REPORT FOR DECISION

Agenda Item	

DECISION OF:	**CABINET** **OVERVIEW & SCRUTINY COMMITTEE** **COUNCIL**
DATE:	**11 DECEMBER 2019** **23 JANUARY 2020** **22 JANUARY 2020**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY – MID YEAR REVIEW 2019/20**
REPORT FROM:	**CABINET MEMBER FOR FINANCE & HOUSING**
CONTACT OFFICER:	**MIKE WOODHEAD, JOINT CHIEF FINANCE OFFICER**
TYPE OF DECISION:	**COUNCIL**
FREEDOM OF INFORMATION/STATUS:	The report is within the public domain
SUMMARY:	This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following: • An economic update for the 2019/20 financial year to 30 September 2019; • A review of the Treasury Management Strategy Statement and Annual Investment Strategy; • The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators; • A review of the Council's investment portfolio for 2019/20 • A review of the Council's borrowing strategy for 2019/20 • A review of any debt rescheduling undertaken during 2019/20 • A review of compliance with Treasury and Prudential Limits for 2019/20

OPTIONS & RECOMMENDED OPTION	It is recommended that, in accordance with CIPFA's Code of Practice on Treasury Management, the report be noted.

IMPLICATIONS:	
Corporate Aims/Policy Framework:	Do the proposals accord with the Policy Framework? Yes
Statement by the S151 Officer: Financial Implications and Risk Considerations:	Treasury Management is an integral part of the Council's financial framework and it is essential that the correct strategy is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.
Equality/Diversity implications:	No
Considered by Monitoring Officer:	The Local Government Act 2003 requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services. The Code requires Full Council to receive as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close. This is the mid-year review for 2019-20.
Wards Affected:	All
Scrutiny Interest:	Overview & Scrutiny Committee

TRACKING/PROCESS **DIRECTOR: MIKE WOODHEAD**

Joint Executive Team	Cabinet Member/Chair Briefed	Ward Members	Partners
18 November		N/a	N/a
Scrutiny Committee	Other Committee	Council	Comms
23 January		22 January	

1.0 BACKGROUND

1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all authorities have been required to prepare a Capital Strategy which is to provide the following:-

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services,
- An overview of how the associated risk is managed,
- The implications for future financial sustainability.

A report setting out our Capital Strategy will be taken to Council before 31st March 2020.

1.2 The Council operates a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:-
"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

1.3 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is: Overview & Scrutiny Committee.

1.3 This report fulfils the requirement to produce a mid-year review.

2.0 ECONOMIC UP-DATE (from Treasury Advisors)

2.1 Economic Performance to date

2.1.1 The first half of 2019/20 has seen UK **economic growth** fall due to Brexit uncertainty. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. The Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit.

2.1.2 With regard to **inflation**, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

2.1.3 Despite the contraction in quarterly GDP growth of -0.2% q/q, (+1.3% y/y), in quarter 2, **employment** continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

2.1.4 In the **political arena**, the general election could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

2.2 Interest rate Forecasts and Outlook

2.2.1 The Council's treasury advisor, Link Asset Services, has provided the following forecast.
This forecast includes the increase in margin over gilt yields of 100bps introduced on 9th October 2019.

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

The above forecasts are based on the assumption that there is an agreed deal on Brexit at some point. Given the current level on uncertainties, the forecasts may need to be materially reassessed in the light of events over the next few weeks. The Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% due to ongoing uncertainty over Brexit. The MPC's policy statement saying that, based on an assumption of an agreed Brexit deal, rates would need to rise as a gradual pace and to a limited extent is now conditional on some recovery in global growth. Brexit uncertainty has dampened UK GDP growth in 2019, and a no deal Brexit will likely lead to cuts in Bank Rate to help support economic growth.

2.2.2 There is an overall balance of downward risks to economic recovery in the UK due to the weight of uncertainties over Brexit, as well as a softening global economic picture. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are broadly similar to the downside.

3.0 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UP-DATE

3.1 The Treasury Management Strategy Statement (TMSS) for 2019/20 was approved by the Council on 20 February 2019.

3.2 There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

4.0 THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

4.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget

Capital Expenditure	2019/20 Original Estimate £m	2019/20 Revised Estimate £m
Non-HRA	37.254	32.090
HRA	9.830	11.104
Total	**47.084**	**43.194**

The increase of the revised estimate over the original estimate is due to slippage from 2018/19 of £8.990m offset by estimated project reprofiling to 2019/20 of £11.033m

4.2 Changes to the Financing of the Capital Programme

The table below shows the main strategy elements of the capital expenditure plans. The borrowing requirement shown will increase the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2019/20 Original Estimate £m	2019/20 Revised Estimate £m
Total capital expenditure	**52,599**	**43,194**
Financed by:		
Capital receipts	**2,744**	**5,153**
Capital grants	**24,217**	**14,267**
Revenue	**9,830**	**11,104**
Total financing	**36,791**	**30,524**
Borrowing requirement	**15,808**	**12,670**

