WOKINGHAM BOROUGH COUNCIL

WOKINGHAM
BOROUGH COUNCIL

UNUM E PLURIBUS

Treasury Management

Mid-Year Treasury Management Report 2016-17

Contents

1. Introduction 3
2. The Economy and Interest Rates forecast.. 3
3. The Council's Capital Expenditure and Financing 2016/17.. 4
4. The Council's Overall Borrowing Need 5
5. External borrowing and compliance with treasury limits and prudential indicators 6
6. Compliance with treasury limits and prudential indicators for investments 8
7. Conclusion 9

Appendices

Prudential and Treasury indicators	Appendix B
Loan Portfolio	Appendix C
Investment Portfolio	Appendix D
Glossary of Terms	Appendix E

1. Introduction

This report presents the Council mid-year treasury position for 2016-17 in accordance with the Council treasury management practices.

It explains the current economic environment expectations for the near future. It then analyses the latest analysis of capital expenditure which is a key driver of treasury management, driving the borrowing requirement of the organisation. It then shows how the Council has financed its borrowing between internal and external borrowing and then how the Council has managed its short-term cash investments.

The Council's treasury management strategy is largely influenced by capital expenditure. Revenue expenditure is largely balanced with expenditure matching income, and short term borrowing and deposits. The large driver of the longer term treasury management strategy is therefore capital expenditure and financing.

There are two aspects of treasury performance – debt management and cash investment:

- debt management relates to the Council's borrowing;
- cash investment relates to the investment of surplus cash balances.

2. The Economy and Interest Rates forecast

The referendum vote on the EU referendum 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, subsequent surveys have shown a sharp recovery in confidence and business surveys, it is generally expected that although the economy will now avoid flat lining, growth will be weak through the end of 2016 and in 2017.

The Bank of England on August 4 addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August which cut the Bank Rate to 0.25% and gave forward guidance that it expected to cut the Bank Rate again to near zero before the year end. The bank of England in November's statement shifted to a "neutral" policy position, stating that central bank policy can respond "to either direction" as per changes in the economic outlook, removing its previous view that a rate cut was a possibility. The governor of the Bank of England (Mark Carney) has repeatedly stated that increases in the bank rate will be slow and gradual after they do start. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently.

The Council's treasury advisor, Capita Asset Services, has provided forecasts for PWLB rates based on the certainty rate (minus 20 bps) which has been accessible to most local authorities since 1 November 2012, as shown in table 1, below.

Table 1: Interest rate forecasts for bank rate and PWLB

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Bank Rate	0.25%	0.25%	0.25%	0.25%	0.10%	0.25%	0.25%	0.25%	0.25%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%

The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017. The MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise the bank rate.

The new Chancellor Phillip Hammond announced in the Autumn Statement on November 23, that the target of achieving a budget surplus in 2020 will be eased after the referendum result.

3. The Council's Capital Expenditure and Financing 2016/17

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- financed in year, immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need or;
- funded by borrowing (internal or external).

The actual capital expenditure forms one of the required prudential indicators. During August 2016/17 the Council under took an exercise to obtain more accurate forecasts of capital expenditure from budget managers. This provides the Council with a more realistic year end outturn giving the Council the opportunity to adjust its capital budget and related funding plans. Tables 2 and 3 below show the actual capital expenditure and the funding.

Table 2: General fund capital expenditure and financing	**2016/17 Budget**	**Quarter 1 16/17 Year end forecast**	**Quarter 2 16/17 Year end forecast**
	£'000	**£'000**	**£'000**
Capital expenditure			
Financed in year	**57,747**	**48,467**	**33,685**
Funded by borrowing (borrowing requirement)	**73,103**	**56,611**	**50,945**
Total	**130,850**	**105,078**	**84,630**

Table 3: HRA capital expenditure and financing	**2016/17 Budget**	**Quarter 1 16/17 Year end forecast**	**Quarter 2 16/17 Year end forecast**
	£'000	**£'000**	**£'000**
Capital expenditure			
Financed in year	**9,827**	**9,991**	**5,909**
Funded by borrowing (borrowing requirement)	**0**	**0**	**0**
Total	**9,827**	**9,991**	**5,909**

4. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). It represents the 2016/17 capital expenditure financed by borrowing, and prior years' unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

The Council's general fund underlying borrowing need (CFR) is not allowed to rise indefinitely. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This ensures the general fund pays for the capital asset and is a proxy for depreciation. The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- an additional revenue contribution to the statutory minimum revenue provision (MRP) each year through a Voluntary Revenue Provision (VRP).

This differs from the treasury management arrangements which relates to cash transfers. External debt can be borrowed or repaid at any time, but this does not change the CFR.

The Council's CFR forecast for 2016/17 year end is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. However no borrowing is actually required against these schemes as a borrowing facility is included in the contract.

