

FAREHAM

BOROUGH COUNCIL

Report to the Executive for Decision 05 November 2018

Portfolio:	Policy and Resources
Subject:	Treasury Management and Capital Monitoring Report 2018-19
Report of:	Director of Finance and Resources
Corporate Priorities:	A dynamic, prudent and progressive Council

Purpose:

This report summarises the Council's investment activity and capital expenditure up to 30 September 2018 and provides details of the Council's money market transactions. It also provides information on the performance against the Treasury and Prudential Indicators.

Executive summary:

During the first half of the year the Council operated within the Treasury and Prudential Indicators.

The overall investment position is set out in the following table:-

	31 March 2018 Actual £'000	Movement £'000	31 Sept 2018 Actual £'000
Total borrowing	52,017	(9,507)	42,510
Total investments	(12,000)	(750)	(12,750)
Net borrowing	40,017	(10,257)	29,760

A summary of the capital programme expenditure against budgets in the current year, is set out in the following table:-

Capital Programme	Budget 2018/19 £'000	Budget to 30 Sep 18 £'000	Actual to 30 Sep 18 £'000	Variation £'000
General Fund	14,760	2,442	2,100	-342
HRA	5,021	2,349	1,180	-1,169
Total	19,781	4,791	3,280	-1,511

Recommendation:

It is recommended that the Executive notes the Treasury Management and Capital Monitoring Report for 2018/19.

Reason:

To inform the Executive of the Council's investment, borrowing and repayment and capital programme activity up to 30 September 2018.

Cost of proposals:

Not applicable.

Appendices: **A:** Economic Commentary and Outlook by Arlingclose
 B: Treasury and Prudential Indicators

Background papers: None

Reference papers: Treasury Management Strategy and Prudential Indicators
 2018-19, Council, 23 February 2018
 Prudential Code for Capital Finance in Local Authorities
 (2017)
 Treasury Management in the Public Services Code of
 Practice (2017)

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BOROUGH COUNCIL

Executive Briefing Paper

Date:	05 November 2018
Subject:	Treasury Management Monitoring Report 2018-19
Briefing by:	Director of Finance and Resources
Portfolio:	Policy and Resources

INTRODUCTION

1. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management at least twice yearly (mid-year and at year end). This report therefore ensures the Council is implementing best practice in accordance with the Code.
2. The Council's Treasury Management Strategy for 2018/19 was approved by Full Council on 26 February 2018.
3. The Council has borrowed and invested large sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.
4. An economic commentary by the Council's Treasury Advisors, Arlingclose, can be found in Appendix A.
5. The report also includes progress to 30 September 2018 on the Capital Programme.

BORROWING ACTIVITY

6. At 30 September 2018, the Council held £42.5 million of loans, (a decrease of £9.5 million on 31 March 2018). The Council expects to borrow externally up to £8 million in 2018/19 to part fund the capital programme.
7. The Council's main objective when borrowing continues to be striking an appropriately low risk balance between securing low interest rates and achieving cost certainty over the period for which the funds are required.
8. In keeping with this objective, no new borrowing was undertaken, while all £10 million of existing short-term loans were allowed to mature without replacement.

9. With short-term interest rates remaining much lower than long-term rates, the Council considered it to be more cost effective in the near term to use internal resources rather than taking out short-term loans. This strategy enabled the Council to reduce net borrowing costs and reduce overall treasury risk.
10. Borrowing activity to 30 September 2018 was:

	Balance on 31 March 2018 £'000	Balance on 30 Sept 2018 £'000	Average Rate
Long-term borrowing	40,000	40,000	3.50%
Short-term borrowing	10,000	0	0.89%
Portchester Crematorium	2,017	2,510	0.25%
Total Borrowing	52,017	42,510	

The Council holds investments from Portchester Crematorium Joint Committee which is treated as a temporary loan.

INVESTMENT ACTIVITY

11. The Council holds large invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period, the Council's investment balance ranged between £10 and £18 million due to timing differences between income and expenditure.
12. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.
13. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2018/19. The policy details the high quality and secure counterparty types the Council can invest with.
14. Details on investment activity to 30 September 2018 are summarised in the table below:

	Balance on 31 March 2018 £'000	Balance on 30 Sept 2018 £'000	Average Rate
Long-term investments	2,000	2,000	4.13%
Short-term investments	7,000	10,000	0.77%
Cash and cash equivalents	3,000	750	0.68%
Total Investments	12,000	12,750	

COMMERCIAL PROPERTIES

15. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return.

