

Treasury Management Activity 1st Report 2015-16

1. 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 Statement on the likely financing and investment activity. 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 2015 and 31st July 2015.

2. Economic Context in the period

As the period progressed, economic data activity was largely overshadowed by events in Greece. Markets' attention centred on whether Greece would default on its debt repayments and the potential of Greece leaving the Euro. If Greece did leave the Euro it was expected that there would be a detrimental impact on other economies including the UK with the small risk of contagion into other Eurozone peripheral economies, such as Portugal, Ireland and Spain. After 61% of Greek voters chose to endorse a call for a "no" to more austerity, Greece's creditors refused to compromise and a default to the European Central Bank on 20th July 2015 looked possible. This would have put Greece's membership of the Euro in serious doubt. A Eurozone bailout agreement was reached to prevent a default. This has not ended the crisis as there will be an election in Greece in September which will delay, or potentially stop, the implementation on the austerity measures proposed as part of the bail-out.

Despite the global uncertainty, the UK economy remained resilient over the period. Economic growth slowed in Q1 2015 to 0.4%, year/year growth to March 2015 was a relatively healthy 2.9%. GDP has now increased for nine consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for consumer price inflation (CPI) briefly turned negative in April, falling to -0.1%, before returning to +0.1%. In the May Quarterly Inflation Report, the Bank of England expected inflation to hover around zero in the near-term due to falls in energy and food prices. The Bank was sanguine that that negative inflation would prove temporary without any damaging consequences for the UK economy. Further improvement in the labour market saw the unemployment rate for March fall to 5.5% of the economically active population. Average earnings excluding bonuses rose 2.2%.

The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics.

2.1 Interest Rate Environment

Short term interest rates continue at the very low levels since the Bank of England reduced the base rate to 0.5% in March 2009. There has been no movement in the base rate since then.

2.2 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 continue to do so. Prospects for interest rate increases are continuously monitored and flexible arrangements are maintained to enable the Council to react in good time should the path of interest rate forecasts change.

3. Current Treasury Management Policy

Full Council approved the 2015/16 treasury management strategy at its meeting on 12th February 2015. The County 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.

3.1 Investment Activity

Investments at the 31st July are £711.94m consisting of £176.81m in bank and Local Authority deposits and £535.13m in bonds. In total investments have increased by £75.37m over the period. The table below shows the investment activity between 1st April 2015 and 31st July 2015.

Bank and Local Authority Deposits	Call/MMF £m	Fixed £m	Structured £m	Total £m
Balance 1 April 2015	107.25	56.50	74.46	238.21
Maturities	-101.18	0.00	-35.13	-136.31
New Investments	74.78	0.00	0.13	74.91
Balance 31 July 2015	80.85	56.50	39.46	176.81
Bonds	LA Bonds £m	Gilts £m	Others £m	Total £m
Balance 1 April 2015	36.70	73.80	287.86	398.36
Maturities	-0.58	-78.19	-216.17	-294.94
New Investments	0.17	298.67	132.87	431.71
Balance 31 July 2015	36.29	294.28	204.56	535.13

Within the period, there has been an increase of £221m in the amount of Gilts being held. Gilts are a low risk investment and the switch into Gilts is part of the County Council's policy of reducing the credit risk of its investments. There has been a

corresponding reduction in Bank and Local Authority deposits of £61m and other bonds of £83m. In addition the County Council has received grants in the first quarter, some of which have been received in advance of the need to incur the expenditure. This has generated a requirement for short term investment of these funds.

The current rate of return on the investment portfolio measured by Arlingclose Ltd treasury consultants is 1.28% which compares favourably with the benchmark 7 day LIBID which averages 0.35% over the same period.

3.2 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 2015 and 31st July 2015.

