Pecyn Dogfennau Cyhoeddus

The following report is an information item for the Policy and Resources Scrutiny Committee.

1. Treasury Management And Capital Financing Prudential Indicators Quarter 3 Monitoring Report (1st April 2017 To 31st December 2017).

POLICY AND RESOURCES SCRUTINY COMMITTEE –
FOR INFORMATION

SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS QUARTER 3 MONITORING REPORT (1ST APRIL 2017 TO 31ST DECEMBER 2017)

REPORT BY: ACTING DIRECTOR OF CORPORATE SERVICES AND SECTION 151 OFFICER

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1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st April 2017 to 31st December 2017.

1.2 To review the Treasury Management Strategy for 2017/18 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

2.1 The Code of Practice on Treasury Management in the Public Services 2009, which was adopted by the Council on 12th October 2010, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate Committee on a quarterly basis.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2017/18 were approved by Council on 22nd February 2017.

3. LINKS TO STRATEGY

3.1 Treasury Management Strategy 2017/18 as agreed by Council on 22nd February 2017.

3.2 Prudent financial management contributes to the following Well-being Goals within the Well-being of Future Generations Act (Wales) 2015:-

- A prosperous Wales.
- A resilient Wales.
- A healthier Wales.

- A more equal Wales.
- A Wales of cohesive communities.
- A Wales of vibrant culture and thriving Welsh Language.
- A globally responsible Wales.

4. THE REPORT

4.1 Treasury Management

4.1.1 Borrowing Activity

The current policy of internal borrowing is not sustainable in the long-term, but where prudent the policy of internal borrowing will be utilised. As at the 31st March 2017 the internal borrowing position was £22m.

The Annual Treasury Management Strategy was approved by Council in February 2017 and indicated that there would be a need to borrow £17.6m in 2017/18 to part fund the General Fund capital programme. As at the 31st December 2017 no new long-term loans were raised.

During the period covered by this report, PWLB loans to the value of £4.32m were repaid on maturity. Such loans had an average interest rate of 5.48%. £30k of the WRU Loan was also repaid. Temporary loans of £10m were repaid during the reported period. The loans were raised during March and November 2017 for the purpose of cashflow requirements as investments were tied in. Total debt outstanding as at 31st December 2017 was £285.5m and comprised of £239.3m PWLB loans; £30m market loans (LOBOs); £10m Bank loan; £180k WRU loan and a £6m temporary loan.

With respect to LOBO loans the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. A LOBO loan with a total value of £10m had a rate option reviewed during quarter one and the lender chose not to exercise the option. LOBO loans will be further reviewed again later in 2017/18 by lenders, with a total value of £10m that is exposed to variable interest rate movement. This represents 3.5% of the Authority's debt portfolio, which is within the Council's determination of 30%. The Authority acknowledges there is an element of refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options.

4.1.2 Rescheduling

The Annual Strategy allows for the utilisation of debt rescheduling providing for both in year and future year savings and additional revenue resources. No rescheduling opportunities presented themselves during the period covered by this report.

4.1.3 Investments

During the reported period the Authority was holding £23.0m of long-term investments where the maturity date is greater than 364 days. These investments are in accordance with the approved Investment Strategy. The long-term investments comprise of covered bonds with UK banks/ building societies and have an AAA rating and UK Gilts. The covered bonds are secured investments and collateralised against the counterparty's pool of assets. The value of short-term investments as at 31st December 2017 was £83.0m.

Total investments held as at 31st December 2017 was £106.0m, which yielded an average rate of return equating to 0.70%. This is a significant improvement over placing deposits with the Debt Management Office (DMO) who continue to pay a rate of 0.25%. The rate of return is above the target rate, as detailed in the Annual Treasury Management Strategy report to Council, of 0.25%. The improvement in returns reflect the Authority's change in investment strategy and lending to high creditworthy counterparties that consist of banks; building societies; supranational institutions; the DMO, local authorities; and corporates using a range of investment products such as corporate bonds; covered bonds; cash deposits; money market fund and treasury bills. Whilst the returns have improved, the riskiness of the investment portfolio has been quantified with a weighted average credit score equivalent to an AA- rating. The UK government is currently rated by two credit rating agencies at AA. Therefore the Authority's portfolio is one notch below the UK Government rating.

The portfolio as at 31st December 2017 comprised of the following types of investments:

Counterparty	Investment Product	Sector	£m
Banks	Certificate of Deposits	Financial	17.00
Moneymarket Fund	Cash Pooled Fund	Financial	2.63
Banks & building societies	Fixed-term cash deposits	Financial	21.62
Banks & building societies	Covered bonds	Financial	25.91
Corporates	Bonds	Automobile/ Consumer Goods/ Utilities/ Financial/ Industrial	23.82
UK Government	Gilts	UK Government	10.00
Local Authorities	Fixed-term cash deposits	Public Sector	5.00
Total Investments as at 31st December 2017			**105.98**

4.1.4 <u>Economic Outlook</u>

The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Both consumer and business confidence remain subdued. Household consumption growth, the driver of UK GDP growth, has softened following a contraction in real wages. Savings rates are relatively low and real earnings growth (i.e. after inflation) struggles in the face of higher inflation.

