Appendix A

Treasury Management Activity 2017-18
April to July 2017

Background

The County Council's Treasury Management activity is governed by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires authorities to produce annually Prudential Indicators and a Treasury Management Strategy on the likely financing and investment activity. A meeting of Full Council agreed these for the 2017/18 financial year in February 2017. The Code also recommends that members are informed of treasury management activities at least twice a year.

This report considers treasury management activity between 1st April and 31st July 2017.

Economic Context in the period

The Prime Minister called a General election in June which led to a minority Conservative government in a confidence and supply arrangement with the Democratic Unionist Party. This political impasse resulted in an enhanced level of political uncertainty. In terms of economic data a key feature of the period was the increase in inflation with the UK Consumer Price Inflation (CPI) index rising to 2.9%, its highest since June 2013. This was due to rises in a number of categories in the CPI 'basket' as the fall in the value of sterling following June 2016's referendum result continued to feed through into higher import prices.

Unemployment rates remained low. The unemployment rate for April was 4.6% which was its lowest since July 1975. However, this had not resulted in a large increase in wages with the squeeze on real wages (i.e. after inflation) intensifying. Quarter 1 GDP data showed economic activity growing at a much slower pace of 0.2%. However recent surveys indicate that the slowdown in the first quarter is being viewed as an anomaly and that Quarter 2 GDP could rebound. Understandably, the Bank of England made no change to monetary policy at its meeting on 15th June.

Having raised rates in March, the US Federal Reserve made no change to monetary policy at the conclusion of its meeting in May. The recent weakness witnessed in the first print of Quarter 1 US GDP was noted in the accompanying statement but the Fed viewed this as a transitory issue and was of the view that the GDP path and household spending would recover during 2017. The US Federal Reserve then increased its target range of official interest rates in June for the second time in 2017 by 25bps (basis points) to between 1% and 1.25% and a further similar increase is expected during the second half of 2017.

In the UK, short term interest rates continue to be at historically low levels. During the period the Bank of England maintained the base rate at 0.25%. The Council's treasury advisors predict no further changes in the base rate for this financial year due to the uncertainty for the UK economy arising from the Brexit negotiations and the fall in real wages.

Implications for Lancashire County Council Treasury Strategy

Since 2010 the County Council have used short term market borrowing to fund capital expenditure so taking advantage of historically low interest rates. This policy has proved to be very effective in an environment where rates have stayed low for much longer than expected and this was continued in the first four months of the financial year 2017/18. However, prospects for interest rate increases are continuously monitored. Although it is not anticipated that the interest rates will rise they are at very low levels including those for long term borrowing. Therefore the opportunity for fixing some of the debt for a longer period will be kept under consideration.

Current Treasury Management Policy

Full Council approved the 2017/18 treasury management strategy in February 2017. The Council's stated treasury management objectives are:

I. To ensure the security of the principal sums invested which represent the County Council's various reserves and balances,
II. To ensure that the County Council has access to cash resources as and when required,
III. To minimise the cost of the borrowing required to finance the County Council's capital investment programme, and
IV. To maximise investment returns commensurate with the County Council's policy of minimising risks to the security of capital and its liquidity position.

Investment Activity

Investments at the 31st July total £525.88m consisting of £219.77m in bank and local authority deposits and £306.11m in bonds. In total investments have decreased by £48.65m reflecting cash flow requirements impacted by the decision to make a pension prepayment in the period. The table below shows the investment activity between 1st April and 31st July 2017.

