

# **BRIDGEND COUNTY BOROUGH COUNCIL**

## **REPORT TO AUDIT COMMITTEE**

**15 NOVEMBER 2018**

### **REPORT OF THE INTERIM HEAD OF FINANCE & SECTION 151 OFFICER**

#### **TREASURY MANAGEMENT – HALF YEAR REPORT 2018-19**

##### **1. Purpose of the Report**

- 1.1 The purpose of the report is to update Audit Committee on the mid-year review and half year outturn position for treasury management activities, Treasury Management and Prudential Indicators for 2018-19 and to highlight the compliance with the Council's policies and practices which have been reported to Cabinet and Council.

##### **2. Connection to Corporate Improvement Objectives/Other Corporate Priorities**

- 2.1 This report assists in the achievement of the following corporate priority:
- Smarter use of resources – ensuring that all its resources (financial, physical, human and technological) are used as effectively and efficiently as possible and support the development of resources throughout the community that can help deliver the Council's priorities.
- 2.2 The work of the Audit Committee supports corporate governance and assists in the achievement of all corporate and service objectives. Prudent treasury management arrangements will ensure that investment and borrowing decisions made by officers on behalf of the Council's smarter use of financial resources and hence assist achievement of Corporate Priorities.

##### **3. Background**

- 3.1 To ensure effective scrutiny of treasury management in accordance with the Treasury Management Strategy (TMS), Audit Committee has been nominated to be responsible for ensuring effective scrutiny of the TMS and policies. During the 2018-19 financial year to date, in addition to the regular treasury management reports to Cabinet and Council, Audit Committee received the Annual Treasury Management Outturn Report 2017-18 in June 2018.
- 3.2 The Council's treasury management activities are regulated by the Local Government Act 2003 which provides the powers to borrow and invest as well as providing controls and limits on this activity. The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 as amended, develops the controls and powers within the Act. This requires the Council to undertake any borrowing activity with regard to the Chartered Institute of Public Finance and

Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities and to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services.

- 3.3 The Council is required to operate the overall treasury function with regard to the Code and this was formally adopted by the Council in February 2012. This includes a requirement for the Council to approve a TMS before the start of each financial year which sets out the Council's and Chief Financial Officer's responsibilities, delegation, and reporting arrangements. Council approved the TMS 2018-19 on 28 February 2018. CIPFA published new editions of Treasury Management in the Public Services: Code of Practice and the Prudential Code for Capital Finance in Local Authorities in late December 2017 however the TMS 2018-19 and this report have been produced using the 2011 Codes.
- 3.4 The Welsh Government (WG) issued revised Guidance on Local Authority Investments in April 2010, which requires the Council to approve an Investment Strategy prior to the start of each financial year and this is included in the TMS.
- 3.5 In March 2018, the Welsh Government also published an amendment to the Local Authorities (Capital Finance and Accounting) (Wales) Regulations which enables the Council to invest in certain instruments which were previously treated as capital expenditure (for example Money Market Funds (MMF)) without the potential revenue cost of Minimum Revenue Provision (MRP) and without the proceeds from sale being considered a capital receipt.

#### **4. Current Situation/Proposal**

- 4.1 The Council has complied with its legislative and regulatory requirements during the first half of 2018-19. The TMS 2018-19 and the Half Year Outturn were reported to Council on 28 February and 24 October 2018 respectively. In addition, a quarterly monitoring report was presented to Cabinet in July 2018.
- 4.2 A summary of the treasury management activities for the first half of 2018-19 is shown in **Appendix A**. The Council has not taken long term borrowing since March 2012 and it is not expected that there will be a requirement for any new long term borrowing in 2018-19, however for cash-flow purposes short term borrowing will be taken and £3 million short term borrowing was taken and repaid between 1 April and 30 September 2018 as detailed in section 3 in **Appendix A**. Favourable cash flows have provided surplus funds for investment and the balance on investments at 30 September 2018 was £34.30 million with an average rate of interest of 0.81%. The first table in section 4 in **Appendix A** details the movement of the investments by counterparty types and shows the average balances, interest received, original duration and interest rates for the first half of 2018-19.
- 4.3 As previously reported to Cabinet and Council in 2017-18, the Council opened a MMF in August 2017 which is an approved financial instrument in the TMS and provides instant access to the funds. The Council set up additional MMF's

in September 2018 (all approved by the Council's treasury management advisors Arlingclose) and also set up a web based portal (at no cost to the Council) to simplify and introduce efficiencies to all aspects of MMFs, from account maintenance through to trading and reporting. The new MMF's and the portal application process were not finalised by 30 September 2018 but will be in use once this is confirmed.

