Northumberland
County Council

AUDIT COMMITTEE

28 NOVEMBER 2018

Treasury Management Mid-Year Review Report for Period 1 April to 30 September 2018

Report of Barry Scarr, Executive Director of Finance and Deputy Chief Executive

Cabinet Member: Councillor Nicholas Oliver – Portfolio Holder for Corporate Services

1. Purpose of the Report

This report provides a mid-year review of the activities of the Treasury Management function for the period 1 April to 30 September 2018, and performance against the Treasury Management Strategy Statement (TMSS) 2018-19 - as approved by the County Council on 21 February 2018. The report provides a review of borrowing and investment performance for the period set in the context of the general economic conditions prevailing so far during the year. It also reviews specific Treasury Management prudential indicators defined by the (CIPFA) Treasury Management Code of Practice and CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code), and approved by Council in the TMSS.

2. Recommendations

It is recommended that Members:

- **receive the report and note the performance of the Treasury Management function from 1 April to 30 September 2018.**
- **Present the report to County Council.**

3. Link to the Corporate Plan

This report supports the “We want to be efficient, open and work for everyone” priority included in the Council’s Corporate Plan 2018-21.

4. Key Issues

The Local Government Act 2003 (the Act) and supporting regulations require the Council to produce a mid-year review of treasury management activities and actual performance against prudential and treasury indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

The report provides a review of the Treasury Management activities for the six month period from 1 April to 30 September 2018, and sets out performance against the Treasury Management Strategy Statement for 2018-19.

TREASURY MANAGEMENT MID-YEAR REVIEW REPORT FOR PERIOD 1 APRIL TO 30 SEPTEMBER 2018

1. INTRODUCTION

1.1. Background

This Treasury Management Mid-Year Report provides a review of the activities of the Treasury Management function for the period 1 April to 30 September 2018, and performance against the Treasury Management Strategy Statement (TMSS) for 2018-19. Its production and submission to Council is a requirement of the CIPFA Code of Practice on Treasury Management.

Treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.2. Statutory and Regulatory Requirements

The Local Government Act 2003 (the Act) and supporting Regulations requires the Council to produce an annual review of treasury management activities and the actual performance against prudential and treasury indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore, important as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

1.3. Basis and Content of Treasury Management Mid-Year Review Report for 2018-19

The report covers:

- Overview of the Treasury Management Strategy for the financial year 2018-19;
- Economic conditions and interest rates for period 1 April to 30 September 2018;
- Overview of the treasury position at 30 September 2018;
- Borrowing activity;
- Investment activity; and,
- Treasury management limits and prudential indicators position.

2. BACKGROUND - TREASURY MANAGEMENT STRATEGY FOR 2018-19

2.1. Overview of the 2018-19 Strategy

The expectation for interest rates within the Treasury Management Strategy Statement for 2018-19 was for UK Bank Rate (often referred to as Base Rate) to remain low with only one rate increase from 0.50% to 0.75% halfway through the year. It was anticipated that throughout the period variable or short-term would be the cheapest form of borrowing, and that investment returns would remain very low and well below borrowing rates.

In these circumstances, the proposed strategy for 2018-19 was to postpone borrowing and wherever possible to use investment balances to repay maturing debt and fund capital expenditure; resulting in the Council operating an under-borrowing position. This practice would in turn avoid the cost of holding higher levels of investments and reduce counterparty risk.

Added to this, it was envisaged that a mixture of short to medium term borrowing, as well as some longer term loans, would be taken to fund the remaining external borrowing requirement which was estimated at £82.00 million for 2018-19, net of maturities, based on the approved capital programme at that time.

2.2. Compliance

The Executive Director of Finance and Deputy Chief Executive confirms that, throughout the period, all treasury activities have been conducted within the parameters and limits of the TMSS 2018-19, alongside best practice suggested by the CIPFA Treasury Management Code and Central Government.

