RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2017-2018

COMMITTEE:
COUNCIL

	AGENDA ITEM NO.11
2017/18 MID YEAR TREASURY MANAGEMENT STEWARDSHIP REPORT	

29th November 2017

REPORT OF :

THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES
Chris Lee (01443) 424088

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 2017/18; and
- Prudential and Treasury Indicators for the same period.

2.0 RECOMMENDATIONS

2.1 It is recommended that Members approve the content of this report including:

2.1.1 Approval to increase the Authorised Limits for each of the 3 years (para 9.2);
2.1.2 Approval to increase the limit of Non Specified Investments to £25M with a maximum maturity of 30 years (para 11.3);
2.1.3 Approval to increase the limit for Investments greater than 364 days to £25M (para 11.5); and
2.1.4 Approval to provide Bridge Loan finance to CSC Foundry Ltd as appropriate and required in line with the shareholder agreement (Section 13).

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 15th March 2017.

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 2017/18:

- 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. On 1st November 2017 the Bank of England increased the Bank Rate from 0.25% to 0.5%. However, the Monetary Policy Committee all agreed that any further increases in the Bank Rate would be expected to be at a gradual pace and to a limited extent.

4.3 UK quarter 2 (2017) growth was 0.3%, after a 0.2% expansion in quarter 1. Both consumer and business confidence remain subdued. Household growth has slowed due to the reduction in real wage growth. Savings rates remain at an all time low.

4.4 In October 2017 the Consumer Price Index (CPI) was 3.0%, its highest level since June 2013, as the fall in the value of sterling following the June 2016 EU referendum result continued to feed through into higher import prices.

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 which are at historically low levels.

4.6 Following the referendum result gilt yields fell sharply for all maturity ranges on the assumption that the Bank Rate would remain extremely low for the foreseeable future. There has been some volatility over the first 6 months but over the medium term these rates are projected to remain relatively stable.

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**
2017/18 (Act 6 mth Average)	0.25%	1.54%	2.12%	2.81%	2.67%
31/03/18	0.50%	1.55%	2.02%	2.60%	2.50%
31/03/19	0.50%	1.65%	2.10%	2.65%	2.55%

5.0 <u>REGULATORY UPDATES</u>

5.1 <u>MiFID II</u>

5.2 The implementation of MiFID II (Markets in Financial Instruments Directive) reclassifies local and public authorities as retail investors from 3rd January 2018. Such a reclassification would increase costs for financial advice and potentially restrict access to certain financial products.

5.3 Local Authorities have been advised to consider electing for a return to professional status ("opt up") in order to ensure they can access the full range of services and products which they require. In order to opt up to professional status, authorities must have an investment balance of at least £10m and the person authorised to make the investment decision must have at least one year's relevant professional experience.

5.4 Accordingly, the opt up process has been instigated for the Council.

5.5 <u>CIPFA CONSULTATION ON PRUDENTIAL AND TREASURY MANAGEMENT CODES</u>

5.6 In February and August 2017 CIPFA consulted on the relevance, adoption and practical application of the Treasury Management and Prudential Codes. The revised Codes are due to be published for inclusion in the 2018/19 Treasury Management Strategy. Transitional arrangements may be in place if the Codes are not finalised in line with timescales for the preparation of 2018/19 strategies.

6.0 BORROWING ACTIVITY AND RESULTS

6.1 The borrowing strategy for 2017/18 approved by Council in March 2017 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.

6.2 In March, the borrowing requirement was estimated to be £40.0m based on the Capital Programme at that time. In line with changes to the Capital Programme, this year's borrowing requirement has increased to £51.1m. The increase in 2017/18 is mainly due to the confirmation of the local government borrowing initiative funding for 21st Century schools.

6.3 It was also reported that the Council would 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 2017/18 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.

6.4 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 2017/18.

6.5 No variance is currently being projected for net capital charges which have a budget for 2017/18 of £19.6m. This is being achieved despite the challenges faced with investment income and maintaining our low risk strategy.

7 CERTAINTY RATE

7.1 The "certainty rate", whereby local authorities are able to access borrowing at 0.2% cheaper than published PWLB rates was available from HM

Treasury again for this year. 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 2018.

8 ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

8.1 During the six months to 30th September 2017, the Council operated within its prudential limits set out in the Prudential Code report approved by Council in March 2017. Details of limits and actual performance are as follows:

8.2 Capital Expenditure and the Capital Financing Requirement

8.2.1 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

	2017/18 Projected Outturn £M	2017/18 Original Estimate £M	2018/19 Revised Estimate £M	2019/20 Revised Estimate £M
Supported spend	73.428	74.269	36.239	23.260
Unsupported spend	44.114	32.976	14.889	4.020
Total spend	117.542	107.245	51.128	27.280
Financed by:-				
Borrowing	51.097	39.959	21.872	11.003
Other Capital Resources (Grants, Capital Receipts)	66.445	67.286	29.256	16.277

8.2.2 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.

