



POLICY AND RESOURCES SCRUTINY COMMITTEE – 12TH NOVEMBER 2019

SUBJECT: TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL INDICATORS QUARTER 1 AND QUARTER 2 MONITORING REPORT (1ST APRIL 2019 TO 30TH SEPTEMBER 2019)

REPORT BY: CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE SERVICES

1. PURPOSE OF REPORT

- 1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st April 2019 to 30th September 2019.
- 1.2 To review the Treasury Management Strategy for 2019/20 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

- 2.1 The Code of Practice on Treasury Management in the Public Services 2009, which was adopted by the Council on 12th October 2010, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate Committee on a quarterly basis.
- 2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.
- 2.3 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The capital strategy will be submitted to Full Council later in the year along with the Revenue Budget Report and the 2020/21 Treasury Management Strategy.
- 2.4 The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2019/20 were approved by Council on 21st February 2019.

3. RECOMMENDATIONS

- 3.1 Members are asked to note the contents of this report.

4. REASONS FOR THE RECOMMENDATIONS

- 4.1 Compliance with the CIPFA “Code of Practice for Treasury Management in the Public Services”.

5. THE REPORT

5.1 Treasury Management

5.1.1 Borrowing Activity

The current policy of internal borrowing is not sustainable in the long-term, but where prudent the policy of internal borrowing will be utilised. As at the 31st March 2019 the internal borrowing position was £56m.

The Annual Treasury Management Strategy was approved by Council in February 2019 and indicated that there would be a need to borrow £27.4m in 2019/20 to part fund the General Fund capital programme. A further £44.2m is planned to be raised for the HRA to fund the WHQS capital programme. As at the 30th September 2019 a £23m 20 year PWLB loan was raised to fund the WHQS capital programme. £1.3m was drawn down from the approved £4.14m Salix loan facility to fund in year capital expenditure relating to the LED street lighting changeover programme that Cabinet approved on 28th November 2018. Total Salix drawn down to date is £3.3m.

During the period covered by this report, PWLB loans to the value of £2.2m were repaid on maturity. Such loans had an average interest rate of 5.56%. £30k of the WRU Loan was also repaid. Temporary loans of £24m were repaid during the reported period. The loans were raised during the year for the purpose of cashflow requirements as investments were tied in. Total debt outstanding as at 30th September 2019 was £302m and comprised of £258.6m PWLB loans; £30m market loans (LOBOs); £10m Bank loan; £120k WRU loan; and a £3.3m Salix Energy Finance loan.

With respect to LOBO loans the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. A LOBO loan with a total value of £10m had a rate option reviewed during quarter one and the lender chose not to exercise the option. LOBO loans will be further reviewed again later in 2019/20 by lenders, with a total value of £10m that is exposed to variable interest rate movement. This represents 3.3% of the Authority's debt portfolio, which is exposed to interest rate risk. The Authority acknowledges there is an element of refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options.

5.1.2 Rescheduling

The Annual Strategy allows for the utilisation of debt rescheduling providing for both in year and future year savings and additional revenue resources. No rescheduling opportunities presented themselves during the period covered by this report.

5.1.3 Investments

During the reported period the Authority was holding £33m of long-term investments where the maturity date is greater than 365 days. These investments are in accordance with the approved Investment Strategy. The long-term investments comprise of covered bonds with UK and international banks and have an AAA rating; UK Gilts and local authority deposits. The covered bonds are secured investments and collateralised against the counterparty's

pool of assets. The value of short-term deposits as at 30th September 2019 was £78.6m.

The total investments held as at 30th September 2019 was £111.6m, and had an average rate of return equating to 1.03% which is a significant improvement over placing deposits with the Debt Management Office (DMO) who continue to pay a rate of 0.50%. The rate of return is above the target rate, as detailed in the Annual Treasury Management Strategy report to Council, of 0.25%. The improvement in returns reflect the Authority's change in investment strategy and lending to high creditworthy counterparties that consist of banks; building societies; supranational institutions; the DMO, local authorities; money market fund and corporates using a range of investment products such as corporate bonds; covered bonds; cash deposits and treasury bills. Whilst the returns have improved, the riskiness of the investment portfolio has been quantified with a weighted average credit score equivalent to an AA rating. The UK government is currently rated by two credit rating agencies at AA. Therefore the Authority's portfolio is on par with the UK Government rating.

