

**Corporate Financial Monitoring 2016/17 – Quarter 3
14 February 2017
Report of the Chief Officer (Resources)**

PURPOSE OF REPORT				
To provide an overview of the Council's financial position for Quarter 3 of the 2016/17 monitoring cycle, and the supporting actions underway.				
Key Decision	<input type="checkbox"/>	Non-Key Decision	<input checked="" type="checkbox"/>	Referral from Cabinet Member
Date of notice of forthcoming key decision		N/A		
This report is public.				

OFFICER RECOMMENDATIONS:

(1) That Cabinet notes the report and the supporting actions set out.

1. Overview

1.1. The corporate financial monitoring report for Quarter 3 is attached at **Appendix A**. Members should note that monitoring for this quarter is now against the revised budget. The headline projections are as follows:

- A current General Fund net underspending of £34K, but expected to be in line with the budget by the year end.
- The Housing Revenue Account is currently in line with the revised budget, but an underspend of £17K is expected by the year end.

1.2. There are no other key issues to highlight as a result of the monitoring work undertaken to date.

1.3. In support of corporate financial monitoring, the latest Treasury Management update report is included at **Appendix B**. The Property update report is not included as it is currently being re-worked following changes requested by Budget and Performance Panel. It is envisaged that an updated version of the report will be available for Qtr 4, as part of wider performance reporting.

2. Performance Monitoring

In terms of performance monitoring, the Organisational Development Manager has been working with Management Team and officers across the Council to

produce a portfolio of key indicators and projects that will provide management information on the performance and delivery of core services and corporate priorities and outcomes. The work is nearing completion and the outcome will be reported in due course.

RELATIONSHIP TO POLICY FRAMEWORK

This report is in support of the delivery of the Council's overall policy framework, and more specifically its Corporate Plan.

CONCLUSION OF IMPACT ASSESSMENT

(including Health & Safety, Equality & Diversity, Human Rights, Community Safety, HR, Sustainability and Rural Proofing)

None directly arising from this report. Any additional implications linked to or arising from the various financial matters raised will be addressed in taking any relevant actions forward.

LEGAL IMPLICATIONS

None directly arising from this report. Any additional implications linked to or arising from the various financial matters raised will be addressed in taking any relevant actions forward.

FINANCIAL IMPLICATIONS

As set out in the attached.

OTHER RESOURCE IMPLICATIONS

Human Resources / Information Services / Property / Open Spaces:

References and any related implications are contained within the report and related appendices.

SECTION 151 OFFICER'S COMMENTS

This report is in the name of the s151 Officer, albeit in her capacity as Chief Officer (Resources).

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS

None.

Contact Officers: Andrew Clarke, Financial Services Manager **Telephone: 01524**

582138

E-mail: ac Clarke@lancaster.gov.uk

Ref:

QUARTER 3 (October to December)

INTRODUCTION

This report provides the key variances to note at the end of quarter 3, in terms of the revenue and capital budgets and local taxation. Please note that monitoring is against the revised budget for the purposes of this update.

REVENUE BUDGET

General Fund – Current underspend of **£34K**, forecast to be in line with budget by year end. Main areas are:

- Employee savings currently -£23K
- Supplies & services currently +£4K
- Income currently -£15K

Housing Revenue Account – Currently in line with budget, but forecast to be an underspend of **£17K** by year end as a result of staff vacancy savings.

CAPITAL PROGRAMME

General Fund – Latest revised programme as reported to Cabinet on 06 December was £16.603M. Spend and commitments at the end of December totalled £7.946M leaving £8.656M still to spend. Further reviews of the programme will be undertaken before the final programme is presented to Budget Council on 01 March.

Housing Revenue Account – Latest revised programme as reported to Cabinet on 17 January was £4.314M. Spend and commitments at the end of December totalled £2.430M leaving £1.884M still to spend.

