LANCASHIRE COMBINED FIRE AUTHORITY
RESOURCES COMMITTEE
Meeting to be held on 29 November 2017

TREASURY MANAGEMENT MID-YEAR REPORT 2017/18
(Appendix 1 refers)

Contact for further information:
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Executive Summary

The report sets out the Authority's borrowing and lending activities during 2017/18. Decisions taken were taken in accordance with the Treasury Management Strategy and were based on anticipated spending and interest rates prevailing at the time.

Recommendation

1. The Authority is asked to note and endorse the report.
2. The Authority is asked to approve an amended Prudential Indicator to allow 100% of debt to mature over 10 years.

Information

In accordance with the CIPFA Treasury Management Code of Practice (2011) and to strengthen Members' oversight of the Authority's treasury management activities, the Resources Committee receives regular updates on treasury management issues including a mid-year report and a final outturn report. Reports on treasury activity are discussed on a quarterly basis with Lancashire County Council Treasury Management Team and the Authority's Director of Corporate Services and the content of these reports is used as a basis for this report to the Committee.

Economic Overview

The key economic messages in the period were the increasing inflation, falling unemployment but reductions in the real wages. The Consumer Price Inflation (CPI) index rose in August to 2.9%, its highest since June 2013. This increase was largely due to the fall in the value of sterling following the June 2016 referendum which has led to higher import prices. The new inflation measure CPIH, which includes owner occupiers' housing costs, was at 2.7%.

The unemployment rate fell to 4.3%, its lowest since May 1975, but the squeeze on consumers intensified as average earnings grew at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar 2017.

The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth. Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months". Subsequently at the MPC meeting of the 2nd November the base rate was increased to 0.5%.

Global growth prospects improved during the period. The US Federal Reserve increased its target range of official interest rates in June for the second time in 2017 by 25bps (basis points) to between 1% and 1.25%. The Fed also announced confirmed that it would be starting a reversal of its vast Quantitative Easing programme.

However geopolitical tensions escalated in August as the US and North Korea exchanged verbal threats over reports about enhancements in North Korea's missile programme. The provocation from both sides helped wipe off nearly $1 trillion from global equity markets but benefited safe-haven assets such as gold, the US dollar and the Japanese yen.

Prime Minister Theresa May called an unscheduled General Election in June, result of which has led to a minority Conservative government with support from the Democratic Unionist Party. This clearly results in an enhanced level of political uncertainty. The uncertainty around future trade relations with the rest of the EU block, is denting business sentiment and investment. The reaction from the markets on the UK election's outcome was fairly muted, business confidence now hinges on the progress (or not) on Brexit negotiations.

