CAERPHILLY COUNTY BOROUGH COUNCIL
CYNGOR BWRDEISTREF SIROL CAERFFILI

# POLICY AND RESOURCES SCRUTINY COMMITTEE – FOR INFORMATION

**SUBJECT:** **TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL INDICATORS QUARTER 3 MONITORING REPORT (1ST APRIL 2018 TO 31ST DECEMBER 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 1st April 2018 to 31st December 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 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 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 for 2019/20 was submitted to Full Council on the 21st February 2019 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 22nd February 2018.

## 3. RECOMMENDATIONS

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

## 4. REASONS FOR THE RECOMMENDATIONS

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

## 5. THE REPORT

### 5.1 Treasury Management

5.1.1 <u>Borrowing Activity</u>

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 31st December 2018 no new long-term loans were raised. Depending on the delivery of the WHQS capital programme for 2018/19, the HRA may raise long-term loans of circa £20m by the end of the financial year to fund in year capital expenditure.

During the period covered by this report, PWLB loans to the value of £1.11m were repaid on maturity. Such loans had an average interest rate of 3.55%. £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 31st December 2018 was £278.4m and comprised of £238.2m 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 quarter three, and the lender chose not to exercise the option. LOBO loans will be further reviewed again later in 2019/20 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.

5.1.2 <u>Rescheduling</u>

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.

5.1.3 <u>Investments</u>

During the reported period the Authority was holding £27.3m 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 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 31st December 2018 was £52.0m.

The total investments held as at 31st December 2018 was £79.3m, and had an average rate of return equating to 1.03% 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 31st December 2018 comprised of the following types of investments:

| Counterparty | Investment Product | Sector | £m |
|---|---|---|---|
| Banks | Certificate of Deposits | Financial | 6.0 |
| Banks & building societies | Fixed-term cash deposits | Financial | 5.0 |
| Banks & building societies | Covered bonds | Financial | 20.0 |
| Corporates | Bonds | Automobile/ Transport Infrastructure/ Financial | 15.6 |
| Money Market Fund | Cash Pooled Fund | Financial | 8.7 |
| Supranational Institutions | Bonds | Sovereign/ Financial | 4.0 |
| UK Government | Gilts | UK Government | 10.0 |
| Local Authorities | Fixed-term cash deposits | Local Government | 10.0 |
| | | | |
| **Total Investments as at 31st December 2018** | | | **79.3** |

5.1.4 Economic Outlook

UK Consumer Price Inflation (CPI) for November was up 2.3% year on year, in line with the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data showed the unemployment rate remained at 4.1% while the employment rate of 75.7% was the joint-highest estimate since comparable estimates began in 1971. But year to year GDP growth remains below trend.

The escalating trade war between the US and China, and the impact of trade tariffs, 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.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe.

The Bank of England's Monetary Policy Committee (MPC) has continued to maintain the Bank Rate at 0.75% during the reported period. 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 MPC has a definite bias towards tighter monetary policy. 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 the 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. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by Parliament. The Bank of England will hold at or reduce interest rates from current levels if economic risks materialise.

| | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | | |
| Upside 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 | **0.17** |
| Arlingclose Central Case | **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** | **1.13** |
| Downside risk | 0.00 | -0.50 | -0.75 | -0.75 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | **-0.85** |

### 5.1.5 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 trading has commenced from 1st January 2019.

Credit Default Swap (CDS) spreads drifted up over the period, reflecting the ongoing uncertainty around Brexit but continuing to remain low in historical terms. The spread on non-ring-fenced bank NatWest Markets plc rose sharply

The Bank of England released its latest report on bank stress testing, illustrating that all entities tested were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The Bank of England did not require any bank to raise additional capital. There were minimal credit rating changes for UK banks during the reported period.

### 5.1.6 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.

## 5.2 Prudential Indicators

### 5.2.1 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.

5.2.2 Prudential Indicators – “Prudence”

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

5.2.3 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.

5.2.4 Capital Expenditure and Funding

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

## 6. ASSUMPTIONS

6.1 The details set out in the report are based on actuals that have occurred between 1st April 2018 and 31st December 2018 (period 9).

## 7. LINKS TO RELEVANT COUNCIL POLICIES

7.1 Treasury Management Strategy 2018/19 as agreed by Council on 22nd February 2018.

7.2 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.

## 8. WELL-BEING OF FUTURE GENERATIONS

8.1 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.

## 9. EQUALITIES IMPLICATIONS

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

## 10. FINANCIAL IMPLICATIONS

10.1 As detailed throughout the report.

## 11. PERSONNEL IMPLICATIONS

11.1 There are no personnel implications arising from this report.

## 12. CONSULTATIONS

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

## 13. STATUTORY POWER

13.1 Local Government Acts 1972 and 2003.

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S. Harris - Interim Head of Business Improvement Services
A. Southcombe – Finance Manager, Corporate Finance
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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- Period 9 Report (Quarters 1, 2 & 3)**

| | 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** | **27,300** |

| 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- Period 9 Report (Quarters 1, 2 & 3)**

| **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 | 7,825 |
| Debt Management costs | 42 | 42 |
| Rescheduling discount | -110 | -110 |
| Investment income | -600 | -800 |
| Interest applied to internal balances | 847 | 846 |
| **Total General Fund** | **11,539** | **10,241** |
| Net revenue stream | 330,643 | 330,643 |
| **Total as percentage of net revenue stream** | **3.49%** | **3.10%** |
| | | |
| **Housing Revenue Account** | | |
| Principal repayments | 2,194 | 2,194 |
| Interest costs | 6,435 | 5,373 |
| Rescheduling discount | -28 | -28 |
| Debt Management costs | 50 | 51 |
| **Total HRA** | **8,651** | **7,590** |
| Net revenue stream | 47,210 | 47,210 |
| **Total as percentage of net revenue stream** | **18.32%** | **16.08%** |

| **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- Period 9 Report (Quarters 1, 2 & 3)**

| | 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** | **-** | **-** |