AUDIT AND GOVERNANCE COMMITTEE

11th October 2019

TREASURY MANAGEMENT UPDATE REPORT

Title of Report	Treasury Management Update Report 2019/20
Purpose of Report	In accordance with CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes,* to inform Members about Treasury Management activities for the 2019/20 Financial Year to date.
Recommendations	To note the Treasury Management Update Report.
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1. Background

The Council's Treasury Management Strategy Statement (TMSS) for 2019/20 was approved at a meeting of the Council in February 2019. The Council borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Council's TMSS.

The Council's Treasury Management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management, the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Ministry for Housing Communities and Local Government (MHCLG) revised Investment Guidance which came into effect from April 2019. The CIPFA Code requires that members be informed of treasury management activities at least twice a year. This mid year report ensures the Council is embracing best practice in accordance with CIPFA's recommendations.

The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is a summary document covering capital expenditure and financing, treasury management and non-treasury investments and should be approved by full council. The Council's Capital Strategy, in accordance with CIPFA's requirement, was approved by full Council in February 2019.

This report considers the Treasury Management activities in relation to the TMSS for 2019/20. It includes a summary of the current economic climate, a review of current investments, an update on the borrowing strategy, and compliance with prudential indicators.

2. The Economy to August 2019

Treasury Management is operating in a period of unprecedented uncertainty. The UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. This continued uncertainty will continue to produce significant volatility in financial markets, including bond markets.

The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target in a way that also helps to sustain growth and employment. In early August 2018 the MPC voted to raise the official Bank Rate to 0.75% this subsequently hasn't changed since, they have also maintained the asset purchase programme at £435 billon and the corporate bond purchase programme at £10 billion.

There were a few credit rating changes during the period. Moody's upgraded Barclays Bank Plc's long-term rating to A2 from A1 which has therefore revised the outlook to positive. The agency also upgraded The Co-operative Bank's long-term ratings to B3 from Caa1, this is still below the rating our strategy permits us to invest but it shows positive signs from the bank.

3. Borrowing Strategy 2019/20

At 31st March 2019, the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £305.2 million. Actual external borrowing was £277.7m at this date and £19.1m of other long term liabilities associated with the Council's PFI schemes – a total of £296.8 million, giving a slightly under borrowed position. The gap was funded by £8.4 million of internal borrowing.

The Council has an approved capital programme in 2019/20 funded from grants, revenue contributions, internal borrowing, capital receipts and reserves.

The borrowing strategy for 2019/20 is to hold any borrowing requirement internally, and ensure all long term debt due to mature in the financial year is repaid. Two loans will mature before the end of the financial year totalling £7.9m, both will be repaid in full.

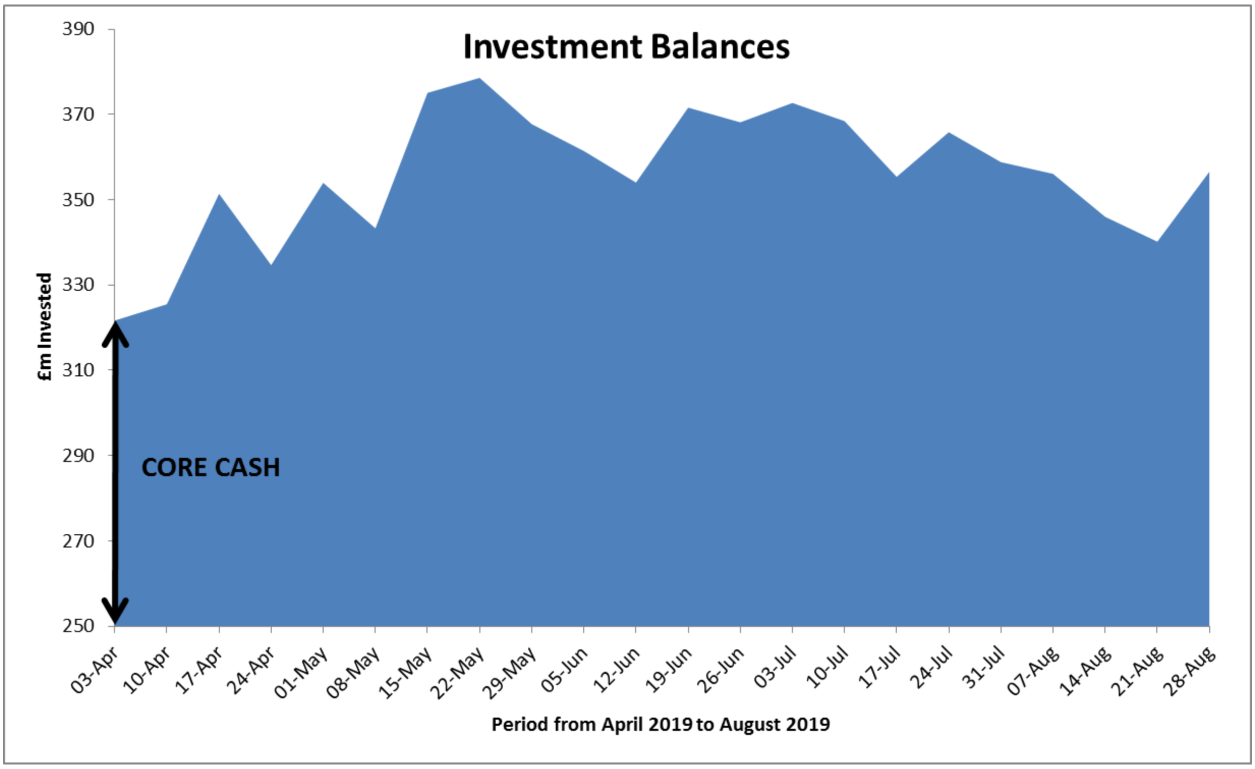
Any shortfall between the underlying need to borrow for capital purposes and total external debt will be funded from internal borrowing because it continues to provide the best value for funding new capital expenditure, as well as being a low risk option.

