WOKINGHAM BOROUGH COUNCIL

Treasury Management

Mid-Year Treasury Management Report 2018-19

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1. Introduction

This report presents the Council's mid-year treasury position for 2018-19 in accordance with the Council's 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

During the first six month Equities have continued to struggle. In October FTSE slipped to a seven month low as the index fell 1.24% as a broad sell off hit European stocks on a damaging mix of weak corporate results, global growth concerns, geopolitical tensions, led by the Saudi Arabia diplomatic row, and Italian budget concerns. The more UK centric FTSE 250 fell 2.2% to its lowest level since February 2017. Risk aversion saw traditional safe havens, such as gold, gilts and utility stocks, push higher.

UK

The October CBI Industrial Trends Survey reported that factory orders declined at the fastest pace for three years, in the three months to October, with the quarterly order book balance at -6, markedly lower than the +15 posted in July. The measure of manufacturers' optimism was the weakest since the Brexit vote back in 2016, while planned investment is being scaled back due to Brexit uncertainty.

Investments

The September MPC meeting delivered the expected no change vote with a unanimous 9-0 vote. The committee reaffirmed that further rate moves will likely be gradual, though inflationary pressures will be monitored. The markets are not factoring in another rate hike at any of the last three meetings this year, with December expectations now put at just a 2.8% chance. Uncertainty around a Brexit deal is resulting in swings of emotion around when the next UK rate hike will take place. With hopes of a Brexit deal seemingly receding by the day, markets have reined in expectations of the timing of the next rate rise. A February increase is now seen as a less than 30% possibility and May is edging towards just a 40% chance, while August prospects have been cut to only marginally above 50%.

Table 1: Interest rate forecasts for bank rate and PWLB

Bank Rate	December 2018	March 2019	June 2019	September 2019	December 2019	March 2020	June 2020	September 2020
Bank Rate								
Link	0.75%	0.75%	0.75%	1.00%	1.00%	1.25%	1.00%	1.25%
Cap Econ	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
5Y PWLB RATE								
Link	2.00%	2.10%	2.00%	2.20%	2.30%	2.30%	2.40%	2.50%
Cap Econ	1.70%	1.70%	1.90%	2.20%	2.40%	2.40%	2.40%	2.40%
10Y PWLB RATE								
Link	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%
Cap Econ	2.10%	2.10%	2.30%	2.60%	2.80%	2.80%	2.80%	2.80%
25Y PWLB RATE								
Link	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%
Cap Econ	2.60%	2.60%	2.90%	3.10%	3.40%	3.40%	3.40%	3.40%
50Y PWLB RATE								
Link	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%
Cap Econ	2.40%	2.40%	2.70%	2.90%	3.20%	3.20%	3.20%	3.20%

25Y PWLB RATE								
Link	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%
Cap Econ	2.60%	2.60%	2.90%	3.10%	3.40%	3.40%	3.40%	3.40%
50Y PWLB RATE								
Link	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%
Cap Econ	2.40%	2.40%	2.70%	2.90%	3.20%	3.20%	3.20%	3.20%

The Council's treasury advisor, Link Asset Services, has provided forecasts for PWLB rates based on the certainty rate (minus 20 bps), as shown in table 1, below.

The Council's Capital Expenditure and Financing 2018/19

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 council is forecasting as at 30th September to achieve 59% of its current capital budget including carry forwards. (See appendix E to a summary by key priority)

The actual capital expenditure forms one of the required prudential indicators. Tables 2 and 3 below show the actual capital expenditure and the funding.
Please note all budgets are based on the Medium Term financial plane budget set in February 2018

Table 2: General fund capital expenditure and financing

	2018/19 MTFP Budget	Quarter 1 2018/19 Year end forecast	Quarter 2 2018/19 Year end forecast
Capital expenditure	**£'000**	**£'000**	**£'000**
Financed in year	**82,843**	**63,900**	**64,008**
Funded by borrowing (borrowing requirement)	**91,234**	**67,030**	**67,137**
Total	**174,077**	**130,930**	**131,145***

Note:* Slippage in the delivery of the capital programme has resulted in this reduction

Table 3: HRA capital expenditure and financing

	2018/19 MTFP Budget	Quarter 1 2018/19 Year end forecast	Quarter 2 2018/19 Year end forecast
Capital expenditure	**£'000**	**£'000**	**£'000**
Financed in year	**5,900**	**4,357**	**4,357**
Funded by borrowing (borrowing requirement)	**0**	**0**	**0**
Total	**5,900**	**4,357**	**4,357**

