Leicester
City Council

Appendix A

WARDS AFFECTED:
ALL WARDS (CORPORATE ISSUE)

EXECUTIVE **25th May 2017**
OVERVIEW SELECT COMMITTEE **22nd June 2017**

REVIEW OF TREASURY MANAGEMENT ACTIVITIES 2016/17

Report of the Director of Finance

1. Purpose of Report

1.1 This report reviews how the Council conducted its borrowing and investments during 2016/17.

1.2 2016/17 has seen continued economic growth in the UK and elsewhere. However, there are risks and this is discussed further in section 5.

1.3 We continue to monitor the impact of the "bail in" requirements for major depositors to inject funds into banks which are running into trouble, introduced earlier in the year. This is further discussed below.

2. Summary

2.1 Treasury Management is the process that ensures that the Council always has enough cash to make the payments that are necessary for its operations, and this involves both borrowing and investment. The Council's borrowing totals some £240 million; and during 2016/17 its investments varied from below £160 million to over £230 million depending on circumstances.

2.2 The Council has a prudent approach to treasury management. It does not borrow more than it needs; generally preferring to use cash balances as an alternative to borrowing. In recent years we have not needed to borrow at all. It only lends money to the safest institutions or funds.

2.3 The report commences with an overview of treasury management, including loans and investments at key dates. It then reviews the credit worthiness of investments and implementation of our strategy, provides outcomes on key performance measures and concludes by reviewing compliance against limits set by the Council.

3. Recommendations

3.1 Members of the Overview Select Committee are recommended to note the report and make any comments to the Director of Finance and the Executive as they wish.

4. **Overview of Treasury Management**

Main elements of Treasury Management

4.1 There are two main elements to treasury management. The first is managing our borrowings which have been taken out to finance capital expenditure. Most capital schemes are now financed by grant, and only a limited number of schemes of local significance are financed by borrowing. In the past the Government expected us to borrow but allowed for the cost of borrowing in our grant settlement, and we still have a lot of debt which was taken to meet this capital expenditure.

4.2 Historic debt can sometimes be restructured to save money, i.e. repaying one loan and replacing it with another and this is always given active consideration. In recent years, Government rule changes have normally made this prohibitively expensive.

4.3 The revenue budget approved by the Council for each financial year includes provision for the interest payable on this borrowing. It also includes a provision for repaying the borrowing over a number of years (broadly speaking over the economic life of the assets acquired).

4.4 The second element is cash management which involves managing the Council's investments to ensure the optimum amount of money is in the bank account on a day-to-day basis – so that there is enough money in the account to cover the payments made on the day but no more (cash held in the bank account earns neglible interest).

4.5 The Council has substantial investments but this is not "spare cash". Some comes from grants received in advance of expenditure and from reserves held for designated purposes. It also includes money set aside to repay debt but which has not been used to repay debt due to the punitive charges referred to above.

4.6 There is a budget for interest earned on investments as part of the Council's revenue budget.

Treasury Management Policy and Monitoring

4.7 The activities to which this report relates were governed by the Treasury Strategy for 2016/17 which was approved by the Council on 21st January 2016. This establishes an outline plan for borrowing and investment. The strategy is drawn up in the light of the Council's expected borrowing requirements, its expected cash balances, the outlook for interest rates and the credit worthiness of the banks with whom the Council might invest its cash balances.

4.8 A twice-yearly report is submitted to your Committee reviewing the treasury activity undertaken in the year. This report is the full-year report for 2016/17

Loans and Investments at Key Dates

4.9 Table 1 below shows the loans (money borrowed by the Council) and investments (money invested by the Council) at 03/11/2016 and 31/03/2017. The rates shown are the averages paid and received during 2016/17.

4.10 It can be seen that the level of gross debt (total loans borrowed) is unchanged at a level of £239m. No new loans have been borrowed and no debt restructuring has taken place.

4.11 Investments have decreased by £38m from £219m to £181m. This movement is broadly in line with expectations – cash balances at mid-year are typically high and subsequently decrease over the remainder of the financial year.

