Kirklees COUNCIL

Name of meeting: Corporate Governance and Audit Committee, 11 May 2018

Title of report: Annual Report on Treasury Management 2017-18

Purpose of report
Financial Procedure Rules require that the Council receives an annual report on Treasury Management activities for the previous financial year. The report reviews borrowing and investment performance.

Key Decision - Is it likely to result in spending or saving £250k or more, or to have a significant effect on two or more electoral wards?	**Not applicable**
Key Decision - Is it in the [Council's Forward Plan (key decisions and private reports)?]	**Yes**
The Decision - Is it eligible for "call in" by Scrutiny?	**No**
Date signed off by Strategic Director & name **Is it also signed off by the Service Director for Finance, IT and Transactional Services?** **Is it also signed off by the Service Director for Governance and Commissioning Support?**	**Rachel Spencer-Henshall 2 May** **Eamonn Croston 2 May** **Karl Larrard 2 May**
Cabinet member portfolio	**Cllr Graham Turner** **Cllr Musarrat Khan**

Electoral wards affected: Not applicable

Ward councillors consulted: Not applicable

Public or private: **Public**

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1. Summary

1.1 The Council's treasury management operation for the year has followed the strategy approved by Council on 15 February 2017. Investments averaged £37.9 million, were largely deposited in instant access accounts and earned an average interest rate of 0.26%. Total external borrowing decreased for the year by £25.0 million to £413.2 million. (£438.2m 31st March 2017) The decrease is due to a variety of reasons including; repayment of existing debt, slippage in the capital plan and increases in reserves due to policy changes. The majority of borrowing is on fixed rate terms and the average borrowing rate for 2017-18 was 4.76%.

1.2 In 2017-18 the Council approved a revision to its Minimum Revenue Provision (MRP) policy, which relates to the amount of revenue resources set aside each year to provide for its outstanding debt repayments over the longer term. This was done by updating its approach to Supported Borrowing from 2007-08 onwards, moving from a 4% reducing balance to an annuity basis in its repayment of debt.

1.3 In updating the approach the Council effectively over-provided in previous years the re-payment of debt to the sum of £91.1m. Within the Treasury Management Strategy 2018-19 the Council set out its approach to unwind this over-provision at £9.1m each year over the next 10 years, starting from 2017-18 onwards. Within the 2017-18 accounts this has resulted in the budgeted over-provision element of £9.1m being transferred to financial resilience reserves in order to strengthen the Council's overall financial resilience as per the Council's approved reserves strategy.

1.4 Treasury management costs incurred in the year include £10.4 million on net interest payments and £4.1 million on providing for the repayment of debt (MRP). The Council complied with its treasury management prudential indicators in the year.

1.5 This report also notes a number of early 2018-19 treasury management issues for consideration. These include options for re-financing two current Lender Option-Borrower Option loans at £10m each, and a proposed amendment to the treasury management strategy to include a further potential loan funding source; SALIX Finance, a government funded interest free loan funding body for public sector services. It also considers potential Council investment in a property fund investment fund, CCLA, specifically set up for not-for profit investors, including local authorities.

2. Information required to take a decision

2.1 Background

2.1.1 The Council has adopted the CIPFA Code of Practice on Treasury Management and operates its treasury management service in compliance with this Code and various statutory requirements. These require that the prime objective of the activity is to secure the effective management of risk, and that borrowing is undertaken on a prudent, affordable and sustainable basis.

2.1.2 Financial Procedure Rules require that the Council receives an annual report on Treasury Management activities for the year. Cabinet is responsible for the implementation and monitoring of the treasury management policies. Corporate Governance and Audit Committee undertake a scrutiny role with regard to treasury management.

2.1.3 In reviewing performance, reference will be made to the Treasury Management Strategy Report approved by Council on 15 February 2017.

2.2 Borrowing and Investment Strategy 2017-18

2.2.1 The Councils overall Treasury Management Strategy prioritises security, liquidity and risk management which was adhered to in 2017-18. The Council aims to invest externally balances of £30 million, largely for the purpose of managing day-to-day cash flow requirements, with any remaining balances invested "internally", offsetting borrowing requirements. The investment strategy is designed to minimise risk, investments being made primarily in instant access accounts or short-term deposits, with the major British owned banks and building societies, or Money Market Funds.

