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COUNTY BOROUGH COUNCIL
CYNGOR BWRDEISTREF SIROL
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REPORT TO:	Executive Board
REPORT NO:	COFI/70/19
DATE:	12 November 2019
LEAD MEMBER:	Councillor Mark Pritchard (Organisation - Finance, Performance, Health and Safety and Governance)
CONTACT OFFICER:	Mark S Owen (Tel: 292701)
SUBJECT:	Semi-Annual Treasury Management Review 2019-20
WARD:	N/A

1. PURPOSE OF THE REPORT

To review the Semi-Annual Treasury Management activity for 2019-2020.

2. EXECUTIVE SUMMARY

2.1 The Capital Financing Requirement is currently forecast to increase by £34.60m to £462.36m between the period 1 April 2019 and 31 March 2020, with a significant element of this required to support the Housing Revenue capital programme in the continued progression toward delivering the Welsh Quality Housing Standard.

2.2 Total debt and long term liabilities decreased by £0.93m to £393.33m between 1 April and 30 September 2019; the Council has replaced £15m of its temporary borrowing with a long term loan with the Public Works Loans Board, the small overall reduction indicative of the writing down of outstanding long term liability in year.

2.3 Consideration in regards to the merits of using short term versus long term borrowing to finance capital expenditure are taken with regard to a number of factors including prevailing interest rates for both, and availability in the market place; any decision in this respect is taken in conjunction with the Council's Treasury Management advisors Arlingclose.

2.4 Investments reduced by £3.48m to £11.80m.

2.5 As the Council's Section 151 Officer, the Chief Officer Finance & ICT confirmed that Treasury Management activity was within the Council's Borrowing Limit and Treasury Management Indicators.

3 RECOMMENDATION

Members note the Treasury Management Semi-Annual review 2019-2020 report.

REASON FOR RECOMMENDATION

(i) To comply with the CIPFA Prudential Code and Code of Practice on Treasury Management.

4 BACKGROUND INFORMATION

4.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in the Public Services. The Code provides that the Section 151 Officer presents an annual report on the performance of the Treasury Management function.

4.2 The Semi-Annual Treasury Management Review report for 2019-20 is attached in Appendix A, this includes at Annex A the schedule of rating criteria for counterparty investments.

5 IMPLICATIONS

5.1 Policy Framework – This falls under the Organisation theme of the Council Plan 2018-2023.

5.2 Budget – The Council's General Fund Capital Financing Budget for 2019/20 is £8,122k, and for the Housing Revenue Account £19,300k.

5.3 Legal – None**.**

5.4 Staffing – There are no direct staffing implications as a result of this report.

5.5 Equality/Human Rights – Equality Impact Assessment has been completed (FIN/EIA00200/2019). There is no impact on groups with protected characteristics as this represents the factual six monthly review position for Treasury Management activities.

5.6 Risks – Treasury Management Risks are addressed in the Council's Treasury Management Practices, last reported to Executive Board on 10 February 2015.

6 CONSULTATION

6.1 The report has been discussed with the Council's Treasury Management and Capital Finance Consultants.

7 EVALUATION OF OPTIONS

7.1 The report is concerned with historical activity only, no options are considered.

BACKGROUND PAPERS	LOCATION	WEBSITE INFO.
1. CIPFA Code of Practice: Treasury Management in the Public Services	Finance Department	Hard copy available in Finance Department.
2. CIPFA Prudential Code	Finance Department	Hard copy available in Finance Department.
3. Welsh Government Guidance on Local Government Investments	Finance Department	http://gov.wales/topics/localgovernment/finandfunding/publications/lginvest/?lang=en
4. Wrexham County Borough Council Financial Regulations	Finance Department	http://www.internal.wrexham.gov.uk/wordpress/sam/departments/finance/financial-regulations-fin-regs/

Appendix A

Semi-Annual Treasury Management Report 2019-2020

Introduction

In December 2011 the Council 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 Council to approve treasury management semi-annual and annual reports.

The Council's treasury management strategy for 2019/20 was approved at full Council on 20 February 2019. The Council has borrowed and invested sums of money proportionate to its financial position 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 remain central to the Council'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 Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 20 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.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU. Mr Johnson prorogued Parliament which led some MPs to put forward a bill to block the UK from leaving without a deal. The move was successful and having been approved by the House of Lords and passed into law, however the Supreme Court subsequently ruled Mr Johnson's suspension of Parliament unlawful.

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 interest rates in a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to a more pronounced global slowdown. These elevated concerns have caused government yield curves in the US and UK 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.

