

**To:** City Executive Board  
**Date:** 18 September 2018  
**Report of:** Head of Financial Services  
**Title of Report:** Treasury Management Annual Report 2017/2018

<b>Summary and Recommendations</b>	
<b>Purpose of report:</b>	The report sets out the Council's Treasury Management activity and performance for the financial year 2017/2018.
<b>Key decision:</b>	No
<b>Executive Board Member:</b>	Deputy Leader - Finance & Asset Management (Councillor Ed Turner)
<b>Corporate Priority:</b>	An Efficient and Effective Council.
<b>Policy Framework:</b>	Treasury Management Strategy.
<b>Recommendations:</b> That the City Executive Board resolves to:	
1. Note the report	

<b>Appendices</b>
None

## Executive Summary

1. The Council held investments of £80.96 million as at 31st March 2018. Interest earned during the year was £1.55 million against a target of £1.23 million.<sup>1</sup>
2. The average rate of return on the Council's investments in 2017/18 was 1.17% compared to 1.05% in 2016/17. The Council's performance target is 0.6% above base rate, equating to 0.85% for April-October 2017 and 1.1% for November 2017-March 2018.
3. The Council has £0.17 million outstanding with the failed Icelandic Banks. Nothing was received in the year and the viability of the remaining balance is under review. If it is felt that this is likely to be irrecoverable, the balance will be written off. Writing off the balances would not stop the Council continuing to take any actions it could to get the funds returned. The write-off is just an "accounting treatment" of the monies owing. Further information can be found in paragraphs 25-28.
4. The Council held £198.5 million of fixed rate Public Works Loan Board (PWLB) debt as at 31st March 2018. The debt was borrowed in March 2012 to fund the

<sup>1</sup> Budget 17-18 Summary item 8 = 7,701,722 – 6,470,240 (PWLB)

buy-out of the Housing Revenue Account (HRA). All of the debt relates to Housing and the maturity profile ranges from 4 to 40 years. Interest paid on the debt in 2017/18 was £6.47 million.

## Background

5. The primary principle governing the Council's investment decisions is the Security of the investment, with Liquidity and Yield being secondary considerations.
6. The Council has a statutory duty to set, monitor and report on its prudential indicators in accordance with the Prudential Code, which aims to ensure that the capital investment plans of authorities are affordable, prudent and sustainable.
7. When considering whether to borrow, the Council's Debt Strategy requires a number of factors to be considered. These include:
  - prevailing interest rates
  - the profile of the Council's debt portfolio
  - the type of asset being financed
  - the availability of cash balances to finance capital expenditure.
8. The Council fully complied with its Treasury Management Strategy in relation to both debt and investment management in 2017/18.
9. The prudential indicators detailed in the body of this report compare the Council's outturn position against the target set for 2017/18.

## Financing the Capital Programme 2017/18

10. Table 1 below shows actual capital expenditure and financing compared to the original budget.

**Table 1**

<b>Capital Expenditure</b>	<b>2017/18 Original Budget £'000</b>	<b>2017/18 Actual £'000</b>	<b>Variation £'000</b>
Non-HRA Capital Expenditure	40,938	18,811	-22,127
HRA Capital Expenditure	21,225	18,899	-2,326
<b>Total Capital Expenditure</b>	<b>62,163</b>	<b>37,710</b>	<b>-24,453</b>
<b>Resourced by:</b>			
Developer Contributions	2,572	1,371	-1,201
Capital Receipts	10,823	5,947	-4,876
Capital Grants and contributions	2,411	5,408	2,997
Major Repairs Reserve	19,491	7,087	-12,404
Prudential Borrowing	17,420	305	-17,115
Revenue	9,446	17,592	8,146
<b>Total Capital Resources</b>	<b>62,163</b>	<b>37,710</b>	<b>-24,453</b>

