Title of meeting:	Cabinet City Council
Date of meeting:	Cabinet 4th February 2020 City Council 11th February 2020
Subject:	Treasury Management Mid-Year Review 2019/20
Report by:	Director of Finance and Information Technology (Section 151 Officer)
Wards affected:	All
Key decision:	No
Full Council decision:	Yes

1. Executive Summary

This report outlines the Council's performance against the treasury management indicators approved by the Council on 19 March 2019.

2. Purpose of report

The purpose of the report is to inform members and the wider community of the Council's Treasury Management position at 30 September 2019.

In March 2009 the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Panel issued a bulletin relating to Treasury Management in Local Authorities. The bulletin states that "in order to enshrine best practice it is suggested that authorities report formally on Treasury Management activities at least twice yearly and preferably quarterly". The report in Appendix A covers the first six months of 2019/20.

3. Recommendations

It is recommended that:

3.1 It be noted that there have been no breaches of the Treasury Management Policy 2019/20 in the period up to 30 September 2019.

3.4 The actual Treasury Management indicators for September 2019 in Appendix A be noted

4. Background

The Council's treasury management operations cover the following:

- Cash flow forecasting (both daily balances and longer term forecasting
- Investing surplus funds in approved investments
- Borrowing to finance short term cash deficits and capital payments
- Management of debt (including rescheduling and ensuring an even maturity profile)
- Interest rate exposure management

The key risks associated with the Council's treasury management operations are:

1. Credit risk - ie. that the Council is not repaid, with due interest in full, on the day repayment is due
2. Liquidity risk - ie. that cash will not be available when it is needed, or that the ineffective management of liquidity creates additional, unbudgeted costs
3. Interest rate risk - that the Council fails to get good value for its cash dealings (both when borrowing and investing) and the risk that interest costs incurred are in excess of those for which the Council has budgeted
4. Maturity (or refinancing risk) - this relates to the Council's borrowing or capital financing activities, and is the risk that the Council is unable to repay or replace its maturing funding arrangements on appropriate terms
5. Procedures (or systems) risk - ie. that a treasury process, human or otherwise, will fail and planned actions are not carried out through fraud, error or corruption

The total borrowings of the Council including finance leases and private finance initiative (PFI) schemes are £727m.

The Council has investments lodged with 47 institutions that amount to £360m.

The cost of the Council's borrowings and the income derived from the Council's investments are included within the Council's treasury management budget of £24m. The Council's treasury management activities account for a significant proportion of the Council's overall budget. As a consequence the Council's Treasury Management Policy aims to manage risk whilst optimizing costs and returns. The Council monitors and measures its treasury management position against the indicators described in this report. Treasury management monitoring reports are brought to the Governance and Audit and Standards Committee for scrutiny.

There have been no breaches of the Treasury Management Policy up to the period ending 30 September 2019.

5. Reasons for Recommendations

Recommendation 3.1

To highlight any variance from the approved Treasury Management Policy and to note any subsequent actions.

Recommendation 3.2

To provide assurance that the Council's treasury management activities are effectively managed.

6. Equality impact assessment (EIA)

The contents of this report do not have any relevant equalities impact and therefore an equalities impact assessment is not required.

7. Legal Implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance's comments

All financial considerations are contained within the body of the report and the attached appendices

…………………………………………………………………….
Signed by Director of Finance & Resources (Section 151 Officer)

Appendices:

Appendix A: Treasury Management Mid-Year Review 2019/20
Appendix B: LIBID Rates

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

	Title of document	**Location**
1	Information pertaining to treasury management strategy and performance	Financial Services

APPENDIX A

TREASURY MANAGEMENT MID YEAR REVIEW OF 2019/20

A1. SUMMARY OF TREASURY MANAGEMENT INDICATORS AS AT 30 SEPTEMBER

The Council's debt at 30 September was as follows:

	Limit	Position at 30/9/2019
Authorised Limit	£807m	£727m
Operational Boundary	£777m	£727m

The maturity structure of the Council's fixed rate borrowing was:

	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Lower Limit	0%	0%	0%	0%	0%	0%	0%	0%
Upper Limit	10%	10%	10%	20%	30%	30%	40%	40%
Actual	1%	1%	4%	7%	22%	8%	25%	32%

The maturity structure of the Council's variable rate borrowing was:

	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Lower Limit	0%	0%	0%	0%	0%	0%	0%	0%
Upper Limit	10%	10%	10%	20%	30%	30%	30%	30%
Actual	2%	2%	6%	10%	22%	23%	21%	14%

Sums invested for periods longer than 365 days at 30 September 2019 were:

Maturing after	Limit £m	Actual £m
31/3/20	205	130
31/3/21	144	24
31/3/22	117	10

A2. GOVERNANCE

The Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council on 19 March 2019 provide the framework within which Treasury Management activities are undertaken.

