Cabinet Meeting on the 20 November 2019

Treasury Management Report for the half-year ended 30 September 2019

Report summary from Mike Sutherland, Cabinet Member for Finance and Corporate Matters

Mike Sutherland said "The UK economy continues to face a challenging outlook with notable signs of a global economic slowdown. At the County Council, we are focused on reducing the authority's exposure to risk and using our resources prudently. Our policy of using cash instead of borrowing continues to generate significant savings, helping reduce the average interest we pay on our debt."

1. This report provides a summary of the Council's borrowing and investment activities during the first six months of the year.

2. An analysis of the first half-year activities is set out in the report, but the key points to note are that;
   - the Treasury Management Panel, chaired by the County Treasurer and comprising other senior finance officers, met regularly to consider treasury matters;
   - all transactions were undertaken by authorised officers and within the limits approved;
   - all investments were to counterparties on the counterparty list and fully met the requirements of the relevant regulations;
   - the Council operated within the limits and Prudential Indicators set out in the Council's Treasury Management Practices and Annual Treasury Management Strategy.

3. The Council maintained a cautious approach to investments. Our policy of using cash instead of borrowing continues to generate significant savings, helping reduce the average interest we pay on our debt.

4. Overall the report shows that the Council's borrowing and investment activities are being undertaken prudently and sensibly and I am happy to recommend the report to Cabinet.

Local Members Interest
N/A

CABINET – 20 NOVEMBER 2019

Treasury Management Report for the half-year ended 30 September 2019

Recommendation of Leader of the Council

1. That Cabinet note the treasury management activities for the half-year ended 30 September 2019, including the Prudential Indicators detailed in **Appendix 2**.

Report of the County Treasurer

Summary

2. On 30 January 2019, the Council adopted the revised Chartered Institute of Public Finance and Accountancy's 'Treasury Management in the Public Services: Code of Practice' ('the CIPFA Code') which requires the Council to approve treasury management semi-annual and annual reports.

3. All activities are set against the context of the Treasury Management Strategy for 2019/20 approved by Cabinet on 30 January 2019. 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 remains central to the Council's treasury management strategy.

4. This report provides a summary of the County Council's treasury management activities for the first six months of the year. It considers both borrowing and investment decisions taken in the light of the interest rates and economic conditions prevailing at the time.

External Context

5. The UK's political and economic environment during the first half of 2019/20 continued to be dominated by the tensions associated with leaving the European Union (EU). Boris Johnson won the Conservative Party leadership contest to become Prime Minister in July 2019 and committed to leaving the EU regardless of whether a deal is reached. However, his extended prorogation of Parliament was deemed unlawful by the Supreme Court whilst Parliament also voted for a bill requiring a Brexit extension, if a deal was not in place by 19th October.

6. Brexit uncertainties impacted the UK economy as it contracted by 0.2% in Q2 2019 with business investment falling by 0.4%; in this period, UK production registered its largest drop since Q4 2012. Although the employment rate remained high at 76.1%, UK Consumer Price Inflation (CPIH) fell to 1.7% in August 2019, weaker than the consensus forecast of 1.9% and below the Bank of England's target of 2%.

7. On an international setting, concerns over a weaker economic environment in the US alongside trade tensions with China prompted fears over a global economic slowdown. The US Federal Reserve responded by cutting rates in September with market expectations for further rate cuts in the financial year. The Eurozone also showed signs of a slowdown as Germany, its largest economy, contracted for the second time in a year. The European Central Bank (ECB) reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1 November 2019.

8. The uncertain economic environment was reflected in financial markets; equities experienced increased volatility and bonds rallied as investors sought greater security. Gilt yields remained volatile during this period with the 10-year gilt falling from 0.83% in June to 0.55% in September. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills; history has shown that a recession can often follow a yield curve inversion.

Borrowing strategy update

9. The Treasury Management Strategy Report for 2019/20 outlined the long-term borrowing strategy for the year. This was:

   "maximising the use of cash in lieu of borrowing required as far as is practical with the ability to borrow new long-term loans where deemed appropriate"

10. In accordance with this, cash has continued to be used in lieu of borrowing and the Council did not require new or replacement loans to be taken out in the first half of the year.

