Agenda Item No: 09

CABINET

9th NOVEMBER 2016

DIRECTOR OF FINANCE: DAMON LAWRENSON

CABINET MEMBER WITH RESPONSIBILITY FOR FINANCE, PERFORMANCE AND LGSS: COUNCILLOR ROBIN BROWN

Subject:	Treasury Management Report, Quarter Two 2016-17
Recommendations:	That Cabinet note the Treasury Management Report and Forward to Full Council for approval

1. Purpose of Report

1.1 This report provides the second quarterly update on the Treasury Management Strategy 2016-17, approved by Council in February 2016.

2. How this decision contributes to the Council Plan

2.1 The Council's vision is to make Northamptonshire a great place to live and work. This is achieved through increasing the wellbeing of your county's communities and/or safeguarding the county's communities.

This initiative specifically delivers increased wellbeing and/or safeguarding by:
• People of all ages are safe, protected from harm and able to live happy, healthy and independent lives in our communities. • People have the information and support they need to make healthy choices and achieve wellbeing. • People achieve economic prosperity, in a healthy, low carbon economy which give access to jobs, training and skills development. • Communities thrive in a pleasant and resilient environment, with robust transport and communications infrastructure. • Resources are utilised effectively and efficiently, in coordination with partners and providers.

3. Background

3.1 Treasury Management is governed by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code). The Code has been developed to meet the needs of Local Authorities and its recommendations provide a basis to form clear treasury management objectives and to structure and maintain sound treasury management policies and practices

4. Summary of Key Headlines

4.1 The main highlights for the quarter are:

- In house investment returns received on cash balances continue to compare favourably to the benchmarks. A return of 0.50% was achieved compared to the 7 day and 3 month inter-bank daily lending rate (LIBID) benchmarks (0.20%, 0.31% respectively). For further information please refer to Section 8.

- A £5.563m underspend is currently reported. The savings have been generated through a combination of the annual review the Minimum Revenue Provision, the Nourish service contribution to capital financing costs and careful management of the Council's balance sheet and a strategy of internal borrowing. This strategy will continue throughout the course of the year to maximise savings where possible. For further information please refer to Section 12.
- Capita were reappointed as the Council's Treasury Advisors for a further two years following a formal procurement exercise over the summer. See Section 13.
- The UK Municipal Bonds Agency is expected to issue its first bond on behalf of local authorities in the coming months which this authority will participate in. See Section 12.
- A balance sheet review (31st March 2016) sets out how the Capital Financing Requirement is resourced from external loans and internal borrowing, and how cash backed reserves and working capital supports the cash that is invested. See Section 11.

5. The Economic Environment

5.1 A detailed economic commentary is provided in Appendix 1. This information has been provided by Capita Asset Services – Treasury Solutions (CAS Treasury Solutions), the Council's treasury management advisors.

5.2 During the quarter ended 30 September 2016:

- The economy remained surprisingly robust since Brexit;
- Households and firms shrugged off referendum uncertainty;
- The labour market began to soften;
- CPI inflation started to pick up;
- The Bank of England cut interest rates and expanded their asset purchases;
- The ECB and the US Fed kept policy unchanged;

6. Summary Portfolio Position

6.1 A snapshot of the Council's debt and investment position is shown in the table below:

	TMSS 2016-17 31 March Forecast (as agreed by Council Feb 2016)		**Actual as at 31 March 2016**		**Actual as at 30 September 2016**		**Revised Forecast to March 2017**	
	£m	Rate %	£m	Rate %	£m	Rate %	£m	Rate %
Long term borrowing								
PWLB	390.4	-	275.4	4.3	275.4	4.3	275.4	4.3
PWLB (Third Party Loans)	0	-	14.0	2.9	13.9	2.9	**22.0**	2.9