3. ECONOMIC CONDITIONS AND INTEREST RATES FOR PERIOD 1 APRIL TO 30 SEPTEMBER 2018

3.1. Economy - At 5 October 2018

The UK economy grew only modestly in the first half of 2018, posting a 0.2% increase in the first quarter following by a 0.4% increase in quarter 2. However, this was seen as sufficiently robust for the Monetary Policy Committee (MPC) to increase Bank Rate on 2 August from 0.5% to 0.75%. Although growth looks as if it will only be moderate in 2018, at around 1.5%, the Bank of England's August Quarterly Inflation Report forecast that growth will increase to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components. It fell to 2.4% in September and is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated that Bank Rate would need to be in the region of 1.5%

by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

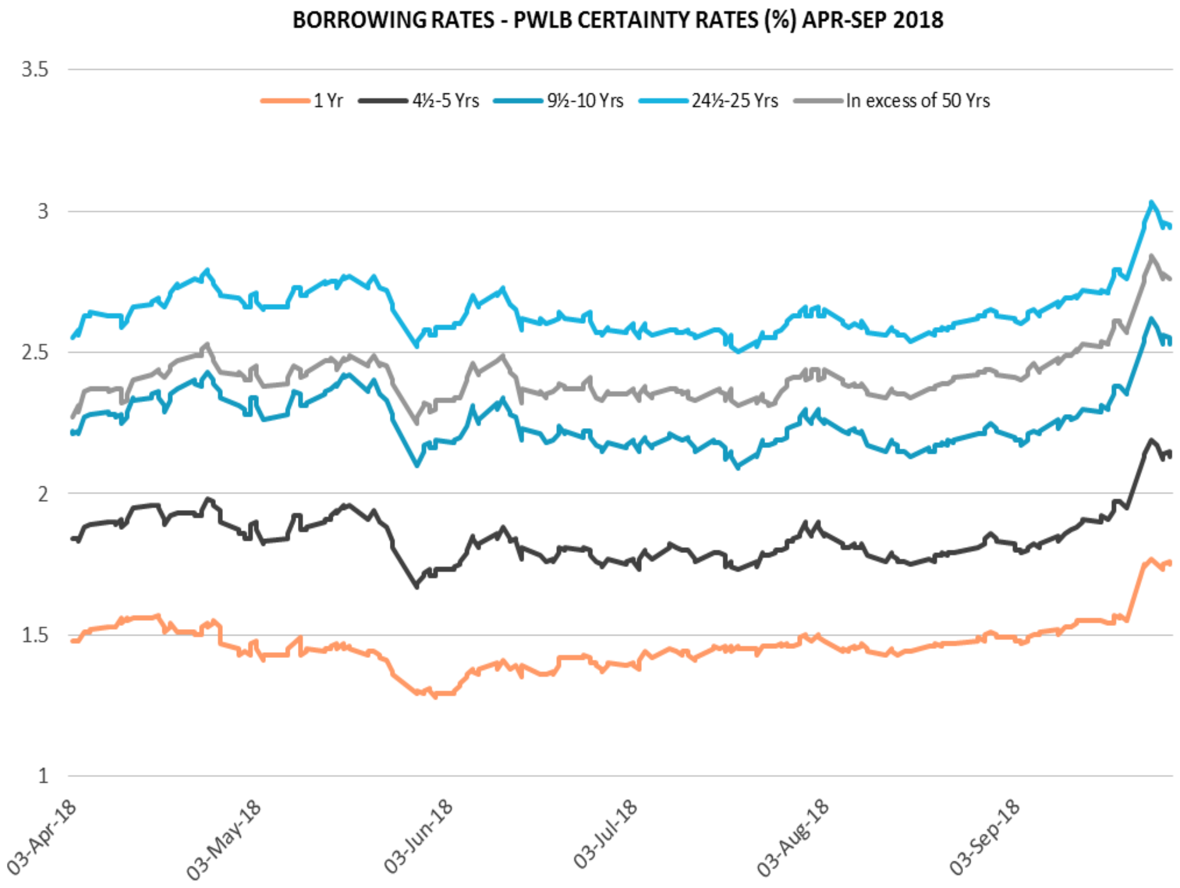
The labour market continues to defy weaker economic growth, with the unemployment rate falling to a 43 year low of 4% in quarter two. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rises less CPI inflation), earnings grew by about 0.4%. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This appears to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