Table 1- Loans & Investments

	Position at 03/11/2016 Principal £M	Position at 31/03/2017 Principal £M	Average Rate
Long Term Fixed Rate Loans			
Public Works Loan Board (PWLB)	134	134	4.2%
Market & Stock	9	9	7.0%
Variable Rate Loans			
Bank Loans	96	96	4.4%
Gross Debt	239	239	4.4%
Investments			
Banks and Build Soc	82	73	
Other Local Authorities	110	100	
Government Debt Management Office	7	-	
Money Market Funds	20	8	
Total Investments	219	181	0.6%
NET BORROWING	**20**	**58**	

5. **Credit Worthiness of Investments**

5.1 2016/17 showed continued economic recovery within the UK economy and within the world economy. Within the Eurozone, economic and financial tensions have eased (especially in respect of Greece) but significant underlying issues remain. The impact of the EU referendum on the economy remains to be seen.

5.2 A number of countries present political risks over the next 12 months with elections or referenda. In France and Germany the presidential elections of recent months will be followed by legislative elections. China, which now has a significant impact on the world economy, faces the challenge of reforming its economy and ensuring that a managed slowdown in its rate of growth does not overshoot.

5.3 The economic consequences of the change in US administration remains to be seen. Taxation changes, if enacted, may boost demand within the US and lead to the repatriation of US companies' overseas holdings of dollars. The potential impact on the world economy may be significant, but is difficult to predict as such changes may impact on a number of markets including those dealing with currencies, government bonds and shares.

5.4 The governments of the largest world economies, including the UK, have implemented measures to make banks less likely to fail but also to reduce the impact on the financial system and on tax payers if they do fail. The measures for dealing with a failing bank see investors who have lent or deposited money taking significant losses before there is any tax payer support ("bail in"). Our assessment of risk is based both on the risk that banks fail (as measured by credit ratings) and also on the level of losses that we might face should the banks fail (or more likely require capital support to prevent failure)

5.5 These developments were reflected in the Council's approach to managing credit risk in its Treasury Strategy for 2016/17. It has adopted a cautious stance over the whole period covered by this report and has only directly lent to strong UK banks, other local authorities and the UK Government.

5.6 The position remains under review. One factor is that other regulatory developments are continuing to require or push banks towards greater financial robustness in terms of their liquidity (their ability to sustain large outflows of cash) and capital strength (their ability to absorb losses). One matter kept under review are the measures that will be put in place to require banks to "ring fence" bank deposits from other more risky activities. Banks have to complete this by 1st January 2019 but some banks plan to complete this earlier. The transition to these new arrangements creates some uncertainties and on a precautionary basis we have recently shortened the maximum period for which we will lend to some UK banks.

5.6 The Council has an indirect exposure to non-UK banks through its investment in money market funds. Money market funds are like "unit trusts" but rather than investing in company shares these funds invest in interest bearing investments such as bank deposits. When we open such funds they are vetted to ensure that they have strong investment and risk management processes to ensure a high level of credit worthiness in the underlying investments, and we receive advice from our treasury advisor, Arlingclose. Investing in this way helps manage credit risk by having a high level of diversification amongst the underlying banks and institutions to whom money is lent.

5.7 Most commentators believe interest rates will remain at historic low levels for a long time. If anything the indications are that rates are likely to remain low for longer than was envisaged when the 2016/17 strategy was set.

5.8 The Treasury Strategy 2016/17 permits investment in a property fund and serious consideration was given to that possibility earlier in that year. At that stage it was considered that the referendum on UK membership of the EU presented too many risks and uncertainties. This was confirmed by the fact that following the vote in favour of “Brexit”, the value of property funds fell and many funds blocked investors from selling their investments. These blocks have now been removed and it is considered that there is a good case for serious consideration of a cautious, limited, investment in a property fund and this is currently being explored for 2017/18.

