CT/16/102
Corporate Services Scrutiny
28 November 2016

Treasury Management - Mid Year Stewardship Report 2016/17

Report of the County Treasurer

All recommendations contained in this report are subject to confirmation by the Committee before taking effect.

Recommendation: That the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the Treasury Management Mid Year Stewardship Report.

1. Introduction

The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in November 2011 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2016. The Treasury Management and Investment Strategy for 2016/17 was also agreed by Council in February 2016 and forms part of the published budget book.

The purpose of this report is to inform members of any key matters arising from the Council's Treasury and Debt Management activities during the first seven months of the 2016/17 financial year. It is intended to enable members to ensure that agreed policy is being implemented.

2. Borrowing Strategy for 2016/17 – 2018/19

The overall aims of the Council's borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required, although this will be kept under review. This has been made possible by the change in the capital financing regime, whereby the Government now provides capital grants rather than supported borrowing, and prudent management of the capital programme.

If short-term borrowing is required to aid cashflow, this will be targeted at an average rate of 0.5%.

3. Implementation of the borrowing strategy in 2016/17

Active treasury management and the maintenance of levels of liquidity aim to avoid the need for short term borrowing. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately. However, the identification of temporary shortfalls in available cash meant that short-term borrowing was required for brief periods at the end of June and October. Three short-term loans totalling £10m were undertaken from other local authorities, each for a period of less than 30 days and at an average rate of 0.31%.

The total amounts borrowed were not required for the full term of each loan and we were able to invest the surplus funds at a higher rate resulting in a small net gain to the authority.

In accordance with the Medium Term Financial Strategy no long term external borrowing has been undertaken this financial year. Instead all borrowing required to fund capital expenditure has been funded by internal cash balances. This position will be kept under review, but the expectation remains that no new external borrowing will be required during the three year period.

At 31st October 2016 the level of long term debt is £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.16 £'m	Interest Rate %	Actual 31.10.16 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

It should be noted that the long term debt figure presented in the Statement of Accounts will be different than the figure stated above. This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The Money Market loans, or LOBOs (Lender Option Borrower Option), have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. This revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

The majority of the Council's borrowing is from the PWLB; however, there are four outstanding LOBO loans, totalling £71.5 million, as shown in the above table. These are historic loans which were all taken out over twelve years ago, at an initial lower rate of interest that then stepped up to a higher rate after the initial period. There is no further stepping built into any of the loans, but the lenders have the option to increase the interest rate at each half year date. If the lender exercises this option, the Council would then have the option of repaying the loan in full, incurring no early repayment premium, or to continue making repayments at the higher rate of interest. Given the current level of interest rates it is unlikely that this will happen for many years. In June, Barclays notified us that they would be waiving their right to change the applicable rate of future interest payable on our LOBO loan (valued at £25m). As a result, this has now converted to a fixed rate loan, based on its current interest rate and maturity date.

No opportunities have arisen during this financial year to repay outstanding debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The Public Works Loan Board (PWLB) sets premature repayment rates and, where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums.

4. Investment Strategy in 2016/17

The investment performance of the County Council's cash continues to be affected by the low interest rates currently available, and the returns on the County Council's cash investments are forecast to remain at low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

5. Implementation of the investment strategy in 2016/17

(a) The following table shows the County Council's fixed and variable rate investments as at the start of the financial year and as at 31st October 2016:

Schedule of Investments

	Maturing in:	Actual 31.03.16 £'m	Interest Rate %	Actual 31.10.16 £'m	Interest Rate %
Bank, Building Society & MMF Deposits					
Fixed Rates					
Term Deposits	< 365 days	45.00	0.84	48.45	0.89
	365 days & >	0.00		0.00	
Callable Deposits					
Variable Rate					
Call & Notice Accounts		73.80	0.60	35.00	0.51
Money Market Funds (MMF's)		0.00		43.34	0.46
Property Fund		10.00	4.67	10.00	4.50
All Investments		**128.80**	**1.00**	**136.79**	**0.92**

The figures as at 31st March 2016 and 31st October 2016 both include approximately £14.6m related to the Growing Places Fund (GPF). Devon County Council has agreed to be the local accountable body for the GPF, which has been established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF funds, based on the average rate achieved by the Council's investments, will accrue to the GPF and not to the County Council.

