

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Cabinet
Date:	14 November 2016
Title:	Revenue Budget Monitoring 2016/17
Reference:	7904
Report From:	Director of Corporate Resources

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1. Executive Summary

- 1.1. The purpose of this report is to provide Cabinet with an update on the revenue budget monitoring position for 2016/17 at the end of Quarter 2 together with the first half year performance for Treasury Management. It also re-examines the impact of the latest revenue budget forecast on the position for 2017/18 and how this will be managed to ensure the County Council's financial position continues to have a firm foundation.
- 1.2. In 2015/16 the Corporate Management Team (CMT) received monthly 'financial resilience' reporting that not only looked at the regular financial reporting carried out in previous years but also focussed on potential pressures in the system and the continued monitoring of the implementation and delivery of the Transformation to 2015 (Tt2015) Programme. As we continue to face pressures within social care, along with most other authorities providing these services, enhanced financial resilience monitoring has continued into 2016/17.
- 1.3. Early delivery of Transformation to 2017 (Tt2017) savings is currently forecast to be £35m in cash terms in 2016/17. Pressures are currently forecast to total £22.3m in 2016/17 and, as in previous years, are predominantly within social care departments.
- 1.4. The forecast pressures within Adults' Health and Care, which relate to a number of service areas, as described in more detail in Section 3, total £11.3m and increase to £13.4m in 2017/18. The position is further impacted by a shortfall of £12.5m in the cash to be delivered from the Tt2017 savings in 2017/18 and highlights that the department will not be able to contain the position within the overall cash limit in that year. Based on the current forecasts the predicted shortfall in 2017/18 after the use of departmental resources is £12.1m, which is an improvement of £1.3m on the month 4 position reported to Cabinet in September.

- 1.5. Pressures within Children's Services set out in Section 3 total £10.1m in 2016/17, a reduction of £2.2m on the position reported to Cabinet in September. However, following further analysis it is now forecast that pressures will total £9.9m in 2017/18. This, along with a predicted shortfall of £0.9m in cash delivery of Tt2017 savings, means that the department is forecasting that it will not be able to contain the position within its overall cash limit in either 2016/17 or 2017/18.
- 1.6. Additional funding has been set aside within the Medium Term Financial Strategy (MTFS) to address the anticipated growth in social care and corporate funding is available for Adults' Health and Care and Children's Services of up to £10m and £2m respectively. After drawing on this central contingency the remaining forecast shortfall in 2017/18 is currently £10.9m.
- 1.7. Cross-departmental underwriting of the remaining deficit position of £10.9m would be required to deliver a balanced position for 2017/18. This deficit is £1.5m higher than the position forecast and reported at month 4. At that point the shortfall was anticipated to be £9.4m and the movement reflects the initial outcome of further work, which it was recognised was required, to review the forecast beyond 2016/17 in Children's Services.
- 1.8. Whilst we are still in the first half of the financial year, and we recognise that these projections are based on a wide range of variables and assumptions, cross-departmental underwriting of the remaining deficit position has been agreed in principle. This will provide resources that might be needed to help balance the budget at the end of the year.
- 1.9. Although the position for 2017/18 in particular is not definitive, a solution has been agreed to manage the potential shortfall in the period up to 2018/19 to maintain the firm foundation that underpins the County Council's financial position, by which point the position is expected to regularise.
- 1.10. Given the challenge facing the social care departments in particular, the need for continued close monitoring remains vital and, a further revenue monitoring update will be provided to Cabinet early in the new year.
- 1.11. In addition, strategies to further underpin the position and to also make provision for the investment required to deliver the next transformation programme will be explored and reported to Cabinet at this point.

2. Contextual Information

- 2.1. The County Council's success in delivering its savings plans to date has been consistently demonstrated by the fact that it has been able to contain expenditure within budget and has achieved under spends in each of the years since austerity began, despite taking significant sums of money out of the budget.
- 2.2. 2015/16 represented a further milestone in this journey, taking the total to £242m since the grant reductions began.
- 2.3. This further level of reduction obviously increased the risk within the budget, in recognition of which monthly 'financial resilience' reporting presented to the Corporate Management Team (CMT) was amended to look not only at

the regular financial reporting carried out in previous years but also to focus on potential pressures in the system and the continued monitoring of the implementation and delivery of the Transformation to 2015 (Tt2015) Programme.

