LANCASHIRE COMBINED FIRE AUTHORITY
RESOURCES COMMITTEE
Meeting to be held on 21 May 2018

YEAR END TREASURY MANAGEMENT OUTTURN 2017/18
(Appendix 1 refers)

Contact for further information:
Keith Mattinson - Director of Corporate Services – Telephone Number 01772 866804

Executive Summary

The report sets out the Authority's borrowing and lending activities during 2017/18. All borrowing and investment activities undertaken throughout the year are in accordance with the Treasury Management Strategy 2017/18, and are based on anticipated spending and interest rates prevailing at the time.

Recommendation

The Resources Committee is asked to note and endorse the outturn position report.

Information

In accordance with the updated CIPFA Treasury Management code of practice 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 Director of Corporate Services and the content of these reports is used as a basis for this report to the Committee.

Economic Overview

Treasury Management activity is influenced by the actual and forecast economic position. During 2017/18 the UK economy showed signs of slowing economic growth with latest estimates showing GDP grew by 1.8% in calendar 2017, the same level as in 2016. Although this was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, it reflected the impact of the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

The year saw an increase in inflation with the Consumer Prices Index (CPI) rising to 3.1% in November partly due to the impact of the falling exchange rate before falling back to 2.7% in February 2018. Data on the unemployment rate was positive with the rate falling to 4.3% in January. However there still remained concerns over the strength of the economy. Average real earnings growth, i.e. after inflation, turned negative before slowly recovering which indicates a potential weakness in consumer spending an important source of economic growth. Also, there is a weakness in UK business investment which was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit. Although the UK and the EU reached an agreement in March 2018 on a transition which will go up to Q4 2020 there is still significant uncertainty over the long term trade arrangements.

With concerns over inflation being above its target The Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 0.25% in November 2017. This was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February Inflation Report indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 months) horizon and indicated there would be 'gradual' and 'limited' increases in rates.

However, there is still uncertainty in the economy which could impact on the policy. The imposition of tariffs on a broadening range of goods initiated by the US, which has led to retaliation by China, could escalate into a deep-rooted trade war having broader economic consequences including inflation rising rapidly, warranting more interest rate hikes.

Credit background:

The rules for UK banks' ring-fencing were finalised by the Prudential Regulation Authority and banks began the complex implementation process ahead of the statutory deadline of 1st January 2019. Under these rules the largest UK banks will be required to separate their retail banking services to individuals and small businesses from their investment banking activities with the retail bank being referred to as the ring fenced bank. As there was some uncertainty surrounding which banking entities the Authority would be dealing with once ring-fencing was implemented and what the balance sheets of the ring-fenced and non ring-fenced entities would actually look like, in May 2017 Arlingclose advised adjusting downwards the maturity limit for unsecured investments to a maximum of 6 months. The rating agencies had slightly varying views on the creditworthiness of the restructured entities.

Barclays was the first to complete its ring-fence restructure over the 2018 Easter weekend; wholesale deposits including local authority deposits will henceforth be accepted by Barclays Bank plc (branded Barclays International), which is the non ring-fenced bank.

Credit Rating developments

The most 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.

Other developments:

In February, Arlingclose advised against lending to Northamptonshire County Council (NCC). NCC issued a section 114 notice in the light of severe financial challenge and the risk that it would not be in a position to deliver a balanced budget. This guidance has now been revised to "Arlingclose is now comfortable with clients lending to

Northamptonshire County Council for treasury management purposes for a maximum duration of 12 months"

Interest Rate Environment

Short term interest rates continue to be at historically very low levels. As referred to above 2017/18 saw the first increase in interest rates for a decade when in November the base rate was increased to 0.5% from 0.25%. The expectation during the year was that interest rates would remain low for the rest of the financial year and beyond. It is anticipated that although rates may increase they will remain at low levels. Lancashire County Council's Treasury Management advisors, Arlingclose Treasury Consultants, are forecasting two small increases in 2018/19 with base rates being at 1% in March 2019.

Cash Flow

Cash flow predictions are made on a rolling basis in order to ensure that the Authority has sufficient funds to meet its day to day requirements and also inform investment and borrowing decisions.

The cash flow position, along with the interest rate environment, form part of the regular discussions between the Director of Corporate Services and the Lancashire County Council Treasury Management Team, in order to inform future decisions on borrowing and investments.

