BRIEFING PAPER

REPORT to :	Audit and Governance Committee
LEAD OFFICER:	Director of Finance and IT
DATE:	13th June 2017

WARD/S AFFECTED: All

TREASURY MANAGEMENT REPORT – 2017/18

Based on monitoring information for the quarter 1st March 2017 – 31st May 2017

1. PURPOSE

To allow scrutiny of the Treasury Management function.

2. RECOMMENDATIONS

It is recommended that Audit and Governance Committee notes the Treasury Management position for the period.

3. BACKGROUND

3.1 The Council has previously adopted CIPFA's latest Code of Practice on Treasury Management in the Public Services and associated guidance notes. The Treasury Management Strategies for 2016/17 and 2017/18, approved at Finance Council in February 2016 and 2017, respectively, comply with both the CIPFA Code and with current Department for Communities and Local Government (CLG) guidance on investments (issued March 2010). The CIPFA Code, Investment Guidance issued by CLG and Audit & Assurance reviews of Treasury Management activities all recommend an enhanced role for elected members in scrutinising the Treasury Management function of the Council.

3.2 This report summarises the interest rate environment for the three month period and the borrowing and lending transactions undertaken, together with the Council's overall debt position. It also reports on the position against the Treasury and Prudential Indicators established by the Council.

3.3 A glossary of Treasury Management Terms is appended to this paper. .

4. KEY ISSUES

4.1 Interest Rates

Since the Bank of England Bank Rate was reduced to 0.25% in August 2016, market interest rates, including the cost of government borrowing, have fluctuated, in reaction to political events and

announcements. From a broader perspective, rates have remained at very low levels.

4.2 Investments Made and Interest Earned

The graph in Appendix 1 shows the weekly movements in totals available for investment, both actuals to date and projections for the rest of the year (which have been inflated by taking significant short term borrowing ahead of the year end).

Investments made were mainly in "liquid" (instant access) deposits, either bank "call accounts" or Money Market Funds (MMFs). Returns on such investments were low, with MMF rates falling again, to between 0.18% and 0.20%. Bank accounts continue to yield 0.10% or 0.15% (though we have been notified that one, RBS, will cut its rate to 0.05% from 5 June).

For limited periods, funds were also placed with the Government's Debt Management Office (at 0.10%). The only other fixed term investments made were:

Start Date	End Date	Counterparty	Amount £	Rate
27-Mar-17	03-Apr-17	Stoke City Council	5,000,000	0.40%
30-Mar-17	24-Apr-17	West Yorkshire Police & Crime Commissioner	2,000,000	0.40%
31-Mar-17	28-Apr-17	London Borough of Ealing	5,000,000	0.35%
27-Apr-17	01-Jun-17	Lewes District Council	4,000,000	0.25%
28-Apr-17	31-May-17	London Borough of Ealing	5,000,000	0.25%
28-Apr-17	31-May-17	Middlesbrough Borough Council	3,000,000	0.25%
04-May-17	11-Aug-17	National Counties Building Society	5,000,000	0.35%
30-May-17	30-Aug-17	Torfaen County Borough Council	5,000,000	0.25%

At 31st March, the Council had just over £22M invested. Appendix 2 shows the breakdown of the £30 million invested at the end of May.

The Council's average return over the 3 months was around 0.20% (a little down compared to 0.22% in the last quarter).

For comparison, benchmark LIBID (London Interbank Bid) rates also remained low. Average rates for 1 month's lending held at around 0.13%, and for 3 months averaged 0.20% (though still on a falling track).

4.3 Borrowing Rates

The cost of long term borrowing through the PWLB (Public Works Loan Board) is linked to Central Government's own borrowing costs. PWLB rates fell in anticipation of, and following, the Bank Rate cut and hit a historic low last summer, then rose up to January 2017, falling again .

Average PWLB borrowing rates are historically low. Based on the cost of new "maturity" loan to the Council, 5 year loans remained at around 1.3% (generally between 1.25% and 1.35%), while loans in the 20 to 50 year range were at around 2.5% (generally between 2.3% and 2.7%)

Short term borrowing rates - based on loans from other councils – were also low, as alternative options for lenders (investment rates) were low. There was a slight upward movement up to the end of March (the low point for most local authorities' cash) before a relaxation of rates again in the new year. By the end of May, 3 month loans usually cost below 0.35%, while 6 month/ 1 year loans were between 0.40% and 0.50%.

4.4 Borrowing and Lending in the 3 month period

The Council's CFR (Capital Financing Requirement) is the key measure of the Council's borrowing **need** in the long term. It is

(a) the accumulated need to borrow **to finance capital spend** (not funded from grants, etc.)
less
(b) the accumulated Minimum Revenue Provision (MRP) charges already made - councils must make a prudent MRP charge in their accounts each year, to finance their debt -
less
(c) any capital receipts applied to finance outstanding debt.

and therefore tends to increase if capital spend financed from borrowing exceeds MRP.

