

2017/18 Treasury Management Activity

August to November 2017

Background

The county 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 activity at least twice a year.

This report considers treasury management activity between 1st August 2017 and 30th November 2017.

Economic Context in the period

During the period, the Monetary Policy Committee (MPC) of the Bank of England raised the base rate for the first time in a decade. At its meeting on 1 November 2017, the MPC voted by a majority of 7-2 to increase the Bank Rate by 0.25 percentage points, to 0.5%. Reasons cited for the increase were concern over inflation and the reduction of slack in the economy. The MPC has been set an inflation target by the Government of 2%. However, in September 2017 the CPI inflation increased to 3% and rose again to 3.1% in November. It is considered that inflation has been pushed above the target by the increase in import prices that resulted from the depreciation of sterling. The MPC has stated that it judges that inflation is likely to be close to its peak, and will decline towards the 2% target in the medium term.

Interest Rate Environment

Despite the increase in the base rate the short term interest rates continue to be at historically very low levels. It was not anticipated that the increase in November was the start of a period of large increases. All indications were that any future increase will be at a very gradual pace. Indeed, the county 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 the council's treasury strategy

Since 2010 the council has 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 continue to do so. To date this has been continued in the current financial year. However, prospects for interest rate increases are continuously monitored, although it is not anticipated that interest rates will rise quickly. The option of fixing some of the debt for a longer period to mitigate against future interest rate increases will be kept under close consideration.

Current Treasury Management Policy

Full Council approved the 2017/18 treasury management strategy at its meeting on 23rd February 2017. The council's stated Treasury Management objectives are:

- a) To ensure the security of the principal sums invested which represent the county council's various reserves and balances.
- b) To ensure that the county council has access to cash resources as and when required.
- c) To minimise the cost of the borrowing required to finance the county council's capital investment programme, and
- d) 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 30 November total £472.1m consisting of £107.8m in bank and Local Authority deposits and £364.3m in bonds. Overall investments have decreased by £53.8m in the period reflecting expected movements in reserves and balances and cash flow forecasts. The table below shows the investment activity between 1 August 2017 and 30 November 2017.

Bank and Local Authority	Call/MMF	Fixed	Structured	Total
Deposits	£m	£m	£m	£m
Balance 1 August 2017	25.000	194.800	0.000	219.800
Maturities	-54.000	-130.000	0.000	-184.000
New Investments	54.000	18.000	0.000	72.000
Balance 30 November 2017	25.000	82.800	0.000	107.800
Bonds	LA Bonds	Gilts	Others	Total
	£m	£m	£m	£m
Balance 1 August 2017	35.400	97.300	173.400	306.100
Maturities	-1.300	-110.800	-55.800	-167.900
New Investments	1.400	147.500	77.100	226.000
Balance 30 November 2017	35.500	134.000	194.700	364.200

Within the period, there has been a reduction in the level of Bank and Local Authority deposits of £112m. This has been due to the reduced requirement to hold investments as a result of the cash flow position but also to accommodate an increase of £36.8m in the volume of gilts and corporate bonds being held as a consequence of the fluctuations in the market.

The current rate of return on the investment portfolio measured by Arlingclose Ltd treasury consultants is 1.22% which compares favourably with the benchmark 7 day LIBID which averages 0.11% over the same period.