A3. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

On 30 September 2019 the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £727m and gross investments of £360m giving rise to a net debt of £367m. The current level of investments has arisen from the Council's earmarked reserves and the borrowing of further cash to take advantage of exceptionally low borrowing rates to fund the Council's capital programme. The current level of investments does increase the Council’s exposure to credit risk, ie. the risk that an approved borrower defaults on the Council’s investment. In the interim period, there is a short term risk that the rates (and therefore the cost) at which money has been borrowed will be greater than the rates at which the cash can be invested. The difference between current borrowing and investment rates is 0.36%. Moreover, securing low cost funding for the capital programme now will have a lower overall cost than if the borrowing was undertaken later when rates had increased.

A4. BORROWING ACTIVITY

There was a slight reduction in Public Works Loans Board (PWLB) rates in the first quarter of 2019/20 with continued uncertainty over the Conservative Party leadership election and a lack of clarity around Brexit.

Although the Council had cash investments of £417m at the start of 2019/20, most of these investments matured after the expected completion date for acquiring Lakeside North Harbour Business Park.

With a lack of clarity over Brexit, trade uncertainty and global growth concerns, market expectations for an increase in interest rates before May 2020 were close to zero. Market expectations for a cut in the Bank Rate before May 2020 had picked up on the dovishness of the Bank of England and the Federal Reserve at their recent policy meetings although this was not a strong view. With the likelihood of an interest rate cut exceeding the likelihood of an increase in interest rates, the remaining £30m required to facilitate the acquisition of Lakeside North Harbour Business Park was borrowed short term and has now been repaid.

Overall there has been a near halving of longer term PWLB rates to completely unprecedented historic low levels over the last half year. As a consequence of this the Council borrowed a further £57m form the PWLB, in addition to the £20m previously borrowed in May 2019, as follows:

- £20m for 25 years fixed at 1.57% on 7th August repayable in equal instalments of principal
- £17m for 49 years fixed at 1.67% on 20th August repayable at maturity
- £20m for 45 years fixed at 1.59% on 5th September repayable at maturity

The average interest rate payable on the long term borrowing of £77m in the first half of 2019/20 is 1.78%.

The Council's gross borrowing at 30th September 2019 of £727m is within the Council's Authorised Limit (the maximum amount of borrowing approved by City Council) of £807m and also within the Council's Operational Boundary (the limit beyond which borrowing is not expected to exceed) of £777m.

The Council plans for gross borrowing to have a reasonably even maturity profile. This is to ensure that the Council does not need to replace large amounts of maturing borrowing when interest rates could be unfavourable.

The actual maturity profile of the Council's borrowing is within the limits contained within the Council's Treasury Management Policy (see paragraph A1).

Future Borrowing

On 9 October 2019 the Treasury and PWLB announced an increase in the margin over gilt yields of 1.00% on top of the current margin of 0.80% which this authority has paid prior to this date for new borrowing from the PWLB. There was no prior warning that this would happen and it now means that every local authority has to fundamentally reassess how to finance their external borrowing needs and the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing.

In the short term, the Council can fund its capital programme from either external borrowing or internal borrowing. Internal borrowing is the practice of using the Council's cash backed reserves to fund the capital programme in the short term. It should be noted that this defers the need to borrow externally rather than avoiding the need to borrow completely, as the Council will ultimately be forced to borrow externally as it spends its cash backed reserves. However, the Council is forecast to have sufficient funds to defer having to borrow externally until 2023/24.

Whereas this authority has previously relied on the PWLB as its main source of funding, it now has to fundamentally reconsider alternative cheaper sources of borrowing. At the current time, this is a developmental area as this event has also taken the financial services industry by surprise. We are expecting that various financial institutions will enter the market or make products available to local authorities. Members will be updated as this area evolves.

