Treasury Management Mid-year Report for 2019/20

SUMMARY

This Report advises members of the Treasury Management Service performance for 2019/20 as at 30th September 2019 and illustrates the compliance to-date with the Treasury Management Indicators for 2019/20.

Portfolio - Finance **Date signed off: 4th November 2019**	
Wards Affected	**All**

Recommendation

The Executive is advised to NOTE and COMMENT on the report.

1. Executive Summary

1.1 This report sets out the performance of the Council's investments and borrowing for the first six months of the year. It is also intended to demonstrate that the Council is complying with the Treasury Management Indicators set by Full Council as part of the Treasury Management Strategy.

1.2 1The Council is complying with all the Treasury Management Indicators set for 2019/20 as at the 30th September 2019.

2. Resource Implications

2.1 None directly as a result of this paper, but the investment income and borrowing costs do impact the revenue budget.

3. Key Issues

Background

3.1 The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid- year and at year end).

3.2 The Council's Treasury Management Strategy for 2019/20 was approved by Executive on 19th February 2019.

3.3 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 19th February 2019.

3.4 Through investment, the Council is potentially exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The Council is also exposed to increases in revenue costs on its borrowing due to changes in interest rates. The Council seeks to moderate this impact by following the advice of its treasury advisers. This report covers treasury and borrowing activity and the associated monitoring and control of risk.

Local Context

3.5 At 31 March 2019, the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £189.7m (2018/19 - £142.2m), an increase of £47.5m from 2018/19 mainly due to property acquisitions of £41m during the year. The property acquisitions were in respect of industrial units at Trade City in Frimley and Vulcan Way in Sandhurst and Theta Building in Frimley. The Council must not borrow in excess of its CFR requirement and indeed at the 30th September total borrowing was £151.2m.

3.6 The Council's CFR is predicted to increase over the next 3 years due to the capital programme as currently known. Any further capital investment, for example in investment in property, would increase the CFR further still.

4. Treasury Performance

Borrowing Activity to 30th September 2019

4.1 At 30 September 2019 the Council held £151.85m of borrowing, (a decrease of £23.8m on 31/3/2019) as part of its strategy for funding previous and current year's capital programmes. The decrease was due to repayment of short term borrowing that became due in the first period of the financial year 2019/20 being repaid by PWLB loans that were taken at the end of the 2018/19 financial year.

The borrowing position is shown in the table below:

Borrowing Position - 30.09.2019

	31.3.19 Balance £m	Movement £m	30.09.19 Balance £m	30.09.19 Weighted average rate %
Public Works Loan Board	57.30	-0.54	56.76	2.54%
Local authorities (long-term)	0.51	-0.27	0.25	0.00%
Local authorities (short-term)	117.85	-23.00	94.85	0.82%
Total Borrowing	**175.65**	**-23.80**	**151.85**	**1.68%**

4.2 At 30th September 2019, the Council had an upper authorised operational limit of borrowing £185m.

4.3 The Council's chief objective when borrowing continues to be striking 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 rates remaining much lower than long term rates, on the advice of its treasury advisers, the Council considered it to be more cost effective in the near term to borrow short term loans instead.

4.4 In order to reduce risk the Council entered into £50million of forward starting loans during 2017/18 with forward starting dates. Hence in 2020/21 a loan of £25million with a fixed interest rate of 2.853% will be advanced to the Council and then a further £25m in 2021/22 with a fixed interest rate of 2.908% will be advanced. Both loans will be repayable over 40 years.

4.5 The PWLB has increased the margin applied to loan rates by 100 basis points as of 9th October 2019. The new margin above gilts is now 180 basis points for certainty rate loans. Early repayment rate margins are unchanged. They cite an increase in the use of PWLB loans at some authorities in recent months as the cost of borrowing has fallen to record lows. This means that the cost of borrowing for 50 years is now almost 3%.

Investment Activity to 30th September 2019

4.6 The Council held invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Council's average investment balance was £11.9 million.