11. The strategy of using cash instead of borrowing has relied on two main factors; the Bank Rate (set by the Bank of England) remaining low, and cash balances being sufficient to meet the Council's day to day requirements.

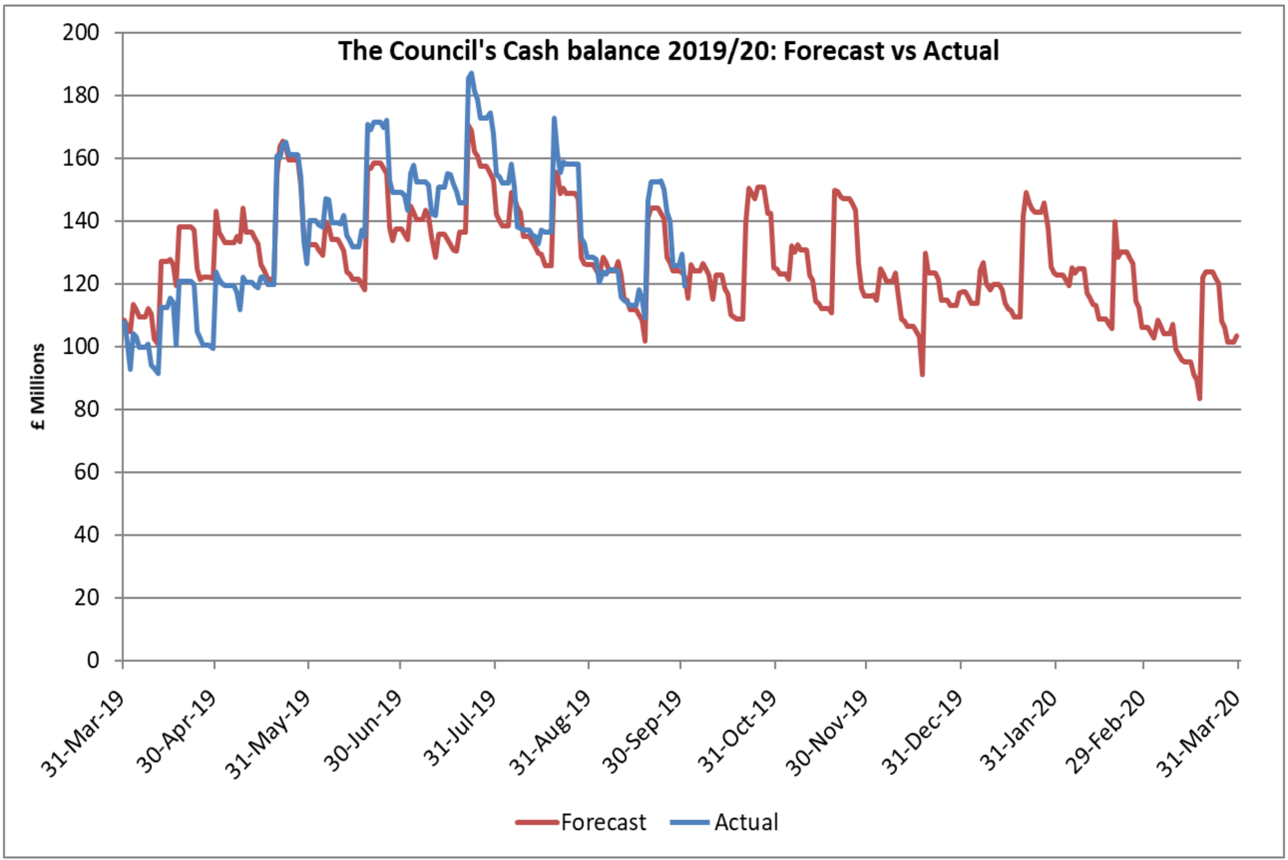
12. Firstly, the Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment. The Bank confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether a deal for the UK to leave the EU is reached by 31 October 2019.

13. In terms of the future, Arlingclose, the Council's treasury advisor, expect Bank Rate to remain at 0.75% for the foreseeable future although there are significant downside risks to the interest rate forecast, dependent on Brexit and global economic outcomes.

