0.30% and 0.65% over the period from January to 21st September.

3.8 **Credit background:** There were a few credit rating changes during the quarter. The most significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities. The agency affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1, placed Lloyds Bank's A1 rating on review for upgrade, revised the outlook of Santander UK plc, and Nationwide building society.

3.9 Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented within the next year. In May, following discussion with our treasury advisers, the Council reduced the maximum duration of unsecured investments with Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months until the banks' new structures are finally determined and published. Until this point, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain.

3.10 New EU regulations for Money Market Funds were approved and published in July and existing funds will have to be compliant by no later than 21st January 2019. The key features include Low Volatility Net Asset Value (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing Net Asset Value, providing they meet strict new criteria and minimum liquidity requirements. MMFs will not be prohibited from having an external fund rating (as had been suggested in draft regulations). The Council expects most of the short-term MMFs it invests with to convert to the LVNAV structure and awaits confirmation from each fund.

4. Regulatory update

4.1 **Markets in Financial Instruments Directive (MiFIDII):** Local authorities are currently treated by regulated financial services firms as professional clients who can "opt down" to be treated as retail clients instead. From 3rd January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), the opposite will be the case, whereby local authorities will be treated as retail clients who can "opt up" to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional, the authority must have an investment balance of at least £10 million and the person authorised to make investment decisions on behalf of the authority must have at least one year's relevant professional experience. In addition, the firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

4.2 The main additional protection for retail clients is a duty on the firm to ensure that the investment is “suitable” for the client. However, local authorities are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service whether they are retail or professional clients. It is also likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

4.3 The Council meets the conditions to opt up to professional status and intends to do so in order to maintain their current MiFID status which will allow the Council to continue to access the full range of treasury management tools and products required to effectively manage the Council’s treasury management activities.

4.4 **CIPFA proposed changes to Prudential and Treasury Management Codes:** In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes and after reviewing responses intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19.

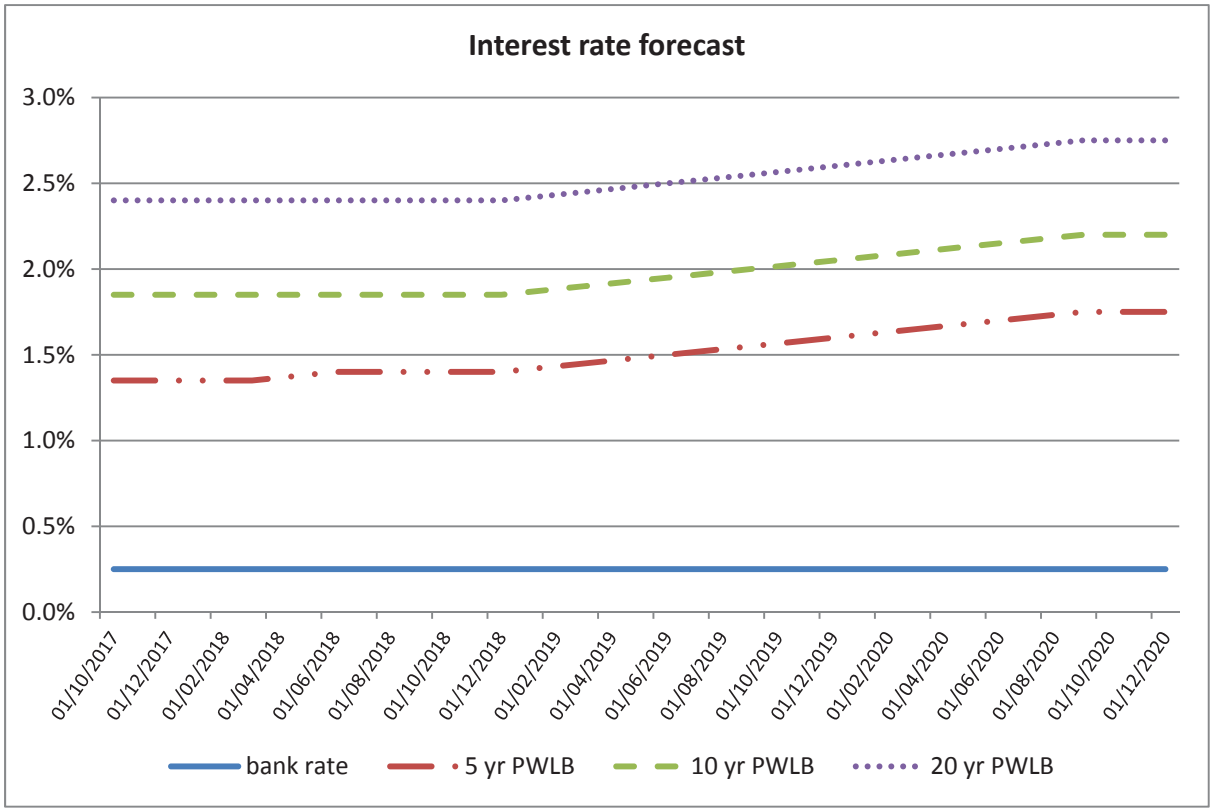
4.5 The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital programme and treasury management. The prudential indicators for capital expenditure and the authorised borrowing limit would be included in this report but other indicators may be delegated to another committee. There are plans to drop certain prudential indicators, however local indicators are recommended for ring fenced funds (including the HRA) and for group accounts.