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. This Authority may make use of this new source of borrowing as and when appropriate.

Early Redemption of Borrowing

With the exception of two loans all the Council's borrowings to finance capital expenditure are fixed rate and fixed term loans. This reduces interest rate risk and provides a high degree of budget certainty.

The Council's borrowing portfolio is kept under review to identify if and when it would be financially beneficial to repay any specific loans early. Repaying borrowing early invariably results in a premium (early repayment charges) by the PWLB that are sufficiently large to make early repayment of borrowing financially unattractive to the Council.

No debt rescheduling or early repayment of debt has been undertaken during the first half of 2019/20 as it has not have been financially advantageous for the Council to do so.

Under/Over Borrowing

The extent to which the Council is "under" or "over" borrowed is determined by comparing the actual value of long term borrowing outstanding with the value of capital expenditure that has been incurred and was financed by borrowing (after deducting Minimum Revenue Provision that has been made in respect of that capital expenditure).

If the Council has borrowed less than it requires to fund the total value of capital expenditure to be funded from borrowing the Council is "under borrowed" and if the value of borrowing is greater than the value of capital expenditure incurred which is to be financed from borrowing it is "over borrowed".

At 31 March 2019 the Council was over borrowed by £29m. Whilst the Council borrowed £77m in the first half of 2019/20, the Council will be under borrowed by the end of 2019/20 following the acquisition of Lakeside North Harbour Business Park.

A5. INVESTMENT ACTIVITY

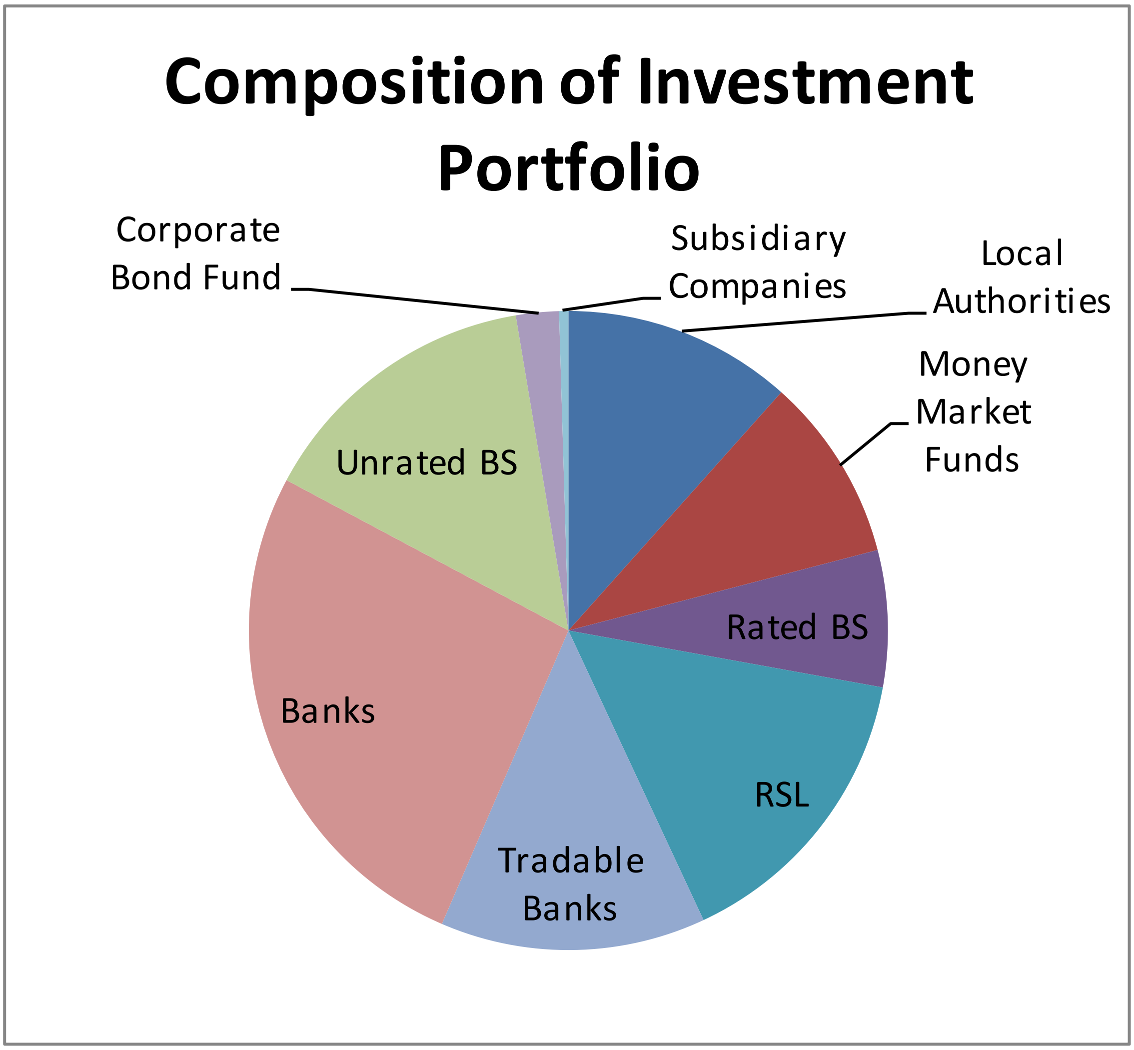
It is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, means that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low. Appendix B shows the actual market rates available for the first half of 2019/20. Bank base rate is not expected to rise again this financial year and then to only rise slowly thereafter.