	TMSS 2016-17 31 March Forecast (as agreed by Council Feb 2016)		Actual as at 31 March 2016		Actual as at 30 September 2016		Revised Forecast to March 2017	
	£m	Rate %	£m	Rate %	£m	Rate %	£m	Rate %
Market	0	-			20.0	3.9	**20.0**	4.6
LOBO	150.0	-	150.0	4.6	130.0	4.6	**130.0**	4.6
Total long term	**554.4**	**4.3**	**439.4**	**4.3**	**439.3**	**4.4**	**447.4**	**4.3**
Short term borrowing	-	-	**15.5**	**0.5**	23.6	0.2	65.0	-
Total actual borrowing	**554.4**	**4.3**	**454.9**	**4.2**	**462.9**	**4.2**	**512.4**	**4.3**
Investments	**11.0**	**-**	**40.1**	**0.7**	**13.1**	**0.4**	**2.0**	**0.5**
Total Net Debt / Borrowing	**543.4**	**-**	**414.8**	**-**	**432.9**	**-**	**510.4**	**-**
3Rd Party loans	**16.0**	**3.0**	**17.2**	**3.0**	**17.1**	**3.0**	**24.0**	**3.0**

6.2 The current position shows that borrowing is likely to be lower than originally forecast at the time the TMSS was approved in February. This is largely due to changing funding assumptions of the capital programme, as well as stronger than anticipated cash backed reserves and working capital surplus. The 31st March 2017 forecast for Net Debt has been revised upwards by £14m on the assumption that Capital Receipts will be utilised to fund the Transformation programme rather than reduce debt.

6.3 The Council is currently reviewing options as to the timing of any potential borrowing and also the alternative approaches around further utilising cash balances and undertaking shorter term borrowing which could potentially generate savings subject to an assessment of the interest rate risks involved**.**

6.4 Further analysis of borrowing and investments is covered in the following two sections.

7. Borrowing

7.1 The Council can take out loans in order to fund spending for its Capital Programme for the benefit of Northamptonshire. The amount of new borrowing needed each year is determined by capital expenditure plans and projections of the Capital Financing Requirement, forecast reserves and current and projected economic conditions.

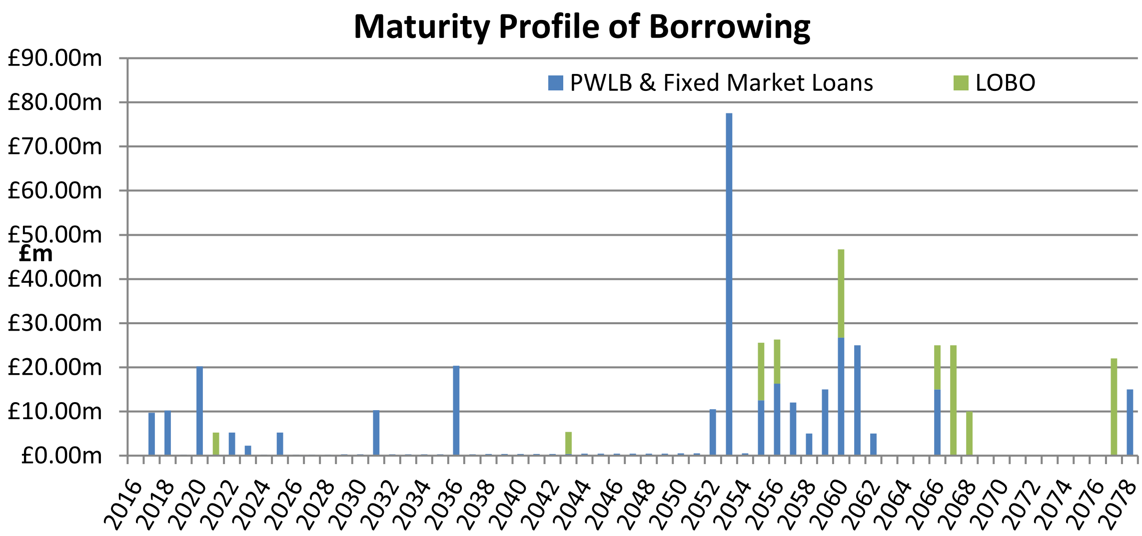
New loans and repayment of loans:

7.2 No new long term (>1yr) loans were raised or repaid during the year to date.

Profile of borrowing:

7.3 The following graph shows the maturity profile of the Council's loans. The majority of loans have a fixed interest rate and are long term which limits the Council's exposure to interest rate fluctuations. The weighted average time to maturity of the portfolio (assuming LOBO loans continue to maturity) is 35.3 years.

7.4 The presentation differs from the Treasury Indicator of Maturity Structure of Borrowing in Appendix 2 paragraph 4, in that the graph below includes LOBO loans at their final maturity rather than their next call date. In the current low interest rate environment the likelihood of the interest rates on these loans being raised and the loans requiring repayment at the break period is extremely low.