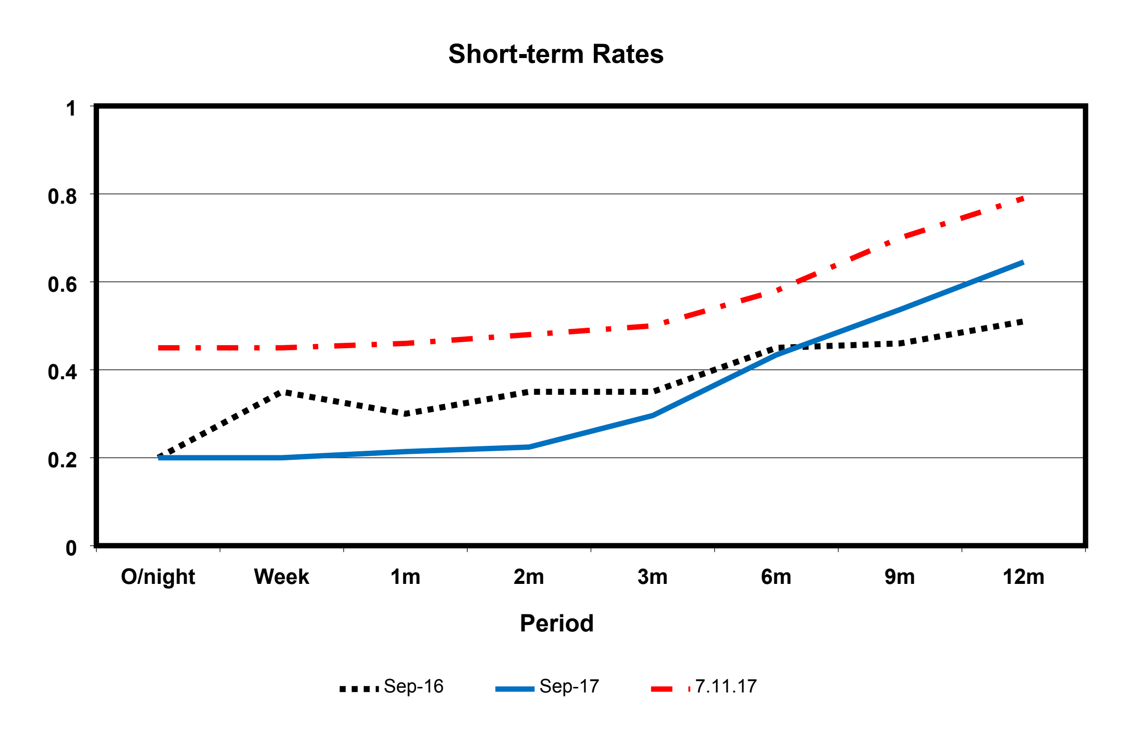
In the face of a struggling economy and Brexit-related uncertainty, Arlingclose expects the Bank of England to take only a very measured approach to any monetary policy tightening, any increase will be gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy through the Brexit transition.

Financial markets: Gilt yields displayed significant volatility over the six-month period with the perceived change in sentiment in the Bank of England's outlook for interest rates, the push-pull from expectations of tapering of Quantitative Easing (QE) in the US and Europe and from geopolitical tensions. The FTSE 100 nevertheless increased reaching a record high of 7548 in May but dropped back to 7377 at the end of September. Money markets rates have remained low: 1-month, 3-month and 12-month LIBID rates have averaged 0.25%, 0.30% and 0.65% over the period from January to 21st September.

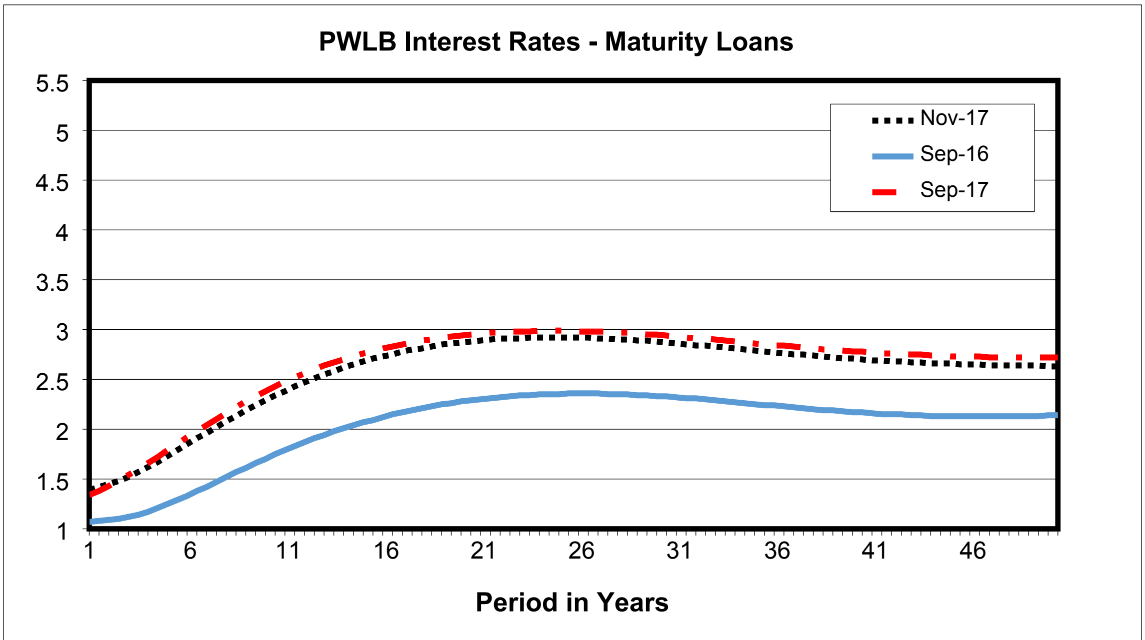
Credit background: The significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities.

