

Subject:	TREASURY MANAGEMENT - QUARTER 2 REPORT 2018/19
Meeting and Date:	Governance – 13 December 2018 Cabinet – 14 January 2019 Council – 30 January 2019
Report of:	Mike Davis, Strategic Director (Corporate Resources)
Portfolio Holder:	Councillor Mike Connolly, Portfolio Holder for Corporate Resources and Performance
Decision Type:	Non-Key Decision
Classification:	Unrestricted
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 30 September 2018 (Q2) and an update of activity to date.
Recommendation:	That the report is received.

1. Summary

- 1.1 The Council's investment return for the period to September was 2.02% (annualised), which outperformed the benchmark¹ by 1.28%. Interest and dividends income achieved for the period was £548k; the year-to-date (YTD) budget is £500k. The Council's projected investment return for 2018/19 is £1,173k, which is £174k better than the original budget estimate of £999k. This improvement is due to additional funds being invested in pooled investment funds, as detailed below.
- 1.2 The Council has remained within its Treasury Management guidelines and has complied with the Prudential Code guidelines during the period.

2. Introduction and Background

- 2.1 CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2011; it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this Council is implementing best practice in accordance with the Code.
- 2.2 Council adopted the 2018/19 Treasury Management Strategy (TMS) on 7th March 2018 as part of the 2018/19 Budget and Medium Term Financial Plan.
- 2.3 In order to comply with the CIPFA code referred to above, a brief summary is provided below and Appendix 1 contains a full report from the Council's Treasury Management Advisors, Arlingclose.
- 2.4 Members are asked to note that in order to minimise the resource requirements in producing this report, Arlingclose's report has been taken verbatim. Treasury

¹ The "benchmark" is the interest rate against which performance is assessed. DDC use the 3 month London Inter-Bank Bid Rate or LIBID, as its benchmark, which was 0.74 at the end of the quarter.

advisors generally use a more journalistic style than is used by our officers, but in order to avoid changing the meaning or sense of Arlingclose's work, this has not been edited out.

3. **Economic Background**

- 3.1 The report attached (Appendix 1) contains information up to the end of September 2018; since then we have received the following update from Arlingclose (in italics). Please note that any of their references to quarters are based on *calendar* years:

"Main points since September:

- i. Brexit: UK and EU have agreed the Withdrawal Agreement, which is legally binding, on separation issues and the financial settlement. On 12th December UK MPs will vote on the deal. Uncertainty remains given continuing opposition to the proposed deal.*
- ii. UK GDP: Q3 GDP (July to September) was estimated at 0.6%, the strongest quarterly growth since Q4 2016. This was driven by a strong summer, particularly July, but some signs of weakness emerged for September. Longer-term economic growth remained subdued.*
- iii. Inflation: CPIH 2.2% and CPI 2.4% in October, both the same as in September.*
- iv. Labour market: Unemployment rose slightly to 4.1%. Wage growth increased to 3.2%, the fastest pace since 2008, suggesting upward pressure on domestic inflation.*
- v. Bank of England: MPC voted to keep Bank Rate at 0.75% in November. The Inflation Report hinted that the pace of further rate rises would need to be increased if Brexit goes smoothly. Growth forecasts were downgraded for 2018 and 2019.*
- vi. Financial market volatility continued – concerns on trade wars, increases in US interest rates and weakening global growth among the drivers."*

4. **Annual Investment Strategy**

- 4.1 The investment portfolio, as at the end of September 2018, is attached at Appendix 2. Total balances held for investment and cash-flow purposes were £50.3m, decreasing to £49.8m at the end of October (see Appendix 4). The decrease reflects normal cash-flow fluctuations arising from the timing of 'major preceptor' payments, which are made over twelve months, while the Council Tax receipts that fund them typically come in over the ten months to January and then decline. Additionally, a further PWLB loan instalment was paid at the end of September 2018 of £2.35m.
- 4.2 As at 30 September 2018, the Council's investment portfolio totalled £48m (see Appendix 2). Cashflow funds were lower than anticipated (£2.3m at 30 September 2018) as £8m was invested in the CCLA Diversified Income Fund and a further £4m was invested in the Investec Diversified Income Fund during the quarter. It is proposed that the additional income generated from these additional investments is transferred to the Special Projects reserve to support future funding for projects.
- 4.3 Cashflow funds have since decreased slightly (to £1.8m at 31 October 2018) due to normal cashflow fluctuations. Short term borrowing will be used to cover fluctuations in the cash flow requirements as required, instead of holding excess funds in call accounts.

5. **New Borrowing**

5.1 As at 30 September 2018 the Council did not anticipate rescheduling any of its long term debt. However, since that time, the Council received notification that KA Finanz were proposing to sell their LOBO (Lender Option Borrower Option) loan portfolio, and the Council was invited to submit a bid to repurchase its £3m LOBO from them. The LOBO was held at an interest rate of 4.75% and had 25 years remaining on the loan. An assessment of the long term costs of the LOBO compared to alternative borrowing options was undertaken and a bid of £3.6m was submitted to the auction process. This bid was successful and work is underway to complete the transaction.

5.2 The refinancing of the LOBO will be initially financed from DDC cashflow. It is not proposed to undertake new long term borrowing to offset this at this time. However, short term borrowing may be undertaken to cover any shortfalls in cashflow.

5.3 The Council's borrowing portfolio is attached at Appendix 3. A £3 million short term loan was taken out with Bristol City Council on the 27 September 2018 to cover a temporary short fall in cash flow monies. This was repaid on the 31 October 2018.

6. Debt Rescheduling

6.1 At this time it is not of benefit to the Council to consider any further rescheduling of its long-term debt.

7. IFRS Statutory Override

7.1 IFRS 9 requires certain investments to be accounted for at fair value through profit and loss, which would potentially have introduced "more income statement volatility" that could have impacted on budget calculations. Basically, movements in the fair value would have impacted the CIES and result for the year, even where investments were being held for the long-term, such that expected 'buy-in' costs for pooled funds (including impact of stamp duty for property funds) and other short-term fluctuations would have had to be recognised at the balance sheet date, even though there would be no intent to sell them, i.e. these short-term capital losses were unlikely to be realised when eventually sold.

7.2 MHCLG consulted on a potential statutory overrides relating to the IFRS 9 Financial Instruments accounting standard from 2018/19, as mentioned in Appendix 1. Following the consultation, MHCLG have decided to implement a statutory override for fair value movements in pooled funds for at least five years until 31st March 2023. This enables the ring-fencing of £2m in the Dover Regeneration & Economic Development reserve to cover such fluctuations to be removed, releasing the funds and making them available for future projects.

8. Compliance with Treasury and Prudential Limits

8.1 The Council has operated within the Prudential Indicators in compliance with the Council's Treasury Management Practices.

9. Corporate Implications

9.1 Comment from the Section 151 Officer: Finance have produced this report and have no further comments to add. (DL)

9.2 Comment from the Solicitor to the Council: The Head of Legal Services has been consulted during the preparation of this report and has no further comment to make.

- 9.3 Comment from the Equalities Officer: This report does not specifically highlight any equality implications, however in discharging their duties members are reminded to comply with the public sector equality duty as set out in section 149 of the Equality Act 2010 <http://www.legislation.gov.uk/ukpga/2010/15>

10. **Appendices**

Appendix 1 – Arlingclose treasury management report for quarter two

Appendix 2 – Investment portfolio as at 30 September 2018

Appendix 3 – Borrowing portfolio as at 30 September 2018

Appendix 4 – Investment portfolio as at 31 October 2018

11. **Background Papers**

Medium Term Financial Plan 2018/19 – 2021/22

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