

Report of Chief Officer Financial Services

Report to Executive Board

Date: 15th November 2017

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2017/18

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Is the decision eligible for Call-In?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

Summary of main issues

1. This report provides a review and update of the treasury management strategy for 2017/18
2. The Council's level of forecast external debt as at 31st March 2018 is anticipated to be £1,949m, £70m lower than approved in February 2017. This lower forecast borrowing requirement is due to a combination of slippage in the capital programme, together with an increase in the level of internal revenue balances that were used to defray external borrowing in comparison to the expectation.
3. In line with the agreed treasury strategy set in February, the Council has taken advantage of lower costs of borrowing by acquiring longer dated debt and thereby reducing exposure to short term fluctuations in the debt markets. This is forecast to be achieved within the current budget for the year.
4. The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

Recommendations

That Executive Board note:-

5. The update on the Treasury Management borrowing and investment strategy for 2017/18.

1 Purpose of this report

1.1 The 2017/18 treasury management strategy was approved by Executive Board on 8th February 2017. This report provides a review and update of the strategy for 2017/18.

2 Background information

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities (amended 2009 and 2011) in particular:

- The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of prudential indicators.
- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least three times a year.

3 Main issues

3.1 Review of Strategy 2017/18

3.1.1 The current borrowing forecasts are shown in Table 1

Table 1

	2017/18 Feb 17 Report £m	2017/18 This Report £m
ANALYSIS OF BORROWING 2017/18		
Net Borrowing at 1 April	1,877	1,809
New Borrowing for the Capital Programme – Non HRA	145	157
New Borrowing for the Capital Programme – HRA	15	0
Debt redemption costs charged to Revenue (Incl HRA)	(13)	(12)
Reduced/(Increased) level of Revenue Balances	(5)	(5)
Net Borrowing at 31 March*	2,019	1,949
Capital Financing Requirement		2,233
* Comprised as follows		
Long term borrowing		
Fixed	1,466	1,565
Variable (less than 1 Year)	0	0
New Borrowing	142	140
Short term Borrowing	419	252
Total External Borrowing	2,027	1,957
Less Investments	8	8
Net External Borrowing	2,019	1,949
% borrowing funded by short term and variable rate loans	28%	20%

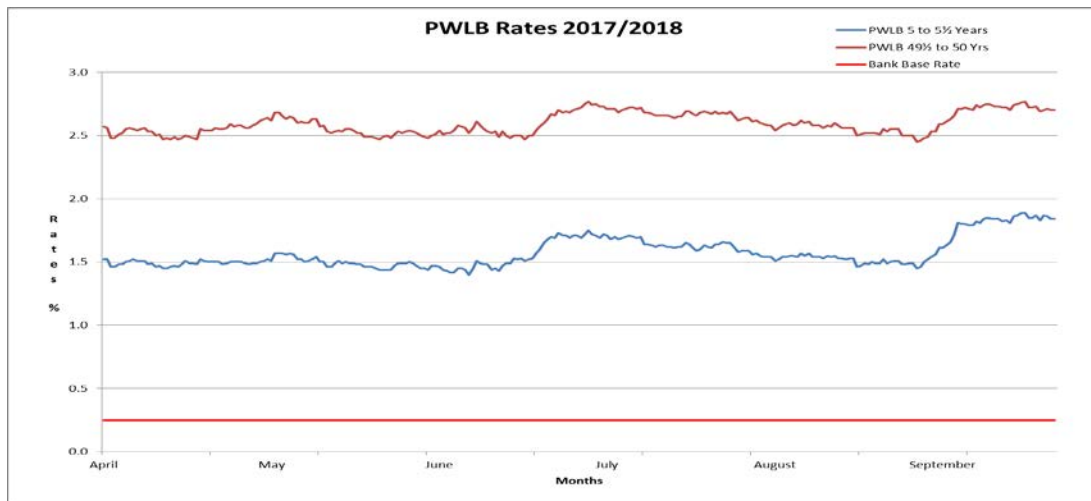
Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing PFI and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes. The above reflects only the borrowing element of the CFR

3.1.2 Table 1 above shows that 2017/18 net external borrowing is now forecast at £1,949m, £70m lower than in the report to Executive Board on 8th February 2017. This lower forecast borrowing requirement is due to a combination of slippage in the capital programme (£13m), together with greater than forecast revenue balances of