The Council's surplus cash investments have decreased by £57m from £417m at 31st March 2019 to £360m at 30th September 2019. This is due to the acquisition of Lakeside North Harbour Business Park. The average rate of return on the Council's cash investments has risen from 1.12% in 2018/19 to 1.42% in the half of 2019/20. The improvement in the return on the Council's cash investments is due to an increase in the market value of tradable investments with returns that cannot be matched in the current low interest rate environment. Investment returns may fall as these current investments mature, unless the interest rates offered on new investments improve.

There have been no defaults on the City Council's investments in the current year. However, £0.6m was lent to Victory Energy Services Limited (VESL), a subsidiary company of the City Council, in 2019/20. VESL is now in the process of being wound up and is expected to default on its debts to the Council. A provision has been made for losses on lending to VESL up to 31st March 2019 of £2.8m. The £0.6m lent to VESL since 1st April 2019 will be a loss to the Council in 2019/20. If the expected losses from lending to VESL are taken into account, the average return falls to 1.15%.

The Council’s budgeted investment return for 2019/20 is £4.2m and performance for the year to date is £0.3m above budget after taking account of the expected losses on lending to VESL. All the Council's investments have been in accordance with the Council's Treasury Management Policy approved by Full Council in March 2019 and there are no breaches to report.

A summary of the Council's surplus cash investment portfolio is shown in the graph below. These investments totaled £360m as at 30th September 2019.



<u>Money Market Funds</u>
Money market funds are instant access investments in AAA rated pooled funds.

<u>Tradable Investments in Banks and Corporates (Commercial Companies)</u>
Some investments in banks and corporates (commercial companies) are tradable. This means that the Council can sell the investments at any time to a third party. This contrasts with bank and building society term deposits which can only be repaid by the bank or building society.

<u>Externally Management Corporate Bond Holdings</u>
The Council has some externally managed corporate bond holdings. These consist of tradable debt issued by commercial companies.

<u>Rated Building Societies</u>
These are building societies with at least two credit ratings from Standard and Poor, Moody's or Fitch.

<u>Unrated Building Societies</u>
These are building societies that do not have at least two credit ratings from Standard and Poor, Moody's or Fitch.

A6. INTEREST RATE EXPOSURES

The Councils net debt position at 30th September 2019 is summarised in the table below.

