NOT CONFIDENTIAL – For public release **Item No. 14**

COUNCIL
16 January 2020

Report of the Head of Resources

TREASURY MANAGEMENT MID-YEAR REPORT FOR 2019/20

PURPOSE OF REPORT

This report seeks approval for the Treasury Management Mid-Year Report for 2019/20.

RECOMMENDATION

That the Treasury Management Mid-Year Report for 2019/20 be approved.

WARDS AFFECTED

All

STRATEGIC LINK

The above recommendation contributes to all of the Council's Corporate Plan Priorities.

1. REPORT

1.1 TREASURY MANAGEMENT REPORT

This report fulfils the Authority's legal obligation to have regard to the CIPFA Code.

The Authority's treasury management strategy for 2019/20 was approved at a meeting of the Authority on 7th March 2019. The Authority 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 are therefore central to the Authority's treasury management strategy.

The 2017 Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy complying with CIPFA's requirement, was approved by Council on 7th March 2019.

1.2 REPORTING REQUIREMENTS

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

The Treasury Strategy The first, and most important, report covers:

- The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- An investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report (this report) - This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report - This report provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are adequately scrutinised by the Corporate Leadership Team before being recommended to the Council.

1.3 EXTERNAL CONTEXT

1.3.1. Economic background

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

1.3.2 Financial markets:

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.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

1.4 LOCAL CONTEXT

On 31st March 2019, the Authority had net investments of £8m 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 and the year-on-year change are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £'000
General Fund CFR	5,898
Less: Other debt liabilities *	151
Total CFR	**5,747**
Actual borrowing	5,540
Under borrowing	297
Usable reserves	(19,311)
Less: Working capital	5,079
Net Investments	**(13,935)**

*Finance leases form part of the Authority's total debt

The Authority pursued its strategy of keeping borrowing below its underlying level, sometimes known as under borrowing or 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 period is shown in table 2 below

Table 2: Treasury Management Summary

	31.3.19 Balance £'000	Movement £'000	30.09.19 Balance £'000
Long-term borrowing	5,450		5,450
Short-term borrowing	151		151
Total borrowing	**5,601**		**5,601**
Long-term investments	931	-8	923
Short-term investments	1,999	11,001	13,000
Cash and cash equivalents	11,005	-4,468	6,537
Total investments	**13,935**	**6,525**	**20,460**
Net investments	**8,334**	**6,525**	**14,859**

Note: the figures in the table are from the balance sheet in the Authority's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

1.5 BORROWING STRATEGY

At 30th September 2019, the Authority held £5.4m of loans from the Public Works Loan Board, the same as the previous year, as part of its strategy for funding previous years' capital programmes.

The Authority'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 Authority's long-term plans change being a secondary objective.

In furtherance of these objectives, no new borrowing was undertaken.

With short-term interest rates remaining much lower than long-term rates, the Authority considered it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead.

Other Debt Activity

After £0.376m repayment of prior years' finance leases liabilities, total debt other than borrowing stood at £0.151m on 30th September 2019, taking total debt to £5.601m.

1.6 TREASURY INVESTMENT ACTIVITY

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period, the authority's investment balance ranged between £10.6 and £21.7 million. The investment position is show in table 3 below.

Table 3: Treasury Investment Position

Investment Held	31.03.19 Balance £'000	Net Movement	30.09.19 Balance £'000	30.09.19 Income Return %	Weighted Average Maturity days
Banks & Building Societies (Unsecured)	5,504	(2,267)	3,237		
Government (Including Local Authorities)	7,500	4,499	11,999		
Money Market Funds	0	4,300	4,300		
Total Internal Funds	**13,004**	**6,532**	**19,536**	**0.90**	**66 days**
Strategic Bond funds - CCLA Property Fund	931	(8)	923		
Total External Funds	**931**	**(8)**	**923**	**3.97**	**N/A**
Total	**13,935**	**6,524**	**20,459**	**0.75**	**66 days**

- For Internal investments, the value is the sum initially invested, for external funds, the value is the fund's bid price on the quarter end date multiplied by the number of units held.
- Returns quoted for the CCLA Property fund include initial losses on the purchase of the shares. On an income only basis the fund currently returns 3.97%. The value of the fund can fluctuate but has grown significantly over the previous 5 years.