The average loan cost for the Council is 4.91%, (5.01% on the PWLB portfolio, 5% on other fixed loans and 4.23% on the LOBO loans) – this compares to an average of 4.98% at the same point in 2018/19. The premium charge for early repayment of PWLB debt has remained expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling or early redemption activity. No rescheduling activity has been undertaken as a consequence.

In the period 1st April 2019 to 31st August 2019, no new long term external debt was incurred and no long term external debt was repaid early. The borrowing strategy will be kept under review to ensure the funding methods remain appropriate. The current maturity profile for the Council is shown in Appendix B.

4. Investment Strategy 2019/20

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Cashflow forecasts indicated that during the period April 2019 to August 2019 the Councils investment balances ranged between £322 million and £379 million as shown below, giving a core cash position of up to £322 million (ie balances that could theoretically be invested for longer periods):



The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

The UK Bank Rate was increased to 0.75% back in August 2018. Short-term money market rates have been increasing through the first quarter of year, as have short fixed deposits rates, but rates have begun to fall with markets reacting to the risk of a hard Brexit. Our longer duration strategy has helped to protect interest income over the medium term and the Council is continuing to explore ways of increasing yield whilst ensuring security and liquidity principles.

The current year budget for interest earned is £2.9 million and the current forecast is that this will be exceeded by £2.9 million in 2019/20 – as reflected in the latest Financial Monitoring Report to Cabinet. This improved year end forecast reflects better diversification of investments, longer term deposits and more investments into strategic funds (equity, property etc.)

The average total return on investments as at the end of June 2019 is currently 1.57% (income only return is 1.77%) – this compares to a 1.80% return (or 1.69% income only return) at the same point in 2018/19. The reason for the reduction is due to worsening market rates during 2019/20. The graph at Appendix C shows the performance of the Council from the income only return (ie excluding capital appreciation of investments) compared to other local authorities. The graph at Appendix D shows the rate of return against the Council's risk appetite in comparison to other councils – which shows a top quartile return with a lower than average credit risk exposure.

Internally Managed Funds

The Council has a number of longer term deposits outstanding totalling £91.43 million. This includes £25 million longer term investments with other local authorities, a Property Fund (£30m), longer dated strategic funds (£30m) and a number of secured deposits with financial institutions.

On a shorter term the Council makes regular fixed term deposits for up to one year with both UK (current limit 6 months) and foreign banks, subject to duration limits advised by Arlingclose. Liquidity is maintained through the use of call facilities and money market funds (MMF's).