4.7 The Council's investment position at the half year is shown in the table below.

Investment Activity Summary at 30 September 2019

Investment Counterparty	Balance on 01/04/19	Investments Made	Maturities/ Investments Sold	Balance on 30/09/19	Average Income Rate at 30th September
	£000s	£000s	£000s	£000s	%
UK Central Government					
- Short Term	27,500	84,050	(109,750)	1,800	0.50%
Banks, Building Societies & Other Organisations					
- Short Term	646	34,403	(34,702)	347	0.21%
AAA-rated Money Market Funds					
- Short Term Cash Equivalents	0	25,150	(15,150)	10,000	0.69%
- Long Term	2,184	14	0	2,198	4.23%
Total Investments	**30,330**	**143,617**	**(159,602)**	**14,345**	**1.17%**

4.8 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.

4.9 The Council maintained its investment of £2m in the CCLA Property Fund whilst the remainder of investments were invested in money market funds. This £2m longer term investment generated an average total return of £55k (4.23% dividend yield), comprising £42k income return which is used to support services in year, and £13k of capital growth.

4.10 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 the Council's, investment in these funds has been maintained.

4.11 Annex A lists the Council's investments as at the 30th September 2019.

Credit Risk

4.12 The table below shows counterparty credit quality as measured by credit ratings.

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2019	3.01	AA	3.00	AA
30/09/2019	4.36	AA-	3.55	AA-

The value weighted average and time weighted average credit ratings reduced to 4.36 and AA- respectively at 30.09.2019 compared to 3.01 and AA at 31.03.2019. This was due to the reduction in investments in the AA rated Debt Management Office at 30.09.2019. This AA- rating at 30.09.19 is still above the Council's target of A+.

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Budgeted Income and Outturn

4.13 The average cash balance was £10m during the half year. The Council's best performing investment was its £2m of externally managed pooled (property fund) which generated income of £55k to 30/09/19.

4.14 The balance of the Council's investments were kept in short-term moneymarkets.

4.15 The Council's investment income for the first six months was £86k compared to an annual budgeted figure of £140k.

Readiness for Brexit

4.16 The scheduled leave date for the UK to leave the EU is now 31st January 2020 as 31st January 2020 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.

Counterparty Update provided in association with Arlingclose Treasury Advisers

4.17 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-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ringfenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

7.1 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-.

Compliance with Treasury Management Indicators

4.18 The Council confirms compliance with its Treasury Management Indicators in the period to 30th September 2019. These were set in February 2019. Details of these indicators are shown in Annexes B and C.

Economic Review and Outlook for the remainder of the year

4.19 The Council's advisers Arlingclose have provided an Economic Review of the year so far and an outlook for Quarters 3 and 4. This is included in Annex D.

5. Options

5.1 The Executive is asked to note and comment on the report as appropriate.

6. Proposals

6.1 It is proposed that the Executive NOTE and COMMENT on the report;

7. Corporate Objectives and Key Priorities

7.1 The Treasury Management processes support the Council's objective of 'Delivering services efficiently, effectively and economically'.

8. Policy Framework

8.1 The Council fully complies with the requirements of the CIPFA Code of Practiceon Treasury Management. The current relevant criteria and constraints incorporated into the Treasury Management Policy Statement are:

- New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council's prudential indicators.

- Investments to be made in accordance with the MHCLG guidance on Local Council Investments, on the basis of credit ratings agencies and as detailed in the Treasury Management Policy statement and approved schedules and practices.

- Sufficient funds to be available to meet the Council's estimated outgoings for any day.

- Investment objectives are to maximise the return to the Council balanced against the risks to protect reserves.

9. Legal Issues

9.1 The report demonstrates that the Council is complying with the Prudential Framework.

10. Risk Management

10.1 Weak returns on investments could lead to a reduction in income generated to support the revenue budget.

10.2 The limits in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Executive Head of Finance in consultation with the Portfolio Holder for Finance to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

10.3 The Council has taken and acted on advice from its advisers in relation to increasing returns albeit at increased risk and its borrowing strategy. There are risks that interest rates can change and that any investment is not guaranteed.

10.4 The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating. However this can be mitigated by spreading investments amongst a number of institutions.