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 by 31st October.

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. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

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.

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%.

Credit background: 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.

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-.

<u>Local Context</u>

On 31st March 2019, the Council had investments of £15.29m and borrowing of £367.60m. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £m
General Fund CFR	156.03
HRA CFR	271.73
Total CFR	**427.76**
Less: *Other debt liabilities	(26.66)
Loans CFR	**401.10**
Less: Usable reserves	(48.79)
Net borrowing	**352.31**

* finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 30th September 2019 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.19 Balance £m	Movement £m	30.9.19 Balance £m
Long-term borrowing	317.10	11.64	328.74
Short-term borrowing	50.50	(11.34)	39.16
Total borrowing	**367.60**	**0.30**	**367.90**
Long-term investments	0.00	0.00	0.00
Short-term investments	15.29	(13.29)	2.00
Cash and cash equivalents	0.00	9.80	9.80
Total investments	**15.29**	**(3.49)**	**11.80**
Net borrowing	**352.31**		**356.10**

Borrowing Strategy during the period

At 30 September 2019 the Council held £367.9m of loans, (an increase of £0.3m similar position to 31 March 2019), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.19 Balance £m	Net Movement £m	30.9.19 Balance £m
Public Works Loan Board	293.97	13.34	307.31
Banks (LOBO)	15.30	0.00	15.30
Banks (fixed-term)	8.50	0.00	8.50
Local authorities (long-term)	0.00	0.00	0.00
Local authorities (short-term)	48.00	(13.00)	35.00
Other	1.83	(0.04)	1.79
Total borrowing	**367.60**	**0.30**	**367.90**

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 Council's long-term plans change being a secondary objective.

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. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, the Council decided to take advantage of the fall in external borrowing rates and borrowed £15m on an EIP basis from the PWLB on a medium term of 11 years. This loan provides some longer-term certainty and stability to the debt portfolio.

Long-dated Loans borrowed	Amount £m	Rate %	Period (Years)
PWLB EIP Loan	15.00	1.29	11
Total borrowing	**15.00**		

The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long-term borrowing was maintained.

LOBO loans: The Council continues to hold £15.3m of LOBO (Lender's Option Borrower's Option) 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 year.

The Council continues to monitor the position in regards to opportunities to renegotiate its current LOBOs where this would be favourable to its debt portfolio.

Treasury Investment Activity

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £0.375 and £32.07 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.19 Balance £m	Net Movement £m	30.9.19 Balance £m
Banks & BS (unsecured)	0.00	7.82	7.81
Government (incl. local authorities)	15.29	(13.29)	2.00
Money Market Funds	0.00	1.99	1.99
Total investments	**15.29**	**(3.48)**	**11.80**

Both the CIPFA Code and government guidance require the Council 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 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. In furtherance of these objectives, the Council has sought to invest with a heavy bias toward security and liquidity.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below. (See Annex A for guide to scoring analysis).

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Rating	Available within 7 days	Bail-in Exposure
31.03.2019	AA	80%	0%
30.09.2019	AA-	83%	83%
Similar LAs	AA-	40%	52%
All LAs	AA-	42%	62%

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, unless the exit date is pushed back yet again, the potential of a no-deal Brexit has increased significantly. As 31st October approaches the Council will ensure there are enough accounts open at UK-domiciled banks and Money Market Funds to hold sufficient liquidity, the Council continues to use its account with the Debt Management Account Deposit Facility (DMADF) which provides the highest level of security available to the Council.

Non-Treasury Investments

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. Welsh Government have recently revised their investment guidance and requested comments by 30 September 2019 before formal issue. In this guidance the definition of investments is widened to include "all of the financial and non-financial assets a local council has invested money into primarily or partially for the purposes of generating a surplus including investment property". Both this updated guidance, and the increase in the PWLB interest rate on 9 October 2019 (see further detail in the Outlook for the Remainder 0f 2019/20 later in the report), can to some extent be seen as a reaction to the increasing take up by local authorities of low interest rate loans to invest in commercial ventures.

The Council does not currently consider that it holds any non-treasury investments that meet the criteria as set out in the guidance.

<u>Compliance</u>

The Chief Officer Finance & ICT reports that all treasury management activities undertaken during the year to date complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.
Compliance with specific investment limits is demonstrated in table 7 below.