- 2.4. 2016/17 is in effect a 'steady state' position, with one off resources being used to allow time for savings to be delivered through the Transformation to 2017 (Tt2017) Programme. However, in recognition of the continuing social care pressures we face, along with most other authorities providing these services, enhanced monitoring has been maintained
- 2.5. To ensure that the monitoring is appropriately targeted the content has been updated to reflect the end of the Tt2015 Programme and the fact that delivery of the Tt2017 Programme itself is being monitored separately and is receiving focused attention to ensure savings are on track, with a further update to be presented to Cabinet in December.

3. Summary of Forecast Position for 2016/17

- 3.1. It is worth reminding Cabinet that at this point in the year the forecasts themselves, whilst more fully developed, tend to concentrate on the more significant negative items without considering in depth other areas of potential under spend that could be used to offset them. Monitoring in the first half of the year therefore tends to the side of prudence. This position will obviously evolve as we move through the remainder of the year, but the forecasts in this report continue to highlight the divide between the social care departments and the rest of the County Council.
- 3.2. The table below summarises the latest forecast position for each department, showing the net position for potential one off support that is required before considering the use of cost of change (and other) reserves and shows the contrast between the different departments:

	Early Delivery of Tt2017 Savings £'000	Pressures £'000	Other Savings(*) £'000	Contrib. to Cost of Change £'000	One-Off Support Required £'000
Adults' Health and Care	(15,517)	11,266		4,251	
Children's Services	(5,830)	10,104	(1,540)		2,734
ETE	(5,063)		(2,451)	7,514	
CCBS	(3,257)		(1,026)	4,283	
Corporate Services	(5,327)	882		4,445	
Departmental Total	(34,994)	22,252	(5,017)	20,493	2,734

(* Including departmental under spends)

- 3.3. For the purposes of the financial forecast it should be noted that the delivery of the transformation programme is judged in terms of cash released in the financial year. As such there will be differences between this and the

assessment presented in the Tt2017 Programme update reports which focus on achievement of milestones and the successful completion of the work required to deliver the savings proposals. From a cash perspective, delivery may begin part way through the year and as such the impact on the financial position that departments need to manage may vary.

- 3.4. The pressures within social care departments are well documented but the table above (and evidence of increased demand and the impacts of service changes) shows that pressures and challenges are also being felt in other Departments. Maintaining capacity across a number of service areas within Corporate Resources to ensure the delivery of enabling projects such as Digital and to progress priority shared service programmes under the banner of "Governance and Controls", whilst one-off, cannot be managed within business as usual resources.
- 3.5. In 2016/17 it is currently anticipated that with the exception of Children's Services one-off funding will not be required, and in fact departments will once again be able to make a significant contribution to their cost of change reserves. When other funding is included then the position is as shown below, with the table presented to highlight the stark differences between social care departments and the rest of the County Council:

	ETE, CCBS & Corp Services £'000	Adults' Health and Care £'000	Children's Services £'000
Early delivery of Tt2017 Savings	(13,647)	(15,517)	(5,830)
Pressures	882	11,266	10,104
Other Savings(*)	(3,477)		(1,540)
Subtotal	(16,242)	(4,251)	2,734
<i>To Be Met From:</i>			
Departmental Contingency (Ongoing)		(4,542)	
Departmental Cost of Change Support (One-Off)		(2,443)	(1,059)
Other Departmental Reserves (One-Off)			
Contribution to Cost of Change	16,242	11,236	
Total	0	0	1,675

(* Including departmental under spends)

- 3.6. For Children's Services the support from the cost of change reserve is the remaining balance that is available after other commitments have been taken into account. Based on this forecast position at this point the department would have no cost of change (or other) reserves to call on in future years.

Pressures

- 3.7. Previously identified pressures within Adults' Health and Care continue to be felt, particularly in relation to the provision of purchased care for both Older People and clients with a disability. The position is closely monitored and plans are in place to actively manage these issues as far as possible and where necessary to pursue other savings areas.
- 3.8. The use of one-off funds, departmental contingencies and cost of change reserves are supporting the position in 2016/17. However, if the forecast demographic pressures continue and the current profile of savings does not change, the department is unlikely to remain within its cash limit for 2017/18. At this stage the current 2017/18 pressure is forecast to be in the region of £13.4 which is an improvement on the position of £17.5m reported to Cabinet in September.
- 3.9. Month 6 monitoring for Children's Services continues to show pressure across a range of service areas including the following:
- Supported lodgings and accommodation costs for post 16 young people.
 - A recent upturn in the numbers of children needing to be taken into care by the local authority.
 - Home to school transport due to increased pupil numbers, particularly relating to children with special education needs.
 - The cost of agency staff covering essential social worker posts.

