Lincolnshire COUNTY COUNCIL
Working for a better future

Policy and Scrutiny

Open Report on behalf of Executive Director of Finance & Public Protection

Report to:	**Overview and Scrutiny Management Board**
Date:	**27 September 2018**
Subject:	**Treasury Management -Quarter 1 Update Report 2018/19 to 30 June 2018**

Summary:

This report has been prepared in accordance with the reporting recommendations of the CIPFA Code of Practice 2017 and details the results of the Council's treasury management activities for the first quarter of 2018/19 to 30 June 2018, comparing this activity to the Treasury Management Strategy for 2018/19, approved by the Executive Councillor for Finance on 23rd March 2018. It will also detail any issues arising in treasury management during this period. Non treasury investments, as defined by recent Government Investment Guidance, are not included in this report and will be picked up witihin the Capital Strategy Reporting due later in the year along with the Council Budget Report for 2019/20.

Actions Required:

That the report be noted and any comments to be passed onto the Executive Councillor with responsibilities for Finance.

1. Background

1. <u>Introduction and Background</u>

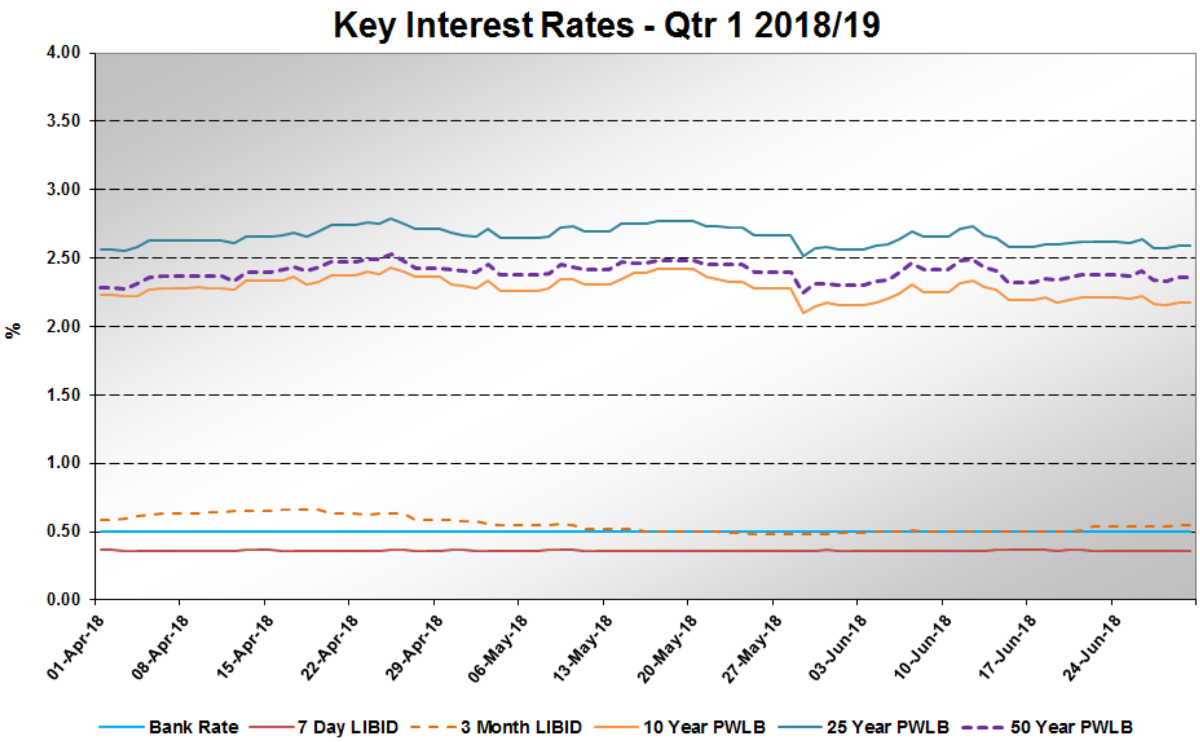
1.1. Treasury Management relates to the policies, strategies and processes associated with managing the cash and debt of the Council through appropriate borrowing and lending activity. It includes the effective control of the risks associated with the lending and borrowing activity and the pursuit of optimum performance consistent with the risks.

1.2. This Treasury Report will cover the following positions to 30th June 2018:
- Interest rate review, economic overview and revised interest rate forecast.
- Annual investment strategy/ authorised lending list changes during the quarter.
- Investment position and comparison with strategy.
- Borrowing & debt rescheduling position and comparison with strategy.
- Other Treasury Management issues arising during period.