2.3 The economy and interest rates

Below paragraphs 2.3.1-2.3.2 are a commentary from our external treasury management advisors, Arlingclose

2.3.1 2017-18 was characterised by the push-pull from expectations of tapering of Quantitative Easing (QE) and the potential for increased policy rates in the US and Europe and from geopolitical tensions, which also had an impact.

2.3.2 The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. Although in March two MPC members voted to increase policy rates immediately and the MPC itself stopped short of committing itself to the timing of the next increase in rates, the minutes of the meeting suggested that an increase in May 2018 was highly likely.

2.4 Investment activity

2.4.1 The Council's treasury management investments totalled £36.1 million as at 31 March 2018 (£31.3 million 31 March 2017). The Council invested an average balance of £37.9 million externally during the year (£41.8 million 2016-17). Income of £98k was generated through these investments (£153k 2016-17). Appendix 1 shows where investments were held at the beginning of April, the end of September and the end of March, by counterparty, by sector and by country. The Council's average lending rate for the year was 0.26% (0.37% 2016-17). The fall in rates between the years reflects the Base Rate in 16-17 being 0.5% until autumn and then a reduction to 0.25%. In the current year there has been 4 months at the increased rate of 0.5%, but there is also an element of lag in institutions passing on the benefit of higher interest rates.

2.4.2 The majority of investments were placed in instant access bank deposit accounts/Money Market Funds (MMFs). MMFs offer greater diversification of counterparties and thus lower risk, as well instant access and relatively good returns.

2.5 Borrowing requirement and debt management

2.5.1 In terms of borrowing, long-term loans at the end of the year totalled £392.5 million and short-term loans (excluding interest accrued) £20.7 million (£400.5 million and £37.7 million 31 March 2017), an overall decrease of £25.0 million. There was no new long term borrowing in 2017-18. Appendix 2 details repayments of long-term loans during the year and short-term loans outstanding as at 31 March 2018.

2.5.2 Fixed rate loans account for 80.5% of total long-term debt (see also Appendix 5, expressed as a percentage of net interest payments) giving the Council stability in its interest costs. The maturity profile for all long-term loans is shown in Appendix 3 and shows that no more than 9% of all debt is due to be repaid in any one year. This is good practice as it reduces the Council's exposure to a substantial borrowing requirement in future years when interest rates might be at a relatively high level.

2.5.3 The primary source of the Council's borrowing is from the Government ie Public Works Loan Board (PWLB).

2.5.4 The table below sets out the estimated external borrowing requirement against actual requirements;

	2017-18 £m estimated	**2017-18 £m** actual
General Fund CFR - Non PFI	437.9	412.8
PFI	52.3	52.3
HRA CFR - Non PFI	182.8	182.8
PFI	54.9	54.9
Total CFR	727.9	710.3
Less: Other debt liabilities*	111.3	106.3
Borrowing CFR	616.6	603.2
Less: Deferred Liabilities	4.1	4.1
Less: Internal borrowing	104.3	185.9
PWLB Loans	278.6	278.6
LOBOs	76.6	76.6
Loan Stock (Fixed Rate)	7.0	7.0
Other LT Loans (Fixed Rate)	30.3	30.3
Temporary Borrowing	115.7	20.7
Total : External Borrowing	508.2	413.2
Investments	30.0	36.1

2.5.5 As can be seen from the table above the temporary borrowing requirement is far lower than expected due to a combination of an increase in internal balances (it was expected that these would reduce in year by £38.0m from £146.4m) and additional slippage in the capital plan of £21.8m.

2.5.6 The Local Capital Finance Company established in 2014 by the Local Government Association as an alternative source of local authority finance. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. It has yet to issue any loans but officers will continue to monitor developments of this potential new funding source.

2.5.7 In terms of debt rescheduling, the premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity in 2017-18.

2.5.8 The average long term borrowing rate for 2017-18 for the Council's long-term loans outstanding was 4.76% (4.78% 2016-17).

2.6 Trends in treasury management activity

2.6.1 Appendix 4 shows the Council's borrowing and investment trends over the last 5 years. This highlights the current trend to re-pay long term debt at maturity and where required borrow over the short term.

2.7 Risk and Compliance Issues

2.7.1 The Council has complied with its prudential indicators for 2017-18, which were approved as part of the Treasury Management Strategy. Details can be found in Appendix 5. Indicators relating to affordability and prudence will be reported in the forthcoming 2017-18 Financial Outturn report to Cabinet and Council in June and July 2018.

