

<b>Audit Committee</b>	<b>Agenda Item:</b>
<b>Meeting Date</b>	21 January 2020
<b>Report Title</b>	Treasury Management Half Year Report 2019/20
<b>Cabinet Member</b>	Cllr Roger Truelove, Leader and Cabinet Member for Finance
<b>SMT Lead</b>	Nick Vickers, Chief Financial Officer
<b>Head of Service</b>	Nick Vickers, Chief Financial Officer
<b>Lead Officer</b>	Phil Wilson, Financial Services Manager & Olga Cole, Management Accountant
<b>Key Decision</b>	No
<b>Classification</b>	Open
<b>Recommendations</b>	<ol style="list-style-type: none"> <li>1. To note the performance information in this report.</li> <li>2. To approve the prudential and treasury management indicators within the report.</li> </ol>

## 1. Purpose of Report and Executive Summary

- 1.1 The purpose of this report is to review the mid-year outturn position on treasury management transactions for 2019/20, including compliance with treasury limits and Prudential and Treasury Performance Indicators. The report was to go to the Audit Committee on 27 November, but the meeting was re-arranged due to the General Election. The report will go to Council on 26 February 2020.
- 1.2 The Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services, which requires the Council to approve treasury management half-year and annual reports.
- 1.3 The Council's treasury management strategy for 2019/20 was approved at a meeting on 20 February 2019. The Council has 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 is therefore central to the Council's treasury management strategy.

## 2. Background

### Market Environment

- 2.1 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.

- 2.2 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.
- 2.3 The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment linked largely to concerns over trade wars.
- 2.4 The Public Works Loan Board (PWLB) increased the margin applied to loan rates by 100 basis points (one percentage point) on 9 October 2019, the new margin above gilts is now 180 basis points for certainty rate loans. HM Treasury say that the reason for the increase in the PWLB borrowing rate was the significant rise in the use of PWLB loans by some authorities. It seems to reflect Government concern over councils borrowing to buy existing commercial property assets. Given that Government also wants to encourage borrowing for Housing and Regeneration purposes, the action does seem to be misguided.
- 2.5 There are plenty of alternatives to the use of the PWLB, such as borrowing from other councils, which is what we have done.

#### Borrowing

- 2.6 In 2019/20, the Council took out two loans of £5 million each, from other local authorities. One loan was for 12 months at a rate of 0.95% and the second loan was for 18 months at a rate of 1.1%.
- 2.7 Together with the two loans taken out in 2018/19, this meant that on 30 September 2019, the Council's external borrowing stood at £20 million.

#### Investments

- 2.8 The counterparties agreed by Cabinet and Council earlier this year, when the 2019/20 Treasury Strategy was approved are:

<b>Counterparties</b>	<b>Limit</b>
Debt Management Office (Debt Management Account Deposit Facility) and Treasury Bills	Unlimited
Major UK banks / building societies. (Barclays, HSBC, Lloyds Banking Group, RBS Group, Santander UK, Nationwide, Standard Chartered) unsecured deposits	£3m
Svenska Handelsbanken unsecured deposits	£3m
Leeds Building Society unsecured deposits	£1.5m
Close Brothers unsecured deposits	£1.5m
Money Market Funds	£3m each
Pooled Funds e.g. Property Real Estate Investment Trusts (REITs), Absolute return, Equity income	£3m each

<b>Counterparties</b>	<b>Limit</b>
Church, Charities and Local Authorities (CCLA) Property Fund	£3m
Supranational Bonds	£3m in aggregate
Corporate Bond Funds and Corporate Bonds	£3m in aggregate
Non treasury investments	To be agreed on a case by case basis
Covered Bonds	£3m in aggregate with £1m limit per bank

- 2.9 Investments held at 30 September 2019 can be found in Appendix I.
- 2.10 Interest income received for the first half of 2019/20 was £157,355.80.
- 2.11 For the six months to 30 September 2019, the Council maintained an average sum invested of £28.9m compared with an original budget of £23.5m, and an average rate of return of 1.09% compared to a budget of 0.47%.
- 2.12 The results for the six months to 30 September 2019 show that the Council achieved 0.56% average return above the average 7 day London Interbank Bid Rate (LIBID) and 0.34% average return rate above the average Bank of England Base Rate.
- 2.13 The Council has £3m invested in an externally managed property fund which is the CCLA property fund which generated an average total return of 4.42%, comprising a £66,507.81 income return. Since this fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. In light of its performance and the Council's latest cash flow forecasts, investment in this fund has been maintained.

