Allerdale Borough Council

Audit Committee – 26 November 2018

Council – 5 December 2018

Treasury Management Operations – Mid-year review 2018/19

The Reason for the Decision	To inform members of the Council's treasury management activities during the six month period ending 30th September 2018. This report also provides assurances that treasury management activities have been undertaken in accordance with the Council's approved Treasury Management Strategy Statement and Investment Strategy.
Recommendations	That the contents of this report are noted.
Financial / Resource Implications	None.
Legal / Governance Implications	The CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities require the Council to report regularly on specific aspects of its treasury management activities.
Community Safety Implications	None.
Health and Safety and Risk Management Implications	The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured.
Equality Duty considered /Impact Assessment completed	N/A
Wards Affected	None directly
The contribution this decision would make to the Council's priorities	None directly
Is this a key decision?	No
Portfolio Holder	Cllr. B Cannon
Lead Officer	Barry Lennox Financial Services Manager Ext: 2586 email: barry.lennox@allerdale.gov.uk

Report Implications

Community Safety	N	Employment (external to the Council)	N
Financial	Y	Employment (internal)	N
Legal	Y	Partnership	N
Social Inclusion	N	Asset Management	N
Equality Duty	N	Health and Safety	N

1.0 Introduction

1.1 The CIPFA Code of Practice on Treasury Management (the Treasury Management Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) requires the Council to report regularly on its treasury management activities.

1.2 The Treasury Management Code recommends that local authorities should, as a minimum, ensure that the Full Council receives:

- before the start of the year, an annual report on the strategy and plan to be pursued in the coming year (Council - 07/03/2018)
- a mid-year review (this report)
- after the year-end, an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year and on any circumstances of non-compliance with the authority's treasury management policy statement.

1.3 To enable the Audit Committee to fulfil its responsibilities for ensuring effective scrutiny of the treasury management strategy and policies the Council's Treasury Management Practices require treasury management reports - including the mid-year report - to be submitted to the Audit Committee prior to consideration by Full Council.

2.0 Scope

2.1 This mid-year report has been prepared in accordance with CIPFA's Code of Practice on Treasury Management 2017 Edition and covers:

i. an update on the economic environment for the first six months of the financial year 2018/19 (section 3)

ii. updated interest rate forecasts (section 4)

iii. Treasury Management Strategy Statement (TMSS) and Investment Strategy update (section 5)

iv. a review of the Council's investment and borrowing activities during the period 1st April to 30th September 2018 (sections 6 and 7)

v. a review of compliance with the Council's treasury and prudential indicators for 2018/19 (section 8).

3.0 Economic Update

U.K.

3.1 After posting GDP growth of 1.8% year-on-year in the third quarter of 2017, growth fell to 1.4% year-on-year in the fourth quarter of 2017; the weakest pace of expansion since the second quarter of 2012. Since then the first half of 2018 has seen UK economic growth post more modest performance. Quarterly National Accounts show GDP grew by 0.1% in quarter 1 (Jan.to March) reflecting, at least in part, the temporary impact of adverse weather, before recovering to 0.4% in quarter 2 (April to June). The latest three month rolling estimates show growth of 0.6% (1.2 y/y) in the three months to July and 0.7% in three months to August 2018. Underlying this modest performance is continued subdued real consumer spending growth and the drag on business investment from the ongoing economic and political uncertainty associated with the outcome of the Brexit negotiations.

3.2 Despite this modest growth, this was deemed sufficiently robust for the Monetary Policy Committee, (MPC) to unanimously vote (9-0) to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast growth to pick up to 1.8% in 2019, albeit there were several caveats to this. These mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

3.3 Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation has remained above the MPC's 2% target throughout the period, pushed above target by external cost pressures resulting from the effects of sterling's past depreciation and higher energy prices. After remaining steady at 2.4% between April and June, CPI rose unexpectedly to 2.7% in August before falling back to 2.4% in September. The increase in August was in part, due to higher energy and utilities prices, but price rises for some volatile items also pushed up the core rate. RPI inflation fell marginally from 3.4% in April to 3.3% in September.

3.4 CPI Inflation is expected to fall back to the 2% inflation target over the next two to three years given a scenario of minimal increases in Bank Rate. The MPC has indicated the Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

3.5 The labour market has remained resilient with the number and proportion of people in work remaining close to record levels. This is despite some predictions that unemployment would rise following the Brexit vote. The employment rate (the proportion of people aged from 16 to 64 years who were in work) for the period June to August 2018 was 75.5%, lower than for March to May 2018 (75.7%) but higher than for a year earlier (75.1%). Whilst employment growth has softened in recent months amid dwindling levels of spare capacity in the labour market, various measured of hiring intentions and surveys of employment growth suggest that firms' demand for workers will remain robust in the short-term.

3.6 Unemployment meanwhile has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, coupled with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff and putting upward pressure on wage growth.

3.7 Reflecting the tightening in the labour market, headline annual wage growth, (three-month average excluding bonuses) picked up to 2.9% in the three months to July. On the single-month measure the figure was 3.1%, the quickest pace since July 2015 and much faster than the 2.5% average for the first half of 2018. Surveys of pay settlements and recruitment difficulties point to earnings growth picking up further towards the end of the year.

3.8 In the three months to August 2018 wage inflation picked up to 3.1%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 0.7%, the highest level since 2009. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given the uncertainties around Brexit.

3.9 In the political arena, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. The view held by the Council's treasury advisors is that the government will endure, despite various setbacks, along the route to Brexit in March 2019. If however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

U.S.

3.10 In the US, a massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth. Growth rose from 2.2% (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5% (3.0%y/y) in quarter 3. It has however also contributed to an upturn in inflationary pressures. With inflation moving towards 3%, the Federal Reserve (the Fed.) increased rates by a further 0.25% in September to between 2.00% and 2.25%, the fourth increases in 2018. The Federal Reserve also indicated that it expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

3.11 However, a combination of an expected four increases in rates of 0.25% by the end of 2019, together with a waning of the boost to economic growth from the

fiscal stimulus in 2018, could combine to depress growth below its potential rate, i.e. monetary policy may prove to be too aggressive and lead to a reverse of policy.

3.12 The tariff war between the US and China has been generating a lot of heat during 2018. Although it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth, there is a risk of escalation.

Eurozone

3.12 Growth was unchanged at 0.4% in quarters 1 and 2 of 2018 but fell back to 0.2% in quarter 3, though this is probably a temporary dip. Growth has therefore undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

3.13 The ECB left its guidance that interest rates are unlikely to rise until Q3 2019 more or less unchanged at its most recent meeting. However, the ECB confirmed that monthly asset purchases would be cut from €30bn to €15bn from October to December, as indicated, and then come to an end in December. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

Asia

3.14 Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property and address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. However concerns remain over whether official economic statistics are inflating the published rate of growth.