## The Council's Overall Borrowing Need

11. The Council's underlying need to borrow, or Capital Financing Requirement (CFR), is the measurement and control of the Council's overall debt position. It represents all prior years' net capital expenditure which has not been financed by other means, i.e. revenue, capital receipts, grants etc.
12. The CFR can be reduced by:
  - The application of additional capital resources, such as unapplied capital receipts; or
  - By charging a Minimum Revenue Provision (MRP), or a Voluntary Revenue Provision (VRP)
13. Table 2 below shows the Council's CFR as at the 31<sup>st</sup> March 2018, this is a key prudential indicator, and shows that actual borrowing is below the CFR:

**Table 2**

<b>CFR</b>	<b>31st March 2018 Estimate £'000</b>	<b>31st March 2018 Actual £'000</b>	<b>Variation £'000</b>
<b>Opening Balance</b>	<b>225,352</b>	<b>222,875</b>	<b>-2,477</b>
Prudential Borrowing	17,420	305	-17,115
Minimum Revenue Provision	-37	-37	0
<b>CFR Closing Balance</b>	<b>242,735</b>	<b>223,143</b>	<b>-19,592</b>
<b>External Borrowing</b>	<b>198,528</b>	<b>198,528</b>	<b>0</b>
<b>Variation</b>	<b>-44,207</b>	<b>-24,615</b>	<b>19,592</b>

14. No new external debt was taken out during 2017/18 and as at 31<sup>st</sup> March 2018 the Council's total external debt was £198.5 million. This is below the CFR and indicates that the Council continues to internally borrow. The prudential borrowing level was lower than that estimated due partly to a reduction in expenditure, including the external capital loans made to Oxford West End Developments Limited and the Housing Company, and the use of capital resources other than borrowing to finance capital expenditure.

## Treasury Position at 31st March 2018

15. Whilst the Council's gauge of its underlying need to borrow is the CFR, the treasury function manages the Council's actual need to borrow by either:
  - Borrowing to the CFR;
  - Choosing to utilise temporary cash flow funds, instead of borrowing (known as "under borrowing");
  - Borrowing for future increases in the CFR (borrowing in advance of need)
16. The Council's treasury position as at the 31<sup>st</sup> March 2018 for both debt and investments, compared with the previous year is set out in Table 3 below:

**Table 3**

Treasury Position	31st March 2017		31st March 2018	
	Principal £'000	Average Rate %	Principal £'000	Average Rate %
<b>Borrowing</b>				
Fixed Interest Rate Debt	198,528	3.15	198,528	3.15
<b>Total Debt</b>	<b>198,528</b>	<b>3.15</b>	<b>198,528</b>	<b>3.15</b>
<b>Investments</b>				
Fixed Interest Investments	47,990	0.61	61,000	0.63
Call Accounts	0	0.00	7,000	0.80
Variable Interest Investments	18,360	0.56	2,960	0.46
Property Funds	10,000	4.05	10,000	4.50
<b>Total Investments</b>	<b>76,350</b>	<b>1.05</b>	<b>80,960</b>	<b>1.17</b>
<b>Net Position</b>	<b>122,178</b>		<b>117,568</b>	

17. Overall, the Council earned a weighted average return of 1.17% on its investment which is above the target of 0.6% above base rate, equating to 1.10% as at 31<sup>st</sup> March 2018.
18. The Council achieved its target due to the base rate rise that occurred in the latter half of the financial year. Fresh investments placed after the Monetary Policy Committee's decision to increase base rate on 2<sup>nd</sup> November 2017 saw improved rates of return, it is important to note that the majority of the Council's investments are held in fixed deposits and therefore any investments already in existence at that point would not have benefited from the increase; this is one of the risks attributed to yield. The majority of investments are linked to base rate and therefore, the overall rate of return saw a gradual increase towards the end of the financial year, a trend that is expected to continue or at least be maintained for 2018/19.

### **Prudential Indicators and Compliance Issues**

19. Some of the prudential indicators provide an overview, others a specific limit on treasury activity. These are detailed below:
20. **Net Borrowing and the CFR** – In order to ensure that borrowing levels are prudent, the Council's external borrowing (net of investments) over the medium-term must only be for a capital purpose, and not exceed the CFR except in the short-term. In the short term the Council can borrow for cash flow purposes. Table 4 below highlights the Council's net borrowing position against the CFR, and shows that it is significantly below the limit, due to the level of internal borrowing that has been undertaken.

