County Council

Treasury Management Mid-Year Report

Thursday 25 November 2019

Report from Cabinet Member for Resources

Purpose of this Report

The Council is required to report to members on the current year's treasury management. It was agreed that a mid-year report on treasury management would be reported to Regulatory and Audit Committee prior to reporting to County Council as required by the CIPFA Code of Practice on treasury management in the public sector.

Background

1 In line with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management and the Council's Financial Regulations (B5), this Council is required to provide Regulatory and Audit Committee with a mid-year report on the treasury management activity for the first six months of the financial year.

2 The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. On 30th September 2019, the Council had net borrowing of £256.1m arising from its revenue and capital income and expenditure. Investments totalled £26.2m. The forecast outturn for interest earned on investments £489k. Loans outstanding totalled £282.3m at 30 September 2019; £250.1m was from the Public Works Loan Board (PWLB), £30m LOBO loans and £2.2m accrued interest. The forecast outturn for interest payments on external debt is £8.6m.

3 The Code of Practice defines Treasury Management as:

The management of the organisation's 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.

Treasury Management Strategy

4 The Council approved the 2019/20 treasury management strategy at its meeting on 21 February 2019. The general policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are the security of capital and liquidity of its investments. The Council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity. The effective management and control of risk are prime objectives of the Council's treasury management activities. In exceptional circumstances, where investments do not meet this criteria, decisions on investments will be delegated to the Director of Finance and Procurement in consultation with both the Leader of the Council and the Cabinet Member for Resources, or where considered appropriate will be referred to Cabinet for such a decision. The Council's cash position is a net borrower:

	31 Mar 2018	30 Sept 2018	31 Mar 2019	30 Sept 2019
Borrowing	**£m**	**£m**	**£m**	**£m**
PWLB Borrowing*	-102.1	-150.0	-243.5	-250.1
LOBO Borrowing#	-78.0	-30.0	-30.0	-30.0
Short term Borrowing	-32.0	-45.0	-20.0	0.0
Accrued Interest	-1.1	-1.0	-2.7	-2.2
Gross Borrowing	**-213.2**	**-226.0**	**-296.2**	**-282.3**
Treasury Cash				
Money Market Funds	15.3	4.8	5.5	21.2
CCLA Property Fund	5.0	5.0	5.0	5.0
Total Cash	**20.3**	**9.8**	**10.5**	**26.2**
Net Cash / (Borrowing)	**-192.9**	**-216.2**	**-285.7**	**-256.1**

*PWLB Public Works Loans Board. The PWLB is a statutory body, part of HM Treasury, it's purpose is to lend money to local authorities The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

#LOBO Lender Option Borrower Option. LOBOs are long term borrowing instruments which include an option for the lender to periodically revise the interest rate. If the lender decides to revise the interest rate, the borrower then has the option to pay the revised interest rate or repay the loan.

5 All treasury management activity undertaken during the period complied with the approved strategy, the CIPFA Code of Practice and the relevant legislative provisions. There were no investments placed which resulted in a breach of the investment strategy.

Debt Management Strategy

6 The Council's borrowing objectives are:

- To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio.

- To manage the Council's debt maturity profile, leaving no one future year with a disproportionate level of repayments.
- To maintain a view on current and possible future interest rate movements and borrow accordingly.
- To monitor and review the balance between fixed and variable rate loans against the background of interest rate levels and the Prudential Indicators.

Outlook for Interest Rates

7 Arlingclose's central case is for 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.

Interim Performance Report

8 The following table summarises interest paid on external debt and interest earned on cash balances in 2018/19 and the forecast for 2019/20:

	2018/19 Outturn	2019/20 Forecast
	£m	£m
Interest paid on Loans	8.7	8.6
Interest Income	-0.5	-0.5
Net Interest Cost	8.2	8.1

9 The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. On 30th September 2019, the Council had net borrowing of £256.1m arising from its revenue and capital income and expenditure. Investments totalled £26.2m. The forecast outturn for interest earned on investments £489k. This includes £5m invested in the CCLA property fund.

10 Loans outstanding totalled £282.3m at 30 September 2019; £250.1m was from the Public Works Loan Board (PWLB), £30m LOBO loans and £2.2m accrued interest. The forecast outturn for interest payments on external debt is £8.6m. In May the Council arranged a new equal instalment of principal (EIP) loan. EIP loans are where equal half-yearly instalments of principal are paid with the interest on the balance outstanding at the time. Annuity loans are where fixed half-yearly payments include principal and interest. A repayment of £7m is due to be paid to the PWLB on 14 February 2020. Instalments of loan principal will be repaid on annuity and EIP loans totalling £3.2m between 1 October 2019 and 31 March 2020.