14. Interest rates remain just above historic lows; low rates mean that the strategy of using cash remains important and represents a cheap way of financing the capital programme. Overall, the short-term interest rate environment now and the forecast both still support the borrowing strategy adopted in 2019/20.

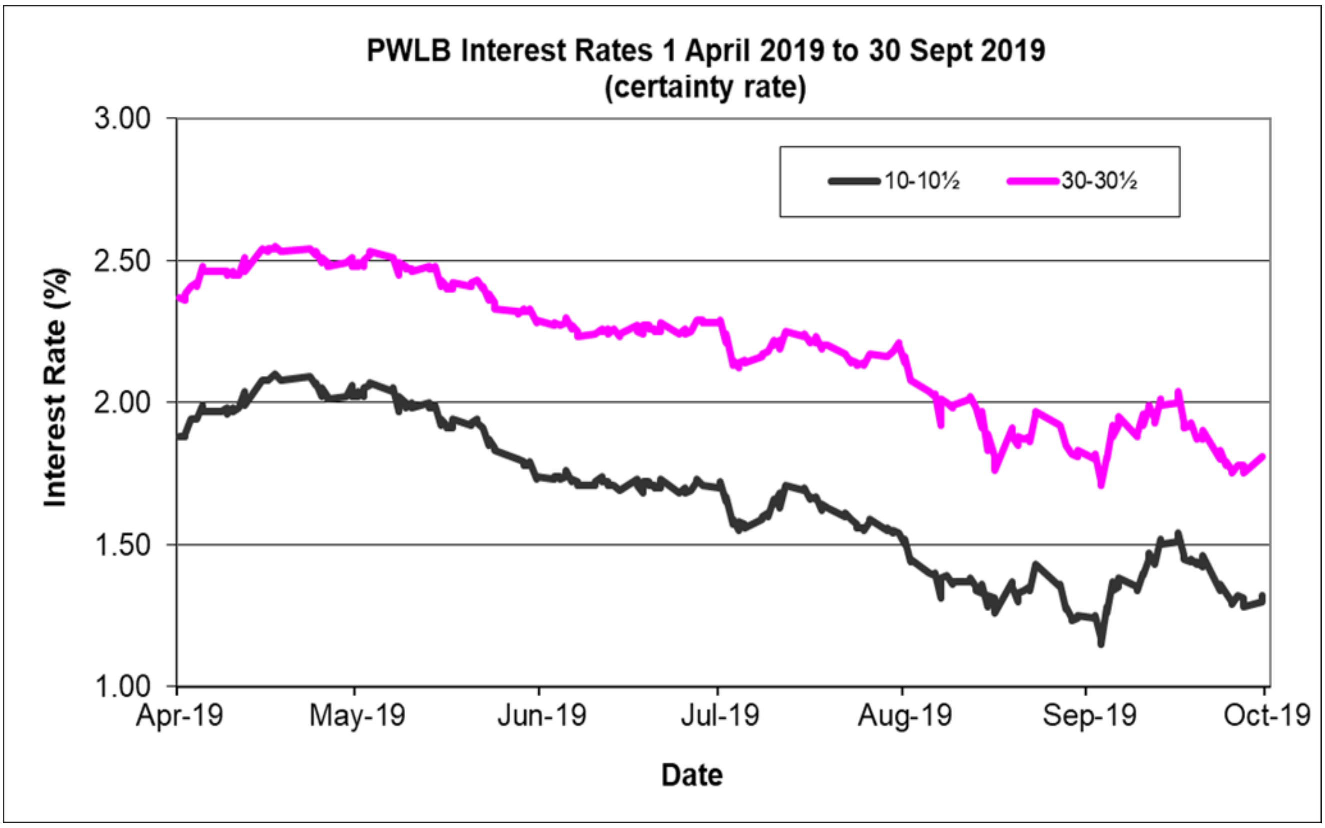
15. Secondly, cash balances have been sufficient to allow day to day cash management in the first half of the year. The following graph shows total actual cash balances for the first half of the year (in blue) against the forecast

for the full year (red). The graph indicates actual cash balances have by and large followed the forecast at the start of the year.



16. Even after the implementation of the borrowing strategy i.e. using cash in lieu of borrowing, cash balances have been sufficient to allow day to day cash management in the first half of the year. Effectively these cash balances are lower by over £115m than they would be, if cash had not been used in lieu of new long-term loans.