Bank Rate increased in November by 0.25% to 0.50%, making it the first increase in interest rate by the Bank of England's Monetary Policy Committee (MPC) since July 2007. The vote to increase Bank Rate was 7-2, reflecting the MPC's growing concern that rising inflation had finally outweighed the risks to growth. The Bank has reiterated that it expects any future increases in Bank Rate to be at a gradual pace and limited in extent.

UK Consumer Price Inflation (CPI) index continued to rise with the data print for November showing CPI at 3.1%, its highest since March 2012 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices.

The number of unemployed in the economy continued to decrease. Consumers' wages continued to shrink, in real terms, given average earnings growth remained subdued at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q2 and Q3 GDP growth of 0.3% and 0.4% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings remaining relatively low and real wage growth negative, there are concerns that these will be a constraint on future economic activity.

The US economy grew steadily and inflation increased to 2.2%. The Federal Reserve increased its target range of official interest rates in December for the third time in 2017 by 25 basis points to between 1.25% and 1.50%.

In the face of a struggling economy and Brexit-related uncertainty, Arlingclose expects the Bank of England to take a very measured approach to any monetary policy tightening. Any increases will be gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy through the Brexit transition. Arlingclose's central case is for gilt yields to remain broadly stable across the medium term.

	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

4.1.5 Counterparty Update

UK bank credit default swaps have remained broadly stable throughout the quarter. Bank share prices have not moved in any pattern.

Much of the activity by credit rating agencies during the quarter has related to the upcoming UK bank ring-fencing which will take effect in 2018. Ring-fencing requires the larger UK banks to separate their core retail banking activity from the rest of their business, resulting in two separate banks. In general, the agencies expect to give the ring-fenced "retail" bank a higher credit rating than the non-ring-fenced "investment" bank. In practice, this will only affect Barclays, HSBC, Lloyds and RBS as other UK banks and building societies either only conduct retail banking activities or have less than £25 billion of deposits covered by the Financial Services Compensation Scheme.

4.1.6 Regulatory Update- MiFID II

On the 3rd January 2018 the second Markets in Financial Instruments Directive (MiFID II) came into force and embedded into UK law. The Directive will treat local Authorities as "retail" clients. The Directive allows local authorities to opt up to "Professional" status if they meet criteria that have been set by the Financial Conduct Authority. The purpose of the Directive is to put in place restrictions on what financial products and services a local authority can have access to. The "retail client" status will restrict access to money market funds; pool funds; bonds; shares and financial advice. Furthermore, there will be additional administration and higher fees. The Authority meets the conditions to opt up to "professional" status and has contacted the relevant financial institutions and intermediaries in order to make them aware of the Authority's MiFID status. As a result of opting up the Authority will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and financial advice.

4.1.7 CIPFA Codes

CIPFA has made changes to the Prudential Code and the Treasury Management Code of Practice. CIPFA has published the two revised Codes at the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year.

The changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital programme and treasury management, and changes to the prudential indicators. The changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of "investments" as well as loans made or shares brought for service purposes

4.2 **Prudential Indicators**

4.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 1 shows a revised projected CFR value of £334.51m as at 31st March 2018. The actual CFR as at 31st March 2017 was £341.55m.

4.2.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management are shown in Appendix 1, and the Authority is currently operating within the approved limits.

4.2.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2, and currently show a projected reduction from the original budget as a consequence of deferred borrowing.

4.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows no change against the planned position.

5. WELL-BEING OF FUTURE GENERATIONS

5.1 The effective management of the Authority's borrowing and investments are key in ensuring that the Well-being Goals within the Well-being of Future Generations Act (Wales) 2015 are met.

6. EQUALITIES IMPLICATIONS

6.1 This report is for information purposes, so the Council's Equalities Impact Assessment (EqIA) process does not need to be applied.

7. FINANCIAL IMPLICATIONS

7.1 As detailed throughout the report.

8. PERSONNEL IMPLICATIONS

8.1 There are no direct personnel implications arising from this report.

9. CONSULTATIONS

9.1 There are no consultation responses that have not been reflected in this report.

10. RECOMMENDATIONS

10.1 Members are asked to note the contents of this report.

11. REASONS FOR THE RECOMMENDATIONS

11.1 Compliance with the CIPFA "Code of Practice for Treasury Management in the Public Services".

12. STATUTORY POWER

12.1 Local Government Acts 1972 and 2003.

Author: N. Akhtar – Group Accountant (Financial Advice and Support)
E-mail: akhtan@caerphilly.gov.uk Tel: 01443 863313
Consultees: S. Harris - Interim Head of Corporate Finance & Deputy S151 Officer
A. Southcombe – Finance Manager, Corporate Finance
Cllr B. Jones- Deputy Leader and Cabinet Member for Finance, Performance and Governance