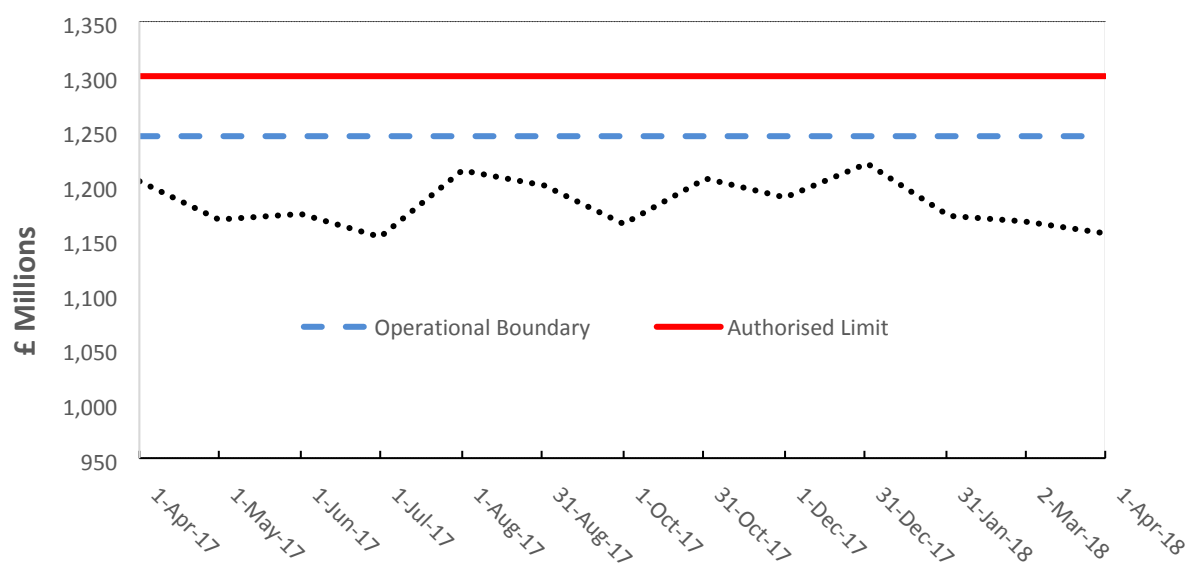
Borrowing Activity

Current market conditions continue to enable the county council to take advantage of short term market borrowing. The council did not have a need to increase its borrowing in the period therefore new borrowing was restricted to the replacement of maturing debt. The table below shows the borrowing activity which has taken place between 1 August 2017 and 30 November 2017.

Borrowing	PWLB Fixed	PWLB Variable	Long Term Market Loan	Police, Fire & Lancashire District Councils	Other Local Authorities	Total
	£m	£m	£m	£m	£m	£m
Balance 1 August 2017	213.100	125.800	50.000	106.700	559.000	1,054.600
New Borrowing	0.000	0.000	0.000	173.300	194.000	367.300
Maturities	0.000	0.000	0.000	-200.800	-193.500	-394.300
Balance 30 November 2017	213.100	125.800	50.000	79.200	559.500	1,027.600
PFI Liability						162.000
Total Borrowing						1,189.600

Total borrowing now stands at £1.19bn including the financing of £162m of assets through remaining Public Finance Initiative (PFI) schemes. The outstanding borrowing has reduced by £27m in the period. This decrease is due to the reduction in shared investment scheme balances.

The graph below shows the level of debt for the current financial year compared with the prudential indicator operational and authorised boundaries. The debt shown from 30 November 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 council's capital expenditure plans and allows sufficient headroom for unusual cash movements.

The 'Operational Boundary' is a prudent estimate of debt but 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. Total debt during the year to date has remained below the Operational Boundary.

The current interest rate payable on debt measured by Arlingclose Ltd treasury consultants is 1.77%. The most recent benchmarking figure available of the average rate for all Arlingclose clients (as measured at 31 March 2017) is 3.76%.

Budget Monitoring Position

The net financing charges budget for 2017/18 is forecast to be £3.9m lower than budget at the end of the financial year. The main reasons for this are:

- Sale of bonds due to market movements during recent months. This enabled some gilt holdings and other traded bonds to be sold resulting in a net gain of £3.6m.
- Increased traded bond coupon and other investment income of £0.3m

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 Finance on a monthly basis.

Prudential Indicators 2017/18

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 capital investment plans are affordable, prudent and sustainable.

During the period the council has been within the Prudential Indicators approved as part of the Treasury Management Strategy for 2017/18.

Annex 'A' provides details of the Prudential Indicators for the reporting period.

Prudential Indicators

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

	2017/18	30th Nov Actual
	£m	£m
2. Authorised limit for external debt		
Borrowing	1,100	1,027
Other long term liabilities (PFI schemes)	200	162
TOTAL	1,300	1,189

	2017/18	30th Nov Actual
	£m	£m
3. Operational boundary for external debt		
Borrowing	1,075	1,030
Other long term liabilities (PFI schemes)	170	162
TOTAL	1,245	1,192

	2017/18	30th Nov Actual
	£m	£m
4. Capital Financing Requirement to Gross Debt		
Borrowing Capital Financing Requirement	843	843
Estimated gross debt	1,003	1,027
Debt to Capital Financing Requirements	119%	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.

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	30th Nov Actual
	£m	£m
Net Interest Payable – Fixed Rate	50	9
Net Interest Payable – Variable Rate	5	3
1 year impact of a 1% rise	10	2

2. Maturity structure of debt

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

	Upper Limit	30th Nov Actual
Under 12 months	75%	10%
12 months and within 2 years	75%	53%
2 years and within 5 years	75%	11%
5 years and within 10 years	75%	7%
10 years and above	50%	19%

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	30th Nov Actual
	£m	£m
Long term Investment Limit	450	412

4. Minimum Average Credit Rating

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

	Benchmark	30th Nov Actual
Average counterparty credit rating	A+	AA+