



RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2018 / 2019

COUNCIL

28TH NOVEMBER 2018

2018/19 MID YEAR TREASURY MANAGEMENT STEWARDSHIP REPORT

REPORT OF THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES

Author : Chris Lee (01443) 424026

1.0 PURPOSE OF REPORT

1.1 The CIPFA Code of Practice on Treasury Management requires a Mid Year Review to be presented to Council. This report provides Members with information on: -

- The Council's Treasury Management activity during the first six months of 2018/19; 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 Treasury Management function operates within the Strategy approved by Council on the 28th March 2018.

3.3 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”.

- 3.4 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 cash flows of such income and expenditure and planning investments and borrowing prudently.
- 3.5 This report includes the following areas of treasury activity during the first six months of 2018/19:
- Economic background;
 - Borrowing activity and results;
 - Estimated and actual treasury position and prudential indicators; and
 - 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 2nd August 2018, the Bank of England increased the Bank Rate from 0.5% to 0.75%. The Monetary Policy Committee have reiterated that any further increases in the Bank Rate are likely to be at a gradual pace and to a limited extent.
- 4.3 Despite the ongoing uncertainty surrounding the country’s exit from the EU, current projections show UK growth to be modest. The unemployment rate is expected to be broadly stable, currently at 4%, with real wage growth unlikely to have much effect on spending power of households.
- 4.4 The Consumer Price Index (CPI) fell back to 2.4% in September, having risen in August to 2.7%. Higher import and energy prices have continued to hold inflation above the 2% target.
- 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 remain at historically low levels. Whilst gilt yields displayed volatility during the first six months of the year, the changes were marginal.

- 4.6 PWLB rates (certainty rate) during the first half of the financial year were as follows:

	5 years	10 years	20 years	50 years
Average	1.89%	2.29%	2.62%	2.41%
Highest	2.04%	2.47%	2.81%	2.64%
Lowest	1.72%	2.13%	2.48%	2.25%

- 4.7 Estimates of future rates are as follows:

	Base Rate	PWLB rates			
		5 years	10 years	20 years	50 years
2018/19 (Act 6 mth Average)	0.75%	1.89%	2.29%	2.62%	2.41%
31/03/19	1.00%	2.00%	2.45%	2.75%	2.65%
31/03/20	1.25%	2.20%	2.55%	2.80%	2.70%

5.0 REGULATORY UPDATES

- 5.1 The revised Treasury Management and Prudential Codes of Practice together with guidance notes have now been published, along with amended statutory Minimum Revenue Provision (MRP) guidance for Wales. This Council's MRP Policy is compliant with the new guidance. The updated Prudential Code includes details of the contents and purpose of a Capital Strategy (with effect from 2019/20), covering capital expenditure and financing, treasury management strategy, investment strategy and the Minimum Revenue Provision (MRP) Policy Statement.

6.0 BORROWING ACTIVITY AND RESULTS

- 6.1 The borrowing strategy for 2018/19 approved by Council in March 2018 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 £48.9m based on the Capital Programme at that time. The borrowing requirement for 2018/19 remains at this level.
- 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 2018/19 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 2018/19.

6.5 No variance is currently being projected for net capital charges which have a budget for 2018/19 of £19.9m. This is being achieved despite the challenges faced with investment income and maintaining our low risk strategy.

7.0 CERTAINTY AND INFRASTRUCTURE RATES

7.1 The “certainty rate”, whereby local authorities are able to access borrowing at 0.2% below 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 2019.

7.2 In December 2017, the UK Government announced plans to make available an amount of lending at the Local Infrastructure Rate whereby local authorities are able to access borrowing at 0.4% below published PWLB rates. A corresponding share has been made available to local authorities in Wales and Welsh Government has allocated a set amount across all 22 Welsh authorities, this Council being allocated £4.4m. This rate is available for a period of 3 years within which to draw down the allocation.

8.0 ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

8.1 During the six months to 30th September 2018, the Council operated within its prudential limits set out in the Prudential Code report approved by Council in March 2018. 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

	2018/19 Projected Outturn £M	2018/19 Original Estimate £M	2019/20 Revised Estimate £M	2020/21 Revised Estimate £M
Supported spend	85.201	76.650	34.613	18.027
Unsupported spend	41.961	41.928	26.071	3.689
Total spend	127.162	118.578	60.684	21.716
Financed by:-				
Borrowing	48.933	48.900	33.043	10.661
Other Capital Resources (Grants, Capital Receipts)	78.229	69.678	27.641	11.055

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)

	31/03/19 Projected Outturn £M	2018/19 31/03/19 Original Estimate £M	2019/20 31/03/20 Revised Estimate £M	2020/21 31/03/21 Revised Estimate £M
CFR	472.991	484.788	493.317	490.479
Net movement in CFR			20.326	(2.838)

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

Indicator: External Debt

	30/09/18 Actuals £M	2018/19 31/03/19 Original Estimate £M	2018/19 31/03/19 Revised Estimate £M	2019/20 31/03/20 Revised Estimate £M	2020/21 31/03/21 Revised Estimate £M
Borrowing	285.797	358.797	327.297	363.797	402.297
Other long term liabilities	0.507	0.835	0.507	0.584	0.583
Total External Debt	286.304	359.632	327.804	364.381	402.880

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)