These pressure areas are being closely monitored by the department with plans in place or being developed to address these issues.

- 3.10. The position for Adults' is monitored regularly by the Director of Corporate Resources in meetings with the Director of Adults' Health and Care and longer term there is an overall plan to balance the budget (prior to considering the Tt2019 savings) albeit that this is based on a wide range of assumptions and predictions.
- 3.11. For Children's Services an equivalent mechanism is now in place with a view to developing a more robust longer term financial plan for the Department that gives better focus on the pressure areas and it is recognised that further work is needed to refine the position for futures years; particularly in relation to Children Looked After (CLA) numbers and the impact on costs.

4. Summary of Forecast Position for 2017/18

- 4.1. Based on current projections, if pressures across Adults' Health and Care and Children's Services continue as forecast into 2017/18 and there is a shortfall in Tt2017 savings cash delivery as predicted, the overall position will be as summarised below:

	ETE, CCBS & Corp Services £'000	Adults' Health and Care £'000	Children's Services £'000
Tt2017 Savings Cash Shortfall	2,005	12,500	910
Pressures		13,442	9,892
Other Savings(*)	(283)		
Subtotal	1,722	25,942	10,802
To Be Met From:			
Departmental Contingency (Ongoing)		(3,442)	
Departmental Cost of Change Support (One-Off)	(2,532)	(10,436)	
Corporate Support		(10,000)	(2,000)
Contribution to / (from) Cost of Change	810		
Total	0	2,064	8,802

(* Including departmental under spends)

- 4.2. For 2017/18 we had already factored into the updated Medium Term Financial Strategy (MTFS) the potential for £10m of the Adult's 2018/19 'base adjustment' to be bought forward into 2017/18 to help cash flow the late delivery of savings.
- 4.3. This together with contingencies set aside for potential growth in CLA numbers (although this pressure has now extended to other related areas such as care leavers) will provide one off funding of £12m to be set against the forecast deficit, leaving an unmet balance in the region of £10.9m to be addressed.
- 4.4. The level and use of cost of change (and other) reserves is shown in the following table:

	ETE, CCBS & Corp Services £'000	Adults' Health & Care £'000	Children's Services £'000
Opening Balance 01/04/2016	28,178	9,006	5,707
Planned Use:			
EVR			(965)
Other	(12,522)	(6,563)	(3,683)
To Balance Overall Position 2016/17		(2,443)	(1,059)
Contribution to Cost of Change	16,242	11,216	
Forecast Balance 01/04/2017	31,898	11,236	0
Planned Use:			
Other	(7,113)	(800)	
To Balance Overall Position 2017/18	(2,532)	(10,436)	
Contribution to Cost of Change	810		
Forecast Balance 01/04/2018	23,063	0	0

5. Forward Financial Planning

- 5.1. Strong financial management has ensured that to date all Departments have remained within their cash limits, containing new pressures and delivering approved savings programmes.
- 5.2. This forecast indicates that the cumulative impact of numerous savings programmes, together with sustained pressure on social care spending in particular, is producing a different picture for 2016/17 and 2017/18 with some departments unlikely to remain within their cash limited expenditure positions over these two years.
- 5.3. The information in Sections 3 and 4 indicates that we could be facing deficits within the Children's Services budget of approaching £1.7m in 2016/17 but it is highly likely that the deficit in 2016/17 can be managed through a combination of positive management action in the pressure areas, under spends elsewhere in the Children's Services Department and the use of corporate contingencies as appropriate.
- 5.4. Looking ahead to 2017/18 based on current projections if social care pressures continue as forecast, and there is a shortfall in Tt2017 savings delivery as predicted, there will be a deficit in the region of £10.9m to be addressed.