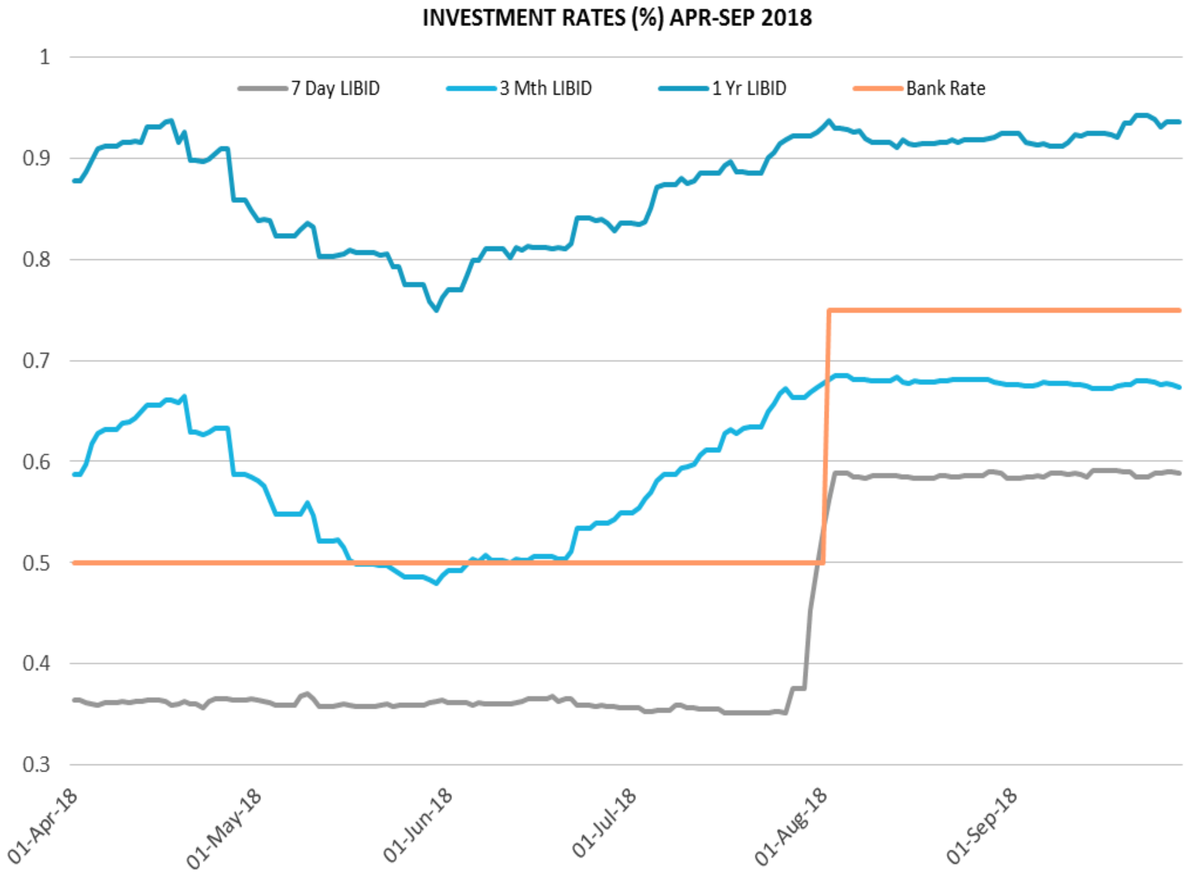
Further afield, in the USA President Trump’s easing of fiscal policy has fuelled a (temporary) boost in consumption and in turn generated an upturn in the rate of growth, which rose from 2.2% (annualised rate) in quarter 1 to 4.2% in quarter 2, but there was also an upturn in inflationary pressures. With inflation moving towards 3%, the Fed increased rates again in September to 2.25%, the fourth increase in 2018, and indicated four further increases may be required by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on imports could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

In the EU economic growth remained at 0.4% in quarter 2, undershooting early forecasts of stronger economic performance in 2018.