£55m. The February forecast assumed that revenue balances would reduce by £85m based on the working capital trend seen to that point. However the actual reduction was £27m with the three main reasons being higher: earmarked ring fenced reserves of £23.5m; capital grants unapplied £29.4m; and working capital of £26.6m. The treasury strategy uses balances and reserves in lieu of borrowing and these balances continue to be monitored closely. However, as expected, the level of working capital will continue to fluctuate based upon the demands of the Council. The economic outlook remains mixed across many of the major economies. China and emerging markets continue to slow down with concerns of excess industrial capacity, unsold stock of property and increasing levels of non-performing loans in the banking and credit system.

- 3.1.4 In Europe the European Central Bank (ECB) is hampered by inflation which is struggling to reach 2%, however growth posted 0.5% in Q1 (2.0% year on year) and 0.6% in Q2 (2.3% year on year). On balance most commentators don't see rate increases in the European Union (EU) before 2019.
- 3.1.5 In the United States growth continues to be volatiles, Q1 was 1.2% year on year whilst Q2 was 3.1% year on year. The Federal Reserve raised rates for the first time since the 2008 crash in December 2015 and has raised rates 3 more times since with 1 more possible in 2017. The Federal Reserve has also indicated that it is to begin unwinding its \$4.5 trillion Quantitative Easing (QE) stimulus by allowing bonds to mature without replacement.
- 3.1.6 United Kingdom Gross Domestic Product (GDP) Q1 growth was weak posting 0.3% (1.7% year on year) and Q2 posting 0.3% (1.5% year on year). The fall in the value of sterling post Brexit referendum has fed into inflation through the mechanism of higher import costs and inflation is now expected to peak at just over 3% before falling back to its 2% target over the 2 year time horizon. The Monetary Policy Committee (MPC) are now more hawkish on the timing of the first base rate rise and appear to be driven by concerns over labour tightness as unemployment has fallen to 4.3% the lowest since 1975. Set against this wage inflation continues to remain subdued and is possibly an effect of globalisation that is being seen as a common theme in many western economies.
- 3.1.7 Chart 1, shows how the cost of longer term borrowing from the Government through Public Works Loan board (PWLB) loans has performed since the start of the financial year. The 5 year to 5½ year PWLB has moved upwards from a starting point in April of 1.45%, to a low of 1.34% in the middle of June and then to a high of 1.82% at the end of September, currently it is in the region of 1.77%. Similarly, the 49½-50 year rate has moved from a starting point in April of 2.57% to a low point in early September of 2.45% and then to a high of 2.77% in late September, this rate is currently in the region of 2.70%. Please note the Council is entitled to a reduction of 20bp on all PWLB rates, including those list above, reflecting eligibility for PWLB certainty rates.

Chart 1



3.1.8 Expectations for the first change in Bank Rate in the UK have been brought forward recently as the wider economic picture has emerged. The markets are currently anticipating an 80% chance of a base rate rise in November and this would be the first rise in 8 years. The impact of a rise on the economy is subject to much debate but further rises are expected to be gradual and over a number of years (see Table 2) reflecting the state of the economy.

Table 2

Budget Rate Assumptions	2017/18	2018/19	2019/20	2020/21
Exec Board Feb 17	0.50	0.75	0.75	1.00
Now	0.50	0.75	0.75	1.00

3.1.9 The current borrowing strategy continues to be to fund the borrowing requirement of the capital programme from short dated loans and internal cash balances. There will come a point when rates begin to rise and more expensive longer dated funding will be required. The Chief Officer Financial Services will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time.

The current strategy also allows for taking advantage of lower longer-term funding to manage the Council's exposure to fluctuations in funding costs. Table 3 below details the long term funding activity undertaken during 2017/18 which consists of £95m of new PWLB funding as volatility in the markets during the summer caused a succession of new lows to be reached.