3.15 Japan is struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries.

3.16 Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

4.0 Interest Rate Forecasts

4.1 The Council's treasury advisor, Link Asset Services, has provided the following interest rate forecast.

Table 1: Forecast interest rates (certainty rates[1])

Quarter ending	Bank rate %	PWLB 5yr rate %	PWLB 10yr rate %	PWLB 25yr rate %	PWLB 50yr rate %
Actual Sept 18	0.75	1.93	2.33	2.74	2.56
Dec-18	0.75	2.00	2.50	2.90	2.70
Mar-19	0.75	2.10	2.50	3.00	2.80
Jun-19	0.75	2.20	2.60	3.10	2.90
Sep-19	1.00	2.20	2.70	3.10	2.90
Dec-19	1.00	2.30	2.70	3.20	3.00
Mar-20	1.00	2.30	2.80	3.20	3.10
Jun-20	1.25	2.40	2.90	3.30	3.10
Sep-20	1.25	2.50	2.90	3.40	3.20
Dec-20	1.50	2.50	3.00	3.50	3.30
Mar-21	1.50	2.60	3.10	3.50	3.30

[1]Certainty rates are calculated by subtracting 0.2% from the standard new loan rates. Certainty rates apply to authorities who provided DCLG with required information on their plans for long-term borrowing and associated capital spending.

4.2 Link Asset Services undertook its last review of interest rate forecasts on 7 August following the quarterly Bank of England Inflation Report and the decisions and forward guidance issued by the Banks Monetary Policy Committee (MPC) at its meeting on 2nd August.

4.3 Following the flow of generally positive economic statistics since the end of the quarter ended 30th June, the Monetary Policy Committee took the decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but declined to give a medium term forecast. At its August meeting, the MPC also voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchased and UK government bond purchases, financed by the issuance of central bank reserves.

4.4 The current expectation is that the MPC will not increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. It is also considered more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

4.5 The forecasts set out in the preceding table are predicated on an 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.

4.6 Financial markets are currently expecting the next increase in Bank Rate to be in February 2019 and then only one more in February 2020, therefore ending March 2021 at only 1.25%. However, the MPC have commented that the markets were too cautious with their view of the pace of increases.

4.7 Whilst geo-political events, sovereign debt issues and emerging market developments can all contribute to short-term volatility in financial markets, the overall longer run trend for gilt yields - and therefore PWLB rates - continues to be for rates to rise, albeit gently, over the forecast period. Aside from some minor advances in the pace of increase change, the expectations for future borrowing rates differ little from that set out in the 2018/19 Treasury Management Strategy Statement.

4.8 At the present time, the overall balance of risks to economic recovery in the UK is probably neutral. However, economic forecasting remains difficult with so many external influences weighing on the UK. The interest rate forecasts set out in table1 (and also MPC decisions) will therefore be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact.

4.9 The PWLB (certainty) rate forecasts included in table 1 are based around a balance of risks. Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- the pace of Bank of England monetary policy action over the next three years (to raise the Bank Rate) causing weaker UK economic growth and increases in inflation than currently anticipated
- a resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system. In addition, the election in March, of a government which has made a lot of anti-austerity noise, is likely to lead to friction with the EU when setting the target for the fiscal deficit in the national budget. Unsurprisingly, investors have taken a dim view of this and so Italian bond yields have been rising.
- Austria, the Czech Republic and Hungary forming a strongly anti-immigration bloc within the EU while Italy, this year, has also elected a strongly anti-immigration government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position as a result of the rise of the anti-immigration AfD party. To compound this, the result of the Swedish general election in September 2018 has left an anti-immigration party potentially holding the balance of power in forming a coalition government. The challenges from these political developments could put considerable pressure on the cohesion of the EU and could spillover into impacting the euro, EU financial policy and financial markets.

- the imposition of trade tariffs by President Trump impacting adversely on world growth. President Trump's specific actions against Turkey pose a particular risk to its economy which could, in turn, negatively impact Spanish and French banks which have significant exposures to loans to Turkey
- weak capitalisation of some European banks
- rising interest rates in the US negatively impacting on emerging countries that have borrowed heavily in dollar denominated debt and causing an investor flight to safe havens e.g. UK gilts
- geopolitical risks in Asia (especially North Korea), Europe and the Middle East, leading to increased safe haven flows.

4.10 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- the pace and strength of increases in Bank Rate is too slow allowing inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than currently expected.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- President Trump's fiscal plans to stimulate economic expansion triggering a significant increase in inflation in the US and causing further sell offs of government bonds in major western countries
- the pace and strength of increases in the Federal Funds Rate and reversal of Quantitative Easing, causing a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities, leading to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spillover into impacting bond yields around the world

5.0 Treasury Management Strategy Statement and Investment Strategy update

5.1 The Council's Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy for 2018/19, was approved by Full Council on 7th March 2018. The Annual Investment Strategy establishes, as the Council's primary policy objective, the security of principal sums invested in priority to liquidity and yield. The Council will then aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity. However, yield will only determine investment decisions when deciding between two or more investments satisfying security and liquidity objectives.

5.2 Ensuring the security of principal sums invested is achieved through active management of the Council's credit risk exposures. This includes placing restrictions and limits on:

- the counterparties with whom investments may be made based on an assessment of the creditworthiness of the counterparty
- the types of investment instruments that may be used
- the amount invested with any single institution or group of institutions on the Council's list of approved counterparties
- the duration of individual investment instruments depending on the financial standing (creditworthiness) of the counterparty.

5.3 During the six months to 30th September there have been no changes to the individual ratings of active investment counterparties.

5.4 Economic developments and performance of financial markets during the period (including those affecting interest rate forecasts) do not require any changes to be made to the previously approved Treasury Management and Investment strategies. The Authority will therefore continue with its policy of investing in higher quality counterparties over relatively short maturities and postponing borrowing where possible, to minimise the cost of carry and counterparty risk.