3.2. Actual Interest Rates 01 April to 30 September 2018

The following graphs show interest rate movements over the period, for various terms of borrowing and investment.





3.3. Forecast Interest Rates

The Council's treasury advisor, Capita Asset Services, interest forecast is shown below:

	Qtr 3 18-19 (Q/E Dec 2018)	Qtr 4 18-19 (Q/E Mar 2019)	Qtr 1 19-20 (Q/E Jun 2019)	Qtr 2 19-20 (Q/E Sep 2019)
Bank Rate	0.75%	0.75%	1.00%	1.00%
5yr PWLB	2.00%	2.10%	2.20%	2.20%
10yr PWLB	2.50%	2.50%	2.60%	2.60%
25yr PWLB	2.90%	2.90%	3.00%	3.10%
50yr PWLB	2.70%	2.70%	2.80%	2.90%

This was accompanied with the following comments:

"The flow of positive economic statistics since the end of the first quarter this year has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2; quarter 3 is expected to come in at around +0.6 to 0.7% but quarter 4 is expected to weaken from that level.

The MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is *neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, and even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from increases in import prices, devaluation of sterling, and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor has held back some spare capacity to provide a further fiscal stimulus."*

4. THE PORTFOLIO POSITION AT 30 SEPTEMBER 2018

4.1. Current Borrowing

The Council's debt at the beginning of the year and at 30 September 2018 is shown below:

TABLE 1: BORROWING	Total Principal 1 Apr 2018 £m	Weighted Average Rate %	Total Principal 30 Sep 2018 £m	Weighted Average Rate %
Public Works Loan Board Loans	295.39	3.30	281.13	3.30
LOBOs	209.50	3.90	194.50	3.87
Market / Local Authority (>1yr)*	247.10	1.83	230.10	1.91
Market / Local Authority (<1yr)*	20.00	0.67	45.00	0.74
Salix	0.07	0.00	0.06	0.00
TOTAL EXTERNAL BORROWING	**772.06**	**2.92**	**750.79**	**2.87**

* Note: above figures are based on the term of loans at their inception

4.2. Current Investments

The table below summarises the investment position at 30 September 2018:

TABLE 2: INVESTMENTS	Total Outstanding 1 Apr 2018 £m	Weighted Average Rate %	Total Outstanding 30 Sep 2018 £m	Weighted Average Rate %
Fixed Term Investments – Long Term (>1yr)*	33.25	3.24	33.25	3.24
Fixed Term Investments – Short Term (<1yr)*	65.00	0.59	50.00	0.67
Money Market Funds and Call Accounts	52.10	0.47	43.90	0.77
TOTAL INVESTMENTS (excl. Cash)	**150.35**	**1.14**	**127.15**	**1.38**

* Note: above figures are based on the term of investments at their inception

5. BORROWING ACTIVITY 2018-19

As shown in the above table, total external borrowing has decreased by £21.27 million, from £772.06 million at the start of year to £750.79 million at 30 September 2018. This is as a result of maturing loans of £46.27 million and new / replacement borrowing of £25.00 million.

Repayments included £15.00 million for the early settlement of a LOBO loan with RBS, in agreement with the lender. After allowing for the associated premium and anticipated replacement borrowing (at 2.45%), this is expected to save in excess of £6.50 million over the remaining 60 year term the original facility.

