REPORT to :	Audit and Governance Committee
LEAD OFFICER:	Director of Finance And Customer Services
DATE:	16th October 2018

WARD/S AFFECTED: All

Treasury Management Mid-Year Strategy Review for 2018/19

1. PURPOSE

1.1 To update Members with regard to the Treasury Management position to date and proposed Strategy for the remainder of 2018/19.

2. RECOMMENDATIONS

It is recommended that Audit and Governance Committee

(a) notes the Treasury Management position for the year to date, and the proposed Strategy for the remainder of the year, and

(b) approves that there be no changes to the existing Treasury and Prudential Indicators for 2018/19, as set at Finance Council (26th February 2018).

3. BACKGROUND

3.1 In February 2018 the Council agreed a Treasury Management Strategy and Minimum Revenue Provision (MRP) Policy for 2018/19. It is necessary to review and consider updating the Strategy, if required.

3.2 Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter.

In England 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.

4. KEY ISSUES AND RISKS

4.1 Treasury Priorities

The Council has operated within CIPFA and statutory guidance and requirements in respect of Treasury Management practice. The approved Treasury Management Policy Statement, together with the more detailed Treasury Management Practices and each year's Annual Strategy have all emphasised the importance of security and liquidity over yield.

5. STRATEGY REVIEW 2018/19

5.1 Original Strategy for 2018/19

5.1.1 The Treasury Management Strategy for 2018/19 was approved by Council on 26th February 2018.

5.1.2 The broad strategy set at the start of 2018/19 continued the approach set across the last few years, recognising a widening, significant long-term under-borrowing against the Council's accumulated Capital Financing Requirement. There was uncertainty over the timing of still anticipated future increases in borrowing costs, but some interest rate increases were expected in the next few years. The availability of cheaper short-term cash still meant, however, that it was still likely that the Council would be able to limit long-term borrowing and generate net interest savings, as it had been doing for a number of years.

5.1.3 **The Original 2018/19 Investment Limits** – which were set by reference to amount, duration and credit rating - distinguished between Unsecured Deposits, which would be subject to greater risk of credit loss, and Secured Deposits, where there was less risk. The limits set were largely comparable to those applying in previous years. The medium term intention was that, should investment balances grow, a greater diversity of investments would be used, again with a view to managing risk. **Appendix 1** summarises the investment criteria set for 2018/19.

5.2 Economic Review 2018/19

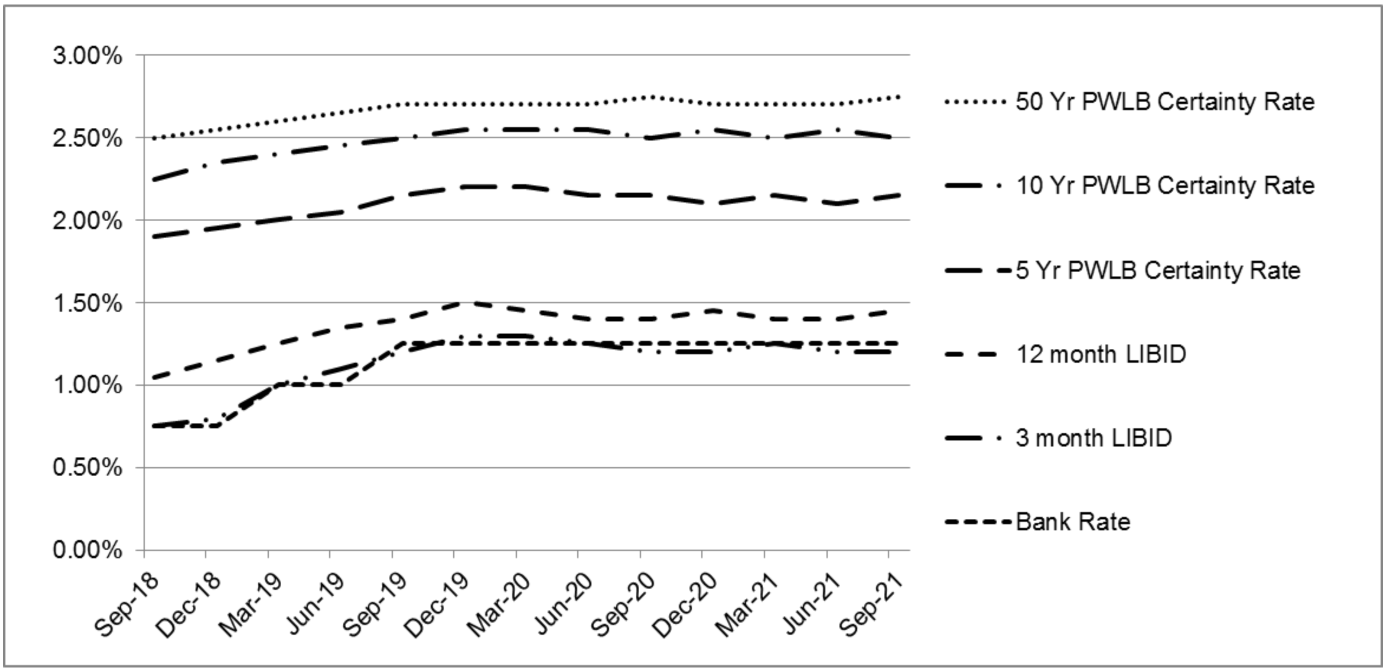
5.2.1 The UK economy's performance and interest rate expectations have been heavily shaped by the forthcoming British exit from the European Union. There has been a falling off in economic growth, though employment levels remain high, and some inflationary pressures have built up, linked in part to sterling exchange rate movements.

