# RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

## MUNICIPAL YEAR 2014-2015

**COUNCIL**

**10th December 2014**

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| | **AGENDA ITEM NO.6** |
| **2014/15 MID YEAR TREASURY MANAGEMENT STEWARDSHIP REPORT** | |

**REPORT OF :**

**THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES**
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## 1.0 PURPOSE OF REPORT

1.1 As per Code of Practice requirements, this report provides Members with information on :-

- the Council's Treasury Management activity during the first six months of 2014/15; and
- Prudential and Treasury Indicators for the same period.

## 2.0 RECOMMENDATIONS

2.1 It is recommended that Members note the content of this report.

## 3.0 INTRODUCTION

3.1 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

3.2 The CIPFA Code of Practice on Treasury Management requires a Mid Year Review to be presented to Council. This report fulfils that requirement.

3.3 The Treasury Management function operates within the Strategy approved by Council on the 26th March 2014.

3.4 Treasury Management is defined as:
*"The management of a local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".*

3.5 The Council sets a balanced budget to ensure that all planned expenditure is financed by various sources of income / reserves. Treasury

Management is concerned with monitoring the cashflows of such income and expenditure and planning investments and borrowing prudently.

3.6 This report includes the following areas of treasury activity during the first six months of 2014/15 :

- Economic background;
- Borrowing activity and results;
- Estimated and actual treasury position and prudential indicators;
- Investment strategy, activity and results.

## 4.0 ECONOMIC BACKGROUND

4.1 General Economic Background

4.2 The Council's investment income is subject to changes in short term interest rates. The level of the Bank Base Rate is one of the main determinants of the rate of interest the Council receives on its short term investments. The Bank of England continued to maintain the Bank Rate at 0.5% throughout the first half of the year. This is expected to continue until late 2015 and will result in continued low investment income for the Council.

4.3 In the UK growth has been on an upward trend during this six month period and indications are that the economic recovery will continue into the next quarter. This is evidenced by the:

- Service sector growing strongly
- Investment from business activity recovering
- Labour market continuing to improve, with the unemployment rate falling to 6.2%

However global growth has slowed and the outlook has weakened, particularly in the Euro area.

4.4 The Monetary Policy Committee's (MPC) general guidance on the Bank Rate remains unchanged. The Governor of the Bank of England, Mark Carney, once again stated the timing of rises in the Bank Rate will be data dependent and that when the Bank Rate does begin to rise, it is expected to do so only gradually and to remain below average historical levels for some time to come.

4.5 Based on revised figures for growth compared to pre-recession periods, the general theme is that the recession was not as deep and the recovery was earlier than initially estimated. In anticipation of these revisions, the MPC has forecast growth at 3.5% in 2014.

4.6 However , this growth will be affected by;

- the Bank of England's Financial Policy Committee announcement of a range of measures to cool the UK's housing market to avert the potential of increased house prices which could affect the sustainable economic recovery;
- the Scottish referendum has set in motion political upheaval that could be problematic in the run up to the next general election;
- the fragile recovery in the Eurozone also seems to be losing pace and this could damage and disrupt financial markets.

4.7 The majority of the Council's borrowing is from the PWLB (Public Works Loans Board). Long-term borrowing rates are influenced by gilt yields. As the UK is considered a "safe haven" for surplus cash, this demand keeps gilt yields and therefore PWLB rates at historically low levels.

4.8 PWLB rates were comparatively higher at the start of this financial year, which is why average rates for the first six months were higher than the projection to the end of this financial year. The expected longer term trend for PWLB borrowing rates is for them to rise. Increasing investor confidence in economic recovery will encourage investors to switch from bonds to riskier equities, thereby increasing PWLB rates.