Social Care Pressures

- 5.5. The particular pressures that are faced by social care departments in managing increasing and volatile demand against reducing cash limits are well recognised and well documented. Previous monitoring reports have highlighted a growing number of demand pressures across various social care categories, including:
 - Increasing numbers of clients with more complex needs
 - Growing numbers of safeguarding referrals and children with a Child Protection Plan
 - Rising numbers of children in care in line with national trends
 - Challenging market conditions
- 5.6. Further work has been continuing to critically review the forward projections for Children's, which are complex, and as a result of this the forecast pressure for 2017/18 has been amended upwards from £6m to £9.9m.
- 5.7. The period from February 2015 to May 2016 has shown a promising reduction in the number of Children Looked After (CLA), the main driver of cost within the department, due primarily to the work being carried out under the auspices of the DfE funded Innovation Programme. The reduction over this period of some 50 CLA against the projected number to the end of the financial year of approximately an additional 104 indicated that the Department were on target to achieve the reductions in numbers and spend predicted in the Tt2017 framework and the Innovation Programme. The trend at this point was downwards.

- 5.8. More recently, in July, August and September there has been a significant spike in the numbers of CLA. Children's Services managers have undertaken a close analysis of these months.
- 5.9. The data shows that the increase of 67 children and young people has included a significant number (25) of children who have been placed at home by the courts and therefore are without placement costs. This reflects a greater emphasis on the scrutiny of placements as determined by the practice guidance issued by the President of the Family Court Division, Judge Munby [*Re A (A Child), Darlington Borough Council v M* [2015] EWFC 11, para 100].
- 5.10. Furthermore, 19 of the additional placements were Unaccompanied Asylum Seeking Children (UASC) placed in Hampshire under the national redistribution scheme. A significant proportion of the costs for these children will be met by the Home Office Scheme – depending on the child's age. Thus, the cost to the local authority is not the full cost but a marginal cost.
- 5.11. When these factors are taken into account the number of children entering the looked after system is not exceptional and a review of the cases concurred that the right children are being taken into care.
- 5.12. There is further exploration to be done around the numbers of children leaving care as this number does appear to have dropped compared to past trends and this is being further investigated.
- 5.13. In summary, the relationship between the numbers of children in care and the financial impact of any increase (or decrease) has become more complex and more sophisticated financial modelling will need to be developed that breaks down the mix of different types of placement and associated cost. This modelling is being developed at pace by Finance staff and Children's Services colleagues.
- 5.14. While significant effort is invested by social care departments in managing demand, the simple statistics show that a high level of growth in numbers and therefore costs is inevitable. In recognition of this, additional funding has been set aside within the MTFS to address anticipated growth. However, in reality this is difficult to predict and may be subject to peaks and troughs throughout a financial year which impacts on the final outturn position and the longer term view.
- 5.15. The outturn for 2015/16 showed a balanced position for both Adults' and Children's which was only achieved through the use of a combination of contingencies and cost of change (and other) reserves. For the other departments a net contribution to cost of change reserves in the order of £21.6m was made in the year as a result of the early delivery of savings and under spends.
- 5.16. The monitoring position in this report continues to tell a similar story. The table in paragraph 3.2 shows a potential over spend position for Children's Services of £2.7m compared to a forecast under spend / early delivery of savings of £16.2m for the non-social care departments. Moving forward cost of change (and other) reserves for social care departments will be fully

utilised by 2017/18 whereas for the others they continue to grow to an estimated figure of nearly £23.1m by the end of 2017/18.

- 5.17. Inevitably, this position has arisen because social care departments need to use their cost of change reserves to support their bottom line budget position and it takes longer to generate cash savings in these areas meaning there is less scope to add additional resources to the cost of change reserves.
- 5.18. Moving forward, the delivery of savings is becoming increasingly challenging across all departments but it is acknowledged that in social care areas releasing the savings takes longer to achieve and requires more resources. Yet based on current forecasts, these social care departments will have no cost of change left in order to affect these changes.