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

Indicator: Capital Financing Requirement (CFR)

	31/03/18 Projected Outturn	2017/18 31/03/18 Original	2018/19 31/03/19 Revised	2019/20 31/03/20 Revised

	£M	Estimate £M	Estimate £M	Estimate £M
CFR	451.124	435.926	461.400	459.710
Net movement in CFR			10.276	(1.690)

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

Indicator: External Debt

	30/09/17 Actuals £M	2017/18 31/03/18 Original Estimate £M	2017/18 31/03/18 Revised Estimate £M	2018/19 31/03/19 Revised Estimate £M	2019/20 31/03/20 Revised Estimate £M
Borrowing	245.717	314.725	303.297	352.297	380.797
Other long term liabilities	0.525	0.836	0.836	0.835	0.834
Total External Debt	246.242	315.561	304.133	353.132	381.631

8.2.5 Other Long Term Liabilities represents the Council's obligation under its finance leases.

9.0 LIMITS TO BORROWING ACTIVITY

9.1 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)

	30/09/17 Actuals £M	2017/18 31/03/18 Original Estimate £M	2017/18 31/03/18 Revised Estimate £M	2018/19 31/03/19 Revised Estimate £M	2019/20 31/03/20 Revised Estimate £M
Gross Borrowing (inc. Other Long Term Liabilities)	246.242	315.561	304.133	353.132	381.631
Capital Financing Requirement		435.926	451.124	461.400	459.710

9.2 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. It is proposed that these limits be amended in line with increases to the underlying need to borrow, that is the Capital Financing Requirement

Indicator: The Authorised Limit

	2017/18 30/09/17 Actuals £M	2017/18 Limit £M	2018/19 Limit £M	2019/20 Limit £M
Gross Borrowing	245.717	458.000	468.000	468.000
Other long term liabilities	0.525	2.000	2.000	2.000
Authorised Limit	246.242	460.000	470.000	470.000

9.3 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

	2017/18 30/09/17 Actuals £M	2017/18 Estimate £M	2018/19 Estimate £M	2019/20 Estimate £M
Gross Borrowing Limit	245.717	320.000	370.000	400.000
Other long term liabilities	0.525	1.000	1.000	1.000
Operational Boundary	246.242	321.000	371.000	401.000

10.0 AFFORDABILITY PRUDENTIAL INDICATORS

10.1 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.

10.2 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

	2017/18 Original Estimate	2017/18 Revised Estimate	2018/19 Revised Estimate	2019/20 Revised Estimate
General Fund	4.84%	4.55%	4.82%	5.28%

10.3 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

	2017/18 Actuals as at 30/09/17	2017/18 Out-turn as at 30/09/17	2017/18 Limit	2018/19 Limit	2019/20 Limit
Borrowing					
Limits on fixed rates	80%	64%	45%-100%	45%-100%	45%-100%
Limits on variable rates	20%	36%	0%-55%	0%-55%	0%-55%
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	80%	64%	45%-125%	45%-125%	45%-125%
Limits on variable rates	20%	36%	-25%-55%	-25%-55%	-25%-55%

* Does not include non specified investments (see para 11.0)

10.4 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.

10.5 The revised amount of LOBO debt held in 2017/18 is £31m, 13%. Although not a requirement of the Prudential Code, an internal limit of LOBO debt is set as follows:

	£M	% of Debt Portfolio
LOBO Limits	50	20

10.6 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

	2017/18 Actuals as at 30/09/17	Upper Limit	Lower Limit
Under 12 months	16.72%	60%	0%
12 months to 2 years	0%	60%	0%
2 years to 5 years	0.28%	60%	0%
5 years to 10 years	1.30%	70%	0%
10 years to 20 years	0.28%	90%	0%
20 years to 30 years	0%	90%	0%
30 years to 40 years	78.89%	90%	0%
40 years to 50 years	2.53%	90%	0%

10.7 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.

11.0 NON SPECIFIED INVESTMENTS

11.1 The Investment Strategy enables lending to organisations upon which we undertake appropriate due diligence **and** put in place appropriate security arrangements. Such loans 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 whilst supporting initiatives for purposes relevant to Council functions and priorities.

11.2 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 in place as part of the commercial agreement.

11.3 In the Treasury Management Strategy approved by Council on 15th March 2017, a maximum exposure for this type of investment was set at £10M with a maximum maturity limit of 10 years. To increase the opportunity for supporting such initiatives, it is proposed to increase this limit to £25M with a maximum maturity limit of 30 years.

