

Lancaster City Council | Report Cover Sheet

Meeting	Cabinet	Date	3 December 2019
Report of	Chief Finance Officer		
Purpose of Report			
This report seeks Cabinet's consideration of various matters in connection with the Treasury Management Mid-Year Review 2019/20 and associated revisions to the Council's Prudential Code Indicators.			
Key Decision (Y/N)	N	Date of Notice	Exempt (Y/N) N

Report Summary
<p>This report provides Cabinet with</p> <ul style="list-style-type: none"> • Performance information in relation to the Council's Treasury Management Activities for the period 1st April to 30th September 2019 (Appendix A). • Details of the total impact on the Prudential Indicators of agreed and likely property investment decisions up to 31st March 2020.

Recommendations of Councillors
<p>That Cabinet</p> <ol style="list-style-type: none"> (1) Consider the various matters in connection with the Treasury Management Mid-Year Review 2019/20 and associated revisions to the Council's Prudential Indicators. (2) Recommend that Full Council approves the acquisitions and associated funding into the Council's capital programme in accordance with the Council's Budget and Policy Framework. (3) Recommend that Full Council approves the revisions to the Council's Capital Financing Requirement (CFR), the Operational and Authorised limits for External Debt and the Ratio of Borrowing Cost to Net Revenue Stream as set out in the report and Appendix A.

Relationship to Policy Framework	
Treasury Management forms part of the Council's budget framework	
Conclusion of Impact Assessment(s) where applicable	
Climate	Wellbeing & Social Value
Digital	Health & Safety
Equality	Community Safety
<p>A Thriving & Prosperous Economy: Economic Prosperity is a high level Corporate Priority for the City Council; whilst the acquisition of an investment does not give an immediate opportunity to generate short term wealth building, the medium term control of land and redevelopment does.</p> <p>Clean Green & Safe Neighbourhoods: As the freeholder of an estate the ability to provide renewable energy sources (solar power), can be delivered as part of the asset</p>	

management strategy, however this can only be undertaken with the tenants consent or once a lease has been determined. The Council cannot force a tenant to change the terms of their lease.

A Smart & Forward Thinking Council: This is the first investment acquisition by the Council, helping to deliver the ambition to be smart, forward thinking and commercially astute. The Property Investment Strategy is one the four pillars of the Funding the Future Strategy which aims to provide financial stability.

Details of Consultation

No specific external consultation has been undertaken.

Legal Implications

None directly arising from this report

Financial Implications

The Council's Capital Financing Requirement will increase by £14.86m as will it's Operational Boundary for External Debt. The Authorised Limit for External Debt will increase to £117m.

The Council currently maintains an under-borrowed position and there is scope to purchase the initial investment, using existing internal balances (internal borrowing) with no additional external borrowing being incurred. There is also currently scope to further extend the amount of internal borrowing to fund the level of potential further investment proposed. This is the most cost effective approach in the current economic climate but this will, as always, be subject to ongoing monitoring.

Other Resource or Risk Implications

There are no additional resource or risk implications

Section 151 Officer's Comments

The s151 Officer has written this report in his role as Chief Finance Officer

Monitoring Officer's Comments

The Monitoring Officer has been consulted and has no further comments

Contact Officer	Paul Thompson
------------------------	---------------

Tel	01524 582603
------------	--------------

Email	pathompson@lancaster.gov.uk
--------------	-----------------------------

Links to Background Papers

--

1.0 Introduction

1.1 The Mid-Year Review (Appendix A) sets out the performance of treasury operations for the first six months of the 2019/20 financial year in terms of long and short term borrowing, investment activities and relevant borrowing limits and prudential indicators. Under CIPFA's Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) it is a requirement that an information report on these matters be presented to Cabinet and full Council.

1.2 The report also contains a number of revisions to the Council's Prudential Code Indicators to reflect Cabinet's agreed property investment acquisition. In addition it seeks to incorporate additional flexibility to facilitate further potential property investment acquisitions up to 31st March 2020. The Code requires Council to formally approve these revisions.