Responding to the Challenge

- 5.19. In response to this challenge the principle of a cross-departmental underwriting of the remaining deficit position was agreed to provide resources that might be needed to help balance the budget at the end of the year or provide social care departments with the transformation funding to support the achievement of their savings programmes.
- 5.20. While the principle of cross departmental underwriting has been agreed it is imperative that all departments continue to drive hard to maximise the delivery of savings and at the same time continue to give a strong focus to business as usual. This will both minimise the level of underwriting that may be needed and maximise the level of cost of change reserves available.
- 5.21. Underwriting should be seen as a solution of last resort but it will enable the authority to manage the potential temporary shortfall in the period to 2018/19. By this point the position is expected to have regularised once further work has been completed to refine the longer term financial planning view for Children's Services and develop an associated action plan.
- 5.22. As we move further through the financial year we will have a clearer picture of the likely outturn position for 2016/17 and each year we prepare a revised budget that is presented to Cabinet in January and which reflects the latest monitoring information as at the end of December. As well as considering the position for departments, corporately we also take this opportunity to review non-departmental budgets, including contingencies.
- 5.23. Contingency sums are set aside for a variety of purposes and it is only at this later stage in the year that these resources can be deployed for other purposes with greater certainty. It will be appropriate to review contingency items in respect of pay and price inflation that have not been used, together with other sums set aside for income risk and the general risk contingency and confirm those amounts that it is considered prudent to release.
- 5.24. At this point consideration can be given to the utilisation of any identified corporate resources alongside available cost of change to both minimise the amount of underwriting required and to provide some certainty to departments about the level of this commitment which could be either capped or fixed.

- 5.25. Part of this assessment will also include consideration of the potential investment required to deliver Tt2019 savings for all departments, including investment in corporate enablers. Given the pressure on departmental cost of change (and other) reserves there may be a requirement for some corporately funded investment.
- 5.26. A further review of corporate reserves will therefore be undertaken to ensure that we maximise the funding available to deliver what it is recognised will be by far the most challenging transformation programme required to date. However, this must be set in the context that we have already identified significant one-off resources (£70m) to bridge the gap in 2018/19 as set out in the MTFS.

6. Treasury Management

- 6.1. Hampshire County Council fully complies with the requirements of the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in the Public Services (2009).
- 6.2. The Code recommends the reporting of Treasury Management activity twice a year and therefore, to ensure that the County Council is following best practice in accordance with CIPFA's recommendations, this report includes an update on treasury management activities to the end of September 2016, which is contained in Appendix 1.
- 6.3. As part of the 2014/15 Strategy the County Council decided to earmark £90m of its cash balances for investments appropriately targeting a higher yield. This was in addition to the £15m of long term investments that had been made for the Street Lighting PFI scheme. Higher yields can be accessed through long-term cash investments (although this is currently less the case as yields have declined) and investments in other assets than cash, such as pooled property, equities and bonds. Non-cash pooled investments must be viewed as long-term investments in order that monies are not withdrawn in the event of a fall in capital values to avoid crystallising a capital loss.
- 6.4. Given the stability of the County Council's cash balances, there is the opportunity to add to this allocation, which would increase the overall rate of return and the income contributed to the revenue budget. It is recommended to increase the allocation targeting higher yields to £200m. This amount represents half of the County Council's forecast minimum cash balance and is therefore an amount that can be managed appropriately as a long-term investment.

7. Recommendation(s)

It is recommended that Cabinet:

- 7.1. Note the forecast financial position outlined in this report which shows exceptionally that possible deficit positions are predicted for some departments over the next two years.

- 7.2. Note that further work will be completed as part of preparing the revised budget to consider any corporate funding that is available to both minimise the amount of cross departmental underwriting required and to provide some certainty to departments about the level of this commitment.
- 7.3. Note that a further review of corporate reserves will also be undertaken to assess the level of corporate investment that may be available to support the delivery of the Tt2019 Programme.
- 7.4. Recommend to County Council an increase to the allocation targeting higher yields to £200m (as set out in the mid-year review of Treasury Management activities in Appendix 1) to increase the overall rate of return and the income contributed to the revenue budget, based on the stability of the County Council's cash balances.
- 7.5. Recommend the mid-year review of Treasury Management activities as set out in Appendix 1 to County Council for approval.

CORPORATE OR LEGAL INFORMATION:**Links to the Corporate Strategy**

Hampshire safer and more secure for all:	Yes
Maximising well-being:	Yes
Enhancing our quality of place:	Yes

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document

Location

None

IMPACT ASSESSMENTS:

1. Equality Duty

1.1. The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited under the Act;
- Advance equality of opportunity between persons who share a relevant protected characteristic (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, gender and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- a) The need to remove or minimise disadvantages suffered by persons sharing a relevant characteristic connected to that characteristic;
- b) Take steps to meet the needs of persons sharing a relevant protected characteristic different from the needs of persons who do not share it;
- c) Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity which participation by such persons is disproportionately low.