Loan restructuring:

7.5 When market conditions are favourable long term loans can be restructured to:

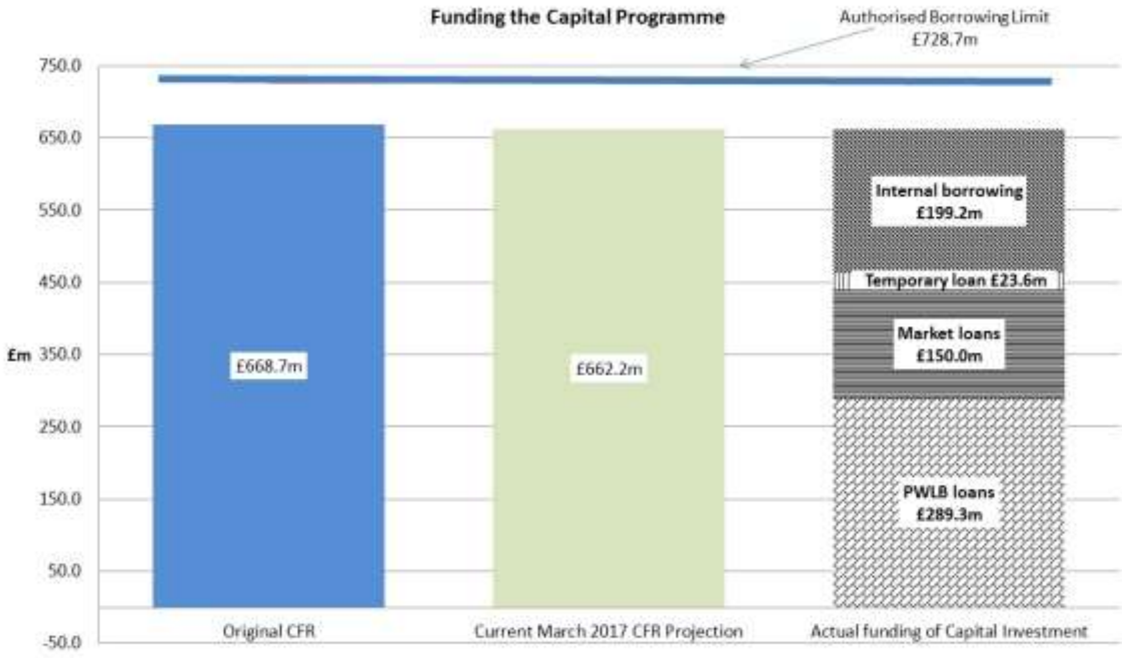
- to generate cash savings
- to reduce the average interest rate
- to enhance the balance of the portfolio by amending the maturity profile and/or the level of volatility. (Volatility is determined by the fixed/variable interest rate mix.)

7.6 During the quarter there were no opportunities for the Council to restructure its borrowing due to the position of the Council's borrowing portfolio compared to market conditions. Further debt rescheduling will be considered subject to conditions being favourable but it is unlikely that opportunities will present themselves during this year. The position will be kept under review, and when opportunities for savings do arise, debt rescheduling will be undertaken to meet business needs.

Funding the Capital Programme:

7.7 The Treasury Management Strategy Statement (TMSS) sets out the plan for treasury management activities over the next year. It identifies where the authority expects to be in terms of borrowing and investment levels. When the 2016-17 TMSS was set, it was anticipated that the Capital Financing Requirement (CFR), the Council's liability for financing the agreed Capital Programme, would be £668.7m. This figure is naturally subject to change as a result of changes to the approved capital programme and slippage that might occur.

7.8 The graph over the page compares the maximum the Council could borrow in 2016-17 with the forecast CFR at 31st March 2017 and the actual position of how this is being financed as at 30th September 2016.



7.9 The current 31st March 2017 CFR projection (centre bar on chart) is £6.5m lower than that set out originally in the TMSS. This is largely due to variances in the profile of net spend of the capital programme and includes the assumption that capital receipts generated during the year will be used for Transformation rather than to repay borrowing.

7.10 The graph shows the Council's current CFR projection is £66.5m below the Authorised Borrowing Limit set at the start of the year.

7.11 In addition, the graph shows how the Council is currently financing its borrowing requirement. As at 30th September the Council was projected to use £199.2m of internal borrowing to finance capital investment by the end of the year. Internal borrowing is the use of the Council's surplus cash to finance the borrowing liability instead of borrowing externally.