2.0 Prudential Indicators

2.1 In compliance with the Prudential Framework the Council sets an annual Treasury Management Strategy including key indicators, determined under regulation, to assist Members in assessing the affordability of borrowing and in determining that it is prudent and sustainable.

2.2 The tables below show the impact of the potential investments on the capital financing requirement, the ratio of borrowing costs to net revenue stream and its operational and authorised limits for external debt.

Capital Financing Requirement (underlying need to borrow)

2.3 This represents the total amount of capital expenditure (including that from prior years) that has not yet been paid for from either revenue or capital resources.

	2019/20 £M	2020/21 £M	2021/22 £M	2022/23 £M
Current	85.82	87.15	84.48	82.43
Proposed	100.68	101.72	98.76	96.41
Change related to commercial activities/non-financial investments	14.86	14.57	14.28	13.98

Ratio of Financing Costs to Net Revenue Stream

2.4 This shows the cost of capital against the net revenue stream and is the main indicator of affordability.

	2019/20 %	2020/21 %	2021/22 %	2022/23 %
Current (General Fund)	16.80	16.60	17.40	16.90
Proposed (General Fund)	16.80	19.70	20.16	19.61
Change related to commercial activities/non-financial investments	0.00	3.10	2.76	2.71

The Operational Boundary

2.5 This is the limit beyond which external debt is not normally expected to exceed

	2019/20 £M	2020/21 £M	2021/22 £M	2022/23 £M
Current	85.82	87.15	84.48	82.43
Proposed	100.68	101.72	98.76	96.41
Change related to commercial activities/non-financial investments	14.86	14.57	14.28	13.98

The Authorised Limit for External Debt

2.6 This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set, or revised by the full Council.

	2019/20 £M	2020/21 £M	2021/22 £M	2022/23 £M
Current approved	102.00	103.00	100.00	98.00
Proposed	117.00	118.00	115.00	112.00
Change related to commercial activities/non-financial investments	15.00	15.00	15.00	14.00

4.0 Options and Options Analysis (including risk assessment)

Option 1: Cabinet considers the report and passes to Full Council for approval of the revisions to the Prudential Code indicators.
Advantages: Should Cabinet forward on to Full Council for consideration and approval of the revisions to the Prudential Code indicators is given, the Council will be able to proceed with the purchase of the investment opportunities and associated net revenues.
Disadvantages: None
Risks: Council does not approve the revisions and the purchases are therefore unable to proceed resulting in the loss of important additional revenue contributions.
Option 2: Cabinet does not consider the report, or pass to Full Council for approval of the revisions to the Prudential Code indicators.
Advantages: None
Disadvantages: Should Cabinet not forward the report on to Full Council for approval, the purchases may stall until a point when Council is able to approve the Treasury Management Strategy and associated indicators, or fail all together resulting in the delay or loss of the associated revenue streams.
Risks: Council does not approve the revisions, the investment and revenue generating opportunities are lost

3. Officer Preferred Option (and comments)

3.1 The officer preferred option is Option 1.

3.2 The Code requires Full Council to approve any revisions to the Council's Prudential Code Indicators. The Indicators have been revised to allow sufficient flexibility to enable the Council to proceed with its agreed initial purchased, but also allow for those which may occur before 31st March 2020.

The acquisition of commercial investment opportunities and the revenues streams for a central pillar in the Councils Funding the Future Strategy and plays a significant role in addressing the budget deficit over the next 4 years.

Appendix A

Treasury Management Strategy Statement and Annual Investment Strategy

r Review 2019/20

1. Background

Capital Strategy

In December 2017 CIPFA (Chartered Institute of Public Finance and Accountancy) issued revised Prudential and Treasury Management codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intend to provide:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out our Capital Strategy was taken to Council on 27 February 2019.

Treasury Management

The Council operates a balanced budget, which broadly means that cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management services is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and, on occasion, any debt previously drawn may be restructure to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

“the management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

2. Introduction

This report has been written in accordance with the requirements of CIPFA's Code of Practice for Treasury Management.

The primary requirements of the Code are as follows:

- (i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- (ii) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- (iii) Receipt by full council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year Review Report and an Annual Report, covering activities during the previous year.
- (iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- (v) Delegation by the council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Budget and Performance Panel.