1.2. Equalities Impact Assessment:

This report does not contain any proposals which may have an equalities impact

2. Impact on Crime and Disorder:

2.1. The County Council has a legal obligation under Section 17 of the Crime and Disorder Act 1998 to consider the impact of all the decisions it makes on the prevention of crime.

2.2. The proposals in this report are not considered to adversely affect the prevention of crime.

3. Climate Change:

- a) How does what is being proposed impact on our carbon footprint / energy consumption?

No specific proposals impacting on our carbon footprint / energy consumption are being proposed.

- b) How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific proposals affecting adaptation to climate change are being proposed.

Treasury Management Monitoring Report 2016/17

1. Purpose

- 1.1. The Treasury Management Strategy (TMS) for 2016/17 is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.
- 1.2. The Code also recommends that members are informed of Treasury Management activities at least twice a year (a mid year and a year end report). This report therefore ensures that the County Council is embracing best practice in accordance with CIPFA's recommendations.
- 1.3. Treasury Management is defined as: "the management of investments and cash flows, banking, money market and capital market transactions; the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks".

2. Recommendation

- 2.1. Based on the stability of the County Council's cash balances it is recommended that there is an to increase the allocation targeting higher yields to £200m, to increase the overall rate of return and the income contributed to the revenue budget.
- 2.2. It is recommended that the mid-year review of treasury management activities be noted.

3. Economic Background

- 3.1. The following section outlines the key economic themes currently in the UK against which investment and borrowing decisions have been made in the year to date.
- 3.2. The preliminary estimate of Quarter 2 2016 Gross Domestic Product (GDP) showed strong growth as the economy grew 0.7% quarter-on-quarter, as compared to 0.4% in Quarter 1 and year-on-year growth running at a healthy pace of 2.2%. However the UK economic outlook changed significantly on 23 June 2016. The surprise result of the referendum on EU membership prompted forecasters to rip up previous projections and dust off worst-case scenarios. Growth forecasts had already been downgraded as 2016 progressed, as the very existence of the referendum dampened business investment, but the crystallisation of these downside risks and the subsequent political turmoil prompted a sharp decline in household, business and investor sentiment.
- 3.3. The repercussions of this plunge in sentiment on economic growth were judged by the Bank of England to be severe, prompting the Monetary Policy Committee (MPC) to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (quantitative easing (QE)) and cheap funding for banks to maintain the supply of credit to the economy. The minutes of the August meeting also suggested that many

members of the Committee supported a further cut in Bank Rate to near-zero levels (the Bank, however, does not appear keen to follow peers into negative rate territory) and more QE should the economic outlook worsen.

- 3.4. In response to the Bank of England's policy announcement, money market rates and bond yields declined to new record lows. Banks are being heavily encouraged to pass on the reduction in rates to customers – great for borrowers, although the outlook for savers is now rather more downbeat. Since the onset of the financial crisis over eight years ago, Arlingclose's rate outlook has progressed from 'lower for longer' to 'even lower for even longer' to, now, 'even lower for the indeterminable future'. Arlingclose's central forecast case for Bank Base Rate is currently 0.25%, but there is a strong possibility that the rate is cut further towards zero.
- 3.5. Meanwhile, inflation is expected to pick up due to a rise in import prices, dampening wage growth and real investment returns. The August Quarterly Inflation Report from the Bank of England forecast a rise in CPI to 0.9% by the end of calendar 2016 and thereafter a rise closer to the Bank's 2% target over the coming year, as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies.

4. Investment Activity

- 4.1. The County Council holds invested funds representing income received in advance of expenditure plus balances and reserves held. The County Council is currently investing according to a low risk, high quality lending list as outlined in its TMS.
- 4.2. The transposition of European Union directives into UK legislation places the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors through potential bail-in of unsecured bank deposits. (The outcome of the EU referendum does not alter the UK's legislated bail-in resolution regime.)
- 4.3. Given the increasing risk and continued low returns from short-term unsecured bank investments, it is the County Council's aim to further diversify into more secure and / or higher yielding asset classes. The majority of the County Council's surplus cash was previously invested in short-term unsecured bank deposits, certificates of deposit and money market funds.
- 4.4. The County Council's investment holding was £546m at 30 September 2016, which was £4m (0.7%) lower than the same time last year, and was placed into the following investment types:

Table 1 – Investments at 30 September 2016

	Overnight	<1 year	>1 year	Total	Av. Rate/Yield	Av. Life
Duration to maturity	£m	£m	£m	£m	%	(Years)
<i>Subject to bail-in risk</i>						
Bank notice accounts		28		28	0.84	0.20
Bank certificates of deposit ¹		30		30	0.55	0.25
	0	58	0	58	0.69	0.23
<i>Exempt from bail-in risk</i>						
Covered floating rate notes		33	70	103	0.76	1.46
Covered fixed bonds		10	15	25	1.16	0.96
Supranational bonds		9		9	0.60	0.19
Government bonds		27		27	0.68	0.19
Corporate fixed bonds		6		6	0.62	0.24
Corporate floating rate notes		10		10	0.67	0.35
Money market funds	5			5	0.38	0.00
Local authorities		98	122	220	1.21	1.38
	5	193	207	405	1.01	1.12
<i>Targeting higher yields</i>						
Local authorities			30	30	3.90	17.40
Pooled property funds			35	35	4.69	n/a
Pooled equity funds ²			13	13	0.77	n/a
Registered provider			5	5	3.40	2.58
	0	0	83	83	3.70	n/a
Total	5	251	290	546	1.46	

- 4.5. Counterparty credit quality was assessed and monitored with reference to credit ratings (the County Council's minimum long-term counterparty rating for institutions defined as having "high credit quality" is BBB across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.
- 4.6. The average interest rate earned on these investments at 30 September 2016 was 1.46%, which should be considered within the context of a recently lowered UK Base Rate of 0.25%, following a period of over 7 years of unchanged UK Base Rate at 0.50%, and very low short-term money market rates. This rate reflects interest rates available prior to the Base Rate cut, and is likely to fall in the coming months.
- 4.7. The Guidance on Local Government Investments in England gives priority to security and liquidity and the County Council's aim is to achieve a yield commensurate with these principles. This has been maintained by following the County Council's counterparty policy as set out in its TMS for 2016/17.

¹ Certificates of deposit have fixed terms but have greater liquidity as they can be sold on the secondary market.

² The average rate/yield listed for pooled equity funds is the total income return for the partial year that the County Council has been invested in these funds.

Investments Targeting a Higher Yield

- 4.8. As part of the 2014/15 Strategy the County Council decided to earmark £90m of its cash balances for investments appropriately targeting a higher yield. This was in addition to the £15m of long term investments that had been made for the Street Lighting PFI scheme. Higher yields can be accessed through long-term cash investments (although this is currently less the case as yields have declined) and investments in other assets than cash, such as pooled property, equities and bonds. Non-cash pooled investments must be viewed as long-term investments in order that monies are not withdrawn in the event of a fall in capital values to avoid crystallising a capital loss.
- 4.9. As shown in Table 1 the County Council has invested £83m of the £105m allocation, and a further £7m has been committed. The County Council is continuing to work with its advisors, Arlingclose, to identify additional opportunities for this allocation. Without this allocation the weighted average return of the Council's cash investments would have been 0.97%, the allocation to higher yielding investments has added 0.49% (£2.7m based on the cash balance at 30 September 2016) to the average interest rate earned by the remainder of the portfolio.
- 4.10. Given the stability of the County Council's cash balances, there is the opportunity to add to this allocation, which would increase the overall rate of return and the income contributed to the revenue budget. It is recommended to increase the allocation targeting higher yields to £200m. This amount represents half of the County Council's forecast minimum cash balance and is therefore an amount that can be managed appropriately as a long-term investment.

5. Borrowing Strategy

- 5.1. The County Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31 March 2016 was £753m. Affordability and the "cost of carry" remained important influences on the County Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.
- 5.2. For the County Council the use of internal resources in lieu of borrowing has, therefore, continued to be the most cost effective means of funding capital expenditure. No new long-term borrowing has taken place to date in 2016/17, nor is planned for the remainder of the year. This has lowered overall treasury risk by reducing both external debt and temporary investments.
- 5.3. As at 30 September 2016 the County Council held £340m of loans, (a decrease of £6m on 31/3/2016), made up of Public Works Loans Board (PWLB) loans and Lender's Option Borrower's Option (LOBO) loans, as part of its strategy for funding previous years' capital programmes.
- 5.4. The premia that applies to the premature repayment of the County Council's PWLB loans is still relatively expensive for the loans in the portfolio, and therefore unattractive for debt rescheduling. As a consequence, no debt rescheduling has taken place. However, consideration will continue to be

given to an advantageous opportunity for the County Council to reduce or restructure its debt portfolio.