The following details the maturity profile of internal balances as at 31st August 2019:

Fund Type / Duration	%	£m
Callable and cnav MMF	7.09%	23.735
Vnav MMF (1-3 days notice)	1.49%	5.000
Under 3 months	23.01%	77.000
95 day notice A/C	11.95%	40.000
3-6 months	6.42%	21.500
6-12 months	22.71%	76.000
Over 12 months (incl Longer Dated Funds)	27.32%	91.430
	100.00%	**334.665**

A list of current investments as at 31st August 2019 is provided at Appendix A.

Investment Activity to Date

Investment activity to date is shown in the table below, note that this table includes £0.1m above the total of £334.665m above relating to economic development schemes (Funding Circle £0.1m):

Investments	Balance on 31/03/2019	Investments Made	Maturities/ Investments	Balance on 31/08/2019	Avg Rate (%)
Short term Investments (call accounts, deposits)					
- Banks and Building Societies with ratings of A- or higher	67.1	48.6	-19.8	95.9	0.97%
- UK Government	0.0			0.0	0%
- Local Authorities	96.0	76.0	-60.0	112.0	1.32%
- Housing Association	5.0	0.0	0.0	5.0	1.95%
- Covered Bonds/ FRN (secured)	4.9	0.0	-2.4	2.5	0.55%
Long term Investments					
- Banks and Building Societies with ratings of A- or higher	0.0	0.0	0.0	0.0	0%
- Strategic Funds	60.0	0.0	0.0	60.0	4.56%
- Housing Association	5.0	0.0	0.0	5.0	1.93%
- Covered Bonds/ FRN (secured)	1.4	0.0	0.0	1.4	1.09%
- Local Authorities	54.0	5.0	-34.0	25.0	1.37%
Money Market Funds	20.2	287.7	-285.1	22.8	0.73%
Other Pooled Funds	5.0	0.0	0.0	5.0	1.46%
Other organisations (e.g. loans to small businesses)	0.1	0.0	0.0	0.1	
TOTAL INVESTMENTS	**318.7**			**334.7**	
Increase/ (Decrease) in Investments £m				16.0	

Security of capital remained the Council's main investment objective. This was maintained during the first part of the financial year by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2019/20. This restricts new investments to the following:

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits and loans where the Council may demand repayment at any time (with or without notice),
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £30 million in total,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments,
- shares in money market funds and other pooled funds, and
- reverse repurchase (repo) agreements.

Credit Risk: Counterparty credit quality was assessed and monitored in line with the approved Treasury Management Strategy.

5. Compliance with Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2019/20, which were set in February 2019 as part of the Council's TMSS.

Details can be found in Appendix E.

6. Outlook for the rest of the year

The MPC increased interest rates to 0.75% in August 2018, and Arlingclose's central case is for Bank Rate not to change in 2019. The MPC has a definite bias towards tighter monetary policy. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and that 2) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise.

	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

Arlingclose's view is that the UK economy still faces a challenging outlook as the Government continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

