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The following reports are Information Items for the Policy and Resources Scrutiny Committee.

1. **PFI (Private Finance Initiative) - Education And Transport Services.**

2. **Treasury Management and Capital Financing Prudential Indicators Quarter 1 And Quarter 2 Monitoring Report (1st April 2018 To 30th September 2018).**

POLICY AND RESOURCES SCRUTINY COMMITTEE – FOR INFORMATION

SUBJECT: PFI (PRIVATE FINANCE INITIATIVE) - EDUCATION AND TRANSPORT SERVICES

REPORT BY: CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE SERVICES

1. PURPOSE OF REPORT

1.1 This report has been prepared following a Member request for information in respect of the Authority's 2 PFI contracts.

1.2 The Authority has 2 PFI contracts, one is for the Sirhowy Enterprise Way (SEW) and the second is for two secondary schools, Lewis School Pengam and YGG Cwm Rhymni.

2. SUMMARY

2.1 SEW is a design, build, finance and operate Contract. The contract was signed on 21 January 2004 and the contract concession period is for 30 years expiring on 20 January 2034. The contract for the 2 schools is again design, build, finance and operate and it was signed on 6 April 2001 with a contract concession period of 30 years from commencement of operations. This contract expires on 31 August 2032.

2.2 As with all contractual arrangements it is good practice to review contract management arrangements and to explore opportunities to vary contracts or even terminate contracts where there are benefits.

2.3 Officers have commenced a thorough review of the 2 contractual arrangements with a view to conclude this review in order to present a range of options to Cabinet in late spring/early summer 2019.

3. LINKS TO STRATEGY

3.1 Good contract management arrangements contribute 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 An Officer group has been established to review the Authority's PFI arrangements. This Officer group comprises:-

Head of Corporate Finance and S151
Interim Head of Business Improvement Services
Contracts Manager
Head of Education Planning and Strategy
Finance Manager, Education.

4.2 The Officer group has met a number of times and established very early on that specialist support would be required to progress an options appraisal to present to Members. This approach has been endorsed by the Corporate Management Team.

4.3 LP (Local Partnerships) have been engaged and have expertise in this specialist area to assist Officers.

4.4 LP have assisted other Local Authorities in Wales with similar reviews. From the outset it became clear that the detailed review culminating in an options appraisal report to Members would take a lengthy period. These are complex high value contracts and the Officers involved at the commencement of the contracts have now left the Authority.

4.5 Officers are anticipating that the options appraisal report will be presented to Cabinet in late spring/early summer 2019.

4.6 At this early stage of the process there are no conclusions and it is still very much work in progress.

5. WELL-BEING OF FUTURE GENERATIONS

5.1 The effective management of the Authority's contractual arrangements 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 The actual costs to date for engaging LP to support the review process are £32.6k. This one-off cost has been funded through underspends in Corporate Finance.

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 To ensure Members are updated in respect of the Authority's PFI arrangements.

12. STATUTORY POWER

12.1 Local Government Acts 1972 and 2003.

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Ed Edmunds – Director Education and Corporate Services
S. Richards - Head of Education Planning and Strategy
J. Southcombe – Finance Manager, Education
I. Evans – Contracts Manager
Cllr B. Jones - Deputy Leader and Cabinet Member for Finance, Performance and Governance

POLICY AND RESOURCES SCRUTINY COMMITTEE – FOR INFORMATION

SUBJECT: **TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL INDICATORS QUARTER 1 AND QUARTER 2 MONITORING REPORT (1^{ST} APRIL 2018 TO 30^{TH} SEPTEMBER 2018)**

REPORT BY: **CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE SERVICES**

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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 1^{st} April 2018 to 30^{th} September 2018.

1.2 To review the Treasury Management Strategy for 2018/19 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 12^{th} 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 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 capital strategy will be submitted to Full Council later in the year along with the Revenue Budget Report and the 2019/20 Treasury Management Strategy.