Borrowing

All of the Fire Authority's debt is held with the Public Works Loans Board (PWLB). The Fire Authority has had a policy setting aside monies in the form of statutory and voluntary minimum revenue provision (MRP) in order to repay debt as it matures or to make an early repayment. Early repayments would be made only if it is deemed to be a financially prudent decision after taking into account the penalties incurred from an early repayment. In line with this policy £0.330m of debt was repaid on maturity and a further £3.184m of debt was repaid early following a report to the resources committee on the 27 September 2017. The early repayment of the loans incurred a penalty of £0.636m which was financed from the earmarked reserve. No new borrowing was undertaken in the year therefore the borrowing position is:

	2017/18
	£'000
Borrowing at 31 March 2017	5,514
Repayment of Maturing Debt	330
Early repayment of debt	3,184
Borrowing at 31 March 2018	**2,000**

The maturity and interest rate of the Authority's outstanding borrowing is:

Loan amount	Maturity Date	Interest rate
£650k	December 2035	4.49%
£650k	June 2036	4.49%
£700k	June 2037	4.48%

Total interest paid on PWLB borrowing was £0.176m, which equates to an average interest rate of 4.50%. This Includes the interest paid on the debt repaid during the year.

A further review of the remaining debt was undertaken February 2018. At the time it was concluded that the penalty charge was too high to justify paying off the loan or restructuring it. The position will continue to be reviewed.

Investments

Both the CIPFA Code and the DCLG 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. Throughout the year when investing money the key aim was to strike an appropriate balance between risk and return.

In order to reduce credit risk to the Authority, Lancashire County Council (credit rating by Moodys Aa3) is the main counterparty for the Authority's investments via the operation of a call account. However the Treasury Management Strategy does include other high quality counterparties. In accordance with this policy, long term investments with other UK local authorities have been held. In July 2017 a 3 year investment matured while at year end a long-term investment is still held. Details are as outlined below:

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

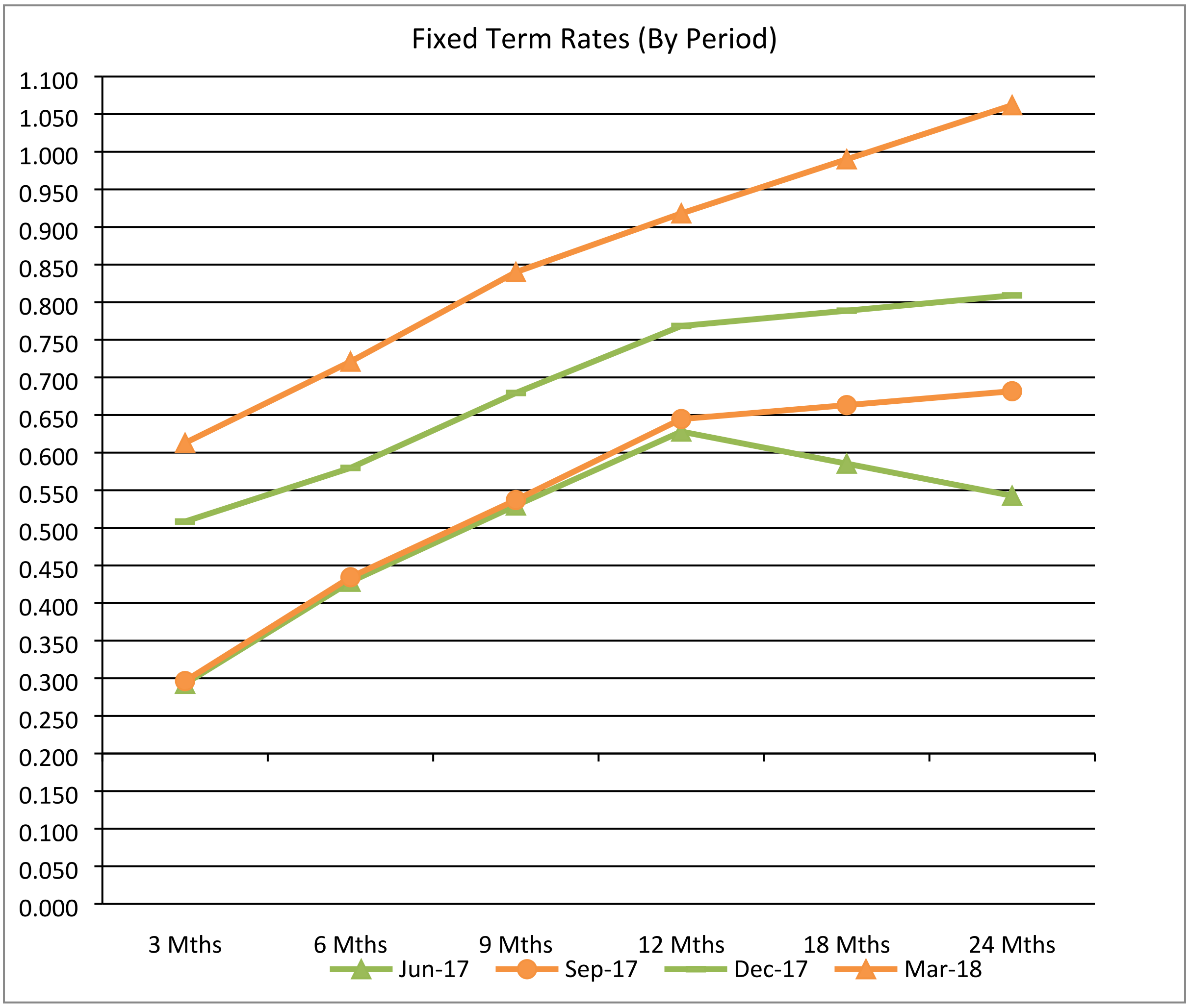
The call account provided by Lancashire County Council paid the base rate throughout 2017/18. Each working day the balance on the Authority's current account is invested in this to ensure that the interest received on surplus balances is maximised. As at 31 March the Authority had £28.6m in the call account, with an average balance during the year of £34.2m earning interest of £0.120m.