2.7.2 When the Council has received unexpected monies late in the day, officers have no alternative but to put the monies into the Barclays Business Reserve Account overnight. The account is maintained so that usually, daily balances are under £100k. The maximum daily amount deposited in this account overnight as a result of unexpected late payments was £1.381m. Whilst this is not an ideal situation, the Council is still within investment limits as per the Treasury Management Strategy which is set at £10m per counterparty.

2.7.3 In line with Council treasury management strategy, the Council has not placed any direct investments in companies as defined by the Carbon Underground 200.

2.7.4 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's consultants (Arlingclose), has proactively managed the debt and investments over the year.

2.7.5 The CIPFA Code of Practice requires that treasury management performance be subject to regular member scrutiny. The Corporate Governance and Audit Committee performs this role and members have received reports on strategy, half yearly monitoring and now the outturn for the year 2017-18. Training was provided to Members on the 17th November 2017.

Looking ahead – Treasury Management developments in 2018-19

2.8 Re-financing/re-payment of current Long Term Borrowing

2.8.1 As outlined within the Council approved Treasury Management Strategy 2018-19, the Council will continue to look to repay existing long term debt when the opportunity arises where it becomes beneficial for the Council to do so.

2.8.2 Within the next 12 months there are 2 Lenders Option Borrowers Option (LOBO) loans which may present us with an option to convert or re-finance and these as detailed further below.

2.8.3 The Council currently has a £10.0m Range LOBO with Barclays. The Range LOBO has an annual rate of interest of 3.4% when the 6 month London Interbank Offered Rate (LIBOR) Rate is between 4%-6%, and a rate of 4.1% when it falls outside of this. Currently the LIBOR Rate is 0.83% and hasn't been as high as 4% since November 2008. The current interest rate is therefore 4.1%.

2.8.4 Barclays have approached the Council to convert the LOBO into a fixed rate of interest. The rate is currently subject to discussion between both parties, and would remain until maturity of the loan on 15th January 2067. This could generate immediate savings per annum. By way of illustration, a mid-point fixed rate of 3.75% would equate to immediate £35k annual savings to the Council for the remainder of the loan.

2.8.5 The Council also has a £10.0m LOBO loan with Commerzbank. The rate of interest applied for the first 2 years of the loan was 3.8%, which then increased to 5.0% after the first 2 years as per the signed agreement. This LOBO loan matures on the 9th June 2042.

2.8.6 Commerzbank have also approached the Council to review options for re-paying this loan early.

2.8.7 On both LOBO loans the Lender has the option to exercise their right to change the interest rate. At which point the borrower can then choose to accept the new interest rate or choose to re-pay at no additional cost.

2.8.8 It is intended that Council officers liaise with the Council's external Treasury Management advisors, Arlingclose, to review both lender options, and proceed if they are considered to be in the longer term best interests of the Council.

2.9 Loan Funding Sources

2.9.1 The Council may be presented with additional sources of long-term funding at certain points in time, beyond those currently listed in the Council's current treasury management strategy. These may be at preferential rates of interest and therefore the Chief Financial Officer (s151 officer) will look to maximise the use of source funds when it is preferential to do so.

2.9.2 One opportunity is a source of funding from SALIX Finance Ltd. SALIX provides interest free Government funding to the public sector to improve their energy efficiency, reduce carbon emissions and lower energy bills. The Council has taken the opportunity to apply to SALIX for interest-free loan funding to be applied against the £11m Council approved street lighting replacement scheme within the 2018-19 – 2022-23 Capital Plan, which would otherwise be funded entirely from Council prudential borrowing.

2.9.3 SALIX has approved an in-principle £5.9m interest-free loan, repayable over a 7 year period.

2.9.4 The in-principle SALIX loan agreement requires Council approval to incorporate this type of loan product into its overall borrowing portfolio. It is estimated that this would save the Council £55k in interest payments over the period of the scheme, based on current short-term borrowing rates. If interest rates were to increase, the comparable savings to the Council would be higher.

2.10 Investment Opportunities

2.10.1 The Local Authorities Property Fund was established in 1972, and is managed by CCLA Fund Managers. Any Local Authority in the United Kingdom can invest in the Fund, and the minimum investment is £25k. The Fund aims to provide investors with a high level of income and long-term capital appreciation, and it is an actively managed, diversified portfolio of UK commercial property. It principally invests in UK assets, but may invest in other assets. There is an accompanying prospectus and factsheet attached to this report, for information.