(b) Following the outcome of the EU referendum in June, the Bank of England was concerned about the impact of the result on the wider economy. They therefore decided to reduce the base rate from 0.5% to 0.25%. As a result of this and other global concerns that have impacted on banks, the rates that are now available have fallen further from the already low rates available in the market. This will have an impact on the future investment return that can be achieved. However, the Council has benefitted from higher rates achieved on four one year loans made in the months before the referendum. As a result, the average interest rate earned on investments, excluding the CCLA property fund, for the 7 months to 31st October 2016 was 0.71%, against a full year budget target return of 0.65%. The CCLA property fund has yielded an average rate of 4.68% for the same period against a full year budget target of 4.5%. The combined total return from all investments was 0.98%.

(c) Revenue lending during the current year to date, including the use of term deposits, call accounts, money market funds and the CCLA property fund, has earned interest of £0.772m against a full year budget of £1.215m. It is estimated that the budget for investment income will be achieved for the full financial year.

(d) The average interest rate earned on investments (excluding the CCLA property fund) for the 7 months to 31st October 2016 was 0.71%, against a full year budget target return of 0.65%. The CCLA property fund has yielded an average rate of 4.68% for the same period against a full year budget target of 4.5%. The total return from all investments was 0.98%.

(e) The County Council continues to adopt a very prudent approach to counterparties to whom the County Council is willing to lend. As a result only a small number of selected UK banks, building societies and money market funds and Non-Eurozone overseas banks in highly rated countries have been used, subject to strict criteria and the prudent management of deposits with them. A longer-term investment of £10m has also been made in the CCLA (Churches, Charities and Local Authorities) Property Fund.

(f) The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list. Following a recent review it is proposed to add Goldman Sachs International Bank, a regulated bank with a UK banking licence (therefore a UK bank), to the Council's approved counterparty list.

(g) All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties.

(h) There have been no breaches of credit limits.

6. Minimum Revenue Provision (MRP)

Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

The current policy, following a review in 2015/16 is to charge MRP in equal instalments over the life of the asset benefiting from the capital spend. The current forecast MRP for 2016/17 is in line with the budgeted figure of £20.0m.

7. Prudential Indicators

Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;

- Treasury management decisions are taken in accordance with professional good practice.

Three Prudential Indicators control the overall level of borrowing. They are:

- **The Authorised Limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for 2017/18 is revised as part of the 2017/18 budget process.

- **The Operational Boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.

- **The Underlying Borrowing Requirement to Gross Debt** - the Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

During the Budget process, the following Borrowing Limits were set for 2016/17

- Maximum borrowing during the period **(Authorised Limit)** - £838.86m
- Expected maximum borrowing during the year **(Operational Boundary)** - £813.86m
- Maximum amount of fixed interest exposure (as a percentage of total) - 100%
- Maximum amount of variable interest exposure (as a percentage of total) - 30%

Members are asked to note that for 2016/17 to date, the Council has remained within its set Borrowing Limits and has complied with the interest rate exposure limits.

8. Prospects for 2017/18

Economic forecasting remains difficult with so many external influences weighing on the UK. Most economists slashed their predictions for UK economic growth immediately after the result of the EU referendum, but these forecasts have gradually increased over recent months as stronger economic data is published.

Business investment is likely to be flat next year, followed by a possible fall in 2018, as companies wait for the outcome of the EU negotiations before investing.

The forecast for future changes in the UK Bank Rate will depend on how economic data and developments in financial markets transpire over the next year. Whilst short term rates are generally linked to the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts.

The County Council retains an external advisor, Capita, who forecast future rates several years forward. Similar information is received from a number of other sources. The general consensus among the market commentators is that any future interest rate rises will not happen for some time. Capita's view is that the Bank of England is likely to maintain the current rate of 0.25% for the duration of 2017/18, in order to promote growth and employment.

The recovery remains volatile, but on the right track, and this should continue into 2017/18; however, the prospect of any increase in the Bank of England base rate any time soon now appears to be limited.

In view of this, it is likely that the target investment return for 2017/18 will be set at no more than 0.50% for bank, building society and money market deposits. If the Bank of England reduces the rate, as per Capita's forecast, then this target return will need to be reviewed accordingly. We expect to achieve a higher rate of return in the region of 4.0% to 4.5% for the CCLA property fund, depending on market conditions at the time the budget is finalised.

9. Summary

i. No long term borrowing has been undertaken to date in 2016/17. The expectation is that no new borrowing will be required during the remainder of the 2016/17 financial Year.

ii. Three short-term loans totalling £10m were undertaken from other local authorities, each for a period of less than 30 days and at an average rate of 0.31%. The surplus borrowing was reinvested at a higher rate resulting in a small net gain to the authority.

iii. Investment income is forecast to achieve the budget target of £1.215m in 2016/17.

iv. It is proposed to add Goldman Sachs International Bank to the approved list of counterparties.

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Electoral Divisions: All
Local Government Act 1972
List of Background Papers – Nil
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