16. The table below shows the current valuation of the commercial property investment acquisitions:

	Date of Purchase	Premises Type	Valuation £m
Clifton House, Segensworth	1 Aug 2013	Industrial	1,980
122-134 Seaside, Eastbourne	20 Dec 2013	Convenience Store	1,020
86-88 Mitcham Lane, Streatham	10 Mar 2014	Convenience Store	1,360
83 St Thomas St, Weymouth	29 Sept 2014	Retail	730
470 Ringwood Road, Poole	24 Nov 2014	Convenience Store	1,230
2 Armstrong Road, Oxford	20 Oct 2015	Nursery	1,980
136-138 Southampton Road, Park Gate	29 Feb 2016	Retail	7,535
Southampton Road Retail Park	16 Nov 2016	Retail	11,600
Total			27,435

17. The eight premises are expected to generate rental income of £1.9 million during 2018/19.

BUDGETED INCOME AND OUTTURN

18. Having raised policy rates in August 2018 to 0.75%, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon. Arlingclose's central case is for the Bank Rate to rise twice in 2019.
19. The Council's budgeted net interest received for the year is £459,900 (£417,911 was received in 2017/18).

COMPLIANCE WITH TREASURY AND PRUDENTIAL INDICATORS

20. The Council confirms compliance with its Treasury and Prudential Indicators for 2018/19, which was set on 26 February 2018 as part of the Council's Treasury Management Strategy.
21. Performance for the first half of the year is shown in Appendix B. During the financial year to date the Council has operated within the treasury limits and prudential indicators.

CAPITAL PROGRAMME

22. On 5 February 2018, the Executive approved the 2018/19 capital programme for General Fund services of £12.5m and Housing Revenue Account (HRA) of £5.5m giving a combined total of £18m.
23. Details of actual capital expenditure in 2017/18 were reported to the Executive on 9 July 2018 and it was noted that the carry forward on the capital programme for 2017/18 was £1.2 million for the General Fund and a £0.5 million spend ahead of the programme for HRA services. The net carry forward of £0.7 million has now been included in the capital programme for 2018/19.
24. Since the capital programme was approved earlier in the year, a number of new schemes, as shown below, have been added to the 2018/19 programme giving a revised total of £19.8m:-
- Hedge Cutting Plant and Machinery - £120,000
 - Play Area Improvement Programme - £500,000
 - Burrigge Village Hall Overflow Parking – £12,000
 - Night Time Closure of Multi-Storey Car Parks - £100,000
 - Depot Building Improvements - £220,000
 - Daedalus Gate Guardian - £100,000
25. The following table sets out the updated capital programme for 2018/19 and has been used as the basis for monitoring progress to 30 September 2018:-

	Approved Programme 2018/19 £	2017/18 Slippage £	New Schemes £	Updated Programme 2018/19 £
Health & Public Protection	0	0	100,000	100,000
Streetscene	569,700	61,500	0	631,200
Leisure & Community	316,100	104,000	512,000	932,100
Housing	840,000	308,200	0	1,148,200
Planning & Development	30,000	11,600	0	41,600
Policy & Resources	10,787,500	679,400	440,000	11,906,900
Total General Fund	12,543,300	1,164,700	1,052,000	14,760,000
Housing Revenue Account	5,498,000	(477,400)	0	5,020,600
Updated Capital Programme	18,041,300	687,300	1,052,000	19,780,600

MAJOR CAPITAL SCHEMES

26. The Council has a number of major capital schemes where budgeted expenditure for 2018/19 is in excess of £500,000. These schemes, with forecast budget to 30 September 2018, are detailed in the following table:-

Capital Scheme	Budget	Budget to	Actual to
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	2018/19 £	30 Sep 18 £	30 Sep 18 £	Variation £
Daedalus Schemes	9,486,800	550,000	507,633	-42,367
HRA Capitalised Repairs/Renewals	2,822,800	1,692,500	688,216	-1,004,284
Bridge Road	1,000,000	0	0	0
Vehicles and Plant	1,025,300	750,000	731,296	-18,704
HRA Stock Repurchases	794,300	556,500	483,949	-72,551
Civic Offices Improvement Programme	753,200	30,000	27,876	-2,124
Disabled Facilities Grant	646,700	354,500	301,062	-53,438
Play Area Improvement Scheme	500,000	0	0	0

