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Regulatory and Audit Committee
13 November 2014

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Regulatory & Audit Committee

Title:	**Treasury Management Mid-year Report 2014/15**
Date:	13 November 2014
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Electoral divisions affected:	n/a

Summary

1 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.

Recommendation

The Committee is asked to NOTE the treasury and investment borrowing performance and the monitoring against the Prudential Indicators.

Supporting information

2 In line with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management revised 2011 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 2014/15 treasury management strategy at its meeting on 13 February 2014. 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.

5 All treasury management activity undertaken during the period complied with the CIPFA Code of Practice and the relevant legislative provisions. There was one investment placed which resulted in a breach of the investment strategy. An investment was made with OCBC bank which resulted in the Singapore national investment limit of £30m being exceeded by £5m. On discovering the breach, the investment was repaid with interest to the Council for the period that the £5m was invested. In order to reduce the chances of a similar occurrence, we have made the national limit warnings much more noticeable and changed the summary sheet so that the 'Can't Do' checkbox only appears when a term deposit is being made, rather than being a static feature.

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 The recent strong performance of the UK economy continued with output growing at 0.8% in Q1 2014 and at 0.9% in Q2. The services sector once again grew strongly. On the back of strong consumption growth, business investment appeared to be recovering quickly, albeit from a low base. The annual CPI inflation rate fell to 1.2% year-on-year in September, the lowest rate for 5 years. The labour market continued to improve, with strong employment gains and the headline unemployment rate falling to 6.2%. However, earnings growth remained very weak, rising just 0.6% for the three months May-July 2014 when compared to the same period a year earlier. The growth in employment was masked by a large number of zero-hour contracts and involuntary part-time working.

Outlook for Interest Rates

8 There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375bn respectively. However, there was a marked shift in tone from the Bank of England's Governor and other MPC members. In his Mansion House speech in June Governor Mark Carney warned that interest rates might rise sooner than financial markets were expecting. In August, September and October the MPC voted 7-2 to maintain the Bank Rate at 0.5%. For most members, there was "insufficient evidence" of inflationary pressure to raise rates. The MPC emphasised that when Bank Rate did begin to rise, it was expected to do so only gradually and would likely remain below average historical levels for some time to come.

Interim Performance Report

9 During the first six months of 2014/15 Buckinghamshire County Council invested cash balances not required on a day to day basis for periods of up to 3 years 8 months. These investments were invested at interest rates between 0.5% and 1.55%. The average rate of return to date is 0.76% which exceeds the weighted average LIBID benchmark rate of 0.49% by 0.27%. The projected revenue of £1.75m for investment income is expected to exceed the budget of £1.62m by £130,000. This is due to average cash balances being higher than anticipated due to receipt of grant income at the beginning of the financial year.

10 Loans outstanding totalled £185.1m at 30 September 2014; £103.1m was from the Public Works Loan Board (PWLB) and £82m from the money markets. The forecast outturn for interest payments on external debt is on target compared to the budget of £11.6m. During the six months to 30 September £866,000 was repaid to the PWLB, a further debt principal repayment of £866,000 was made on 1 October 2014 and a further payment of £10m is due to be paid on 14 February 2015, reducing the total outstanding loans to £174.2m. There has been no new long term borrowing during the six months to 30 September 2014, The Council continues to actively monitor debt restructuring options.

11 Each year, the Council agrees Prudential Indicators under the Local Government Act 2003 which are affordable, prudent and sustainable. The Indicators 2014/15 to 2017/18 agreed by County Council at its meeting on 13 February 2014 are shown in Appendix 1 along with the Prudential Indicator forecast for 2014/15.

Resource implications

There are no additional costs associated with the recommendation.

Legal implications

The publication of a mid year treasury report conforms to best practice as required by the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice.

Other implications/issues

Not applicable.

Feedback from consultation, Local Area Forums and Local Member views (if relevant)

Not applicable

Background Papers

Treasury Management Strategy Report to County Council 13 February 2014
https://democracy.buckscc.gov.uk/documents/g5662/Public%20reports%20pack%2013th-Feb-2014%2009.30%20County%20Council.pdf?T=10

Appendix 1

PRUDENTIAL INDICATORS ESTIMATES 2014/15 to 2017/18

1. BACKGROUND

1.1. The prudential framework for local authority capital investment was introduced through the Local Government Act 2003. The key objectives of the Prudential Code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable. A further objective is to ensure that treasury management decisions are taken in accordance with good professional practice.