LOCAL TAXATION

Council Tax – Current deficit of £20K which is a reduction of £89K on the Qtr2 surplus of £69K. Main changes are:

- Reduced cost of Council Tax Support -£133K
- Reduced charge for Second/Empty Homes +£11K
- Other Movements in Tax Base +£211K

The formal calculations of the Council Tax surplus or deficit will be reported to Cabinet in February.

Retained Business Rates – The latest position on business rates will be formalised at the end of January, in line with the statutory deadline, and reported to Cabinet in February.

Collection Performance

	Full Year Target	Target / Actual To Date	
Council Tax	96.8%	84.9%	84.7%
Business Rates	98.8%	80.2%	80.0%

Both slightly behind target, but only marginally so no cause for concern at this point in the year.

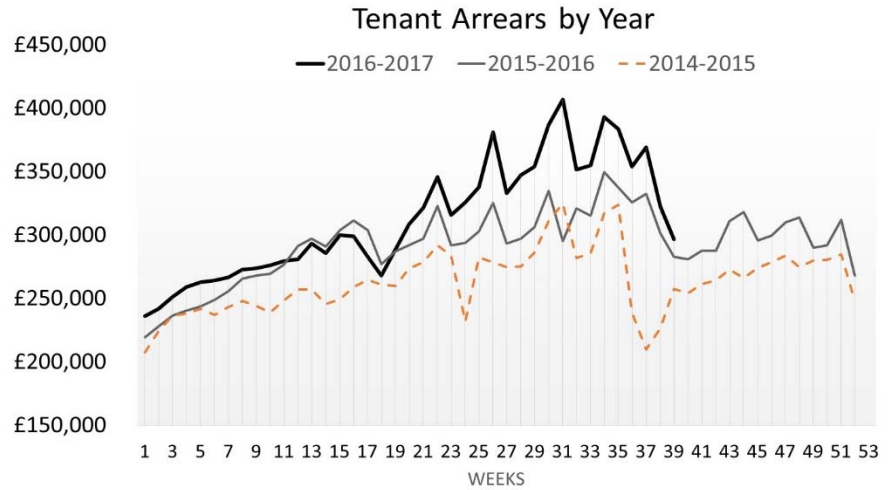
INCOME COLLECTION

Sundry Debts – At the end of December the level of debt was £2.805M which is a reduction of £576K from Qtr2 (£3.381M). The bad debt provision is due to be reassessed in January and the outcome will be reported to Cabinet in February.

SERVICE	< 28 Days	28-59 Days	60-91 Days	92-183 Days	184-364 Days	365+ Days	2016/17 QUARTER 3 TOTALS	Compared to 2015/16 Quarter 3 Totals
	£	£	£	£	£	£	£	£
Enviromental Services	82,246	50,076	8,083	11,126	80,283	20,400	252,213	697,429
Regeneration & Planning	14,174	19,594	627	-	6,553	7,660	48,607	32,557
Resources	233,106	22,294	18,550	43,555	45,887	104,946	468,339	384,956
Health & Housing	36,054	18,941	170	18,527	5,136	900	79,727	59,214
Goverance	500	-	-	-	-	-	500	-
Hsg Benefits (Revenues)	39,672	53,899	55,540	169,695	340,057	1,296,720	1,955,584	1,899,019
2016/17 Quarter 3 Totals	405,751	164,804	82,970	242,903	477,916	1,430,627	2,804,970	3,073,176
2016/17 Quarter 2 Totals	767,692	190,005	90,227	489,819	436,395	1,406,510	3,380,648	

INCOME COLLECTION

Council Housing Rent Arrears – At the end of December the level of arrears was £297K (2015/16 Qtr 3 £283K) which is a reduction of £40K from Qtr2 (£3.381M), and in line with previous years fluctuations. Given this, no specific actions are proposed at this time.