4.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

	2019/20 Original Estimate £m	2019/20 Revised Estimate £m
Prudential Indicator - Capital Financing Requirement		
CFR – non HRA	144.412	140.288
CFR – HRA existing	40.531	40.531
Housing Reform Settlement	78.253	78.253
Total CFR	**263.196**	**259.072**
Prudential Indicator - External Debt / the Operational Boundary		
Borrowing	273.200	269.100
Other long term liabilities	5.000	5.000
Total	**278.200**	**274.100**

4.4 Limits to Borrowing Activity

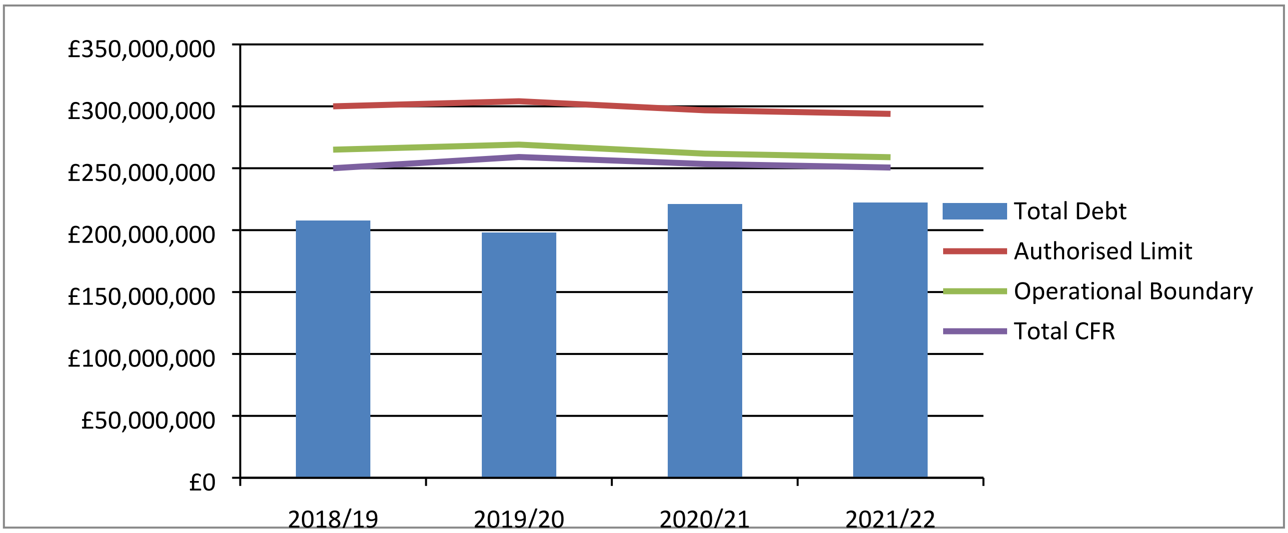
4.4.1 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

4.4.2 The Joint Chief Financial Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

4.4.3 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit for External Debt	2019/20 Original Indicator £m	2019/20 Revised Indicator £m
Borrowing	308.200	269.100
Other long term liabilities	5.000	5.000
Total	**313.200**	**274.100**

4.4.4 The chart below shows the projected trend of the Council's Prudential Indicators.



5 INVESTMENT PORTFOLIO 2019/20

5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 2, 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 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact 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.

5.2 The Council held £12.1m of investments as at 30 September 2019 (£14.8m at 31 March 2019) and the investment portfolio yield for the first six months of the year is 0.67% against a 3 month benchmark of 0.66%.

5.3 The investments held as at 30 September 2019 were:-

Type of Investment	£ Million
Call Investments (Cash equivalents)	12.1
Fixed Investments (Short term investments)	0.0
Total	**12.1**

5.4 The Joint Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2019/20.

5.5 The Council's budgeted investment return for 2019/20 is £0.2m, and performance for the year to date is in line with the budget.

5.6 The Cabinet have approved a “Property Investment Strategy” which aims to increase investment income by investing in property rather than investing with financial institutions where returns are low at present. Additional borrowing may need to be undertaken to finance property acquisitions; each investment will be subject to a robust business case and also non-financial factors (e.g. ethical stance) will be considered.