Bank and Local Authority Deposits	Call/MMF	Fixed	Total
	£m	£m	£m
Balance 1 April 2017	**26.17**	**78.00**	**104.17**
Maturities	-32.21	-128.00	-160.21
New Investments	31.01	244.80	275.81
Balance 31 July 2017	**24.97**	**194.80**	**219.77**

Bonds	LA Bonds	Gilts	Others	Total
	£m	**£m**	**£m**	**£m**
Balance 1 April 2017	**35.85**	**233.18**	**201.33**	**470.36**
Maturities	-0.70	-301.79	-125.70	-428.19
New Investments	0.24	165.93	97.77	263.94
Balance 31 July 2017	**35.39**	**97.32**	**173.40**	**306.11**

Within the period, there has been a reduction of £136m in the amount of Gilts being held to reduce the exposure in the portfolio to the volatility in this market. This has resulted in an increase in bank and local authority deposits.

The current rate of return on the investment portfolio measured by Arlingclose Ltd treasury consultants is 0.77% which compares favourably with the benchmark 7 day LIBID which averages 0.11% over the same period.

Borrowing Activity

Current market conditions continue to enable the County Council to take advantage of short term market borrowing. The table below shows the borrowing activity which has taken place between 1st April and 31st July 2017.

Borrowing	PWLB Fixed	PWLB Variable	Long Term Market Loan	Other local authorities *	Call Accounts	Total
	£m	£m	£m	£m	£m	£m
Balance 1 April 2017	**213**	**126**	**52**	**590**	**61**	**1,042**
New Borrowing	0	0	0	284	202	486
Maturities	0	0	0	-315	-156	-471
Balance 31 July 2017	**213**	**126**	**52**	**559**	**107**	**1,057**

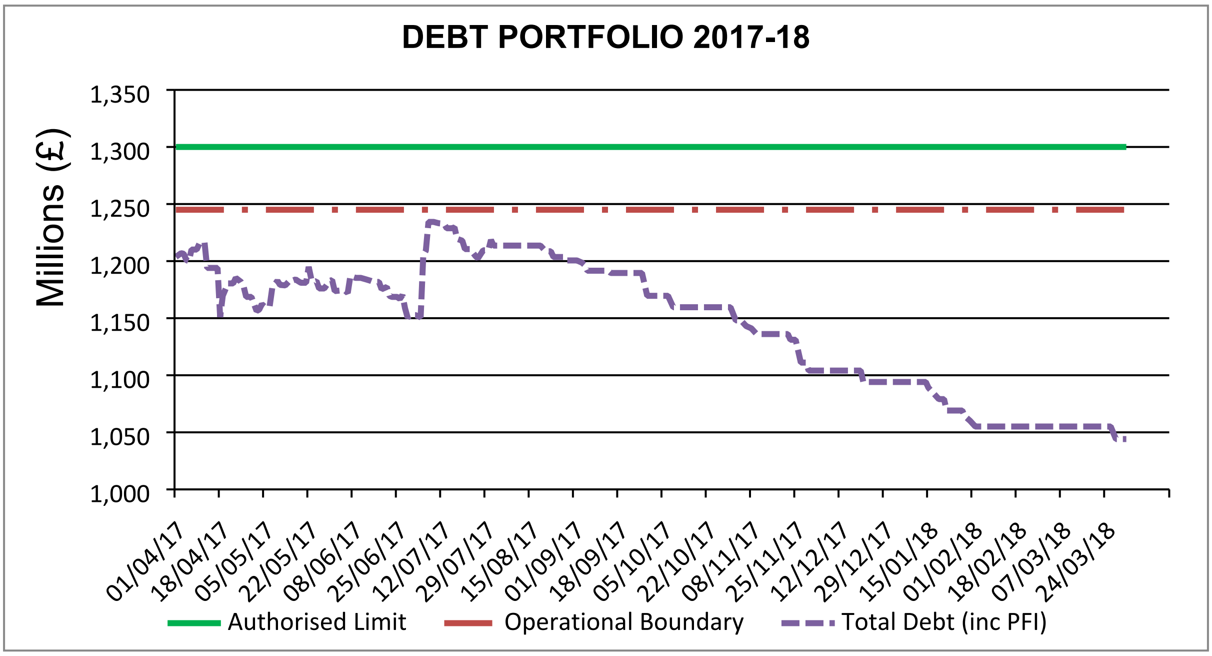
Public Finance Initiative Liability	162
Total Borrowing including PFI	**1,219**

*Including Police & Crime Commissioners

The outstanding borrowing has increased by £15m in the period. This increase is mainly due to the increase in shared investment scheme balances.