This mid-year report covers the following:

An economic update for the first part of the 2019/20 financial year

A review of the Treasury Management Strategy Statement and Annual Investment Strategy

- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators
- A review of the Council's investment portfolio for 2019/20
- A review of the Council's borrowing strategy for 2019/20
- A review of any debt rescheduling undertaken during 2019/20
- A review of compliance with Treasury and Prudential Limits for 2019/20
-

3. Economic Background (provided by Link Asset Services)

This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, so far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. There has been a delay in the date for Brexit to 31 January 2020 and a general election has been called for 12 December. In such circumstances, any interest rate forecasts are subject to material change as the situation evolves

The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some

developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit.

As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, (July 2.1%), and is likely to shift only a little upwards over the rest of 2019/20. It does

Link Asset Services Interest Rate View											
	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	1.20	1.30	1.50	1.60	1.70	1.70	1.80	1.90	2.00	2.00	2.10
10yr PWLB Rate	1.50	1.60	1.80	1.90	2.00	2.00	2.10	2.20	2.30	2.30	2.40
25yr PWLB Rate	2.10	2.30	2.40	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00
50yr PWLB Rate	2.00	2.20	2.30	2.40	2.50	2.60	2.60	2.70	2.80	2.90	2.90

not therefore pose any immediate concern to the MPC at the current time.

In the political arena, if there is a general election soon, 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 although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

4. Interest Rate Forecast

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its last meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year.

The balance of risks to the UK

- *The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.*
- *The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also to the downside.*

5. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy (TMS) for 2019/20, which includes the Annual Investment Strategy, was approved by the Council on 27 February 2019. There are no policy changes to the TMS; the details in this report update the position in light of the updated economic position and budgetary changes already approved.

6. Investment Portfolio

The Council aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. As shown by forecasts in section 4, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.75% Bank Rate. Given this risk environment and the fact that increases in the Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

Officers confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30 September 2019.

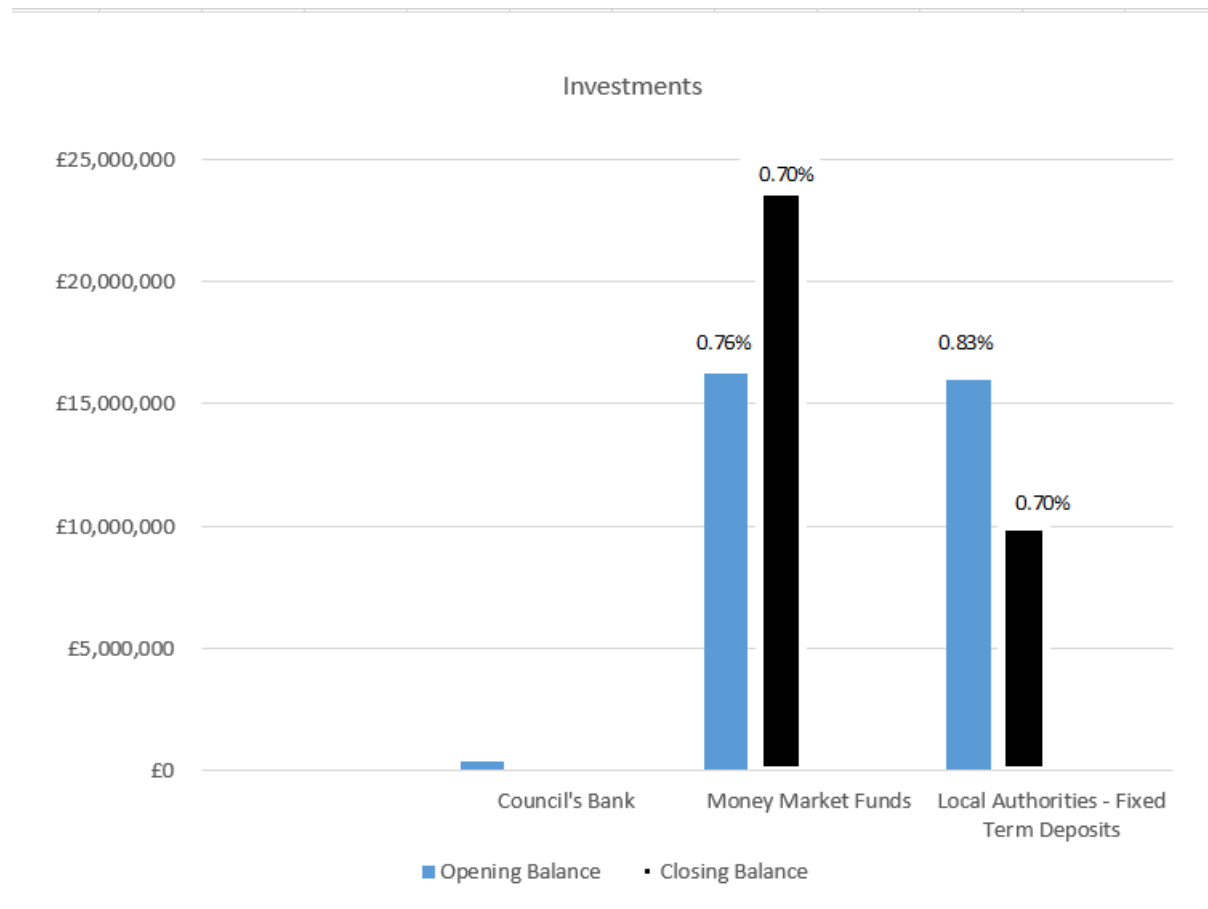
The average level of funds available for investment purposes over the six month period was **£32.9M**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept and business rate related payments, the receipt of grants and progress on the Capital Programme.