The new borrowing in the period, which was largely taken to (temporarily) cover the above early repayment, was made up of 3 loans with other local authorities. These loans had a combined weighted average term of just over 2 months and overall average interest rate of 0.80%.

The overall weighted average rate of interest on all outstanding loans at 30 September 2018 was 2.87%. This represents a reduction of 0.05% compared to start of the year average of 2.92%.

A recent review of the 2018-19 capital programme has identified that a considerable proportion of the original budgeted capital expenditure will not now be spent until later years (see 7.1 below). As a result, overall borrowing is projected to increase by a further £14.00 million (net) by the financial year end. This comprises £110.00 million of new/replacement borrowing and £96.00 million of maturities. This is around £61 million less than originally forecast.

The reduced need to borrow is in turn anticipated to generate an overall saving of around £1.81 million against the original interest payable budget for 2018-19 of £23.61 million.

6. INVESTMENT ACTIVITY 2018-19

The Council's investment policy (as set out in the Treasury Management Strategy Statement for 2018-19) is governed by the Communities and Local Government's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies (Moody's, Fitch Group and Standard and Poor's), supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

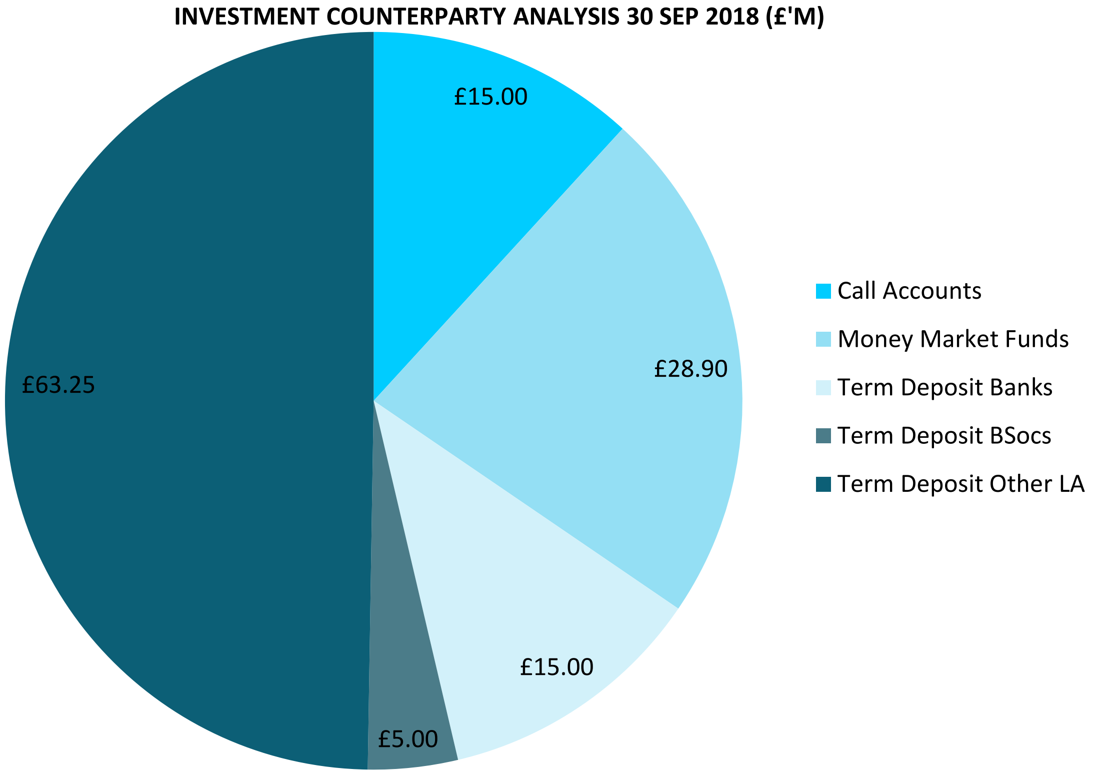
All investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

As identified above, the current policy is to use a significant proportion of available investment balances as 'internal borrowing' to support the financing of the Capital Financing Requirement (CFR).