7. Summary

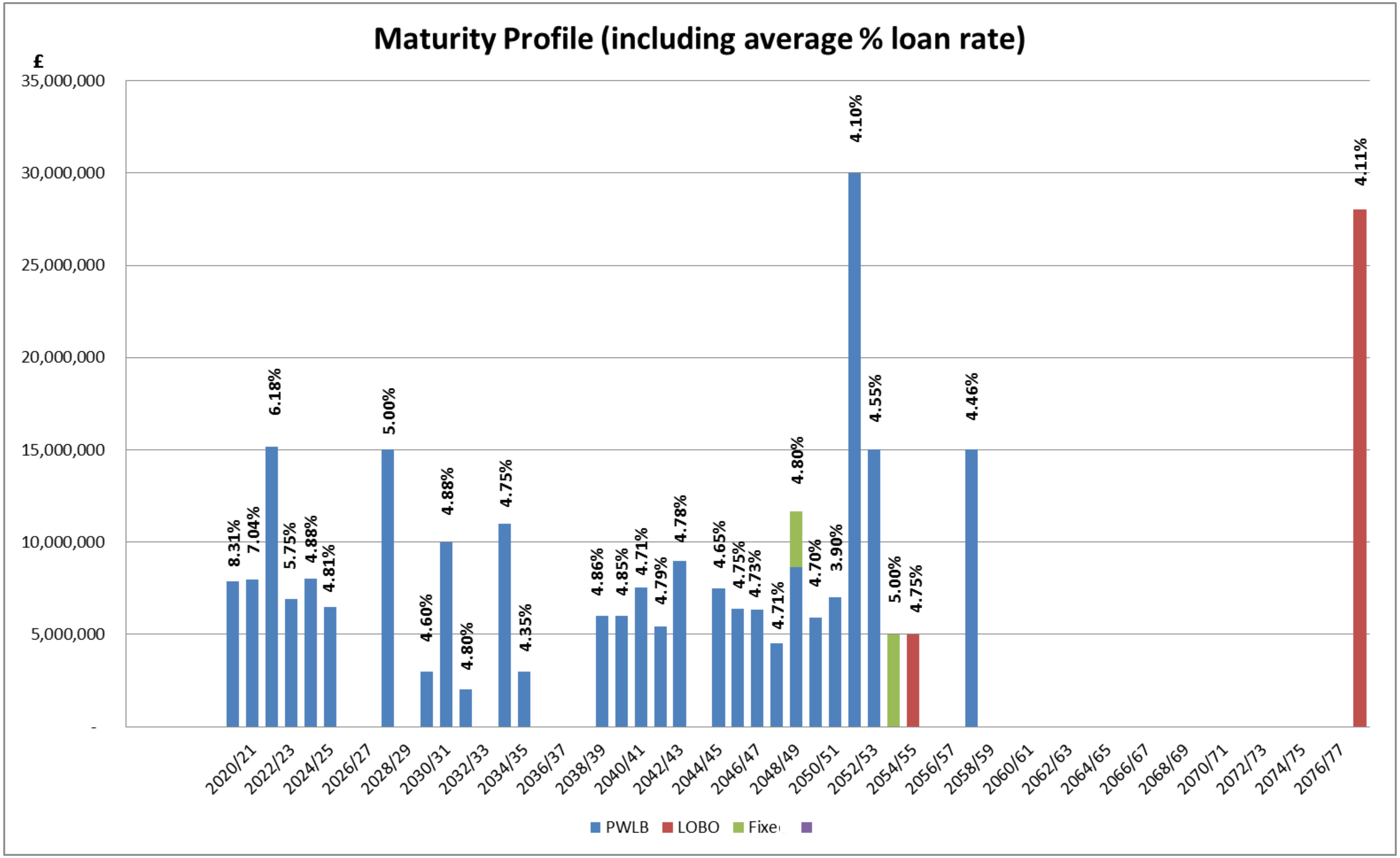
In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first period of 2019/20 to August 2019. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Appendix A

In-House Investments as at 31st August 2019

Type	Country/ Domicile	Counterparty	Current £m Unsecured	Current £m Secured	Maximum Duration Limit (Unsecured)
Term Deposits / Call Accounts / CDs / Covered Instruments	UK	Santander UK Plc (Banco Santander Group)	15.0	1.4	6 months
		Bank of Scotland (Lloyds Banking Group)	-	-	6 months
		Lloyds (Lloyds Banking Group)	15.0	2.5	6 months
		HSBC Bank Plc	5.0	-	6 months
		Close Brothers	5.0	-	6 months
		Nationwide Building Society	-	-	6 months
		Furness Building Society	-	-	100 days
		National Counties Building Society	-	-	100 days
		Barclays Bank Plc	-	-	100 days
		Goldman Sacs International Bank	15.0	-	100 days
		Standard Chartered Bank	5.0	-	6 months
	Australia	Australia and NZ Banking Group	15.0	-	6 months
		Commonwealth Bank of Australia	-	-	6 months
		National Australia Bank	-	-	6 months
		Westpac Banking Corp	-	-	6 months
	Canada	Bank of Montreal	-	-	6 months
		Bank of Nova Scotia	-	-	6 months
		Canadian Imperial Bank of Commerce	-	-	6 months
		Royal Bank of Canada	-	-	6 months
		Toronto-Dominion Bank	-	-	6 months
	Finland	Nordea Bank Finland	5.0	-	13 months
		OP Corporate Bank	-	-	6 months
	Germany	Helaba	-	-	6 months
	Netherlands	ING Bank NV	-	-	100 days
		Rabobank	10.0	-	13 months
		Danske Bank	-	-	100 days
	Sweden	Svenska Handelsbanken	0.9	-	13 months
	Switzerland	Credit Suisse	-	-	100 days
	Singapore	DBS	-	-	13 months
		OCBC	-	-	13 months
		UOB	5.0	-	13 months
LA / Bills	UK	Other UK Local Authorities	137.0	-	4 years
AAA-rated Money Market Funds	UK / Ireland / Luxembourg domiciled	CNAV MMFs	5.0	-	-
		VNAV MMFs (where there is greater than 12 month history of a consistent £1 Net Asset Value)	22.8	-	
Other MMFs and CIS	UK / Ireland / Luxembourg domiciled	Pooled funds which meet the definition of a Collective Investment Scheme per SI 2004 No 534 and subsequent amendments	60.0	-	-
HA's	UK	One Housing Group	5.0	-	5 years
		Southern Housing group	5.0	-	5 years
TOTAL			330.7	3.9	

