

Treasury Management Activity April to September 2018

The council's treasury management activity is underpinned 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. The Code also recommends that members are informed of treasury management activities. As a minimum this should cover an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

This report provides a review of treasury management activity between 1 April and 30 September 2018.

Economic context

During the period, economic growth has continued to be positive, albeit at historically low levels, and unemployment is low with the Bank of England projecting that it will fall a little further. At the same time, inflation has remained above the Bank of England's 2% target rate. In August the CPI rose to 2.7%. As a consequence of these economic factors, in August the Bank of England's Monetary Policy Committee (MPC) voted unanimously to increase Bank Rate by 0.25% to 0.75%.

Internationally, the US economy has continued to grow and at their meeting in September the central bank increased interest rates for the third time in 2018. In Europe the level of growth has moderated after a period of strong growth.

There is still a lot of uncertainty over the economy much of it arising from political factors. Domestically, the progress and unknown impact of the UK's withdrawal from the European Union continues to dampen investment. On the world economy the period has seen an increase in the potential for a trade war between the USA and China. Economic problems in Turkey and Argentina are also causing concern in international markets.

Interest rate environment

The Bank of England has raised expectations of gradual increases in interest rates and the increase in August was part of this. It is expected that this trend will continue. This is reflected in the Arlingclose forecast for interest rates. Their central forecast sees a further 0.25% increase in March and September 2019 which would take the bank rate to 1.25%. They anticipate the rate would then stay constant up to September 2021 which is the end of the forecast period. However, with the current economic data and the risks in the economy they consider that there are also downside risks to the forecast.

Implications for the council's treasury strategy

Since 2010 the council has used short term 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. Despite the recent increase

in the base rate, rates are still low and the Arlingclose forecast suggests that this will remain the case for the rest of the financial year. The prospect of interest rate increases will continue to be monitored.

Although it is not anticipated that the interest rates will rise significantly over the next three years the opportunity to take fixed debt for a longer period will be kept under consideration.

Treasury management policy

Full Council approved the 2018/19 treasury management strategy at its meeting on 8 February 2018. The council's stated treasury management objectives are:

- a) To ensure the security of the principal sums invested which represent the council's various reserves and balances,
- b) To ensure that the council has access to cash resources as and when required,
- c) To minimise the cost of the borrowing required to finance the council's capital investment programme, and
- d) To maximise investment returns commensurate with the council's policy of minimising risks to the security of capital and its liquidity position.

Investment Activity

Investments at 30 September totalled £573.5m and consisted of £168.8m in bank and local authority deposits and £404.7m in corporate and government bonds. The following table shows the investment activity between 1 April and 30 September.

Bank and Local Authority Deposits	Call accounts	Fixed	Structured	Total
	£m	£m	£m	£m
1 April 2018	49.6	74.8	0.0	124.4
Maturities	-243.8	-104.5	0.0	-348.3
New Investments	196.7	196.0	0.0	392.7
30 September 2018	2.5	166.3	0.0	168.8
Bonds	LA Bonds	Gilts	Others	Total
	£m	£m	£m	£m
1 April 2018	35.6	97.2	63.2	196.0
Maturities/sales	-2.8	-1,011.4	-282.8	-1,297.0
New Investments	0.3	1,155.9	349.5	1,505.7
30 September 2018	33.1	241.7	129.9	404.7

Within the period, there has been an increase in the level of investments held. This is mostly resulting from the level of balances held at 31 March 2018 being relatively low due to the use of internal borrowing at that time and the positive cash-flow in the year to date. It is anticipated that during the rest of the year the investments will fall as the impact of the use of reserves materialises. In line with the treasury management strategy, the investments have been made in low credit risk investments, principally Gilts and fixed deposits with other local authorities.

The current rate of return on the investment portfolio measured by Arlingclose is 1.46% which compares favourably with the benchmark 7 day LIBID that averaged 0.43% over the same period.

