County Council

Treasury Management Update

Thursday 22 November 2018

Report from Cabinet Member for Resources

Purpose of this Report

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

Background

1 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 (B5), 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.

2 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

3 The Council approved the 2018/19 treasury management strategy at its meeting on 22 February 2018. 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 Procurement 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. The Council's cash position is a net borrower:

	31 Mar 2017	**31 Mar 2018**	**30 Sept 2018**
Borrowing:	**£m**	**£m**	**£m**
PWLB*	-68.7	-102.1	-150.0
LOBO#	-82.0	-78.0	-30.0
Temporary Borrowing	-72.5	-32.0	-45.0
Accrued Interest	-1.1	-1.1	-1.0
Gross Borrowing	-224.3	-213.2	-226.0
Treasury Cash:			
Money market funds	11.8	15.3	4.8
Term deposits<1 year	0.0	0.0	0.0
Term deposits >1 year	5.0	0.0	0.0
Property fund	5.0	5.0	5.0
Gross Cash	21.8	20.3	9.8
Net Cash / (Borrowing)	**-202.5**	**-192.9**	**-216.2**

*PWLB Public Works Loans Board. The PWLB is a statutory body, part of HM Treasury, it's purpose is to lend money to local authorities The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

#LOBO Lender Option Borrower Option. LOBOs are long term borrowing instruments which include an option for the lender to periodically revise the interest rate. If the lender decides to revise the interest rate, the borrower then has the option to pay the revised interest rate or repay the loan.

4 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

5 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

6 UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year, above the consensus forecast and that of the Bank of England's in its August Inflation Report, as the effects of sterling's large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages. However real wages (i.e. adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.

7 The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year/year GDP growth at 1.2% also remains below trend. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

Outlook for Interest Rates

8 Having raised policy rates in August 2018 to 0.75%, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon. The MPC has a definite bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly.

9 Arlingclose's central case is for Bank Rate to rise twice in 2019 to 1.25%. The risks are weighted to the downside. The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average.

Interim Performance Report

10 The following table summarises interest paid on external debt and interest earned on cash balances:

	2016/17 **£m**	**2017/18** **£m**	**2018/19** **£m**
Interest paid on Loans	8.9	7.7	8.6
Interest Income	0.8	0.4	0.4

11 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 2018, the Council had net borrowing of £216.2m arising from its revenue and capital income and expenditure. Investments totalled £9.8m. The forecast outturn for interest earned on investments £426k. This includes £5m invested in the CCLA property fund.

12 Loans outstanding totalled £226.0m at 30 September 2018; £150m was from the Public Works Loan Board (PWLB), £30m from the money markets, £45m temporary borrowing and £1.0m accrued interest. The forecast outturn for interest payments on external debt is £8.6m. A repayment of £10m is due to be paid to the PWLB on 14 February 2019. Approximately £80m new borrowing from the PWLB will be taken out later this year prior to completion of investment in Commercial properties.

13 As reported to the Regulatory and Audit Committee in May 2018, the Council pre-paid 3 LOBO loans totalling £48m running at 4.28%. These loans were replaced by £48m of PWLB loans with an average interest rate of 2.34%. The eventual prepayment of the £48m loan totalled £74m. 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. Savings over the next 25 years are projected to be £10.4m. Savings will be reduced should interest rates rise faster than expected. 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 Council continues to be aware of the potential to restructure PWLB debt, but there are unlikely to be opportunities in the prevailing interest rate environment.

14 The forecast external borrowing as at 31 March 2019 is £286m which includes £220m from the PWLB, £30m LOBO loans, £35m temporary borrowing from other local authorities and £1m accrued interest. This includes borrowing for new commercial acquisitions approved by Cabinet. The Council may potentially invest in more commercial properties later this year to provide additional revenue income in 2018/19. On 30 September, the Council had 7 short term loans in place totalling £45m ranging in value from £5m to £15m, with maturities from 1 to 6 months. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

15 With short-term interest rates remaining much lower than long-term rates, the Authority considered it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead. 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

16 Each year, the Council agrees Prudential Indicators under the Local Government Act 2003 which are affordable, prudent and sustainable, the indicators 2018/19 to 2021/22 were agreed by County Council at its meeting on 22 February 2018.

17 The Council may potentially invest in more commercial properties later this year to provide additional revenue income in 2018/19. It is proposed that a change to some of Prudential Indicators is taken to full Council for approval. The Committee is asked to recommend to County Council the following changes:

An increase of £50m each year from 2018/19 to 2021/22 for Prudential Indicator 5.1 the authorised limit for borrowing is proposed. This is the maximum figure that the Council could borrow at any given point during each financial year.

5.1 Authorised limit (for borrowing)	**Unit**	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Recommended revised limit	£000	390,000	435,000	460,000	380,000
Limit approved February 2018	£000	340,000	385,000	410,000	330,000

An increase of £50m each year from 2018/19 to 2021/22 for Prudential Indicator 5.2 the operational boundary for borrowing is proposed to reflect the increase in the authorised limit for external debt. The operational boundary is based on an estimate of the most likely level of external borrowing at any point in the year.

5.2 Operational boundary for (borrowing)	**Unit**	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Recommended revised limit	£000	360,000	405,000	430,000	350,000
Limit approved February 2018	£000	310,000	355,500	380,000	300,000

An increase of £50m each year from 2018/19 to 2021/22 for Prudential Indicator 6.3 the upper limit of fixed rate borrowing is proposed to reflect the increase in the authorised limit for external debt.

6.3 Upper Limit of Fixed Rate Borrowing	**Unit**	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Recommended revised limit	£000	390,000	435,000	460,000	380,000
Limit approved February 2018	£000	340,000	385,000	410,000	330,000

An increase of £60m each year from 2018/19 to 2021/22 for Prudential Indicator 4.1 is proposed to reflect the increase in the authorised limit for external debt and also correct an anomaly between Indicator 4.1 and Indicator 5.1 approved in February 2018.

4.1 Gross Borrowing	Unit	2018/19	2019/20	2020/21	2021/22
Recommended revised indicator	£000	390,000	435,000	460,000	380,000
Indicator approved February 2018	£000	330,000	375,000	400,000	320,000

Prudential and Treasury Management Codes

18 Following consultation in 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice. In England the Ministry of Housing Communities and Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018. The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority will be producing its Capital Strategy later in 2018/19 for approval by full Council.

Recommendation

Council is asked to:

1. **Agree the Treasury Management Update Report and the Prudential Indicators for 2018/19 to 2021/22.**
2. **Agree a change to the authorised limit for borrowing within Prudential Indicator 5.1 to £390m in 2018/19, £435m in 2019/20, £460m in 2020/21 and £380m in 2021/22.**
3. **Agree a change to the operational boundary for borrowing within Prudential Indicator 5.2 to £360m in 2018/19, £405m in 2019/20, £430m in 2020/21 and £350m in 2021/22.**
4. **Agree a change to the Upper Limit of Fixed Rate Borrowing within Prudential Indicator 6.3 to £390m in 2018/19, £435m in 2019/20, £460m in 2020/21 and £380m in 2021/22.**
5. **Agree a change to the gross external borrowing value within Prudential Indicator 4.1 to £390m in 2018/19, £435m in 2019/20, £460m in 2020/21 and £380m in 2021/22**

CABINET MEMBER FOR RESOURCES

Appendix 1 – Prudential Indicators for MTFP 2018/19 to 2021/22