2.10.2 Such funds tend to generate a higher rate of return. For example, (2016-17 returned 3.07% dividend on the Local Authority Property Fund compared with the Council's average rate of return on investments of 0.37%.

2.10.3 Clearly there are increased risks associated with higher yield investment opportunities, and any potential investment would need to be considered very much as a much longer term investment strategy, pro-actively managed by CCLA, to manage those risks over time.

2.10.4 Investment opportunities in funds such as the CCLA are not part of the current Treasury Management Investment Strategy for 2018-19.

2.10.5 The annual budget report to Budget Council on 14 February 2018, in setting out the treasury management strategy for 2018-19, noted that the strategy reflected the pre-existing CIPFA Prudential Code and statutory Government guidance on Investment strategy and Minimum Revenue Provision. The CIPFA code and Government statutory guidance was updated early 2018, and officers intend to bring forward an updated Treasury Management Strategy, for member consideration, at the same time as the Budget Strategy Update report, in Autumn 2018.

2.10.6 It is proposed that as part of the treasury management strategy update, officers will bring forward more detailed proposals for potential investment in the Local Authority Fund and any other investment opportunities.

3. Implications for the Council

3.1 Early Intervention and Prevention (EIP) – no impact
3.2 Economic Resilience (ER) – no impact
3.3 Improving Outcomes for Children – no impact
3.4 Reducing demand of services - no impact

3.5 Other implications – Any changes in assumed borrowing and investment requirements, balances and interest rates will be reflected in revenue budget monitoring reports during the year.

4. Consultees and their opinions

None.

5. Next steps

Comments and feedback from CGAC will be incorporated into this report which will be subsequently considered at Cabinet in June and Council in July 2018 as part of the overall financial outturn and rollover report 2017-18.

6. Officer recommendations and reasons

CGAC are asked to recommend the following for Cabinet and Council approval ;

6.1 note treasury management performance in 2017-18 as set out in this report;

6.2 agree officer proposals to review the two LOBO loan re-financing options in conjunction with Arlingclose, and to proceed if considered beneficial to the Council;

6.3 agree an amendment to the existing borrowing strategy to incorporate

SALIX Finance as an interest free loan funding source; and

6.4 note officer intention to bring forward more detailed proposals regarding potential investment in the Local Authority Fund, as part of the Treasury Management strategy update later in the year, for member consideration

7. Contact officer

Eamonn Croston Acting Service Director for Finance, IT and Transactional Services

James Buttery Finance Manager

8. Background Papers and History of Decisions

CIPFA's Code of Practice on Treasury Management in the Public Services.
CIPFA's Prudential Code for Capital Finance in Local Authorities.
MHCLG Investment Strategy Guidance
Public Works Loan Board Website.
Treasury Management Strategy Report approved by Council on 14 February 2018.
Local Authorities Property Fund & Factsheet

9. Service Director responsible

Eamonn Croston 01484 221000

APPENDIX 1

Kirklees Council Investments 2017/18											
		Credit	**1 April 2017**			**30 September 2017**			**31 March 2018**		
Counterparty		**Rating**	**£m**	**Interest**	**Type of**	**£m**	**Interest**	**Type of**	**£m**	**Interest**	**Type of**
		Mar 2018*		**Rate**	**Investment**		**Rate**	**Investment**		**Rate**	**Investment**
Specified Investments											
Bank of Scotland	Bank	F1/A+	1.3	0.20%	Instant Access			Instant Access			Instant Access
Svenka Handelsbanken	Bank	F1+/AA			Instant Access	8.0	0.20%	Instant Access			Instant Access
Std Life	MMF**	AAAmmf	8.7	0.28%	Instant Access	10.0	0.20%	Instant Access	9.9	0.46%	Instant Access
Aviva	MMF**	Aaa-mf	7.3	0.22%	Instant Access	10.0	0.16%	Instant Access	10.0	0.42%	Instant Access
Deutsche	MMF**	AAAmmf	6.9	0.20%	Instant Access			Instant Access	9.0	0.37%	Instant Access
Goldman Sachs	MMF**	AAAmmf	7.1	0.20%	Instant Access	3.5	0.13%	Instant Access	7.2	0.37%	Instant Access
			31.3			**31.5**			**36.1**		
Sector analysis			**£m**	**%age**		**£m**	**%age**		**£m**	**%age**	
Bank			1.3	4%		8.0	25%				
Building Society											
MMF**			30.0	96%		23.5	75%		36.1	100%	
Local Authorities/Cent Govt											
			38.3	100%		**31.5**	100%		**36.1**	100%	
Country analysis			**£m**	**%age**		**£m**	**%age**		**£m**	**%age**	
UK			1.3	4%							
Sweden						8.0	25%				
MMF**			30.0	96%		23.5	75%		36.1	100%	
			31.3	100%		**31.5**	100%		**36.1**	100%	