CONTRACT PROCEDURE RULES AND OTHER EXCEPTIONS TO TENDER

Exceptions to Tender – There were two exceptions to tender in quarter 3:

- Use of Hays Recruitment Agency as recommended supplier for recruitment to specific roles, for a period of 2 years. Exception granted due to the need to formalise the current arrangements, and also provide sufficient time to develop a specification and evaluation criteria for undertaking a full tendering process at the end of 2 years.
- Extension granted for current contracts with VCFS providers for a further year (2017/18), to allow sufficient time to undertake specific service specifications and procure services accordingly.

**Treasury Management Update
Quarter Ended 31 December 2016
Report of Chief Officer (Resources)**

2016/17 Treasury Management Update

Quarter Ended 31 December 2016

1. Introduction

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (through the reporting of the Treasury Management Strategy, and annual and midyear reports). This report is in line with best practice in accordance with that Code, to help demonstrate transparency and promote accountability.

2. Economic update (provided by Capita Asset Services)

Growth has been fairly robust at +0.6% qtr/qtr, +2.2% yr/yr in quarter 3 of 2016 to confound the pessimistic forecasts by the Bank of England in August and by other forecasters, which expected to see near zero growth during 2016 after the referendum. Prior to the referendum, the UK economy had been facing headwinds for exporters from the appreciation of sterling against the Euro plus weak growth in the EU, China and emerging markets, and the dampening effect of the Government's continuing austerity programme. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, there was then a sharp recovery in confidence and business surveys and the fall in the value of sterling has had a positive effect in boosting manufacturing in the UK due to improved competitiveness in world markets.

The Bank of England meeting on 4th August addressed its forecast of a slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report cut the forecast for growth in 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. While the MPC was prepared to cut Bank Rate again by the end of 2016, Carney also warned that the Bank could not do all the heavy lifting and suggested that the Government would need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on November 23 and which he duly delivered.

The robust growth in quarter 3 of +0.6%, plus forward indicating business surveys also being very positive on growth, caused the MPC in November to pull back from another cut in Bank Rate. The November Inflation Report also included a forecast for inflation to rise to around 2.7% in 2018 and 2019, well above its 2% target, due to a sharp rise in the cost of imports as a result of the sharp fall in the value of sterling after the referendum. However, the MPC is expected to look through a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December 2015 and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. In December 2016, it extended its QE programme;

monthly purchases at €80bn will continue to March 2017 and then continue at €60bn until December 2017. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 3 2016 (1.7% y/y) but forward surveys are, at last, positive about a modest upturn to growth while inflation has also started to increase significantly. There have been many comments from forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in their economies and economic growth.

3. Interest Rate Forecast

The council's treasury advisor, Capita Asset Services has provided the following forecast:

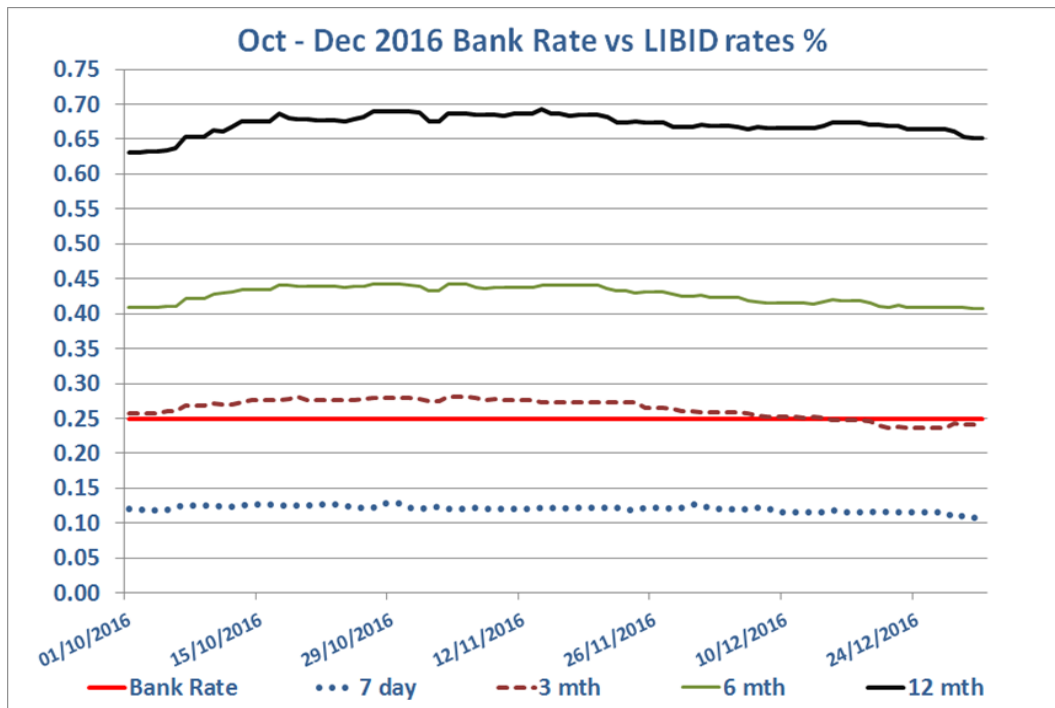
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half of 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling after early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