Borrowing activity

The council's capital programme includes a requirement to borrow to fund new capital investment. With the low interest environment anticipated to continue any new borrowing has been with other local authorities and it is relatively short term in duration. The table below summarises the borrowing activity which has taken place between 1 April and 30 September.

Borrowing	PWLB Fixed	PWLB Variable	LOBO*	Police, Fire & Lancashire District Councils	Other Local Authorities	Total
	£m	£m	£m	£m	£m	£m
1 April 2018	213.1	125.8	50.0	42.6	518.5	950.0
New Borrowing	0.0	0.0	0.0	328.2	439.3	767.5
Maturities	0.0	0.0	0.0	-281.1	-329.0	-610.1
30 September 2018	213.1	125.8	50.0	89.7	628.8	1,107.4
PFI Liability						157.4
Total Borrowing						1,264.8

*Lender option borrower option loan

Total borrowing at the end of September was £1.265bn including the financing of £157.4m of assets through remaining PFI schemes. The outstanding borrowing has increased by £314.8m in the period.

This increase is due to the requirement to fund the capital programme. It includes the reduction in the use of working capital from 1 April and an increase in investments from other authorities.

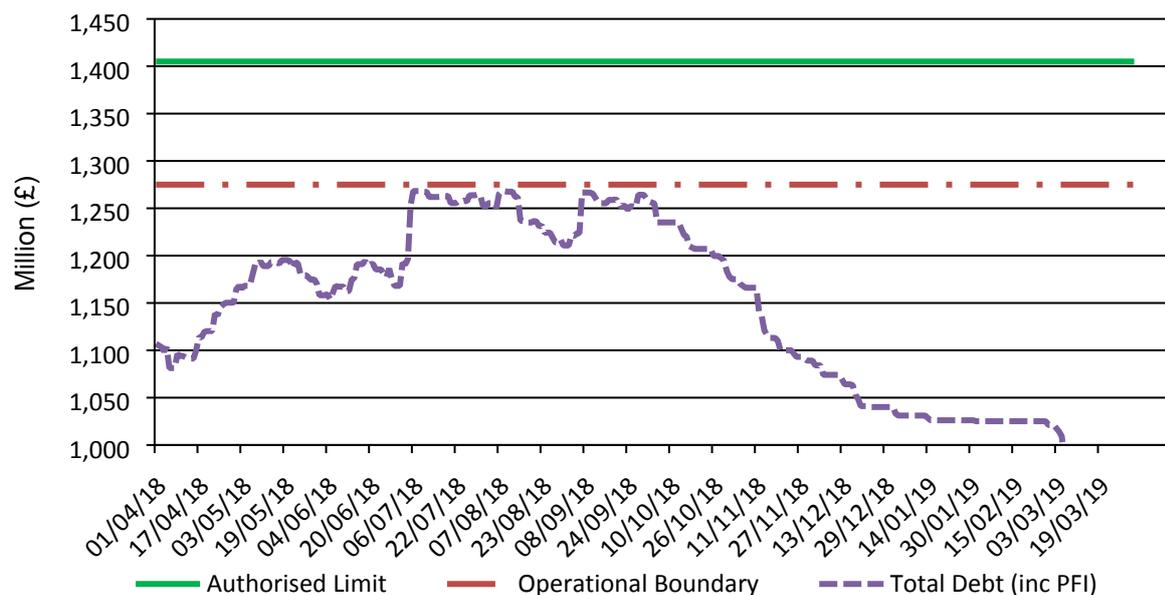
The actual borrowing at 30 September is higher than the amount required, as defined by the Capital Financing Requirement (CFR). However within the actual borrowing at 30 September there is some £280m which will mature before the end of the financial year, bringing the total borrowing below the CFR once again.

A key concept in managing the level of debt is the comparison to the authorised and operational limit. The authorised limit is a prudent estimate of debt which reflects the council's capital expenditure plans and allows sufficient headroom for unusual cash movements.

