Report of the Director of Policy & Resources

Agenda Item No: 9
Meeting: 10th November 2015

NORTH LINCOLNSHIRE COUNCIL

COUNCIL

TREASURY MANAGEMENT AND STRATEGY REPORT MID YEAR REVIEW 2015/16

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1 To provide a mid-year review of the treasury strategy approved by council as part of the 2015/16 budget. The report gives details of progress to date.

1.2 It covers treasury management performance for the seven months between April and October 2015. The report explains how the strategy has been implemented during the first part of the year, the state of the financial markets, and the response to changing conditions in those markets.

2. BACKGROUND INFORMATION

2.1 **The investment strategy for 2015/2016** aims to reduce risk by;

- Limiting the maximum investment period to twelve months
- Applying a maximum investment limit of £7m or lower for counter-parties (except the council's own bankers)
- Applying a maximum limit to financial groups rather than separate institutions
- Investing in a range of financial institutions including UK institutions with a minimum of an adequate credit rating or equivalent and Money Market Funds.
- Investing in additional instruments such as Certificates of Deposit

2.2 **The borrowing strategy for 2015/2016** aims to**;**

- Borrow at the most advantageous point possible
- Track short-and long-term interest rates alongside investment rates to determine that point
- Consider borrowing from a range of institutions to ensure the best value for money
- Generally borrow only to support the capital programme
- Borrow for shorter periods if cash flow requires or to avoid long term borrowing for a period.

2.3 The council's budget was framed against the state of financial markets at the time of approval and prospects for the year ahead. This included the Bank of England Base Rate which was set on 5th March 2009 at 0.5% and continues at that level. The Monetary Policy Committees decision, on the 6th October, to retain this rate followed:

- A twelve month CPI Inflation of zero in August, well below the 2% target rate
- Although rising, increases in labour costs remain lower than would be consistent with meeting the inflation target in the medium term, were they to persist at current rates
- And global growth has continued at below-average rates

By retaining the rate at this level it was hoped that it would meet the 2% inflation target and in a way that helps to sustain growth and employment.

2.4 The budget provides for an average annual cost of interest at 4% and principal repayment over 20 years for future external borrowing once internal borrowing is no longer an option. The strategy for 2015/16 anticipated that the council would be required to move to external borrowing at the end of the financial year.

2.5 Existing debt is based on a mix of borrowing terms. The rates are taken into account when the council sets prudential indicators for the treasury function. Performance is monitored against these targets to ensure the capital investment programme remains affordable and sustainable.

3. OPTIONS FOR CONSIDERATION

3.1 The report considers the implementation of an agreed strategy. There are therefore no options to consider.

4. ANALYSIS OF OPTIONS

Investment strategy

4.1 Economic data is less positive than expected, not just in the UK, but in the US too, with the slowing Chinese economy also influencing markets. As a result the rate-rise expectations have been pushed back.

4.2 The latest inflation rates, announced for September, are still low (-0.1% CPI & 0.8% RPI) which means there is less pressure for an increase in interest rates. The Office for Budget Responsibility (OBR) Forecast Evaluation Report for October, 2015 suggests a modest increase in their bank rate projections for later in the financial year.

4.3 The focus of cash management remains to maximise security and liquidity. Cash is currently being held in a range of call accounts with

UK banks or, on short term deposit (12 months present maximum) with banks and building societies, who maintain an adequate credit rating.

4.4 In addition to this investments have been placed with Money Market funds meeting the council's investment criteria. These offer more competitive rates than many of the bank and building society counter parties while diversifying credit and interest rate risk.

4.5 At the end of October outstanding investments were £13.2m, including £10.2m with the council's own bankers (**Appendix 1).** The downward trend in cash balances is expected and may require short-term borrowing in the second half of the year. This is in line with the approved policy.

4.6 The low base rate means returns on investments continue to be very modest. So far an average return of 0.51% has been achieved.

4.7 Short term cash flow requirements have also prevented significant funds being invested to the term limits allowed within the strategy. Our "small" investments, in terms of period and size (compared to the market), can only attract lower interest rates. Therefore the Investment income of £61k achieved to date falls short of the £87k target. However, this use of cash balances delivers greater savings in borrowing costs.

4.8 Work will now start preparing the Investment Strategy for 2016/17 ready for presentation to Council in February.

Borrowing strategy

4.9 In setting the current strategy it had been anticipated that the level of repayment of maturing debt, the extent of capital investment to be funded directly by the council and a reduction in the level of surplus balances would mean that the council would be unable to continue the practise of internal borrowing during 2015-16.