2.4 The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2018/19 were approved by Council on 22^{nd} February 2018.

3. LINKS TO STRATEGY

3.1 Treasury Management Strategy 2018/19 as agreed by Council on 22^{nd} February 2018.

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 2018 the internal borrowing position was £33m.

The Annual Treasury Management Strategy was approved by Council in February 2018 and indicated that there would be a need to borrow £22.6m in 2018/19 to part fund the General Fund capital programme. A further £44.3m is planned to be raised for the HRA to fund the WHQS capital programme. As at the 30th September 2018 no new long-term loans were raised.

During the period covered by this report, PWLB loans to the value of £552k were repaid on maturity. Such loans had an average interest rate of 3.98%. £30k of the WRU Loan was also repaid. A Temporary loan of £6.9m was repaid during the reported period. The loan was raised for the purpose of cashflow requirements as investments were tied in. Total debt outstanding as at 30th September 2018 was £279.5m and comprised of £239.3m PWLB loans; £30m market loans (LOBOs); £10m Bank loan and £150k WRU 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 2018/19 by lenders, with a total value of £20m that is exposed to variable interest rate movement. This represents 7.2% of the Authority's debt portfolio, which is exposed to interest rate risk. 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 £34.3m of long-term investments where the maturity date is greater than 365 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; UK Gilts and supernational bonds. The covered bonds are secured investments and collateralised against the counterparty's pool of assets. The value of short-term deposits as at 30th September 2018 was £62.6m.

The total investments held as at 30th September 2018 was £96.9m, and had an average rate of return equating to 0.86% which is a significant improvement over placing deposits with the Debt Management Office (DMO) who continue to pay a rate of 0.50%. 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; money market fund and corporates using a range of investment products such as corporate bonds; covered bonds; cash deposits 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 on par with the UK Government rating.

The portfolio as at 30th September 2018 comprised of the following types of investments:

Counterparty	Investment Product	Sector	£m
Banks	Certificate of Deposits	Financial	8.0
Banks & building societies	Fixed-term cash deposits	Financial	7.0
Banks & building societies	Covered bonds	Financial	18.4
Corporates	Bonds	Automobile/ Transport Infrastructure/ Financial/ Consumer/ Natural Resources	25.8
Money Market Fund	Cash Pooled Fund	Financial	7.7
Supranational Institutions	Bonds	Sovereign/ Financial	7.0
UK Government	Gilts/ T Bills	UK Government	13.0
Local Authorities	Fixed-term cash deposits	Local Government	10.0
Total Investments as at 30th September 2018			**96.9**

4.1.4 Economic Outlook

The UK Consumer Price Inflation (CPI) index for September showed CPI at 2.4%, a reduction from the previous month (2.7%). The unemployment rate remained unchanged at 4.0% for the three months to August 2018, its lowest since May 1975. Economic activity improved in quarter two due to an increase in inventories held by businesses. But year to year GDP growth remains below trend.

The Bank of England's Monetary Policy Committee (MPC) voted unanimously to increase Bank Rate to 0.75% in August. The market's reaction to the rate hike suggests that investors expect both the relatively weak economic environment and ongoing political developments (Brexit negotiations and US trade relations). However the MPC is reluctant to push interest rate expectations too strongly to avoid a sharp rise in government bond yields. The MPC see a long-term Base Rate level between 2% and 3%.

The escalating trade war between the US and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just to China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019. Uncertainty continues to depress capital investment in the UK as a result of the ongoing Brexit negotiations and a failure to find a compromising a trade agreement which will shape the future UK/EU relationship.

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 ultra-low interest rates result in other economic problems; and that a higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise and cuts are required.

Arlingclose's central case is for Bank Rate to rise twice in 2019. The UK economic environment is relatively fragile, despite seemingly strong labour market data. GDP growth remains well below the long term average.

	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Ca	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Downside risk	0.00	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

4.1.5 Counterparty Update

The ring-fencing of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc – is complete, the transfer of their business lines into retail (ring-fenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018.