The Council's **actual** long term debt was more than £75M below the CFR at the start of 2016/17, and this gap widened to more than £88M by the end of the year (as the CFR increased and long term debt was repaid). The Council has taken no new long term borrowing for several years, and is repaying existing debt at maturity.

We are effectively using "internal borrowing" from available revenue cash balances to part cover this gap. Two benefits of this are:
(a) a net saving on interest (as long term borrowing costs more than investments would earn), and
(b) fewer funds held, so a lower risk of funds invested being lost.

The rest of the gap is covered by taking enough short term borrowing to ensure that the Council has sufficient funds to pay its liabilities and commitments, and in anticipating future borrowing needs.

Over the period, there was an increase in short term borrowing of £10M, as loans of £30M of were repaid and **£40M of new loans** had been taken (listed below).

Start Date	End Date	Counterparty	Amount £	Rate
09/03/2017	09/01/2018	Tendring District Council	1,000,000	0.42%
15/03/2017	15/12/2017	Vale of Glamorgan	1,000,000	0.43%
15/03/2017	22/06/2017	Derby City Council	3,000,000	0.40%
15/03/2017	14/06/2017	Bridgend Borough Cncl	2,000,000	0.40%
20/03/2017	20/09/2017	Kent Police Authority	5,000,000	0.40%
20/03/2017	20/06/2017	Portsmouth City Council	5,000,000	0.40%
30/03/2017	29/09/2017	Basildon District Council	2,000,000	0.45%
31/03/2017	30/06/2017	Vale of White Horse District Cncl	2,000,000	0.40%
04/04/2017	04/07/2017	Middlesbrough Pension Fund	6,000,000	0.40%
21/04/2017	23/06/2017	Derbyshire County Council	5,000,000	0.40%
27/04/2017	29/01/2018	North East Combined Authority	5,000,000	0.42%
08/05/2017	30/11/2017	Gwent Police Authority	3,000,000	0.35%

Note of Future deals already agreed by end of period

Start Date	End Date	Counterparty	Amount £	Rate
01/06/2017	31/05/2018	London Borough of Havering	5,000,000	0.45%
15/06/2017	29/03/2018	Wokingham BC	5,000,000	0.40%
30/06/2017	29/03/2018	Tendring District Council	1,000,000	0.40%
04/07/2017	30/04/2018	London Borough of Brent	10,000,000	0.45%
18/07/2017	18/04/2018	Kent Police Authority	2,000,000	0.40%
18/07/2017	19/02/2018	Kent Police Authority	2,000,000	0.38%
10/07/2017	10/04/2018	West Yorks Police & Crime Commissnr	5,000,000	0.43%

4.5 Analysis of debt outstanding -

	1st March 2017		31st May 2017	
	£'000	£'000	£'000	£'000
TEMPORARY DEBT				
Less than 3 months	8,000		20,000	
Greater than 3 months (full duration)	45,000		43,000	
		53,000		63,000
LONGER TERM DEBT				
Bonds	21,503		21,503	
Mortgages	17		17	
PWLB	106,125		105,345	
Stock & Annuities	258		258	
		127,903		127,123
Lancs County Council transferred debt		16,158		15,992
Recognition of Debt re PFI Arrangements		68,680		68,311
TOTAL DEBT		**265,741**		**274,426**
Less: Temporary Lending - fixed term		(6,000)		(10,000)
- instant access		(21,415)		(20,075)
NET DEBT		**238,326**		**244,351**

The key elements of long term borrowing included above are:

(a) £21.5M classed as bonds, borrowed from the money markets, largely in the form of "LOBO" (Lender Option, Borrower Option) debt. The overall average interest rate paid on this debt is now around 5%, with individual deals ranging from 4.35% to 7.625%
(b) £105M borrowed from the PWLB at a range of fixed rates, at an overall average rate of around 4.2%. Loans repayable on maturity range from 3.06% to 7.875%, while EIP (Equal Instalment of Principal) loans range from 1.94% to 3.77%.
(c) Debt managed by Lancashire County Council after Local Government Reorganisation, which is repaid in quarterly instalments across the year – charged provisionally at 2%.
(d) Debt recognised on the balance sheet as a result of accounting adjustments in respect of bringing into use those new school buildings financed through Public Finance Initiative (PFI) arrangements. The Council's effective control over and use of these assets is thereby shown "on balance sheet", with corresponding adjustments to the debt. This does not add to the costs faced by the Council Tax payer as these are incurred through the payments made from the PFI contractor (and are largely offset by PFI grant funding from the Government).

4.6 Issues to note in the period

The most significant cash flow movement in the period was the payment of £13.4 M in respect of the pension deficit contributions due to Lancashire Pension Fund following the triennial actuarial valuation. The Pension Fund gave the authority a significant discount for paying what would have been thirty six monthly instalments of the pension deficit repayment, as a single lump sum at the start of the three years. Though additional borrowing was and will be required over the three years, it is still projected that this will generate net savings for the Council over the period of between £617k and £755k. This matter was reported to Council Forum on 20th April.