Overall external investments (excluding cash) decreased during the first 6 months of the year from £150.35 million to £127.15 million. This is largely because of the utilisation of cash balances to support capital spend (in lieu of borrowing externally), as well as other cash flow variances (i.e. the timing differences between income coming in and expenditure being incurred).

Based on the forecast revised capital spend for the year, investment balances are anticipated to reduce to around £60 - £70 million by 31 March 2019.

An analysis of the mid-year investment balance (excluding cash) by counterparty is shown in the following chart:



The internally managed funds earned an overall average rate of return of 1.23% during the first 6 months of 2018-19. This is largely due to the (longer term) investments with other LA's, but nonetheless compares favourably against the average London Interbank Bid Rate (LIBID) benchmark indicators of:

- 7 Day - 0.43%
- 3 Month - 0.61%
- 1 Year – 0.87%

The Council's budgeted investment return for 2018-19 is £1.19 million (excluding interest of loans to thirds parties). Based on the current position and forecasts for the remainder of the year, the year-end performance is estimated to be around £0.46 million ahead of budget at £1.65 million.

The improved performance is mainly due to higher than estimated level of balances in the early part of year, as well as higher than forecast interest rates.

The above figures are exclusive of interest received on loans to third parties, such as the facilities to Arch and Northumbria Healthcare Trust etc. These loans are made for policy/service reasons, as opposed to day-to-day treasury undertakings in relation to the investment of cash flows.

7. PRUDENTIAL INDICATORS AND TREASURY LIMITS 2018-19

The Prudential Code has been developed by CIPFA. The Code has a central role in capital finance decisions, including borrowing for capital investment. Its key objectives are to provide a framework for local authority finance that will ensure individual authorities' capital expenditure plans are affordable; all external borrowing is within prudent and sustainable levels; and, that treasury management decisions are taken in accordance with good professional practice.

Performance against the approved prudential indicators, as set out in the 2018-19 Treasury Management Strategy Statement, is outlined below. None of the indicators have been exceeded during the year to 30 September 2018.

7.1. Capital Expenditure

This table shows the original approved capital programme (as agreed as part of the MTFP), current expenditure and forecast outturn for the year.

Capital Expenditure	**2018-19 Original Estimate £m**	**Position 30 Sept 2018 £m**	**2018-19 Forecast Outturn £m**
Regeneration work undertaken by Arch	13.94	0.00	2.20
Finance (Corporate Resources)	30.49	7.36	22.91
IT	7.34	2.27	1.82
Leisure Services / Active Northumberland	6.77	0.17	2.00
Regeneration	2.47	0.28	1.45
Property Services	2.17	0.19	1.23
Strategic Estates	6.41	0.60	2.43
Renewable Energy	1.00	0.17	1.83
Fire and Rescue	1.54	0.45	1.62
Neighbourhood Services	12.29	2.87	10.72
Technical Services (Local Services)	37.93	21.60	40.74
Housing – GF	0.38	0.05	0.20
Housing – HRA	10.89	4.24	8.03
Planning and Development	6.40	0.01	0.70
Adult Services	2.60	1.10	2.54
Schools	59.85	6.84	21.51
TOTAL EXPENDITURE	**202.47**	**47.73**	**121.93**

7.2. Authorised Limit and Operational Boundary

The authorised limit - is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

The table below demonstrates that during 2018-19 the Council has maintained gross borrowing within its authorised limit.

	Authorised Limit for External Debt £m	Operational Boundary for External Debt £m	Actual 30 September 2018 £m
Borrowing	1,209.45	1,007.87	750.79
Other Long Term Liabilities (PFI)	86.64	72.20	72.20
TOTAL EXTERNAL DEBT	**1,296.09**	**1,080.07**	**822.99**

7.3. Limits to Borrowing Activity

One of the key controls over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of Capital Financing Requirement (CFR) [i.e. the underlying need to borrow] in the preceding year plus the estimates of any additional CFR for 2018-19 and next two financial years.