11 The forecast external borrowing as at 31 March 2020 is £272.6m which includes £240.4m from the PWLB, £30m LOBO loans and £2.2m accrued interest. On 30 September, the Council had no short term loans in place. The Council'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. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

12 The PWLB increased the margin applied to loan rates by 1% on 8 October, the new margin above gilts is now 1.8%. Arlingclose suggested that those authorities that can sensibly delay long-term funding do so and select shorter-term loans from other local authorities in the interim. There are several alternatives to PWLB funding, such a bank

loans and the municipal bonds agency. Arlingclose held a detailed discussion with HM Treasury (HMT) policy makers. HMT is keen to ensure borrowing across local government is controlled. They observed a clear correlation between the reduction in PWLB rates and the increase in borrowing undertaken in recent months. While they increased the statutory PWLB limit by £10bn to £95bn, they were fearful that, at the current rate of borrowing, this could be exhausted in a few months. With no appetite to extend the statutory limit beyond this, HMT decided to control demand by increasing rates, thereby preserving the facility. HMT are less concerned about the type of borrowing or purpose, than the overall level of local authority debt.

13 The Council continues to be aware of the potential to restructure debt, but there are unlikely to be opportunities in the prevailing interest rate environment.

Prudential Indicators

14 Each year, the Council agrees Prudential Indicators under the Local Government Act 2003 which are affordable, prudent and sustainable. The indicators were agreed by County Council at its meeting on 21 February 2019.

Borrowing Indicators

15 The Capital Financing Requirement measures the Council's underlying need to borrow for capital purposes. This is essentially the Council's outstanding debt, necessary to finance the Council's capital expenditure. The actual debt is dependent on the type and maturity of the borrowing undertaken as well as seeking the optimal cashflow situation.

16 Comparing gross debt with the capital financing requirement is an indicator of the Council's prudence in managing its capital expenditure and is designed to ensure that, over the medium term, external borrowing is only for capital purposes. The Council should ensure that gross debt does not, exceed the total of capital financing requirement. The values are measured at the end of the financial year. Where gross debt is greater than the capital financing requirement the reasons for this will be stated in the annual treasury management strategy.

17 The authorised limit for external debt is required to separately identify external borrowing (gross of investments) and other long term liabilities such as covenant repayments and finance lease obligations. The limit provides a maximum figure that the Council could borrow at any given point during each financial year.

18 The Operational Boundary for External Debt is a key management tool for in-year monitoring and is lower than the Authorised Limit as it is based on an estimate of the most likely level of external borrowing at any point in the year. In comparison, the authorised limit is the maximum allowable level of borrowing.

Indicator	Unit	Revised Estimate 2019/20	2019/20
Gross Borrowing	£000	425,000	425,000
Capital Financing Requirement	£000	462,767	468,208

Indicator	Unit	Revised Estimate 2019/20	2019/20
Authorised limit (for borrowing) *	£000	435,000	435,000
Authorised limit (for other long term liabilities) *	£000	10,000	10,000
Authorised limit (for total external debt) *	£000	445,000	445,000

* These limits can only be breached with the approval of the full Council to raise ther

Indicator	Unit	Revised Estimate 2019/20	2019/20
Operational boundary (for borrowing)	£000	405,000	405,000
Operational boundary (for other long term liabilities)	£000	7,500	7,500
Operational boundary (for total external debt)	£000	412,500	412,500

Treasury Management Indicators

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

20 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Indicator as at 30 September 2019	Target
Portfolio average credit rating	AA-	A

21 **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 one month period, without additional borrowing.

Liquidity risk indicator	Actual	Target
Total cash available within one month	£29m	£10m

22 **Interest rate exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Actual	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	-£36,000	-£23,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£36,000	£23,000

23 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

24 **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 borrowing will be:

Refinancing rate risk indicator	Actual 30 Sept 2019	Upper limit	Lower limit
Under 12 months	10%	25%	0%
12 months and within 24 months	2%	20%	0%
24 months and within 5 years	7%	20%	0%
5 years and within 10 years	20%	25%	0%
10 years and above	61%	70%	25%

25 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.

26 **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 long-term principal sum invested to final maturities beyond the period end are:

Price risk indicator	2019/20	2020/21	2021/22
Actual principal invested beyond year end	£0m	£0m	£0m
Limit on principal invested beyond year end	£10m	£10m	£10m

Recommendation

Council is asked to:

1. **Agree the Treasury Management Mid-Year Report and the Prudential Indicators for 2019/20.**

CABINET MEMBER FOR RESOURCES