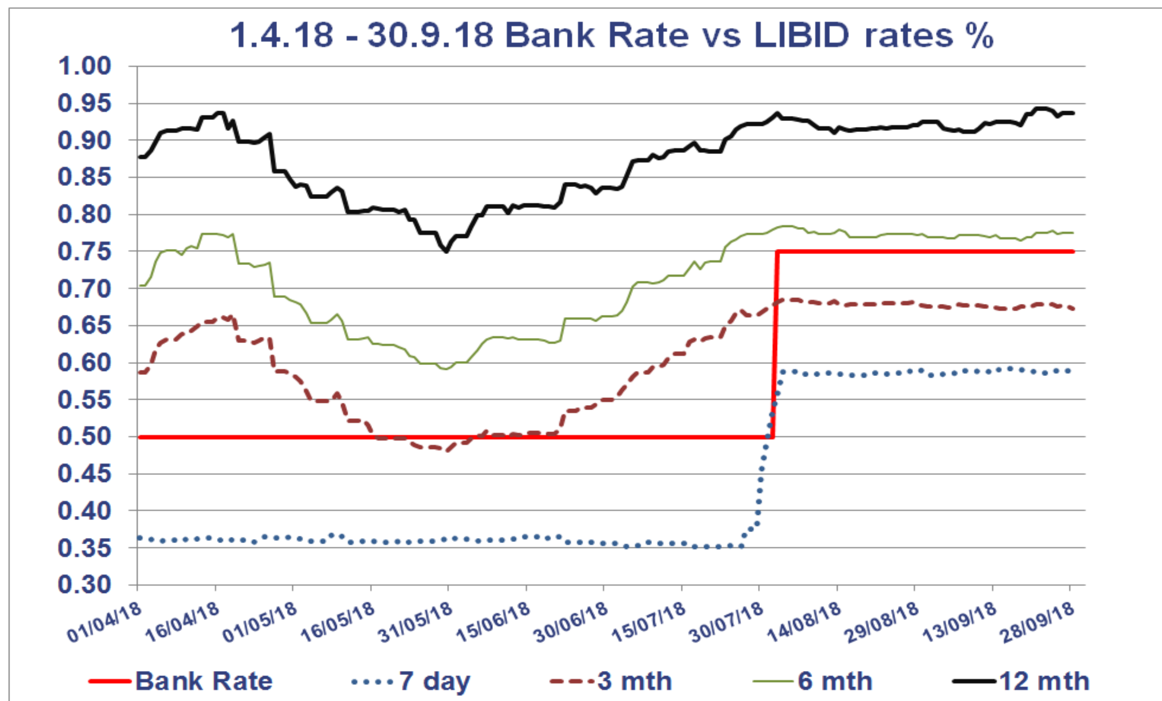
6.0 Investment Activity

6.1 The investment market remains difficult in terms of earning the levels of interest commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate.

6.2 The 7-day rate remained broadly stable between April and July 2018 before increasing sharply in August, as a result of the increase in Bank Rate. Over the course of the first six months the 7-day LIBID fluctuated between a high of 0.59% (14/9/18) and a low of 0.35% (19/7/18). The average 7-day rate for the six months to September was 0.43%. This compares with an average of 0.11% for the corresponding period last year and an average for the financial year 2017/18 of 0.22%.

6.3 Investment rates for terms of three months and longer, fell during April and May after expectations collapsed that the MPC would raise Bank Rate at its May meeting. Rates reached lows at the end of May before rising steadily over the remainder of the period.

Bank and Money Market Rates (London Interbank Bid Rate - LIBID)



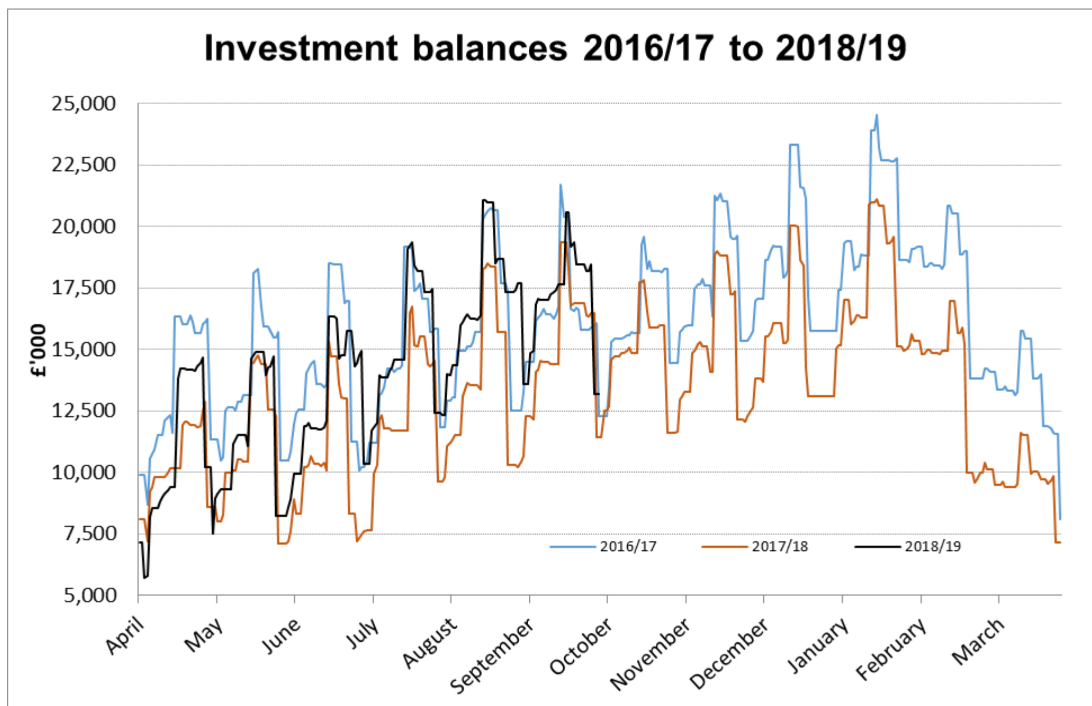
6.4. At 30th September 2018 the Council's investment balances (excluding cash in hand and bank current accounts) stood at £13.2m. This compares with a balance of £7.1m at 31st March 2018 and £12.1m at 30th September 2017.

6.5 A summary of investment activity during the six months ending 30th September 2018 - excluding 'policy investments' falling outside of the Council's Treasury Management and Investment Strategies - is included in table 2 below.

Table 2: Investment activity 1.4.18 to 30.9.18

	Credit Rating	1 April 2018 £'000	Investments Made £'000	Investments Repaid £'000	30 Sept 2018 £'000
Specified investments					
Call Accounts	AA	822	12,398	(10,695)	2,525
Call Accounts	A/A-	796	11,641	(11,588)	849
Money Market Funds	AAA	5,515	30,050	(25,765)	9,800
Non specified investments					
Equity Shares	-	11	0	0	11
Total		**7,144**	**54,089**	**(48,048)**	**13,185**

6.6 The average level of funds invested during the period was £14.03m. This compares with an average of £12.07m over the corresponding period in 2017/18. These funds were available on a temporary basis with the level of funds available mainly dependent on the timing of cash flows associated with precept and business rate payments, income from grants and local taxation (council tax and business rates) and payments related to the Council's Capital Programme.