2. Interest Rate Review, Economic Overview and Revised Interest Rate Forecast to 30th June 2018

2.1. At the time of setting the Strategy in March 2018, short term bank rate was forecast to rise moderately to 0.75%, from 0.50%, by the end of the financial year, this increase expected around November 2018. Forward guidance from the MPC at this time indicated Base rate to rise to no more than 1.00% by 2020. Long term rates were predicted to rise gradually over 2018/19 by around 0.30%.

2.2. Actual rates, both short term and long term, for quarter 1 to 30th June 2018 have remained relatively flat since the start of the year as shown in the graph below:



2.3. The Monetary Policy Committee (MPC) did however increase Base Rate by 0.25% to 0.75% on 2nd August 2018, in conjunction with its August inflation report, earlier than market expectations for the increase. The MPC sighted worries over wage inflation and shortage in the labour market as the main reason for the earlier increase.

2.4. Economic Background -The quarter ended 30th June 2018 saw the following:

- The economy showed signs of picking up in the first quarter, with estimated growth for the next three years forecast at 1.8%.
- Little change to inflation forecasts, with inflation forecast to hit the 2% target rate or just above, in two years' time.
- Low unemployment, rising employment, but low productivity leading to concerns for wage inflation.
- Continued uncertainty around Brexit negotiations, consumer spending and business investment.

2.5. The latest interest rate forecast from Link Asset Services, the Council's Treasury Advisor, is shown below which was revised on 7th August 2018 after the MPC August Inflation Report. The only change from the previous forecast being the increase in Bank Rate being brought forward to August instead of November 2018. Link believes the next increase in Base Rate will now not be until August 2019.

Link Asset Services Interest Rate View 7th August 2018												
	NOW	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.70%	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.80%	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	0.90%	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	1.84%	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.23%	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.64%	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.44%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

2.6. Link stress that forecasting rates remains difficult, the forecasts above are predicated on the assumption that sufficient progress is made in respect of negotiations to produce a reasonable agreement for Brexit that benefits both the EU and the UK in a sensible manner. If no agreement is reached at all, then the forecasts for increases in Bank Rate and PWLB rates will be subject to greater change, most likely downwards. The forecasts for average investment earnings beyond the three year time horizon will be heavily dependent on economic and political developments.

3. Annual Investment Strategy/ Authorised Lending List Changes to 30th June 2018

3.1. The Council's Annual Investment Strategy for 2018/19 was approved, along with the Treasury Strategy, by the Executive Councillor for Finance on 23rd March 2018, after being scrutinised by the Overview and Scrutiny Management Board on 1st March 2018. This Strategy relates to the Council's treasury investments only, as defined by latest Ministry of Housing, Communities & Local Government (MHCLG) Guidance, and for these treasury investments, outlines the Council's investment priorities as **the security of capital and the liquidity of investments**, with the aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity.

3.2. As such treasury investments are only placed with highly credit rated financial institutions, using Link's suggested creditworthiness approach, including Short and Long Term Ratings, Sovereign Credit Ratings and Credit Default Swap overlay information provided by Link.

3.3. In addition to Link's credit methodology, the Council also maintains a minimum limit of **A+ Long Term Rating (two out of three agencies)** for all its Counterparties, excluding part-nationalised UK banks and a **minimum limit AA- Sovereign Rating, (two out of three agencies)** for any Country in which a Counterparty is based. Appendix A shows the Council's Authorised Lending List at 30 June 2018, based on this creditworthiness approach, together with a key explaining the credit rating scores.

3.4. The table below details changes to the Authorised Lending List during the first quarter of 2018/19:

Counterparty	**Action**	**Reason**
RBS Group –RBS and NatWest (Part-Nationalised).	Ring-fenced bank name change: -National Westminster Bank PLC -Royal Bank of Scotland PLC Non-Ring fenced banks removed form List.	Bank Ring fencing Legislation. Only Ring Fenced bank deemed as Government risk.

3.5. At the time of writing the report, a £2m investment remains outstanding with the Non Ring Fenced bank of Natwest, which is no longer on the Authorised Lending List. This amount is due back on 27th November 2018 and there is no concern over this maturity.

3.6. A full list of the investments held at 30th June 2018, compared to Link's creditworthiness list, and changes to credit rating of counterparties during June 2018 are shown in Appendix B.

