Treasury Management Half Yearly Report 2019/20

Introduction

The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2019/20 was approved at a meeting on 27th February 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 remains central to the Authority's treasury management strategy.

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 Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 27th February 2019.

External Context

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.

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.

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 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.

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 could be in either direction depending on whether or not a deal is ultimately reached.

Financial markets: 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. Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk.

Credit background: There were minimal credit rating changes during the period.

Our treasury advisor Arlingclose will provide credit ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in. Arlingclose's creditworthiness advice will continue to include unsecured bank deposits and certificates of deposit (CDs) but not senior unsecured bonds issued by commercial banks.

Local Context

On 31st March 2019, the Authority had net investments of £35.450m arising from its revenue and capital income and expenditure. The treasury management position at 30th September 2019 and the change during the year is shown in Table 1 below.

Table 1: Treasury Management Summary

	31.3.19 Balance £m	**Movement £m**	**30.9.19 Balance £m**
Long-term borrowing	0	0	0
Short-term borrowing	-3.000	-7.000	-10.000
Total borrowing	**-3.000**	**-7.000**	**-10.000**
Long-term investments	34.250	0	34.250
Short-term investments	4.200	-3.300	0.900
Total investments	**38.450**	**-3.300**	**35.150**
Net borrowing / investments	**35.450**	**-10.300**	**25.150**

Borrowing Strategy during the period

At 30th September 2019 the Authority held no long-term loans, (same positon as at 31st March 2019), as part of its strategy for funding previous and current years' capital programmes. Some external borrowing is assumed in the current estimates of future year's capital funding, but has not yet been taken out.

The Authority's chief objective when borrowing will be 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.

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

Other Debt Activity

Although not classed as borrowing, the Authority can raise capital finance via Private Finance Initiatives and finance leases, etc. The Authority has not done this in the period to 30th September 2019.

Treasury Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves. During the six-month period, the Authority's investment balances ranged between £34.270m and £46.985m due to timing differences between income and expenditure. The investment position is shown in table 2 below.

Table 2: Treasury Investment Position

	31.3.19 Balance £m	Net Movement £m	30.9.19 Balance £m	30.9.19 Rate of Return %
Banks & building societies (unsecured)	0.000	0.000	0.000	n/a
Covered bonds (secured)	2.250	0.000	2.250	1.01
Government (incl. local authorities)	2.000	-2.000	0.000	0.90
Corporate bonds and loans	0.000	0.000	0.000	n/a
Money Market Funds	2.200	-1.300	0.900	0.72
Cash plus funds	3.000	0.000	3.000	1.15
Short-dated bond funds	3.000	0.000	3.000	0.97
Strategic bond funds	5.000	0.000	5.000	3.04
Equity income funds	8.000	0.000	8.000	5.59
Property funds	5.000	0.000	5.000	3.04
Multi asset income funds	8.000	0.000	8.000	4.49
Total investments	**38.450**	**-3.300**	**35.150**	**3.08**

**Weighted average maturity will apply to the first five categories above and to cash plus and bond funds*.

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 rate of return, or 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.

In furtherance of these objectives, and given the increasing risk and falling returns from short-term unsecured bank investments, the Authority has diversified into more secure and/or higher yielding asset classes. The Authority's Treasury advisors, Arlingclose, compile quarterly investment benchmarking across their client base. Table 3 shows extracts from this, focussing on measures of risk (credit rating and bail-in exposure) and return (Rate of return).

Table 3: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
31.03.2019	3.00	AA	34%	80	0.92%
30.09.2019	6.28	A	100%	1	0.92%
Similar LAs	4.26	AA-	61%	80	0.86%
All LAs	4.28	AA-	62%	28	0.83%

*Weighted average maturity

The Authority's £32m of externally managed pooled funds generated an £0.583m income return which is used to support services in year, and £1.6m of capital growth. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed.