6.7 In accordance with the Annual Investment Strategy for 2018/19, all investments made during the period were:

- restricted to approved investment instruments (MM funds and call accounts) with counterparties holding a minimum long-term rating across all three of the main credit ratings agencies (Fitch, Moody's and Standard & Poor's) of A- or equivalent (AA+ or equivalent for non-UK sovereigns)
- for periods not exceeding the maximum permitted durations determined by reference to the relative creditworthiness of the counterparty and subject to a maximum maturity of 365 days (from the date of acquisition).

6.8 During the first six months of 2018/19, there were no breaches of the counterparty limits placed on the amount invested with any single institution or group of institutions on the Council's list of approved counterparties.

6.9 At 30th September forecast investment interest for the year to 31st March 2019 was £32,775 against a budget of £19,980. The investment portfolio yield for the six months to 30th September was approximately 0.40%. This is broadly in line with the Council's benchmark (7 day LIBID) rate which averaged 0.43% over the period April to September 2018. At 30th September the approximate rate of return (yield) on investments held (calculated on an annualised basis) was 0.61% (30th September 2017: 0.14%). This compares with the Council's benchmark return (7-day LIBID) rate at 30th September 2017 of 0.59% (30th September 2017: 0.11%).

6.10 The forecast increase in interest receivable on investments in 2018/19, compared to budget, reflects the rise in investment rates since the budget was prepared. This increase in investment income has been reflected in the 2018/19 revised revenue budget by way of £12k virement to increase the investment income budget to a level consistent with current forecasts and address potential overspending against other budgets.

7.0 Borrowing activities

7.1 No new borrowing was undertaken during the six months to 30th September 2018. PWLB principal of £156k was repaid during the period. A summary of borrowing transactions undertaken during the six months to 30th September 2018 is set out in table 3 below.

7.2 By utilising cash from reserves, revenue balances and favourable cash flows the Council has been able to meet its liquidity requirements without the need to borrow externally. This has allowed the Council to minimise borrowing costs and reduce treasury risk by reducing its external investment balances. In the current economic climate - with low investment returns and relatively high counterparty risks - this is a prudent and cost effective approach, but will require ongoing monitoring in the event that upside risks to gilt yields prevail.

7.3 The Council's 2018/19 Budget and Treasury Management Strategy Statement anticipated additional PWLB borrowing during 2018/19 of up to £5.4m to fund the Council's capital programme. As a result of changes included in the Council's revised 2018/19 capital programme, including the impact of the re-profiling of expenditure funded from borrowing between financial years, anticipated (maximum) external borrowing requirements in 2018/19 has been revised down marginally to £5.2m.

7.4 The decision to draw down loans will be determined in accordance with the borrowing strategy set out in the Council's Treasury Management Strategy Statement with the timing and amount of any additional borrowing reflecting:

- current and future liquidity (cash flow) requirements including in particular, amounts required to fund the Council's capital programme
- expected future movements in interest rates
- management of treasury risk.

Table 3: Borrowing activity 1.4.18 to 30.9.18

	01 Apr 2018 £'000	New Borrowing £'000	Borrowing Repaid £'000	30 Sept 2018 £'000
Long-term				
PWLB – fixed rates	15,380	0	(156)	15,224
Short-term				
Local Bonds	31	0	0	31
Trust Funds	54	0	0	54
	15,465	**0**	**(156)**	**15,309**

7.5 At 30th September 2018 the Council's PWLB loan portfolio consisted of fixed rate:

- maturity loans totalling £8.0m (1st April 2018: £8.0m)
- fixed rate annuity loans totalling £1.664m (1st April 2018: £1.70m)
- equal instalment of principal loans of £5.560m (1st April 2018: £5.680m).

Interest charged on borrowings

7.6 Interest rates applying to individual loans within the Council's PWLB loan portfolio range from 2.44% to 9.5%. The weighted average interest rate on the PWLB loan portfolio currently stands at 5.44% (30th September 2017: 5.86%).This compares with the following PWLB rates applying to new maturity, annuity and equal instalment of principal (EIP) loans at 30th September 2018 (table 4).

Table 4: PWLB new loan & premature repayment rates at 30th September 2018

Term	Certainty[1]			Premature repayment[2]		
	Annuity %	Maturity %	EIP %	Annuity %	Maturity %	EIP %
Over 4½ Years not over 5	1.71	1.93	1.71	0.77	0.96	0.77
Over 9½ Years not over 10	1.96	2.33	1.96	1.02	1.38	1.01
Over 24½ Years not over 25	2.53	2.74	2.49	1.60	1.82	1.56
Over 49½ Years not over 50	2.72	2.56	2.74	1.80	1.64	1.82

[1] Certainty rates are calculated by subtracting 0.2% from standard new loan rates. They apply to new loans taken out by authorities who provided DCLG with required information on their long-term borrowing and capital spending plans.

[2] Premature repayment rates apply to loans which are being repaid early.

7.7 The maturity structure of external borrowing at 30th September 2018 (principal only) is shown in table 5.

Table 5: Maturity profile of external borrowing

	At 30 Sept 2018	At 30 June 2018 £'000	At 31 March 2018 £'000	At 30 Sept 2017 £'000	At 31 March 2017 £'000
Less than 1 year	401	401	398	315	312
Between 1 & 2yrs	323	323	320	236	233
Between 2 & 5yrs	1,018	1,016	1,005	753	742
Between 5 & 10yrs	1,906	1,900	1876	1447	1,419
Between 10 & 20yrs	2,901	2,915	2,986	2,268	2,346
Between 20 & 30yrs	760	880	880	560	640
Between 30 & 40yrs	8,000	8,000	8,000	8,000	7,000
Between 40 & 50yrs	0	0	0	0	1,000
	15,309	**15,435**	**15,465**	**13,579**	**13,692**

7.8 At 30th September 2018 the weighted average time to maturity of the Council's PWLB debt portfolio was approximately 29 years. The weighted average life of the PWLB debt portfolio at 30th September 2018 was 25 years.

7.9 At 30th September the full year forecast for interest payable on borrowings (adjusted to include the amortisation of deferred premia and discounts incurred in prior years) was £845k compared to an original budget of £989k. The difference of £144k reflects:

- changes to the expected timing of capital expenditure (funded from borrowing) across financial years and the impact of these changes on the Authority's external borrowing requirements and timing of borrowing
- revisions to interest rates to reflect the latest available forecasts
- lower interest cost applicable to borrowing undertaken in 2017/18 in comparison to that allowed for in the original budget.

7.10 The forecast reduction of interest costs has been accommodated in the 2018/19 revised revenue budget by way of recurring and non-recurring savings adjustments.

7.11 The graph and table below shows that whilst PWLB rates were on a rising trend during the latter half of the second quarter there has been little consistent trend in rates during the current financial year to date.