1.2. Local Authorities are required to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003. To demonstrate compliance the Code sets prudential indicators designed to support and record local decision making.

1.3. The purpose of this report is to provide an update on the indicators approved by Council earlier this year, and to estimate the position for the period 2014/15 to 2017/18. The report describes the purpose of each of the indicators and the values and parameters for Buckinghamshire County Council. Monitoring of the Prudential Indicators takes place throughout the year, a mid-year and annual report are reported to Regulatory & Audit Committee and Council.

2. CAPITAL EXPENDITURE INDICATORS

2.1. CAPITAL EXPENDITURE

This indicator is required to inform the Council of capital spending plans for the next four years. It is the duty of a local authority to determine and keep under review the amount that it can afford to allocate to capital expenditure.

The estimates of gross capital expenditure to be incurred for the current and future years is summarised below:

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Estimates of capital expenditure	£000	**73,439**	88,353	63,721	233,389	36,646

The Approved estimate of capital expenditure for 2014/15 has been updated to reflect the revised budget (inclusive of slippage). The forecast outturn shows an anticipated £14.9m (16.9%) slippage on the revised capital expenditure budget for the year. The main variations relate to:

- **£1.250m** relates to the Marlow Flood Defence scheme. The project will require a decision on the progression of the schemes in order to facilitate forecasting.
- **£2.656m** due to delays in Health & Wellbeing scheme permissions, in particular for Orchard House and Burnham.
- **£3.2m** due to decisions outstanding on Hughendon quarter.

The estimate of capital expenditure for 2015/16 to 2017/18 does not reflect any proposed changes as part of the 2015/16 MTP.

In 2016/17 an allowance is shown for the Facilities Payment Sum (a single bullet payment of £180m) in respect of the Energy from Waste plant, which will be supported in part through prudential borrowing.

Members were advised in June 2014 of a technical accounting requirement to recognise expenditure on the EfW plant as an asset under construction, in advance of the Facilities Payment Sum. As a result of this requirement it is anticipated that a further £88m will be accounted for as capital expenditure within 2014/15 in addition to the forecast outturn above. This has been reflected in the estimated capital financing requirement at indicator 2.2 below.

2.2. CAPITAL FINANCING REQUIREMENT

The Capital Financing Requirement measures the Council's underlying need to borrow for capital purposes. This is essentially the Council's outstanding debt, necessary to finance the Council's capital expenditure. The actual debt is dependent on the type and maturity of the borrowing undertaken as well as seeking the optimal cashflow situation (see 5.3). Estimates of the end of year Capital Financing Requirement for the Council for the current and future years, net of repayments are:

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Estimates of capital financing requirement (CFR)	£000	343,161	219,660	343,104	335,328	325,366

Authorities can finance schemes in a variety of ways these include;

- The application of useable capital receipts
- A direct charge to revenue
- Application of a capital grant
- Contributions received from another party
- Borrowing

It is only the latter method that increases the Capital Financing Requirement (CFR) of the Council.

The capital financing requirement was updated in June 2014 to reflect a technical accounting requirement to recognise expenditure on the EfW plant, and the financing of that expenditure through prudential borrowing, during the construction phase.

The profile above also reflects:

- Prudential borrowing of £16m in 2014/15 as the accountable body on behalf of the LEP to support Transportation projects;
- Prudential borrowing of £1.4m in 2015/16 to support the capital programme;
- Notional prudential borrowing of £124.5m in 2014/15 and £130m in 2015/16, in respect of the Energy from Waste (EfW) Project.

AFFORDABILITY INDICATORS

2.3. RATIO OF FINANCING COSTS TO NET REVENUE STREAM

Purpose of the Indicator

This indicator measures the proportion of the revenue budget that is being allocated to finance capital expenditure. For the General Fund this is the ratio of financing costs of borrowing against net expenditure financed by government grant and local taxpayers.

Estimates of the ratio of financing costs to net revenue stream for the current and future years are:

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Estimates of ratio of financing costs to net revenue stream	%	6.01%	6.02%	5.9%	6.6%	6.9%

2.4. ESTIMATES OF INCREMENTAL IMPACT OF NEW CAPITAL INVESTMENT DECISIONS ON COUNCIL TAX

This is a key affordability indicator that demonstrates the incremental effect of planned capital expenditure and hence any increased or decreased borrowing, on Council Tax.