7.12 The Council has now maximised this internal borrowing position to optimise the treasury position, reduce credit risk associated with investing and generate revenue savings. Therefore new loans, which have been budgeted for, will be required to maintain sufficient operational cash resources. Sources of finance include short term loans (out to 5 years) from other local authorities, the PWLB and the Municipal Bonds Agency.

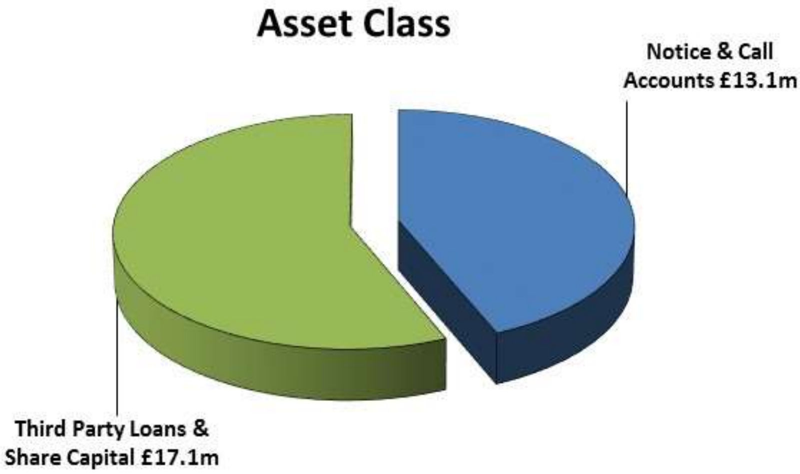
8. Investments

8.1 Investment activity is carried out within the Council's counterparty policies and criteria, and with a clear strategy of risk management in line with the Council's treasury strategy for 2016-17. This ensures that the principle of considering security, liquidity and yield, in that order (SLY), is consistently applied. The Council will therefore aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity. Any variations to agreed policies and practices are reported to Cabinet and Council.

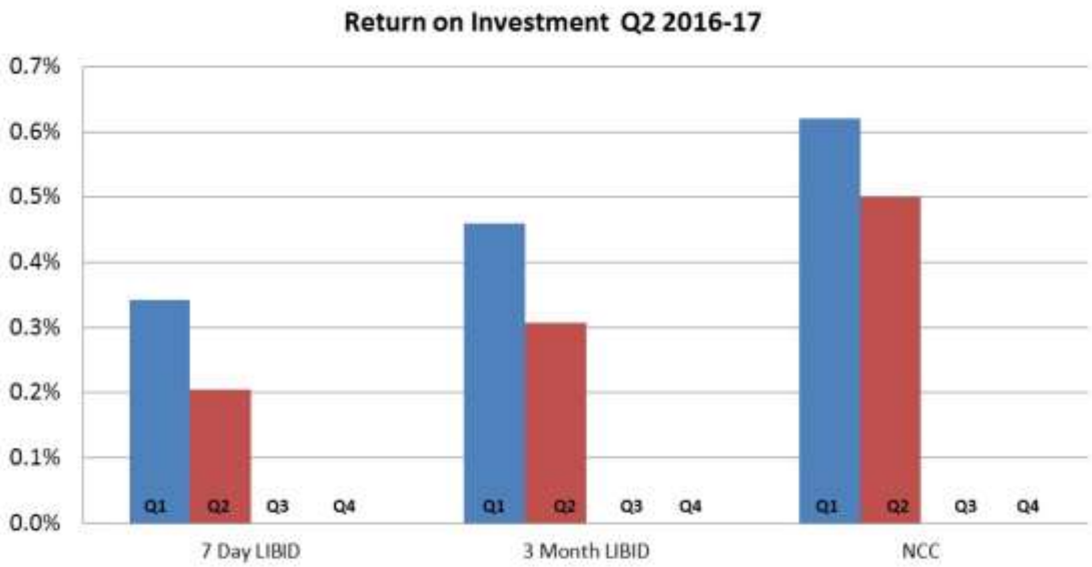
8.2 As described in paragraph 7.11, the strategy currently employed by the Council of internal borrowing also has the effect of limiting the Council's investment exposure to the financial markets, thereby reducing credit risk.

