

Treasury Management Six Month Performance Review

1.0 Introduction

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

The Council's treasury management strategy for 2019/20 was approved at a meeting on 27th February 2019. The Council has borrowed and invested 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 remain central to the Council's treasury management strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 27th February 2019.

2.0 External Context

2.1 Economic background

Inflation

UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target.

In local context, the inflationary pressures have eased and as a result there is reducing pressure on some budgets. However, the MTFs forecast should factor in the rate of inflation in order to accommodate increase in prices in medium to long term.

Labour Market

The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

In local context, the Council may find it harder to recruit suitable skilled staff and

may have to offer a higher starting salary to attract skilled workers.

Economic Growth

The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

Locally, the challenging conditions in the economy will impact on the Council's services that are income earning.

Politics

Politics both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU.

Withdrawal from the EU may create skills shortages especially in the construction and tourism industries. Whilst it seems to have a no direct impact on the Council, there may be a role for the Council to engage with the local economy to help to support local businesses where there are skills shortages.

Global Monetary Policy

Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

A reduction in economic activity could have an adverse effect on the Council's trading operations (e.g. CIS, Markets, Car Parks, Building Control, Development Control and leisure); as well as receipts from business rates and council tax.

Interest Rates Forecast

The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October.

The historical low level of interest rates, have made it difficult to achieve a higher rates returns on investment.

2.2 Financial markets

After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

2.3 Credit background

Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ring-fenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ring-fenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ring-fenced and non-ring-fenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

3.0 Local Context

On 31st March 2019, the Council had net borrowing of £13.08m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Estimate £m	31.3.19 Actual £m
General Fund CFR	44.60	57.70
Less: *Other debt liabilities	0.50	0.50
Total CFR	44.10	58.20
External borrowing	20.70	28.53
Internal borrowing	23.40	29.67
Less: Usable reserves	39.40	43.12
Less: Working capital	4.00	9.04
Net Investing	20.00	22.49

The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 30th September 2019 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.19 Balance £m	Movement £m	30.9.19 Balance £m	30.9.19 Rate %
Long-term borrowing	28.53	11.70	40.23	2.76
Short-term borrowing	0.00		0.00	
Total borrowing	28.53		40.23	
Long-term investments	12.53	0.12	12.41	3.85
Short-term investments	1.00	(1.00)	0.00	
Cash and cash equivalents	1.92	14.13	16.05	0.59
Total investments	15.45		28.46	3.38
Net borrowing	13.08		11.77	

The large movement in long-term borrowing was as a result of additional borrowing of £11.96m on the 26th June 2019 from PWLB to fund the asset purchase of CMS Distribution TriLink, Wakefield Europort. The total cost of this asset was £14.42m and the remaining £2.46m amount was funded by internal borrowing.

The movement in the cash and cash equivalent has been as result of council tax and NNDR receipts; these funds were invested in bank deposits and Money Market Funds for easy access and liquidity reasons.

3.1 Borrowing Strategy during the period

At 30th September 2019 the Council held £40.23m of loans, an increase of £11.70m to 31st March 2019, as part of its strategy for funding CIS programmes. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.19	Net	30.9.19	30.9.19	30.9.19
	Balance	Movement	Balance	Weighted	Weighted
	£m	£m	£m	Average	Average
				Rate	Maturity
				%	(years)
Public Works Loan Board	28.53	11.70	40.23	2.76	23.90
Local authorities (short-term)	-		-		
Total borrowing	28.53		40.23		23.90

The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

With short-term interest rates remaining much lower than long-term rates, the Council considered it to be more cost effective in the near term to use internal resources or short-term loans instead. The Council had not used short-term loans facility so far in this financial year.

The Council has an increasing CFR due to the capital programme including CIS purchases and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, the Council decided to take some advantage of the fall in external borrowing rates and borrowed £11.96m maturity loans.

Long dated Loans borrowed	PWLB Reference	Amount £	Rate %	Period (Years)
PWLB 1	495152	5,000,000	3.91	39.0
PWLB 2	495153	5,000,000	3.90	38.5
PWLB 3	502463	640,353	2.24	3.5
PWLB 4	504487	698,064	3.28	27.0
PWLB 5	504598	928,734	3.10	27.0
PWLB 6	504810	463,278	2.91	27.0
PWLB 7	504922	375,756	3.10	27.5
PWLB 8	504993	304,723	2.92	27.5
PWLB 9	505255	605,334	2.31	27.5
PWLB 10	505372	464,938	2.18	27.5

PWLB 11	505649	827,972	2.67	28.0
PWLB 12	506436	5,000,000	2.78	18.0
PWLB 13	508696	7,291,685	2.49	19.0
PWLB 14	508931	666,667	1.48	2.0
PWLB 15	509389	11,963,000	2.18	19.5
Total borrowing		40,230,504	2.76	23.9

The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

3.2 Treasury Investment Activity

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held and money borrowed in advance of need. During the year, the Council's investment balances ranged between £2.52m and £24.65 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.19 Balance	Net Movement	30.9.19 Balance	30.9.19 Income Return	30.9.19 Weighted Average Maturity days
	£	£m	£m	%	
Banks & building societies (unsecured)	1,171,315	6,440,685	7,612,000	0.32	30
Government (incl. local authorities)	1,000,000	(1,000,000)	-	-	7
Money Market Funds	745,000	7,695,000	8,440,000	0.73	7
Loans to other organisation	8,566,528	(121,775)	8,444,753	3.29	>365
Other Pooled Funds.					
- Property funds	3,965,539		3,965,539	4.23	>365

Total investments	15,448,382	13,013,910	28,462,292	3.51*
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The weighted average rate for the investment portfolio up to 30.09.2019 was 3.51%.