17. Forecasts indicate the Council should have sufficient balances to fund its debt for 2019/20 without the need to take out further long-term loans. When loans are taken-up these are mainly sourced from the Public Works Loan Board (PWLB), whose loan interest rates reflect changes in Gilt yields in the UK Government bond market. The following chart shows two typical loan periods where rates have been adjusted to reflect the “certainty-rate” reduction of 0.20% that is available to all local authorities who register with the Government.



18. Gilt yields are very sensitive to the risk appetite of international investors and the current low yields reflect the uncertain global financial environment. Gilt yields decreased throughout the first half of 2019/20 and reached a record low in early September – the 10-year gilt was at 0.382% on 3 September 2019. Investors sought the safety of bond markets in the face of global economic slowdown concerns and a no-deal Brexit and this has been reflected in a similar downturn in PWLB interest rates.

19. On 9 October 2019, HM Treasury, the government department responsible for the PWLB, increased the margin over gilt yields from 80bps to 180bps for certainty rate loans. The government reasoned that the cost of borrowing had fallen to record lows in recent months and some local authorities have substantially increased their use of PWLB borrowing. This new shift in policy was aimed to restore PWLB lending rates to 'normal' levels.

20. The following table compares the certainty rates for standard new maturity 10-year and 30-year PWLB loans under the old and new policy.

PWLB loan period	**Certainty rate 8 Oct 2019 (80 bps above gilt yields)**	**Certainty rate 9 Oct 2019 (180 bps above gilt yields)**
10-10 ½	1.22%	2.25%
30-30 ½	1.76%	2.78%

The new rates are substantially higher than the rates under the old policy although they are still low when compared to historical PWLB rates.

21. The Council's current external loans portfolio includes £51m Lender Option Borrower Option (LOBO) loans. LOBO loans are long term loans where the lender has the option to increase the interest rate at pre-determined intervals; if the lender exercises its option to change the rate, the borrower's option is triggered. The borrower must either accept the revised rate or they can repay the loan without penalty. LOBO loans were initially taken out by the Council when their rates compared favourably to PWLB rates.

22. The following table shows the interest rates incurred on the Council's debt portfolio for 2018/19 and for this half year, including an adjustment reflecting the use of cash.

	2018/19 Full Year %	**2019/20 Half Year %**
Weighted average rate of interest for external loans *	4.65	4.64
* adjusted for the use of cash	4.20	4.09

23. The average rate on external loans is lower than last year as it does not include the £15m of PWLB loans that the Council repaid upon maturity in the second half of 2018/19. Once the use of cash is taken into account the rate falls considerably. This illustrates our policy of using cash instead of borrowing continues to generate significant savings, helping reduce the average interest we pay on our debt. It is estimated that the Council has saved £0.360 million in interest payments in the first half of the financial year, by using internal funds instead of borrowing.

24. A graph illustrating the maturity profile of the long-term debt at 30 September 2019 is provided at **Appendix 3**.

Loan restructuring

25. Movements in interest rates over time may provide opportunities to restructure the loan portfolio in one of two ways:

- to replace existing loans with new loans at a lower rate (known as loan rescheduling); or
- repay loans early, without replacing the loans. This would increase the use of cash.

26. The Treasury Strategy for 2019/20 approved loan rescheduling where this re-balances risk and approved repayment of loans with no replacement, where deemed appropriate.

27. A combination of factors has meant that PWLB loan restructuring has not been financially viable so far in 2019/20:

- Relatively low gilt yields mean that a large penalty would be payable; and
- Government policy, whereby a margin is applied to the early repayment of a PWLB loan, increases the penalty payable.

Investment Strategy update

28. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. As shown in the chart at **paragraph 15**, the Council's investment balances during the year have ranged between £91 million and £187 million due to timing differences between income and expenditure.

29. The Annual Investment Strategy (AIS) forms part of the Treasury Management Strategy and sets out those parties the Council will lend its money to. The AIS details the requirements of government guidance and the CIPFA Code; both documents require the Council to invest its funds prudently and to have regard to the following two prime risk issues over return:
    - The security of capital.
    - The liquidity of investments.