27. Progress updates on the major schemes are detailed below:-

- (a) Most of the expenditure to date on the **Daedalus Schemes** relate to the refurbishment of the control tower and new car park and final works to the 6 new business hangars. The budget will be reprofiled to reflect current spending plans.
- (b) Expenditure to date for **HRA Capitalised Repairs/Renewals** is underspent against the budget to date in this financial year. A stock condition survey has been commissioned and will inform a detailed programme of works that will be reflected in the revised capital programme budget.
- (c) The capital budget for **Bridge Road** will be reprofiled to show consultants costs only in the current financial year and building costs in 2019/20 as the phasing of completion is reviewed.
- (d) Expenditure to date on **Vehicles and Plant** has been for three refuse trucks, three transit vans, a sweeper and various items of plant and machinery for grounds maintenance as part of bringing the hedge cutting contract back in-house.
- (e) Four properties have been purchased so far in the current financial year for **HRA Stock Repurchases**.
- (f) Expenditure on the **Civic Offices Improvement Programme** is expected to be less than budget for 2018/19. The budget will be reprofiled to reflect current spending plans.
- (g) Arrangements for the processing of **Disabled Facilities Grants** was passed to Portsmouth City Council on 1 April 2017. Expenditure for the first half of the year is slightly below budget.
- (h) The **Play Area Improvement Programme** has slipped due to the tendering process. Eight play area improvements will take place in 2019/20 and the budget will be reprofiled to reflect this.

CAPITAL MONITORING

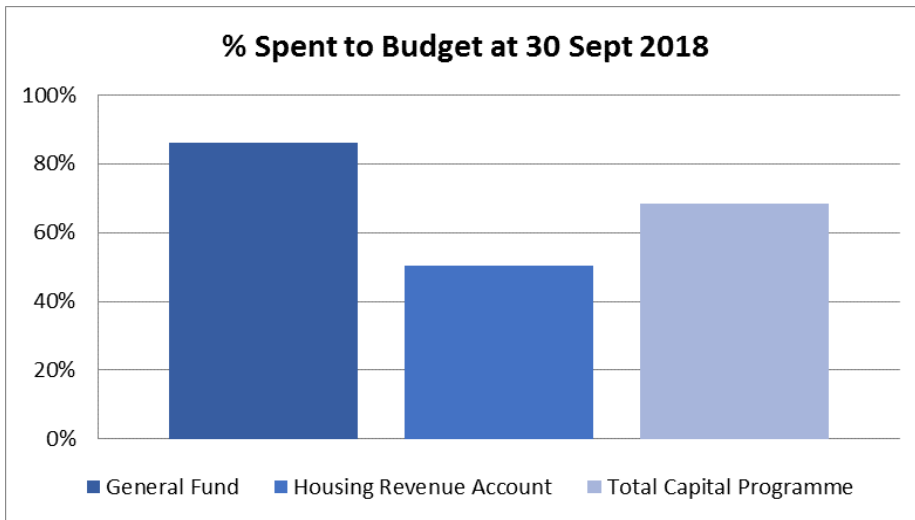
28. The following table provides summary information for the period to 30 September

2018, for the schemes within each portfolio.

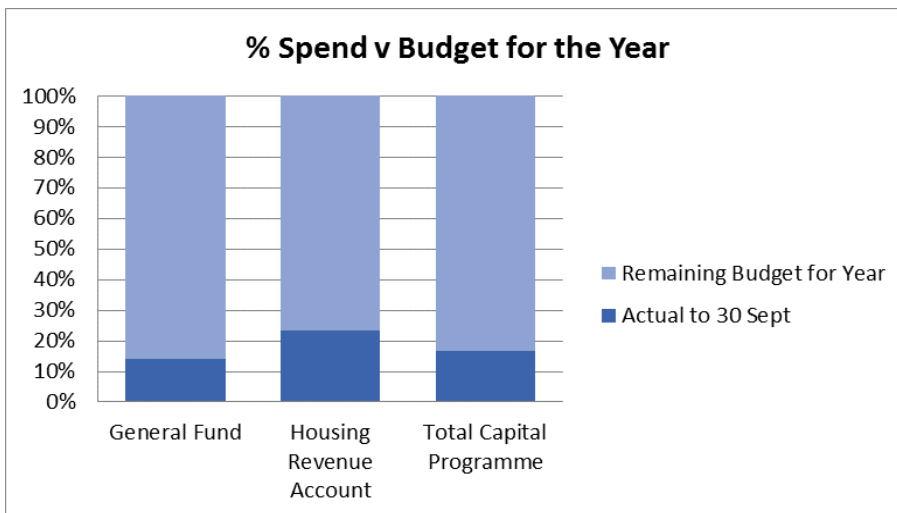
	Budget 2018/19	Budget to 30 Sep 18	Actual to 30 Sep 18	Variation
	£	£	£	£
Health and Public Protection	100,000	20,000	16,799	-3,201
Streetscene	631,200	20,000	75,775	55,775
- Holly Hill Cemetery Extension	274,500	0	880	880
- Bus Shelters	331,500	20,000	11,547	-8,453
- Other	25,200	0	63,348	63,348
Leisure and Community	932,100	474,000	141,849	-332,151
- Buildings	258,000	319,000	42,909	-276,091
- Play and Parks	585,000	135,000	88,248	-46,753
- Grants to Community Groups	25,000	0	0	0
- Other Community Schemes	64,100	20,000	10,693	-9,308
Housing	1,148,200	400,000	499,015	99,015
- Enabling	360,000	0	38,090	38,090
- Home Improvement Schemes	788,200	400,000	460,924	60,924
Planning and Development	41,600	37,682	67,654	29,972
- Car Parks	23,900	20,000	4,986	-15,014
- Coastal Protection	17,700	17,682	62,668	44,986
Policy and Resources	11,906,900	1,490,146	1,298,414	-191,732
- Daedalus	9,486,800	550,000	507,633	-42,367
- Civic Offices	753,200	30,000	27,876	-2,124
- Depot	220,000	0	0	0
- Vehicles and Plant	1,025,300	750,000	731,296	-18,704
- ICT	416,600	160,146	31,610	-128,536
- Town Centre Hotel	5,000	0	0	0
Total General Fund	14,760,000	2,441,828	2,099,505	-342,323
Housing Revenue Account				
- New Build	1,000,000	100,000	7,737	-92,263
- Capitalised Repairs/Renewals	2,822,800	1,692,500	688,216	-1,004,284
- Stock Repurchases	794,300	556,500	483,949	-72,551
- Other HRA Schemes	403,500	0	0	0
Total Housing Revenue Account	5,020,600	2,349,000	1,179,901	-1,169,099
Total Capital Programme	19,780,600	4,790,828	3,279,406	-1,511,422