5.9 The Council does not invest with the Co-op bank because of its weak financial state. It does, however, have a credit exposure to the Co-op bank in respect of balances held for operational purposes. This arises in respect of payments of Council Tax, rent etc. through the “Paypoint” system because the payments are processed through a Co-op bank account. A new supplier of this service has been appointed who does not process payments through the Co-op and when this new contract starts the credit exposure will cease. XXXX judging from last week’s news it sounds like we will know very soon what is happening with the Co-op bank, in which case we will redraft this paragraph as appropriateXXXX

6. <u>Implementation of Borrowing & Investment Strategy</u>

6.1 The strategy approved by Council for 2016/17 envisaged using cash balances instead of borrowing, and this strategy has been adhered to.

6.2 Given that the Council continues to have a high level of investments active consideration is given to the possible early redemption of a limited amount of debt. This, however, is not straightforward as debt repayment usually involves the payment of a premium. The level of such premiums payable in 2016/17 is too high for premature debt redemption to be viable.

7. <u>Other Sources of Capital Finance</u>

7.1 Major assets are funded primarily by grant or capital receipts. The acquisition of smaller assets such as vehicles and computer equipment can be financed by borrowing or leasing and a comparison is made in order to choose the option that is most cost effective. During the period under review, leasing has not been used, and assets have been bought outright.

8. <u>Key Performance Measures</u>

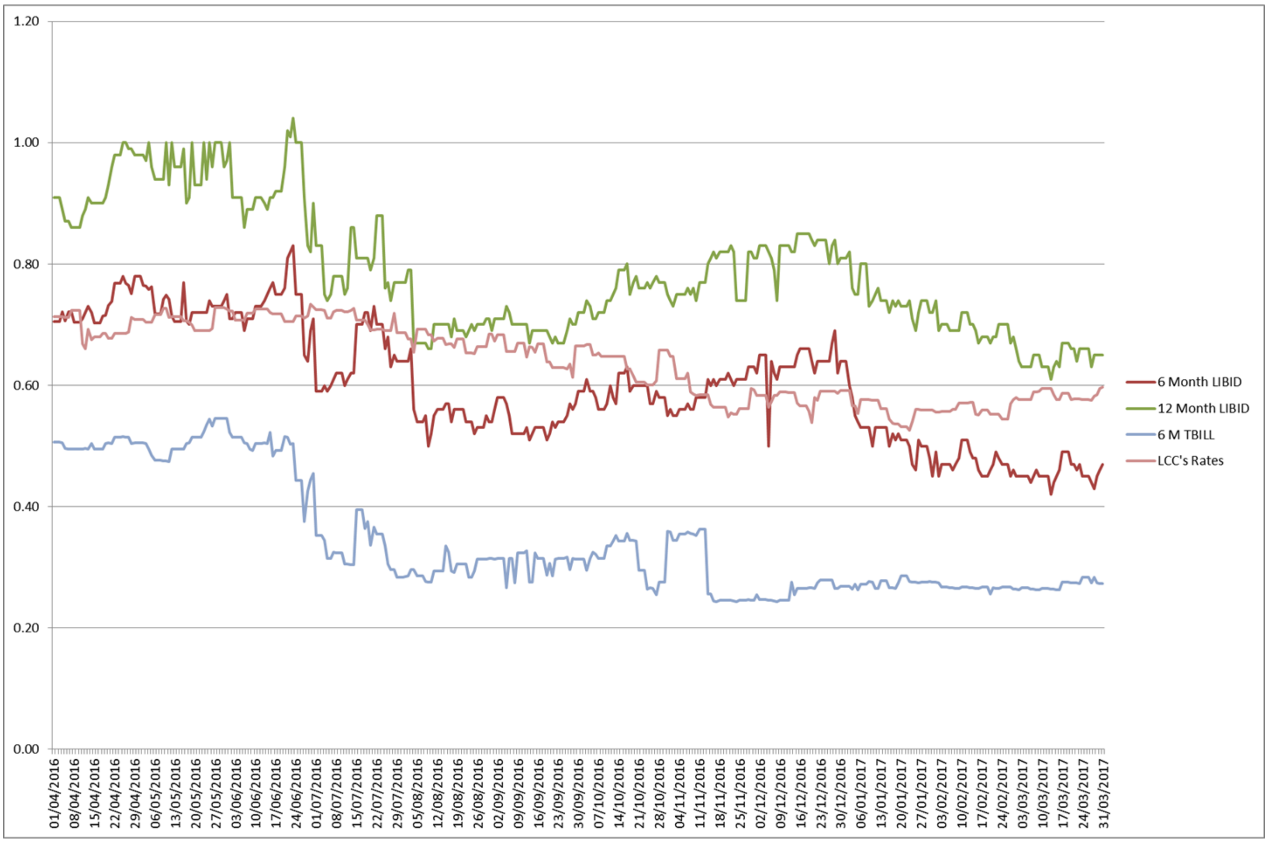
8.1 The most important performance measures are the rate of interest on the Council’s borrowings, the timing of borrowing decisions, the timing of decisions to prematurely repay debt and the return on investments. However, no new loans have been borrowed and no existing loans have been prematurely repaid.