7.12 At 30th September the 50 year PWLB certainty rate for new loans closed at 2.56%, up from 2.27% at the beginning of the financial year, while the 25-year rate ended the quarter at 2.64% compared to 2.55% at 3rd April 2018. This compares with forecasts included in the TMSS for 50 and 25-year maturities of 2.8% and 3.0%.

PWLB Maturity Certainty Rates 2018-2019

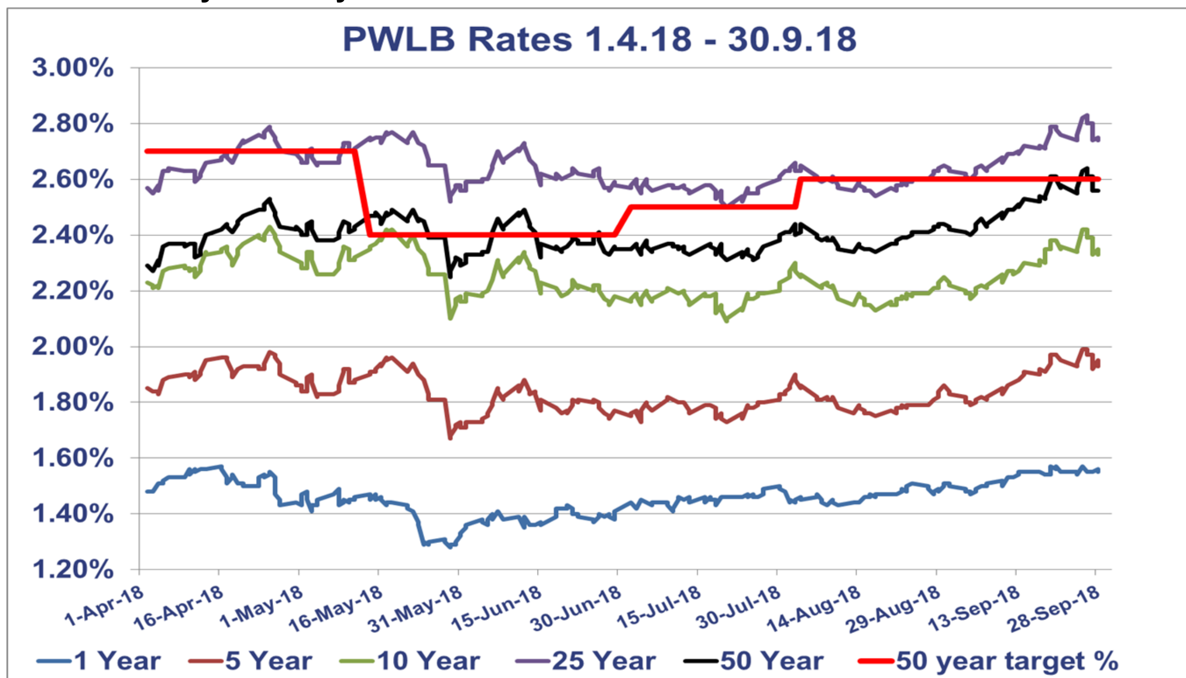


Table 6: PWLB certainty rates - 6 months ending 30th September 2018

	1-Years %	4½- 5 Years %	9½-10 Years %	24½- 25 Years %	49½ - 50 Years %
At 31.3.18	1.47	1.85	2.23	2.57	2.29
At 3.4.17	1.48	1.84	2.22	2.55	2.27
Low	1.28	1.67	2.09	2.50	2.25
High	1.57	1.99	2.43	2.83	2.64
At 30. 9.18	1.55	1.93	2.33	2.74	2.56
Average	1.46	1.84	2.25	2.64	2.41

Debt Rescheduling

7.13 The historic nature of the Council's PWLB loans portfolio and the exclusive use of fixed rate loans mean that rates of interest applying to these loans are significantly higher than those currently applied to new PWLB loans. However, the differential between new borrowing rates (certainty rate) and the PWLB's premature redemption rates makes rescheduling unviable at the present time. As a consequence, no debt rescheduling was undertaken during the 6 month period ending 30th September 2018.

7.14 At 30th September 2018 the redemption value of the Council's PWLB debt - calculated using PWLB premature redemption rates - was £28.1m. This compares with a redemption value of £29.61m at 31st March 2018 and £26.8m at 30th September 2017.

7.15 The difference of £12.9m between the fair value and the principal outstanding of £15.2m (see table 3) reflects the premium that would be payable - as at 30th September - in order to repay the outstanding principal prematurely of £12.7m plus interest accrued from the previous scheduled repayment date of £0.2m.

8.0 Prudential Indicators

8.1 The Local Government Act 2003 requires the Council to determine and keep under review, limits on how much money it can afford to borrow by way of loans and other forms of credit (for example finance leases). The process the Council must follow in setting these limits (the 'Authorised limit for external debt') is set out in the Prudential Code for Capital Finance in Local Authorities to which the Council is required to 'have regard to' under provisions contained in the 2003 Act.

8.2 In addition to the Authorised Limit, CIPFA's Prudential and Treasury Management Codes and accompanying sector guidance include a number of other key treasury management indicators designed to ensure the Council operates its treasury activities within well-defined limits. These include:

- setting an operational boundary for external debt based on the expectations of the most likely maximum external debt for the year
- ensuring that gross debt does not, except in the short term, exceed the Capital Financing Requirement (CFR) - the underlying need to borrow for capital purposes - at the end of the preceding year plus the estimates of any additional CFR for current and the following two financial years
- placing upper and lower limits on the maturity structure of borrowings

- placing upper limits on the total of principal sums invested longer than 365 days.

8.3 The Council's Authorised Borrowing Limit (the statutory limit on borrowing under the Local Government Act 2003), Operational Boundary (the limit beyond which external debt is not expected to exceed) and other indicators and limits required by CIPFA's Prudential and Treasury Management Codes, were set out in the Council's Treasury Management Strategy Statement and Investment Strategy for 2018/19.

8.4 During the financial year to date, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The Council's Prudential and Treasury Indicators are shown in Appendix 2.

8.5 At 30th September the Council's gross external debt was £15.3m. The maximum external debt outstanding during the period was £15.5m (1st April 2018).This compares with:

- a Capital Financing Requirement (the Council's underlying need to borrow for capital purposes) at 1st April 2018 of £18.9m and a forecast CFR at 31st March 2019 of £23.7m (based on the revised capital budget for 2018/19)
- an Operational Boundary (representing the Council's expected maximum external debt based on probable events) of £26m, and
- an Authorised Borrowing Limit (the statutory limit on borrowing) of £28m.