4. Investment Position to 30th June 2018- Comparison with Strategy

4.1. The Council's investment position and cumulative annualised return at 30th June 2018 are detailed in the table below:

Investment Position At 30.06.18	Return (Annualised %)	Weighted Benchmark (Annualised %)	Outperformance
£280.571m	**0.69%**	**0.52%**	**0.17%**

4.2. The investment balance is made up of general and earmarked reserves, Pension Fund cash, borrowing and other income received but not yet used/spent and general movement in debtor and creditor amounts.

4.3. All investments have been placed in line with the Strategy. Some one year investments have been taken during the first quarter, when value offered, but these have been limited during the rising interest rate environment. The investment portfolio weighted average maturity (WAM) fell slightly from 167 days at 31st March 2018 to 156 days at 30th June 2018.

4.4. The benchmark target return used is a weighted benchmark that uses both the 7 day LIBID and 3 month LIBID market rates, weighted, to better reflect the maturity of the investments made and therefore the risk parameters of the investment portfolio. Being a market rate, this benchmark moves relative to market movements and is therefore the target rate used for investments. The investment return of 0.69% and benchmark target of 0.52% for the 1st quarter of the year have both increased in line with rising market interest rates, from 0.53% and 0.28% respectively, at the end of 2017/18.

4.5. The investment performance was also benchmarked against the Link quarterly benchmark analysis, comprising a mixture of 9 other authorities in the East Midlands area and 13 English Counties. The results of this benchmarking for the 1st quarter are detailed below, which shows that the Council's return was still above that of the comparators, achieved by having a longer WAM. The Council's return is also in line with Link's suggested risk banding achievable for the level of risk being taken on its investments.

Link Benchmarking –Position at 30/6/2018			
	LCC	Benchmark Group (9)	English Counties (13)
30 June Return %	0.74%	0.64%	0.67%
Risk Banding	0.66% to 0.77%	0.55% to 0.66%	0.59% to 0.71%
WAM (days)	156	87	96

4.6. Temporary borrowing of £12m was outstanding at 30th June 2018, taken to support identified cash flow requirements forecast in 2018/19. This was at an interest rate of 0.35% and is cash neutral, being offset with Investment returns in excess of this amount.

5. Borrowing & Debt Rescheduling Position to 30th June 2018 - Comparison with Strategy

5.1. The Strategy for 2018/19 stated that new borrowing would be undertaken in all periods with the aim of achieving an even spread of maturity profile and keeping an increase in the average cost of the Council's debt to a minimum. Borrowing would be undertaken at a time appropriate to coincide with an identified dip in borrowing rates available.

5.2. The Council's Capital Expenditure plans and Borrowing Requirement at 30th June 2018, from that originally agreed by full Council at its meeting on 23rd February 2018 is shown below:

	Original Budget at 1/4/2018 £m	Position at 30/6/2018 after Carry Forwards
Net Capital Expenditure Programme 2018/19	84.676	111.426
Borrowing Requirement 2018/19	84.076	106.022

5.3. To date, no external debt has been taken or debt rescheduling undertaken and the Council's borrowing position at 30th June 2018 is as follows:

Borrowing Activity 2018/19	Maturing Debt £m	Debt To Fund Capital Expenditure £m	Total £m	% Cost
Opening Balance at 1.4.2018 New Borrowing to 30.6.2018 Borrowing Repaid to 30.6.2018	0.000 0.000 (10.677)	461.391 0.000 (0.000)	461.391 0.000 (10.677)	4.088%
Debt Rescheduling to 30.6.2018 -Borrowing Repaid -Borrowing Replaced	0.000 0.000	0.000 0.000	0.000 0.000	
Balance at 30.6.2018	**(10.677)**	**461.391**	**450.714**	**4.094%**
Projected Further Borrowing Required in 2018/19 (net of internal borrowing CF) Projected Further Borrowing Repayments –Actual -Voluntary	15.673 (24.820) (0.000)	84.076 (0.000) (0.000)	99.749 (24.820) (0.000)	
Projected Borrowing Position at 31.03.2019	**(19.824)**	**545.467**	**525.643**	
Authorised Limit For External Debt			651.751	

5.4. Internal borrowing is using internal balances instead of taking external borrowing to finance the capital programme. This strategy reduces interest rate risk (the risk of unexpected adverse changes in interest rate) and credit risk (the risk of default by counterparties to whom investments are held as investment exposure falls) and also provides a net saving in interest costs in the short term, provided that Council balances are sufficiently available to maintain this strategy. The balance of internal borrowing stood at £82.152m at 31st March 2018. A further £21.946m of internal borrowing will be made in 2018/19 to cover the 2017/18 carry forward of capital expenditure, making the total predicted internal borrowing balance for 2018/19 of £104.097m.