Table 3

Rescheduling and Funding 2017/18							
Premature Repayments				New Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate (%)	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB				PWLB			
				03/04/2017	20	50	2.37%
				19/04/2017	20	47	2.26%
				26/06/2017	20	50	2.28%
				15/08/2017	35	49	2.33%
Sub Total		0		95			
LOBOs				LOBOs			
Sub Total		0		0			
Total		0		Total		95	

3.1.10 The strategy of deferring long term borrowing will increase the amount of debt that the Council is funding from short term loans and its balance sheet to a forecast £668m. This exposure will be influenced by historical capital programme slippage, the continued strength of the Council's balance sheet and the market for supplying short term funds remaining strong. To mitigate against the exposure to rising interest rates the Council is in discussions to acquire forward funding which will give the Council the ability to lock in future funding at current rates, thereby allowing the Council to continue to take advantage of low short-term rates.

The short term exposure will continue to be monitored and should be considered in the context of the stability of the current debt maturity profile. The Council's current long term debt of £1.565bn has an average maturity of just under 39 years if all debts run to maturity. Approximately 15% of the Council's long term debt has options for repayment, in the unlikely event that all these options were exercised at the next option date then the average maturity of long term debt would be lowered to 31½ years. This compares favourably with the average maturity of the UK Government debt portfolio of nearly 18 years. The existing profile of the Council's debt provides considerable certainty of funding costs. Prudential Indicator 16 in Appendix A shows the maturity profile of the Council's long term fixed debt and highlights that approximately 75% or £1,128m matures in periods greater than 10 years.

3.1.11 The strategy of continued use of existing balances, continued low short-term financing rates and taking the opportunity to lock in low longer term rates is forecast to be delivered within the budget.

3.2 *Borrowing Limits for 2017/18, 2018/19 and 2019/20*

3.2.1 The Council is required to set various limits for 2017/18, 2018/19 and 2019/20 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2009 and 2011). These limits including prudential indicators are detailed in Appendix A.

3.2.2 It is anticipated that the Council will continue to remain within the Authorised Limits for 2017/18. Both the Authorised Limit and Operational Boundary are made up of a limit for borrowing and a limit for other long term liabilities.

3.2.3 The Chief Officer Financial Services has delegated authority to make adjustments between the two separate limits for borrowing and other long term liabilities, provided that the overall limit remains unchanged. Any such adjustments will be reported to the next available Council meeting following the change.

3.2.4 Borrowing limits for 2017/18 were approved by Council on 8th February 2017 and remain unchanged.

3.3 *Investment Strategy & Limits*

3.3.1 The Council's external debt is reduced by the availability of revenue balances. The Treasury policy also allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. At present the Council's surplus monies continue to be held in short periods until required. Except for £900k which has been invested in the 4½ year period at a rate of 0.95% at the request of St Aidan's trust. As market sentiment to counter-party risk improves, together with enhanced returns, surplus monies will be invested in

accordance with the approved lending list. This lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's view of the credit worthiness of counter-parties.

- 3.3.2 The investment strategy, as re-affirmed by Executive Board and full Council in February, allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend up to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good.

3.4 Prudential Code and Treasury Management Code

- 3.4.1 Members are asked to note that the Chartered Institute of Public Finance and Accountancy (CIPFA) has consulted upon changes to the prudential code and treasury management code. The changes when published, will be reported in the next update to Executive Board.

4 Corporate Considerations

4.1 Consultation and Engagement

- 4.1.1 This report is an update on strategy as presented to Executive Board in February 2017, as such no consultation has taken place. However, consultation with the Council's treasury advisors takes place regularly throughout the year.
- 4.1.2 The borrowing requirement is an outcome of the capital programme. Consultation is undertaken by individual services in relation to capital investment schemes. A capital programme update report is included elsewhere on this agenda.

4.2 Equality and Diversity / Cohesion and Integration

- 4.2.1 Equality, diversity, cohesion and integration requirements are addressed as part of individual capital scheme and programme approvals. The borrowing to deliver these capital schemes is executed through treasury strategy and as such there are no further equality diversity cohesion and integration issues.

4.3 Council policies and Best Council Plan

- 4.3.1 Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Best Council Plan.

4.4 Resources and Value for Money

- 4.4.1 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where borrowing is supported the revenue costs are met by the Government, whilst for unsupported borrowing revenue costs are met either by the General Fund or HRA.
- 4.4.2 The updated strategy 2017/18 is forecasting no additional costs against the budgeted position despite taking higher rate longer dated funding than was anticipated in the budget as part of the agreed strategy to lock out financing risk as

opportunities arise. This has been offset by funding at lower than forecast from temporary borrowing and internal resources.

