RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2016-2017.

COMMITTEE:	**AGENDA ITEM NO.9**
COUNCIL	**2016/17 MID YEAR TREASURY MANAGEMENT STEWARDSHIP REPORT**

30TH November 2016

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 2016/17; 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 23rd March 2016.

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 2016/17 :

- 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 or 'Bank Rate' is one of the main determinants of the rate of interest the Council receives on its short term investments. With the result of the referendum to leave the EU and the subsequent downgrading of growth forecasts, the Bank of England cut its Bank Rate from 0.5% to 0.25% in August 2016. This lower rate is expected to continue into the long term and will result in continued low investment income for the Council.

4.3 The preliminary estimate of the second quarter in the UK economy showed reasonably strong growth, building on the 0.4% growth in the first quarter. With the June result to leave the EU, growth forecasts were downgraded with lower expected business investment and an anticipated sharp decline in household spending. However, recent data presents a more positive picture for the post – referendum UK economy due to continued strong household spending.

4.4 In the August Quarterly Inflation Report, the Bank of England forecasts an increase in the Consumer Price Index (CPI) to 0.9% by the end of 2016. UK inflation is expected to rise closer to the banks 2% target (and may even exceed the target) over the coming year as previous rises in commodity prices and the depreciation in sterling drive up imported material costs for companies.

4.5 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.

4.6 Following the referendum result gilt yields fell sharply for all maturity ranges on the view that Bank Rate would remain extremely low for the foreseeable future. This has been reflected in the projections for the PWLB borrowing rates, with only small increases over future years.

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

	5 years	10 years	20 years	50 years
Average	1.54%	2.12%	2.81%	2.67%
Highest	2.00%	2.71%	3.40%	3.28%
Lowest	1.15%	1.62%	2.20%	2.07%

4.8 Estimates of future rates are as follows:

	Base Rate	PWLB rates			
		5 years	10 years	20 years	50 years
2016/17 (Act 6 mth Average)	0.25%	1.54%	2.12%	2.81%	2.67%
31/03/17	0.25%	1.30%	1.75%	2.25%	2.25%
31/03/18	0.25%	1.40%	1.80%	2.25%	2.25%

5.0 BORROWING ACTIVITY AND RESULTS

5.1 The borrowing strategy for 2016/17 approved by Council in March 2016 reported that the Group Director, Corporate and Frontline Services as Section 151 Officer (or in his absence the Deputy 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 £44.4m based on the Capital Programme at that time. In line with changes to the Capital Programme, this year's borrowing requirement has decreased to £39.4m. The decrease in 2016/17 is mainly due to rephasing of some schemes and subsequent reprofiling of budgets, for example, in respect of the 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 not taken short term temporary borrowing in the first half of 2016/17 but based on cashflow projections, it is likely we will undertake short term borrowing to meet cash shortfalls during the second half of the financial year. 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 2016/17.

5.5 No variance is currently being projected for net capital charges which have a budget for 2016/17 of £23.0m. This is being achieved despite the challenges faced with investment income and maintaining our low risk strategy.

6.0 CERTAINTY RATE

6.1 Three years ago HM Treasury introduced "the certainty rate", whereby local authorities were able to access borrowing at 0.2% cheaper than published PWLB rates. This year again, authorities were required to provide an indication of their potential borrowing requirements for the next 3 years. This Council provided such information to HM Treasury and will continue to be able to access the discounted rate up to 31st October 2017.

7.0 ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

7.1 During the six months to 30th September 2016, the Council operated within its prudential limits set out in the Prudential Code report approved by Council in March 2016. 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

	2016/17 Projected Outturn £M	2016/17 Original Estimate £M	2017/18 Revised Estimate £M	2018/19 Revised Estimate £M
Supported spend	83.702	64.864	52.929	26.271
Unsupported spend	32.462	37.425	15.913	11.087
Total spend	116.164	102.289	68.842	37.358
Financed by:-				
Borrowing	39.403	44.366	22.854	18.028
Other Capital Resources (Grants, Capital Receipts)	76.761	57.923	45.988	19.330

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)

	31/03/17 Projected Outturn £M	2016/17 31/03/17 Original Estimate £M	2017/18 31/03/18 Revised Estimate £M	2018/19 31/03/19 Revised Estimate £M
CFR	419.584	430.109	430.521	436.104
Net movement in CFR			10.937	5.583

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

Indicator : External Debt

	30/09/16 Actuals £M	2016/17 31/03/17 Original Estimate £M	2016/17 31/03/17 Revised Estimate £M	2017/18 31/03/18 Revised Estimate £M	2018/19 31/03/19 Revised Estimate £M
Borrowing	196.942	251.970	266.070	325.425	367.279
Other long term liabilities	23.321	23.982	0.836	0.836	0.836
Total External Debt	220.263	275.952	266.906	326.261	368.115

7.2.5 Other Long Term Liabilities previously included the Council's obligation under its PFI scheme and finance leases. To proceed with the voluntary termination of the PFI contract of the School and Lifelong Learning Centre at Garth Olwg, as agreed by Cabinet, the Council will need to secure external borrowing to replace the PFI long term liability. This results in a reduction in "Other long term liabilities" and a corresponding increase in "Borrowing".