11. Officer Comments

11.1 None other than within the report.

ANNEXES	**Annex A – Investments as at 30th September 2018** **Annex B – Treasury Management Performance Indicators**
BACKGROUND PAPERS	**CIPFA code on Treasury Management**
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Annex A

INVESTMENTS as at 30th September 2019

	£
Debt Management Office	1,800,000
Total Central Government	**1,800,000**
Money Market Fund - Aberdeen Standard	3,000,000
Money Market Fund - BlackRock	3,000,000
Money Market Fund - CCLA	1,000,000
Money Market Fund - Legal and General	3,000,000
Total Money Market Funds	**10,000,000**
CCLA Property Fund	2,198,234
Total Longer Term Investments	**2,198,234**
NatWest Bank Accounts	346,099
Total Invested	**14,344,332**

Annex B

Treasury Management Indicators as at the 30th September 2019

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

Debt Limits: 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.

	30.9.19 Actual £m	2019/20 Operational Boundary £m	2019/20 Authorised Limit £m	Complied? Yes/No
Borrowing	151.85	185.00	190.00	Yes

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 fixed rate borrowing will be:

	Upper	Lower	Actual	30.09.19 £000s
Not over 1 year	100%	0%	63%	95,690
Over 1 but not over 2 years	100%	0%	2%	3,350
Over 2 but not over 5 years	100%	0%	2%	3,283
Over 5 but not over 10 years	100%	0%	4%	5,571
Over 10 but not over 15 years	100%	0%	5%	7,216
Over 15 but not over 20 years	100%	0%	4%	5,887
Over 20 but not over 30 years	100%	0%	4%	5,337
Over 25 but not over 30	100%	0%	2%	3,073
Over 30 but not over 40 years	100%	0%	7%	11,027
Over 40 years	100%	0%	8%	11,415
Total				**151,848**

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 total principal sum invested to final maturities beyond the period end will be:

	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£2m	£2m	£2m
Actual	£2m		

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average [credit rating] or [credit score] 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.

	Target	Actual 30/09/2019
Portfolio average credit rating	A+	AA-

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.

	Target	Actual 30/09/2019
Total cash available within 3 months	£5m	£7m

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The Council has set the limit on one-year revenue impact of a 1% rise in interest rates at £1m. The Council complied with this indicator as the interest payable for the half year was £824k. The Council has sufficient reserves in an Interest Equalisation Reserve to mitigate the impact of an interest rate rise for 2019/20.

Annex C

Additional Compliance Information

The Council reports that all treasury management activities undertaken during complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in the table below:

Investment Limits

	2019/20 Limit	**30.9.19 Actual**	**Complied**
Any single organisation, except the UK Government	£3m each	0	Yes
UK Central Government	Unlimited	£1.8m	Yes
Any group of organisations under the same ownership	£3m per group	£0.3m	Yes
Any group of pooled funds under the same management	£5m per manager	£2.2m	Yes
Negotiable instruments held in a broker's nominee account	£10m per broker	0	Yes
Limit per non-UK country	£2m per country	0	Yes
Registered providers	£5m in total	0	Yes
Unsecured investments with building societies	£5m in total	0	Yes
Loans to unrated corporates	£2m in total	0	Yes
Money Market Funds	£10m in total	£10.0m	Yes

Annex D

Economic Review provided by the Council's Treasury Advisors, Arlingclose

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. 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.

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.

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. Mr Johnson prorogued Parliament which led some MPs to put forward a bill requiring him to seek a Brexit extension if no deal is in place by 19th October. The move was successful and, having been approved by the House of Lords, was passed into law. The Supreme Court subsequently ruled Mr Johnson's suspension of Parliament unlawful.

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.

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.

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%.

Outlook for the remainder of 2019/20

The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased dramatically.

There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance.

Parliament appears to have frustrated UK Prime Minister Boris Johnson's desire to exit the EU on 31st October. The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out for 2019 and the risk of this event remains for 2020. The risk of a general election in the near term has, however, increased.

Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will continue to offer longer-term borrowing opportunities.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-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 Cas	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	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75