4.9 PWLB rates during the first half of the financial year were as follows:

| | **5 years** | **10 years** | **20 years** | **50 years** |
|---|---|---|---|---|
| Average | 2.86% | 3.67% | 4.22% | 4.27% |
| Highest | 3.07% | 3.86% | 4.42% | 4.48% |
| Lowest | 2.68% | 3.36% | 3.87% | 3.92% |

4.10 Estimates of future rates are as follows:

| | **Base Rate** | **PWLB rates** | | | |
|---|---|---|---|---|---|
| | | **5 years** | **10 years** | **20 years** | **50 years** |
| 2014/15 (Act 6 mth Average) | 0.5% | 2.86% | 3.67% | 4.22% | 4.27% |
| 31/03/15 | 0.5% | 2.85% | 3.55% | 4.05% | 4.10% |
| 31/03/16 | 1.0% | 3.30% | 3.80% | 4.30% | 4.35% |

## 5.0 BORROWING ACTIVITY AND RESULTS

5.1 The borrowing strategy for 2014/15 approved by Council in March 2014 reported that the Section 151 Officer, under delegated powers, will take the most appropriate form of borrowing depending upon the prevailing interest rates at the time, and taking into account advice provided by our advisors.

5.2 In March, the borrowing requirement was estimated to be £32.4m based on the Capital Programme at that time. In line with changes to the Capital Programme, this year's borrowing requirement has increased to £43.1m.

The increase in 2014/15 is mainly due to slippage and spend on school modernisation projects.

5.3 It was also reported that the Council will monitor prevailing PWLB rates for any opportunities to reschedule debt to generate savings. I can report that to the 30th September this financial year, the Council has not had a viable option to reschedule debt. Affordability and the cost of carry remained important influences on the Council's borrowing strategy. As short term interest rates have remained lower than long term rates, the Council determined it was more cost effective in the short term to use internal resources and borrow short term. The Council has taken short term temporary borrowing in the first half of 2014/15 and based on cashflow projections, it is likely we will undertake more short term borrowing to meet cash shortfalls. However, this approach may change if longer term interest rates are at risk of increasing significantly. In this case, long term borrowing may be undertaken.

5.4 In line with the above strategy, this Council has not borrowed in advance of need during the first 6 months of the year and has no current intention to borrow in advance during the remainder of 2014/15.

5.5 No variances are currently being projected for net capital charges which have a budget for 2014/15 of £23.8m. This is being achieved despite the challenges faced with investment income and maintaining our low risk strategy.

## 6.0 CERTAINTY RATE

6.1 Two years ago HM Treasury introduced "the certainty rate", whereby local authorities were able to access borrowing at 0.2% cheaper than published PWLB rates. In August 2014, authorities were required to provide Welsh Government (and onward, the Debt Management Office) with an indication of their potential borrowing requirements for the next 3 years. This Council provided such information and will continue to be able to access the discounted rate up to 31st October 2015.

## 7.0 ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

7.1 During the six months to September 2014, the Council operated within its prudential limits set out in the Prudential Code report approved in March 2014. Details of limits and actual performance are as follows:

## 7.2 Capital Expenditure and the Capital Financing Requirement

7.2.1 The Capital Expenditure plans of the Council are primarily financed by capital receipts and capital grants. The remaining element which cannot be immediately financed from other resources will constitute our borrowing requirement. The estimated level of available capital resources is provided in summary as the Capital Expenditure Indicator below.

**Indicator : Capital Expenditure**

| | 2014/15 Projected Outturn £M | 2014/15 Original Estimate £M | 2015/16 Revised Estimate £M | 2016/17 Revised Estimate £M |
|---|---|---|---|---|
| Supported spend | 54.595 | 46.051 | 34.123 | 21.745 |
| Unsupported spend | 36.173 | 25.402 | 9.743 | 3.600 |
| Total spend | 90.768 | 71.453 | 43.866 | 25.345 |
| Financed by:- | | | | |
| Borrowing | 43.132 | 32.361 | 16.702 | 10.559 |
| Other Capital Resources (Grants, Capital Receipts) | 47.636 | 39.092 | 27.164 | 14.786 |

7.2.2 The Capital Financing Requirement (CFR) represents the Council's underlying need to borrow for capital purposes. The CFR is capital expenditure that has not yet been paid for from either revenue or capital resources.