29. The graphs below show the actual expenditure to 30 September 2018 as a percentage of the programme for the equivalent period and for the whole year.

30. 68% of the capital programme has been spent compared to the profiled budget for the first half of the year.



31. 17% has been spent compared to the total budget for the year. The budgets will be reviewed and re-phased where applicable as part of the forthcoming budget setting process.



RISK ASSESSMENT

- 32. In the current economic climate, there are continued risks that financial institutions holding Council investments could default and be unable to fulfil their commitments to repay the sums invested with them.
- 33. To help mitigate this risk, the Council maintains a list of approved institutions based on a grading system operated by the Council's treasury management advisors. Maximum limits are also set for investments with individual institutions.

Enquiries:

For further information on this report please contact Caroline Hancock (Ext 4589).

ECONOMIC COMMENTARY BY TREASURY ADVISORS ARLINGCLOSE

Economic background: Oil prices rose by 23% over the six months to around \$82/barrel. UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year, above the consensus forecast and that of the Bank of England's in its August *Inflation Report*, as the effects of sterling's large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages. However real wages (i.e. adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.

The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year/year GDP growth at 1.2% also remains below trend. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in each of June and September by 0.25% to the current 2%-2.25%. Markets now expect one further rise in 2018.

The escalating trade war between the US and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just to China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019.

The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29th March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

Financial markets: Gilt yields displayed marked volatility during the period, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven UK, German and US government bonds. Over the period, despite the volatility, the net change in gilt yields was small. The 5-year benchmark gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%. The increase in Bank Rate resulted in higher money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

Credit background: Reflecting its perceived higher risk, the Credit Default Swap (CDS) spread for non-ringfenced bank NatWest Markets plc rose relatively sharply over the period to around 96bps. The CDS for the ringfenced entity, National Westminster Bank plc, has held steady below 40bps. Although the CDS of other UK banks rose marginally over the period, they continue to remain low compared to historic averages.

The ringfencing of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc – is complete, the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018.

There were a few credit rating changes during the period. Moody's downgraded Barclays Bank plc's long-term rating to A2 from A1 and NatWest Markets plc to Baa2 from A3 on its view of the credit metrics of the entities post ringfencing. Upgrades to long-term ratings included those for Royal Bank of Scotland plc, NatWest Bank and Ulster Bank to A2 from A3 by Moody's and to A- from BBB+ by both Fitch and Standard & Poor's (S&P). Lloyds Bank plc and Bank of Scotland plc were upgraded to A+ from A by S&P and to Aa3 from A1 by Moody's.

Our treasury advisor Arlingclose will henceforth provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in. Arlingclose's creditworthiness advice will continue to include unsecured bank deposits and CDs but not senior unsecured bonds issued by commercial banks.