Interest Rate Environment

Short term interest rates continue at the very low levels with the Bank of England keeping the base rate to 0.25% throughout the first half of the financial year. However, as noted above the base rate was increased to 0.5% in November. The graphs below show the latest short term rates and for comparison the rates that were available at the end of September 2016 and 2017.



Current longer term PWLB rates are shown below, again with September data for information.



Outlook for Interest Rates

The table below shows Arlingclose, the County Council's Treasury Management advisors, latest forecast for interest rates issued in November which takes into account the increase in November. They stated that "The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides".

Period	Bank Rate	3 month LIBID	12 month LIBID	20-year Gilt Rate
Q4 2017	0.50	0.50	0.70	1.85
Q1 2018	0.50	0.50	0.70	1.85
Q2 2018	0.50	0.50	0.70	1.85
Q3 2018	0.50	0.50	0.70	1.85
Q4 2018	0.50	0.50	0.80	1.85
Q1 2019	0.50	0.50	0.80	1.90
Q2 2019	0.50	0.50	0.80	1.90
Q3 2019	0.50	0.50	0.80	1.95
Q4 2019	0.50	0.50	0.80	1.95
Q1 2020	0.50	0.50	0.80	2.00
Q2 2020	0.50	0.50	0.80	2.05
Q3 2020	0.50	0.50	0.80	2.05
Q4 2020	0.50	0.50	0.80	2.05

Borrowing

There has been no new borrowing in the first six months of the financial year. This is in line with the policy of using cash balances to fund capital expenditure which has resulted in no new borrowing being undertaken since 2007.

All of the Fire Authority's existing borrowing is from the Public Works Loan Board. The long term debt outstanding at the beginning of the year was £5.514m which has remained unchanged up to 30th September.

However, the viability of repaying the PWLB loans is reviewed on a regular basis. As a result a report was submitted to the Resources Committee on 27 September which provided information on the impact of repaying the loans. As a result the Committee agreed to pay off all loans that matured in the next 10 years. Subsequently on 5 October loans of £3.184m were repaid which incurred a premium charge of £0.636m. Therefore the outstanding PWLB balance was reduced to £2.330m. Of this £0.330m is due to mature in December 2017 and was not repaid as PWLB do not normally accept repayments for loans with less than one year to maturity. Therefore the estimated balance at the end of the financial year is £2m.

The table below show the maturity profile of the Authority's borrowings, along with an interest rate paid.

Loan Amount	Maturity Date	Interest rate
£0.330m	December 2017	4.10%
£0.650m	December 2035	4.49%
£0.650m	June 2036	4.49%
£0.700m	June 2037	4.48%

Investments

Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving low investment returns and having the value of reserves eroded by inflation.

The Authority principally invests in a call account provided by Lancashire County Council which pays the base rate. Each working day the balance on the Authority's Current Account is invested in this to ensure that the interest received on surplus balances is maximised. During the period all new investments were placed with the County Council via this arrangement. At 30th September there was a balance of £41.081m with the average balance invested in LCC for the period was £33.951m.