In terms of performance against external benchmarks, the return on investments compared to the 7 day LIBID and bank rates at the end of the period is as follows. This is viewed as reasonable performance, given the need to prioritise security of investments, and liquidity (i.e. making sure that the Council's cashflow meets its needs):

Base Rate	0.75%
7 day LIBID	0.57%
Lancaster City Council investments	0.74%

Investment Balances – quarter ended 30 September 2019

At the start of the year investments totalled £32m rising to £34m by 30 September. Fixed term investments with local authorities fell to £10m whilst Money Market Fund balances increased to £24m.



Other Investments	Term	Maturity Date	Opening 1.4.19 £	Closing 30.9.19 £	Indicative Rate (YTD)	Current Fixed Rate	Interest to Date £	
Call Accounts								
Natwest (Cash Manager Plus)			385,684	97,162		0.01%	262	
Money Market Funds								
Blackrock Sterling Liquidity First Fund			6,000,000	5,650,000	0.68%		20,285	
Blackrock Sterling Government Liquidity Fund			0	0	0.62%		1,900	
Insight			0	0	0.71%		5,491	
LGIM			4,230,000	6,000,000	0.71%		20,654	
Aberdeen Life Investments			6,000,000	6,000,000	0.73%		22,629	
Goldman Sachs			0	6,000,000	0.68%		8,343	
Fixed Term Deposits								
Thurrock Council	92 days	07/05/2019	5,000,000	0		0.90%	4,438	
Thurrock Council	184 days	07/11/2019	0	5,000,000		0.85%	17,117	
North Ayrshire Council	89 days	21/05/2019	5,000,000	0		0.90%	6,164	
Barking & Dagenham Council	92 days	28/05/2019	5,000,000	0		0.90%	7,454	
Barking & Dagenham Council	92 days	28/08/2019	0	0		0.78%	9,403	
Barking & Dagenham Council	123 days	27/01/2020	0	5,000,000		0.78%	534	
Northamptonshire County Council	363 days	01/04/2019	1,000,000	0		0.70%	19	
Glasgow City Council	31 days	01/08/2019	0	0		0.80%	3,397	
Sub-total			32,615,684	33,747,162			128,090	
							Budgeted income	130,150
								(2,060)

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMS is meeting the requirement of the treasury management function.