- 5.5. The County Council holds £60m of LOBO loans (down from £73m due to the conversion of Barclays LOBO loans, which is further explained in paragraph 5.6) where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost. None of the LOBO loan options were exercised by the lender in the year to date.
- 5.6. In June Barclays Bank informed the County Council of its decision to cancel all the embedded options within standard LOBO loans. This effectively converts £13m of the County Council's Barclays LOBO loans to fixed rate loans removing the uncertainty on both interest cost and maturity date. This waiver has been done by 'deed poll'; it is irreversible and transferable by Barclays to any new lender.

6. Compliance with Prudential Indicators

- 6.1. During the period to date of 2016/17, the County Council operated within the Prudential Indicators for 2016/17, which were set in February 2016 as part of the County Council's TMS Statement.

Authorised Limit and Operational Boundary for External Debt

- 6.2. CIPFA's Code of Practice requires authorities to set an authorised limit for external debt, defined as the sum of external borrowing and other long-term liabilities. The annual strategy report agreed by the County Council in February 2016 set an authorised limit for external debt of £850m.
- 6.3. This limit is based on the estimated CFR in order to enable it to be financed entirely from external borrowing should the County Council's internal reserves become depleted. The limit also includes an allowance for temporary borrowing to cover normal revenue cash flow requirements and unexpected outflows or delays in receiving cash.
- 6.4. The County Council has set an operational boundary for external debt reflecting the more likely scenario and consistent with the County Council's capital plans and TMS. Temporary breaches of 2016/17 operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The County Council approved an operational boundary for 2016/17 of £780m.

Table 2 – Authorised Limit and Operational Boundary for External Debt

	Authorised Limit £m	Operational Boundary £m	2016/17 Actual £m
Borrowing	640	610	442
Other long-term liabilities	210	170	111
Total Debt	850	780	553

- 6.5. During the period to 30 September 2016, borrowing remained well within the authorised limit and operational boundary, and no new long-term borrowing has been taken out.

7. Treasury Management Indicators

- 7.1. The County Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures

- 7.2. The County Council has to set an upper limit on its fixed and variable interest rate exposures for both total investments and total external debt. This indicator is set to control the County Council's exposure to interest rate risk. The County Council approved the following upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed or invested. None of the limits have been exceeded.

Table 3 – Interest Rate Exposures

	2016/17 Limit	Maximum to 30 September 2016
Upper limit on fixed interest rate investment exposure	£285m	£172m
Upper limit on variable interest rate investment exposure	£700m	£473m
Upper limit on fixed interest rate borrowing exposure	£780m	£442m
Upper limit of variable interest rate borrowing exposure	£780m	£111m

- 7.3. The limit for borrowing rate exposures has been set to enable maximum policy flexibility for the potential for refinancing e.g. from variable to fixed rate borrowing. The County Council's entire long-term debt portfolio is currently made up of fixed interest loans.
- 7.4. The upper limit for exposures for investments rates is based on an extreme case of the total investment balances, and to allow for all of this to be held at variable rates (investments with a maturity of less than one year) if necessary.

Maturity Structure of Borrowing

- 7.5. The Code also requires the County Council to set upper and lower percentage limits on the maturity structure of its long-term fixed rate borrowing during 2016/17. The following table shows the limits approved by the County Council. These have been set to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

Table 4 – Maturity Structure of Borrowing

	Upper	Lower	Actual
Under 12 months	50%	0%	3%
12 months and within 24 months	50%	0%	4%
24 months and within 5 years	50%	0%	9%
5 years and within 10 years	75%	0%	12%
10 years and within 20 years	75%	0%	47%
20 years and within 30 years	75%	0%	23%
30 years and above	100%	0%	2%

Principal Sums Invested for Periods Longer than 364 days

- 7.6. The purpose of this indicator is to control the County Council's exposure to the risk of incurring losses by seeking early repayment of its investments. For 2016/17 the County Council restricted investments for periods of over a year to maximum of £285m. In July 2016 the County Council approved a new limit of £350m. At 30 September 2016 the County Council had £236m of investments with over 364 days to their maturity.