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 £4.023m of such investments in

- directly owned property £0.923m
- loans to housing associations £3.1m

These investments are expected to generate £0.183m of investment income for the Authority in the year after taking account of direct costs, representing a rate of return of 4.5%. This compares favourably against Treasury investment rates, particularly against shorter term deposits. These investments represent a different risk to the Authority, as property investments do not carry the same interest rate or credit risk, but there is the risk of loss of income through voids and other market factors. They also require more staff time to manage than externalised pooled investments.

The Authority does not currently rely on these funds from Non-Treasury investments to balance the budget, but in a climate of reduced Government funding, is likely to do so more in the future. To guard against the risk of reducing levels of income from these investments, they are proactively managed by experienced and qualified individuals within the Authority, with external advice as required.

Treasury Performance

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 4 below.

Table 4: Performance

	Actual £m	**YTD Budget £m**	**Over/ (under)**	**Actual %**	**Budget %**	**Over/ under**
Term Deposits & Covered Bonds	0.035	0.007	0.028	0.81	1.09	Under
Pooled Funds	0.583	0.607	(0.024)	3.63	3.57	Over
Total treasury investments	**0.618**	**0.614**	**(0.004)**	**4.44**	**4.66**	**Under**

Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the first 6 months of the 2019/20 financial year 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 5 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

Table 5: Debt Limits

	H1 Maximum	**30.9.19 Actual**	**2019/20 Operational Boundary**	**2019/20 Authorised Limit**	**Complied?** Yes/No
Total debt	**£12m**	**£10m**	**£15.030m**	**£23.400m**	Yes

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.

Table 6: Investment Limits

	Half-year Maximum	30.9.19 Actual	2019/20 Limit	Complied? Yes/No
Any single organisation, except the UK Central and Local Government	Nil	Nil	£6m each	Yes
UK Central and Local Government	£2m	Nil	Unlimited	
Any group of organisations under the same ownership	Nil	Nil	£6m per group	Yes
Any group of pooled funds under the same management	Max £7m	Max £7m	£15m per manager	Yes
Negotiable instruments held in a broker's nominee account	£2.25m (King & Shaxon)	Nil	£10m per broker	Yes
Foreign countries	Nil	Nil	£6m per country	Yes
Registered providers and registered social landlords	Nil	Nil	£10m in total	Yes
Unsecured investments with building societies	Nil	Nil	£5m in total	Yes
Loans to unrated corporates	Nil	Nil	£5m in total	Yes
Money Market Funds	£11.425m	£0.9m	£16m in total	Yes
Real estate investment trusts	Nil	Nil	£10m in total	Yes

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 score 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.

	30.9.19 Actual	2019/20 Target	Complied?
Portfolio average credit score	6.28	6.0	No

At the half year, due to cash flows, the Authority had very low levels of liquid cash which were deposited mostly with Barclays Bank. This reduces the average credit score of the portfolio below its usual levels, so we have not complied with this indicator.

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

	30.9.19 Actual	2019/20 Target	Complied?
Total cash available within 3 months	£0.9m	£3m	No

The current market for short term borrowing means liquidity is easily accessible, so it has not been necessary to hold excess liquid cash in the bank or Money Market Funds.

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:

Interest rate risk indicator	30.9.19 Actual	2019/20 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.04m	£0.6m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.04m	£0.6m	Yes

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

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 all borrowing were:

	30.9.19 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	£10m	100%	0%	Yes
12 months and within 24 months	0	100%	0%	Yes
24 months and within 5 years	0	100%	0%	Yes
5 years and within 10 years	0	100%	0%	Yes
10 years and above	0	100%	0%	Yes

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 a year: 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	2020/21	2021/22
Actual principal invested beyond year end	£34.25m	£32m	£32m
Limit on principal invested beyond year end	£42m	£42m	£42m
Complied?	Yes	Yes	Yes

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.

The Authority 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 the evolution of the global economy. Expectations are for gilt yields to remain at low levels for the foreseeable future and the risks to be weighted to the downside; that volatility will continue to offer longer-term borrowing opportunities.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
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	0.25	0.25	0.25
Arlingclose Central Cas	0.75	0.75	0.75	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	0.75	0.75	0.75