Borrowing	PWLB Fixed £m	PWLB Variable £m	Long Term Market Loan £m	Other Locals £m	Police, Fire & Lancashire District Councils £m	Total £m
Balance 31 April 15	213.10	125.75	52.23	573.00	71.46	1,035.54
New Borrowing	0.00	0.00	0.00	297.40	191.71	489.11
Maturities	0.00	0.00	0.00	-303.50	-158.24	-461.74
Balance 31 July 15	213.10	125.75	52.23	566.90	104.93	1,062.91
Public Finance Initiative (PFI) Liability	-	-	-	-	-	172.00
Total Borrowing & PFI						1,234.91

The outstanding borrowing has increased by £27.37m in the period. The increase in borrowing reflects the re-financing of deals maturing in the near future in order to take advantage of current low interest rate offers from other Local Authorities.

The increased borrowing in the period is due to the need to re-borrow for the Waste recycling centre loans. In July 2015 the Waste PFI contract was terminated and the debt was replaced with a number of short term loans which have now matured.

Total borrowing now stands at £1.235bn including the financing of £172m of assets through remaining non-waste PFI schemes.

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 1st August 2015 represents the debt position if no maturing debt was replaced rather than an estimate of the expected position.

- The saving on the MRP and higher than budgeted income received are offset by the agreed contribution towards the Todmorden Curve Rail project of £0.800m which was not in the original budget.

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

5. Prudential Indicators 2015/16

The Local Government Act 2003 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.

The County Council are within the Prudential Indicators as detailed in Annex 1.

6. Credit Rating issued by Moody's

The County Council's credit rating is reviewed by Moody's on a yearly basis. This review was completed in the period and the rating remained unchanged at Aa2, which is a high credit rating. The rating is in place for the Council to issue its own bonds at an appropriate time.

7. Outlook

There is still significant economic uncertainty especially as a result of the slow-down in the economic growth in China. In response to this, during August 2015 the Chinese government reduced its interest rates and revalued its currency which raises concerns over deflationary pressures in the world economy. This uncertainty makes it unlikely that there will be an increase in interest rates in the short term. The County Council's treasury management consultants Arlingclose Ltd are forecasting the first rise for official bank interest rates to be in the second calendar quarter of 2016 with a gradual pace of increases thereafter and the average bank rate for 2015/16 being 0.5%. Consequently, the Treasury Management Strategy set in February 2015 is still appropriate for the current market conditions and that the level of borrowing and investments are in line with this strategy and within the indicator limits.

Prudential Indicators

1. Adoption of CIPFA Treasury Management Code of Practice	Adopted
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2. 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.	2014/15	31st July 2015 Actual
	£m	£m
Borrowing	1,300	1,063
Other long term liabilities (PFI schemes)	250	172
TOTAL	1,550	1,235

3. Operational boundary for external debt 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 County Council's current plans.	2014/15	31st July 2015 Actual
	£m	£m
Borrowing	1,250	1,063
Other long term liabilities (PFI schemes)	200	172
TOTAL	1,450	1,235

4. 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.	2014/15	31st July 2015 Actual
	£m	£m
Capital Financing Requirement	861	830
Estimated gross debt	1,010	1,063
Debt to Capital Financing Requirements	117%	128%

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 financial requirement calculation.

The County Council confirms that it has complied with its Prudential Indicators for 2015/16 which were approved on 26th February 2015 as part of the County Council's Treasury Management Strategy Statement.

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	50.40	5.70
Net Interest Payable – Variable Rate	5.00	2.40
1 year impact of a 1% rise	10.00	1.60

2. Maturity structure of debt			
The limit on the maturity structure of debt helps control refinancing risk.	Lower Limit %	Upper Limit %	Actual %
Under 12 months	-	75	41
12 months and within 2 years	-	75	24
2 years and within 5 years	-	75	8
5 years and within 10 years	-	75	6
10 years and above	25	100	21

3. Investments over 364 days		
The limit on the level of long term investments helps to control liquidity, although the majority of these investments are held in available for sale securities.	Upper Limit	Actual
	£m	£m
Total invested over 364 days	900	585

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+