5.5. Total LOBO debt the Council has secured is still at £30m, well within the limit set in the strategy of 10% of total external debt (equating to £46m). A limit is set on this type of borrowing to limit the amount of variability within the debt portfolio of debt repayment. The average cost of the Council's LOBO debt is 3.93%.

5.6. No debt rescheduling activity of existing debt has taken place to 30th June 2018, due to all existing borrowing loans being in premium position. (Meaning that the coupon rate of existing debt is higher than the current market rate for equivalent outstanding periods and so a premium would be incurred to repay this debt back early).

5.7. Full Council, at its meeting on 23rd February 2018, approved the Council’s Prudential Indicators for 2018/19, set as a requirement of the Prudential Code to ensure the Council’s capital financing, in particular its long term borrowing, is prudent, affordable and sustainable. It can be confirmed that no Prudential Indicator limits have been breached in the first quarter to 30th June 2018.

6. <u>Other Treasury Management Issues</u>

6.1. Capital Strategy

Work is underway to produce a new Capital Strategy for the Council, as per the requirements of the revised Prudential Code 2017, which will pick up the affordability and risk profile of the non-treasury investment activity of the Council as well as look at the process of the formulation of the Capital Programme in line with the Council's Strategic Plans. It is intended to align this Strategy with the Budget Reporting cycle for 2019/20. Further Prudential Indicators will also be introduced for 2019/20 to cover the different risk profile of the non-treasury investment and borrowing activity.

6.2. International Financial Reporting Standard (IFRS) 9 – Financial Instruments

This standard is effective from 2018/19 and reclassifies financial assets held by the Council on its Balance Sheet. Certain categories of investments will have to be held at their 'Fair Value' instead of historic cost, for example Pooled Funds. The difference in the fair value from the purchase price will represent the profit or loss of holding these investments at the balance sheet date. The impact for Lincolnshire of this fair value movement is being calculated but not thought to be significant as it currently holds minimal amounts of the type of investments that are effected. This accounting standard also requires an expected credit loss amount to be calculated and accounted for upfront of any financial assets held, instead of an impairment figure calculated retrospectively if necessary. This is to promote the consideration of risk of taking investments at the onset of making such investments. This figure is also currently being calculated for Lincolnshire.

6.3. MHCLG Consultation on mitigating the impact of fair value

The Government have recently issued a proposal to mitigate the impact of any Fair Value changes that will affect Councils regarding the investments they hold as detailed above, for a 3 year period, and are seeking a consultation on these proposals. This will give Council's time to adjust their investment portfolios accordingly without the impact of holding them hitting Council Tax payer in the short term. We support this proposal and have responded to the consultation accordingly.

2. Conclusion

Interest Rates have remained flat over the quarter in line with forecasts. The Council continues to outperform the investment benchmark by lengthening the Weighted Average Maturity of the Fund. No external borrowing has been undertaken to date. The cost of the Councils borrowing at 30th June 2018 was 4.094% The Council's internal borrowing level stood at £82.152m at 31st March 2018 with £21.946m of internal borrowing being carried forward in 2018/19 along with capital expenditure and borrowing requirement underspends. Temporary borrowing of £12m was outstanding at 30th June 2018 taken to cover predicted liquidity shortfalls at a cost neutral level. A Capital Strategy is being formulated to meet the requirements of the new Prudential Code 2017 and will align with the 2019/20 Budget Report. Accounting requirements under IFRS9 – Financial Instruments will be followed.

3. Consultation

a) Have Risks and Impact Analysis been carried out??

Yes

b) Risks and Impact Analysis

Risk & Impact Analysis for Treasury Management forms TMP1 of the Treasury Management Practices, as required by the CIPFA Code of Practice 2017. A Risk Register which details the main risks for Treasury Management has been completed and is reviewed annually. Both the TMPs and the Risk Register are held in the Treasury Files held on IMP at County Offices.

4. Appendices

These are listed below and attached at the back of the report	
Appendix A	Authorised Lending List and Credit Rating Key.
Appendix B	Investment Analysis Review at June 2018 -Capita Asset Services Ltd.

5. Background Papers

Document title	Where the document can be viewed
Treasury Management Strategy Statement and Annual Investment Strategy 2018/19 -23/3/2018	Lincolnshire County Council, Finance and Public Protection
Council Budget 2018/19 - 23/2/2018	Lincolnshire County Council, Finance and Public Protection

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