Appendices:
Appendix 1 – Treasury Management Prudential Indicators – Prudence
Appendix 2 – Capital Finance Prudential Indicators – Affordability
Appendix 3 – Capital Expenditure and Funding

'Appendix 1 Treasury Management Prudential Indicators- Period 9 report (Quarters 1, 2 & 3)

	Budget 2017-18	Estimated 2017-18
	£000	£000
Authorised limit for external debt -		
Borrowing	403,699	403,699
Other long term liabilities	34,139	34,139
Total	**437,838**	**437,838**
Operational boundary for external debt -		
Borrowing	322,959	279,498
Other long term liabilities	34,139	34,139
Total	**357,098**	**313,637**
Capital Financing Requirement	359,522	334,514
Upper limits for interest rate exposure		
Principal outstanding on borrowing	322,959	279,498
Principal outstanding on investments	100,000	100,000
Net principal outstanding	**222,959**	**179,498**
Fixed rate limit – 100%	222,959	179,498
Variable rate limit – 30%	66,888	53,849
Upper limit for total invested for over 364 days	**50,000**	**50,000**

Maturity structure of fixed rate borrowing	Upper Limit	Lower Limit
Under 12 months	**35%**	**0%**
Over 12 months and within 24 months	**40%**	**0%**
Over 2 years and within 5 years	**50%**	**0%**
Over 5 years and within 10 years	**75%**	**0%**
Over 10 years	**100%**	**0%**

Gross Debt and Net Debt	Budget 2017-18	Estimated 2017-18
	£000	£000
Outstanding Borrowing	322,959	279,498
Other long term liabilities	34,139	34,139
Gross Debt	**357,098**	**313,637**
Less investments	100,000	100,000
Net Debt	**257,098**	**213,637**

Gross and The CFR	Budget 2017-18	Estimated 2017-18
	£000	£000
Gross Debt	357,098	313,637
CFR	359,522	334,514
CFR Breached?	No	No

'Appendix 2 - Prudential Indicators - Capital Finances- Period 9 report (Quarters 1, 2 & 3)

Ratio of Financing costs to net revenue stream	Budget 2017-18	Estimated 2017-18
General Fund	**£000**	**£000**
Principal repayments	2,373	2,347
Interest costs	8,709	8,080
Debt Management costs	45	45
Rescheduling discount	-153	-153
Investment income	-400	-850
Interest applied to internal balances	813	813
Total General Fund	**11,386**	**10,282**
Net revenue stream	324,031	324,031
Total as percentage of net revenue stream	**3.51%**	**3.17%**
Housing Revenue Account		
Principal repayments	2,267	2,260
Interest costs	6,083	5,190
Rescheduling discount	-39	-39
Debt Management costs	39	30
Total HRA	**8,352**	**7,442**
Net revenue stream	46,400	46,400
Total as percentage of net revenue stream	**18.00%**	**16.04%**

Estimate of incremental impact of capital investment on Council Tax and Housing Rents	Budget 2017-18	Estimated 2017-18
General Fund	**£000**	**£000**
Unsupported borrowings - principal	351	351
- interest	804	804
Loss of investment income	34	34
Total	**1,189**	**1,189**
Impact on Band D council tax	**19.86**	**19.86**
Housing Revenue Account		
Loss of investment income	1	1
Unsupported borrowings - principal	518	518
- interest	907	907
Total	**1,426**	**1,426**
Impact on average weekly rent	**0.23**	**0.23**

This is a notional calculation

Capital financing requirement [end of year position]	Budget 2017-18	Estimated 2017-18
	£000	**£000**
Council Fund	223,337	224,828
Housing Revenue Account	136,185	109,687
Total Authority	**359,522**	**334,514**

'Appendix 3 - Capital Expenditure and Funding- Period 9 report (Quarters 1, 2 & 3)

	Budget 2017-18	Estimated 2017-18
Expenditure	**£000**	**£000**
Council Fund	16,456	16,456
Housing Revenue Account	50,200	50,200
Total	**66,656**	**66,656**
Funding		
Surplus/ (Deficit) Balance b/f	971	971
Borrowings - Supported (GF)	5,002	5,002
General Capital Grant - WG	3,044	3,044
Internal Borrowing		
RCCO Budget	128	128
Capital underspends from previous years		
One off funding- MRP Review 16.17	5,540	5,540
One off funding- MRP Review 17.18	1,929	1,929
RCCO- (HRA)	16,700	16,700
Capital Receipts (HRA)	300	300
Borrowings - Unsupported (HRA)	25,900	25,900
Major Repairs Allowance (HRA)	7,300	7,300
Total	**66,814**	**66,814**
Surplus C/f	**158**	**158**