Regulatory and Audit Committee

Title: Treasury Management Update

Date: Wednesday 9 November 2016

Author: Richard Ambrose - Director of Assurance

Contact officer: Julie Edwards – Pensions & Investments Manager
Telephone (01296) 383910

Local members affected:

For press enquiries concerning this report, please contact the media office on 01296 382444

Summary

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.

Local authorities are also required to prepare an annual Minimum Revenue Provision (MRP) Statement as part of the Treasury Management Strategy. Appendix 2 to this report sets out a proposed change to the policy for 2016/17, in respect of unfunded capital expenditure incurred before 1 April 2008. This change will require Full Council approval.

It is proposed to change the MRP policy for pre 2008 debt from a 4% reducing balance basis to a straight line basis over 50 years from 1 April 2016 as a prudent basis over which to repay debt:

- The approach has a beneficial impact on the Council's overall budget position with an initial saving in 2016/17 of £3.564m and a saving of £15.8m over the first 5 years;
- Moving to a straight-line basis will ensure that all debt is paid-off over this period; unlike the existing method whereby where £30m or 18% of debt remains un-provided for;
- This is in line with the estimated average age of this group of assets;
- There is sufficient capacity in the capital programme to maintain the assets going forward to ensure that they will continue to be operational for at least another 50 years;
- The straight-line basis provides consistency and certainty for forward planning within the MTP in respect of pre-2008 unfunded capital expenditure fixed at £3.6m per annum.

Recommendations

The Committee RECOMMENDS to Council the Treasury Management Update Report and the Prudential Indicators for 2016/17to 2019/20.

The Committee RECOMMENDS to Council a change to the authorised boundary for external debt within Prudential Indicator 3.2 from £250m to £275m in 2016/17.

The Committee RECOMMENDS the proposed change to the MRP policy from a reducing balance basis to a straight line basis over 50 years from 1 April 2016 for the approval of full Council.

Supporting information

1 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.

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 2016/17 treasury management strategy at its meeting on 18 February 2016. 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 Assurance 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.

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 The first estimate of the third quarter Gross Domestic Product (GDP) released on the 27th October by the ONS showed the UK economy growing by 0.5% over the quarter and 2.3% year-on-year. Both these figures were slightly above market expectations as the UK economic outlook changed significantly on 23rd June 2016 following the surprise result of the referendum on the UK's membership of the EU. The August Quarterly *Inflation Report* from the Bank of England forecasts a rise in Consumer Price Inflation (CPI) to 0.9% by the end of calendar 2016 and thereafter a rise closer to the Bank's 2% target over the coming year due to the expectation that inflation will increase due to a rise in import prices, dampening real wage growth and real investment returns. On 18th October it was reported that CPI rose by 1% in the year to September 2016, the main contributors were rising prices for clothing, overnight hotel stay and motor fuel. These upward pressures were partially offset by falls in air fares and food prices.

Outlook for Interest Rates

7 The subsequent political turmoil following the outcome of the referendum prompted a sharp decline in household, business and investor sentiment. The repercussions of this plunge in sentiment on economic growth were judged by the Bank of England to be severe, prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy. Since the onset of the financial crisis over eight years ago, Arlingclose's, the Council's treasury advisor, outlook for the Bank Rate has progressed from 'lower for longer' to 'even lower for even longer' to, now, 'even lower for the indeterminable future'.

Interim Performance Report

8 During the first three months of 2016/17 Buckinghamshire County Council invested cash balances in short term deals or liquidity accounts in anticipation of the payment due in respect of the Energy from Waste (EfW) Plant. The Council paid a single bullet payment of £180m plus £36m VAT, which has been reclaimed, in June 2016 in respect of the EfW Plant. As reported to members previously this was financed by a combination of borrowing, earmarked reserves and cash investments, subsequently the Council's average day to day cash balances reduced from £200m to £30m. As at 30 September 2016 investments totalled £35.7m, the average rate of return on these investments is 0.82%. These include two £5m investments placed at higher rates during 2013 and 2014 which will mature in 2017 and £5m invested in the CCLA property fund.

9 Loans outstanding totalled £202.9m at 30 September 2016; £79.6m was from the Public Works Loan Board (PWLB), £82m from the money markets, £40m temporary borrowing and £1.3m accrued interest. The forecast outturn for interest payments on external debt is on target compared to the budget of £10m. 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 2016 and a further payment of £10m is due to be paid on 14 February 2017, reducing the long term outstanding loans to £152.0m. There has been no new long term borrowing during the six months to 30 September 2016. 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 ranging in value from £2m to £10m, with maturities from 1 month to 6 months. 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.

10 Each year, the Council agrees Prudential Indicators under the Local Government Act 2003 which are affordable, prudent and sustainable, the indicators 2015/16 to 2017/18 were agreed by County Council at its meeting on 18 February 2016. Revisions to 3.3 the operational boundary for external debt 2016/17 and 4.4 the upper limit of variable fixed rate of borrowing 2016/17 were approved by County Council on 26 May 2016. Appendix 1 shows the approved Prudential Indicators for 2016/17 to 2019/20 along with the Prudential Indicator forecast for 2016/17. It is proposed that a change to the Prudential Indicator 3.2 from £250m to £275m in 2016/17 is taken to full Council for approval. This will enable the Council to further invest in Commercial properties to provide additional revenue income in 2016/17 with the full year effect in 2017/18.

11 Local authorities are required to prepare an annual Minimum Revenue Provision (MRP) Statement that is approved by Full Council as part of the Treasury Management Strategy. This report sets out a proposed change to the policy for 2016/17, in respect of unfunded capital expenditure incurred before 1 April 2008. This change will require Full Council approval. Appendix 2 provides further background about the review of the MRP policy.

12 It is proposed to change the MRP policy for pre 2008 debt from a 4% reducing balance basis to a straight line basis over 50 years from 1 April 2016 as a prudent basis over which to repay debt:

- The approach has a beneficial impact on the Council's overall budget position with an initial saving in 2016/17 of £3.564m and a saving of £15.8m over the first 5 years;
- Moving to a straight-line basis will ensure that all debt is paid-off over this period; unlike the existing method whereby where £30m or 18% of debt remains un-provided for;
- This is in line with the estimated average age of this group of assets;
- There is sufficient capacity in the capital programme to maintain the assets going forward to ensure that they will continue to be operational for at least another 50 years;
- The straight-line basis provides consistency and certainty for forward planning within the MTP in respect of pre-2008 unfunded capital expenditure fixed at £3.6m per annum.

Resource implications

The impact of the change to the MRP Policy would be a saving to the General Fund in 2016/17 of £3.564m and a saving of £15.8m over the first 5 years. Over 50 years there is an increase in the charge to the General Fund but this does not take into account the time-value of money.

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 18 February 2016
http://moderngov/ieListDocuments.aspx?CId=107&MId=6704&Ver=4

Treasury Management Annual Report 2015/16 to County Council 26 May 2016
http://moderngov/documents/g6706/Public%20reports%20pack%2026th-May-2016%2009.30%20County%20Council.pdf?T=10