Appendix B



Maturity Profile (including average % loan rate)
£
35,000,000
30,000,000
25,000,000
20,000,000
15,000,000
10,000,000
5,000,000
-
8.31%
7.04%
6.18%
5.75%
4.88%
4.81%
5.00%
4.60%
4.88%
4.80%
4.75%
4.35%
4.86%
4.85%
4.71%
4.79%
4.78%
4.65%
4.75%
4.73%
4.71%
4.80%
4.70%
3.90%
4.10%
4.55%
5.00%
4.75%
4.46%
4.11%
2020/21
2022/23
2024/25
2026/27
2028/29
2030/31
2032/33
2034/35
2036/37
2038/39
2040/41
2042/43
2044/45
2046/47
2048/49
2050/51
2052/53
2054/55
2056/57
2058/59
2060/61
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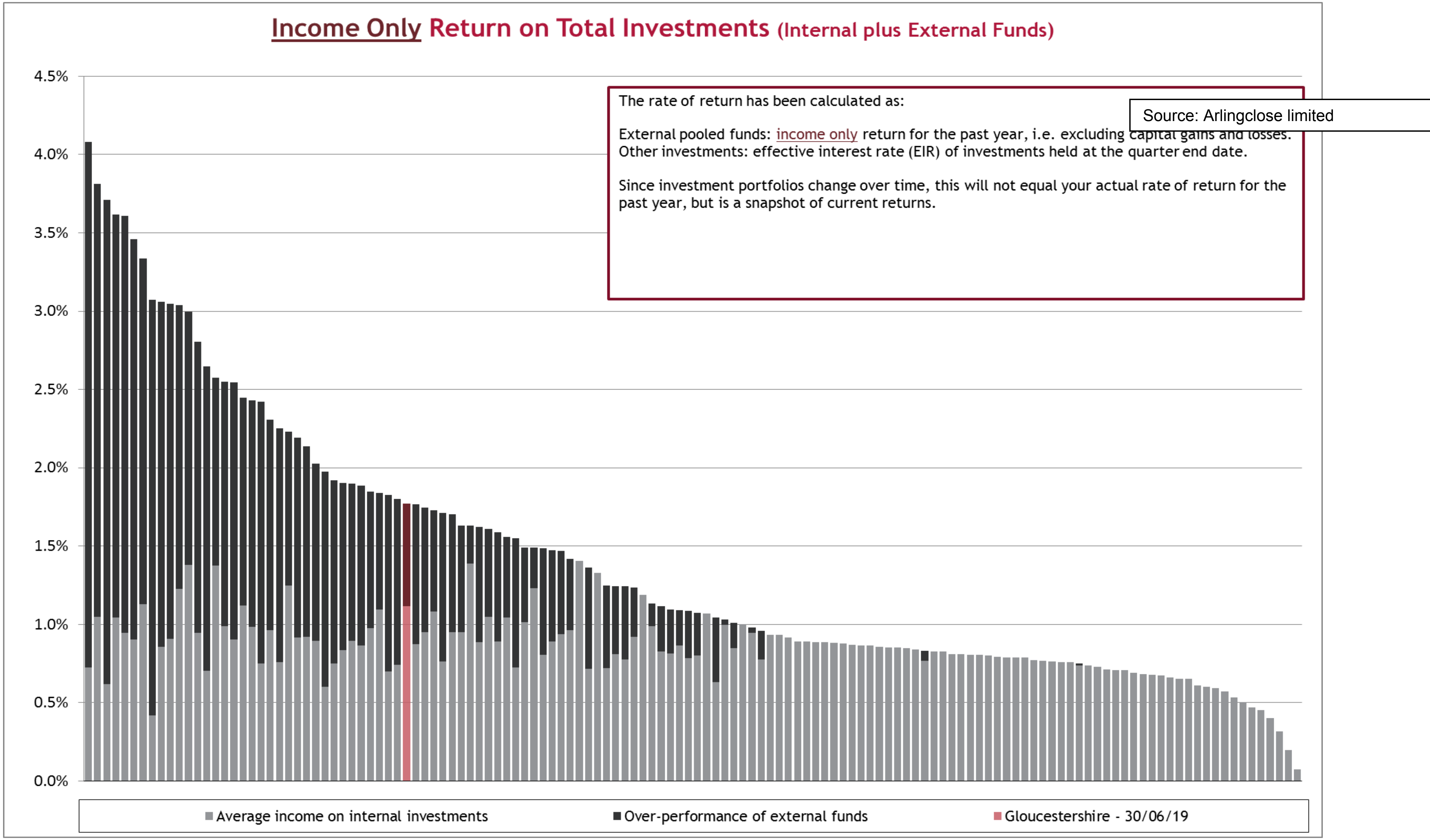
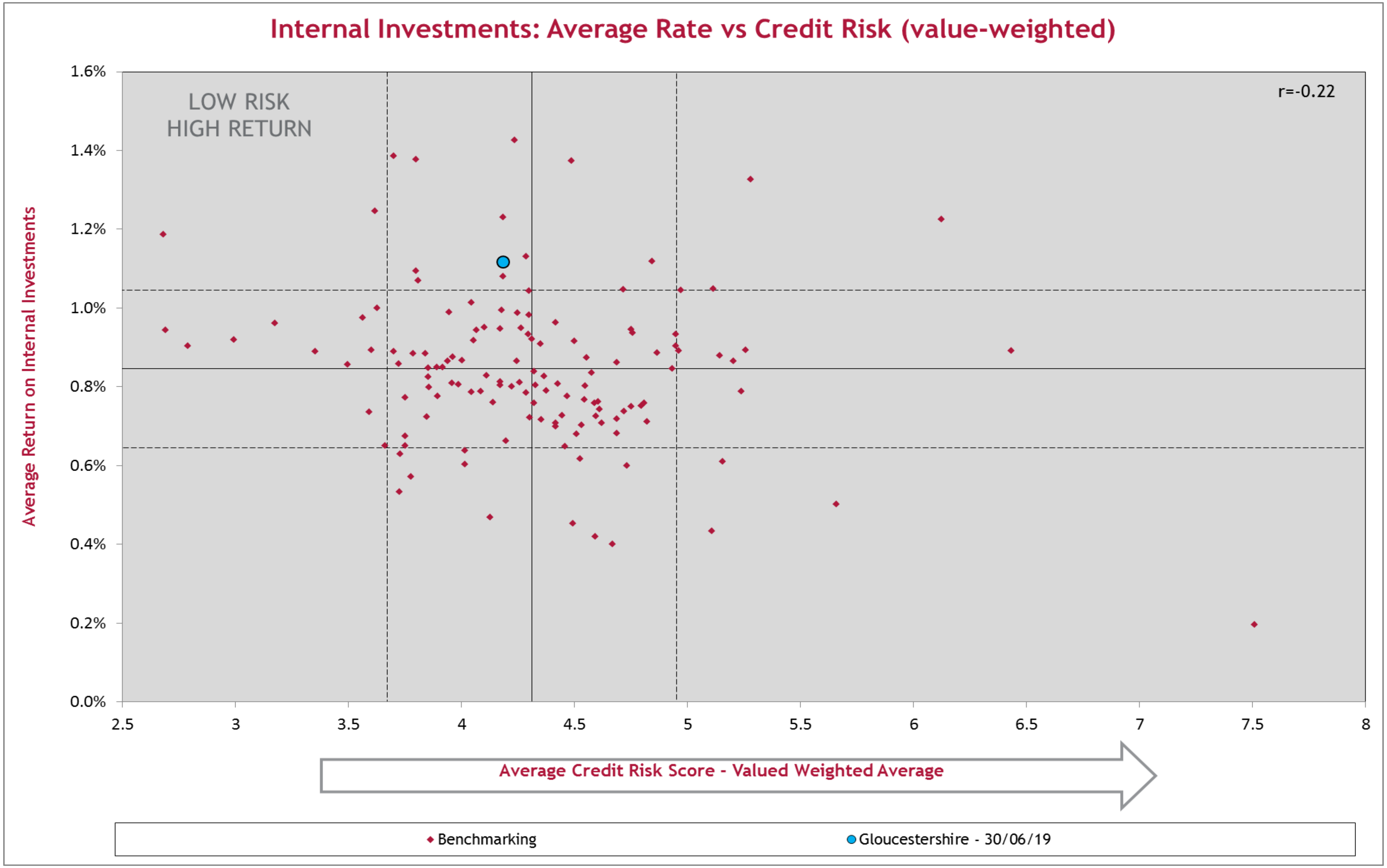
2074/75
2076/77
PWLB
LOBO