The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29th March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

5.2.2 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. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that (a) ultra-low interest rates result in other economic problems, and that (b) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise and cuts are required.

5.2.3 Market expectations are now for two further increases in Bank Rate over 2019, but, overall, interest rates are projected to remain at relatively low levels. The **Council's current projections for interest rates**, based on the latest central forecast from our advisors Arlingclose is summarised in the chart below.



5.3 Treasury Performance to Date

5.3.1 Thus far, cash balances have typically averaged between £20M and £35M. These levels have been supported by short term borrowing (at rates averaging around 0.75%). No long term borrowing has yet been taken, while short term borrowing has fluctuated, but currently stands at around the same level as the start of the year.

Analysis of debt outstanding	31st March 2018		30th Sept 2018	
	£M	£M	£M	£M
TEMPORARY DEBT				
Short Term borrowing	85.0		72.0	
		85.0		72.0
LONGER TERM DEBT				
Public Works Loans Board (PWLB)	104.5		103.8	
Bonds	20.5		18.0	
Other Market Debt	0.3		0.3	
		125.3		122.1
Lancs County Council transferred debt		15.4		15.0
Recognition of Debt re PFI Arrangements		66.8		66.0
TOTAL DEBT		292.5		275.1
Less: Temporary Lending		-33.7		-24.6
		258.8		250.5

5.3.2 Investments have continued to be made with a limited range of banks, building societies and Money Market Funds, along with other local authorities, and the Government's Debt Management Office (DMO), earning interest at low levels (averaging around 0.50% in the first half of the year). It is likely that investment returns will remain low in the second half of the year.

5.3.4 Increased net interest costs have already been reported through corporate monitoring, reflecting higher interest rates this year. This is because the higher costs of borrowing outweigh the benefit from increased returns on investments. Further increases in net interest costs are possible, depending upon interest rate movements and on the borrowing strategy adopted later in the year.

5.4 Investment and Borrowing Strategy for the rest of the year

5.4.1 **Investment**

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Though the Council's Investment Criteria allow investment in other organisations and structures, the priority given to maintaining liquidity, and limited opportunities for straightforward trading in Secured Deposits, have meant that simple, short dated options have been used. Therefore, actual investments have continued to be made in: fixed term deposits and instant access accounts with banks and building societies; instant access Money Market Funds; and fixed term deposits with local authorities and the UK Government's Debt Management Office.

It is possible, particularly if material levels of borrowing are taken in future, that at least some investments will be made in a wider range of high grade instruments, such as Treasury bills. The Council's professional treasury advisers, Arlingclose, consider that such widening of the range of the Council's investment instruments would be both appropriate and prudent.

It is proposed that there be no changes to the existing Investment Criteria (set out in Appendix 1).

5.4.2 **Borrowing**

The Authority'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.

It is proposed that the Borrowing Strategy also remain largely unchanged, with the Council looking to take new borrowing as determined by cash flow requirements and by reference to movements in long term interest rates.

