Audit and Governance Committee

Date of meeting:	09 December 2019
Title of Report:	**Mid- Term Treasury Management Report 2019/20**
Lead Member:	Councillor Mark Lowry (Cabinet Member for Finance)
Lead Strategic Director:	Andrew Hardingham (Service Director for Finance)
Author:	Chris Flower (Finance Business Partner for Capital and Treasury Management)
Contact Email:	Chris.flower@plymouth.gov.uk
Your Reference:	Finance/CF
Key Decision:	No
Confidentiality:	Part I - Official

Purpose of Report

The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. The Council's Strategy for 2019/20 was approved by full Council at its budget meeting on 15 February 2019.

This report provides an update on the progress and outcomes against the Treasury Management Strategy for the six month period ended 30 September 2019. It is a requirement of the CIPFA Code of Practice on Treasury Management that a mid- year report, as a minimum, should be presented to Full Council.

Recommendations and Reasons

1. The Mid-Year Treasury Management Report 2019/20 to be noted by the Audit Committee.

Alternative options considered and rejected

It is statutory requirement under the Local Government Act 2003 and supporting regulations to set an annual treasury strategy for borrowing and prepare an Annual Investment Strategy. The Council has adopted the CIPFA Code of Practice for Treasury Management which requires a mid-year report to be submitted to the Audit Committee and full council.

Relevance to the Corporate Plan and/or the Plymouth Plan

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for the Medium Term Financial Plan and Resource Implications:
Treasury Management affects the Council's budget in terms of borrowing costs and investment returns and its implications have been fully incorporated into the Council's Medium Term Financial Planning.

Carbon Footprint (Environmental) Implications:

No direct Impact.

Other Implications: e.g. Health and Safety, Risk Management, Child Poverty:
** When considering these proposals members have a responsibility to ensure they give due regard to the Council's duty to promote equality of opportunity, eliminate unlawful discrimination and promote good relations between people who share protected characteristics under the Equalities Act and those who do not.*
N/A

Appendices

**Add rows as required to box below*

Ref.	**Title of Appendix**	**Exemption Paragraph Number** (if applic *If some/all of the information is confidential, you must indi why it is not for publication by virtue of Part 1of Schedule of the Local Government Act 1972 by ticking the relevant*						
		1	**2**	**3**	**4**	**5**	**6**	**7**
A								
B								

Background papers:

**Add rows as required to box below*

Please list all unpublished, background papers relevant to the decision in the table below. Background papers are unpublished works, relied on to a material extent in preparing the report, which disclose facts or matters on which the report or an important part of the work is based.

Title of any background paper(s)	**Exemption Paragraph Number** (if applicable) *If some/all of the information is confidential, you must indicate why it is not for publication by virtue of Part 1of Schedule 12A of the Local Government Act 1972 by ticking the relevant box.*						
	1	**2**	**3**	**4**	**5**	**6**	**7**

Sign off:

Fin	PL.19.20.153	Leg	ALT/30508/29	Mon Off	ALT/30508/29	HR	Click here to enter text.	Assets	Click here to enter text.	Strat Proc	Click here to enter text.
Originating Senior Leadership Team member: Andrew Hardingham											
Please confirm the Strategic Director(s) has agreed the report? Yes Date agreed: 24/10/2019											
Cabinet Member approval: *Mark Lowry verbally* Date approved: 04/11/2019											

Mid-Year Treasury Management Report 2019/20

1. Introduction

1.1 This report is to provide the Audit Committee and the Council with a mid-year review of the Council's treasury management activities for the first 6 months to 30 September 2019.

1.2 The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end).

1.3 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy and the Council's Treasury Management Strategy for 2019/20 were approved by full Council on 25 February 2019.

1.4 The Council has borrowed and 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.

2. External Context as at 1st October 2019

2.1 **Economic background:** 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. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

2.2 The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

2.3 Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. There will be an election on 12 December 2019 and the EU have given the government an extension on Brexit until 31 January 2020.

2.4 Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September, the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

2.5 The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit. This could go in either direction depending on what happens after the election.

3. Financial markets:

3.1 After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

3.2 Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

3.3 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. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

4. Credit background:

4.1 Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ringfenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

4.2 There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

5. Local Context

5.1 At 31st March 2019 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £573m, while usable reserves £57m. The Council had £449m of borrowing and £85m of investments.