7.2.3 The Council's expectation for the CFR for the next three years is shown below.

**Indicator : Capital Financing Requirement (CFR)**

| | 31/03/15 Projected Outturn £M | 2014/15 31/03/15 Original Estimate £M | 2015/16 31/03/16 Revised Estimate £M | 2016/17 31/03/17 Revised Estimate £M |
|---|---|---|---|---|
| CFR | 398.232 | 395.533 | 400.011 | 395.206 |
| Net movement in CFR | | | 1.779 | (4.805) |

7.2.4 The expected external debt for each year is as detailed below.

**Indicator : External Debt**

| | 30/09/14 Actuals £M | 2014/15 31/03/15 Original Estimate £M | 2014/15 31/03/15 Revised Estimate £M | 2015/16 31/03/16 Revised Estimate £M | 2016/17 31/03/17 Revised Estimate £M |
|---|---|---|---|---|---|
| Borrowing | 204.844 | 255.521 | 240.360 | 289.815 | 341.270 |
| Other long term liabilities | 27.260 | 26.421 | 27.177 | 26.420 | 25.224 |
| Total External Debt | 232.104 | 281.942 | 267.537 | 316.235 | 366.494 |

7.2.5 Long Term Liabilities include the Council's obligation under its PFI scheme and finance leases.

## 8.0 LIMITS TO BORROWING ACTIVITY

8.1 The first key control over the Council's activity is to ensure that, over the medium term, borrowing will only be for a capital purpose. The Council needs to ensure that external borrowing does not exceed the total of the capital financing requirement in the preceding year plus the estimate of the additional capital financing requirement for the next three financial years. This allows some flexibility within a three-year period to deliver an effective Treasury Management strategy.

**Borrowing Activity (Gross Borrowing)**

| | 30/09/14 Actuals £M | 2014/15 31/03/15 Original Estimate £M | 2014/15 31/03/15 Revised Estimate £M | 2015/16 31/03/16 Revised Estimate £M | 2016/17 31/03/17 Revised Estimate £M |
|---|---|---|---|---|---|
| Gross Borrowing (inc. Other Long Term Liabilities) | 232.104 | 281.942 | 267.537 | 316.235 | 366.494 |
| Capital Financing Requirement | | 395.533 | 398.232 | 400.011 | 395.206 |

8.2 The Authorised Limit represents the limit beyond which borrowing is prohibited, and needs to be set, monitored and revised by Members. It reflects the maximum level of borrowing to fund existing capital commitments, which could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some added headroom for unexpected movements.

**Indicator : The Authorised Limit**

| | 2014/15 30/09/14 Actuals £M | 2014/15 Limit £M | 2015/16 Limit £M | 2016/17 Limit £M |
|---|---|---|---|---|
| Gross Borrowing | 204.844 | 352.000 | 353.000 | 354.000 |
| Other long term liabilities | 27.260 | 28.000 | 27.000 | 26.000 |
| Authorised Limit | 232.104 | 380.000 | 380.000 | 380.000 |

8.3 The Operational Boundary is based on the probable external debt during the course of the year; actual borrowing could vary around this boundary, for short times, during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

**Indicator : The Operational Boundary**

| | 2014/15 30/09/14 Actuals £M | 2014/15 Estimate £M | 2015/16 Estimate £M | 2016/17 Estimate £M |
|---|---|---|---|---|
| Gross Borrowing Limit | 204.844 | 252.000 | 283.000 | 314.000 |
| Other long term liabilities | 27.260 | 28.000 | 27.000 | 26.000 |
| Operational Boundary | 232.104 | 280.000 | 310.000 | 340.000 |

## 9.0 AFFORDABILITY PRUDENTIAL INDICATORS

9.1 Previous sections have covered overall capital and control of borrowing indicators, but there is also a requirement to assess the affordability of capital investment plans. This provides an indication of the impact of the capital investment plans on the overall Council finances.