3. 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 2017/18 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 2018/19 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

	2018/19 Budget	Quarter 1 2018/19 Year end forecast	Quarter 2 2018/19 Year end forecast
Opening balance £'000	198,804	182,899	182,899
Capital expenditure funded by Borrowing	91,234	67,030	67,137
Sub Total	290,038	249,929	250,036
Less Minimum Revenue Provision			
MRP Charge	(3,350)	(2,350)	(2,350)
PFI Principle Charge	(215)	(215)	(215)
Prior year adjustment (swap funding / forward funding)	(11,124)	(1,291)	(1,291)
Sub Total	(14,689)	(3,856)	(3,856)
Closing Balance	275,349	246,073	246,180
Movement		41,007	41,114

Note: * The opening balance for the budget was an estimate as at Jan 2018. The Actual closing balance for 2017/18 was higher than forecast, this has resulted in a higher 2018/19 opening balance.

Table 5: Capital financing requirement: Housing Revenue Account (HRA)

	2018/19 Budget	Quarter 1 2018/19 Year end forecast	Quarter 2 2018/19 Year end forecast
Opening balance	87,836	88,650	88,650
Closing Balance	87,836	88,650	88,650
Less Minimum Revenue Provision			
Repayment of Loan Principle	(3,482)	(3,482)	(3,482)
PFI Principle Charge			
Sub Total	(3,482)	(3,482)	(3,482)
Closing Balance	84,354	85,168	85,168

Movement	5,232	5,232

Table 6: Capital financing requirement: General fund and HRA	2018/19 Budget	Quarter 1 2018/19 Year end forecast	Quarter 2 2018/19 Year end forecast
Opening balance £'000	286,640	271,549	271,549
Capital expenditure funded by Borrowing	91,234	67,030	67,137
Sub Total	377,874	338,579	338,686
Less Minimum Revenue Provision			
MRP Charge	(6,832)	(5,832)	(5,832)
PFI Principle Charge	(215)	(215)	(215)
Prior year adjustment (swap funding / forward funding)	(11,124)	(1,291)	(1,291)
Sub Total	(18,171)	(7,338)	(7,338)
Closing Balance	359,703	331,241	331,348
Movement		46,239	46,346

Note: All borrowing is within are authorised limits.

The capital expenditure funded by borrowing requirement includes the funding of the following:

- Town centre regeneration
- Loans to group companies
- Forward funded schemes

The above borrowing will be reduced when capital receipts are recovered, loans repaid and when 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.

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

Table 7, below, demonstrates the current and forecast 2018/19 external borrowing.

Table 7: External Borrowing	Actuals @ 30-09-18	Quarter 1 2018/19 Year end forecast	Quarter 2 2018/19 Year end forecast
	£'000		
Market	24,000	24,000	24,000
PWLB *	120,256	177,158	157,158
Local Enterprise Partnership **	1,000	750	750
local Authorities	0	0	0

Total borrowing	**145,256**	**201,908**	**181,908**

Note:* reduction due to a HRA self-financing loan repayment
Note: reduction due to a Local Enterprise Partnership loan repayment**

During the first six months of the 2018/19 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 on the following page 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 as at 30-09-17

	Has the limit/boundary been broken
Gross external borrowing exceeding CFR	**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**

Note: prudential indicators is shown in table 8 and full details are available in appendix B.

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.

5. 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	Quarter 1 Actuals invested	Quarter 2 Actuals invested
Money Market funds	2,300	4,000
Local Authorities	86,000	89,000
Fund Mangers	601	601
Internal Companies investments (including the HRA)	76,080	75,416
Total	164,981	169,017

During the first six months of the 2017/18 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 : Investments return	Quarter 1 Forecast outturn	Quarter 2 Forecast outturn
Money Market funds	20	22
Local Authorities	445	460
Fund Mangers	3	3
Internal Companies investments (including the HRA)	2,948	2,915
Total	3,416	3,400

Current forecast of investment return shows we will under achieve the budget (Budget £4,059,000 year end outturn forecast as at September is £3,646,000). This is due to loans budgeted to be made to our housing companies have not materialised, however this is offset by external borrowing has not need to be taken out. This has meant the council is under spending on the interest charges budgets.

6. Conclusion

The Director of Corporate Services confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19 and that no difficulties are envisaged for the remaining six 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.

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