*Fitch short/long term ratings, except Aviva MMF (highest Moody rating). See next page for key. ** MMF – Money Market Fund. These funds are domiciled in Ireland for tax reasons, but the funds are made up of numerous diverse investments with highly rated banks and other institutions. The credit risk is therefore spread over numerous countries, including the UK. The exception to this is the Aviva Government Liquidity Fund which invests directly in UK government securities and in short-term deposits secured on those securities.

Key – Fitch's credit ratings:

		Long	Short
Investment Grade	Extremely Strong	AAA	
		AA+	
	Very Strong	AA	F1+
		AA-	
		A+	
	Strong	A	F1
		A-	
		BBB+	F2
	Adequate	BBB	
		BBB-	F3
Speculative Grade		BB+	
	Speculative	BB	
		BB-	
		B+	B
	Very Speculative	B	
		B-	
		CCC+	
		CCC	
	Vulnerable	CCC-	C
		CC	
		C	
	Defaulting	D	D

Appendix 2

Long-term loans repaid and short-term loans outstanding 31 March 2018

Long-term loans repaid during 2017/18

	Amount £000s	Rate %	Date repaid
Repayments on maturity			
PWLB (498358)	2,768	4.24	21 Aug 17
PWLB (496734)	4,613	8.375	6 Dec 17
Repayments on annuity loans			
PWLB (496956)*	322	4.58	29 Sep 17
PWLB (496956)*	329	4.58	29 Mar 18
Total	**8,032**		

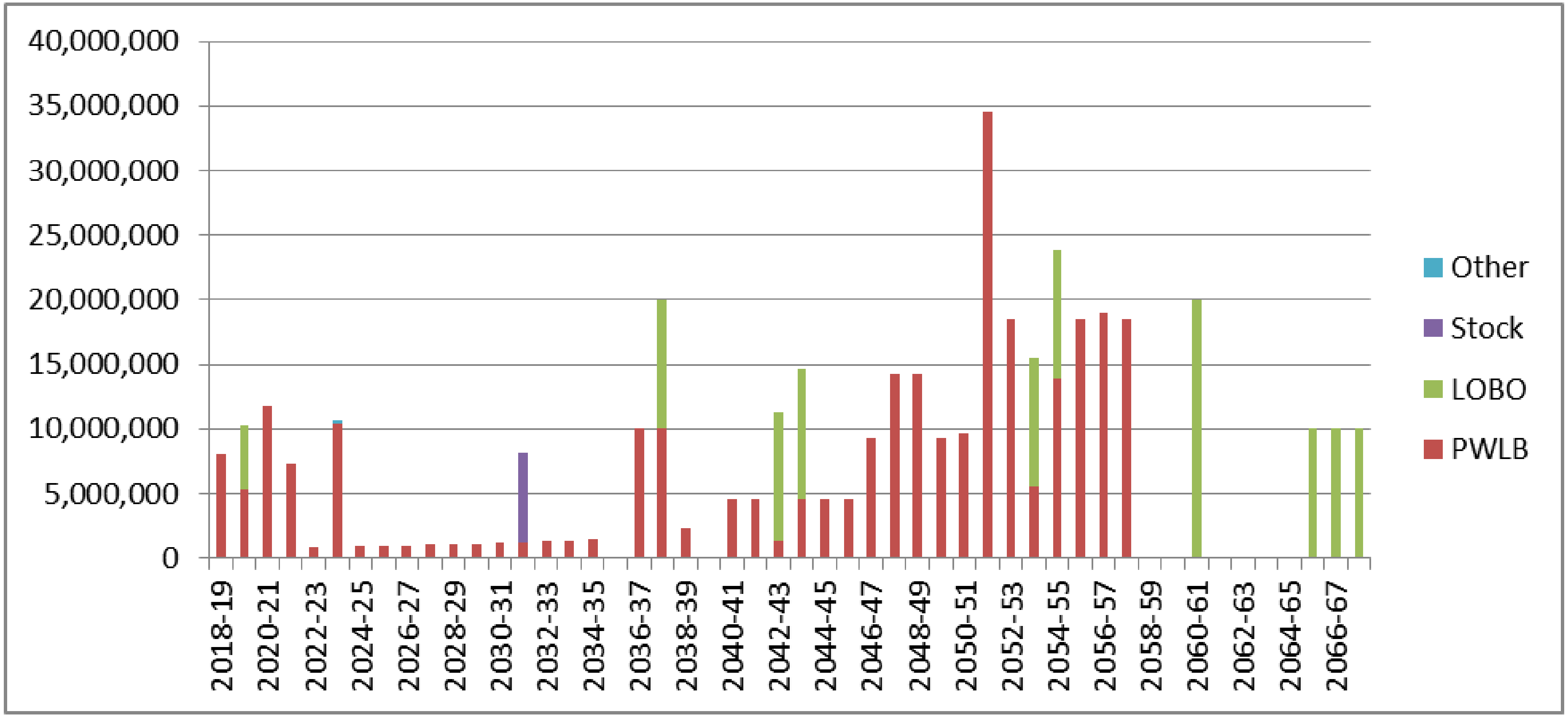
* represents loan extended to Kirklees College, for which the College is making similar repayments to the Council