- 4.4 The 2011 Treasury Management Code and Prudential Code require the Council to set and report on a number of Treasury Management and Prudential Indicators. The indicators either summarise the expected activity or introduce limits upon the activity, and reflect the underlying capital programme. Details of the estimate for 2018-19 set out in the Council's TMS and also the projected indicators for 2018-19 are shown in section 6 in **Appendix A** and these show that the Council is operating in line with the approved limits.
- 4.5 The Council defines high credit quality as organisations and securities having a credit rating of A- or higher and **Appendix B** shows the equivalence table for credit ratings for Fitch, Moody's and Standard & Poor's and explains the different investment grades.
- 4.6 CIPFA's Code of Practice for Treasury Management requires all local authorities to conduct a mid-year review of its treasury management policies, practices and activities. As a result of this review it was not deemed necessary to make any major changes to the TMS 2018-19, although Council approved a revised MRP policy for 2018-19 on 19 September 2018 as detailed in section 5 in **Appendix A** and also in **Appendix C**.

## **5. Effect upon Policy Framework & Procedure Rules**

- 5.1 As required by Financial Procedure Rule 20.3 within the Council's Constitution, all investments and borrowing transactions have been undertaken in accordance with the TMS 2018-19 as approved by Council with due regard to the requirements of the CIPFA's Code of Practice on Treasury Management in the Public Services.

## **6. Equality Impact Assessment**

- 6.1 There are no equality implications.

## **7. Well-being of Future Generations (Wales) Act 2015 Implications**

- 7.1 The well-being goals identified in the Act were considered in the preparation of this report. As the report is for information only and is retrospective in nature it is considered that there will be no significant or unacceptable impacts upon the achievement of well-being goals/objectives as a result of this report.

## **8. Financial Implications**

8.1 The financial implications are reflected within the report.

## **9. Recommendation**

9.1 It is recommended that the Committee:

- Note the treasury management activities for 2018-19 for the period 1 April 2018 to 30 September 2018 and the projected Treasury Management and Prudential Indicators for 2018-19 which were all reported to Council on 24 October 2018.

**Gill Lewis**

**Interim Head of Finance and Section 151 Officer**

**24 October 2018**

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### **Background documents:**

Treasury Management Strategy 2018-19

**SUMMARY OF TREASURY MANAGEMENT ACTIVITIES  
01 APRIL 2018 TO 30 SEPTEMBER 2018**

**1. External Debt and Investment Position 1 April to 30 September 2018**

- 1.1 The Council's external debt and investment position for 1 April to 30 September 2018 is shown below in table 1; more detail is provided in section 3 the Borrowing Strategy and Outturn and section 4 the Investment Strategy and Outturn:

**Table 1: Council's external debt and investments 1 April to 30 September 2018**

|   | <b>Principal<br/>01-04-18<br/>£m</b> | <b>Average<br/>Rate<br/>01-04-18<br/>%</b> | <b>Principal<br/>30-09-18<br/>£m</b> | <b>Average<br/>Rate<br/>30-09-18<br/>%</b> |
|---|--------------------------------------|--|--------------------------------------|--|
| <b>External Long Term Borrowing:</b>      |                                      |  |                                      |  |
| Public Works Loan Board                   | 77.62                                | 4.70                                       | 77.62                                | 4.70                                       |
| Lender's Option Borrower's Option         | 19.25                                | 4.65                                       | 19.25                                | 4.65                                       |
| <b>Total External Borrowing</b>           | <b>96.87</b>                         | <b>4.69</b>                                | <b>96.87</b>                         | <b>4.69</b>                                |
| <b>Other Long Term Liabilities (LTL):</b> |                                      |  |                                      |  |
| Private Finance Initiative (PFI)*         | 17.64                                |  | 17.32                                |  |
| Llynfi Loan**                             | 2.40                                 |  | 2.40                                 |  |
| Other LTL                                 | 0.98                                 |  | 0.93                                 |  |
| <b>Total Other Long Term Liabilities</b>  | <b>21.02</b>                         |  | <b>20.65</b>                         |  |
| <b>Total Gross External Debt</b>          | <b>117.89</b>                        |  | <b>117.52</b>                        |  |
| <b>Treasury Investments:</b>              |                                      |  |                                      |  |
| Banks                                     | 7.40                                 | 0.58                                       | 8.00                                 | 0.85                                       |
| Building Societies                        | 2.00                                 | 0.54                                       | 1.00                                 | 0.80                                       |
| Local Authorities                         | 21.00                                | 0.64                                       | 23.00                                | 0.80                                       |
| Money Market Fund***                      | -                                    | -  | 2.30                                 | 0.69                                       |
| <b>Total Treasury Investments</b>         | <b>30.40</b>                         | <b>0.62</b>                                | <b>34.30</b>                         | <b>0.81</b>                                |
| <b>Net Debt</b>                           | <b>87.49</b>                         |  | <b>83.22</b>                         |  |

\* (PFI) arrangement for the provision of a Secondary School in Maesteg 15.50 years remaining term

\*\* Loan from the WG Central Capital Retained Fund for regeneration works within the Llynfi Valley which has not yet commenced

\*\*\*the fund provides instant access

- 1.2 Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the WG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, or as equity investments and loans to the Council's subsidiaries. Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with the TMS. The Council's existing non-treasury investments relate to investment properties and

the balance as at 31 March 2018 was £4.36 million.