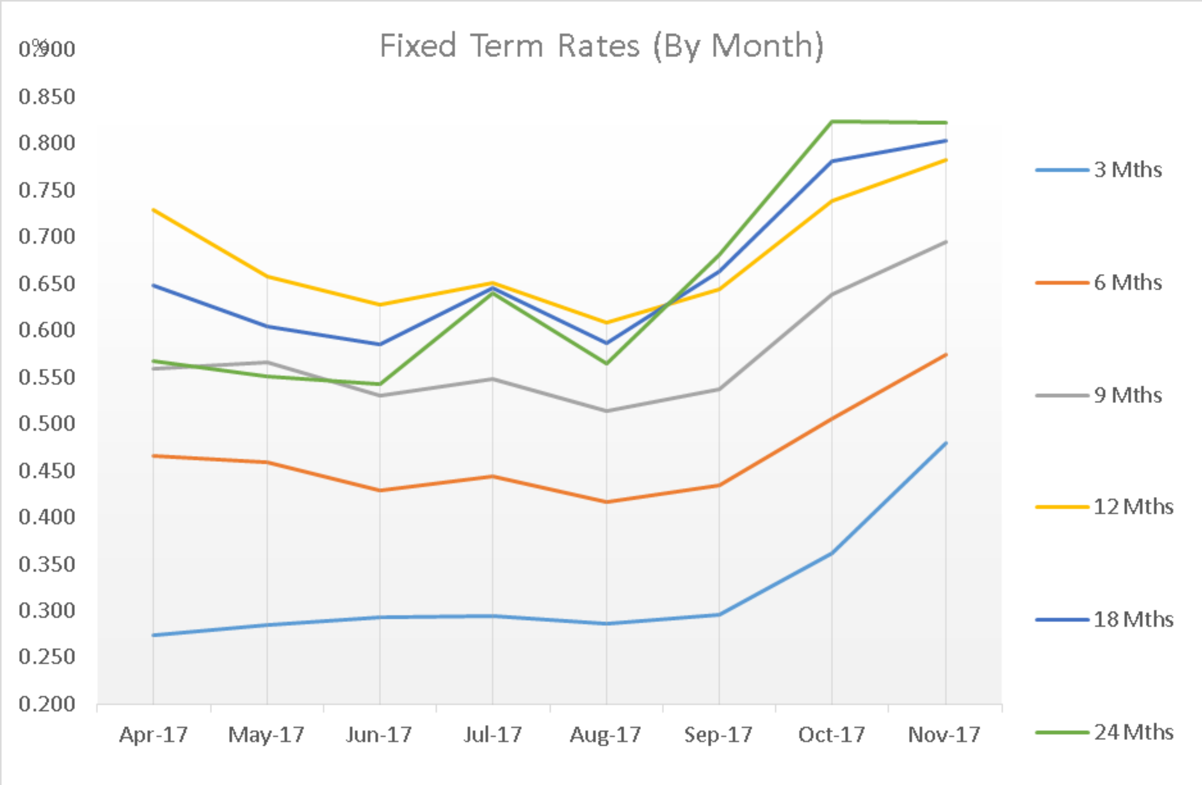
In addition the Authority has a long term investments that has been placed with UK local authority as outlined below. Another £5m investment matured in July and has been repaid.

Start Date	End Date	Principal	Rate	Annual Interest	Interest 2016/17
30/6/14	28/6/19	£5,000,000	2.4%	£120,000	£120,000

Therefore the total investment held at 30 September is £46.081m. As a result of the repayment of loans mentioned earlier the total level of investments reduced to £43.2m at 31 October 2017.

The overall the rate of interest earned during this period was 0.61% which compares favourably with the benchmark 7 day LIBOR index which averages 0.24% over the same period.

In order to increase the rate earned on current balances, the authority would need to place fixed investments for a longer period of time. The graph over the page shows the current fixed term rates available in the market; although with the limits on the credit rating of the counterparties in the Fire Strategy the rate available to the Authority may be slightly lower.



Attached at appendix 1 is a forecast cash flow for the year. This shows that further sums could be placed on fixed term investments. However, to obtain a better interest rate return than the call account would involve fixing investment for at least 6 months. This position is kept under constant review and suitable opportunities will be taken.

All investments are made in accordance with the current Treasury Management Strategy and the CIPFA treasury management code of practice.

Prudential Indicators

In order to control and monitor the Authority's treasury management functions, a number of prudential indicators are determined against which performance may be measured. The indicators for 2017/18 were approved by the Authority on 20th February 2017 are shown in the table over the page alongside the current actual.