Total borrowing now stands at £1.219bn including the financing of £162m of assets through remaining Public Finance Initiative Liability (PFI) schemes.

The following graph shows the level of debt for the current financial year compared with the prudential indicator operational and authorised boundaries. The debt shown from 1st August 2017 represents the debt position if no maturing debt was replaced rather than an estimate of the expected position.



The 'authorised limit' is a prudent estimate of debt which reflects the authority's capital expenditure plans and allows sufficient headroom for unusual cash movements.

The 'operational boundary' is a prudent estimate of debt but includes no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the County Council's current plans and as such it is expected that the boundary could be breached but not on a regular basis.

Total debt during the year to date has remained below the 'operational boundary'.

The current interest rate payable on debt as measured by Arlingclose treasury consultants is 1.71%. The most recent benchmarking figure available for the average rate for all Arlingclose clients (as measured on 31st March 2017) is 3.76%.

Budget Monitoring Position

The net financing charges for 2017/18 are currently forecast to be £0.5m lower than the budget by the end of the financial year. The main reasons for this are:

- Sale of bonds due to market movements during recent months, resulting in a gain of £1m.
- This gain is reduced by the lost interest receivable, as a result of selling these bonds.

This position is kept under regular review taking account both of ongoing performance and also market movements and the forecast is provided to the Director of Financial Resources on a monthly basis.

Prudential Indicators 2017/18

The Local Government Act and supporting regulations require the County Council to have regard to the Prudential Code and to set Prudential Indicators to ensure the County Council's capital investment plans are affordable, prudent and sustainable.

During the reporting period the County Council has been within the Prudential Indicators approved as part of the Treasury Management Strategy in February 2017. Annex 1 provides details of actual performance against the indicators as at July 2017.

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Annex 1

Prudential Indicators

Adoption of CIPFA Treasury Management Code of Practice	Adopted

	£m 2017/18 Benchmark	£m Actual at July
Authorised limit for external debt		
The Authorised Limit is a prudent estimate of debt which reflects the authority's capital expenditure plans and allows sufficient headroom for unusual cash movements.		
Borrowing	1,100	1,057
Other long term liabilities (PFI schemes)	200	162
TOTAL	**1,300**	**1,219**

Operational boundary for external debt		
The Operational Boundary is a prudent estimate of debt with no provision for unusual cash movements.		
Borrowing	1,075	1,057
Other long term liabilities (PFI schemes)	170	162
TOTAL	**1,245**	**1,219**

Capital Financing Requirement to Gross Debt		
The Capital Financing requirement is the underlying need to borrow for capital purposes. This is the cumulative effect of past borrowing decisions and future plans. This is not the same as the actual borrowing on any one day, as day to day borrowing requirements incorporate the effect of cash flow movements relating to both capital and revenue expenditure and income.		
Capital Financing Requirement	844	871
Gross debt	1,003	1,057
Debt to Capital Financing Requirement	**119%**	**121%**

Gross borrowing is higher than the capital financing requirement because the shared investment scheme is accounted for as borrowing but it does not form part of the capital financing requirement calculation.

Treasury Management Indicators:

Interest Rate exposure		
	Upper Limit £m	Actual £m
1 year impact of a 1% rise	10.0	0.8

Maturity structure of debt		
	Upper Limit %	Actual %
Under 12 months	75	35
12 months and within 2 years	75	32
2 years and within 5 years	75	7
5 years and within 10 years	75	7
10 years and above	50	19

Investments over 364 days		
	Upper Limit £m	Actual £m
Long term Investment Limit	450	332

Minimum Average Credit Rating	Benchmark	Actual
Average counterparty credit rating	A+	AA+