	30/09/18 Actuals £M	2018/19 31/03/19 Original Estimate £M	2018/19 31/03/19 Revised Estimate £M	2019/20 31/03/20 Revised Estimate £M	2020/21 31/03/21 Revised Estimate £M
Gross Borrowing (inc. Other Long Term Liabilities)	286.304	359.632	327.804	364.381	402.880
Capital Financing Requirement		484.788	472.991	493.317	490.479

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

	2018/19 30/09/18 Actuals £M	2018/19 Limit £M	2019/20 Limit £M	2020/21 Limit £M
Gross Borrowing	285.797	500.000	500.000	500.000
Other long term liabilities	0.507	2.000	2.000	2.000
Authorised Limit	286.304	502.000	502.000	502.000

- 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

	2018/19 30/09/18 Actuals £M	2018/19 Estimate £M	2019/20 Estimate £M	2020/21 Estimate £M
Gross Borrowing Limit	285.797	325.000	380.000	425.000
Other long term liabilities	0.507	1.000	1.000	1.000
Operational Boundary	286.304	326.000	381.000	426.000

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

	2018/19 Original Estimate	2018/19 Revised Estimate	2019/20 Revised Estimate	2020/21 Revised Estimate
General Fund	4.65%	4.60%	4.96%	5.31%

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

	2018/19 Actuals as at 30/09/18	2018/19 Out-turn as at 30/09/18	2018/19 Limit	2019/20 Limit	2020/21 Limit
Borrowing					
Limits on fixed rates	68%	60%	45%-100%	45%-100%	45%-100%
Limits on variable rates	32%	40%	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	72%	61%	45%-125%	45%-125%	45%-125%
Limits on variable rates	28%	39%	-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 2018/19 is £31m, 11%. 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

	2018/19 Actuals as at 30/09/18	Upper Limit	Lower Limit
Under 12 months	16%	70%	0%
12 months to 2 years	0%	70%	0%
2 years to 5 years	0%	60%	0%
5 years to 10 years	1%	70%	0%
10 years to 20 years	0%	90%	0%
20 years to 30 years	0%	90%	0%
30 years to 40 years	80%	90%	0%
40 years to 50 years	3%	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 The maximum exposure for this type of investment is set at £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.

Indicator: Total principal funds invested for periods longer than 1 year:

	Revised Limit	31/03/19 Estimate
Maximum principal sums invested over 1 year	£25m	£5m

11.5 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 28th March 2018.

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 Security (protecting monies invested), then Liquidity (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 2018/19. 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	0.039	9.61	0.40	0.46

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

12.5 The return on investments is slightly below the benchmark return. This is attributed to our low risk strategy.

13.0 TREASURY MANAGEMENT ADVISORS

13.1 The Council appointed Arlingclose as its Treasury Management Advisors during March 2014 and they continue to support the Council's Treasury Management function. The contract is due to end 31st March 2019 and the procurement process for a new contract has commenced.

14.0 TRAINING

14.1 On 12th June, 12th September and 18th October 2018, officers attended events hosted by Arlingclose which provided 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 May and November this year. Officers continue to receive interest rate information, economic data, credit ratings and general market environment information on a regular basis.

15.0 MINIMUM REVENUE PROVISION (MRP)

15.1 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 in accordance with Welsh Government Statutory Guidance.

15.2 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 on the 28th March 2018.

16.0 EQUALITY AND DIVERSITY IMPLICATIONS

16.1 The report provides an overview of the Council's Treasury Management activities during the first six months of 2018/19 in line with the Strategy approved by Council in March 2018. As a result, no Equality Impact Assessment is required for the purposes of this report.

17.0 CONSULTATION

17.1 Following consideration by Council, this report will be presented to the Finance and Performance Scrutiny Committee in line with the laid down codes of practice and also the Terms of Reference for this Committee.

18.0 FINANCIAL IMPLICATION(S)

18.1 The financial results / implications of the Council's Treasury Management arrangements during the first six months of 2018/19 have been incorporated into quarterly Performance Reports during the year.

19.0 LEGAL IMPLICATIONS OR LEGISLATION CONSIDERED

19.1 The report ensures the Council complies with its legal duty under the Local Government Act 2003 and in doing so is in line with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

20.0 LINKS TO CORPORATE AND NATIONAL PRIORITIES AND THE WELL-BEING OF FUTURE GENERATIONS ACT

20.1 This report evidences the progress made in delivering the Council's Corporate Plan – '*The Way Ahead*' in particular through supporting the 'Living Within Our Means' theme by pursuing optimum treasury management performance or return at the same time as managing associated risk.

20.2 The report also supports the Well-being of Future Generations Act in particular 'a globally responsible Wales' through responsible management and investment of the Council's resources.

21.0 CONCLUSION

21.1 The 2018/19 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.

Other information:

Relevant Scrutiny Committee – Finance and Performance Scrutiny Committee

LOCAL GOVERNMENT ACT 1972

AS AMENDED BY

THE LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

COUNCIL 28TH NOVEMBER 2018

**REPORT OF THE GROUP DIRECTOR, CORPORATE AND FRONTLINE
SERVICES**

**Item: 2018/19 MID YEAR TREASURY MANAGEMENT STEWARDSHIP
REPORT**

Background Papers

- [28th March 2018](#) Council meeting – Report: Treasury Management Strategy Incorporating Investment Strategy, Prudential Indicators and MRP Statement for 2018/19. This report was also presented to the Finance and Performance Scrutiny Committee on 23rd April 2018.

Officer to contact: Chris Lee (Group Director, Corporate and Frontline Services)