9.2 The Ratio of Financing Costs to Net Revenue Stream identifies the trend in the cost of capital (borrowing costs net of interest and investment income) against the "net revenue stream". The net revenue stream for the General Fund is the amount collectable from Council Tax payers added to the Council's Rate Support Grant (RSG) and Non Domestic Rates (NDR). The key use of this indicator is to compare trends in the ratio of financing costs to the net revenue stream, over time.

**Indicator : Ratio of Financing Costs to Net Revenue Stream**

| | 2014/15 Original Est | 2014/15 Revised Estimate | 2015/16 Revised Estimate | 2016/17 Revised Estimate |
|---|---|---|---|---|
| General Fund | 5.36% | 5.55% | 5.77% | 6.28% |

9.3 The Code requires limits to be set for :

I. Upper limits on variable rate exposure – this indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

II. Upper limits on fixed rate exposure – similar to the above indicator this covers a maximum limit on fixed interest rates.

**Indicator : Interest Rate Exposure**

| | 2014/15 Actuals as at 30/09/14 | 2014/15 Out-turn as at 30/09/14 | 2014/15 Limit | 2015/16 Limit | 2016/17 Limit |
|---|---|---|---|---|---|
| **Borrowing** | | | | | |
| Limits on fixed rates | 60% | 68% | 55%-90% | 55%-90% | 55%-90% |
| Limits on variable rates | 40% | 32% | 10%-45% | 10%-45% | 10%-45% |
| **Investments** | | | | | |
| Limits on fixed rates | 0% | 0% | 0%-25% | 0%-25% | 0%-25% |
| Limits on variable rates | 100% | 100% | 75%-100% | 75%-100% | 75%-100% |
| **Net Borrowing** | | | | | |
| Limits on fixed rates | 60% | 68% | 55%-125% | 55%-125% | 55%-125% |
| Limits on variable rates | 40% | 32% | -25%-45% | -25%-45% | -25%-45% |

It is the view of our Treasury Management Advisors that it is unlikely the LOBO's will be called within this financial year.

9.4 The amount of LOBO debt held (£85.5m, 37%), has not changed in 2014/15. Although not a requirement of the Prudential Code, an internal limit of LOBO debt is set as follows:

| | £m | % of Debt Portfolio |
|---|---|---|
| LOBO Limits | 100 | 45 |

9.5 The maturity structure indicator sets gross limits to reduce the Council's exposure to large fixed rate sums falling due for refinancing annually. The Code of Practice requires LOBO's to be represented in the maturity structure at the next option date, hence the table below demonstrates a high maturity within 12 months.

**Indicator : Maturity Structure**

| | 2014/15 Actuals as at 30/09/14 | Upper Limit | Lower Limit |
|---|---|---|---|
| Under 12 months | 38% | 60% | 0% |
| 12 months to 2 years | 0% | 60% | 0% |
| 2 years to 5 years | 1% | 60% | 0% |
| 5 years to 10 years | 0% | 70% | 0% |
| 10 years to 20 years | 13% | 90% | 0% |
| 20 years to 30 years | 0% | 90% | 0% |
| 30 years to 40 years | 41% | 90% | 0% |
| 40 years to 50 years | 7% | 90% | 0% |

9.6 In order to maximise investment returns there could be opportunities for sums to be invested for longer than one year. This would only be undertaken with a prudent view of the primary considerations of security and liquidity.

**Indicator : Total principal funds invested for periods longer than 364 days**

| | Limit | 31/03/15 Estimate |
|---|---|---|
| Maximum principal sums invested over 1 year | £15m | £1m |

9.7 The funds invested with a maturity period of greater than 1 year is an operational investment (as opposed to a treasury investment) relating to the Local Authority Mortgage Scheme (LAMS) which Members approved during July 2012.