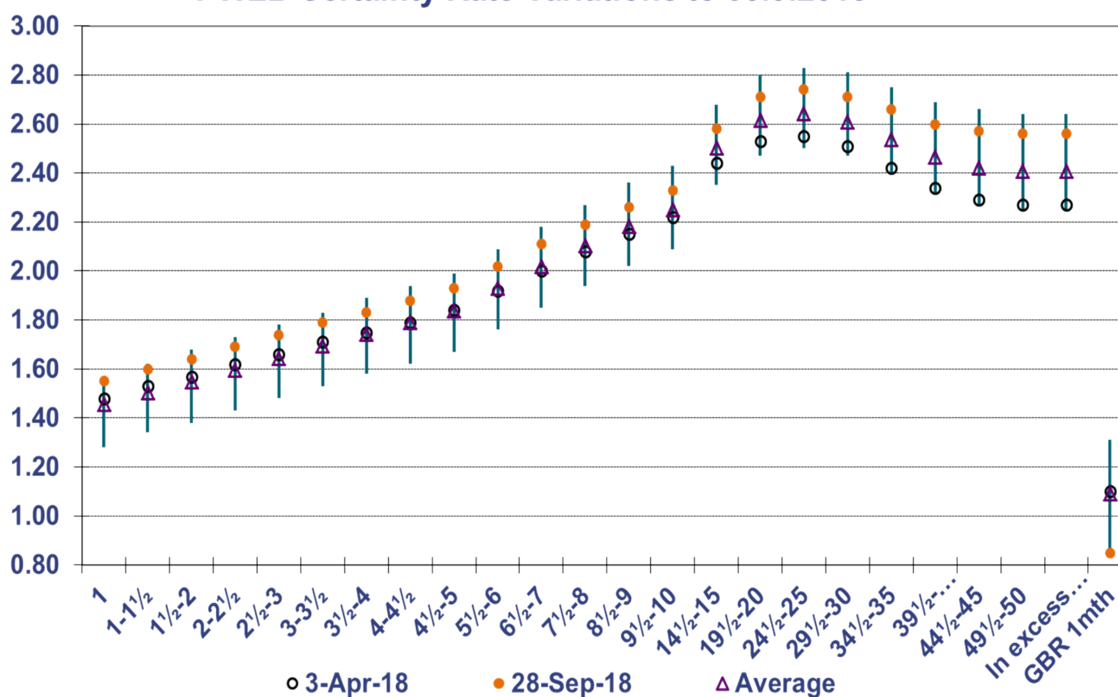
8.6 At 30th September 2018, the difference between the Operational Boundary (£26m) and the actual amount of external debt outstanding (£15.3m) is £10.7m. The key components of this difference are:

- current under borrowing (at 30th September 2018) against the Council's CFR of approximately £3.4m
- borrowing of up to £7.4m (including £1.9m deferred from 2017/18) included in the Operational Boundary to accommodate the additional borrowing requirements in relation to the Council's (original) capital expenditure plans for 2018/19.

8.7 As noted above, no additional borrowing has been undertaken during the first six months of 2018/19. By utilising cash from reserves, revenue balances and favourable cash flows, the Council has been able to avoid the need to borrow up to the level of the CFR. In turn, this has allowed the Council to minimise borrowing costs and reduce overall treasury risk by reducing the level of its external investment balances.

8.8 The Council does not anticipate the need for any revisions to be made to the existing approved Operational Boundary or Authorised Borrowing Limit during the remainder of 2018/19.

Appendix 1



Money Market Rates (London Interbank Bid Rate - LIBID)

	Average 1 April to 28 Sept 2018 %	At 28 Sept 2018 %	At 30 June 2018 %	At 1 April 2018 %
Bank Rate	0.58	0.75	0.5	0.5
7 days' notice	0.43	0.59	0.36	0.36
1 month fixed	0.47	0.60	0.38	0.39
3 months fixed	0.61	0.67	0.55	0.59
6 months fixed	0.71	0.78	0.66	0.70
1 year fixed	0.87	0.94	0.84	0.88

Money market investment rates (London Interbank Bid Rate - LIBID)

	Bank Rate	7 day	1 month	3 months	6 months	1 year
High	0.75	0.59	0.6	0.68	0.78	0.94
Low	0.5	0.35	0.37	0.48	0.59	0.75
Average	0.58	0.43	0.47	0.61	0.71	0.87
Spread	0.25	0.24	0.23	0.21	0.19	0.19
High date	2/8/18	14/9/18	18/9/18	6/8/18	3/8/18	21/9/18
Low date	1/4/18	19/7/18	30/5/18	30/5/18	30/5/18	30/5/18

Appendix 2

Prudential and treasury indicators

1 Indicators required by the Prudential Code

1.1 The Prudential Code requires authorities to self-regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans by setting estimates and limits and by publishing actuals for a range of prudential indicators. It also requires them to ensure their treasury management practices are in accordance with good practice.

1.2 The prudential and treasury indicators required by the Prudential Code, Treasury Management Code and accompanying sector guidance are designed to support and record local decision making. They are not designed to be comparative performance indicators and should not be used for this purpose.

1.3 Details of the Council's approved prudential and treasury indicators for 2018/19 are summarised in the following sections together with:

- forecast outturn information for the year to 31st March 2019 based on outturn projections included in the Council's Quarterly Finance Report to September 2018
- updated estimates based on the proposed 2018/19 revised revenue and capital budgets
- actuals at 30th September 2018.

2 Actual capital expenditure

2.1 Table A summarises the Council's original and revised capital expenditure plans for 2018/19 and the actual capital expenditure incurred to 30th September 2018.

Table A: Capital expenditure 2018/19

	2018/19 Approved £000	2018/19 Actual to 30.9.18 £000	2018/19 Forecast Outturn (Q2) £000	2018/19 Revised Budget[2] £000
General Fund Capital Expenditure	14,593	2,107	5,664	8,970
Financed by:				
Capital receipts	0	97	177	177
Capital grants & contributions	9,043	1,282	2,872	2,872
Revenue (GF & Earmarked Reserves)	20	279	473	473
Total expenditure financed in year	9,063	1,658	3,522	3,522
Unfinanced capital expenditure:				
Supported borrowing[1]	0	0	0	0
Unsupported borrowing	5,530	449	2,142	5,448
Total financed & unfinanced	14,593	2,107	5,664	8,970

[1] Following the Spending Review 2010 there have been no new supported borrowing allocations since 2010/11.

[2] Updated to reflect carry forward of budgets from 2017/18, re-profiling adjustments and capital bids included in the (proposed) revised capital budget 2018/19.

2.2 Capital expenditure is defined in section 16 of the Local Government Act 2003 and includes all expenditure that falls to be capitalised in accordance with proper practices together with any items capitalised in accordance with regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended), or by virtue of a capitalisation direction issued under section 16(2) of the 2003 Act.