4. Investing Activities

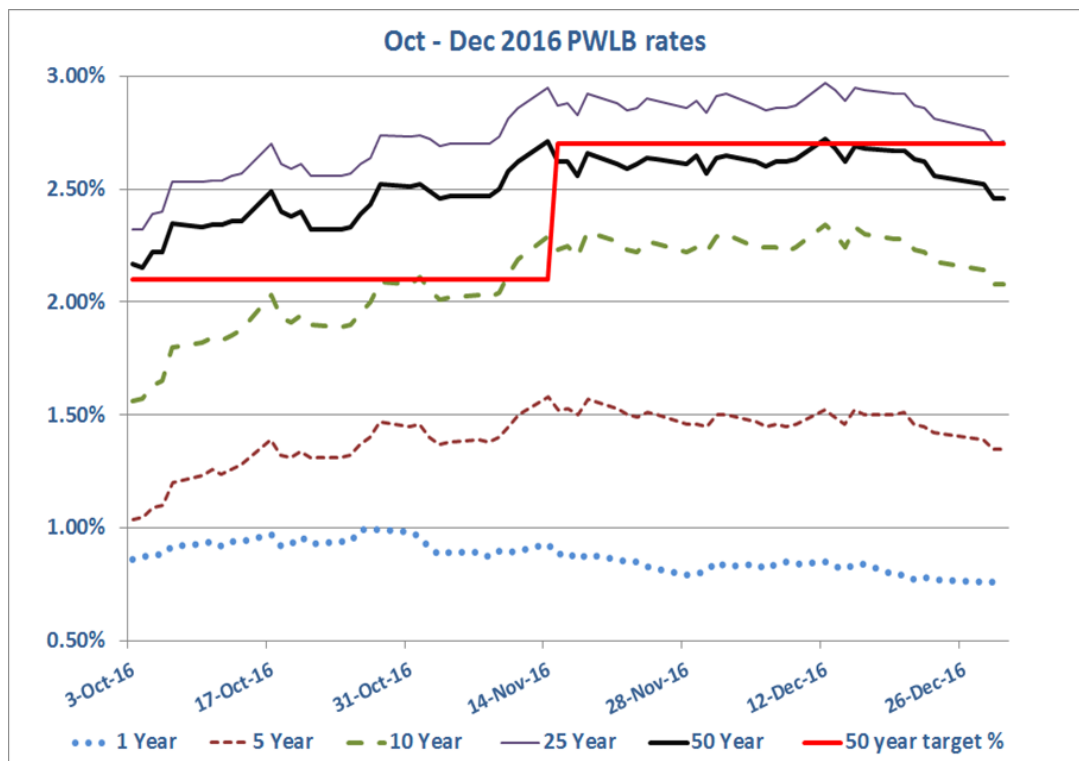
The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by the Council on 2 March 2016. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.



