Gateshead Council

REPORT TO AUDIT AND STANDARDS COMMITTEE
02 OCTOBER 2017

TITLE OF REPORT: **Treasury Management – Performance to 30 September 2017**

REPORT OF: **Darren Collins – Strategic Director, Corporate Resources**

Purpose of the Report

1. The purpose of this report is to review Treasury Management performance for the six months to 30 September 2017, covering investments and borrowing. This is consistent with approved performance management arrangements.

Background

2. The mid-year performance of the Treasury Management Service is reported in line with CIPFA's Code of Practice on Treasury Management and the Council's Treasury Policy Statement and Treasury Strategy which was approved by Council on 16 March 2017.

3. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

4. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations.

5. Accordingly, treasury management is defined as:

   "The management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

6. The primary objective of the investment strategy is to safeguard the Council's assets with a secondary objective of obtaining an optimum rate of return on investments and minimising the costs of borrowing.

Investment Performance

7. The latest projection of gross investment income for 2017/18 based on interest earned to date and expected interest to March 2018 is £0.315m, compared to the original estimate of £0.190m.

8. This gross investment interest is adjusted to account for £0.171m interest payable to third parties and interest receivable of £1.293m from various third parties, the most significant of which is Newcastle International Airport. This gives a projected net interest to the General Fund 2017/18 of £1.437m compared to the budget of £1.312m. The current variance to budget is mainly as a result of higher levels of investment balances than anticipated when the 2017/18 budget was set.

Rate of Return

9. The average rate of return is monitored for each investment type that the Council enters into and these are used to calculate an average rate of return for the Council for the year to date. The current rate of return is 0.49%, which is greater than the original estimate of 0.32%.

10. As a means of benchmarking, the average rate of return for the month and year to date is compared to the equivalent 7 day London Inter-Bank Bid Rate (LIBID), which is the rate that banks are willing to borrow money from each other. The monthly return of 0.04183% exceeds the LIBID 7 day rate equivalent of 0.00937%. The Council's average rate of return of 0.49123% is also well in excess of the equivalent LIBID 7 day rate of 0.11152%.

11. The quarterly Capita Asset Services Investment Benchmarking report assesses both the rate of return and the risk of the counterparty to calculate a weighted average rate of return, which is used for comparison across other authorities. In the most recent report received, June 2017, the Council achieved a weighted average rate of return of 0.50% on its investments which is in line with the risk adjusted expectations defined in the benchmarking report. The Council is between the lower (0.43%) and upper (0.55%) performance boundaries which compares over 200 Local Authorities against an expected rate of return based on the amount of risk applied.

12. This rate of return would be expected to decrease during the year as investment balances reduce and current deposits are replaced with shorter, lower yielding deposits.

13. It is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.25% Bank Rate. Capita Asset Services indicate in their forecast that there is no expectation of a Bank Rate rise until Q2 2019 which reflects huge uncertainty following the EU Referendum. Given this scenario investment returns are likely to remain relatively low for the remainder of the year.

Heritable Bank

14. The Council had a deposit of £2.792m at risk in Heritable Bank, a wholly owned subsidiary of an Icelandic bank, Landsbanki, when it entered administration in October 2008. The full deposit in Heritable was due to mature by the end of 2008/09 with interest. The majority of the investment has been recovered leaving a balance outstanding of £0.056. The most recent update from the administrators, Ernst and Young, advised of a further extension of the Administration for a year, to 6 October 2017, any final distribution will be made after this time.

Borrowing

15. The total borrowing for the Council and HRA as at 30 September 2017 was £645.189m, which was within the operational borrowing limit of £800m. This borrowing is made up of £500.189m PWLB loans and £145m market loans.

16. The Treasury Strategy estimates for the 2017/18 financial year were based on a borrowing requirement of £51.751m. To date this year the Council has taken a combination of £10m long term borrowing from the PWLB and £25m in the form of short term Market Loans. The timing of further borrowing will depend on a combination of cash flow requirements to support the capital programme and achieving preferential borrowing rates at the time.

17. The current forecast for interest payable on borrowing is allocated to the General Fund and the Housing Revenue Account (HRA) as shown in the following table:

	General Fund	**HRA**
Interest Payable	£11.434m	£14.825m
Average rate of interest	3.81%	4.43%

This represents a gross saving of £0.930m on the original estimate, of which £0.589m is a saving for the General Fund and £0.341m is for the HRA.

Summary of Mid-year Performance

18. The projected net impact of investment and borrowing activity on the revenue budget in 2017/18 is an underspend of £1.056m, comprising £0.715m General Fund and £0.341m HRA.

General Fund	**Estimate £m**	**Projected Outturn £m**	**Variance £m**
Investments	(1.312)	(1.437)	(0.125)
Borrowing	12.024	11.434	(0.590)
Net Position	10.712	9.997	(0.715)

19. Investment returns are likely to remain relatively low during 2017/18 and beyond and interest rates are expected to be below long term borrowing rates therefore value for money considerations indicate that best value can be obtained by delaying new external borrowing and by using internal cash balances to finance new capital expenditure in the short term (this is referred to as internal borrowing).

20. The current approach of borrowing internally provides benefits in terms of reduced credit risk, as the Council has less cash invested than if it had gone to the markets and borrowed externally. This means that cash balances and investment returns, are historically low resulting in reduced levels of income, which is significantly outweighed by the savings achieved from avoiding external borrowing.

21. Internal borrowing does have an element of interest rate risk on the overall treasury management position, if interest rates were suddenly to rise but this is being taken

into account when discussing potential borrowing options with our treasury management advisers, CAPITA

Recommendation

22. The Committee is asked to note the Treasury Management Performance to 30 September 2017.