2018/19 INDICATORS – HALF YEARLY PERFORMANCE

PRUDENTIAL INDICATORS

1) Level of Planned Capital Expenditure

ON TRACK

This prudential indicator is a summary of the Council's capital expenditure plans and shows how these plans are being financed by capital or revenue resources.

Capital Expenditure and Financing	Original Estimate £'000	Actual to 30 Sept £'000
Health and Public Protection	0	17
Streetscene	570	76
Leisure and Community	316	142
Housing	840	499
Planning Development	30	68
Policy and Resources	10,787	1,298
Total General Fund	12,543	2,100
HRA	5,498	1,180
Total Expenditure	18,041	3,280
Capital Receipts	856	198
Capital Grants	2,031	850
Capital Reserves	6,017	1,271
Revenue	1,326	768
Internal Borrowing	7,811	193
Total Financing	18,041	3,280

Expenditure to 30 September is within the overall original budget for the year. The budgets will be reviewed and re-phased where applicable as part of the forthcoming budget setting process to take account of carry forwards from 2017/18 and new schemes approved during the year.

2) The Council's Borrowing Need (Capital Financing Requirement)

ON TRACK

The Capital Financing Requirement (CFR) is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure financed by borrowing will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing in line with the asset's life.

ON TRACK

	Estimate £'000	Actual to 30 Sept £'000
General Fund	44,546	39,600
HRA	50,681	51,149
Total CFR	95,227	90,749

The CFR is slightly lower than projected due to lower internal borrowing for Daedalus capital expenditure.

ON TRACK

3) Financing Costs as % of Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

	Estimate	Actual to 30 Sept
General Fund	3%	7%
HRA	14%	14%
Total	10%	13%

ON TRACK

4) Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and housing rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

	Estimate	Actual to 30 Sept
Council tax band D	£1.22	£1.23
Weekly housing rent levels	£0.04	£0.34

ON TRACK

5) Housing Revenue Account (HRA) Ratios

Due to the HRA Reforms in 2012, the Council moved from a subsidy system to self-financing and was required to take on £49.3 million of debt. The table below shows additional local indicators relating to the HRA in respect of this debt.

	Estimate	End of Year Forecast
HRA debt £'000	49,268	49,268
HRA revenues £'000	11,140	12,594
Number of HRA dwellings	2,400	2,411
Ratio of debt to revenues %	4.42:1	3.91:1
Debt per dwelling £	£20,528	£20,435

TREASURY INDICATORS

6) Investments - Principal Sums Invested for Periods Longer than 364 days

ON TRACK

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

£M	Estimate	Actual
Principal sums invested > 364 days	10	2

£2 million is placed with a pooled property fund which is a long-term investment and the remaining investments are currently placed for less than 364 days to allow cash to be available for schemes in the capital programme that require internal borrowing.

7) Borrowing - Gross Debt and the Capital Financing Requirement

ON TRACK

In order to ensure that over the medium-term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence. The indicator shows that total debt is expected to remain below the CFR.

£'000	Estimate £'000	Actual to 30 Sept £'000
Debt at 1 April	51,835	42,510
Expected change in debt	7,800	193
Gross Debt at 31 March	59,635	42,703
Capital Financing Requirement (CFR)	95,227	90,749
Under/(Over) Borrowing	35,592	48,046
CFR for last, current and next 2 years	332,649	370,611

8) Borrowing - Limits to Borrowing Activity

ON TRACK

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

	Limit £'000	Actual £'000
Operational Boundary		
Borrowing	63,000	42,510
Other long-term liabilities	5,000	0
Total	68,000	42,510
Authorised Limit		
Borrowing	105,000	42,510
Other long-term liabilities	7,000	0
Total	112,000	42,510

Total debt at 30 September was £42.5 million. During the first half of 2018/19 the Authorised Limit of £112 million was not breached at any time.

9) Interest Rate Exposures

ON TRACK

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed are, shown in the table below.

Upper limits on interest rate exposures	Limit %	Actual %
Upper limit on variable interest rate exposures	25	2
Upper limit on fixed interest rate exposures	100	100

10) Maturity Structure of Borrowing

ON TRACK

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing are:

Maturity structure of borrowing	Upper Limit %	Actual %
Loans maturing within 1 year	25	6
Loans maturing within 1 - 2 years	25	0
Loans maturing within 2 - 5 years	25	0
Loans maturing within 5 - 10 years	50	0
Loans maturing in over 10 years	100	94

The £40m HRA loans represent 94% of loans maturing in over 10 years. The Council holds investments from Portchester Crematorium which is treated as a temporary loan. These represent 6% of loans maturing within 1 year.