CFR vs Borrowing	2018-19 Original Estimate £m	Position 30 Sept 2018 £m	2018-19 Forecast Outturn £m
Borrowing	824.52	750.79	759.52
Other Long Term Liabilities (PFI)	72.20	72.20	70.63
TOTAL EXTERNAL DEBT	**896.72**	**822.99**	**830.15**
CFR	**1,042.98**	**N/A**	**981.77**

The Executive Director of Finance and Deputy Chief Executive reports that no difficulties are envisaged for the current or future years in complying with this indicator.

The purpose of the following limit is to restrain the activity of the treasury function within certain limits; thereby managing risk; and, reducing the impact of any adverse movement in interest rates.

Interest Rate Exposure	Limit for 2018-2019	Actual 30 Sep 2018
Fixed Rate Exposure	0% - 100%	87.61%
Variable Rate Exposure	0% - 50%	12.39%

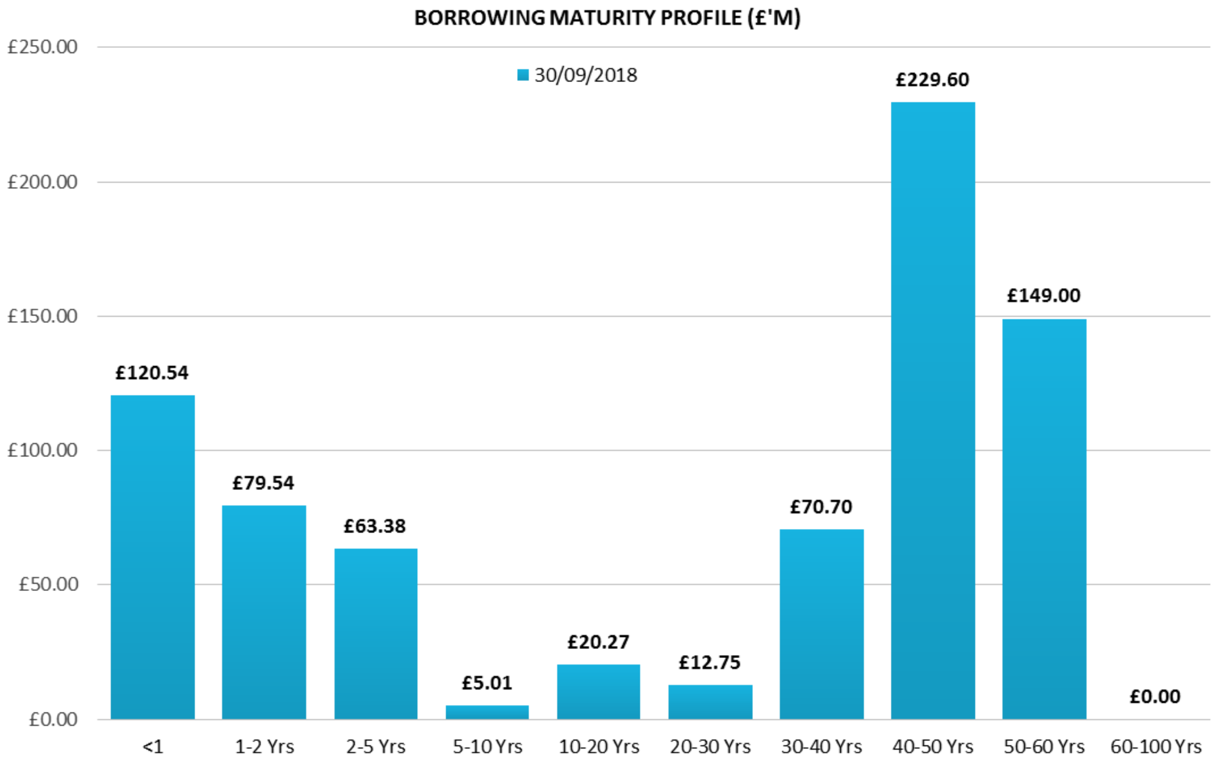
Lender option, borrower option loans (LOBOs) callable within 12 months are classed as variable; if the rate is fixed for a longer period they are classed as fixed. At 30 September 2018 the total of variable rate loans was £93.00 million and is within the set limit.