- 1.3 It should be noted that the accounting practice required to be followed by the Council requires financial instruments in the accounts (debt and investments) to be measured in a method compliant with International Financial Reporting Standards (IFRS). The figures shown in the above table and throughout the report are based on the actual amounts borrowed and invested and so may differ from those in the Statement of Accounts, which include accrued interest or are stated at fair value in different instances.
- 1.4 The Council's treasury management advisors are Arlingclose. The current services provided to the Council include:-
- advice and guidance on relevant policies, strategies and reports
  - advice on investment decisions
  - notification of credit ratings and changes
  - other information on credit quality
  - advice on debt management decisions
  - accounting advice
  - reports on treasury performance
  - forecasts of interest rates
  - training courses

## **2. External Context**

- 2.1 The interest rate views incorporated in the Council's TMS 2018-19, were based upon officers' views supported by a selection of City forecasts provided by Arlingclose. When the TMS 2018-19 was prepared in January 2018 it was forecast that the Bank Rate would remain at 0.50% during 2018-19.
- 2.2 The Bank Rate started the financial year at 0.50% and remained at that rate until 2 August 2018 when the Bank of England's Monetary Policy Committee (MPC) increased the rate by 0.25% to 0.75%. The current forecast is that there will be a further 0.25% increase in the Bank Rate by March 2019 reaching 1% by the end of 2018-19.

## **3. Borrowing Strategy and Outturn for 1 April to 30 September 2018**

- 3.1 The Council's primary objective for the management of its debt is to ensure its long term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board (PWLB) at long term fixed rates of interest.
- 3.2 With short-term interest rates lower than long term rates, it is likely to be more cost effective in the short term to either borrow short term loans or use internal resources. Short term and variable rate loans expose the Council to the risk of short term interest rate rises and are therefore subject to the limit on the net

exposure to variable interest rates as shown in the treasury management indicators in section 6. However, with long term rates forecast to rise in the coming years, any such short term savings will need to be balanced against the potential longer-term costs. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis.

- 3.3 The £19.25 million in table 1 above relates to Lender's Option Borrower's Option (LOBO) loans which have a maturity date of 2054, however these may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, the lender exercising their option to increase rates at one of the bi-annual trigger points and therefore the Council being given the option to accept the increase or to repay the loan without incurring a penalty. The next trigger point is 22 January 2019 and the lender is not expected to exercise this option (given the current low interest rate environment) however, an element of refinancing risk remains. Following advice from Arlingclose, the Council approached the LOBO's lender for potential repayment options in 2017-18 but the premium was deemed too excessive to action but the Council would take the option to repay these loans at no cost if it has the opportunity to do so in the future.

The current average interest rate for these LOBO's is 4.65% compared to the PWLB Loans average interest rate of 4.70%.

- 3.4 The last time the Council took long term borrowing was £5 million from the PWLB in March 2012 and it is not expected that there will be a requirement for any new long term borrowing in 2018-19, however for cash-flow purposes short term borrowing will be taken and £3m million short term borrowing was taken and repaid between 1 April and 30 September 2018. Market conditions have meant that there has been no loan rescheduling so far this year however, in conjunction with Arlingclose, the loan portfolio will continue to be reviewed for any potential savings as a result of any loan rescheduling.
- 3.5 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This is known as Internal Borrowing. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

#### **4. Investment Strategy and Outturn 1 April to 30 September 2018**

- 4.1 Both the CIPFA Code and the WG Guidance require the Council 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 Council's objective when investing money is to strike an appropriate balance between risk and return, balancing the risk of incurring losses from defaults against receiving unsuitably low investment income.

The major objectives during 2018-19 are:-

- To maintain capital **security**
- To maintain **liquidity** so funds are available when expenditure is needed
- To achieve the **yield** on investments commensurate with the proper levels of security and liquidity

- 4.2 The Annual Investment Strategy incorporated in the Council's TMS 2018-19 includes the credit ratings defined for each category of investments and the liquidity of investments. The Council's investments have historically been placed in short term bank and building society unsecured deposits and local and central government, however, investments may be made with any public or private sector organisations that meet the minimum credit criteria specified in the Investment Strategy and any new instruments used will be in full consultation with Arlingclose.
- 4.3 Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's to ensure that this lies within our agreed minimum credit rating. **Appendix B** shows the equivalence table for these published ratings and explains the different investment grades. Where available the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. In the current climate, relying mainly on credit ratings is considered to be inappropriate and the Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard is therefore given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.
- 4.4 On a day to day basis, the Council potentially has positive cash balances arising from the cash flow e.g. timing differences between grants being received and making various payments. These are invested on the market via brokers, direct with the institution or held in deposit accounts or a money market fund with instant access. The Council usually invests for a range of periods dependent on cash flow requirements and the interest rates on offer having regard to the Investment Strategy.
- 4.5 The Council's primary objective for the management of its investment portfolio is to give priority to the security and liquidity of its funds before seeking the best rate of return. As shown in the tables below, the majority of investments have been held as short term investments with UK Local Authorities and banks of high credit quality. This has therefore resulted in more of the investment



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portfolio being moved into investment instruments with lower rates of return but higher security and liquidity.