4.6 Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of “investments” as well as loans made or shares brought for service purposes. Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee rather than needing approval of full Council. There are also plans to drop or alter some of the current treasury management indicators.

5 Outlook for the remainder of 2017/18

5.1 The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Both consumer and business confidence remain subdued. Household consumption growth, the driver of UK GDP growth, has softened following a contraction in real wages. Savings rates are at an all-time low and real earnings growth (i.e. after inflation) struggles in the face of higher inflation.

5.2 Information from the Bank of England appears to suggest an increased likelihood of a rise in the Bank Rate in the coming months, and this has been translated into a general market sentiment that rates will indeed increase. This decision is still very data dependant and our treasury adviser while maintaining a central case for Bank Rate remaining at 0.25% in the medium term, also suggests that it would appear that rates will increase marginally in the near term although any increase has not as yet been formally incorporated into their forecast.



6 Review of the Treasury Management Strategy Statement 2017-2018 (incorporating annual investment strategy) as at 13 October 2017

6.1 The Treasury Management Strategy Statement for 2017-2018 was approved by Council on 16 February 2017. The Council's annual investment strategy, which is incorporated in the Treasury Management Strategy Statement, sets out the Council's investment priorities as follows:

- the security of capital and
- the liquidity of its investments.

6.2 The Council also aims to achieve the optimum returns on its investments commensurate with the proper levels of security and liquidity. Investments and borrowing during the first six months of the year have been in line with the strategy and there have been no changes to the policies set out in the Treasury Management Strategy Statement 2017-2018. The details

in this report update the position in light of the updated economic position and budgetary changes already approved.

7 Review of borrowing and investments over the period 1 April 2017 to 21 October 2017

7.1 The Council's net borrowing position as at 13 October 2017 is shown in Appendix 1.

7.2 During the period 1 April 2017 to 13 October 2017 the Council's total external borrowings have decreased by £10.35 million to £229.15 million, mainly due to the scheduled repayments of PWLB debt.

7.3 During the period 1 April 2017 to 13 October 2017, temporary investments have increased from £133.45 million to £153.46 million. The increase in investments is after financing the £10.35 million of debt repayment and reflects:

- the re-profiling of elements of the current capital programme;
- the "front-loading" (that is, more income being received in the early part of the year) of revenue support grant income and non-domestic rates pool receipts.

7.4 The Director of Finance and Resources confirms that, during the period 1 April 2017 to 13 October 2017, the approved limits set out within the annual investment strategy sections of the Treasury Management Strategy Statement 2017-2018 were complied with. The Council only invested with institutions listed in the Council's approved lending list. Similarly, only permitted investment vehicles were used, mainly call accounts, fixed term deposits and money market funds.

7.5 In accordance with CIPFA's Treasury Management in the Public Services Code of Practice, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

7.6 The table below shows the average interest rate achieved by the Council on its temporary investments during the period 1 April 2017 to 13 October 2017. The table also shows for comparison the benchmark comparator, which is the average 7-day LIBID rate (uncompounded). (The 7-day LIBID rate is the London Interbank Bid Rate, being the rate at which a bank is willing to borrow from other banks, for borrowings of a maturity of seven days.)

Interest rates achieved on investments	Average value of investments	Actual rate of return	Benchmark return

Internally managed investments	£147.838m	0.453%	0.112%

7.7 **Debt rescheduling**

Debt rescheduling opportunities have been limited in the current economic climate and it is not anticipated that this is likely to change over the short to medium term. However, in conjunction with the Council's treasury advisors, the service will remain alert to any opportunities which may arise.

8 Review of compliance with treasury management indicators for 2017-2018

8.1 During the period 1 April 2017 to 13 October 2017 the Council complied with the approved treasury management indicators as set out in the Treasury Management Strategy Statement 2017-2018. These indicators relate to:

- interest rate exposures: the upper limit on the proportion of investments which are exposed to fixed interest rates and the upper limit on the proportion of investments which are exposed to variable interest rates;
- the maturity structure of borrowing: the lower and upper limits on the proportion of investments which fall into each maturity band.