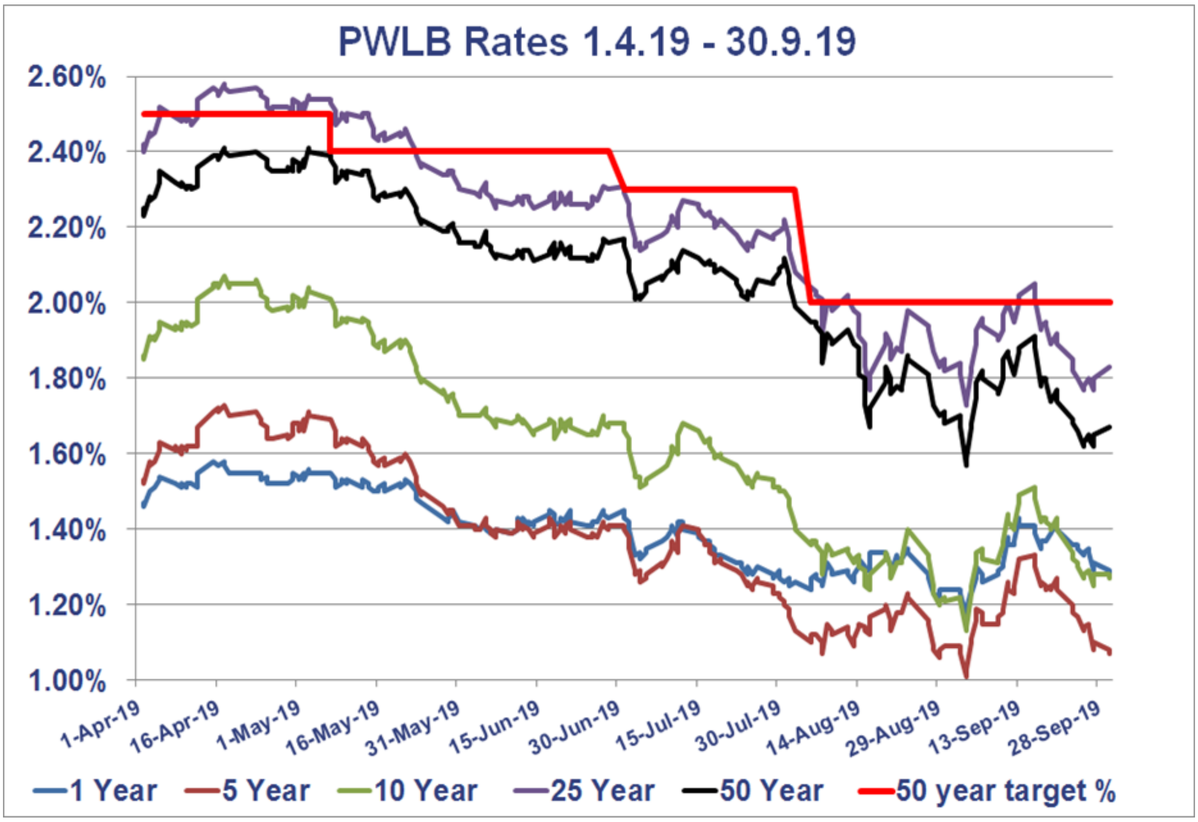
6.0 BORROWING

6.1 The Council’s capital financing requirement (CFR) for 2019/20 is £274.1m. The CFR denotes the Council’s underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table below shows the Council has borrowings of £192.9m and has utilised £66.2m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevail.

	01 April 2019			30 September 2019		
	Principal		Avg.	Principal		Avg.
	£000	£000	Rate	£000	£000	Rate
Fixed rate funding						
PWLB Bury	139,253			134,073		
PWLB Airport	11,828			11,828		
Market Bury	44,000	195,081		44,000	189,901	
Variable rate funding						
PWLB Bury	0			0		
Market Bury	0	0		0	0	
Temporary Loans / Bonds	7,503	7,503		3,003	3,003	
Total Debt		**202,584**	**3.95%**		**192,903**	**3.95%**
Capital Financing Requirement		**250,028**			**259,072**	
Over/ (under) borrowing		**(47,444)**			**(66,169)**	
Total Investments		**14,760**	**0.66%**		**12,050**	**0.67%**
Net Debt		**187,824**			**180,853**	

6.2 External borrowing of £3.0 million has been undertaken from the market during the first 9 months of 2019/20. 1 short term temporary loan was taken to take advantage of low interest rates. The loan was required to partly replace a loan, totalling £10m, which matured in the first half of the year.
Additional external borrowing will be required during the remainder of this financial year.

6.3 The graph below shows the movement in PWLB certainty rates for the first six months of the year to 30.09.19. PWLB have been a falling trend during this period and longer rates had almost halved to reach historic lows. The 50 year PWLB target (certainty) rate for new long term borrowing fell from 2.50% to 2.00% during this period.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.01%	1.13%	1.73%	1.57%
Date	03/09/2019	03/09/2019	03/09/2019	03/09/2019	03/09/2019
High	1.58%	1.73%	2.07%	2.58%	2.41%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	17/04/2019
Average	1.40%	1.37%	1.62%	2.20%	2.07%

6.4 On 9 October 2019 the Treasury and PWLB announced an increase in the margin over gilts yields of 100bps on top of the current margin of 80 bps 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 an the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing. Representations are going to be made to HM Treasury to suggest that areas of capital expenditure that the Government are keen to see move forward e.g. housing, should not be subject to such a large increase in borrowing.

6.5 Whereas this authority has previously relied on the PWLB as its only source of long term 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. It is expected that various financial institutions will enter the market or make products available to local authorities. Members will be updated as this area evolves.

6.6 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.

7.0 DEBT RESCHEDULING

7.1 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling was undertaken during the first six months of 2019/20.

7.2 The 100bps increase in PWLB rates from 9th October 2019 only apply to new borrowing rates, not to premature repayment rates.

Councillor Eamonn O'Brien
Cabinet Member for Finance and Housing

List of Background Papers:-
None

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