30. The resulting strategy adopted was characterised by:
    - the use of selected counterparties (high level of security);
    - the use of diversified sterling "AAA" money market funds (high level of security and liquidity);
    - a maximum duration of 12 months (high level of security);
    - the use of same day liquidity accounts (high level of liquidity).

Treasury Investments

31. Approved investments stood at £129.398m on 30 September 2019 (£117.018m on 30 September 2018). These are analysed by type, term and credit rating below:

Long-term local authority	**£m**	**Term**	**Credit rating**
Derby City Council	7.500	28/11/2030	Unrated
Derby City Council	7.500	28/11/2031	Unrated
Redcar and Cleveland Borough Council	7.500	29/11/2032	Unrated
Redcar and Cleveland Borough Council	7.500	29/11/2033	Unrated
Short-term local authority			
London Borough of Havering	5.000	1 month	Unrated
Mid Suffolk District Council	4.000	2 months	Unrated
Reading Borough Council	5.000	3 months	Unrated
London Borough of Barking & Dagenham	5.000	3 months	Unrated
Wirral Met Borough Council	5.000	3 months	Unrated
Telford & Wrekin Borough Council	5.000	6 months	Unrated
Thurrock Borough Council	5.000	6 months	Unrated
Banks and building societies			

Lloyds Bank Plc	6.398	Instant Access	A+
Money Market Funds			
Aberdeen	16.000	Instant Access	AAA
Black Rock	5.000	Instant Access	AAA
Insight	5.000	Instant Access	AAA
Federated	16.000	Instant Access	AAA
State Street	12.000	Instant Access	AAA
Collective Investment Scheme			
Royal London Cash Plus Fund	5.000	3 day notice	AAA
TOTAL	**129.398**		

32. Whilst most local authorities are unrated by credit agencies, both regulations (which list local authorities as acceptable bodies to invest in) and their status as tax raising bodies make them highly creditworthy. As cash forecasts remained relatively high for 2019/20, the Council invested some of its cash with local authorities for longer durations to gain a higher return.

33. The following table shows the Council's investment returns in 2018/19 and 2019/20 to date.

	2018/19 Full Year	**2019/20 Half Year**
Average return on investments	1.53%	1.48%
7 day LIBID * (benchmark)	0.51%	0.53%
Additional return generated	1.02%	0.95%
Adjusted without long-term local authority investments	0.61%	0.68%

** LIBID (London Interbank BID interest rate)*

34. Returns on investments have benefited from the four long-term local authority investments shown in **paragraph 31**, as these were entered into at an average rate of 4%. The average return in 2019/20 has comfortably outperformed the benchmark, although this is lower than the return achieved in 2018/19. This was mainly because cash balances were lower in 2018/19 meaning that a greater proportion of the return came from the higher rated long-term local authority investments. Without the inclusion of the long-term local authority investments, the Council achieved a higher return in 2019/20.

35. A copy of the counterparty list as at 30 September 2019 is shown at **Appendix 4**.

<u>Brexit update</u>

36. The UK were scheduled to leave the EU on 31 October 2019, but the UK Parliament failed to agree on Prime Minister Boris Johnson's revised Brexit deal. As required by law under the Benn Act, the UK accepted the EU offer of a further extension to 31 January 2020. The Brexit issue has now been put back to the people with an early general election approved for 12 December

2019. There remains little political clarity as to whether a Brexit deal will be agreed or even if Brexit will take place.

37. During the first half of the year, the Council were aware of the risks of a no deal Brexit and potential delays in redeeming cash balances from non-UK domiciled MMFs. As a result, the Council ensured that its account with the UK Government DMADF remained available for use in an emergency. The Council also had its UK domiciled Federated MMF and Lloyds bank account available to hold sufficient liquidity required in the near term.

Non-treasury investments

38. 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. The revised Investment Guidance from MHCLG broadened this definition further to include loans and investments for service purposes.

39. The County Council currently has one non-treasury investment. This non-treasury investment made for service purposes is a 49% share in the company Entrust which provides education support services to schools. At 31 March 2019, the Council's share in Entrust was revalued to £0.0m.