Table 4: Capital financing requirement: General Fund	**2016/17 Budget £'000**	**2016/17 Quarter 1 Year end forecast £'000**	**2016/17 Quarter 2 Year end forecast £'000**
Opening balance	**113,308**	**118,580**	**118,580**
Capital expenditure funded by Borrowing	**73,103**	**56,611**	**50,946**
Sub Total	**186,411**	**175,191**	**169,526**
Less Minimum Revenue Provision			
MRP Charge	**(3,310)**	**(3,024)**	**(3,024)**
PFI Principal Charge	**(215)**	**(215)**	**(215)**
Sub Total	**(3,525)**	**(3,239)**	**(3,239)**
Closing Balance	**182,886**	**171,952**	**166,287**
Movement	**69,578**	**53,372**	**47,707**

Table 5: Capital financing requirement: HRA	2016/17 Budget £'000	2016/17 Quarter 1 Year end forecast £'000	2016/17 Quarter 2 Year end forecast £'000
Opening balance	93,876	93,876	93,876
Repayment of Loan Principle	(3,476)	(3,476)	(3,476)
Closing Balance	90,400	90,400	90,400

Table 6: Capital financing requirement: General fund and HRA	2016/17 Budget £'000	2016/17 Quarter 1 Year end forecast £'000	2016/17 Quarter 2 Year end forecast £'000
Opening balance	207,184	212,456	212,456
Movements	66,102	49,896	44,231
Closing Balance	273,286	262,352	256,687

The in-year increase in the borrowing requirement is due to a large increase in the capital programme for schemes such as the town centre regeneration and loans to group companies and will reduce again when capital receipts are recovered or loans repaid. It has also increased as a result of the forward funded schemes. These will decrease again as developer contributions are received.

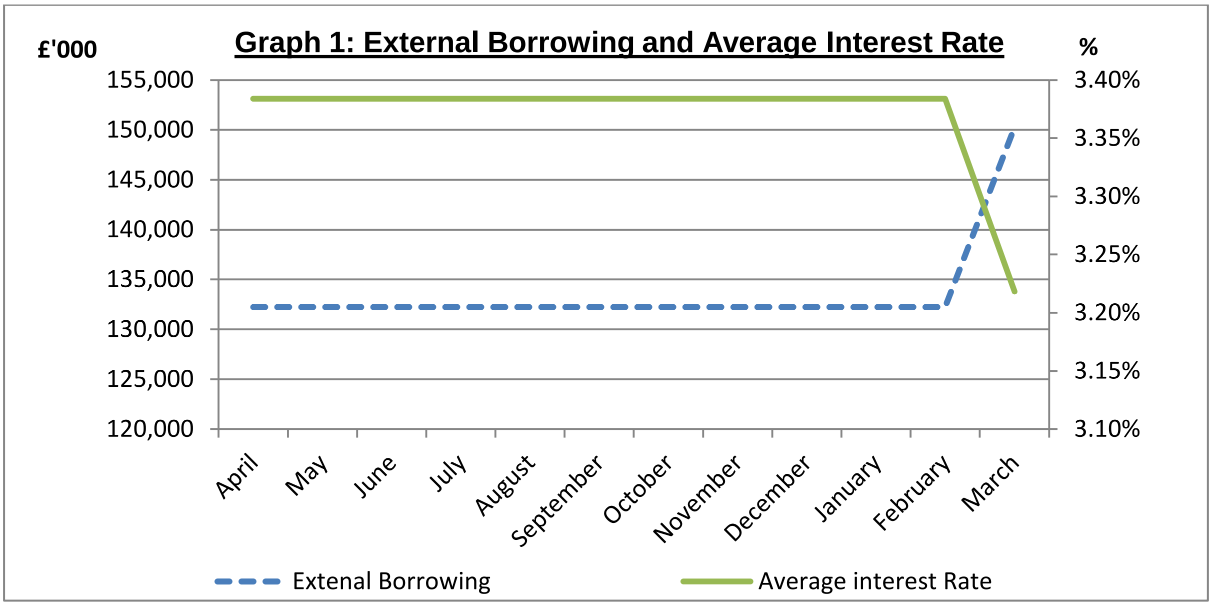
Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. The Council does not borrow all of this money externally but uses some of its internal cash reserves to fund this expenditure. This is referred to as "internal borrowing". This means that the Council's capital financing requirement is higher than its external borrowing figures. External borrowing may be sourced from bodies such as the Public Works Loan Board [PWLB] or the money markets.

5. External borrowing and compliance with treasury limits and prudential indicators

Table 7, below, demonstrates the current and forecast for 2016/17 external borrowing.

