Gateshead Council

REPORT TO AUDIT AND STANDARDS COMMITTEE
01 OCTOBER 2018

TITLE OF REPORT: **Treasury Management – Performance to 30 September 2018**

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 2018, 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 22 March 2018.

3. The Council operates a balanced approach, and this means broadly that 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 2018/19 based on interest earned to date and expected interest to March 2019 is £0.559m, compared to the original estimate of £0.417m.

8. This gross investment interest is adjusted to account for £0.254m interest payable to third parties and interest receivable of £1.591m from various third parties, the most significant of which is Newcastle International Airport. This gives a projected

net interest to the General Fund 2018/19 of £1.896m compared to the budget of £1.525m. The current variance to budget is mainly as a result of higher levels of interest received on loans to third parties than anticipated when the 2018/19 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 0.70%, which is greater than the original estimate of 0.59%.

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 0.06467% exceeds the LIBID 7-day rate equivalent of 0.04849%. The Council's year to date rate of return of 0.70050% is also well in excess of the equivalent LIBID 7-day year to date rate of 0.40245%.

11. The quarterly LINK 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, September 2018, the Council achieved a weighted average rate of return of 0.72% on its investments for Quarter 1 2018/19 which is in line with the risk adjusted expectations (0.61% to 0.74%) defined in the Benchmarking Report for our Group.

12. The 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. The investment market remains very difficult in terms of actuarial earning levels with much dependent in the near future on achieving a reasonable Brexit agreement which benefits both the UK and the EU. Given this scenario investment returns are likely to remain relatively low for the remainder of the year.

Brexit and the Economy

14. The Bank of England's Monetary Policy Committee (MPC) sets UK monetary policy using a 2% inflation target. Following the release of the Quarterly Inflation Report the Committee voted unanimously to increase Bank Rate by 0.25%, to 0.75% from 2nd August 2018. However, they have emphasised that future Bank Rate increases would be at a gradual pace and to a limited extent with a projected Bank Rate of 2.50% in ten years' time.

15. The deadline for the UK's departure from the European Union is March 2019. Our Treasury Management advisors, LINK Asset Services are forecasting that the next Bank Rate rise will not happen before the Brexit deadline and that the MPC are more likely to wait until August 2019 before they increase rates again.

Borrowing

16. The total borrowing for the Council and HRA as at 30 September 2018 was £641.915m, which was within the operational borrowing limit of £850m. This borrowing is made up of £516.915m PWLB loans and £125m market loans.

17. The Treasury Strategy estimates for the 2018/19 financial year were based on a borrowing requirement of £78.363m. To date this year the Council has taken £5m long term borrowing from the PWLB. 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.

18. 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	£12.193m	£13.942m
Average rate of interest	3.66%	4.15%

This represents a gross saving of £1.936m on the original estimate, of which £1.042m is a saving for the General Fund and £0.894m is for the HRA.

Summary of Mid-Year Performance

19. The projected net impact of investment and borrowing activity on the revenue budget in 2018/19 is an underspend of £2.307m, comprising £1.413m General Fund and £0.894m HRA.

General Fund	Estimate £m	Projected Outturn £m	Variance £m
Investments	(1.525)	(1.896)	(0.371)
Borrowing	13.235	12.193	(1.042)
Net Position	11.710	10.297	(1.413)

20. Investment returns are likely to remain relatively low during 2018/19 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).

21. 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.

22. Internal borrowing does incur an additional element of interest rate risk on the overall treasury management position, but this is being taken into account and

mitigated by the monitoring and review of potential borrowing options and overall market conditions.

Recommendation

The Committee is asked to note the Treasury Management Performance to 30 September 2018.