8.3 As at 30th September the level of investment totalled £13.1m, excluding 3rd party loans and Share Capital which are classed as capital expenditure. The level of cash available for investment is as a result of reserves, balances and working capital the Council holds. These funds can be invested in money market deposits, placed in funds or used to reduce external borrowings.

8.4 A breakdown of investments, as at 30th September by asset class is shown in the graph below. The majority of investments are held within notice and call account with banks with a notice period of up to three months. This level of liquidity is required to meet payment obligations as they fall due. The weighted average time to maturity is 70 days (excluding 3rd party loans). Where possible deposits are placed for longer durations with appropriate counterparties to obtain enhanced rates of return in an environment of falling interest rates.



8.5 The graph below compares the returns on investments with the relevant benchmarks for each quarter this year.



8.6 From the graph, it can be seen that in-house funds returned 0.50% (with a weighted average time to maturity of 70 days) during the quarter, significantly more than both the 7 day LIBID (0.20%) and 3 month LIBID (0.31%) benchmarks.

8.7 Using credit ratings, the investment portfolio's historic risk of default stand at 0.001%. This simply provides a calculation of the possibility of average default against historical default rates. The Council is also a member of a benchmarking group run by CAS which shows that, for the value of risk undertaken and duration of investments, the returns generated are in line with the Model Band**.** The benchmarking model is derived from all Capita Asset Services' local authority clients.

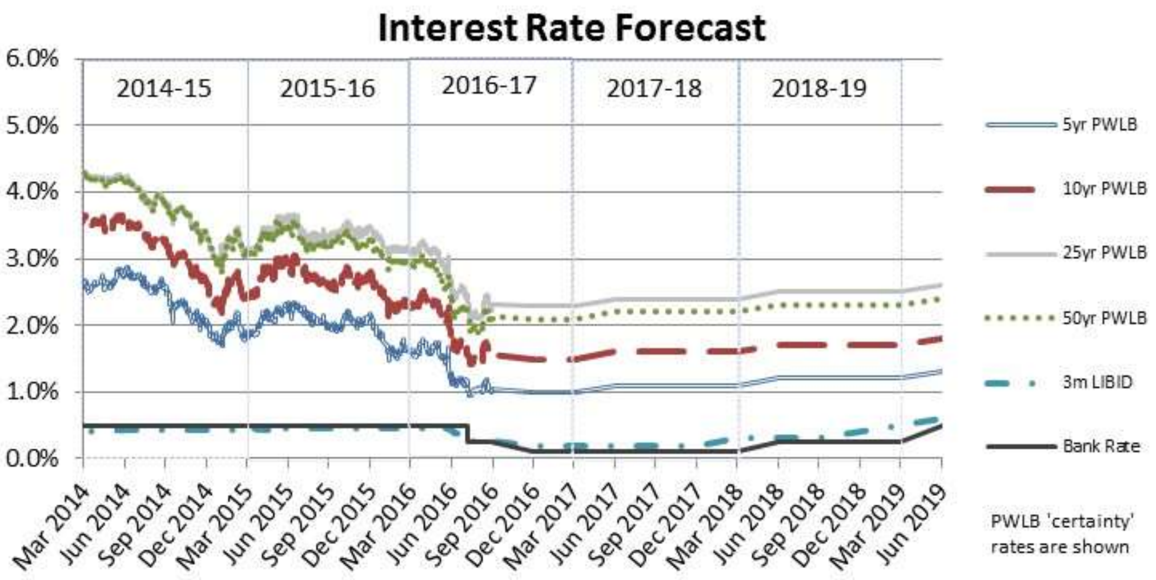
8.8 A further cut in Bank Rate will result in falling returns on the Council's investment portfolio. However interest rates have fallen across all parts of the yield curve right out to 50 years, so the revenue pressure resulting from falling interest rates has been more than offset by lower borrowing costs for new loans.

8.9 Leaving market conditions to one side, the Council's return on investment is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument. Credit risk is a measure of the likelihood of default and is controlled through the creditworthiness policy approved by Council. The duration of an investment introduces liquidity risk, the risk that funds cannot be accessed when required, and interest rate risk, the risk that arises from fluctuating market interest rates. These factors and associated risks are actively managed by the LGSS Treasury team together with the Council's treasury advisors (Capita Asset Services).