11.4 Such transactions will be included in the indicators reported as part of the quarterly performance reports and statutory Treasury Management Reports.

11.5 As a consequence, an amendment is proposed to the indicator for investments held with maturity greater than 1 year. The strategy approved on the 15th March 2017 limited the amount to £15M. In line with the change to Non Specified Investments detailed above, it is proposed that the limit be increased from £15M to £25M.

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

	Revised Limit	31/03/18 Estimate
Maximum principal sums invested over 1 year	£25m	£5m

11.6 The £5m represents the Council's commercially agreed 10 year loan to Trivallis.

12.0 INVESTMENT STRATEGY, ACTIVITY & RESULTS

12.1 The Council manages its investments in-house, investing in line with the Council's approved lender criteria as approved by Council on the 15th March 2017.

12.2 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

Yield (return on investment). The order of these "SLY" priorities are detailed in Investment Guidance produced by the Welsh Government.

12.3 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 2017/18. Members will be kept informed of any changes as part of the Council's quarterly performance reports.

12.4 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	0.170	6.22	2.73	0.11

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

12.5. Despite our low risk strategy our return on investments is above the benchmark return. The key contributory factors are the part year return on the £1m 5-year deposit with Lloyds in respect of the Local Authority Mortgage Scheme and the commercial loan arrangement with Trivallis.

13.0 BRIDGE LOAN TO CSC FOUNDRY LTD

13.1 The Cardiff Capital Regional City Deal Joint Committee approved the decision to invest (as a repayable loan) in the CSC (Compound Semi Conductor) project on 2nd May 2017. CSC Foundry Ltd has been established by the 10 Councils of the Cardiff Capital Region City Deal in order to implement and contract with IQE Silicon Compounds Ltd to deliver the CSC project. CSC Foundry is a company limited by shares equally held by the 10 Councils.

13.2 The project is to develop a high tech compound semi conductor plant to include the purchase of the site from Welsh Government, initial works and the grant of a lease to IQE with a right to purchase.

13.3 City Deal expenditure is funded by a combination of HM Treasury grant and from Council contributions. The Joint Working Agreement (JWA) Business Plan is required to be approved before the Council's contributions can be accessed and utilised. The JWA is currently anticipated to be approved before 31st March 2018.

13.4 The project expenditure (loan) of £38.5M is to be funded from the City Deal funding, however due to the timing of the grant profile and the sign off of the JWA, there is a temporary shortfall in 2017/18 and 2018/19 totalling £9.985M.

13.5 In order to expedite the project, and to resolve a potential short term cash-flow issue, RCT CBC offered to provide Bridge Loan finance to meet the shortfall of up to £9.985M, in the event that it was required. This is included in the CSC Foundry Ltd Shareholders agreement and this Council is indemnified by the other Councils in this regard.

13.6 Approval is therefore sought from Council to provide the Bridge Loan finance to CSC Foundry Ltd in line with the shareholders agreement.

13.7 Loans made by local authorities to other organisations for the purposes that, if the local authority itself were to incur the expenditure, would be capital expenditure, then the loan must be treated as capital expenditure.

13.8 There is no requirement to charge MRP to revenue for the loan until loan repayments are received. The MRP charge will be offset by the loan repayment income to ensure no impact upon General Fund Balances.

14.0 LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)

14.1 As approved by Council on 4th July 2012, the Council launched the Local Authority Mortgage Scheme during September 2012, which supported First Time Buyers in purchasing a home. The scheme was facilitated by Lloyds Bank and allowed First Time buyers to access 95% loan to value mortgages on terms similar to 75% loan to value mortgages. It was a requirement of the scheme that the Council placed a deposit with the bank for the length of the indemnity. Therefore, the Council had a deposit of £1m with Lloyds for 5 years. The scheme is now closed and the deposit has been repaid to the Council in September 2017. There is a future potential liability as the Council provides an indemnity for each individual mortgage taken until the 5th anniversary of the mortgage being issued.

15.0 TREASURY MANAGEMENT ADVISORS

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

16.0 TRAINING

16.1 On 4th October and 14th November 2017, officers attended events hosted by Arlingclose to give an overview of the economic environment, to highlight the changes to the Prudential and Treasury Management code 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 of the Finance and Performance Scrutiny Committee with Treasury Management training on 23rd October 2017.

17.0 MINIMUM REVENUE PROVISION (MRP)

17.1 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.

17.2 The method of charging MRP for Supported Borrowing is a straight line policy over 40 years. With regard to 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 approved by Council 15th March 2017.

18.0 CONCLUSION

18.1 The 2017/18 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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