- 4.6 Occasionally, investments are placed with the UK Debt Management Office (DMO - Executive Agency of UK Government) but only for very short term deposits and after all other options have been explored. The interest rates offered by this facility are lower than most other counterparties but this is commensurate with the high level of security and reduced risk offered. It provides another option when examining potential investments and ensures compliance with the Council's investment objective that security takes priority over yield. There were no deposits outstanding at 30 September 2018.
- 4.7 Favourable cash flows have provided positive cash balances for investment and the balance on investments at 30 September 2018 was £34.30 million as shown in Table 2 below which details these investments by counterparty type.

**Table 2: Investments Profile 1 April to 30 September 2018**

| Investment Counterparty Category     | Balance 01 April 2018 | Investments Raised | Investments Repaid | Balance 30 Sept 2018 | Interest Received ** | Average Original Duration of the Investment | Weighted Average Investment Balance Apr - Sept 2018 | Weighted Average Interest Rate Apr-Sept 2018 |
|--------------------------------------|-----------------------|--------------------|--------------------|----------------------|----------------------|---|---|--|
|                                      | (A)                   | (B)                | (C)                | (A+B-C)              |                      |   |   |  |
|                                      | £m                    | £m                 | £m                 | £m                   | £'000                | Days  | £m  | %  |
| Government DMO                       | -                     | 41.80              | 41.80              | -                    | 1.58                 | 5   | 1.02  | 0.31   |
| Local Authorities                    | 21.00                 | 95.60              | 93.60              | <b>23.00</b>         | 65.99                | 148   | 29.32   | 0.65   |
| Building Societies                   | 2.00                  | 6.00               | 7.00               | <b>1.00</b>          | 11.01                | 99  | 2.40  | 0.63   |
| Banks (Fixed Maturity)               | 5.00                  | 8.00               | 9.00               | <b>4.00</b>          | 33.46                | 209   | 5.82  | 0.66   |
| Banks Instant Access/Notice Period * | 2.40                  | 58.48              | 56.88              | <b>4.00</b>          | 9.62                 | n/a   | 4.40  | 0.52   |
| Money Market Fund (Instant Access)*  | -                     | 6.60               | 4.30               | <b>2.30</b>          | 4.68                 | n/a   | 1.94  | 0.58   |
| <b>Total/Average</b>                 | <b>30.40</b>          | <b>216.48</b>      | <b>212.58</b>      | <b>34.30</b>         | <b>126.34</b>        | <b>115</b>                                  | <b>44.90</b>  | <b>0.63</b>                                  |

\* An average duration is not shown as there is no original duration as instant access or notice period and money is added and withdrawn to/from these accounts as required by cash-flow

\*\* Received in the Council's bank account not interest earned

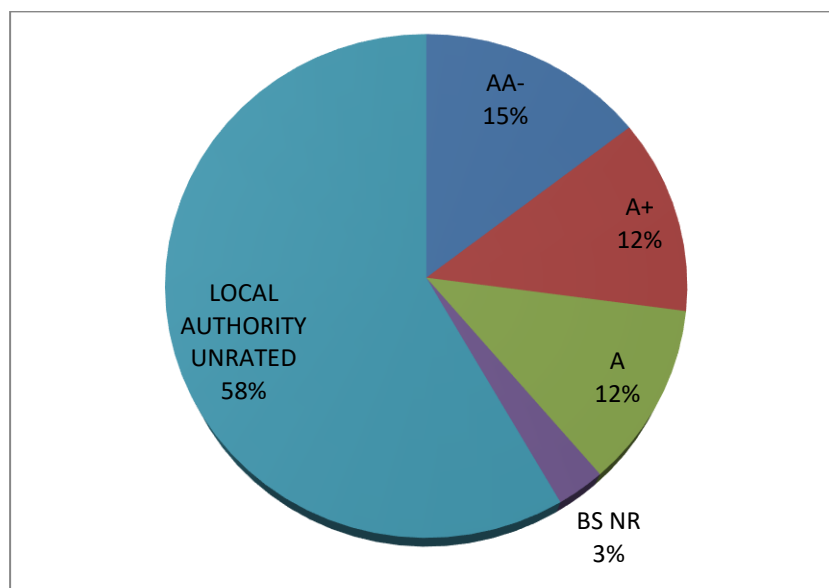
- 4.8 There were four long term investments (original duration of 12 months or more) outstanding at 30 September 2018 totalling £9 million with Local Authorities shown in table 3 below. £5 million maturing in 2019-20 and £4 million maturing in 2020-21. All other investments at 30 September 2018 were short term deposits (including instant access and notice accounts). Table 3 below details

these investments by counterparty type based on the remaining maturity period as at 30 September 2018:

**Table 3: Investments Outstanding Maturity Profile 30 September 2018**

| Counterparty Category | Instant Access<br>£m | Deposits Maturing Within 1 Month<br>£m | Deposits Maturing Within 2-3 Months<br>£m | Deposits Maturing Within 4-12 Months<br>£m | Deposits Maturing Within 1-2 Years<br>£m | Deposits Maturing Within 2-3 Years<br>£m | Total<br>£m  |
|-----------------------|----------------------|--|---|--|--|--|--------------|
| Local Authorities     | -                    | 8.00                                   | 1.00                                      | 5.00                                       | 5.00                                     | 4.00                                     | 23.00        |
| Building Societies    | -                    | -                                      | 1.00                                      | -  | -  | -  | 1.00         |
| Banks                 | -                    | -                                      | 4.00                                      | 4.00                                       | -  | -  | 8.00         |
| Money Market Fund     | 2.30                 | -                                      | -   | -  | -  | -  | 2.30         |
| <b>Total</b>          | <b>2.30</b>          | <b>8.00</b>                            | <b>6.00</b>                               | <b>7.00</b>                                | <b>5.00</b>                              | <b>4.00</b>                              | <b>34.30</b> |

- 4.9 The Council defines high credit quality as organisations and securities having a credit rating of A- or higher. The pie chart below summarises the above table by credit ratings and shows the £34.30 million investments at 30 September 2018 by percentage outstanding. Most Local Authorities do not have credit ratings and the unrated building society (shown as 'BS NR' below) was approved by Arlingclose whilst the remainder of our investments all had a credit rating of A or above.



- 4.10 The Council participates in a benchmarking exercise with Arlingclose and the Council's average rate of return on investments at the end of each quarter in 2018-19 is shown below. At 30 September 2018, the Council's average rate of return was more favourable than the average of Arlingclose Welsh Local Authorities Unitary clients:

| 2018-19  | Bridgend CBC<br>Average Rate of<br>Return on Investments | Arlingclose Welsh Local<br>Authorities Clients<br>Average Rate of<br>Return on Investments |
|----------|--|--|
| 30-06-18 | 0.65%  | 0.69%  |
| 30-09-18 | 0.81%  | 0.70%  |

## 5. Review of the Treasury Management Strategy 2018-19

- 5.1 CIPFA's Code of Practice for Treasury Management requires all local authorities to conduct a mid-year review of its treasury management policies, practices and activities. As a result of this review it was not deemed necessary to make any major changes to the TMS 2018-19, although Council approved a revised MRP policy for 2018-19 on 19 September 2018.
- 5.2 Under regulation 21 of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003, local authorities are required to charge MRP to their revenue account for each financial year to account for the principal cost of their debt in that financial year. The revised MRP policy for 2018-19 amends the method of calculating a prudent annual amount to charge to revenue to repay capital financing costs. The revision of the MRP Policy 2018-19 for calculating MRP on capital expenditure funded from supported borrowing has resulted in a change from a 4% reducing balance method to a straight-line method over 45 years and a revised MRP Statement is shown in Appendix C. The figures in Appendix B have been revised to reflect a minor change from the report approved by Council to reflect the more up to date information available and a minor accounting adjustment in 2018-19.

## 6. Treasury Management and Prudential Indicators 2018-19

Details of the estimate for 2018-19 set out in the Council's TMS and also the projected indicators for 2018-19 are shown below.

### 6.1 Treasury Management Indicators 2018-19

- 6.1.1 The following indicators (which are forward looking parameters) form part of the CIPFA Code of Practice on Treasury Management. They enable the Council to measure and manage its exposure to Treasury Management risks.

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The Council needs to set the upper limits to its **Interest Rate Exposure** for the effects of changes in interest rates. There are two treasury management indicators that relate to both fixed interest rates and variable interest rates. These limits have been calculated with reference to the net outstanding principal sums and are set to control the Council's exposure to interest rate risk as shown in the table below. Fixed rate investments and borrowings for the purpose of this indicator are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or transaction date if later and all other instruments are classed as variable. The majority of the Council's investments are less than 12 months and even though interest rates may be fixed for the investment duration these would be classed as variable.

| No. |  | TMS<br>2018-19<br>£m | Projection<br>31-03-2019<br>£m |
|-----|--|----------------------|--------------------------------|
|     | Total Projected Principal Outstanding on Borrowing 31 March 2019       | 96.87                | <b>96.87</b>                   |
|     | Total Projected Principal Outstanding on Investments 31 March 2019     | 20.00                | <b>15.00</b>                   |
|     | <b>Net Principal Outstanding</b>                                       | <b>76.87</b>         | <b>81.87</b>                   |
| 1.  | <b>Upper Limit on fixed interest rates (net principal) exposure</b>    | 130.00               | <b>68.62</b>                   |
| 2.  | <b>Upper Limit on variable interest rates (net principal) exposure</b> | 50.00                | <b>13.25</b>                   |

The Section 151 Officer will manage interest rate exposures between these limits in 2018-19.

- 6.1.2 A further indicator for Treasury Management measures the **Maturity Structure of Borrowing** and is the amount of projected borrowing that is fixed rate, maturing in each period as a percentage of total projected fixed rate borrowing. This indicator is set to control the Council's exposure to refinancing risk and has been set to allow for the possible restructuring of long term debt where this is expected to lead to an overall saving or reduction in risk.

The 19.87% shown in the table below relates to £19.25 million Lender's Option Borrower's Option (LOBO) loans which may be re-scheduled in advance of their maturity date of 2054, as detailed in paragraph 4.3.3 of the main report. The Code requires the maturity of LOBO loans to be shown as the earliest date on which the lender can require payment, i.e. the call date of January 2019 so the maturity date is actually uncertain but is shown in the "Under 12 months" category as per the Code.