5. Borrowing Activities

As depicted in the graph below, there has been significant volatility in PWLB rates during Quarter 3 as rates rose from historically very low levels at the beginning of the quarter but then fell back somewhat towards the end of December. During the quarter ended 31 December 2016, the 50 year PWLB target (certainty) rate for new long term borrowing started at 2.10% and ended at 2.70%.



Due to the overall financial position there is no new underlying need to borrow for capital purposes (the Capital Financing Requirement – CFR), therefore no new borrowing was undertaken.

6. Debt Rescheduling

Officers continue to monitor potential saving opportunities associated with the early repayment of existing debt. This takes into account the premiums or discounts associated with early repayment and the projected cost of refinancing or loss in investment interest. Debt rescheduling opportunities have been limited in the current economic climate and at present it would not be financially prudent to repay any debt because of the high penalties associated with early repayment.

7. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The Council's approved Treasury and Prudential Indicators are included in the approved Treasury Management Strategy.

8. Risk management (Key Aspects)

Investment Security:

There is still significant inherent risk generally affecting counterparties (i.e. who investments are placed with). These are considered to be managed effectively through the creditworthiness framework currently applied.

Liquidity:

The Council has had higher risk than might have been considered normal for a council of its size with cash balances having been extraordinarily high. On 30 December the significant reduction in balances linked to business rates which had been anticipated crystallised, levelling out this particular risk. Liquidity risks are further managed through cash flow monitoring and forecasting together with the periods chosen for investment. This arrangement helps to ensure that the Council will have sufficient cash available to meet its payment obligations.

Interest Risk:

Investment Returns are low and have been reducing during the year. As has been previously reported the Council has risk exposure because all of its borrowings are long term at fixed rates whilst investments are inevitably shorter term to maintain liquidity. Investments are, therefore, more influenced by movements in the Bank Rate. Although little can be done to mitigate this risk, the Bank Rate is so low that there is little scope for the Council's net interest rate exposure (i.e. the difference between its borrowing and investment interest rates) to increase significantly.

Other:

Counterparty investment capacity (the counterparties and their combined investment limits currently available to the Council) had been tight for much of the quarter. The expected reduction in cash balances at the end of December means that this risk has eased.

Treasury Management Glossary of Terms

- **Annuity** – method of repaying a loan where the payment amount remains uniform throughout the life of the loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.
- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.
- **Call account** – instant access deposit account.
- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.
- **Credit Rating** – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's, and Moody's. They analyse credit worthiness under four headings:
 - **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.
 - **Long Term Rating** – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.
 - **Individual/Financial Strength Rating** – a measure of an institution's soundness on a stand-alone basis based on its structure, past performance and credit profile.
 - **Legal Support Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

- **DMADF and the DMO** – The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.
- **EIP** – Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal, therefore the interest due with each payment reduces as the principal is eroded, and so the total amount reduces with each instalment.
- **Gilts** – the name given to bonds issued by the U K Government. Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt.
E.g. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as $8\%/1.45 = 5.5\%$.
See also PWLB.

- **LIBID** – The London Inter-Bank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time.
- **LIBOR** – The London Inter-Bank Offer Rate, the rate at which banks with surplus funds are offering to lend them to other banks, again published at 11am each day.
- **Liquidity** – Relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.
- **Maturity** – Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.
- **Money Market Fund (MMF)** – Type of investment where the Council purchases a share of a cash fund that makes short term deposits with a broad range of high quality counterparties. These are highly regulated in terms of average length of deposit and counterparty quality, to ensure AAA rated status.
- **Nonfarm Payroll Employment** - is a compiled name for goods, construction and manufacturing companies in the US. It does not include farm workers, private household employees, or non-profit organization employees.
- **Policy and Strategy Documents** – documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.
- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.
- **Capita Asset Services** – are the City Council's Treasury Management advisors. They provide advice on borrowing strategy, investment strategy, and vetting of investment counterparties, in addition to ad hoc guidance throughout the year.
- **Yield** – see Gilts

Members may also wish to make reference to *The Councillor's Guide to Local Government Finance*.