#### Compliance with Prudential Indicators

- 2.14 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 Treasury Management Strategy Statement. The Council is required to report on the highly technical Prudential Indicators. There are no issues of concern to highlight with members. The indicators are based on approved commitments and the current budget.
- 2.15 Prudential and Treasury Management Indicators are set out in Appendix II.

### **3. Proposals**

- 3.1 No changes are proposed at this stage.

## 4. Alternative Options

- 4.1 The Chief Financial Officer will consider changes to the counterparty criteria with reference to the Council's agreed policy with regard to risk.

## 5. Consultation Undertaken

- 5.1 Consultation has been undertaken with Arlingclose.

## 6. Implications

Issue	Implications
Corporate Plan	Supports delivery of the Council's objectives.
Financial, Resource and Property	As detailed in the report.
Legal, Statutory and Procurement	Need to comply with MHCLG guidance on treasury management.
Crime and Disorder	Following CIPFA's Treasury Management Code of Practice is important to avoid involvement in potential fraud or money laundering.
Environment and Sustainability	The Council does not own any shares or corporate bonds so there are no ethical investment consideration to be met.
Health and Wellbeing	Not relevant to this report
Risk Management and Health and Safety	Risk is controlled through adherence to specific guidance included in CIPFA's Treasury Management Code of Practice. The principle of security of funds over-rides investment performance.
Equality and Diversity	Not relevant to this report
Privacy and Data Protection	Not relevant to this report

## 7. Appendices

- 7.1 The following documents are to be published with this report and form part of the report.

- Appendix I: Investments and Borrowing as at 30 September 2019
- Appendix II: Prudential and Treasury Management Indicators

## 8. Background Papers

None

## Investments and Borrowings as at 30 September 2019

Counterparty	Long-Term Rating	Balance Invested & Borrowed at 30 September 2019 £'000
Debt Management Office (Bank of England)	AA	3,350
Debt Management Office (Bank of England)	AA	350
<b>Total Bank Deposits</b>		<b>3,700</b>
<b><u>Money Market Funds</u></b>		
Invesco Money Market Fund	AAmmf	3,000
Deutsche Money Market Fund	AAmmf	2,130
Goldman Sachs Money Market Fund	AAmmf	3,000
Aberdeen Money Market Fund	AAmmf	3,000
Black Rock Money Market Fund	AAmmf	3,000
JP Morgan Money Market Fund	AAmmf	690
Amundi Money Market Fund	AAmmf	3,000
Morgan Stanley Money Market Fund	AAmmf	3,000
SSGA Money Market Fund	AAmmf	3,000
CCLA Property Fund		3,000
<b>Total Money Market and Property Funds</b>		<b>26,820</b>
<b>Total Investments</b>		<b>30,520</b>
London Borough Hammersmith & Fulham		-5,000
Wycombe District Council		-5,000
London Borough of Camden		-5,000
London Borough of Islington		-5,000
<b>Total Borrowing</b>		<b>-20,000</b>

The Ratings above are from Fitch credit rating agency. The Long-Term Rating is the benchmark measure of probability of default. These ratings are shown for illustrative purposes only, as the Council uses the lowest rating across three agencies on which to base its decisions.

AAmmf: Fund have very strong ability to meet the dual objective of providing liquidity and preserving capital

AA: Banks with AA rating are judged to be of low credit risk

## Investments and Borrowings as at 30 September 2019

Investment Activity in 2019/20

<b>Investments</b>	<b>Balance on 01/04/2019</b>	<b>Investments Made</b>	<b>Investments Repaid</b>	<b>Balance on 30/09/2019</b>	<b>Average Rate</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>%</b>
Short Term Investments and Cash and Cash Equivalents	17,990	98,920	(89,390)	27,520	1.09
Long Term Investments	3,000	0	0	3,000	4.42
<b>TOTAL INVESTMENTS</b>	<b>20,990</b>	<b>98,920</b>	<b>(89,390)</b>	<b>30,520</b>	

Borrowing Activity in 2019/20

<b>Borrowing</b>	<b>Balance on 01/04/2019</b>	<b>Borrowing Made</b>	<b>Borrowing Repaid</b>	<b>Balance on 30/09/2019</b>	<b>Average Rate</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>%</b>
External Borrowing	10,000	10,000	0	20,000	1.125
<b>Total Borrowing</b>	<b>10,000</b>	<b>10,000</b>	<b>0</b>	<b>20,000</b>	

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 Council 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 Council holds £3m of such investments in directly owned property.

These investments are expected to generate £0.2m of investment income for the Council after taking account of direct costs, representing a rate of return of 5.9%.