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Estimates of the incremental impact of capital investment decisions on Council Tax	£ per Band D Equivalent	-£0.11	-£8.05	-£0.42	-£9.75	-£17.85
	%	-0.01%	-0.73%	-0.04%	-0.87%	-1.56%

The revised estimate has been reduced due to the delay in the introduction of a bio-waste treatment facility; however the delivery of a number of other projects within the capital programme including the replacement of Street Lamps with more efficient equipment and rationalisation of premises will result in revenue savings. In addition a net saving is forecast in relation to the Energy from Waste project in 2016/17 and 2017/18.

3. FINANCIAL PRUDENCE INDICATOR

3.1. NET DEBT AND THE CAPITAL FINANCING REQUIREMENT

This indicator records the extent that gross external borrowing is less than the capital financing requirement (2.2 above).

This is a key indicator of the Council's prudence in managing its capital expenditure and is designed to ensure that, over the medium term, external borrowing is only for capital purposes. The Council should ensure that gross debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. The values are measured at the end of the financial year.

Where gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual treasury management strategy.

The figures for 2014/15 onwards are based on estimates:

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Gross Borrowing	£000	205,000	205,000	205,000	205,000	195,000
Capital Financing Requirement	£000	343,161	219,660	343,104	335,328	325,366

The Council is committed to building an EfW plant. This may require additional borrowing during 2016/17, although in practice much of this may be financed through a combination of earmarked reserves and current cash investments. The gross borrowing indicator assumes borrowing £10m per annum in advance during 2014/15 and 2015/16 and a further £10m during 2016/17. The need for borrowing in advance will be reviewed. No additional debt had been raised as at 30 September 2014.

The indicator also includes £16m in 2014/15 borrowed on behalf of the Buckinghamshire Thames Valley Local Enterprise Partnership (BTVLEP) for Aylesbury Eastern Link Road. HM Treasury has agreed that the LEP can access the PWLB Project Rate at a discount of 40 basis points below the standard PWLB rate, the County Council will arrange the loan and pay the interest to the PWLB on behalf of the LEP, the LEP will reimburse the costs incurred to the County Council so that the loan is cost neutral to the County Council.

TREASURY AND EXTERNAL DEBT INDICATORS

3.2. AUTHORISED LIMIT FOR EXTERNAL DEBT

The authorised limit for external debt is required to separately identify external borrowing (gross of investments) and other long term liabilities such as covenant repayments and finance lease obligations. The limit provides a maximum figure that the Council could borrow at any given point during each financial year.

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Authorised limit (for borrowing) *	£000	250,000	250,000	250,000	300,000	300,000
Authorised limit (for other long term liabilities) *	£000	150,000	150,000	200,000	15,000	15,000
Authorised limit (for total external debt) *	£000	400,000	400,000	450,000	315,000	315,000

* These limits can only be breached with the approval of the full Council

The authorised limits were increased at a meeting of full Council on 17 July 2014 and are consistent with approved capital investment plans and the Council's Treasury Management Policy and Practice documents, but allow sufficient headroom for unanticipated cash movements.

The limit will be reviewed on an on-going basis during the year. If the authorised limit is liable to be breached at any time, the Service Director (Finance & Commercial Services) will either take measures to ensure the limit is not breached, or seek approval from the Council to raise the authorised limit.

3.3. OPERATIONAL BOUNDARY FOR EXTERNAL DEBT

This is a key management tool for in-year monitoring and is lower than the Authorised Limit as it is based on an estimate of the most likely level of external borrowing at any point in the year. In comparison, the authorised limit is the maximum allowable level of borrowing.

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Operational boundary (for borrowing)	£000	210,000	210,000	210,000	250,000	250,000
Operational boundary (for other long term liabilities)	£000	130,000	5,500	136,500	6,500	6,500
Operational boundary (for total external debt)	£000	340,000	215,500	346,500	256,500	256,500

Technical accounting rules require the Council to recognise an asset under construction and a corresponding PFI-equivalent liability for the work certified to date and forecast for the EfW plant. This liability is included in the 'other long-term liabilities' line and has resulted in the increase in the operational boundary.

This indicator is consistent with the Council's plans for capital expenditure and financing and with its Treasury Management Policy and Practice document. It will be reviewed on an on-going basis.