However, while the cheapest short term option will be to continue to take a mix of short term borrowing, at rates of between 0.50% and 1.10%, it is possible that, having regard to the Council's borrowing costs in the medium to long term, consideration will be given to taking at least some longer term borrowing. This may generate short run cost pressures this year, and into next year.

5.5 Risk Management

5.5.1 The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return. The majority of its surplus cash is therefore held as short-term investments with the UK Government, highly rated banks and pooled funds. In addition, the Council holds some investments that entail a slightly higher level of risk, including unrated building society deposits (where risks have been mitigated by limiting the amount and duration of exposure).

5.5.2 The Council's primary objective for the management of its debt is to ensure its long-term affordability. The largest part of its loans is from the PWLB at long-term fixed rates of interest.

5.5.3 Another significant element of the Council's long term debt is £18M of loans from banks and other institutions. Of these, £13M worth are "lender's option, borrower's option" (LOBO) loans with initially fixed (and initially low) rates of interest. Under these instruments the Lender can, at certain times, exercise an option to increase the rate payable on the debt, and the Borrower has the choice then either to accept the proposed increase or repay the whole loan (which would mean, effectively, having to live with whatever the market conditions for interest rates were at that point).

This exposes the Council to some risk of rising long-term interest rates, but that is mitigated by the fact that £5M of this debt (forming a large part of the lowest interest rate elements) can only be "called" once in every five years. Recent estimates based on the current projected future interest rates, suggest LOBOs are unlikely to be called in the next 5 years (assuming no extraneous influences).

5.5.4 A combination of short duration investments and long duration debt exposes the Council to the risk of falling investment income during periods of low interest rates. However, the risk of low investment returns is viewed as of lower priority compared to the benefits of optimising the security and liquidity of investments, and the savings made on borrowing costs. Also, though the Council has no long term investments, it is hedged against the investment return risk by its short term debt.

5.5.5 The large and expanding part of the debt portfolio - of around £70M to £80M in short term loans from other local authorities - does raise interest rate risk issues. If the medium to long term cost of debt were to move sharply upwards, it may be necessary to restructure the Council's debt quickly, and cope with an increased cost of borrowing. This issue is kept under review, with regular updates from Arlingclose.

5.6 Treasury and Prudential Indicators

5.6.1 The originally approved Treasury and Prudential Limits and Indicators were set at cautious levels and can remain unchanged.

The Council has complied with the Limits and Indicators is has set, and expects to do so over the remainder of the year.

5.7 Minimum Revenue Provision (MRP) Policy

5.7.1 The Council's MRP is the minimum amount which must be charged to revenue each year as a provision for the repayment of debt. The Council, within regulatory guidance, sets its own policy to ensure that the MRP it makes each year is prudent. The charge includes elements relating to "historic debt", acquired before the Prudential Borrowing regime, together with elements relating to more recent "Prudential Borrowing debt".

5.7.2 In setting the 2018/19 MRP Policy, the Council reflected policy changes made in previous years which had generated significant savings. No further changes to MRP Policy are now recommended.

6. FINANCIAL IMPLICATIONS

The financial implications arising from the 2017/18 Treasury Outturn and latest position for 2018/19 have been incorporated into Corporate Budget Monitoring Reports.

7. LEGAL IMPLICATIONS

7.1 Under the Local Government Act 2003, local authorities determine locally their levels of capital investment and associated borrowing. The Prudential Code has been developed to support local authorities in taking these decisions, and the Council is required by Regulation to have regard to the Code when carrying out its duties under Part 1 of the Local Government Act 2003.

7.2 The Department for Communities and Local Government issued Guidance on Local Government Investments, under the Local Government Act 2003, effective from 1st April 2010. Authorities must manage their investments within an approved strategy, setting out what categories of investment they will use and how they will assess and manage the risk of loss of investments.

---

8. POLICY IMPLICATIONS, RESOURCE IMPLICATIONS, CONSULTATIONS

None

9. 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:	**0.01**

CONTACT OFFICER:	Ron Turvey - Deputy Finance Manager extn 5303 Louise Mattinson - Director of Finance and IT extn 5600
DATE:	4th October 2018
BACKGROUND PAPER:	Treasury Management strategy for 2018/19 approved at Council 26th February 2018.