2.3 The approved prudential indicator for capital expenditure of £14,593k reflects the capital budget approved by Full Council on 7th March 2018. The decrease of £5,623k between this and the revised indicator (£8,970k) - based on the proposed revised capital budget for 2018/19 - reflects:

- approved capital budget carry forwards from 2017/18 of £2,786k
- additional capital bids included in the revised three year capital budget (2018/19 to 2020/21) of £(711)k, including net savings bids of £(1,366)k applicable to 2018/19
- reprofiling of approved budgets between financial years £(7,043)k.

2.4 At the end of September 2018 capital expenditure to date stood at £2,107k compared to a current budget - inclusive of budget carry forwards and other adjustments agreed as part of the 2017/18 capital outturn report - of £17,379k. A total of £3,556k is currently forecast to be spent against this budget during the period October 2018 to March 2019 with a further £3,043k forecast to be carried forward to 2019/20. The forecast carry forward of £3,043k and net outturn variance of £8,673k is reflected in the budget adjustments included in the revised 2018/19 capital budget.

2.5 The impact of the 2018/19 revised budget proposals on the capital expenditure indicator for the period 2018/19 to 2020/21 is summarised below. Further details of the changes made to Authority's capital expenditure plans are set out in the Quarter 2 Finance Report and Revised Budget 2018/19, presented to the Council's Executive on 21st November 2018.

Table B: Capital expenditure – proposed revised budget 2017/18 -2019/20

	Financial year			
	2018-19 £000	**2019-20 £000**	**2020-21 £000**	**Total £000**
Indicator approved in TMSS	14,593	**2,340**	**2,040**	**18,973**
2017/18 budget carried forward	2,786	0	0	2,786
Original Budget	**17,379**	**2,340**	**2,040**	**21,759**
Re-profiling adjustments	(3,043)	3,043	0	0
Reallocations & Re-profiling (net)	(4,000)	4,000	0	0
Capital Growth & Savings (net)	(1,366)	655	0	(711)
Revised Budget	**8,970**	**10,038**	**2,040**	**21,048**

3 Actual Capital Financing Requirement (CFR)

3.1 The Capital Financing Requirement (CFR) is a measure of an authority's underlying need to borrow for capital purposes. It represents the historic cost of

capital expenditure that has yet to be financed by setting aside resources (grants, contributions, capital receipts and revenue financing). The CFR also includes items of capital expenditure included in an authority's balance sheet associated with other long term liabilities, such as assets held on finance leases, but excluding the underlying liability. The CFR does not necessarily correspond with an authority's actual borrowing position which is determined in accordance with an authority's treasury management strategy and practices.

3.2 Capital expenditure not financed up-front through the application of capital grants, contributions, capital receipts or a direct charge to revenue will increase the Capital Financing Requirement. Charging the minimum revenue provision or a voluntary revenue provision against the general fund will reduce the CFR.

Table C: Capital financing requirement

	2017/18 Actual £000	2018/19 Approved Estimate £000	2018/19 Actual to 30.9.18 £000	2018/19 Forecast Outturn £000	2018/19 Revised Budget £000
CFR at 1 April	18,674	20,643	18,917	18,917	18,917
CFR at 31 March	18,917	25,460	18,695	20,338	23,694
Movement in CFR	243	4,817	(222)	1,421	4,777
Movement represented by:					
Unfinanced expenditure	866	5,530	449	2,142	5,448
Less MRP	(623)	(713)	(671)	(671)	(671)
Less Voluntary set aside	0	0	0	0	0
Movement in CFR	243	4,817	(222)	1,471	4,777

3.3 The key variable in the calculation of the CFR at 31st March 2019 is the level of unfinanced capital expenditure incurred during 2018/19. The amount of unfinanced capital expenditure included in the revised 2018/19 capital budget is £5,448k. This includes:

- £3,171k relating to expenditure on refuse collection vehicles
- £867k in respect of the purchase of land at Lillyhall Industrial Park, and Reedlands Road industrial development
- £277k relating to strategic acquisitions.

4 Gross debt and the capital financing requirement (CFR)

4.1 A fundamental provision of the Prudential Code and a key indicator of prudence is that, over the medium term, debt will only be for a capital purpose. To ensure this is the case, gross external debt should not, except in the short-term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.2 This requirement allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes. Gross debt refers to the sum of borrowing and other long-term liabilities (credit arrangements). Table D compares the Council's gross debt and CFR.

Table D: Gross debt & the CFR

	31.3.18 Actual £000	Actual at 30.9.18 £000	2018/19 Forecast Outturn[1] £000	2018/19 Revised Budget[1] £000	2018/19 Estimate (max) £000
PWLB	15,380	15,224	15,067	15,067	20,259
Other borrowing	85	85	85	85	85
Total debt	**15,465**	**15,309**	**15,152**	**15,152**	**20,344**
CFR at 1 April	18,674	18,917	18,917	18,917	18,917
Add: Unfinanced capital expenditure	866	449	2,142	5,448	5,448
Less: MRP	(623)	(671)	(671)	(671)	(671)
CFR at 31 March	**18,917**	**18,695**	**20,388**	**23,694**	**23,694**
(Under)/Over borrowing	(3,452)	(3,386)	(5,236)	(8,542)	(3,350)

[1] based on the maturity profile of the Council's existing loan portfolio at 30.9.18

4.3 At 31st March 2018, the Council was under-borrowed against its capital financing requirement by £3.45m and at 30th September 2018 by £3.39m. The decrease in the level of underborrowing during the six months to 30th September is £66k and is represented by:

- a net decrease in the CFR of £222k generated from unfinanced capital expediture incurred during the period less amounts set aside from revenue to finance capital expenditure
- repayments of borrowing of £156k.

4.4 Based on the current forecast movement in the CFR outlined in section 3 above and the maturity profile of the Council's existing loan portfolio, the forecast outturn (at 31st March 2019) is for the Council to be underborrowed by £8.54m. Any additional borrowing undertaken during the period 1st October 2018 to 31st March 2019 will result in a commensurate reduction in the forecast under borrowing postion at 31st March 2019. Additional borrowing of £5.2m in 2018/19 would reduce the forecasted level of underborrowing at the end of the financial year to £3.35m.

5. Authorised limit for external debt

5.1 The Authorised Borrowing Limit represents the statutory limit on borrowing determined under section 3 of the Local Government Act 2003 (Affordable Limit). It imposes an upper limit on the Council's gross external debt (excluding investments), separately identifying borrowing (external loans) from other long-term liabilities (for example finance lease liabilities). Breach of the Affordable Borrowing Limit is prohibited by section 2(1)(a) of the Local Government Act 2003.