Total investment held at the start and end of the year were:-

	Call Account	Fixed Term Deposit	Total
1 April 2017	£29.1m	£10.0m	£39.1m
Change in Year	(£0.5m)	(£5.0m)	(£5.5m)
31 March 2018	£28.6m	£5.0m	£33.6m

The overall interest earned during this period was £0.240m at a rate of 0.61% which compares favourably with the benchmark 7 day notice index which averages 0.35% over the same period.

The chart below shows the interest rates for different investment maturities during the year. Although indicative of the rates available they might have been offered by lenders who do not meet the credit rating criteria of the Authority's policy but it does illustrate that higher rates could potentially be achieved if longer term investments, were undertaken.



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

Cash flow and interest rates continue to be monitored by the Director of Corporate Services and the County Council's treasury management team, and when rates are felt to be at appropriate levels further term deposits will be placed.

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 revised indicators for 2017/18 are shown in the table over the page alongside the actual outturn position.

	Revised	Actual
Adoption of the CIPFA Code of Practice for Treasury Management	Adopted	Adopted
Authorised limit for external debt	£000	£000
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	2,000
Other long-term liabilities – these relate to vehicle finance leases and the PFI agreements	15,400	14,316
Total	23,200	16,316
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	2.000
Other long-term liabilities – these relate to vehicle finance leases and the PFI agreements	14,500	14,316
Total	21,300	16,316
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	15%
Upper limit for variable rate exposure		
Borrowing	25%	-
Investments	100%	85%
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	100%/nil	-
12 months and within 24 months	30%/nil	-
24 months and within 5 years	50%/nil	-
5 years and within 10 years	50%/nil	-
10 years and above	100%/nil	100.0

Financial Implications

The following table summarises the Financing costs for the Authority, comparing actual with budget:-

	Revised Budget £m	Actual £m	Reason for variance
Interest Payable on PWLB loans	0.251	0.176	Repaid all but £2m loans during the year
Interest Receivable on call account and fixed term investments	(0.186)	(0.256)	Higher cash balances than forecast, favourable interest rates
Minimum Revenue Provision re PWLB loans	0.058	0.058	In line with revised budget
Net financing income from Treasury Management activities*	0.123	(0.022)	

* There are financing costs associated with vehicle finance leases and the PFI agreements, which are not included in the balances above as they are not the result of Treasury Management activities.

Human Resource Implications

None

Equality and Diversity Implications

None

Business Risk Implications

The Treasury Management Strategy is designed to maximise interest earned, minimise interest paid whilst maintaining an acceptable level of risk. The reviews of performance provide members with an assurance that this has been complied with.