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| No | Maturity structure of fixed rate borrowing during 2018-19 | Upper limit | lower limit | Projection 31-03-19 |
|----|---|-------------|-------------|---------------------|
| 3. | Under 12 months   | 50%         | 0%          | 19.87%              |
|    | 12 months and within 24 months                            | 25%         | 0%          | -                   |
|    | 24 months and within 5 years                              | 25%         | 0%          | -                   |
|    | 5 years and within 10 years                               | 50%         | 0%          | 13.91%              |
|    | 10 years and within 20 years                              | 60%         | 0%          | 23.49%              |
|    | 20 years and above  | 100%        | 40%         | 42.73%              |

6.1.3 The **Upper Limit for Total Principal Sums invested over 364 days** indicator controls the amount of longer term investments which mature beyond the period end. This is set to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

| No. |   | TMS 2018-19 (Limit)<br>£m | Projection Principal Outstanding Over 364 days 31-03-19<br>£m |
|-----|---|---------------------------|---|
| 4.  | <b>Upper Limit for Total Principal Sums Invested for more than 364 days</b> | 15                        | 4   |

## 6.2 Prudential Indicators 2018-19

The Prudential Indicators are required to be set and approved by Council in accordance with CIPFA's Prudential Code for Capital Finance in Local Authorities. The 2011 Code requires the Council to formally adopt CIPFA's Treasury Management Code and this was adopted by Council on 22 February 2012.

### 6.2.1 Prudential Indicators for Prudence

The following Prudential Indicators are based on the Council's capital programme which is subject to change. The Council's capital expenditure plans are summarised below and this forms the first prudential indicator for Prudence. The total capital expenditure is funded from capital grants and contributions, capital receipts and revenue with the remainder being the **Net Financing Need for the Financial Year** to be met from borrowing.

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| No. | Prudential indicators For Prudence         | Estimate<br>TMS<br>2018-19<br>£m | Projection<br>31-03-19<br>£m |
|-----|--|----------------------------------|------------------------------|
| 1.  | <b>Total Capital Expenditure (Non HRA)</b> | 33.69                            | 40.32                        |
|     | <b>Total Capital Expenditure</b>           | <b>33.69</b>                     | <b>40.32</b>                 |
|     | <b>Financed by :-</b>                      |                                  |                              |
|     | Capital Grants and Contributions           | 6.84                             | 6.21                         |
|     | Capital Receipts                           | 9.18                             | 18.40                        |
|     | Revenue Contribution to Capital            | 7.49                             | 9.26                         |
|     | <b>Net Financing Need for Year</b>         | <b>10.18</b>                     | <b>6.45</b>                  |

The capital expenditure figures have changed from the Treasury Management Strategy 2018-19 as the capital programme approved by Council on 28 February 2018 has been amended to include new approved schemes and to incorporate slippage of schemes from 2017-18 and a change in the profile of funding and prudential borrowing. This has resulted in a decrease in the Net Financing Need for 2018-19 which is a decrease in Unsupported Borrowing.

The process for charging the financing of capital expenditure to revenue is a statutory requirement and is called the Minimum Revenue Provision (MRP). The actual MRP charge needs to be prudent and the methodology is detailed in the Council's MRP policy in the TMS 2018-19. The updated methodology in **Appendix C** was approved by Council 19 September 2018 as referred to in the main report. Directorates who receive Council approval for capital schemes via Unsupported Borrowing make annual contributions to the capital costs of their schemes known as Voluntary Revenue Provisions (VRP) or additional MRP. This type of borrowing is only approved when Directorates have the necessary revenue resources to make VRP to fund the capital costs though this will be deferred in some cases until the asset becomes operational in accordance with the Council's MRP Policy.

The second Prudential Indicator is the **Capital Financing Requirement (CFR)** for the Council and is shown in the table below. This shows the total outstanding capital expenditure that has not been funded from either revenue or other capital resources. It is derived from the actual Balance Sheet of the Council. It is essentially a measure of the underlying need to finance capital expenditure and forms the basis of the charge to the Council Fund in line with the Prudential Code. The MRP requirement for the Maesteg School PFI Scheme will be equivalent to the write down of the liability for the year and is met from existing budgets.