Compliance with Treasury Limits and Prudential Indicators

40. It can be certified that for the half year ended 30 September 2019:

(i) in accordance with Financial Regulations, the Treasury Management Panel chaired by the County Treasurer and comprising other senior finance officers, met regularly to consider treasury matters;

(ii) all treasury related transactions were undertaken by authorised officers and within the limits approved by the County Council;

(iii) all investments were to counterparties on the Lending List current at the time and fully met the requirements of relevant legislation;

(iv) the Council operated within the limits and Prudential Indicators for Treasury Management as set out in the Council's Treasury Management Practices and Annual Treasury Management Strategy;

(v) The latest position for Treasury Management Prudential Indicators is shown in **Appendix 2**.

Rob Salmon
County Treasurer

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Background Documents

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2017)
2. Prudential Code for Capital Finance in Local Authorities (CIPFA) (2017)
3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)

Appendix 1

Equalities Implications – There are no equalities implications arising from this report.

Legal Implications – There are no legal implications arising from this report.

Resource and Value for Money Implications – The resource and value for money implications are contained within the body of the report.

Risk Implications – Counterparty and interest rate risk arising as a result of Treasury Management activity have been considered in the body of this report.

Climate Change Implications – There are no climate change implications arising from this report.

Health Impact Assessment screening – There are no health impact assessment implications arising from this report.