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)

	30/09/16 Actuals £M	2016/17 31/03/17 Original Estimate £M	2016/17 31/03/17 Revised Estimate £M	2017/18 31/03/18 Revised Estimate £M	2018/19 31/03/19 Revised Estimate £M
Gross Borrowing (inc. Other Long Term Liabilities)	220.263	275.952	266.906	326.261	368.115
Capital Financing Requirement		430.109	419.584	430.521	436.104

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

	2016/17 30/09/16 Actuals £M	2016/17 Limit £M	2017/18 Limit £M	2018/19 Limit £M
Gross Borrowing	196.942	406.000	419.000	418.000
Other long term liabilities	23.321	24.000	23.000	22.000
Authorised Limit	220.263	430.000	442.000	440.000

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

	2016/17 30/09/16 Actuals £M	2016/17 Estimate £M	2017/18 Estimate £M	2018/19 Estimate £M
Gross Borrowing Limit	196.942	252.000	290.000	320.000
Other long term liabilities	23.321	24.000	23.000	22.000
Operational Boundary	220.263	276.000	313.000	342.000

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 Revenue 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

	2016/17 Original Estimate	2016/17 Revised Estimate	2017/18 Revised Estimate	2018/19 Revised Estimate
General Fund	4.62%	4.63%	4.79%	4.95%

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

	2016/17 Actuals as at 30/09/16	2016/17 Out-turn as at 30/09/16	2016/17 Limit	2017/18 Limit	2018/19 Limit
Borrowing					
Limits on fixed rates	100%	79%	55%-100%	55%-100%	55%-100%
Limits on variable rates	0%	21%	0%-45%	0%-45%	0%-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	107%	74%	55%-125%	55%-125%	55%-125%
Limits on variable rates	-7%	26%	-25%-45%	-25%-45%	-25%-45%

* Does not include non specified investments (see para 9.10)

9.4 A LOBO is a financial instrument called a "Lender's Option Borrower's Option". It provides a lower rate of interest for the initial period and a higher rate for the rest of its term (reversionary period), albeit that the higher rate was comparable with interest rates prevailing at the time the loans were taken. At the end of the initial period and at six monthly intervals, the lender has the option to increase the interest rate payable. This provides the Council with the option to repay the loan if the terms are not acceptable. It is the view of our Treasury Management Advisors that it is unlikely the LOBO's will be called within this financial year.

9.5 In June 2016 Barclays Bank informed the Council of its decision to cancel all the embedded options within their standard LOBO loans. This effectively converts £56.5m of the Council's Barclays LOBO loans to fixed rate loans removing the uncertainty on both interest costs and maturity date.

9.6 The revised amount of LOBO debt held in 2016/17 is £31m, 12%. 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

9.7 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

	2016/17 Actuals as at 30/09/16	Upper Limit	Lower Limit
Under 12 months	38.36%	60%	0%
12 months to 2 years	0%	60%	0%
2 years to 5 years	0%	60%	0%
5 years to 10 years	0.21%	70%	0%
10 years to 20 years	1.17%	90%	0%
20 years to 30 years	0%	90%	0%
30 years to 40 years	58.39%	90%	0%
40 years to 50 years	1.88%	90%	0%

9.8 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	31/03/17 Estimate
Maximum principal sums invested over 1 year	£15m	£1m

9.9 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.

9.10 **Non Specified Investments**

9.11 Council on the 20th July 2016, approved an amendment to the agreed Investment Strategy enabling lending to organisations upon which we would undertake appropriate due diligence **and** put in place appropriate security arrangements. This could result in the Council being able to achieve better investment returns at an acceptable level of risk and to secure base budget savings over the short to medium term to protect frontline services.

9.12 Investment decisions in these “Non Specified Investments” are subject to S151 officer determination, following appropriate due diligence and subject to appropriate and acceptable security arrangements being put in place as part of the commercial agreement.

9.13 A maximum exposure for this type of investment was set at £10M with a maximum maturity limit of 10 years.

9.14 In accordance with the relevant Officer Delegated Decision one such arrangement has now been concluded on 8th November 2016, with a commercially agreed loan agreement having been entered into with Trivallis, for an amount of £5.125M over 10 years.

9.15 This transaction will be included in the prudential indicators reported as part of the Quarter 3 performance report and the year end Treasury Management Review.

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 23rd March 2016(amendment approved by Council 20th July 2016).

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 could be forced to call upon their shareholders, bondholders and their biggest customers for cash before turning to taxpayers. The European Banking Authority have released the results of its 2016 round of stress tests on the large banks. The stress tests give an indication of how the large banks might fare under a particular economic scenario. No bank was said to have failed the tests.

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 2016/17. 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	0.054	16.97	0.32	0.28

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

10.6 Despite our low risk strategy our return on investments is above the benchmark return. The key contributory factor is the return on the £1m 5-year deposit with Lloyds in respect of the Local Authority Mortgage Scheme. The Economic Background section of this report states that UK growth is experiencing continuing difficulties and as a result interest rates remain low.

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. The scheme is now closed with 70 loans given to first time buyers.

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 4th April 2016, 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. In addition, strategy meetings have been held between Arlingclose and officers in July and October this year. Officers continue to receive interest rate information, economic data and general market environment information on a regular basis. Arlingclose also provided Members with Treasury Management training on 17th October 2016.

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) and must be a prudent amount.

14.2 The method of charging MRP for Supported Borrowing is a straight line policy over 40 years. With regard to PFI and Finance leases MRP is equivalent to the principal value of repayments. With regard to the method of charging MRP to Council Fund Balances in respect of Unsupported Borrowing only, the method used is dependent upon the type of asset being created as set out in the approved MRP Policy statement.

15.0 CONCLUSION

15.1 The 2016/17 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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