9. Outlook

9.1 The current interest rate forecast, updated following the referendum result to take account of the Monetary Policy Committee meeting of the 4th August which cut Bank Rate from 0.5% to 0.25%, is shown in the graph below. Forward guidance had suggested that a further cut in Bank Rate to near zero was likely, but this view has now faded. Clearly, the performance of the economy over the coming months will be critical to this decision. The forecast now is for increases in Bank Rate in June 2018 to 0.25% and then to 0.5% in June 2019, but these will very much depend on how strongly and how soon the economy makes a gradual recovery, and so start a process of very gradual increases in Bank Rate over a prolonged period.

9.2 Geopolitical events, sovereign debt crisis developments and slowing emerging market economies make forecasting PWLB rates highly unpredictable in the shorter term. The general expectation for an eventual trend of gently rising gilt yields and PWLB rates is expected to remain unchanged. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.



9.3 From a strategic perspective, the Council is continually reviewing options as to the timing of any potential borrowing and also the alternative approaches around further utilising cash balances and undertaking shorter term borrowing which could potentially generate savings subject to an assessment of the interest rate risks involved. Cash flows in the last couple of years have been sufficiently robust for the Council to use its balance sheet strength to limit the amount of new borrowing undertaken. However during 2016-17 it is anticipated that additional borrowing will be required as the Council experiences an increasing Capital Financing Requirement and fall in cash backed reserves.

10. Third party loans

10.1 Two loans totalling £1.923m have been made to the Northamptonshire County Cricket Club to develop their facilities of the last couple of years. The first £1m loan due to be repaid in 2018 is to be repaid one year early, in January 2017, following the English Cricket Board (ECB) announcement of an early payment of a Special Fee Payment. The second loan is scheduled to be repaid in 2020.

10.2 A 40 year annuity loan to the University of Northampton (UoN) for the value of £14m to develop the waterside campus was approved by the Council in 2014-15 and advanced in March 2016. An additional loan of £8m to the UoN to enable an Energy Centre to be constructed on the site has been evaluated by officers and was approved by Cabinet in March 2016. It is anticipated that this loan will be drawn down in March 2017.

10.3 An overdraft facility of up to £1m was made available to LGSS Law Limited in April 2015 to support cash flows during the initial stages of the newly formed company. As at 30th September £950k was outstanding.

10.4 Interest and principal repayments for these loans, along with other smaller value loans, have been paid in accordance with the loan agreements.

11. Balance Sheet Review 31st March 2016

11.1 A balance sheet review has been carried out following completion of the final accounts. This shows:

- The underlying borrowing requirement increased by £45m to £604m. The borrowing requirement was financed by external loans of £455m (up £39m y/y), resulting in internal borrowing of £149m.
- Reserves and balances in the balance sheet amounted to £132m (down £28m y/y). Cash investments totalled £46m, resulting in a difference of £86m representing internal investments.
- A net working capital surplus of £64m, which when added to internal investments equals £149m (internal borrowing).
- The Council maintained a robust use of its balance sheet to maximise revenue savings. As the underlying borrowing requirement rose and reserves and balances fell, additional loans (both long term and very short term) were raised at opportune points in the year to finance a proportion of the requirement. Cash balances were also run down to increase internal borrowing. Given the underlying borrowing requirement is forecast to rise and reserves are likely to be drawn down this year, borrowing options this year are actively being considered. It is expected that the majority of the borrowing required will be financed from short term loans from other local authorities. In addition a small amount of borrowing from the newly formed Municipal Bonds Agency may also be undertaken. See Appendix 4 for further information on the balance sheet review.

12. Debt Financing Budget

12.1 An underspend of £5.563k is currently forecast and reported, the variances are analysed below:

- Interest rates across the yield curve have softened since the referendum result in June and Bank of England Bank Rate cut to 0.25% in August. This will impact the Council's investment returns, however the adverse variance is more than offset by falling borrowing rates resulting in favourable variance for interest payable.
- Minimum Revenue Provision (MRP) savings have been generated following the annual review and the efficiencies gained by applying capital receipts to short life assets.
- The pressure showing against Capitalised Interest represents the change in the amount of interest relating to the build aspects of capital projects that is expected to be capitalised.
- The variance within the "other" category largely reflects the revenue contribution from Nourish for capital financing costs associated with purchase and lease pods.