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority 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 holds £1.5m of such investments in directly owned commercial property that is leased out. These investments generated £0.097m of investment income for the Authority after taking account of direct costs, representing a rate of return of 6.39%. This is higher than the return earned on treasury investments but reflects the additional risks to the Authority of holding such investments.

Treasury Performance

The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue Budget. Investment income for the first half of the year is £68,706, compared to a budget of £52,500.

Both the CIPFA code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum return to the security and yield. The Authority'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 Authority has further diversified into more secure and high yielding asset classes as shown above. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in the table below.

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return (Total Portfolio) %
31st March 2019	3.97	AA-	82%	18	0.51
30th September 2019	3.94	AA-	39%	66	0.55*
Similar LA's All LA's	4.26 4.28	AA- AA-	61% 62%	80 28	1.58 1.22

*Includes loss on the capital value of CCLA Fund of 3.76%

1.7 COMPLIANCE REPORT

The Head of Resources is pleased to report that all treasury management activities undertaken complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

Compliance with specific investment limits is demonstrated in table 4 below.

<u>Table 4: Investment Limits</u>

	30.09.19 Actual	2019/20 Limit	Complied
Banks – Council's Own banker (Lloyds)	£1.2m	£6m	✓
Local Authorities per Authority	£3m per authority £11m Total 30/09	£3m	✓
Money Market Funds Total	£4.3m	£12m	✓
UK Government	£0.99m	Unlimited	✓
Certificates of Deposits	£2m	£3m	✓
Strategic Funds	£0.92m	£5m	✓

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 5 below.

Table 5: Debt Limits

	30.09.19 Actual	2019/20 Operational Boundary	2019/20 Authorised Limit	Complied
Borrowing	5,450	8,000	11,000	✓
PFI & finance leases	151	1,000	1,000	✓
Total debt	**5,601**	**9,000**	**12,000**	✓

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.

1.8 TREASURY MANAGEMENT INDICATORS

The Authority measures and manages its exposures to treasury management risks using the following indicators:

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

	30.09.19 Actual	2019/20 Target	Complied
Portfolio average credit rating/score	AA-	AA-	✓

Liquidity: The Authority 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.

	30.09.19 Actual	2019/20 Target	Complied
Total cash available within 3 months	6,537	6,000	✓
Total sum borrowed in past 3 months without prior notice	0	n/a	✓

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

	2019/20 Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	154,500
Upper limit on one-year revenue impact of a 1% fall in interest rates	110,500

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	30.09.19 Actual	Upper Limit	Complied
Under 12 months	0	50%	✓
12 months and within 24 months	0	50%	✓
24 months and within 5 years	0	50%	✓
5 years and within 10 years	0	75%	✓
10 years and above	100%	100%	✓

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 364 days: The purpose of this indicator is to control the Authority'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 £000	2020/21 £000	2021/22 £000
Actual principal invested beyond year end	1,000	0	0
Limit on principal invested beyond year end	3,000	3,000	3,000
Complied	✓	✓	✓

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.

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 evolution of the global economy. Arlingclose judges that the risks are significantly weighted to the downside.

Gilt yields have fallen to historic lows. The risks to economic growth from global political uncertainty appear to have crystallised, dampening rate expectations and dragging yields lower. Arlingclose expects yields to remain at low levels for the foreseeable future and see the risks as broadly balanced. Volatility will continue to offer longer-term borrowing opportunities.

2 RISK ASSESSMENT

2.1 Legal

The report complies with best practice and government guidance on the preparation of the treasury management strategy statement. The legal risk is therefore low.

2.2 Financial

Financial Information is contained within the report. The budget for investment income in the first half of year to 30th September is £52,500, Actual Investment income earnt is £68,706. If actual levels of investments and actual rates differ from those forecast, performance against budget will be correspondingly different. The overall risk is assessed as low.

2.3 Corporate

This strategy sets in place a proposed structure and systems that place security of investments above yield. The risk is therefore assessed as low.

3 OTHER CONSIDERATIONS

In preparing this report the relevance of the following factors has also been considered prevention of crime and disorder, equalities, environmental, climate change, health, human rights, personnel and property.

4 CONTACT INFORMATION

For further information contact:

Karen Henriksen 01629 761284 or

Email: karen.henriksen@derbyshiredales.gov.uk

5 BACKGROUND PAPERS

None