## Prudential and Treasury Management Indicators

### 1. Background

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in local authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

### 2. Gross Debt and the Capital Financing Requirement (CFR)

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

<b>Gross Debt and the Capital Financing Requirement</b>	<b>2018/19 Actual</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Capital Financing Requirements	27,765	42,475	41,395	40,314
Gross External Debt	(10,000)	(5,000)	0	0
<b>Net Investments</b>	<b>17,765</b>	<b>37,475</b>	<b>41,395</b>	<b>40,314</b>

**External Borrowing:** as at 30 September 2019 the Council had £20 million of external borrowing – please see Appendix I for further details.

## Prudential and Treasury Management Indicators

## 3. Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

<b>Capital Expenditure and Financing</b>	<b>2018/19 Actual £'000</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>	<b>2021/22 Estimate £'000</b>
<b>Total Expenditure</b>	<b>18,871</b>	<b>18,652</b>	<b>2,240</b>	<b>2,470</b>
Capital receipts	438	350	0	0
Grants and other contributions	2,382	3,763	2,105	2,264
Reserves	359	326	135	206
Internal/External borrowing	15,692	14,213	0	0
<b>Total Financing</b>	<b>18,871</b>	<b>18,652</b>	<b>2,240</b>	<b>2,470</b>

## 4. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability, highlighting the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code. The ratio is based on costs net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2018/19 Actual %</b>	<b>2019/20 Estimate %</b>	<b>2020/21 Estimate %</b>	<b>2021/22 Estimate %</b>
Total	0.94	3.2	5.6	5.4



## Prudential and Treasury Management Indicators

**5. Actual External Debt**

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

<b>Actual External Debt as at 30/09/2019</b>	<b>£'000</b>
Borrowing	20,000
Other Long-term Liabilities	0
<b>Total</b>	<b>20,000</b>

**6. 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) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing, and its approved treasury management strategy and practices.

The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

<b>Authorised Limit for External Debt</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>	<b>2021/22 Estimate £'000</b>
Borrowing	60,000	60,000	60,000
Other Long-term Liabilities	2,000	2,000	2,000
<b>Total</b>	<b>62,000</b>	<b>62,000</b>	<b>62,000</b>

The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst-case scenario but without the additional headroom included within the Authorised Limit.

## Prudential and Treasury Management Indicators

<b>Operational Boundary</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>	<b>2021/22 Estimate £'000</b>
Borrowing	55,000	55,000	55,000
Other Long-term Liabilities	500	500	500
<b>Total Debt</b>	<b>55,500</b>	<b>55,500</b>	<b>55,500</b>

The Chief Financial Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30 September 2019.

## 7. Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums (i.e. fixed rate debt net of fixed rate investments).

<b>Upper Limit for Interest Rate Exposure</b>	<b>Existing level at 30/09/19</b>	<b>2019/20 Approved Limit</b>	<b>2020/21 Approved Limit</b>	<b>2021/22 Approved Limit</b>
Interest on fixed rate borrowing	100%	100%	100%	100%
Interest on fixed rate investments	-12%	-100%	-100%	-100%
<b>Upper Limit for Fixed Interest Rate Exposure</b>	<b>88%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>
Interest on variable rate borrowing	0%	100%	100%	100%
Interest on variable rate investments	-88%	-100%	-100%	-100%
<b>Upper Limit for Variable Interest Rate Exposure</b>	<b>-88%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>

## Prudential and Treasury Management Indicators

### 8. Maturity Structure of Borrowing

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

Maturity structure of fixed rate borrowing	Existing level at 30/09/19 %	Lower Limit for 2019/20 %	Upper Limit for 2019/20 %	Complied
Under 12 months	0	0	100	✓
12 months and within 24 months	100	0	100	✓
24 months and within 5 years	0	0	100	✓
5 years and within 10 years	0	0	100	✓
10 years and above	0	0	100	✓

### 9. Credit Risk

The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- sovereign support mechanisms;
- credit default swaps (where quoted);
- share prices (where available);
- economic fundamentals, such as a country's net debt as a percentage of its GDP;
- corporate developments, news, articles, markets sentiment and momentum; and
- subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

## Prudential and Treasury Management Indicators

The Chief Financial Officer confirms that there were no breaches to counterparty limits or credit ratings at the time of placing investments.

### 10. Principal Sums Invested for Periods Longer than over 364 days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

<b>Total Principal Sums Invested Over 364 Days</b>	<b>2019/20</b> <b>£'000</b>
Upper Limit Estimate	10,000
Actual	3,000
Complied?	✓

### 11. Investment Benchmarking for the six months to 30 September 2019

Average Actual Return on Investments	Original Estimate Return on Investments	Average Bank Base Rate	Average 7 day LIBID Rate
1.09%	0.47%	0.75%	0.53%