3.3 Risk Management

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Given the increasing risk and low returns from short-term unsecured bank investments, the Council has maintained a diversified portfolio of asset classes as shown in table 4 above. £7.7m that was available for short-term investment was moved from bank and building society deposits into Money Market funds which had higher rates of return than bank deposits. As a result, investment risk was diversified while the average income return has increased by 0.11% to 3.51%.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return
			%		%
31.03.2019	4.30	AA-	66	2	3.60
30.09.2019	4.72	A+	100	1	1.35
Similar LAs	4.26	AA-	53	86	1.80
All LAs	4.28	AA-	55	29	1.43

*Weighted average maturity

£3.97m of the Council's investments are held in externally managed strategic pooled property funds – CCLA Property Fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. This fund generated an average total return of £83,478 (4.23%), comprising a £29,842 (0.59%) income return from bank deposit

and MMFs combined for period of 1st April to 30 September 2019 which is used to support services in year.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates. In light of their performance over the medium-term and the Council's latest cash flow forecasts, investment in these funds has been maintained.

3.4 Readiness for Brexit

The scheduled leave date for the UK to leave the EU is now 31st October 2019 and there remains little political clarity as to whether a deal will be agreed by this date and there is the possibility that the exit date is pushed back yet again. As 31st October approaches the Council will ensure there are enough accounts open at UK-domiciled banks and Money Market Funds to hold sufficient liquidity required in the near term and that its account with the Debt Management Account Deposit Facility (DMADF) remains available for use in an emergency.

3.5 Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held £60.1m of such investments in:

- directly owned property £60.0m
- shareholding in subsidiaries £0.1m

Table 6: Property held for investment purposes in £'000

Property	Actual Purchase cost	31.3.2019 Gains or (losses)	actual Value in accounts	31.3.2020 Gains or (losses)	expected Value in accounts
Existing Portfolio	19,644	1,234	20,878	0	19,644
2 Stonehill	1,400	250	1,650	0	1,400

80 Wilbury Way	2,200	(125)	2,075	0	2,200
Shawlands Retail Park	6,500	(500)	6,000	0	6,500
1400 & 1500 Parkway	5,425	(175)	5,250	0	5,425
Units 21a, 21b,23a,b,c Little End Road, St Neots	3,200	0	3,200	0	3,200
Rowley Centre, St Neots	7,600	(400)	7,200	0	7,200
Tri-link, Wakefield	13,750	0	0	0	13,750
TOTAL	59,719	284	46,253	0	60,003

These investments generated £2.8m of investment income for the Authority in 2018/19 after taking account of direct costs, representing a rate of return of 6.1%.

The Authority is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Authority is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net profit, the Authority's contingency plans for continuing to provide these services, are to use reserves where necessary to offset any negative variances in the final outturn. Unallocated general fund balances and budget surplus reserve can be used in case of a downturn in investment income to meet any detrimental effect.

Table 7: Proportionality of Investments in £'000

	2017/18 Actual	2018/19 Actual	2019/20 Budget	2020/21 Budget	2021/22 Budget
Gross service expenditure	78,322	75,729	69,951	63,638	59,787
Investment income	2,639	2,753	2,792	2,950	2,516
Proportion	3.4%	3.6%	4.0%	4.6%	4.2%

4.0 Compliance

The Finance Manager (s151 officer) reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 8: Debt Limits

	30.9.19 Actual £m	2019/20 Operational Boundary £m	2019/20 Authorised Limit £m	Complied?
General	10.00	70.00	80.00	Yes
Loans	5.98	15.00	20.00	Yes
CIS	24.25	30.00	30.00	Yes
Total debt	40.23	115.00	130.00	

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt was below the operational boundary all through the quarter.

Table 9: Investment Limits

Deposit Accounts	30.9.19 Actual £m	2019/20 Limit £m	Complied?
NatWest	0.83	1.00	Yes
Debt Management Office (DMO)	-	unlimited	Yes
Santander	2.04	4.00	Yes
Handelsbanken	0.87	4.00	Yes
Barclays	3.88	4.00	Yes

Money Market Funds	30.9.19 Actual £m	2019/20 Limit £m	Complied?
BlackRock Institutional sterling liquidity Fund	1.00	2.00	Yes
CCLA Public Sector Deposit Fund	1.00	1.00	Yes
Federated Short Term Prime Fund	1.50	2.00	Yes
Insight Liquidity Funds	1.50	2.00	Yes
Legal & General Sterling Liquidity Fund	2.00	2.00	Yes
Aberdeen Liquidity Fund	0.44	2.00	Yes

5.0 Treasury Management Indicators

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

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.19 Actual	2019/20 Target	Complied?
Portfolio average credit rating	A+	A-	Yes

Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.9.19 Actual £m	2019/20 Target £m	Complied ?
Total cash available within 3 months	14.2	2.0	Yes

Interest Rate Exposures

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	30.9.19 Actual	2019/20 Limit	Complied?
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	0*	£128,000	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	0*	£128,000	Yes

*There has not been any significant change in interest rate of borrowing that could impact the Council's one-year revenue because the PWLB loans were all fixed rates.

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.19 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	0%	80%	0%	Yes
12 months and within 24 months	6.70%	80%	0%	Yes
24 months and within 5 years	6.70%	80%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	86.70%	100%	0%	Yes

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than a year

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2019/20	2020/21	2021/22
Actual principal invested beyond year end	£8.44m	£7.56m	£7.19m
Limit on principal invested beyond year end	£10.00m	£10.00m	£10.00m
Complied?	Yes	Yes	Yes