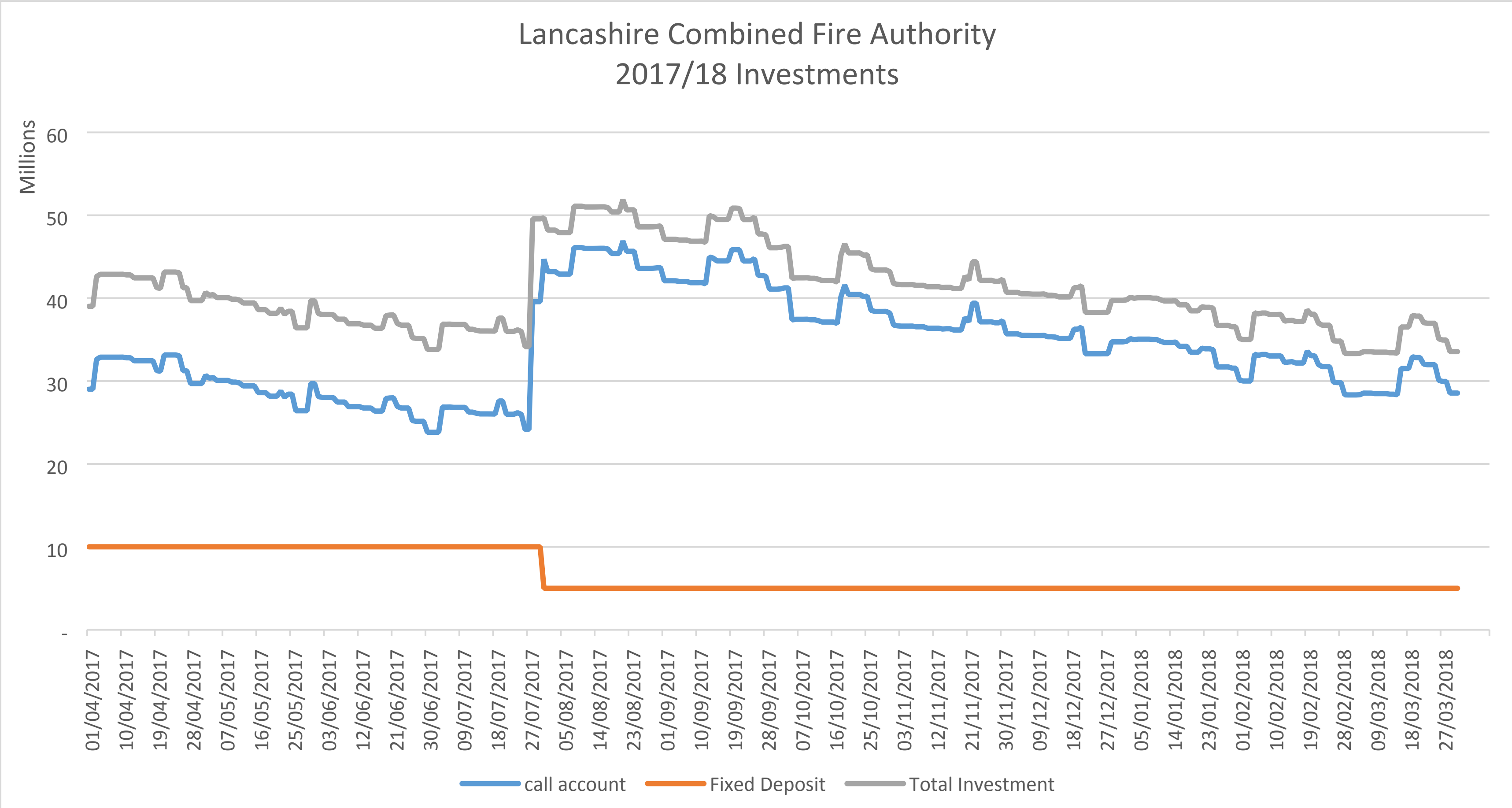
Environmental Impact

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
Treasury Management Guidance	February 2017	Keith Mattinson, Director of Corporate Services
Reason for inclusion in Part II, if appropriate:		

Appendix 1


Lancashire Combined Fire Authority
2017/18 Investments
Millions
60
50
40
30
20
10
-
01/04/2017
10/04/2017
19/04/2017
28/04/2017
07/05/2017
16/05/2017
25/05/2017
03/06/2017
12/06/2017
21/06/2017
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30/11/2017
09/12/2017
18/12/2017
27/12/2017
05/01/2018
14/01/2018
23/01/2018
01/02/2018
10/02/2018
19/02/2018
28/02/2018
09/03/2018
18/03/2018
27/03/2018
call account
Fixed Deposit
Total Investment