3.4. ACTUAL EXTERNAL DEBT

This is a factual indicator showing actual external debt for the previous financial year.

The actual external borrowing as at 31 March 2014 was £187.6m which includes £1.7m accrued interest. During the current financial year £1.7m of debt will be repaid relating to 'Equal Instalment of Principal' loans and £10m relating to 'Maturity' loans where the principal is repaid on maturity. The forecast external borrowing as at 31 March 2015 is £175.8m.

4. TREASURY MANAGEMENT INDICATORS

The prudential code links with the CIPFA Code of Practice for Treasury Management in the Public Services.

The Treasury Management indicator consists of five elements that are intended to demonstrate good professional practice is being followed with regard to Treasury Management. The proposed values and parameters provide sufficient flexibility in undertaking operational Treasury Management.

6.1 Security Average Credit Rating

The Council is asked to adopt a voluntary measure of its exposure to credit risk by monitoring the weighted average rating of its investment portfolio.

Security Average Credit Rating	Actual / Target
Portfolio Average Credit Rating	AA- / A+ or above

For the purpose of this indicator local authorities, which are unrated are assumed to hold an AAA rating.

6.2 Has the Council adopted the CIPFA Treasury Management Code?

The Council has adopted the Code. In line with the Code the Treasury Strategy, the mid year review and the annual review are reported to Cabinet and Council.

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Adoption of the CIPFA Code of Practice for Treasury Management in the Public Services	N/A	Yes	Yes	Yes	Yes	Yes

6.3 Upper limit of fixed rate borrowing for the 4 years to 2017/18.

This indicator is set to control the Council's exposure to interest rate risk and the rate is set for the whole financial year. The upper limits on fixed interest rate exposures expressed as an amount will be:

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Fixed interest rate exposure - upper limit *	£000	215,000	215,000	215,000	265,000	265,000

* Any breach of these limits will be reported to the full Council

6.4 Upper limit of variable rate borrowing for the 4 years to 2017/18.

This indicator is set to control the Council's exposure to interest rate risk. Here instruments that mature during the year are classed as variable, this includes the Council's Lender Option Borrower Option (LOBO) loans. For LOBO loans, on specified call dates, the lender has the option to increase the interest rate paid on the loan. If the lender exercises this option, then the borrower can agree to pay the revised interest rate or repay the loan immediately. The upper limits on variable interest rate exposures expressed as an amount of the net principal will be:

Indicator	Unit	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Variable interest rate exposure - upper limit *	£000	110,000	110,000	80,000	80,000	95,000

* Any breach of these limits will be reported to the full Council

6.5 Maturity structure of fixed rate borrowing for 2014/15 – 2017/18

This Indicator is set to control the council's exposure to refinancing risk. The upper and lower limits on the maturity structure of the fixed borrowing will be:

Maturity Structure of Fixed Rate Borrowing	Revised Estimate as at 30 Sept 2014		Approved Estimate 2014/15		2015/16		2016/17		2017/18	
Period	Upper Limit	Lower Limit	Upper Limit	Lower Limit	Upper Limit	Lower Limit	Upper Limit	Lower Limit	Upper Limit	Lower Limit
Under 12 months	50%	0%	50%	0%	45%	0%	55%	0%	55%	0%
12 months and within 24 months	35%	0%	35%	0%	45%	0%	40%	0%	40%	0%
24 months and within 5 years	55%	0%	55%	0%	55%	0%	55%	0%	55%	0%
5 years and within 10 years	55%	0%	55%	0%	55%	0%	60%	0%	60%	0%
10 years and above	100%	20%	100%	20%	100%	20%	100%	20%	100%	20%

These parameters control the extent to which the Council will have large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6.6 Total principal sums invested for periods longer than 364 days

The purpose of this indicator is to control the council's exposure to the risk of incurring losses by seeking early repayment of its investments.

Indicator	Revised Estimate as at 30 Sept 2014	Approved Estimate 2014/15	2015/16	2016/17	2017/18
Total principal sums invested for periods longer than 364 days	£75M	£75M	£75M	£75M	£75M

With regard to longer term investments the recommendation is to limit sums for periods longer than 364 days to no more than £75m.

7 <u>CONCLUSION</u>

In approving, and subsequently monitoring, the above prudential indicators the Council is fulfilling its duty to ensure that spending plans are affordable, prudent and sustainable.