	2017/18 PIs	Actual to 30.9.17
Adoption of the CIPFA Code of Practice for Treasury Management	Adopted	Adopted
Authorised limit for external debt	£m	£m
A prudent estimate of total external debt, which does not reflect the worst case scenario, but allows sufficient headroom for unusual cash movements		
Borrowing	7.800	5.514
Other long-term liabilities	15.000	14.638
Total	22.800	20.152
Operational boundary for external debt		
A prudent estimate of debt, but no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the Authority's current plans		
Borrowing	6.800	5.514
Other long-term liabilities	14.500	14.638
Total	21.300	20.152
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	10.9%
Upper limit for variable rate exposure		
Borrowing	25%	0%
Investments	100%	89.1%
Upper limit for total principal sums invested for over 364 days (per maturity date)	25.000	5.000
Maturity structure of debt	**Upper/ Lower Limits**	**Actual %**
Under 12 months	30% / nil	6.0
12 months and within 24 months	30% / nil	6.0
24 months and within 5 years	50% / nil	15.4
5 years and within 10 years	80% / nil	36.3
10 years and above	90% / nil	36.3

With the repayment of the PWLB loans the current maturity structure of the debt is:

Under 12 months 14.2%
Over 10 years 85.8%

Although these are within the current Prudential Indicators once the maturing loan is repaid in December then 100% of the debt will be over 10 years. Therefore it is recommended that approval is given to increase the Prudential Indicator for the upper limit for debt in excess of 10 years to 100%.

Regulatory Updates

The first half year saw work being undertaken on two areas namely moves towards the implementation of MiFID II and CIPFA consulting on changes to the Prudential and Treasury Management Codes.

MiFID II

Local authorities are currently treated by regulated financial services firms as professional clients who can “opt down” to be treated as retail clients instead. But from 3rd January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can “opt up” to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional, the Authority must have an investment balance of at least £10 million and the person authorised to make investment decisions on behalf of the Authority must have at least one year’s relevant professional experience. In addition, the firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The main additional protection for retail clients is a duty on the firm to ensure that the investment is “suitable” for the client. However, local authorities are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service whether they are retail or professional clients. It is also likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Authority meets the conditions to opt up to professional status and intends to do so in order to maintain their current MiFID status.

CIPFA Consultation on Prudential and Treasury Management Codes

The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to the Authority which will cover the basics of the capital programme and treasury management. The prudential indicators for capital expenditure and the authorised borrowing limit would be included in this report but other indicators may be delegated to another committee. There are plans to drop certain prudential indicators, however local indicators are recommended for ring fenced funds (including the HRA) and for group accounts. Other proposed changes include applying the principles of the Code to subsidiaries.

Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of “investments” as well as loans made or shares brought for service purposes. Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee rather than needing approval of the full Authority. There are also plans to drop or alter some of the current treasury management indicators.

CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year. The Department of Communities and Local Government (DCLG) and CIPFA wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical. It is understood that DCLG will be revising its Investment Guidance (and its MRP guidance) for local authorities in England; however there have been no discussions with the devolved administrations yet.

Financial Implications

Included within report above

Human Resource Implications

None

Equality and Diversity Implications

None

Business Risk Implications

The Treasury Management strategy is designed to minimise the Authority's financial risk associated with investment decisions, whilst maximising the return on any investments made. As such the adoption of the CIPFA's Code of Practice on Treasury Management and the monitoring arrangements in place ensure that any risks faced by the Authority are managed.