Source: Arlingclose limited

Appendix D



Source: Arlingclose limited

Appendix E

Prudential Indicators 2019/20

The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Capital Financing Requirement

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). Estimates of the Council's cumulative maximum external borrowing requirement for 2018/19 to 2020/21 are shown in the table below:

	2018/19 Estimate £m	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Closing CFR	305.188	313.321	327.301	337.680
Less:				
Existing Profile of External Borrowing	277.650	269.786	261.823	251.878
Other Long Term Liabilities (PFI)	19.138	18.465	17.688	17.096
Cumulative Maximum External Borrowing Requirement	**8.401**	**25.070**	**47.790**	**68.706**

The Councils strategy remains to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. The capital financing requirement is forecast to increase over the next three years as the Council invests in a number of approved capital schemes.

Authorised Limit and Operational Boundary for External Debt:

- The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is the statutory limit which should not be breached. The Council's Affordable Borrowing Limit was set at £385m for 2019/20.

- The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. (This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario, without the additional headroom included within the Authorised Limit). The Operational Boundary for 2019/20 was set at £365m.

- There were no breaches to the Authorised Limit and the Operational Boundary during the period to 31/08/19; borrowing at its peak to date was £277.65m.

Proportion of Financing Costs to Net Revenue Stream:

- This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income. The estimate for interest payments in 2019/20 is £13.6 million and for interest receipts is £5.8 million.

	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Proportion of Financing Costs to Net Revenue Stream	4.76%	4.55%	4.57%	4.44%

Maturity Structure of Fixed Rate Borrowing:

- This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit	Lower Limit	Actual Fixed Rate £m Borrowing as at 31/03/19	Actual Fixed Rate £m Borrowing as at 31/03/19	Actual Fixed Rate £m Borrowing as at 31/03/19	Fixed Rate Borrowing as at 31/03/19	Compliance with Set Limits?
	%	%	LOBO*	Market	PWLB	%	
under 12 months	25	0	33.050		7.863	14.7	Yes
12 months and within 24 months	25	0			7.963	2.9	Yes
24 months and within 5 years	50	0			30.045	10.8	Yes
5 years and within 10 years	75	0			21.500	7.7	Yes
10 years and within 20 years	100	0			35.000	12.6	Yes
20 years and within 30 years	100	0		3.000	61.328	22.1	Yes
30 years and within 40 years	100	0		5.000	72.900	28.1	Yes
40 years and within 50 years	100	0			0.000	0.0	Yes
* Note that LOBO's are included in the table above at earliest call date and not at maturity.							

Note: LOBO's are shown at their earliest maturity (call) date. In reality these loans tend to be much longer term and cannot be redeemed early, unless called, without significant penalty. Barclays LOBO's are now classified as fixed loans and their maturity date is shown in the 30-40 years category.

Total principal sums invested for periods longer than 365 days:

- This indicator allows the Council to manage the risk inherent in investments longer than 365 days. The limit for 2019/20 was set at £200m, and in total the Council has £91.4 million invested for over 365 days as follows:
  - The Council has £30 million invested in the CCLA Property Fund. Although funds can be received within 6 months this investment is treated as a longer term investment by the Council as there are no plans to mature the funds.
  - The Council has one longer dated covered bond with Santander for £1.4 million maturing in 2021.

- The Council has £25 million invested longer term with various local authorities, periods ranging from 2 years to 4 years.
- The Council has £15 million invested in multi asset funds. Although funds could be matured earlier this fund is treated as a long term investment.
- The Council has £15 million invested in an equity funds. Although funds could be matured earlier this fund is treated as a long term investment.
- The Council has £5 million invested in a housing association (Southern Housing Group).