5.2 The Council has an increasing CFR over the next 5 years due to the capital programme, but will maintain their investments and will therefore require borrowing of up to £420m over the forecast period.

6. Borrowing Strategy

6.1 At 30/9/2019 the Council held £503m of loans, (an increase of £54m from 31/3/2019), as part of its strategy in funding the capital programme.

The Council's chief objective when borrowing continues to be striking 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 Council's long-term plans change being a secondary objective.

In furtherance of these objectives, new short term borrowing was taken on to invest in the capital programme. The new borrowing has been taken at historically low interest rates so that the cost to the council tax payer is kept to a minimum.

6.2 Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained, and are likely to remain at least over the forthcoming two years, lower than long-term rates, the Council determined it was more cost effective in the short-term to use internal resources and borrow short-term loans.

6.3 The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the Council with this 'cost of carry' and breakeven analysis.

6.4 Temporary and short term loans borrowed from the markets, predominantly from other local authorities, has also remained affordable and attractive. The Council has £283m of such loans that were borrowed at an average life of 3 months. Arlingclose supports the Council's borrowing strategy to maintain the short term borrowing. However this strategy is kept under constant review.

7. Borrowing activity in during the half year

7.1 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.

7.2 At 30/9/2019 the Council held £503m of loans, (an increase of £54m on 31/3/2019), as part of its strategy for funding the capital programme.

The 30th September 2019 borrowing position is show in the table below.

	Balance at 01/04/2019 £m	Movement £m	Balance at 30/09/2019 £m
Short Term Borrowing	323	54	377
LOBO	64	-	64
Public Works Loans Board	44	-	44
Other long term loans	18	-	18
Total Borrowing	**449**	**54**	**503**
Long Term Investments	38	15	53
Short Term Investments	20	-	20
Cash and Cash Equivalents	26	5	31
Total Investments	**84**	**20**	**104**
Net Borrowing	365	36	401

7.3 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.

7.4 In keeping with these objectives new borrowing was kept to a minimum. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

7.5 With short-term interest rates remaining much lower than long-term rates, the Council considered it to be more cost effective in the near term to use short-term loans instead. The net movement in short term loans is shown in the table above.

7.6 As the Council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. The Council decided to take advantage of falling interest rates and it borrowed an additional £54m short term loans.

7.7 **PWLB**

On 8 October 2019 the government increased the PWLB rates by 1%. HM Treasury explained that the main reason for doing this was due to the increase in the use of PWLB loans at some authorities in recent months as the cost of borrowing has fallen to record lows.

The Council is not currently planning to borrow from PWLB and it obtains most of its borrowing from other Local Authorities, which have increased their rates because of the PWLB interest rate rise.

7.8 **Debt Rescheduling:**

The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

7.9 **LOBO**

The LOBOs (Lender's Option Borrower's Option) are loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the first half of 2019/20.

It is the Council's strategy to try and renegotiate the LOBO loans with the banks to refinance the debt without additional cost to the Council. The aim is to remove the options and remove the uncertainty of possible future interest rate rises.

7.10 **Other Debt Activity**

Although not classed as borrowing, the Council also raise capital finance via Private Finance Initiative (PFI) and finance leases etc. As at 30th September 2019, the total debt was £106m including PFI £104m Finance leases £2m. The Council has raised no additional PFI borrowing during the period to 30th September 2019.

8. Investment Activity

8.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held.

8.2 The investment position during the half year is shown in the table below.

Investment Activity

Investments	Balance on 01/04/2019 £m	Movement Movement £m	Balance on 30/09/2019 £m
Short Term Investments			
Other Investments	20	0	20
Money Market Funds	26	5	31
Long Term Investments			
CCLA Pooled Funds	25	0	25
Other Funds	13	15	28
TOTAL INVESTMENTS	**84**	**20**	**104**
Increase/ (Decrease) in Investments £m			20

8.3 Both the CIPFA Code and MHCLG guidance requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council'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.

