CT/19/117
Corporate Infrastructure & Regulatory Services Scrutiny Committee
26 November 2019

**Treasury Management - Mid Year Stewardship Report 2019/20**

**Report of the County Treasurer**

All recommendations contained in this report are subject to confirmation by the Committee before taking effect.

**Recommendation: That the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the Treasury Management Mid Year Stewardship Report.**

## 1. Introduction

1.1. The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2017 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2018. The Treasury Management and Investment Strategy for 2019/20 was agreed by Council in February 2019 and forms part of the published budget book.

1.2. The purpose of this report is to inform members of any key matters arising from the Council's Treasury and Debt Management activities during the first seven months of the 2018/19 financial year. It is intended to enable members to ensure that agreed policy is being implemented. This report, together with any comments offered by this committee, will be considered by Cabinet on 11th December.

## 2. Borrowing Strategy for 2019/20 – 2021/22

2.1. The overall aims of the Council's borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

2.2. The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required, although this will be kept under review. The majority of the capital programme is funded by capital grants or use of capital receipts. Some use is made of internal borrowing from the Council's cash resources, and prudent management of the capital programme aims to ensure that there is no requirement to take on additional external borrowing.

2.3. If short-term borrowing is required to aid cashflow, this will be targeted at an average rate of 0.4%.

## 3. Implementation of the borrowing strategy in 2019/20

3.1. Active treasury management and the maintenance of levels of liquidity have ensured that no short term borrowing has been required for the financial year to date. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

3.2. In accordance with the Medium Term Financial Strategy no long term external borrowing has been undertaken this financial year. Instead all borrowing required to fund capital expenditure has been funded by internal cash balances. This position will be kept under review, but the expectation remains that no new external borrowing will be required during the three year period.

3.3. On 9th October HM Treasury announced an increase in interest rates for borrowing from the Public Works Loan Board (PWLB). Some local authorities have substantially increased their use of the PWLB in recent months, as the cost of borrowing has fallen to record lows. HM Treasury was concerned about the level of local authority borrowing and therefore announced that they would restore interest rates to levels available in 2018, by increasing the margin that applies to new loans from the PWLB by 100bps (one percentage point) on top of usual lending terms. Should the Council decide that it wished to take out new external debt, then this move by HM Treasury would increase the cost of the external borrowing. However, this has no impact on the rates applicable to the Council's current long term debt, which were set at fixed rates when the loans were taken out.

3.4. At 31st October 2019 the level of long term debt remains unchanged at £507.85m as detailed in the table below.

### Analysis of Long Term Debt

| | Actual 31.03.19 | Interest Rate | Actual 31.10.19 | Interest Rate |
|---|---|---|---|---|
| | £'m | % | £'m | % |
| **Fixed Rate Debt** | | | | |
| PWLB | 436.35 | 4.99 | 436.35 | 4.99 |
| Money Market | 71.50 | 5.83 | 71.50 | 5.83 |
| **Variable Debt** | | | | |
| PWLB | 0.00 | | 0.00 | |
| Money Market | 0.00 | | 0.00 | |
| **Total External Borrowing** | **507.85** | **5.11** | **507.85** | **5.11** |

3.5. It should be noted that the long term debt figure presented in the Statement of Accounts will be different than the figure stated above. This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The Money Market loans, or LOBOs (Lender Option Borrower Option), have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. This revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

3.6. The majority of the Council's borrowing is from the Public Works Loan Board (PWLB); however, there are three outstanding LOBO loans, totalling £46.5 million and one fixed loan valued at £25m (previously a LOBO), as shown in the above table. These are historic loans which were all taken out over thirteen years ago, at an initial lower rate of interest that then stepped up to a higher rate after the initial period. There is no further stepping built into any of the loans, but the lenders of the LOBOs have the option to increase the interest rate at each half year date. If the lender exercises this option, the Council would then have the option of repaying the loan in full, incurring no early repayment premium, or to continue making repayments at the higher rate of interest. Given the current level of interest rates it is unlikely that this will happen for many years.

3.7. No opportunities have arisen during this financial year to repay outstanding debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The PWLB sets premature repayment rates and, where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. These repayment rates are unaffected by the move to increase the rates for new borrowing, in effect increasing the margin between the rates for new loans and the repayment rates. With current low rates of interest these penalties would be of a significant cost. Therefore it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums.

## 4. Investment Strategy in 2018/19

4.1. The County Council continues to adopt a very prudent approach to counterparties to whom the County Council is willing to lend. As a result, only a small number of selected UK banks and building societies, money market funds and Non-Eurozone overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. In addition, the CCLA (Churches, Charities and Local Authorities) Property Fund is being used. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list.

4.2. The 2019/20 Treasury Management Strategy also included provision for the use of multi-asset income funds or short dated bond funds. Use of such funds would be subject to the approval of the Cabinet Member for Resources Management.

4.3. The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

4.4 The target rate for interest on deposits with banks, building societies and money market funds is 0.75%. The target rate for the CCLA Property Fund is 4.5%.