<u>Table 6: Debt Limits</u>

	Half Year Maximum £m	**30.9.19 Actual £m**	**2019/20 Operational Boundary £m**	**2019/20 Authorised Limit £m**	**Complied?**
Borrowing	369.25	367.90	434.37	449.37	Yes
PFI and Finance Leases	25.43	25.43	28.43	28.43	Yes
Total debt	**394.68**	**393.33**	**462.80**	**477.80**	

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 7: Investment Limits

	Half Year Maximum £m	30.9.19 Actual £m	2019/20 Limit	Complied?
Any single organisation, except the UK Government	3	3	£3m each	Yes
UK Central Government	22	2	unlimited	Yes
Any group of organisations under the same ownership	-	-	£3m per group	Yes
Any group of pooled funds under the same management	-	-	£3m per manager	Yes
Negotiable instruments held in a broker's nominee account	-	-	£15m per broker	Yes
Foreign Countries		-	£9m per country	Yes
Registered providers and registered social landlords	-	-	£3m in total	Yes
Unsecured investments with building societies		-	£7m in total	Yes
Money Market Funds	2.25	1.99	£15m in total	Yes
Real Estate Investment Trusts		-	£9m in total	Yes

Treasury Management Indicators

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

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. 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 rating	AA-	A	Yes

Liquidity: The Council takes every precaution to ensure that an appropriate amount of cash is available to meet unexpected payments over the short to medium term; the Council has not quantified this with a figure for this voluntary indicator as it is felt to make this a determinant of action could unnecessarily influence Treasury Management cash flow decisions.

Interest rate exposures: The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances, against which the organisation has failed to protect itself. The Council guards against this risk by actively adjusting their exposure to reflect changing market or organisational circumstances. Although the Council does not set limits against which to measure this exposure it pays due regard to the previous set limit of 30% of total debt being exposed to variable interest rates.

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 all borrowing were:

Maturity Structure of Borrowing*	Upper Limit %	Lower Limit %	Actual Borrowing at 30/09/2019 £m	Actual Borrowing at 30/09/2019 %	Compliance with Set Limits
under 12 months	30	0	54.45	14.80	Yes
12 months and within 24 months	20	0	3.50	0.95	Yes
24 months and within 5 years	20	0	13.17	3.58	Yes
5 years and within 10 years	80	0	51.69	14.05	Yes
10 years and within 20 years	80	0	164.23	44.64	Yes
20 years and within 30 years	80	0	21.83	5.93	Yes
30 years and within 40 years	80	0	59.03	16.05	Yes
40 years and within 50 years	80	0	0.00	0.00	Yes
50 years and above	90	0	0.00	0.00	Yes
Total			**367.90**	**100.00**	

*Time periods start on the first day of each period immediately following stated date (i.e. 30th September 2019). 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 Council'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	-	-	-
Limit on principal invested beyond year end	£10m	£5m	£5m
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. Prime Minister Boris Johnson has pledged to exit the EU on 31st October with or without a deal. It is unlikely the UK will be able to negotiate a different withdrawal deal before the deadline. The probability of a no-deal EU exit has therefore increased, which has implications for the future path of interest rates.

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

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 judges that the risks are significantly weighted to the downside.

	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-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 Case	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	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

Gilt yields have fallen to historic lows. The risks to economic growth from global political uncertainty appear to have crystallised, dampening rate expectations and dragging yields lower. Arlingclose expects gilt yields to remain at low levels for the foreseeable future and see the risks as broadly balanced. Volatility will continue to offer longer-term borrowing opportunities.

On the 9th of October 2019 HM Treasury notified the market of an increase in the margin over gilts of the PWLB lending of 100bps, on top of usual lending rates. The letter issued from HM Treasury identifies that the Government recognises the freedoms afforded local authorities to borrow under the Prudential Framework, but goes on to state that some local authorities have substantially increased their use of the PWLB in recent months as the cost of borrowing has fallen to record lows, and that therefore HM Treasury are restoring interest rates to levels available in 2018.

Reference to local authority borrowing powers under the Prudential Code, increased take up of low cost loans and restoration of rates to the 2018 level suggests that this increase is an attempt by the Government to encourage a slowdown in local authority borrowing, a tool used in conjunction with a revision to investment guidance and a potential review of the current iteration of the Prudential Code. One view of these pre-emptive actions is that the Government is looking to urge local authorities to consider its actions very carefully before borrowing to invest for predominantly financial gain.

Annex A

Scoring:

Long-Term Credit Rating	**Score**
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10
BB+	11
BB	12
BB-	13
B+	14
B	15
B-	16
CCC+	17
CCC	18
CCC-	19
CC+	20
CC	21
CC-	22
C+	23
C	24
C-	25
D	26

The Council aimed to achieve a score of 7 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating of threshold of A- for investment counterparties.