9.8 To date, during 2014/15, there have been no treasury investments with a maturity of greater than 1 year.

## 10.0 INVESTMENT STRATEGY, ACTIVITY & RESULTS

10.1 The Council manages its investments in-house, investing in line with the Council's approved lender criteria as approved by Council on the 26th March 2014.

10.2 The Financial Services (Banking Reform) Act 2013 gave the Bank of England powers to bail-in uninsured and unsecured creditors of a failing bank or building society. This means that banks on the verge of collapse will be forced to call upon their shareholders, bondholders and their biggest customers for cash before turning to taxpayers. As a result credit rating agencies have stated their plan to review EU banks' ratings. There is therefore a realistic risk that some major UK banks' credit ratings will become BBB rated (good credit quality), rather than A category (high credit quality). Implementation is due in January 2015 so this will be considered when preparing the Treasury Management strategy for 2015/16.

10.3 Members will recall that following the onset of the unprecedented national and international economic crisis in 2008, all of this Council's cash flows are currently being invested in the Debt Management Account Deposit Facility and other Government backed public sector bodies, in line with the aforementioned approved strategy. This strategy ensures we prioritise **S**ecurity (protecting monies invested), then **L**iquidity (cashflow) and finally **Y**ield (return on investment). The order of these "SLY" priorities are detailed in Investment Guidance produced by the Welsh Government.

10.4 I have kept this under constant review subsequently with a view to returning to market investment activity at an appropriate time. To date, the Council has not returned to market investments but has set up a number of AAA rated money market funds to provide further diversification options when the opportunity does arise. These accounts have not been used during 2014/15. Members will be kept informed of any changes as part of the Council's quarterly performance reports.

10.5 The following table shows the overall result of the investment activities undertaken by the Council:

| | Interest Received £M | Average Cash Balance £M | Return on Investments % | Benchmark Return % |
|---|---|---|---|---|
| General Balances | 0.046 | 13.20 | 0.35 | 0.55 |

The benchmark for Local Authority internally managed funds is the average 7-day LIBID rate.

10.6 As a result of our low risk strategy, our return on investment is lower than the benchmark return. Whilst the Economic Background section of this report states that UK growth is on an upward trend, the economy is experiencing continuing difficulties as this growth has been gradual and weak. As a result of these conditions, interest rates remained low impacting adversely on investment returns.

## 11.0 LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)

11.1 As approved by Council on 4th July 2012, the Council launched the Local Authority Mortgage Scheme during September 2012, which supports First Time Buyers in purchasing a home. The scheme is facilitated by Lloyds Bank and allows First Time buyers to access 95% loan to value mortgages on terms similar to 75% loan to value mortgages. The bank is able to offer such loans where the Council guarantees the loan up to 20% of the value of the property. It is a requirement of the scheme that the Council places a deposit with the bank for the length of the indemnity. Therefore the Council has a deposit of £1m with Lloyds for 5 years.

## 12.0 TREASURY MANAGEMENT ADVISORS

12.1 The Council appointed Arlingclose as its Treasury Management Advisors during March 2014 and they continue to support the Council's Treasury Management function.

## 13.0 TRAINING

13.1 On 15th October 2014, officers attended an investment workshop hosted by Arlingclose to give an overview of the economic environment, interest rate forecasts and associated implications for the Council.

## 14.0 MINIMUM REVENUE PROVISION (MRP)

14.1 In accordance with legislative requirements applicable to local government (Local Government Act 2003), there is a requirement to charge an amount to revenue each year in respect of capital expenditure that is funded by borrowing. This charge is known as Minimum Revenue Provision (MRP).

14.2 The methods of charging MRP for Supported Borrowing and PFI and Finance leases are defined by regulations. The Group Director – Corporate and Frontline Services has discretion with regard to the method of charging MRP to Council Fund Balances in respect of Unsupported Borrowing only.

## 15.0 CONCLUSION

15.1 The 2014/15 financial year continues to be a challenging year for Treasury Management and this report highlights for Members the Treasury Management activities that have been undertaken during the first half of this year.

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