

Cherwell District Council

Accounts, Audit and Risk Committee

25 September 2019

Treasury Management Report – Q1 2019/20

Report of the Executive Director of Finance (Interim)

This report is public

Appendix 1 is exempt from publication by virtue of paragraph 3 of Schedule 12A of Local Government Act 1972

Purpose of report

To receive information on treasury management performance and compliance with treasury management policy for 2019/20 as required by the Treasury Management Code of Practice.

1.0 Recommendations

The meeting is recommended:

- 1.1 To note the contents of the June 2019 Treasury Management Report.

2.0 Introduction

- 2.1 In 2012 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.
- 2.2 The Council's treasury management strategy for 2019/20 was approved at a meeting on 25 February 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 is therefore central to the Council's treasury management strategy.
- 2.3 Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice; the local authority specific Guidance Notes for the Codes were published in July 2018. In England MHCLG published its revised Investment Guidance which came into effect from April 2018.
- 2.4 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 Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 25 February 2019.

3.0 Report Details

2019/20 Performance

- 3.1 As at the end of June 2019 the Council had borrowing of £108m and investments of £20.4m– a net borrowing position of £87.6m.

Appendix 1 details the schedule of borrowing and investments as at 30 June 2019.

Strategy

- 3.2 The Treasury Management Strategy for 2019/20 includes the Annual Investment Strategy which sets out the Council's investment priorities.

Security of capital has remained the Council's main investment objective, followed by liquidity of capital, and then by yield. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2019/20.

- 3.3 Counterparty credit quality is assessed and monitored with reference to:
- Credit Ratings - the Council's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, S&P and Moody's
 - Credit default swaps – a type of insurance to protect against default risk
 - GDP of the country in which the institution operates
 - The country's net debt as a percentage of GDP
 - Sovereign support mechanisms or potential support from a well-resourced parent institution
 - Share price
- 3.4 The Arlingclose ratings and advice encompass all of these and other factors and is the Council's primary source of guidance in selecting investments. In addition to Arlingclose ratings and advice, the council keeps an internal counterparty 'Watch List' based on intelligence from a variety of other sources available to officers.
- 3.5 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.
- 3.6 In furtherance of these objectives new borrowing was kept to a minimum, whilst options for securing lower rates for longer term borrowing were reviewed, as part of an ongoing process. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
- 3.7 All treasury management activities undertaken during the first quarter of 2019/20 complied with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy, and all indicators were met during, and at the end of, the reporting period.

Investment performance for 3 months ended 30 June 2019:

- 3.8 Investment rates available in the market have continued at low levels, with the Bank of England Base rate remaining at 0.75% since August 2018.

Funds available for investment are on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and funding of the Capital Programme.

The **average** level of funds available for investment purposes up to 30 June 2019 was £25.9m.

- 3.9 Table 1 shows the investment position as at 30 June 2019:

Investment Amount £	Interest Budget £	Interest Actual £	Variance £	Annualised rate of return
20.4m	39k	44k	5k	0.68%
Rate Benchmarking	Overnight	7-day	1-month	
Average LIBOR rates	0.67%	0.70%	0.73%	

Interest receivable is currently ahead of target and is forecast to remain above budget at the end of the year. Cash balances are higher than forecast and offset the forecast increase in interest rates that did not materialise.

The average duration of investments held at 30 June was 5 months and the weighted average interest rate was 0.81%. The rates achieved during the period are below LIBOR rates as they are held primarily for liquidity purposes in short-term money market funds and deposits, and the Council's investment counterparty criteria are more stringent than the market average, in order to maintain the security of capital.

A full list of current investments is shown at Appendix 1.

Borrowing performance for 3 months ended 30 June 2019:

- 3.10 The Council requires external borrowing to fund its capital programme and had total debt of £108m at the report date; 38% of the current debt is at fixed rate for the medium-long term from the Public Works Loan Board (PWLB), with the remainder short term variable rate from other local authorities. As borrowing will increase further, and the prospect of rate increases remains, we may seek to take a higher proportion of the debt at medium-long term fixed rates. This may cost more in the short term but will provide certainty of cost and provide savings in the longer term.

3.11 Table 2 shows the borrowing position as at 30 June 2019:

Borrowing Amount £	Interest Budget £	Interest Actual £	Variance £	Annualised interest rate £
108.0m	691k	415k	276k	1.56%
Borrowing Benchmarking	3-year	5-year	10-year	20-year
Average PWLB Maturity rate	1.68%	1.74%	2.05%	2.55%

Interest payable for the full year is forecast to remain significantly under budget, due to lower than forecast interest rates.

The average term of the current borrowing portfolio is 5 years. The annualised interest rate above shows that we compare favourably to average PWLB rates for all durations for the reporting period.

3.12 Non-treasury investment activity.

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council. 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 to generate a profit.

As at 30 June 2019, the Council holds £64.8m of investments in the form of shares (£22.9m) and loans (£41.9m – excluding accrued interest) to subsidiary companies and other organisations, primarily Graven Hill and Crown House.

The loans elements of these non-treasury investments generate, or are expected to generate, a higher rate of return than earned on treasury investments, but this reflects the additional risks to the Council of holding such investments.

3.13 Overall performance

The overall performance for the 3 months to 30 June 2019 is as follows:

	Budget £k	Actual £k	Variance £k
Borrowing costs	739	463	276
Treasury income	(38)	(43)	5
Non-treasury income	(751)	(937)	186
Total cost/(income)	(50)	(517)	467

The full year forecast is expected to achieve savings against budget in excess of £1m – this figure will be updated in future reports as events progress in terms of borrowing activity and interest rate changes.