12.2 The table below shows the variances analysed by main budget headings.

	Budget	**Outturn**	**Variance**
	£m	**£m**	**£m**
Interest payable (net of 3rd party loan interest)	21.510	19.570	(1.940)
Interest receivable	(0.271)	(0.156)	0.115

Technical Adjustments & MRP	11.301	7.673	(3.628)
Capitalised Interest	(1.789)	(1.300)	0.489
Other	0.276	(0.322)	(0.598)
Total	**31.027**	**25.464**	**(5.563)**

13. Municipal Bonds Agency

The UK Municipal Bonds Agency is now ready to issue bonds on behalf of local authorities and the first bond issuance is expected in the autumn. This authority has approved the relevant documents and guarantees allowing borrowing from the Agency. It is anticipated that Northamptonshire will participate in the first bond issue to raise a small amount of borrowing to resource the increasing Capital Financing Requirement. Please refer to report to Council in June 2016 for background.

14. Treasury Management Advisory Contract

14.1 The Council's Treasury Management Advisory Contract was put out to public tender in July in a joint procurement process with LGSS partners and customers (Cambridgeshire County Council, Northampton Borough Council and Norwich City Council). This was concluded in September and the contract was awarded back to Capita Asset Services on improved terms for a two year period.

15. Compliance with Treasury Limits and Prudential Indicators

15.1 With effect from 1st April 2004 The Prudential Code became statute as part of the Local Government Act 2003 and was revised in 2011.

15.2 The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable. To ensure compliance with this the Council is required to set and monitor a number of Prudential Indicators.

15.3 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement (TMSS) and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in Appendix 2.

16. Consultation and Scrutiny

16.1 This report has been developed in consultation with the Council's external investment managers and treasury advisers, Capita Asset Services (CAS).

16.2 The report will also be subject to scrutiny through the Outturns Working Group of the Finance and Resources Scrutiny Committee.

17. Equality Screening

17.1 There are no equalities implications for this report.

Reason that no EqIA is required	✓ as appropriate
The paper is for information only	✓
The proposal/activity/decision has no impact on customers or the service they receive	
The proposal impacts upon staff but the proposed staffing changes will not affect the service that customers receive*	
Other (please explain further)	

* where a proposal affects staff, the appropriate HR processes will be followed, which have already been subject to the EqIA process and will be compliant with HR legislation

18. Alternative Options Considered

18.1 This report has been based on factual information in accordance with Cabinet requirements.

19. Financial Implications

19.1 The Financial implications of this report are set out in sections 3 to 13 above.

20. Risk and Business Continuity Management

20.1 A risk to NCC is that the Council does not adhere to the policies and criteria set out in the Treasury Management Strategy Statement with regards to lending and borrowing decisions. There are internal control processes in place to ensure the Council treasury management operations operates within the policies set. Treasury Management risks will be managed and monitored daily.

21. List of Appendices

Appendix 1: Economic Update (provided by Capita Asset Services Treasury Solutions)

Appendix 2: Capital and Treasury Prudential Indicators

Appendix 3: Investment Portfolio

Appendix 4: Balance Sheet review 31st March 2016

Author:	Name: Mike Batty Team: LGSS Corporate Finance
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Background Papers:	
Does the report propose a key decision is taken?	NO
If yes, is the decision in the Forward Plan?	NO
Will further decisions be required? If so, please outline the timetable here	NO
Does the report include delegated decisions? If so, please outline the timetable here	NO
Is this report proposing an amendment to the budget and/or policy framework?	NO
Have the financial implications been cleared by the Strategic Finance Manager (SFM)? Have any capital spend implications been cleared by the Capital Investment Board (CIB)	YES Name of SFM: Neil Walker N/A
Has the report been cleared by the relevant Director?	YES Name: Damon Lawrenson (S151)
Has the relevant Cabinet Member been consulted?	YES Cabinet Member: Cllr Robin Brown
Has the relevant scrutiny committee been consulted?	The report will be reviewed by the Finance Improvement Plan working group.
Has the report been cleared by Legal Services?	YES Name of solicitor: Shahin Ismail Solicitor’s comments: None
Have any communications issues been cleared by Communications and Marketing?	YES Name of officer: Simon Deacon / Annalee Bougourd
Have any property issues been cleared by Property and Asset Management?	N/A
Are there any community safety implications?	None apparent
Are there any environmental implications:	None apparent
Are there any Health & Safety Implications:	NO
Are there any Human Resources Implications:	NO
Are there any human rights implications:	None apparent
Constituency Interest:	Countywide