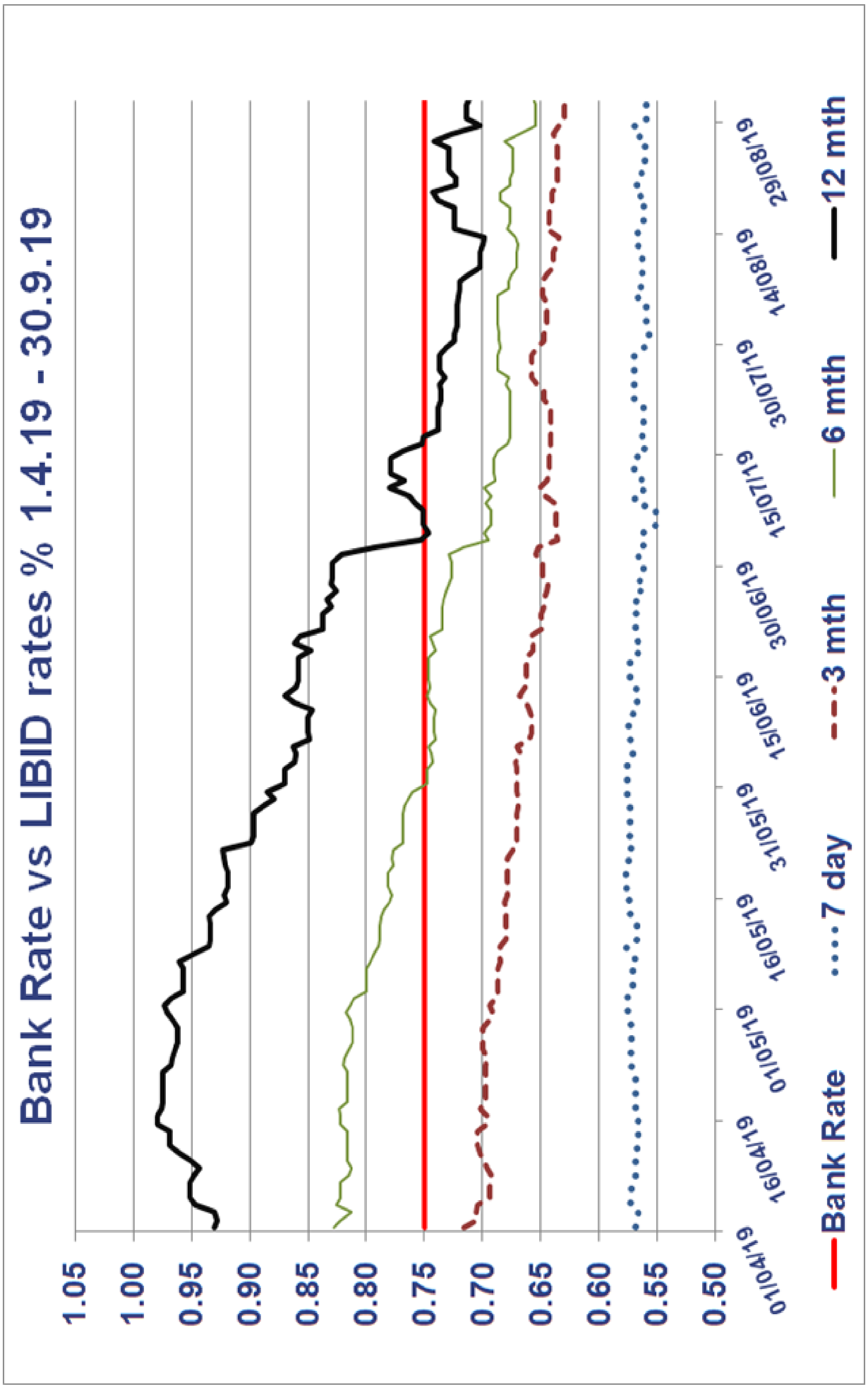
	Principal	**Average Interest Rate**	**Interest to 30th September 2019**
Borrowing (including finance leases & private finance initiative (PFI) schemes)	£727m	3.19%	£11.6m
Investments	(360m)*	(1.42%)	(£3.0m)
Net Debt	£367m		£8.6m

*Although the Council's investments had fallen £360m at 30th September 2019, the average sum invested over this period was £423m.

APPENDIX B

LIBID RATES

LIBID rates are London inter-bank bid rates and give an indication of the rates available in the London money market


Bank Rate vs LIBID rates % 1.4.19 - 30.9.19
1.05
1.00
0.95
0.90
0.85
0.80
0.75
0.70
0.65
0.60
0.55
0.50
01/04/19
16/04/19
01/05/19
16/05/19
31/05/19
15/06/19
30/06/19
15/07/19
30/07/19
14/08/19
29/08/19
Bank Rate
7 day
3 mth
6 mth
12 mth