The portfolio as at 30th September 2019 comprised of the following types of investments:

Counterparty	Investment Product	Sector	£m
Banks	Certificate of Deposits	Financial	12.98
Banks & building societies	Fixed-term cash deposits	Financial	15.00
Banks & building societies	Covered bonds	Financial	15.00
Banks & building societies	Notice accounts	Financial	5.00
Corporates	Bonds	Automobile/ Transport Infrastructure/ Financial/ Consumer/ Natural Resources	28.25
Money Market Fund	Cash Pooled Fund	Financial	8.40
Supranational Institutions	Bonds	Sovereign/ Financial	2.00
UK Government	Gilts/ T Bills	UK Government	10.00
Local Authorities	Fixed-term cash deposits	Local Government	15.00
Total Investments as at 30th September 2019			111.63

5.1.4 Economic Outlook

UK Consumer Price Inflation (CPIH) remained at 1.7% year on year in September 2019. The most recent labour market data for the three months to August 2019 showed the unemployment rate edged back up to 3.9% while the employment rate fell to 75.9. 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. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

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 Monetary Policy Committee confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October. Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty.

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, 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 European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November to address concerns of an economic slowdown in the Eurozone.

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

Our treasury advisor Arlingclose 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. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future.

	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

5.1.5 Counterparty Update

Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. There were minimal credit rating changes during the period.

5.1.6 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. Such investments can comprise of property; shared ownership housing; loans to local businesses/ subsidiaries; and shareholdings. During the reported period the Authority did not hold any non-treasury related investments.

5.1.7 Regulatory Changes

The Welsh Government is consulting on proposed changes to its Statutory Guidance on Local Government Investments to be effective from the 2020/21 financial year. This involves a complete re-write along the lines of the guidance issued last year by the Ministry of Housing, Communities and Local Government (MHCLG) for local authorities in England.

The definition of investments is widened to include "all of the financial and non-financial assets a local authority has invested money into primarily or partially for the purpose of generating a surplus including investment property" providing it has been made using the power to invest contained in the Local Government Act 2003. In addition, loans to wholly-owned companies or associates, to a joint venture, or to a third party count as investments, irrespective of the purpose or legal power used.

5.1.8 Readiness for Brexit

The scheduled leave date for the UK to leave the EU is now 31st October 2019 and there remains little political clarity as to whether a deal will be agreed by this date and there is the

possibility that the exit date is pushed back yet again. As 31st October approaches the Authority will ensure there are enough accounts open at UK domiciled banks and Money Market Funds to hold sufficient liquidity required in the near term, and that its account with the Debt Management Account Deposit Facility (DMADF) remains available for use in an emergency.

5.2 Prudential Indicators

5.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 1 shows a projected CFR value of £382.66m as at 31st March 2020. The actual CFR as at 31st March 2019 was £367.18m.

5.2.2 Prudential Indicators – “Prudence”

The Prudential Indicators for Treasury Management are shown in Appendix 1, and the Authority is currently operating within the approved limits.

5.2.3 Prudential Indicators – “Affordability”

There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2 and currently show a projected reduction from the original budget as a consequence of deferred borrowing for the General Fund.

5.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows no change against the planned position.

6. ASSUMPTIONS

6.1 The details set out in the report are based on actuals that have occurred between 1st April 2019 and 30th September 2019.

7. LINKS TO STRATEGY

7.1 Treasury Management Strategy 2019/20 as agreed by Council on 21st February 2019.

7.2 Prudent financial management contributes to the following Well-being Goals within the Well-being of Future Generations Act (Wales) 2015:-

- A prosperous Wales.
- A resilient Wales.
- A healthier Wales.

- A more equal Wales.
- A Wales of cohesive communities.
- A Wales of vibrant culture and thriving Welsh Language.
- A globally responsible Wales.