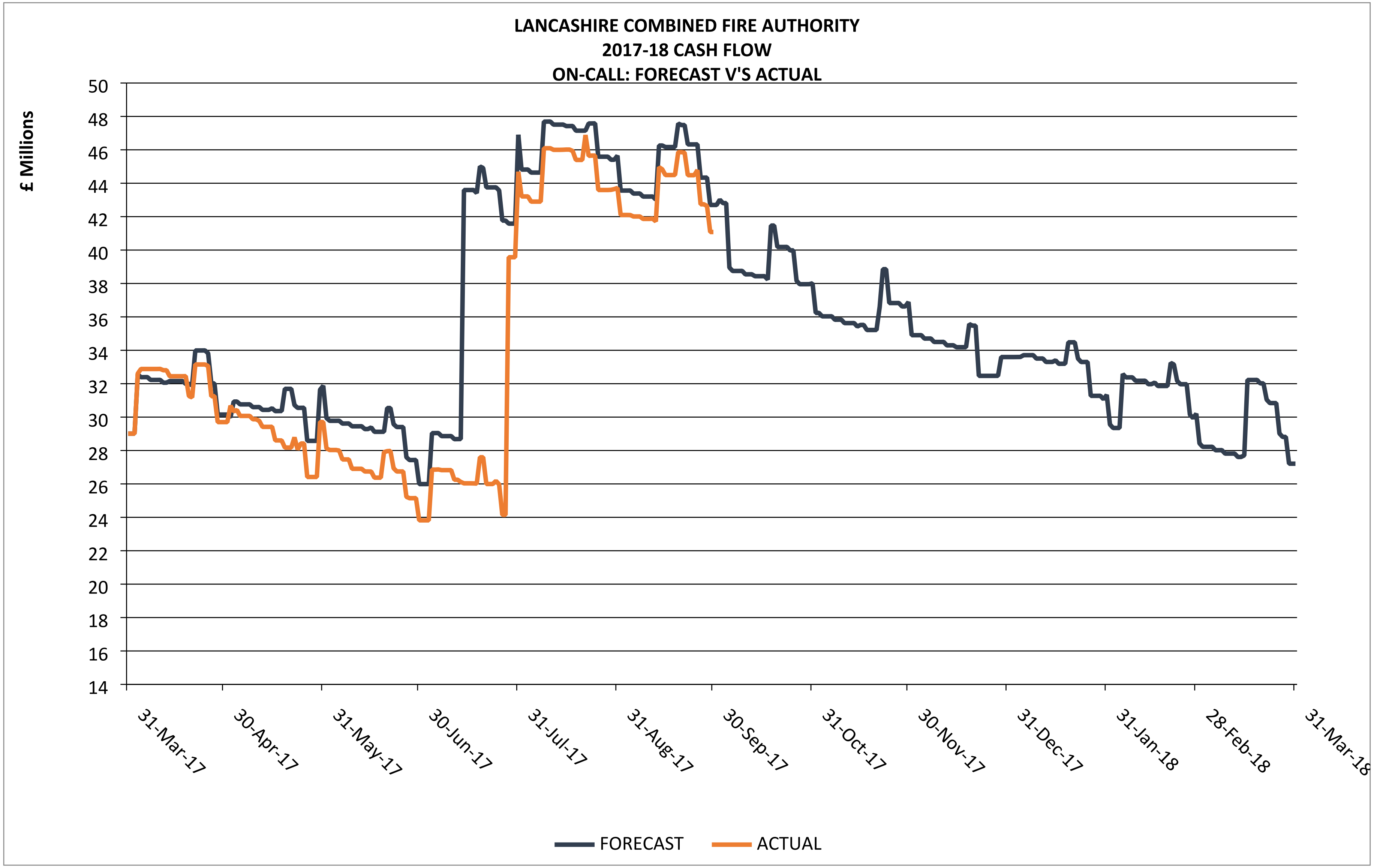
However, it must be acknowledged that there will always be a balance between risk and return and hence the strategy does not completely eliminate the risk of any further default on investments in the future.

Environmental Impact
None

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact
Treasury Management Strategy 2017/18	February 2017	Keith Mattinson, Director of Corporate Services
Reason for inclusion in Part II, if appropriate:		

APPENDIX 1


LANCASHIRE COMBINED FIRE AUTHORITY
2017-18 CASH FLOW
ON-CALL: FORECAST V'S ACTUAL
£ Millions
50
48
46
44
42
40
38
36
34
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28
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18
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31-Mar-17
30-Apr-17
31-May-17
30-Jun-17
31-Jul-17
31-Aug-17
30-Sep-17
31-Oct-17
30-Nov-17
31-Dec-17
31-Jan-18
28-Feb-18
31-Mar-18
FORECAST
ACTUAL