Leicester
City Council

WARDS AFFECTED:
ALL WARDS (CORPORATE ISSUE)

OVERVIEW SELECT COMMITTEE **14th December 2017**

MID-YEAR REVIEW OF TREASURY MANAGEMENT ACTIVITIES 2017/18

Report of the Director of Finance

1. **Purpose of Report**

1.1 This report reviews how the Council conducted its borrowing and investments during the first six months of 2017/18.

1.2 2017/18 has seen continued economic growth in the UK and elsewhere. However, there are risks and these are discussed further in section 5.

1.3 We continue to monitor the impact of the "bail in" requirements whereby major depositors could be forced 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 2017/18 its investments varied from £185 million to over £275 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 are financed by borrowing (generally those which pay for themselves). 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 2017/18 which was approved by the Council on 2nd February 2017 and amended on 5th October 2017. 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 mid-year report for 2017/18

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) as at 31/03/2017 and 7/11/2017. The rates shown are the averages paid and received during 2017/18.

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 increased by £72m from £186m to £258m. 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 31/03/2017 Principal £M	**Position at 07/11/2017 Principal £M**	**Average Rate**
Long Term Fixed Rate Loans			
Public Works Loan Board (PWLB)	134	134	4.2%
Market & Stock	34	34	4.9%
Variable Rate Loans			
Bank Loans	71	71	4.5%
Gross Debt	**239**	**239**	**4.4%**
Treasury Investments			
Banks and Build Soc	73	67	
Other Local Authorities	100	159	
Government Debt Management Office	-	4	
Money Market Funds	8	23	
Total Treasury Investments	**181**	**253**	**0.5%**
Local Investment Fund			
Loans	5	5	
Total Local Investment Fund Investments	**5**	**5**	9.3%
Total Investments	**186**	**258**	0.7%
NET BORROWING	**58**	**5**	

5. **Credit Worthiness of Investments**

5.1 2017/18 showed continued economic recovery within the UK economy and within the world economy. Within the Eurozone, economic and financial tensions have eased but significant underlying issues remain. The impact of the UK's exit from the EU on the economy remains to be seen.

5.2 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 (which includes us) 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 require capital support to prevent failure.

5.3 These developments were reflected in the Council's approach to managing credit risk in its Treasury Strategy for 2017/18. 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. Other lending has been part of pooled funds (see 5.5 below).

5.4 The position is continually under review. One factor is that other regulatory developments are continuing to require or push banks towards greater financial robustness. One matter kept under review is 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 until these are resolved the maximum period for which we will lend to some UK banks are shorter than might overwise be the case.

5.5 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.

5.6 The Council has a "Local Investment Fund" which invests in local commercial opportunities. This fund is managed within the Council's framework for managing capital expenditure and it is not considered in detail within this report. However, investments within this fund are included at table 1 below because the rationale of this fund is that it puts to work cash balances which would otherwise be invested in low interest paying deposits.

5.7 Most commentators believe interest rates will remain at low levels for a long time although it is unclear whether the recent increase in base lending rates will be followed by some further small increases

5.8 The Treasury Strategy 2017/18 permits investment in a property fund and at the time of writing this report a short list of funds is being evaluated.

5.9 The Council used to bank with the Co-op bank and started 2017/18 with some limited residual risk around income collection systems (for Council Tax, rent etc.). This exposure has ceased.

6. Implementation of Borrowing & Investment Strategy

6.1 The strategy approved by Council for 2017/18 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 2017/18 is high and premature debt redemption is usually not financially viable.

6.3 We hold £70m of debt which is described as variable rate loans in table 1. These are technically "LOBOs" which are fixed rate but on which the lender may ask for a rate rise. We have the option to repay if they do. Members may be aware of some criticism of LOBOs nationally, principally in respect of authorities which have complex mechanisms for calculating interest rates. We do not: we would be pleased to receive a request for a rate rise as we would then take the opportunity to repay. To all intents and purposes they are simply fixed rate loans.

6.4 Lenders would face large losses on these loans if they did request a rate rise which we then accepted. Accordingly they are unlikely to request such as rate rise. There are indications that some lenders may be open to negotiated repayments and we will explore such options.

7. Other Sources of Capital Finance

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. Key Performance Measures

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 2017/18.

8.3 Treasury investments comprise internally managed investments, longer maturity externally managed funds and in the case of Leicester its local investment fund.

8.4 The following table compares our performance against that of participating authorities. This information is available for internally managed investments (including money market funds) and externally managed funds. No comparative data is held for the local investment fund. The data is for income received but excludes fluctuations in the capital value of investments held in externally managed funds.

Investment	**Leicester City Council Revenue return**	**All Authorities Revenue return**
Internally managed	0.46%	0.54%
Externally Managed Funds		3.48%
Local Investment Fund	9.2%	n/a
Total	**0.63%**	**0.89%**

8.5 The average rate of interest on internally managed investments for participating authorities over the first six months of 2017/18 is 0.54%. The Council's own rate is lower: 0.46%. It is expected that changes to the lending strategy authorised by the revised strategy on 5th October 2017, and especially the addition of investments in property funds, will increase the Council's return.

8.6 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 2017/18 and in the current economic climate continues to be a most important consideration. The "return of the principal" is more important than the "return on the principal": 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.

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. 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.

10.4 In July 2017 loans were made to local authorities which resulted in the aggregate level of loans to all local authorities exceeding the limit set in the treasury strategy. This did not create a significant credit risk given the high level of credit worthiness of local government (second only to the UK Government itself). Monitoring processes were tightened in response to this event.

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 2017/18" (Council 22nd February 2017) and "Treasury Strategy 2017/18" (Council 5th October 2017). 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.