Appendix 2

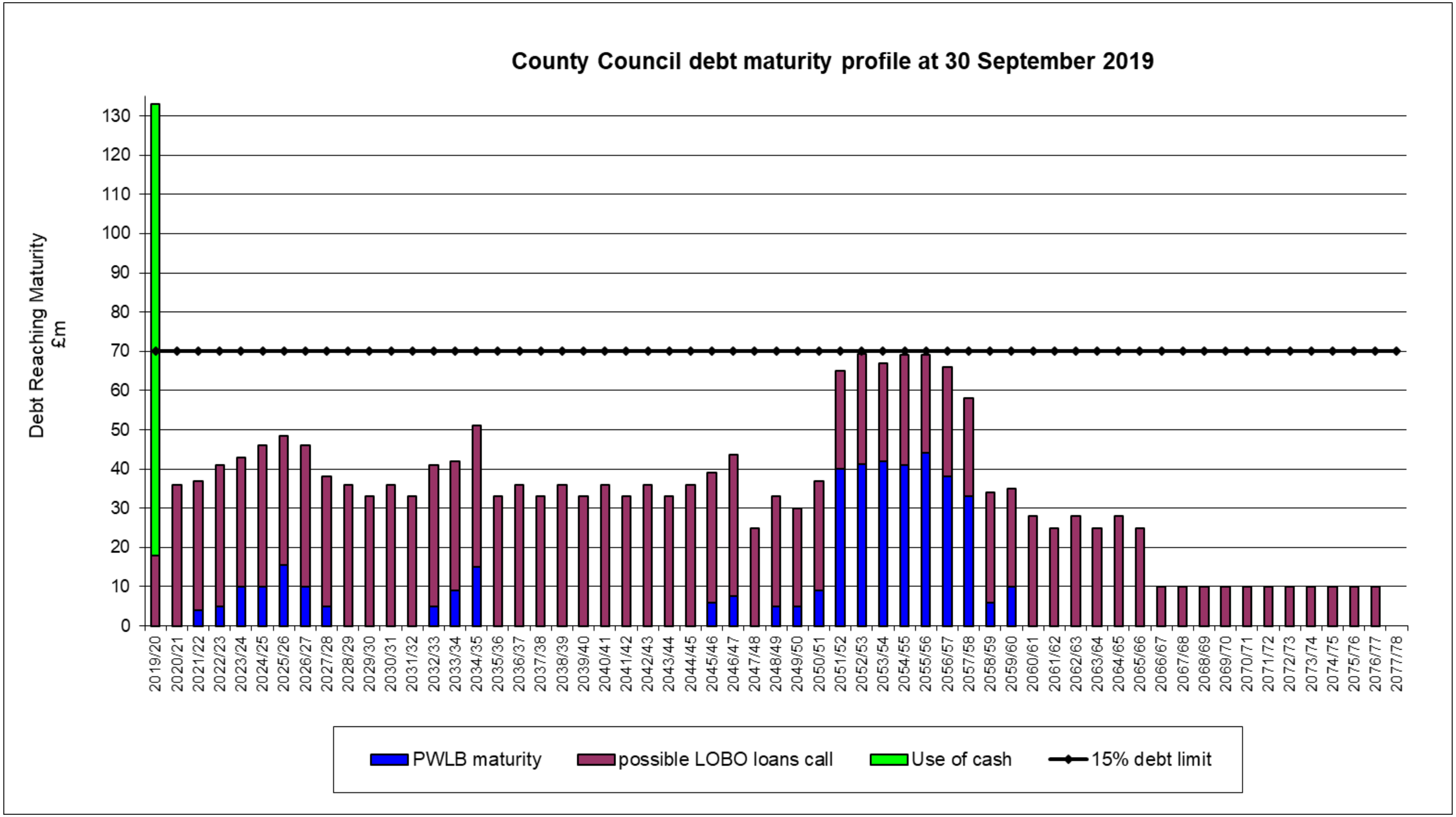
Staffordshire County Council

Cabinet
20 November 2019

Prudential Indicators for Treasury Management

Indicator	Estimated Limit 2019/20	Actual Position at 30/09/19
1. External Debt		
Authorised Limit for borrowing	£632m	£468m
Authorised Limit for other liabilities	£249m	£239m
TOTAL	**£881m**	**£707m**
Operational Boundary for borrowing	£515m	£468m
Operational Boundary for other liabilities	£249m	£239m
TOTAL	**£764m**	**£707m**
External Loans	**£468m**	**£468m**
The Authorised Limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the Capital Programme. *The Operational Boundary represents the County Treasurer's estimate of the day to day limit for treasury management activity based on the most likely i.e. prudent but not worst-case scenario.* *"Other liabilities" relate to PFI schemes which are recorded in the Council's accounts.*		
2. Interest Rate Exposures		
a. Upper Limit (Fixed)	£557m	£438m
b. Upper Limit (Variable)	(£118m)	(£99m)
The Council sets upper limits of fixed and variable borrowing and investments. The effect of setting these upper limits is to provide ranges within which the Council will manage its exposure to fixed and variable rates of interest. Negative figures are shown in brackets; these relate to the" high- point" of investments at a variable rate which are not offset by variable borrowings. The exposure to variable rate movements has been reduced by the use of cash in lieu of borrowing.		
3. Maturity Structure of Borrowing		
See Graph at **Appendix 3**		
This indicator relates to the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. The Council currently applies the practice of ensuring that no more than 15% of its total gross fixed rate loans mature in any one financial year. *Because this is a complex situation for the Council, involving PWLB loans, LOBO loans with uncertain call dates and the use of internal cash, specific indicators have not been set. Instead the Council will manage its exposures within the limits shown on the graph at **Appendix 3**. This graph shows all LOBO call options on a cumulative basis; in fact the actual pattern of repayment, although uncertain, will not be of this magnitude.*		
4. Total principal sums invested for periods longer than a year	**£95m**	**£30m**
Any investments made for over longer than a year will be in accordance with the County Council's limits on non-standard investments.		

Appendix 3



County Council debt maturity profile at 30 September 2019
Debt Reaching Maturity £m
0
10
20
30
40
50
60
70
80
90
100
110
120
130
2019/20
2020/21
2021/22
2022/23
2023/24
2024/25
2025/26
2026/27
2027/28
2028/29
2029/30
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2068/69
2069/70
2070/71
2071/72
2072/73
2073/74
2074/75
2075/76
2076/77
2077/78
PWLB maturity
possible LOBO loans call
Use of cash
15% debt limit

Appendix 4

Counterparty list - September 2019	
	Time Limit
Regulation Investments	
DMADF account	6 months
UK Government T-bills	6 months
UK Local Authority	12 months
Banks and Building Societies	
Barclays	100 days
Lloyds	6 months
HSBC	6 months
Nationwide	6 months
Santander	6 months
MMF	
Black Rock	same day
Insight	same day
Federated	same day
Aberdeen	same day
State Street (SSGA)	same day
Enhanced MMF	
Royal London Cash Plus	3 day notice