8.2 The Council benchmarks its investments and the latest data is for the first six months of 2016/17. The average rate of interest on investments for participating authorities over the first six months of 2016/17 is 0.86%. The Council’s own rate is lower: 0.67%. This difference in performance can be attributed in part to the average rate for all authorities being boosted by a number of authorities that have invested in external funds with investment returns of between 5% and 7%. Once these are excluded the average rate of other authorities is 0.57%. Full year data for 2016/17 is not yet available but if available it would most likely present a broadly similar position.

8.3 Higher investment returns are available if higher credit risk is accepted. However, the trade-off between risk and reward was considered when investment strategies were set for 2016/17 and in the current economic climate continues to be a most important consideration. The "return of the principal" is considered more important than the "return on the principal", that is our primary concern is to ensure that the funds invested will be repaid on time and in full. This remains our approach during the current financial year.

8.4 During 2016/17 the average rate on the Council's pool of investments, calculated on a daily basis, rose from 0.71% on 1st April 2016 to a peak of 0.73% in May and by 31st March had fallen to 0.60%. This movement in the interest rate earned has broadly tracked movements in market interest rates. The current view of most commentators is that interest rates are likely to remain low for a long time.

*** following graph to be removed from final version– but shows interest rate movements ***



9. Use of Treasury Advisors

9.1 The Council are advised by Arlingclose Ltd. They advise on all aspects of treasury management but their main focus is on providing advice on the following matters:

- the creditworthiness of banks
- the most cost effective ways of borrowing
- appropriate responses to Government initiatives
- technical and accounting matters.

10. Compliance with the Council's Treasury Strategy

10.1 As required by the statutory borrowing framework, the Council is required to set a number of prudential limits and indicators, and is encouraged to supplement these with local indicators when appropriate. These limits are set annually and can be found within the budget and Treasury Strategy.

10.2 For the operational implementation of the Council's Treasury Management Strategy the most important limits and indicators that need to be monitored throughout the year are:

- The authorised limit – the maximum amount of borrowing that the Council permits itself to have outstanding at any one time
- The operational limit – a lower limit to trigger management action if borrowing is higher than expected.
- The maximum proportion of debt that is fixed rate.
- The maximum proportion of debt that is variable rate.
- Limits on the proportion of debt maturing in a number of specified time bands
- Limits on sums to be invested for more than 364 days

10.3 These limits are monitored, and have been complied with.

11. Financial and Legal Implications

11.1 This report is solely concerned with financial issues. Kamal Adatia, Legal Services has been consulted as Legal Advisor and there are no legal issues.

12. **Other Issues**

OTHER IMPLICATIONS	YES/NO	Paragraph References Within Supporting information
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	
Corporate Parenting	No	
Health Inequalities Impact	No	

13. **Background Papers**

13.1 The Council's Treasury Management Strategy - "Treasury Strategy 2016/17" – Council 21st January 2016. The Council's Treasury Policy Document – "Framework for Treasury Decisions" – Council 29 March 2012.

14. **Consultation**

14.1 Arlingclose Ltd (the Council's Treasury Management advisers).

15. **Author**

15.1 The author of this report is David Janes, Treasury Manager, on extension 37 4058.

Alison Greenhill
Director of Finance.