8.2 In addition to the treasury management indicators referred to at 6.1, there are two *prudential* indicators (as set out in the Prudential Framework for Capital Finance 2016-2018 and Treasury Management Strategy Statement 2017-2018, approved by Council on 16 February 2017) which are of particular relevance to the Council's treasury management strategy:

- operational boundary for external debt;
- authorised limit for external debt.

8.3 During the period 1 April 2017 to 13 October 2017 the Council operated within the operational boundary for external debt, and within the authorised limit for external debt. These indicators, along with the Council's actual external debt, are shown in Appendix 2.

Implications of the Report

1. **Financial** – As described in the report. The Treasury Management Strategy Statement and treasury management indicators assist in providing assurance that the Council's treasury management activities and longer term plans are affordable, prudent and sustainable.

2. **HR & Organisational Development** – none

3. **Community Planning** – none

4. **Legal** – none

5. **Property/Assets** – none

6. **Information Technology** – none

7. **Equality & Human Rights** – Recommendations contained within this report have been assessed in relation to their impact on equalities and human rights. No negative impacts on equality groups or potential for infringement of individuals' human rights have been identified arising from the recommendations contained in the report because it is for noting only. If required following implementation, the actual impact of the recommendations and the mitigating actions will be reviewed and monitored, and the results of the assessment will be published on the Council's website.

8. **Health & Safety** – none

9. **Procurement** – none

10. **Risk** – The Treasury Management Strategy Statement and treasury management indicators provide a framework to take forward the Council's treasury activities in the context of the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. This mid-year review report demonstrates that the treasury management activities carried out during the period 1 April 2017 to 13 October 2017 have been consistent with the Treasury Management Strategy Statement 2017-2018 and have complied with the treasury management indicators set out in the Strategy Statement

11. **Privacy Impact** – none

12. **COSLA Policy position** - none

List of Background Papers

None

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Appendix 1

Borrowing and investment position as at 13 October 2017

	balance at 01-Apr-17	new borrowing in 2017-2018	principal repayments	debt restructuring	net cash movements	balance at 13-Oct-17
Long term borrowings						
PWLB - fixed	186,409,451.81	-	(10,175,233.04)	-	-	176,234,218.77
PWLB - variable	-	-	-	-	-	-
Market loans	52,916,000.00	-	-	-	-	52,916,000.00
	239,325,451.81	-	(10,175,233.04)	-	-	229,150,218.77
Short term borrowings						
Temporary loans	-	-	-	-	-	-
Renfrewshire Leisure Ltd	175,126.14	-	(175,126.14)	-	-	0.00
	175,126.14	-	(175,126.14)	-	-	0.00
Total external borrowings	239,500,577.95	-	(10,350,359.18)	-	-	229,150,218.77
Investments						
Fixed term deposits	94,250,000.00	-	-	-	22,450,000.00	116,700,000.00
Notice accounts	6,500,000.00	-	-	-	(6,500,000.00)	0.00
Call accounts	22,250,000.00	-	-	-	(4,250,000.00)	18,000,000.00
Money market funds	10,450,000.00	-	-	-	8,310,000.00	18,760,000.00
Total investments	133,450,000.00	-	-	-	20,010,000.00	153,460,000.00
Net borrowing	106,050,577.95	-	(10,350,359.18)	-	(20,010,000.00)	75,690,218.77

Appendix 2

Treasury Management Indicators as at 13 October 2017

	2017-2018 estimate	2017-2018 probable	2018-2019 estimate	2019-2020 estimate
Authorised limit for external debt	£430m	£407m	£473m	£542m
Operational boundary for external debt	£413m	£391m	£454m	£521m
Actual external debt at 13 October 2017	n/a	£309m	n/a	n/a
Upper limit for fixed interest rate exposure (borrowing) expressed as percentage of total net outstanding principal	100%	n/a	100%	100%
Upper limit for variable interest rate exposure (borrowing) expressed as percentage of total net outstanding principal	25%	n/a	25%	25%

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	new borrowing in 2017-2018		total of all borrowing	
	value	maturity structure	upper limit	actual at 13 Oct 2017
Maturity structure of fixed rate borrowing				
under 12 months	0	0%	15%	0.45%
12 months and within 24 months	0	0%	15%	1.54%
24 months and within 5 years	0	0%	45%	2.35%
5 years and within 10 years	0	0%	50%	5.55%
10 years and above	0	0%	100%	90.11%