Short-term loans outstanding 31 March 2018

	Amount £000s	Rate %	Length (days)
Temporary borrowing from the Money Market			
London Borough of Newham	5,000	0.45	19
Gateshead Council	5,000	0.55	9
Local lenders/Trust Funds	2,626		
Long-term loans due to mature in the next twelve months	8,062		
Total*	20,688		

* excludes interest accrued

Kirklees Council Loan Maturity Profile (All Debt) **Appendix 3**



Appendix 4

Kirklees Council - Borrowing and Investment Trends

At 31 March	2018	2017	2016	2015	2014
Investments	36.1m	31.3m	38.3m	38.7m	33.1m
ST Borrowing (excl interest accrued)	20.8m	37.7m	16.0m	21.1m	29.6m
LT Borrowing	392.4m	400.5m	408.4m	422.6m	432.4m
Total Borrowing	413.2m	438.2m	424.4m	443.7m	462.0m
Deferred liabilities (non PFI)	4.1m	4.1m	4.3m	4.4m	4.5m
Net debt position	**373.0m**	**411.0m**	**390.4m**	**409.4m**	**433.4m**
Capital Financing Requirement (excl PFI)					
General Fund	420.3m	412.8m	411.3m	422.2m	447.5m
HRA	182.8m	186.2m	192.4m	196.6m	203.3m
Total CFR	**603.2m**	**599.0m**	**603.7m**	**618.8m**	**650.8m**
Balances “internally invested”	185.9m	156.7m	175.0m	170.7m	184.3m
Ave Kirklees’ investment rate for financial year	0.3%	0.4%	0.5%	0.4%	0.4%
Ave Base rate (Bank of England)	0.3%	0.3%	0.5%	0.5%	0.5%
Ave LT Borrowing rate (1)	2.5%	2.5%	3.2%	3.7%	4.3%

(1) Based on average PWLB rate throughout the year on a 20 year loan repayable on maturity.

APPENDIX 5

Treasury Management Prudential Indicators

Interest Rate Exposures

While fixed rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance justifies retaining a degree of flexibility through the use of variable interest rates on at least part of the treasury management portfolio. The Prudential Code requires the setting of upper limits for both variable rate and fixed interest rate exposure:

	Limit Set 2017-18	Actual 2017-18
Interest at fixed rates as a percentage of net interest payments	60% - 100%	86%
Interest at variable rates as a percentage of net interest payments	0% - 40%	14%

The interest payments were within the limits set.

Maturity Structure of Borrowing

This indicator is designed to prevent the Council having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate	Limit Set 2017-18	Actual Levels 2017-18
Under 12 months	0% - 20%	3%
12 months to 2 years	0% - 20%	2%
2 years to 5 years	0% - 60%	6%
5 years to 10 years	0% - 80%	4%
More than 10 years	20% - 100%	85%

The limits on the proportion of fixed rate debt were adhered to.

Total principal sums invested for periods longer than 364 days

The Council has not invested any sums longer than 364 days.