Table 7: External Borrowing	Actuals @ 30-09-16 £'000	Quarter 2 16/17 Year end forecast £'000
Market	24,000	24,000
PWLB	107,482	125,482
Local Enterprise Partnership	750	750
Total borrowing	132,232	150,232

Included in the total borrowing is an estimated £18m loan to be taken out prior to 31 March 2017.This will be at a special rate of 40 bases point lower than the PWLB rate. (Local Enterprise Partnership Agreement)



Graph 1 shows the £18m loan will increase the external borrowing to £150.2m. The loan however is likely to be at a significantly lower rate than our current loans. This will mean the average interest rate will drop to 3.2% from 3.39%

During the first six months of the 2016/17 financial year, the Council operated within the treasury limits as set out in treasury management strategy. The position for the treasury management prudential indicators is shown in table 8, below. These show that all prudential indicators have been complied with. Further detail on each of these indicators is included in Appendix B.

Table 8: Prudential Indicator – Debt	Forecast year-end position @ 30-09-16 Does gross borrowing exceed CFR?	Has the limit/boundary been broken
Gross external borrowing	**NO**	
Authorised limit		**NO**
Operational boundary for external debt		**NO**
HRA debt limit		**NO**
Maturity structure of borrowing		**NO**
Upper limits on interest rate exposure		**NO**
The percentage of financing costs set aside to service debt financing costs		**NO**

In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does 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). This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs.

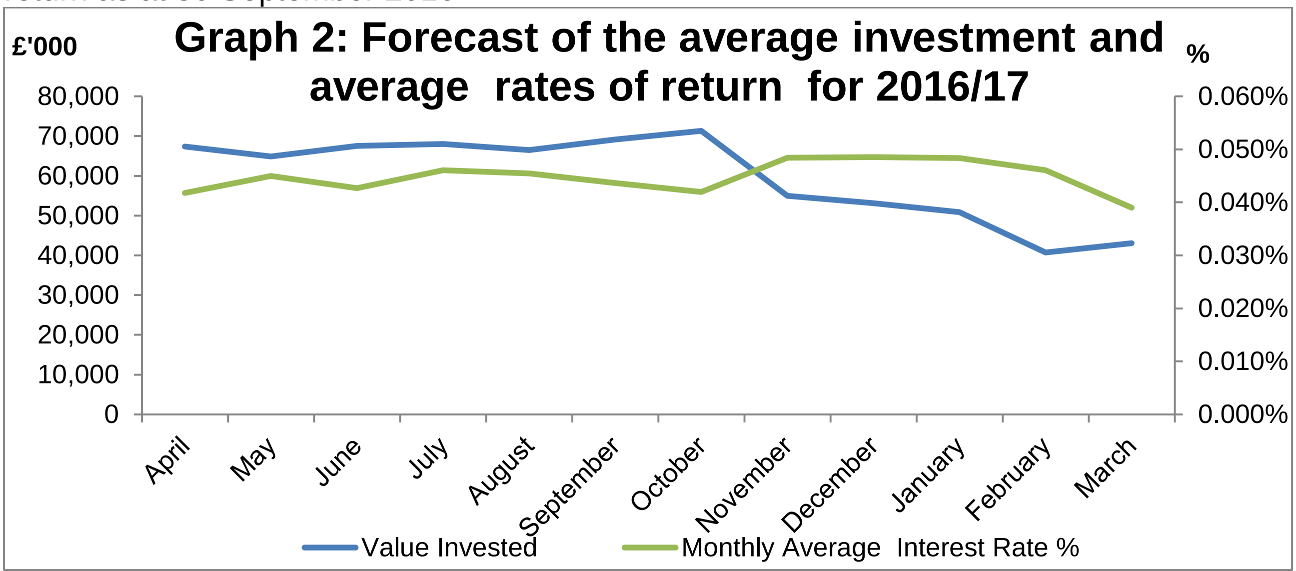
6. Compliance with treasury limits and prudential indicators for investments

The treasury management team ensure the cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return. The return on investments contributes to the Council's budget for both the general fund and housing revenue account.

Table 9, below, shows the counterparties where cash deposits are held. Further detail is available in appendix D.

Table 9: Investment Type	Actuals invested @ 31-03-16	Actuals invested @ 30-09-16 £'000
Money Market funds	0	0
Local Authorities	37,000	52,000
Fund Mangers	21,413	12,575
Internal Companies investments	12,128	15,961
Total	70,541	80,536

Graph 2 shows analysis of forecast of the average values invested and the rate of return as at 30 September 2016.



During the first six months of the 2016/17 financial year the Council operated within the treasury limits as set out in investment strategy. The position for the investment prudential indicators is shown in table 10 and full details are available in appendix B.

Table 10: Prudential Indicator – Investment Forecast year-end position @ 30-09-16	Has the limit/boundary been broken	Is the budget forecast to achieve at year end
Upper limits on interest rate exposure	NO	
Investment interest received		Yes

7. Conclusion

The Director of Finance and Resources confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2016/17 and that no difficulties are envisaged for the remaining 6 months in complying with the prudential indicators. The Council is operating in a stringent financial climate, but is still managing to deliver within budgeted interest levels.

This page is intentionally left blank