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| No.       | Prudential indicators For Prudence                                    | Estimate<br>TMS<br>2018-19<br>£m | Projection<br><br>2018-19<br>£m |
|-----------|---|----------------------------------|---------------------------------|
| <b>2.</b> | <b>Capital Financing Requirement (CFR)</b>                            |                                  |                                 |
|           | Opening CFR (1 April 2018) adjusted excluding PFI & other liabilities | 152.56                           | 153.24                          |
|           | Opening PFI CFR   | 17.64                            | 17.64                           |
|           | Opening Innovation Centre*  | 0.60                             | -                               |
|           | <b>Total Opening CFR</b>  | <b>170.80</b>                    | <b>170.88</b>                   |
|           | Movement in CFR excluding PFI & other liabilities                     | 3.62                             | 2.04                            |
|           | Movement in PFI CFR   | (0.64)                           | (0.64)                          |
|           | Movement in Innovation Centre CFR                                     | (0.06)                           | -                               |
|           | <b>Total Movement in CFR</b>  | <b>2.92</b>                      | <b>1.40</b>                     |
|           | <b>Closing CFR (estimated 31 March 2019)</b>                          | <b>173.72</b>                    | <b>172.28</b>                   |
|           | Movement in CFR represented by :-                                     |                                  |                                 |
|           | Net Financing Need for Year (above)                                   | 10.18                            | 6.45                            |
|           | Minimum and Voluntary Revenue Provisions**                            | (7.26)                           | (5.05)                          |
|           | <b>Total Movement</b>   | <b>2.92</b>                      | <b>1.40</b>                     |

\*Innovation Centre accounting adjustment at 01-04-18 now included in the opening CFR so not shown separately

\*\*Minimum Revenue Provision (MRP) and Voluntary Revenue Provision (VRP) represent the revenue charge for the repayment of debt and includes MRP for the Private Finance Initiative (PFI)

### 6.2.2 Limits to Borrowing Activity

The Council's long term borrowing at the 30 September 2018 was £96.87 million as detailed in section 4 of the main report. External Borrowing can arise as a result of both capital and revenue expenditure and timing of cash flows. As the Council has an integrated TMS there is no association between individual loans and particular types of expenditure. Therefore, the Capital Financing Requirement and actual external borrowing can be very different especially when a Council is using Internal Borrowing as highlighted in paragraph 4.3.5 in the main report.

The **Gross Debt** position (Borrowing and Long Term Liabilities) is shown below:

| No.       | Prudential indicators<br>For Prudence | Estimate<br>TMS<br>2018-19<br>£m | Projection<br>31-03-19<br>£m |
|-----------|---------------------------------------|----------------------------------|------------------------------|
|           | <b>Gross Debt 31 March</b>            |                                  |                              |
| <b>3.</b> | External Borrowing                    | 96.87                            | 96.87                        |
|           | Long Term Liabilities (including PFI) | 20.24                            | 20.27                        |
|           | <b>Total Gross Debt</b>               | <b>117.11</b>                    | <b>117.14</b>                |

Within the Prudential Indicators, there are a number of key indicators to ensure the Council operates its activities within well-defined limits. One key control is

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to ensure that over the medium term debt will only be for a capital purpose. The Council needs to ensure that external debt does not, except in the short term, exceed the Capital Financing Requirement for 2018-19. The table below shows that the Council is on target to comply with this requirement.

| No.       | Prudential indicators For Prudence | Estimate<br>TMS<br>2018-19<br>£m | Projection<br>31-03-19<br>£m |
|-----------|------------------------------------|----------------------------------|------------------------------|
| <b>4.</b> | <b>Gross Debt &amp; the CFR</b>    |                                  |                              |
|           | Total Gross Debt                   | 117.11                           | 117.14                       |
|           | Closing CFR (31 March 2019)        | <b>173.72</b>                    | <b>172.28</b>                |

A further two Prudential Indicators control the Council's overall level of debt to support Capital Expenditure. These are detailed below and confirms that the Council is well within the limit set :-

- The **Authorised Limit** for External Debt – this represents the limit beyond which borrowing is prohibited. It reflects a level of borrowing that could not be sustained even though it would be affordable in the short term. It needs to be set and approved by Members.
- The **Operational Boundary** for External Debt – this is not an actual limit and actual borrowing could vary around this boundary during the year. It is based on the probable external debt during the course of the year.

| No.       | Prudential indicators For Prudence          | TMS<br>2018-19<br>£m | Projection<br>31-03-19<br>£m |
|-----------|---|----------------------|------------------------------|
| <b>5.</b> | <b>Authorised limit for external debt -</b> |                      |                              |
|           | Borrowing                                   | 140                  |                              |
|           | Other long term liabilities                 | 30                   |                              |
|           | <b>Total</b>                                | <b>170</b>           |                              |
| <b>6.</b> | <b>Operational Boundary</b>                 |                      |                              |
|           | Borrowing                                   | 105                  |                              |
|           | Other long term liabilities                 | 25                   |                              |
|           | <b>Total</b>                                | <b>130</b>           |                              |
|           | <b>Borrowing</b>                            |                      | <b>96.87</b>                 |
|           | <b>Other long term liabilities</b>          |                      | <b>20.27</b>                 |
|           | <b>Total</b>                                |                      | <b>117.19</b>                |

### 6.2.3 Prudential Indicators for Affordability

The **Ratio of Financing Costs to Net Revenue Stream** indicator demonstrates the trend in the cost of capital against the total revenue amount to be met from local taxpayers and the amount provided by the Welsh Government in the form



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of Revenue Support Grant. The estimates of capital financing costs include interest payable and receivable on treasury management activities and the MRP charged to the Comprehensive Income and Expenditure Statement. The revenue stream is the amount to be met from government grants and local taxpayers. The projection has reduced from the TMS estimate due to the change in the MRP policy detailed in section 5 above and **Appendix C**.