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

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 30 September represents the debt position if no maturing debt was replaced rather than an estimate of the expected position.



Total debt during the year has remained below the authorised and operational limits.

The current interest rate payable on debt measured by Arlingclose is 1.87%. The most recent benchmarking figure available of the average rate for all Arlingclose clients (as measured on 31 March 2018) is 3.66%.

Budget monitoring position

The net financing expenditure for 2018/19 is forecast to be £13.3m lower than budget at the end of the financial year. The main reasons for this are:

- The change in the Minimum Revenue Provision (MRP) policy has resulted in a reduction of £9.4m in the MRP charge
- The sale of bonds has resulted in a net gain of £3.6m
- Increased traded bond coupon and other investment income of £0.3m

The position is kept under regular review and discussed with the Director of Finance on a monthly basis.

Prudential indicators

The Local Government Act 2003 and supporting regulations require the council to have regard to the prudential code and to set prudential indicators to ensure the council's capital investment plans are affordable, prudent and sustainable.

During the reporting period the council has been within the prudential indicators approved as part of the treasury management strategy on 8 February 2018. Annex A provides details including the 2018/19 limit and the actuals at September 2018.

The investments over 364 days indicator is a limit which helps to control liquidity. For 2018/19, it was initially approved at a limit of £300m although it was stated that the limit was an operational one and therefore if required can be exceeded with the approval of the Director of Finance.

It was anticipated that the reserves and balances would fall during the year and that the £300m amount was more indicative of the year end position rather than the start. This was the case in the first half of the year and the Director of Finance therefore approved a limit of £450m to be used. The latest estimates are that reserves and balances will still reduce during the year but not by as much as initially anticipated. It is currently estimated that the level of reserves and balances at 31 March 2019 will be £375m. As such, it is proposed that a limit of £425m is approved for the rest of the year. However, the level of reserves will continue to be monitored and the level of investments reduced as required.

Prudential Indicators

1. Adoption of CIPFA Treasury Management Code of Practice: Adopted

	Limit	Actual
2. Authorised limit for external debt	£m	£m
Borrowing	1,220	1,107
Other long term liabilities (PFI schemes)	185	157
TOTAL	1,405	1,264

	Limit	Actual
3. Operational boundary for external debt	£m	£m
Borrowing	1,115	1,107
Other long term liabilities (PFI schemes)	160	157
TOTAL	1,275	1,264

	Limit	Actual
4. Capital Financing Requirement to Gross Debt	£m	£m
Borrowing Capital Financing Requirement	953	906
Estimated gross debt	1,095	1,107
Debt to Capital Financing Requirements	115%	122%

The Capital Financing Requirement (CFR) 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.

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

5. Ratio of financing costs to net revenue expenditure

This indicator provides information on the impact of borrowing on the revenue budget and the long term affordability of the capital programme.

	Indicator	Latest estimate
Ratio of capital financing to net revenue expenditure	5.2	3.4

Treasury Management Indicators

1. Interest Rate exposure

The limit measures the county council's exposure to the risk of interest rate movements. The one year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.

	Upper Limit	Actual
	£m	£m
Net Interest Payable – Fixed Rate	50.4	7.7
Net Interest Payable – Variable Rate	5.0	4.9
1 year impact of a 1% rise	10.0	2.4

2. Maturity structure of debt

The limit on the maturity structure of debt helps control refinancing risk.

	Upper Limit	Actual
Under 12 months	75%	34%
12 months and within 2 years	75%	36%
2 years and within 5 years	75%	9%
5 years and within 10 years	75%	6%
10 years and above	50%	16%

3. Investments over 364 days

The limit on the level of long term investments helps to control liquidity, although the majority of these existing investments are held in available for sale securities.

	Upper Limit	Actual
	£m	£m
Long term investments	300	390

4. Minimum Average Credit Rating

To control credit risk the county council requires a very high credit rating from its treasury counterparties.

	Benchmark	Actual
Average counterparty credit rating	A+	AA+