There were a few credit rating changes for UK banks during the period mainly driven by the restructuring of bank structures as a consequence of the Vickers Report (The Independent Commission on Banking - September 2013) that recommended the separation of retail and investment divisions of UK banks. This has resulted in a ring-fence and a non-ring-fence banking entities, each with a separate credit rating.

4.1.6 Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Such investments can comprise of property; shared ownership housing; loans to local businesses/ subsidiaries; and shareholdings. During the reported period the Authority did not hold any non-treasury related investments.

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 projected CFR value of £359.03m as at 31st March 2019. The actual CFR as at 31st March 2018 was £345.14m.

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 for the General Fund.

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.

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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- Mid Year report (Quarters 1 & 2)

	Budget 2018-19	Estimated 2018-19
	£000	**£000**
Authorised limit for external debt -		
Borrowing	430,277	430,277
Other long term liabilities	32,504	32,504
Total	**462,781**	**462,781**
Operational boundary for external debt -		
Borrowing	344,221	298,698
Other long term liabilities	32,504	32,504
Total	**376,726**	**331,202**
Capital Financing Requirement	389,132	359,028
Upper limits for interest rate exposure		
Principal outstanding on borrowing	339,259	298,698
Principal outstanding on investments	100,000	90,000
Net principal outstanding	**239,259**	**208,698**
Fixed rate limit – 100%	239,259	208,698
Variable rate limit – 30%	71,778	62,609
Upper limit for total invested for over 364 days	**50,000**	**28,000**

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 2018-19**	**Estimated 2018-19**
	£000	**£000**
Outstanding Borrowing	344,221	298,698
Other long term liabilities	32,504	32,504
Gross Debt	**376,726**	**331,202**
Less investments	100,000	90,000
Net Debt	**276,726**	**241,202**

Appendix 2 Treasury Management Prudential Indicators- Mid Year report (Quarters 1 & 2)

Ratio of Financing costs to net revenue stream	**Budget 2018-19**	**Estimated 2018-19**
General Fund	**£000**	**£000**
Principal repayments	2,383	2,437
Interest costs	8,977	8,195
Debt Management costs	42	42
Rescheduling discount	-110	-110
Investment income	-600	-600
Interest applied to internal balances	847	846
Total General Fund	**11,539**	**10,811**
Net revenue stream	330,643	330,643
Total as percentage of net revenue stream	**3.49%**	**3.27%**
Housing Revenue Account		
Principal repayments	2,194	2,194
Interest costs	6,435	5,627
Rescheduling discount	-28	-28
Debt Management costs	50	51
Total HRA	**8,651**	**7,844**
Net revenue stream	47,210	47,210
Total as percentage of net revenue stream	**18.32%**	**16.61%**

Capital financing requirement [end of year position]	**Budget 2018-19**	**Estimated 2018-19**
	£000	**£000**
Council Fund	238,410	231,293
Housing Revenue Account	150,722	127,736
Total Authority	**389,132**	**359,028**

Appendix 3 Treasury Management Prudential Indicators- Mid Year report (Quarters 1 & 2)

	Budget 2018-19	Estimated 2018-19
Expenditure	**£000**	**£000**
Council Fund	13,652	13,652
Housing Revenue Account	55,801	55,801
Total	**69,453**	**69,453**
Funding		
Surplus/ (Deficit) Balance b/f	158	158
Borrowings - Supported (GF)	4,962	4,962
General Capital Grant - WG	3,020	3,020
General Fund Working Balances	3,446	3,446
RCCO Budget	128	128
Capital underspends from previous years	168	168
Property Services Capital Earmarked Reserve	12	12
One off funding- MRP Review	1,758	1,758
RCCO- (HRA)	27,154	27,154
Borrowings - Unsupported (HRA)	21,300	21,300
Major Repairs Allowance (HRA)	7,347	7,347
Total	**69,453**	**69,453**
Surplus C/f	**-**	**-**