| No. | Prudential Indicator for Affordability         | Estimate<br>TMS<br>2018-19<br>% | Projection<br>2018-19<br>% |
|-----|--|---------------------------------|----------------------------|
| 7.  | Ratio of Financing Costs to Net Revenue Stream | 4.55                            | 3.77                       |

APPENDIX B

Credit Rating Equivalence Table

|                   | Description      | Fitch |       | Moody's |                | Standard & Poor's |       |   |
|-------------------|------------------|-------|-------|---------|----------------|-------------------|-------|---|
|                   |                  | Long  | Short | Long    | Short          | Long              | Short |   |
| INVESTMENT GRADE  | Extremely strong | AAA   |       | Aaa     |                | AAA               |       |   |
|                   | Very strong      | AA+   | F1+   | Aa1     | P-1            | AA+               | A-1+  |   |
|                   |                  | AA    |       | Aa2     |                | AA                |       |   |
|                   |                  | AA-   |       | Aa3     |                | AA-               |       |   |
|                   | Strong           | A+    | F1    | A1      | P-2            | A+                | A-1   |   |
|                   |                  | A     |       | A2      |                | A                 |       |   |
|                   |                  | A-    |       | A3      |                | A-                |       |   |
|                   | Adequate         | BBB+  | F2    | Baa1    | P-3            | BBB+              | A-2   |   |
|                   |                  | BBB   |       | Baa2    |                | BBB               |       |   |
|                   |                  | BBB-  |       | Baa3    |                | BBB-              |       |   |
| SPECULATIVE GRADE | Speculative      | BB+   | B     | Ba1     | Not Prime (NP) | BB+               | B     |   |
|                   |                  | BB    |       | Ba2     |                | BB                |       |   |
|                   |                  | BB-   |       | Ba3     |                | BB-               |       |   |
|                   | Very speculative | B+    | B1    | B+      |                |                   |       |   |
|                   |                  | B     | B2    | B       |                |                   |       |   |
|                   |                  | B-    | B3    | B-      |                |                   |       |   |
|                   | Vulnerable       | CCC+  | C     | Caa1    |                | C                 | CCC+  | C |
|                   |                  | CCC   |       | Caa2    |                |                   | CCC   |   |
|                   |                  | CCC-  |       | Caa3    |                |                   | CCC-  |   |
|                   |                  | CC    |       | Ca      |                |                   | CC    |   |
|                   | C                |       |       | C       |                |                   |       |   |
| Defaulting        | D                | D     | C     |         | D              | D                 |       |   |

## ANNUAL MINIMUM REVENUE PROVISION STATEMENT 2018-19

The Annual Minimum Revenue Provision Statement needs to be approved by Council before the start of each financial year. The MRP charges for 2018-19 will be on the following bases:-

- i. Capital expenditure incurred before 1 April 2008 and any capital expenditure after 1 April 2008 that is government supported expenditure the charge to revenue will be based on a straight line basis over 45 years of the opening Capital Financing Requirement after accounting adjustments. This charge was supplemented by voluntary MRP (based on the useful asset life) in respect of those assets which were financed by unsupported borrowing before 1 April 2008.
- ii. Supported capital expenditure that results in a significant asset (based on an internal assessment) incurred on or after 1 April 2008 and all unsupported capital expenditure, exercised under the Prudential Code, the MRP charge will be based on the Asset Life Method. The minimum revenue provision will be at equal annual instalments over the life of the asset. The first charge can be delayed until the year after the asset is operational but this will be at the discretion of the Section 151 Officer
- iii. for assets reclassified as finance leases under International Financial Reporting Standards (IFRS) or resulting from a Private Finance Initiative, the MRP charge will be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability for the year
- iv. Where loans are made to other bodies for their capital expenditure with an obligation for the bodies to repay, no MRP will be charged. The capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead
- v. MRP may be waived on expenditure recoverable within a prudent period of time through capital receipts (e.g. land purchases) or deferred to when the benefits from investment are scheduled to begin or when confirmed external grant payments towards that expenditure are expected.

The MRP Charge 2018-19 based on the estimated capital financing requirement is detailed below:-

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|   | Options | Capital Financing Requirement<br>01-04-18<br>£m | 2018-19<br>Estimated<br>MRP<br>£m |
|---|---------|---|-----------------------------------|
| Capital expenditure before 01-04-2008 and any after 01-04-2008 that does not result in a significant asset<br>(Supported) | (i)     | 122.79  | 2.73                              |
| Capital Expenditure before 01-04-2008<br>(Unsupported)  |         | -   | -                                 |
| Supported capital expenditure that results in a significant asset, incurred on or after 1 April 2008<br>(Supported)       | (ii)    | 3.42  | 0.13                              |
| Unsupported capital expenditure, exercised under the Prudential Code<br>(Unsupported)                                     |         | 27.03   | 1.55                              |
| PFI, Finance Leases and other arrangements<br>PFI School  | (iii)   | 17.64   | 0.64                              |
| <b>TOTAL</b>  |         | <b>170.88</b>                                   | <b>5.05</b>                       |