## 5. Implementation of the investment strategy in 2019/20

5.1. The following table shows the County Council's fixed and variable rate investments as at the start of the financial year and as at 31st October 2019:

## Schedule of Investments

| | Maturing in: | Actual 31.03.19 £'m | Interest Rate % | Actual 31.10.19 £'m | Interest Rate % |
|---|---|---|---|---|---|
| **Bank, Building Society & MMF Deposits** | | | | | |
| **Fixed Rates** | | | | | |
| Term Deposits | < 365 days | 147.50 | 1.01 | 132.50 | 1.04 |
| | 365 days & > | 10.00 | 1.00 | 10.00 | 1.25 |
| Callable Deposits | | | | | |
| **Variable Rate** | | | | | |
| Call Accounts | | 0.00 | 0.00 | 0.00 | 0.00 |
| Notice Accounts | | 12.50 | 1.01 | 40.00 | 1.04 |
| Money Market Funds (MMF's) | | 46.83 | 0.77 | 41.20 | 0.72 |
| **Property Fund** | | 10.00 | 4.23 | 10.00 | 4.26 |
| **All Investments** | | **226.83** | **1.10** | **233.70** | **1.13** |

5.2. The figure as at 31st March 2019 includes approximately £11.7m related to the Growing Places Fund (GPF). This figure had reduced to approximately £6.8m as at 31st October 2019. Devon County Council has agreed to be the local accountable body for the GPF, which was established by the then Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF funds, based on the average rate achieved by the Council's investments, will accrue to the GPF and not to the County Council.

5.3. The Bank of England's Monetary Policy Committee (MPC) have held the base rate at 0.75% since August 2018. Any further moves in the base rate are likely to depend on the outcome of the UK general election and the consequences for Brexit. A move could be made in either direction, but is unlikely to have any significant effect on investment income that can be achieved in 2019/20.

5.4. Revenue lending during the current year up to 31st October, including the use of term deposits, call accounts, money market funds and the CCLA property fund, has earned interest of £1,503,000 against a full year budget of £1,600,000. It is forecast that the investment income for the full financial year will exceed budget by around £750,000. The surplus income has resulted from better rates being achieved than the prudent target that was set for the year, plus a higher average cash balance over the year to date than was anticipated.

5.5. The County Council continues to adopt a very prudent approach to counterparties to whom the County Council is willing to lend. As a result only a small number of selected UK banks, building societies and money market funds and Non-Eurozone overseas banks in highly rated countries have been used, subject to strict criteria and the prudent management of deposits with them. A longer-term investment of £10m has also been made in the CCLA (Churches, Charities and Local Authorities) Property Fund. However the Council has no direct investments in property or other non-treasury management investments for commercial purposes. The provision in the Strategy for the use of multi asset income funds and short dated bond funds has not yet been utilised.

5.6. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list. All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties. There have been no breaches of credit limits.

## 6. Minimum Revenue Provision (MRP)

6.1. Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

6.2. The current policy, following a review in 2018/19 is to charge MRP in equal instalments over the life of the asset benefiting from the capital spend, based on the annuity method. The budgeted MRP for 2019/20 is £12.685m.

## 7. Prudential Indicators

7.1. Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

7.2. The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

7.3. Three Prudential Indicators control the overall level of borrowing. They are:

- **The Authorised Limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for 2020/21 is revised as part of the 2020/21 budget process.
- **The Operational Boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- **The Underlying Borrowing Requirement to Gross Debt** - the Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

7.4. During the Budget process, the following Borrowing Limits were set for 2019/20

- Maximum borrowing during the period **(Authorised Limit)** - £776.73m
- Expected maximum borrowing during the year **(Operational Boundary)** - £751.73m
- Maximum amount of fixed interest exposure (as a percentage of total) - 100%
- Maximum amount of variable interest exposure (as a percentage of total) - 30%

7.5. Members are asked to note that for 2019/20 to date, the Council has remained within its set Borrowing Limits and has complied with the interest rate exposure limits.

## 8. Prospects for 2020/21

8.1. Investment returns are likely to remain low during 2020/21. However, much will depend on the outcome of the UK general election and its impact on the resolution of Brexit, and updated forecasts for UK GDP.

8.2. Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Brexit – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- The Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new unlikely alliance of two very different parties will endure.
- Concerns around the level of US corporate debt which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions.
- Geopolitical risks, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

8.3. Upside risks to current forecasts for UK gilt yields and PWLB rates

- Brexit – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

8.4. In view of this, it is likely that the target investment return for 2020/21 for bank, building society and money market deposits will continue to be set at a prudent level of around 0.75%, reflecting the current Bank of England base rate. However, the target rate will be reviewed in the light of the general election outcome and progress made in resolving Brexit between now and when the Council's budget is set in February. We expect to achieve a higher rate of return in the region of 4.0% to 4.5% for the CCLA property fund.

8.5. Multi asset income funds and short dated bond funds remain within the strategy. The use of such funds will be reviewed when the outcome and consequences of Brexit are clearer.

**9. Summary**

9.1. No long term borrowing has been undertaken to date in 2019/20. The expectation is that no new borrowing will be required during the remainder of the 2019/20 financial Year.

9.2. No short term borrowing has been undertaken to date in 2019/20.

9.3. The investment income achieved as at the end of October stands at around £1.5 million compared to the budget target for the year of £1.6 million.

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Electoral Divisions: All
<u>Local Government Act 1972</u>
<u>List of Background Papers – Nil</u>
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