



## **POLICY AND RESOURCES SCRUTINY COMMITTEE – FOR INFORMATION**

**SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS QUARTER 1 AND QUARTER 2 MONITORING REPORT (1ST APRIL 2017 TO 30TH SEPTEMBER 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 1<sup>st</sup> April 2017 to 30<sup>th</sup> September 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 12<sup>th</sup> 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 22<sup>nd</sup> February 2017.

### **3. LINKS TO STRATEGY**

- 3.1 Treasury Management Strategy 2017/18 as agreed by Council on 22<sup>nd</sup> 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 31<sup>st</sup> 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 30<sup>th</sup> September 2017 no new long-term loans were raised.

During the period covered by this report, PWLB loans to the value of £3.78m were repaid on maturity. Such loans had an average interest rate of 6.51%. £30k of the WRU Loan was also repaid. A temporary loan of £6m was repaid during the reported period. The loan was raised during March 2017 for the purpose of cashflow requirements as investments were tied in. Total debt outstanding as at 30<sup>th</sup> September 2017 was £280.1m and comprised of £239.9m PWLB loans; £30m market loans (LOBOs); £10m Bank loan and £180k 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 2017/18 by lenders, with a total value of £20m that is exposed to variable interest rate movement. This represents 7.1% 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 £27.9m 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; UK Gilts and supranational bonds. The covered bonds are secured investments and collateralised against the counterparty's pool of assets. The value of short-term deposits as at 30<sup>th</sup> September 2017 was £87.90m.

The total investments held as at 30<sup>th</sup> September 2017 was £115.80m, and had an average rate of return equating to 0.74% which is a significant improvement over placing deposits with the Debt Management Office (DMO) who continue to pay a rate of 0.10%. 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;



#### 4.1.5 Counterparty Update

There were a few credit rating changes during the reported period. The significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities. UK bank credit default swaps continued their downward trend, reaching three-year lows by the end of June. Bank share prices have not moved in any particular pattern.

#### 4.1.6 Regulatory Update

On the 3rd January 2018 the second Markets in Financial Instruments Directive (MiFID II) comes into force and embeds into UK law. The Directive will treat local Authorities as "retail" clients. At present local authorities are regarded as "professional" clients. The Directive allows local authorities to opt up 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.

CIPFA has proposed to make changes to the Prudential Code and the Treasury Management Code of Practice. CIPFA intends to publish the two revised Codes towards 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 proposed 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 Proposed 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 £357.74m as at 31<sup>st</sup> March 2018. The actual CFR as at 31<sup>st</sup> 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.

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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)**

	<b>Budget 2017-18</b>	<b>Estimated 2017-18</b>
	<b>£000</b>	<b>£000</b>
<b>Authorised limit for external debt -</b>		
Borrowing	403,699	403,699
Other long term liabilities	34,139	34,139
<b>Total</b>	<b>437,838</b>	<b>437,838</b>
<b>Operational boundary for external debt -</b>		
Borrowing	322,959	305,398
Other long term liabilities	34,139	34,139
<b>Total</b>	<b>357,098</b>	<b>339,537</b>
Capital Financing Requirement	359,522	357,738
<b>Upper limits for interest rate exposure</b>		
Principal outstanding on borrowing	322,959	305,398
Principal outstanding on investments	100,000	100,000
<b>Net principal outstanding</b>	<b>222,959</b>	<b>205,398</b>
<b>Fixed rate limit – 100%</b>	222,959	205,398
<b>Variable rate limit – 30%</b>	66,888	61,619
<b>Upper limit for total invested for over 364 days</b>	<b>50,000</b>	<b>50,000</b>

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

<b>Gross Debt and Net Debt</b>	<b>Budget 2017-18</b>	<b>Estimated 2017-18</b>
	<b>£000</b>	<b>£000</b>
<b>Outstanding Borrowing</b>	322,959	305,398
<b>Other long term liabilities</b>	34,139	34,139
<b>Gross Debt</b>	<b>357,098</b>	<b>339,537</b>
<b>Less investments</b>	100,000	100,000
<b>Net Debt</b>	<b>257,098</b>	<b>239,537</b>

<b>Gross and The CFR</b>	<b>Budget 2017-18</b>	<b>Estimated 2017-18</b>
	<b>£000</b>	<b>£000</b>
Gross Debt	357,098	339,537
CFR	359,522	357,738
CFR Breached?	No	No

**'Appendix 2 - Prudential Indicators - Capital Finance- Mid Year report (Quarters 1 & 2)**

<b>Ratio of Financing costs to net revenue stream</b>	<b>Budget 2017-18</b>	<b>Estimated 2017-18</b>
<b>General Fund</b>	<b>£000</b>	<b>£000</b>
Principal repayments	2,373	2,373
Interest costs	8,709	7,869
Debt Management costs	45	45
Rescheduling discount	-153	-153
Investment income	-400	-763
Interest applied to internal balances	813	813
<b>Total General Fund</b>	<b>11,386</b>	<b>10,183</b>
Net revenue stream	324,031	324,031
<b>Total as percentage of net revenue stream</b>	<b>3.51%</b>	<b>3.14%</b>
<b>Housing Revenue Account</b>		
Principal repayments	2,267	2,260
Interest costs	6,083	5,576
Rescheduling discount	-39	-39
Debt Management costs	39	39
<b>Total HRA</b>	<b>8,352</b>	<b>7,836</b>
Net revenue stream	46,400	46,400
<b>Total as percentage of net revenue stream</b>	<b>18.00%</b>	<b>16.89%</b>

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

*This is a notional calculation*

<b>Capital financing requirement [end of year position]</b>	<b>Budget 2017-18</b>	<b>Estimated 2017-18</b>
	<b>£000</b>	<b>£000</b>
Council Fund	223,337	224,802
Housing Revenue Account	136,185	132,937
<b>Total Authority</b>	<b>359,522</b>	<b>357,738</b>

**'Appendix 3 - Capital Expenditure and Funding- Mid Year report (Quarters 1 & 2)**

	<b>Budget 2017-18</b>	<b>Estimated 2017-18</b>
<b>Expenditure</b>	<b>£000</b>	<b>£000</b>
Council Fund	16,456	16,456
Housing Revenue Account	50,200	50,200
<b>Total</b>	<b>66,656</b>	<b>66,656</b>
<b>Funding</b>		
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
<b>Total</b>	<b>66,814</b>	<b>66,814</b>
<b>Surplus C/f</b>	<b>158</b>	<b>158</b>