8.4 Counterparty credit quality was assessed and monitored with reference to credit ratings (the Council's minimum long-term counterparty rating is A- across rating agencies Fitch, S&P or Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

9. Budgeted Income and Outturn

9.1 At the start of the year the UK Bank Rate was 0.5% and on 2nd August 2018 it went up to 0.75%. Short-term money markets and the Debt Management Account Deposit Facility (DMADF) still offer very low rates of return.

9.2 The Council's budgeted investment income for the year is estimated at £1.794m. The Council is currently anticipating delivering this by the year end.

10. Non-Treasury Investments

10.1 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.

10.2 The Council also holds £167.488m of investments in directly owned property as part of the Asset Investment Fund as at 30th September 2019. This represents an increase in the first six months of the year of £26.985m.

10.3 The non-treasury investments in the Asset Investment Fund are forecast to generate £2.724 (budget £1.800m) of investment income for the Council after taking account of direct costs and service borrowing, representing a rate of return of 2.2%.

11. Compliance with Prudential Indicators

11.1 Prudential Indicators 2019/20

The Local Government Act 2003 requires the Council to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

11.2 To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Investment Limits

	30.9.19 Actual	2019/20 Limit	Complied
Any group of funds under the same management	£20m	£25m	✓
Investments held in a broker's nominee account	£0	£25m	✓
Foreign countries	0	£10m	✓
Registered Providers	£0	£25m	✓
Unsecured investments with Building Societies	£5m	£10m	✓
Loans to unrated corporates	£10m	£25m	✓
Money Market Funds (maximum held)	£46m	£60m	✓

12. Debt Limits

12.1 The Operational Boundary for external debt is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

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

Operational Boundary	30.09.19 Actual £m	2019/20 Target £m	Complied
Borrowing	503	720	✓
Other long-term liabilities	121	122	✓
Total Debt	624	842	✓

The Council confirms that during 2019/20 the Operational Boundary has not been breached.

12.2 The Authorised Limit for external debt is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	**30/09/19 Actual £m**	**2019/20 Target £m**	**Complied**
Borrowing	503	775	✓
Other long-term liabilities	121	145	✓
Total Debt	624	920	✓

Total debt as at 30/9/2019 was £624m. The Council confirms that during 2019/20 the Authorised Limit was not breached at any time.

13. Treasury Management Indicators

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

13.1 **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.

	30.09.19 Actual	2019/20 Target	Complied
Portfolio average credit rating	A	A	✓

13.2 **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.

13.3 **Interest Rate Exposures:**

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed was:

	30.09.19 Actual	2019/20 Target	Complied
Upper limit on fixed interest rate exposure	100%	100%	✓
Upper limit on variable interest rate exposure	0%	25%	✓

13.4 **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 fixed rate borrowing were:

	30.09.19 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	72%	90%	0%	✓
12 months and within 24 months	1%	40%	0%	✓
24 months and within 5 years	0%	40%	0%	✓
5 years and within 10 years	7%	25%	0%	✓
10 years and above	20%	95%	0%	✓

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.

13.5 **Principal Sums Invested for Periods Longer than 365 days:** 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 total principal sum invested to final maturities beyond the period end will be:

	30.09.19 Actual	Target	Complied
Limit on principal invested beyond year end	£0m	£45m	✓

The Council does, however, have £20m invested in the CCLA Pooled Property Fund and £5m in the CCLA Diversified Income Fund which the Council is holding the investment for the long term. However, these investments are classified as a short term investment because it can be called upon at any point.

14. Investment Training

14.1 During the period to 30 September 2019 officers have attended the following Treasury Management training:

- Arlingclose Meetings – Treasury Management Board Meeting
- CIPFA – Treasury Management Workshop
- Arlingclose - Investment workshop
- Arlingclose – Strategy Workshop for Investments, Capital and Treasury Management

15. Outlook for the remainder of 2019/20

15.1 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.

15.2 There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance.

15.3 Parliament appears to have frustrated UK Prime Minister Boris Johnson's desire to exit the EU on 31st October. The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out for 2019 and the risk of this event remains for 2020. The risk of a general election in the near term has, however, increased.

15.4 Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

15.5 Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependent on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will continue to offer longer-term borrowing opportunities

	Dec-2019	Mar-2020	Jun-2020	Sep-2020	Dec-2020	Mar-2021	Jun-2021	Sept-2021	Dec-2021	Mar-2022
Official Bank Rate										
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside Risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75