County Council

Treasury Management Update

Thursday 23 November 2017

Report from Cabinet Member for Resources

Purpose of this Report

1. The Council is required to report to members on the current year's treasury management activity. It was agreed that a mid-year report on treasury management would be reported to Regulatory and Audit Committee followed by a report to County Council as required by the CIPFA Code of Practice on treasury management in the public sector.

Background

2. In line with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management and the Council's Financial Regulations (A3.2), this Council is required to provide Regulatory and Audit Committee with a mid-year report on the treasury management activity for the first six months of the financial year.

3. The Code of Practice defines Treasury Management as:

   The management of the organisation'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.

Treasury Management Strategy

4. The Council approved the 2017/18 treasury management strategy at its meeting on 16 February 2017. The general policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are the security of capital and liquidity of its investments. The Council will aim to achieve the optimum return on its investments commensurate with the proper levels of security

and liquidity. The effective management and control of risk are prime objectives of the Council's treasury management activities. In exceptional circumstances, where investments do not meet this criteria, decisions on investments will be delegated to the Director of Finance and Assets in consultation with both the Leader of the Council and the Cabinet Member for Resources, or where considered appropriate will be referred to Cabinet for such a decision.

5. All treasury management activity undertaken during the period complied with the approved strategy, the CIPFA Code of Practice and the relevant legislative provisions. There were no investments placed which resulted in a breach of the investment strategy.

Debt Management Strategy

6. The Council's borrowing objectives are:
    - To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio.
    - To manage the Council's debt maturity profile, leaving no one future year with a disproportionate level of repayments.
    - To maintain a view on current and possible future interest rate movements and borrow accordingly.
    - To monitor and review the balance between fixed and variable rate loans against the background of interest rate levels and the Prudential Indicators.

Economic Review

7. UK Consumer Price Inflation (CPI) index rose with the data print for September showing CPI at 3.0%, its highest since June 2013 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. The latest ONS statistics for the three months to August 2017 showed that the unemployment rate remained at 4.3%, down from 5% a year earlier and joint lowest since May 1975. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar 2017.

Outlook for Interest Rates

8. The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. At September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months". At its meeting on 1 November 2017, the MPC voted by a majority of 7-2 to increase Bank Rate by 0.25 percentage points, to 0.5%.

Interim Performance Report

9. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. On 30th September 2017, the Council had net borrowing of £166m arising from its revenue and capital income and expenditure. Investments totalled £13.3m. The forecast outturn for interest earned on investments is on target compared to the budget of £362k. This includes £5m invested in the CCLA property fund.

10. Loans outstanding totalled £179.0m at 30 September 2017; £67.9m was from the Public Works Loan Board (PWLB), £78m from the money markets, £32m temporary borrowing and £1.1m accrued interest. The forecast outturn for interest payments on external debt is an underspend of £200k compared to the budget of £8.5m. During the six months to 30 September £866,000 was repaid to the PWLB, a further debt principal repayment of £866,000 was made to PWLB on 1 October 2017 and a further payment of £10m is due to be paid on 14 February 2018. There has been no new long term borrowing during the six months to 30 September 2017, £25.1m new borrowing from the PWLB was undertaken on 30 October following completion of investment in a Commercial property.

11. The Council pre-paid a £4m LOBO loan running at 4.11% and will consider other prepayment options as they arise. The Council had been offered attractive prepayment terms from the bank and decided to proceed following consideration of the risk/benefits of maintaining the current position against a range of alternative restructuring scenarios. The eventual prepayment totalled £6.1m. At the point of prepayment, net interest savings are expected to be at least £0.3m over the remainder of this and the next four financial years. Savings will be reduced should interest rates rise faster than expected or higher cost debt is taken to replace principal and premium.

12. Additionally, the Council has both reduced its exposure to the uncertain refinancing risk represented by the inherent optionality of the LOBO structure and reduced the overall term of the debt portfolio. Consequently, the debt portfolio and borrowing need can now be managed more flexibly. The actual long term external borrowing at 31 March 2018 is forecast to be £160m. Arlingclose advised that with short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective to borrow short-term loans initially. On 30 September, the Council had 7 short term loans in place totalling £32m ranging in value from £2m to £5m, with maturities from 6 months to 1 year. The Council continues to be aware of the potential to restructure debt, but there are unlikely to be opportunities in the prevailing interest rate environment.

Prudential Indicators

13. Each year, the Council agrees Prudential Indicators under the Local Government Act 2003 which are affordable, prudent and sustainable, the indicators 2017/18 to 2020/21 were agreed by County Council at its meeting on 16 February 2017.

CIPFA Consultation on Prudential and Treasury Management Codes

14. In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes and after reviewing responses launched a further consultation on changes to the codes in August with a deadline for responses of 30th September 2017.

15. The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital programme and treasury management. The prudential indicators for capital expenditure and the authorised borrowing limit would be included in this report but other indicators may be delegated to another committee. There are plans to drop certain prudential indicators, however local indicators are recommended for ring fenced funds (including the Housing Revenue Account) and for group accounts. Other proposed changes include applying the principles of the Code to subsidiaries.

16. Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of “investments” as well as loans made or shares bought for service purposes. Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee rather than needing approval of full Council. There are also plans to drop or alter some of the current treasury management indicators.

17. CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year. The Department of Communities and Local Government (DCLG) and CIPFA wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical.

Recommendation

Council is asked to:

1. Agree the Treasury Management Update Report and the Prudential Indicators for 2017/18 to 2020/21.

CABINET MEMBER FOR RESOURCES