Treasury Management Activity
October to December 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.

A report on the treasury management activity in 2018/19 was presented to the Committee in October which covered the year to 30 September. This report provides a brief update on treasury management activity between 1 October and 31 December 2018.

Economic context

A key factor facing the economy continues to be the uncertainty arising from the unknown impact of the UK's withdrawal from the European Union and continuing potential for an increased trade war between the worlds' two largest economies namely the USA and China.

Economic growth has continued to be positive with the final estimate of Quarter 3 GDP published on 24 December by ONS showed the UK economy expanded by 0.6% over the quarter and 1.5% year-on-year

At the same time, inflation has remained above the Bank of England's 2% target rate. However, CPI in August was 2.7% which fell to 2.3% in November. As a consequence of these economic factors, the Bank of England's Monetary Policy Committee (MPC) has kept the base rate at 0.75%.

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

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. Although there was no further increase in 2018, 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 their 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.

Investment activity

Investments at 30 September totalled £450.7m and consisted of £171.8m in bank and local authority deposits and £278.9m in corporate and government bonds. The following table shows the investment activity between 1 October and 31 December.

Bank and Local Authority Deposits	Call accounts	Fixed	Structured	Total
	£m	£m	£m	£m
1 October 2018	2.5	166.3	0.0	168.8
Maturities	-	(242.0)	-	(242.0)
New Investments	77.0	168.0	-	245.0
31 December 2018	79.5	92.3	0.0	171.8
Bonds	LA Bonds	Gilts	Others	Total
	£m	£m	£m	£m
1 October 2018	33.1	241.7	129.9	404.7
Maturities/sales	(0.5)	(447.1)	(76.4)	(524.0)
New Investments	0.4	332.3	65.5	398.2
31 December 2018	33.0	126.9	119.0	278.9

Within the period, there has been a reduction in the level of investments held. It was anticipated that the level of investments would 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 period also saw some significant volatility in the price of the Gilts held. This resulted in the opportunity being taken to sell some of the holdings to enhance the overall return on the investments.

The current rate of return on the investment portfolio measured by Arlingclose is 1.69% 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 October and 31 December.

Borrowing	PWLB Fixed	PWLB Variable	LOBO*	Police, Fire & Lancashire District Councils	Other Local Authorities	Total
	£m	£m	£m	£m	£m	£m
1 October 2018	213.1	125.8	50.0	89.7	628.8	1,107.4
New Borrowing	15.0	0.0	0.0	118.5	220.0	353.5
Maturities	(7.5)	0.0	(50.0)	(162.6)	(216.5)	(436.6)
31 December 2018	220.6	125.8	0.0	45.6	632.3	1,024.3
PFI Liability						152.0
Total Debt						1,176.3

*Lender option borrower option loan

Total borrowing at the end of December was £1.176bn including the financing of £152m of assets through remaining PFI schemes. The outstanding borrowing has reduced by £83.1m in the period.

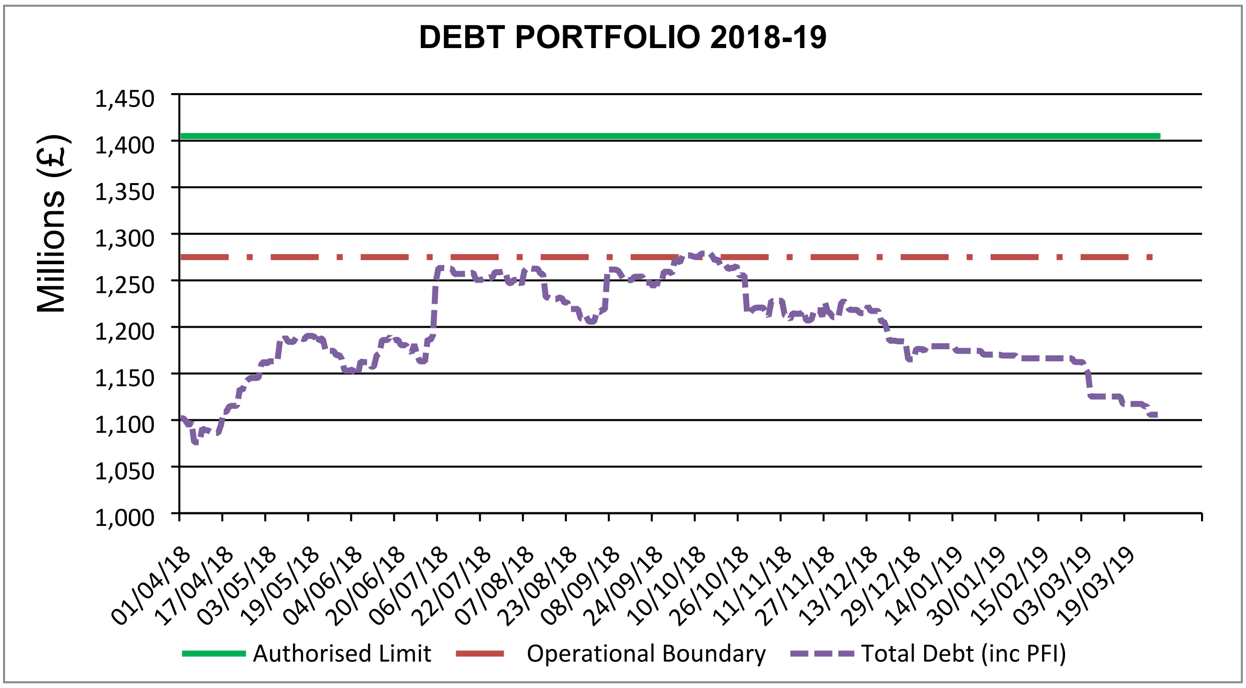
The main reason for the reduction in the level of debt held in the period was the repayment of the council's LOBO loan.

The actual borrowing at 31 December is higher than the amount required, as defined by the Capital Financing Requirement (CFR). However within the actual borrowing at 30 December there is an estimated £137m which relates to debt held on behalf of other local authorities and premiums. By excluding these from the total debt, as permitted by the Prudential Code, the debt is below the CFR.

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 31 December 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 1.77%. 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 £21m 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 £10.3m in the MRP charge
- Investment income has increased by a net £10.5m
- Reduced net interest payable of £0.2m due to debt refinancing

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 December 2018.

Annex A

Prudential Indicators

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

2. Authorised limit for external debt	Limit £m	Actual £m
Borrowing	1,220	1,024
Other long term liabilities (PFI schemes)	185	152
TOTAL	1,405	1,176

3. Operational boundary for external debt	Limit £m	Actual £m
Borrowing	1,115	1,024
Other long term liabilities (PFI schemes)	160	152
TOTAL	1,275	1,176

4. Capital Financing Requirement to Gross Debt	Limit £m	Actual £m
Borrowing Capital Financing Requirement	953	903
Estimated gross debt	1,095	1,024
Debt to Capital Financing Requirements	115%	113%

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 transferred debt, the shared investment scheme and borrowing for premiums form part of the borrowing but they do 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	5.1	2.4

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	10.7
Net Interest Payable – Variable Rate	5.0	(0.2)
1 year impact of a 1% rise	10.0	2.3

2. Maturity structure of debt

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

	Upper Limit	Actual
Under 12 months	75%	9%
12 months and within 2 years	75%	53%
2 years and within 5 years	75%	15%
5 years and within 10 years	75%	6%
10 years and above	50%	18%

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	425	338

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