7.4. Maturity Structure of Borrowing

Measuring maturity structure of borrowing ensures a reasonable spread of maturing debt as a safety mechanism to ensure significant amounts of debt do not mature at a time when interest rates for refinancing the debt may be high.

Maturity Structure	Upper Limit for 2018-2019	Actual 30 Sep 2018
Under 12 months	25%	16%
1 year - 2 years	40%	11%
2 years within 5 years	60%	8%
5 years within 10 years	80%	1%
10 years and above	100%	64%

The following graph shows maturity of loans by monetary value. LOBOs are shown as held to maturity. In the current climate it is not envisaged that loans would be called for repayment within the next 12 months, as rates are so low.



7.5. Investments for periods longer than 365 days

These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

	Limit 2018-2019 £m	Actual Highest £m	Actual 30 Sept 2018 £m
Principal sums invested > 364 days	120.00	33.25	33.25

8. Update on Treasury Management Annual Report for the Financial Year 2017-18

At the time of writing the Annual Report for 2017-18, comparison data for other local authorities from CIPFA's benchmarking club was not available.

The data has since been published and officers can confirm the authority's borrowing and investment rates compare favourably with those of other local authorities:

	NCC	Other LA Average	NCC Rank
Borrowing – average interest rate paid for 2017-18	2.76%	3.80%	4th lowest (out of 27)
Investments – average interest rate received for 2017-18	0.98%	0.81%	7th highest (out of 23)

Implications

Policy	The report provides a half-year review of the Treasury Management activities for 2018-19, and sets out performance against the Treasury Management Strategy Statement for 2018-19. It is consistent with “We want to be efficient, open and work for everyone” priority included in the Council’s Corporate Plan 2018-21.
Finance and value for money	The financial implications of the 2018-19 investment and borrowing transactions have been taken into account within the revenue budget for 2018-19. Northumberland County Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Capita benchmarking clubs.
Legal	Under Section 1 of the Local Government Act 2003 (the Act) the Council may borrow money for any purpose relevant to its functions under any enactment, or for the purpose of the prudent management of its financial affairs. The Act and supporting regulations also requires the Council to ‘have regard to’ the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice (which were adopted by Northumberland County Council in February 2010).
Procurement	There are no direct procurement implications for the County Council.
Human Resources	There are no direct staffing implications for the County Council.
Property	There are no direct property implications for the County Council.
Equalities (Impact Assessment attached) Yes ☐ No ☐ N/A ☐	Not applicable for the County Council.

Risk Assessment	The report highlights the principal financial risks within the Treasury Management function. The identification, monitoring and control of risk are the prime criteria by which the effectiveness of the County Council's Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the Council. The investment priority is security and liquidity rather than yield, which is a secondary aim.
Crime & Disorder	There are no Crime and Disorder implications for the County Council.
Customer Consideration	There are no Customer Considerations for the County Council.
Carbon reduction	None.
Wards	All divisions.

Background Papers:

Treasury Management Strategy Statement for 2018-19

CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance notes (revised 2011)

CIPFA Prudential Code for Capital Finance in Local Authorities

Guidance on Local Government Investments The Local Government Act 2003

Local Authorities (Capital Finance and Accounting) Regulations 2012 (S.I.2012/265)

Report sign off:

Authors must ensure that officers and members have agreed the content of the report:

	Name
Monitoring Officer/Legal	Liam Henry
Executive Director of Finance & S151 Officer	Barry Scarr
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