**Table 4**

Net Borrowing & CFR	31st March	31st March
	2017	2018
	Actual	Actual
	£'000	£'000
Total Debt	198,528	198,528
Total Investment	76,350	80,960
<b>Net Borrowing Position</b>	<b>122,178</b>	<b>117,568</b>
<b>CFR</b>	<b>222,875</b>	<b>223,143</b>
<b>Under Borrowing plus Investments</b>	<b>100,697</b>	<b>105,575</b>

21. In the current climate, internal borrowing is preferable to borrowing externally as the interest rate payable on an external loan is much higher than that which can be earned on investments. Therefore, forfeiting interest receivable on investments is more economical than paying additional interest charges for new external debt. If the net borrowing position, interest rate position and/or CFR changed significantly, the prospect of taking on additional debt would be reviewed.
22. **The Authorised Limit** – The Authorised Limit is the ‘affordable borrowing limit’ required by S3 of the Local Government Act 2003. The Council does not have the power to borrow above this level unless it explicitly agrees to do so. Table 5 below demonstrates that during 2017/18 the Council’s gross borrowing was within its Authorised Limit. The Authorised Limit allows for some headroom above the Council’s projected CFR.

**Table 5**

Authorised Limit compared to Actual Borrowing	31st March 2017		31st March 2018	
	Limit	Actual	Limit	Actual
	£'000	£'000	£'000	£'000
Borrowing	338,199	198,528	338,199	198,528
Other Long Term Liabilities	0	0	0	0
<b>Total Borrowed</b>	<b>338,199</b>	<b>198,528</b>	<b>338,199</b>	<b>198,528</b>
<b>Amount under Limit</b>	<b>139,671</b>		<b>139,671</b>	

23. **The Operational Boundary Limit** – the Operational Boundary Limit is the expected borrowing position of the Council during the year. It is possible to exceed the Operational Boundary Limit, for a short period of time, providing that the Authorised Borrowing Limit is not breached. Table 6 below shows the limits for the last two financial years. Actual borrowing remained unchanged at £198.5m hence the limits were not breached during either period.

**Table 6**

<b>Operational Boundaries</b>	<b>31st March 2017 £'000</b>	<b>31st March 2018 £'000</b>
Operational Borrowing Limit	225,528	243,528
Other Long Term Liabilities	0	0
<b>Totals</b>	<b>225,528</b>	<b>243,528</b>

24. **Actual financing costs as a proportion of net revenue stream** – this indicator identifies the trend in the net cost of capital against the net revenue stream and is an indicator of affordability. Table 7 below shows that for the General Fund, the ratio is negative as external loans have been repaid and investment income is positive. The HRA ratio has worsened slightly due to an reducing income stream meaning that financing costs as a proportion have risen.

**Table 7**

<b>Actual Finance Costs</b>	<b>2016/17 £'000</b>	<b>2017/18 £'000</b>
<b>Revenue Stream</b>		
General Fund	22,410	22,858
Housing Revenue Account	47,253	44,739
<b>Comparison to Actual Revenue Position</b>		
Financing Costs as a proportion of Net Revenue Stream - General Fund	-5.43%	-6.78%
Financing Costs as a proportion of Net Revenue Stream - HRA	16.03%	16.93%

### **Icelandic Banks**

25. During 2008/09 the Council invested £4.5 million with two of the now failed Icelandic banks: £3.0 million was deposited with Heritable Bank and £1.5 million with Glitnir Bank.
26. As at 31st March 2016, the Council had received approximately £2.94 million of its original Heritable Bank investment. An outstanding balance of £0.06 million remains. The prospect of a full recovery is uncertain.
27. As at 31st March 2016, the Council had received approximately £1.39 million of its Glitnir investment. An outstanding balance of £0.11 million remains with the prospect of full recovery uncertain.
28. There have been no further receipts in 2016/17 or 2017/18.