4.10 So far there has been no need for external borrowing. The impact of those factors above is being monitored, along with the risk of interest rate rises. Borrowing pre any significant rise in interest rise would enable the council to lock into lower interest rates and provide long term savings over the life of the loan. A balance has to be struck between avoiding external borrowing in the short-term to maximise revenue savings now, and the longer term costs of interest rates rise.

4.11 In the meantime there is a possibility that short term borrowing may be needed to meet periodic cash flow shortfalls, towards the end of the financial year.

4.12 By the 26th of October the long term borrowing rate (25 year PWLB annuity rate) had risen to just over 3.2% from 3.0% in April 2015. The prospect of increased returns on investment remains low and the difference between borrowing and lending rates would suggest that, while affordable, the use of balances for internal borrowing continues to offers the best value for money to the council.

4.13 A potential new source of borrowing is imminent as progress continues with the newly formed UK Municipal Bonds Agency. NLC is a shareholder and relevant legal documents will require approval in due course.

4.14 Scheduled debt repayments continue to be made and at the end of October 2015 debt outstanding was £105.3m. By the end of March 2016 this will have been reduced further to £103.4m.

4.15 Key performance indicators have been updated following the re-phasing of the capital programme since the start of the financial year (**Appendix 2)**. There are no other performance issues to note.

5. RESOURCE IMPLICATIONS (FINANCIAL, STAFFING, PROPERTY, IT)

5.1 The treasury strategy aims to minimise risk to the council's finances from further instability in financial markets while seeking to achieve a favourable return from investment income.

5.2 The projected costs of financing debt are within budget and the prudential ratio of financing costs to net revenue streams at 9.7% (**Appendix 2 ii**) is below the 10% -12% range set by council.

5.3 There have been adjustments to the capital programme in 2015/16 largely due to approved re-phasing of programme spending and changes to programme financing. This is reflected in **Appendix 2.**

6. OUTCOMES OF INTEGRATED IMPACT ASSESSMENT (IF APPLICABLE)

6.1 Not applicable

7. OUTCOMES OF CONSULTATION AND CONFLICTS OF INTERESTS DECLARED

7.1 Not applicable.

8. RECOMMENDATIONS

8.1 That the Council notes the mid-year treasury management performance.

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Background Papers used in the preparation of this report
Treasury Management Strategy Report 2015/16
Financial Times/FTfm 19th October, 2015
OBR Forecast Evaluation Report October 2015
Bank of England Monetary Policy Committee Minutes 6 October 2015

APPENDIX 1

INVESTMENT POSITION AS AT 31 OCTOBER 2015

CALL ACCOUNT BALANCES

		£m	
Barclays Bank plc Flexible Interest Bearing Current Account	0.45%	10.2	On call
Bank of Scotland Plc Call Account	0.40%	0.0	On call
HSBC Bank Plc Call Account	0.30%	0.0	On call
National Westminster Bank Plc Corporate Cash Manager Plus	0.25%	0.0	On call

OTHER INVESTMENTS

Bank of Scotland Plc 32 Day Notice Account	0.50%	3.0	Notice given
CCLA Public Sector Deposit Fund	(variable)	0.0	Money Market Fund (On Call)

TOTAL **13.2**

In addition to those specified above, the only counterparties with whom any investment has been placed in the period up until 31st October 2015 are the Nationwide and Leeds Building Societies.

APPENDIX 2

		2015/16	2015/16
		Budget (Feb 2015)	Revised
(i)	Estimates of capital expenditure	£m 57.7	£m 68.3
(ii)	General Fund ratio of financing costs to the net revenue stream % (Based on Prudential Code 2011)	% 9.7	% 9.7
(iii)	an estimate of the capital financing requirement	£m 190.2	£m 190.2
(iv)	the authorised limit for external debt borrowing other long term liabilities total	£m 245.0 5.0 250.0	no change
(v)	the operational boundary for external debt borrowing other long term liabilities total	£m 193.0 2.0 195.0	no change
(vi)	upper limit for fixed rate exposure	% 100.0	no change
(vii)	upper limit for variable rate exposure	20.0	no change
(viii)	upper and lower limits for maturity structure of borrowing UPPER LIMIT under 12 months 12 months and within 24 months 24 months and within 5 years 5 years and within 10 years 10 years and above LOWER LIMIT 10 years and above	 15.0 15.0 50.0 75.0 90.0 25.0	no change no change
(ix)	total principal sums invested for periods longer than 364 days	£000 0	£000 0