5.2 The Authorised Borrowing Limit is set with reference to the Council's capital expenditure plans, capital financing requirement (or underlying borrowing requirement) and the potential need to borrow to meet temporary revenue borrowing requirements, pending the receipt of amounts due to the Council. The Affordable Borrowing Limit also includes headroom over and above the Operational Boundary (see below) to accommodate any unusual or unforeseen cash movements. The indicator separately identifies limits for borrowing and

other long-term liabilities. No change is required to the Authorised Limit for 2018/19.

Table E: Authorised Limit for External Debt

	2017/18 Limit £000	2017/18 Actual debt (max) £000	2018/19 Limit £000	30.9.18 Actual debt £000	2018/19 Actual debt (max)[1] £000
Borrowing	25,000	15,465	28,000	15,309	20,344
Other long-term liabilities	0	0	0	0	0
Total	25,000	15,465	28,000	15,309	20,344

[1] inclusive of additional borrowing of up to £5.19m

6 Operational boundary for external debt

6.1 The Operational Boundary represents the limit beyond which (gross) external debt is not expected to exceed. It is based on expectations of the maximum external debt of a local authority according to probable events (that is the most likely (prudent) but not worst case scenario) and is consistent with the maximum level of external debt projected by these estimates. The Operational Boundary links directly to the Council's plans for capital expenditure, estimates of the capital financing requirement and cash flow requirements for the year for all purposes but without the additional headroom included within the Authorised Limit. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table F: Operational boundary for external debt

	2017/18 Limit £000	2017/18 Actual debt (max) £000	2018/19 Limit £000	30.9.18 Actual debt £000	2018/19 Actual debt (max) £000
Borrowing	23,000	15,465	26,000	15,309	20,344
Other long-term liabilities	0	0	0	0	0
Total	23,000	15,465	26,000	15,309	20,344

6.2 Provided the total Authorised Limit and total Operational Boundary for a year is unchanged, the Head of Financial Services has delegated authority to make changes to the separately identifiable limits for borrowing and other long-term liabilities. Any movement between these separate totals will be reported to the next meetings of the Audit Committee and Full Council. No change is required to the Operational Boundary for 2018/19.

7 Estimates of the ratio of financing costs to net revenue stream

7.1 This indicator of affordability highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs (net of interest and investment income).

Table G: Ratio of Financing Costs to Net Revenue Stream

	2016/17 Actual %	2017/18 Actual %	2018/19 Estimate %	2018/19 Forecast/revised estimate %
Ratio	7.4	9.0	11.9	10.5

7.2 Financing costs comprise the aggregate of:

- interest charged to the General Fund with respect to borrowing
- interest payable under finance leases and other long-term liabilities
- premiums and discounts from debt restructuring charged or credited to the amount to be met from government grants and local taxpayers
- interest and investment income (excluding interest on policy investments falling out with the Council's Treasury Management and Investment Strategies)
- amounts payable or receivable in respect of financial derivatives
- minimum revenue provision plus any additional voluntary contributions
- any amounts for depreciation/impairment charged to the amount to be met from government grants and local taxpayers.

7.3 Estimates for the net revenue stream are taken from the Council's estimates of the amounts to be met from government grants and local taxpayers, using the equivalent figures from the Council's original and revised budgets. Actual figures for the Net Revenue Stream are taken from the Council's Comprehensive Income and Expenditure Statement for 'taxation and non-specific grant income and expenditure'.

8.0 Indicators required by the Treasury Management Code

8.1 In addition to the indicators required by the Prudential Code there are also a number of treasury indicators required by the Treasury Management Code and accompanying sector guidance. These are:

- upper and lower limits to the maturity structure of its borrowing
- upper limits on the total of principal sums invested over 365 days.

8.2 These treasury management indicators specify ranges (rather than targets) designed to limit the Council's exposure to interest rate, liquidity and refinancing risks.

9 Upper and lower limits to the maturity structure of borrowing

9.1 This indicator highlights potential exposures to refinancing risk arising from concentrations of debt falling due for refinancing and is designed to facilitate reductions in the Council's exposure to refinancing at times of volatile or high interest rates.

9.2 It is calculated as the amount borrowing maturing in each period as a percentage of total borrowing. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Table H: Lower/upper limits on % of borrowing maturing in each period

	At 31.3.18 Actual %	Lower limit 2018/19 %	Upper limit 2018/19 %	At 30.9.18 Actual %	Forecast 31.3.19[1] %
Under 12 months	2.23	0	20	2.62	2.67
12 months to 2 years	2.08	0	20	2.11	2.16
2 years to 5 years	6.52	0	20	6.65	6.81
5 years to 10 years	12.17	0	30	12.45	12.76
10 years to 20 years	19.38	0	40	18.95	18.58
20 years to 30 years	5.71	0	40	4.96	4.22
30 years to 40 years	51.91	0	80	52.26	52.80
40 years to 45 years	0	0	80	0	0

[1]Forecast based on the maturity profile of the existing loan portfolio at 30.9.18

9.3 There is currently a maturity peak between June 2056 and June 2057, with maturity loans of £6m scheduled to be repaid during this period. This is not however considered a significant risk as ample rescheduling opportunities are anticipated before the maturity date of these loans.

9.4 The expected impact of additional borrowing on the maturity profile shown in table I is shown below. This demonstrates that no revisions are required to existing limits to accommodate the additional borrowing.

Table I: Forecast fixed rate maturity profile including additional planned borrowing

	Forecast 31.3.19 %	Lower limit 2018/19 %	Upper limit 2018/19 %
Under 12 months	4.38	0	20
12 months to 2 years	4.00	0	20
2 years to 5 years	12.23	0	20
5 years to 10 years	17.55	0	30
10 years to 20 years	16.87	0	40
20 years to 30 years	4.40	0	40
30 years to 40 years	40.03	0	80
40 years to 45 years	0.18	0	80
45 years to 50 years	0.36	0	80

10 Upper limits to the total of principal sums invested for period of more than 365 days

10.1 A local authority that invests, or plans to invest, for periods of more than 365 days is required to set an upper limit for each forward financial year period for the maturing of such investments. The purpose of the limit for principal sums invested for periods longer than 365 days is to contain the authority's exposure to the possibility of loss that might arise as a result of its having to seek early repayment or redemption of principal sums invested.

Table J: Upper limit on total principal invested for periods or more than 365 days

	2017/18 Actual £000	2018/19 Limit £000	At 30.9.18 Actual £000	Forecast 31.3.19[1] £000
Principal sums invested > 365 days[1]	11	20	11	11

[1] Measured at fair value. The nominal value (historic cost) of principal sums investment as 30th September is £1k