8. WELL-BEING OF FUTURE GENERATIONS

- 8.1 The effective management of the Authority's borrowing and investments are key in ensuring that the Well-being Goals within the Well-being of Future Generations Act (Wales) 2015 are met.

9. EQUALITIES IMPLICATIONS

- 9.1 This report is for information purposes, so the Council's Equalities Impact Assessment (EqIA) process does not need to be applied.

10. FINANCIAL IMPLICATIONS

- 10.1 As detailed throughout the report.

11. PERSONNEL IMPLICATIONS

- 11.1 There are no direct personnel implications arising from this report.

12. CONSULTATIONS

- 12.1 There are no consultation responses that have not been reflected in this report.

13. STATUTORY POWER

- 13.1 Local Government Acts 1972 and 2003.

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Appendices:

Appendix 1 – Treasury Management Prudential Indicators – Prudence

Appendix 2 – Capital Finance Prudential Indicators – Affordability

Appendix 3 – Capital Expenditure and Funding

Appendix 1 Treasury Management Prudential Indicators- Mid Year report (Quarters 1 & 2)

	Budget 2019-20	Estimated 2019-20
	£000	£000
Authorised limit for external debt -		
Borrowing	432,771	432,771
Other long term liabilities	30,653	30,649
Total	463,424	463,420
Operational boundary for external debt -		
Borrowing	346,217	331,530
Other long term liabilities	30,653	30,649
Total	376,870	362,179
Capital Financing Requirement	401,438	382,663
Upper limits for interest rate exposure		
Principal outstanding on borrowing	346,217	331,530
Principal outstanding on investments	75,000	111,629
Net principal outstanding	271,217	219,901
Fixed rate limit – 100%	271,217	219,901
Variable rate limit – 30%	81,365	65,970
Upper limit for total invested for over 364 days	50,000	33,000

Maturity structure of fixed rate borrowing	Upper Limit	Lower Limit
Under 12 months	35%	0%
Over 12 months and within 24 months	40%	0%
Over 2 years and within 5 years	50%	0%
Over 5 years and within 10 years	75%	0%
Over 10 years	100%	0%

Gross Debt and Net Debt	Budget 2019-20	Estimated 2019-20
	£000	£000
Outstanding Borrowing	346,217	331,530
Other long term liabilities	30,653	30,649
Gross Debt	376,870	362,179
Less investments	75,000	111,629
Net Debt	301,870	250,550

Appendix 2 Treasury Management Prudential Indicators- Mid Year report (Quarters 1 & 2)

Ratio of Financing costs to net revenue stream	Budget 2019-20	Estimated 2019-20
General Fund	£000	£000
Principal repayments	2,492	2,492
Interest costs	8,842	7,942
Debt Management costs	46	46
Investment income	-950	-800
Interest applied to internal balances	735	735
Total General Fund	11,165	10,414
Net revenue stream	336,695	336,695
Total as percentage of net revenue stream	3.32%	3.09%
Housing Revenue Account		
Principal repayments	2,555	2,555
Interest costs	6,563	6,563
Debt Management costs	43	43
Total HRA	9,161	9,161
Net revenue stream	49,100	49,100
Total as percentage of net revenue stream	18.66%	18.66%

Capital financing requirement [end of year position]	Budget 2019-20	Estimated 2019-20
	£000	£000
Council Fund	254,436	258,186
Housing Revenue Account	147,003	124,477
Total Authority	401,438	382,663

Appendix 3 Treasury Management Prudential Indicators- Mid Year report (Quarters 1 & 2)

	Budget 2019-20	Estimated 2019-20
Expenditure	£000	£000
Council Fund	10,074	10,074
Housing Revenue Account	56,618	56,618
Total	66,692	66,692
Funding		
Surplus/ (Deficit) Balance b/f		
Borrowings - Supported (GF)	4,923	4,923
General Capital Grant - WG	2,997	2,997
RCCO Budget	128	128
Capital underspends from previous years	326	326
One off funding- MRP Review	1,700	1,700
RCCO- (HRA)	17,086	17,086
Borrowings - Unsupported (HRA)	32,181	32,181
Major Repairs Allowance (HRA)	7,351	7,351
Total	66,692	66,692
Surplus C/f	-	-