4.5 Legal Implications, Access to Information and Call In

4.5.1 There are no legal, or access to information issues arising from this report. The report is subject to call in.

4.6 Risk Management

4.6.1 This report sets out the framework for the treasury strategy for the year ahead. The execution of strategy and associated risks are kept under regular review through:

- Monthly reports to the Finance Performance Group
- Quarterly strategy meeting with the Chief Officer Financial Services and the Council's treasury advisors
- Regular market, economic and financial instrument updates and access to real time market information

4.6.2 The above monitoring mitigates the directorate level risk of "Failure to recover money invested in other financial institutions" and in addition the Treasury Management Strategy is linked to the corporate risk on 'Financial Forecasting'.

5 Conclusions

5.1 The Council's level of net external debt at 31st March 2018 is anticipated to be £1,949m, £70m lower than expectations in February 2017.

5.2 Treasury Management activity has incurred no additional costs against budget. This is largely due to taking higher rate longer term funding at attractive rates in comparison to the budget provision offset by lower than anticipated costs of temporary borrowing and funding from internal resources.

6 Recommendations

That Executive Board note:-

6.1 The update on the Treasury Management borrowing and investment strategy for 2017/18.

7. Background documents¹

None

¹ The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.

Leeds City Council - Prudential Indicators 2017/18 - 2019/20

No.	PRUDENTIAL INDICATOR	2017/18	2018/19	2019/20
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS				
1	Ratio of Financing Costs to Net Revenue Stream General Fund - Excluding DSG (Note1)	10.19%	12.73%	11.70%
2	HRA	11.01%	11.07%	11.28%
Impact of Unsupported Borrowing on Council Tax & Housing Rents		£ . P	£ . P	£ . P
3	increase in council tax B7(band D, per annum) (Note 2)	10.97	40.77	63.06
4	increase in housing rent per week	0.00	0.01	0.20
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
Estimate of total capital expenditure				
6	Non HRA	288,778	237,573	203,200
7	HRA	85,927	86,583	131,170
	TOTAL	374,705	324,156	334,370
Capital Financing Requirement (as at 31 March)		£'000	£'000	£'000
8	Non HRA	2,030,097	2,109,480	2,184,901
9	HRA	815,077	811,611	832,844
	TOTAL	2,845,174	2,921,091	3,017,745
9a	Limit of HRA Indebtedness as implemented under self financing	721,327	721,327	721,327

No.	PRUDENTIAL INDICATOR	2017/18	2018/19	2019/20
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS				
		£'000	£'000	£'000
10	Authorised limit for external debt - (Note 5)			
	borrowing	2,450,000	2,450,000	2,500,000
	other long term liabilities	740,000	720,000	690,000
	TOTAL	3,190,000	3,170,000	3,190,000
11	Operational boundary - (Note 5)			
	borrowing	2,200,000	2,300,000	2,350,000
	other long term liabilities	720,000	700,000	670,000
	TOTAL	2,920,000	3,000,000	3,020,000
14	Upper limit for fixed interest rate exposure expressed as either:- Net principal re fixed rate borrowing / investments OR:- Net interest re fixed rate borrowing / investments	115%	115%	115%
15	Upper limit for variable rate exposure expressed as either:- Net principal re variable rate borrowing / investments OR:- Net interest re variable rate borrowing / investments	40%	40%	40%
17	Upper limit for total principal sums invested for over 364 days (Note 5) (per maturity date)	150,000	150,000	150,000
18	Net Debt as a percentage of Gross debt	99.4%	99.4%	99.5%

16	Maturity structure of fixed rate borrowing as at 31/03/2018	Lower Limit	Cumulative Upper Limit	Projected 31/03/2018
	under 12 months	0%	15%	2.76%
	12 months and within 24 months	0%	20%	5.43%
	24 months and within 5 years	0%	35%	11.52%
	5 years and within 10 years	0%	40%	5.06%
	10 years and within 20 years			1.67%
	20 years and within 30 years			0.00%
	30 years and within 40 years	25%	90%	41.21%
	40 years and within 50 years			24.02%
	50 years and above			8.33%
				100%

Notes.

- The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.
- The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.
- In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.
- Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.
- Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003, and the revised code in February 2010 and 2012

Prudential Code Monitoring 2017/18 - Debt