Over the period as a whole, net borrowing increased and cash balances built up (as short term borrowing was taken to ensure there were sufficient funds to cover the upfront pension payment as well as day to day operational cash flow needs). Further short term borrowing will be taken over the rest of the year as both long and short term loans mature, and as material capital expenditure is incurred.

If it appears likely that the short run cost of carrying long term borrowing would be outweighed by future interest rate increases, some longer term borrowing may be taken.

Investments will continue to be kept short term, and mainly in liquid deposits.

4.7 Potential negotiations over the re-financing of the existing PFI contract for BSF schools

It is likely that the Council's partner in the current PFI (Private Finance Initiative) contract covering three BSF (Building Schools for the Future) schools in the borough will shortly look to re-finance the existing deal. The Council will be involved in this process by default, and it will have the option of being more actively involved.

4.8 Performance against Prudential and Treasury Indicators

Appendix 3 shows the current position against the Prudential and Treasury Indicators set by the Council for the previous and current year.

Movements in the key indicator – Overall Borrowing against Borrowing Limits – are shown as the first graph in Appendix 4. Our total borrowing at 31st May 2017 was £274.4M, well within our Authorised and Operational Borrowing Limits for 2017/18 (£312.8M and £322.8M respectively). The Authorised Borrowing Limit is the key Prudential Indicator - loans from the PWLB cannot be taken if this Limit is (or would be caused to be) breached.

This total debt includes the impact on the balance sheet of the recognition of assets brought into use that have been financed through PFI. The accounting adjustments are designed to show our effective long term control over the assets concerned, and the "indebtedness" arising from financing the cost of them. They do not add to the "bottom line" cost met by the Council Tax payer.

The significant level of short term borrowing resulted in the Council breaching the limit it set for itself for the Maturity Structure of its Borrowing, in the last two weeks of 2016/17, with more than 30% of debt held having a maturity of less than one year. The equivalent limit for 2017/18 (set at 35%) has not been breached as yet, but may be – for example if opportunities arise to take short term borrowing at a good rate, a little ahead of need in the year.

The breach is not a major issue – Prudential and Treasury Indicators are not hard and fast limits - but highlights the high level of short term borrowing being taken. It occurred was as a result of taking advantage of the opportunity to make savings.

Interest Risk Exposures

Our **Variable Interest Rate Exposure** (see second graph at Appendix 4) ended the period at around £44M. At the end of 16/17, it was over £46M - the limit set for that year (of £43M) was breached in the last two weeks of the year.

A new limit (£54.2 M) was set for 2017/18, in setting the Treasury Management Strategy at Finance Council in February 2017 – this year's limit has not been breached.

This indicator exists to ensure that the Council does not become over-exposed to changes in interest rates impacting adversely on its revenue budget. The limit is set to allow for short as well

as long term borrowing, and takes:

(a) all variable elements of borrowing (including short term borrowing – up to 364 days – and any LOBO debt at risk of being called in the year), which are then offset by
(b) any lending (up to 364 days).

The high level of short term, variable borrowing now being taken caused the breach at the end of 2016/17, and means we will continue to run close to the limit set for 2017/18. Such a breach is only a warning flag, rather than a serious concern. If there are signs of significant upward movements in interest rates, the borrowing strategy will be reviewed (as noted at 4.6, above).

The Prudential and Treasury Indicators set for 2016/17, and to some extent for 2017/18, did not allow for the scale of borrowing that was eventually taken ahead of the up-front pension payment. If necessary, the Indicators set for 2017/18 can be amended at the Mid-Year Treasury Management Strategy review which will be taken to Council later this year.

Our **Fixed Interest Rate Exposure** fell - with the PWLB debt repayments made at the end of March - to around £115.6M, against the 2016/17 limit of £223 M and the 2017/18 limit of £220 M. This indicator effectively mirrors the previous indicator, tracking the Council's position in terms of how much of the debt will **not** vary as interest rates move. The historically low interest rates prevailing over recent decades led the Council to hold a large part of its debt in this way.

This limit was set to allow for the possibility of higher levels of new long term, fixed rate borrowing, which have not been taken.

5. POLICY IMPLICATIONS None

6. FINANCIAL IMPLICATIONS

The financial implications arising from Treasury Management activities are reflected in the Council's overall Budget Strategy, and in ongoing budget monitoring throughout the year.

7. LEGAL IMPLICATIONS

The report is in accordance with the CIPFA code and therefore is in accordance with the Financial Procedure Rules under the Council's Constitution.

8. RESOURCE IMPLICATIONS None

9. CONSULTATIONS None

10. STATEMENT OF COMPLIANCE

The recommendations are made further to advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation and an equality analysis and impact assessment has been considered. The recommendations reflect the core principles of good governance set out in the Council's Code of Corporate Governance.

VERSION:	**0.03**

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BACKGROUND PAPERS:	CIPFA Guidance - CLG Investment Guidance - Council Treasury Management Strategies approved Finance Council 29th Feb 2016 and 27th February 2017