7. Borrowing

The Council's capital financing requirement (CFR) for 2019/20 was £85.82m as set out at **Annex A**. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council currently has borrowings of £62.13m and has utilised £23.67m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

Members are currently being asked to approve the acquisition of an investment property for a commercial return. In order to facilitate this, and to build in sufficient flexibility to make further potential acquisitions during this financial year, the Capital Financing Requirement, Operational Boundary and Authorised limit for external debt have been increased as set out in **Annex A**.

8. Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted PWLB new

borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

9. Compliance with Treasury and Prudential Limits

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 and in compliance with the Council's Treasury Management Practices.

It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The mid-year position in respect of the Council's approved Treasury and Prudential Indicators (affordability limits) which include the impact of the recommended investments appended **at Annex A**.

10. Other Issues

Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or to other types of investment instruments this change in risk appetite and policy should be brought to members' attention in treasury management update reports. There are no such changes to report.

ANNEX A

PRUDENTIAL INDICATORS - MID YEAR REVIEW

There details in this annex update relevant prudential indicators to reflect the impact of the recommended investments

Prudential Indicator for Capital Expenditure

This table shows the current estimates for the General Fund and Housing Revenue Account capital programmes, compared to the original estimates:

Capital Expenditure by Service	2019/20	
	Original Estimate £m	Quarter 2 Position £m
Communities and Environment	4.38	4.88
Economic Growth and Regeneration	2.14	2.05
Corporate Services	0.23	0.31
Development Pool	2.45	2.45
Total for General Fund	9.20	9.69
Council Housing (HRA)	4.77	4.77
Commercial activities/non-financial investments	0.00	14.86
Total Capital Expenditure	13.97	29.32

Changes to the Capital Financing Requirement

The following table shows the changes in the financing of the capital programmes, and the level of borrowing required. The latter is recommended to increase by £14.86m.

Capital Financing Requirement	2019/20	
	Original Estimate £m	Quarter 2 Position £m
General Fund	47.49	47.53
HRA	38.31	38.29
Commercial activities/non-financial investments	0.00	14.86
Total Capital Financing Requirement	85.80	100.68
Net movement in CFR	3.30	14.86

Limits to Borrowing Activity

A key control over treasury management activity is to ensure that over the medium term, net borrowing (borrowings less investments) will only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total capital financing requirement.

The tables below shows that extra debt is being taken on so formal changes are being recommended to the original approved indicators as set out below.

External Debt v Borrowing Need (CFR)	2019/20	
	Original Estimate £m	Quarter 2 Position £m
External Debt	63.17	63.17
Other long term liabilities	-1.04	-1.04
Total Debt	62.13	62.13
Compared to current approved:		
Capital Financing Requirement	85.80	100.68
Operational Boundary:-		
Debt	85.80	85.82
Commercial activities/non-financial investments	0.00	14.86
Authorised Limit:-		
Debt	102.00	102.00
Commercial activities/non-financial investments	0.00	15.00

Definitions:

Operational Boundary

The limit beyond which external debt is not normally expected to exceed is known as the operational boundary.

Authorised Limit for External Debt

A further prudential indicator controls the overall level of borrowing. This is the authorised limit which represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, whilst not desired, could be afforded in the short term, but it is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements.

Affordability

The indicator below shows the proportion of financing costs to net revenue stream

Ratio of Financing Costs to Net Revenue Stream	2019/20		2020/21	2021/22
	Original Estimate	Quarter 2 Position	Estimate	Estimate
	%	%	%	%
General Fund	17.7	16.8	16.6	17.4
HRA	21.5	20.9	20.3	19.5
Commercial activities/non-financial investments	0.00	0.00	3.1	2.8

Authorised Limit for External Debt

A further prudential indicator controls the overall level of borrowing. This is the authorised limit which represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, whilst not desired, could be afforded in the short term, but it is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements.

Affordability

The indicator below shows the proportion of financing costs to net revenue stream

Ratio of Financing Costs to Net Revenue Stream	2019/20		2020/21	2021/22
	Original Estimate	Quarter 2 Position	Estimate	Estimate
	%	%	%	%
General Fund	17.7	16.8	16.6	17.4
HRA	21.5	20.9	20.3	19.5
Commercial activities/non-financial investments	0.00	0.00	3.1	2.8