## **Investment Income**

29. The majority of the Council's investments are held in fixed deposits and as such, investments that were already active in November 2017 did not benefit immediately from the base rate rise. The Council strives to mitigate this risk by ensuring it has an evenly spread maturity profile and a diverse investment portfolio, subject to the approved counterparty listing. Conversely, new investments arranged after November were arranged at an improved rate of return but the effects of this will not be fully evident until early 2018/19 given that the majority of investments tend to be arranged over a six-month period.
30. Rates further improved in the final quarter of 2017/18 and this may be attributed in part to the traditional "supply and demand" requirements frequently observed at year-end but moreover, the markets appeared to be stimulated by speculation of another rate rise in May 2018 (which did not happen).
31. The Council manages its investments in-house and invests with institutions listed in the Council's approved counterparty list. The Council invests for a range of periods from overnight to 364 days, dependant on cash flow requirements, its view on interest rates and duration limits set out in the Council's Investment Strategy.
32. During 2017/18, the Council maintained an average investment balance of £94.8 million and received an average return of 1.17%.
33. The upper limit of non-specified investments allowed in the strategy is 25% of the average investment balance for the preceding calendar year. The average balance for 2017 was £93.7 million giving a limit on non-specified investments of £23.4 million. Only the property funds fell into the non-specified investment category; their original investment value was £10 million which within the non-specified limit at 10.7% of the average investment balance.
34. The Property Funds are classified as Non-specified Investments within the approved Strategy. The current rate of return on the investments is circa 4.05% per annum. The capital value of the Communities, Churches and Local Authorities (CCLA) Fund has increased by 32.31% between April 2013 and March 2018. However, it is important to reiterate that fluctuations in value are to be expected with property fund investments over the short term and that they are a long term investment; as such, any gains and losses in fund value should be considered over the long term.
35. The overall value of the Lothbury property fund investment has increased by 24.19% since inception in August 2014.
36. Actual investment income for 2017/18 was £1.55 million; £0.20m higher than the budget estimate of £1.23 million. The difference is primarily due to reinvestments being arranged at a higher rate than previously assumed following the rate rise.
37. Fluctuations in the Council's balances have been managed through a mix of instant access and notice accounts, money market funds and short term deposits (up to 364 days). This approach is in line with the Investment Strategy approved by Council.

## **Interest Rates since 31<sup>st</sup> March 2018**

38. The Council takes advice from Link Asset Services on the appropriate durations to place investments with counterparties. These durations and also the availability of individual counterparties are subject to change dependant on market conditions

and the credit ratings of the individual institutions. This means that the investment portfolio has to be actively managed to ensure both the availability of enough suitable counterparties and that the Council achieves the best interest rates possible within the agreed security and liquidity parameters.

- 39. There has been a further increase in Base Rate of 0.25% following the Monetary Policy Committee meeting of the Bank of England in August 2018. Link's current view is that it will increase to 1% by the end of September 2019.
- 40. The Council continues to use money market funds, call accounts and instant access accounts for liquidity purposes, whilst seeking to maximise its returns by arranging longer term deposits where possible. In order to achieve this position, it is vital to maintain a robust cashflow model which is continuously reviewed and updated. However, given the volatile nature of the Council's cashflow requirements, it is not always possible to "lock away" funds for as long as may be desirable and so a strategic approach to investments is fundamental in order to achieve the most practicable yet favourable outcome.

**Financial implications**

- 41. These are set out within the body of the report.

**Legal issues**

- 42. The Council is required to report on its Treasury Management function on an annual basis. This report meets that requirement.

**Level of risk**

- 43. There are no risks in connection with the report's recommendations. Risk assessment and management is a key part of Treasury Management activity, especially in the selection of counterparties when investment is being considered. The Council uses external advisors and counterparty credit ratings issued by the rating agencies to assist in this process.

**Equalities impact**

- 44. There is no equalities impact relating to this report.

<b>Report author</b>	Angela Turner
Job title	Technical Officer, Treasury Management
Service area or department	Financial Services
Telephone	01865 252739
e-mail	<a href="mailto:aturner2@oxford.gov.uk">aturner2@oxford.gov.uk</a>

**Background Papers:** None