3.14 Our Treasury advisers, Arlingclose, have provided the following economic commentary and outlook. The report is dated July 2019 and events, particularly in the UK, have moved on since then:

Economic background: UK Consumer Price Inflation (CPI) for June 2019 was 2.0% year/year, coming in at consensus and meeting the Bank of England's inflation target. The most recent labour market data for the three months to May 2019 showed the unemployment rate remain at a low of 3.8% while the employment rate of 76.0% dipped by 0.1%, the first quarterly decrease since June to August 2018. The 3-month average annual growth rate for pay excluding bonuses was 3.6% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.7%.

There was a rise in quarterly GDP growth in the first calendar quarter for 2019 to 0.5%, from 0.2% in Q4 2018 with stockpiling ahead of the (now delayed) 29th March Brexit distorting data. Production and construction registered positive output and growth, however at the end of June 2019, seasonally adjusted Markit UK Construction PMI (Purchasing Manager's Index) logged a record-low figure of 43.1, suggesting that construction has suffered a largest contraction in output since April 2009. GDP growth was 1.8% year/year, however with the service sector slowing and a weaker global backdrop the outlook was for subdued growth.

Politics has been a big driver over the last quarter. The 29th March Brexit deadline was extended to 12th April and then to 31st October 2019: there is still no clear consensus as to the terms on which the UK will leave the EU. Theresa May announced her resignation as Prime Minister and leader of the Conservative Party in May and the leadership contest for her successor is ongoing with Boris Johnson the current favourite.

The struggling British high street has continued to dominate headlines with the Arcadia group being saved from collapse in June following an agreement for rent reductions from landlords. The car industry has also struggled in the UK and beyond with announcements of cuts to 12,000 jobs across Europe by Ford.

With the deterioration in the wider economic environment, compounded by Brexit-related uncertainty and the risk of a no-deal Brexit still alive, the speech by Bank of England Governor Mark Carney in early July signalled a major shift to the Bank's rhetoric and increased the possibility of interest rate cuts, rather the Bank's erstwhile 'gradual and limited' rate hike guidance.

Globally, tensions between the US and China became progressively more fraught with US President Donald Trump threatening to more than double tariffs on some Chinese goods. There were also moves in both the US and UK to block or restrict access to markets by Chinese telecoms giant Huawei. Amid low inflation and a weak economy in the Eurozone Mario Draghi signalled in late June that another round of stimulus (QE) may be likely. The US and EU have also carved the path for interest rates to be cut in the future.

Financial markets: 2018 was a year to forget in terms of performance of riskier asset classes, most notably equities. However, since the beginning of 2019 markets have rallied, and the FTSE 100 is up over 10% in pure price terms for the first 6 months of the calendar year. Nearly all of these gains were realised in the last quarter of FY 2018/19, as Q1 2019/20 has only seen a modest increase of around 2%.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. Gilt yields fell - the 5-year benchmark gilt yield falling to 0.63% at the end of June from 0.75% at the start of April. There were falls in the 10-year and 20-year gilts over the same period dropping from 1.00% to 0.83% and from 1.47% to 1.35% respectively. Money markets rates stabilised with 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.60%, 0.68% and 0.92% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. The US yield curve inverted (10-year Treasury yields were lower

than US 3-month money market rates) in March 2019 and this relationship remained and broadened throughout the period. History has shown that a recession hasn't been far behind a yield curve inversion. Germany sold 10-year Bunds at -0.24% in June, the lowest yield on record. Bund yields had been trading at record lows in the secondary market for some time, however the negative yield in the primary market suggests that if investors were to hold until maturity, they are guaranteed to sustain a loss - highlighting the uncertain outlook for Europe's economy.

Credit background: Credit Default Swap (CDS) spreads fell slightly across the board during the quarter, continuing to remain low in historical terms. After hitting around 97bps at the start of the period, the spread on non-ringfenced bank NatWest Markets plc fell back to around 82bps at the end of June, while for the ringfenced entity, National Westminster Bank plc, the spread fell from 67bps to 58bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 28 and 59bps at the end of the period.

S&P upgraded RBS Group and its subsidiaries, including National Westminster Bank PLC, Natwest Markets PLC, The Royal Bank of Scotland and Ulster Bank Ltd. S&P raised the long-term issuer ratings by one notch due to RBS Group's strengthened credit fundamentals following a long period of restructuring. S&P believes the group and its subsidiaries have enhanced their capacity to manage the current UK political and economic uncertainties.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Barclays Bank PLC to positive from stable to reflect the bank's progress in its restructuring plans, including de-risking the balance sheet, improving its risk profile and profitability and resolving litigation issues in the US. Moody's also revised the outlook to stable from negative for Goldman Sachs International Bank, reflecting a slowdown in loan growth as well as a stronger revenue growth for sales and trading.

Outlook for the remainder of 2019/20

Having increased interest rates by 0.25% in November 2018 to 0.75%, the Bank of England's Monetary Policy Committee (MPC) is now expected to maintain Bank Rate at this level for the foreseeable future. There are, however, upside and downside risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy.

The resignation of Theresa May has added further political uncertainty. Boris Johnson appears to be the frontrunner to become Prime Minister and also appears to favour exiting the EU on 31st October. It is unlikely the UK will be able to negotiate a different withdrawal deal before the deadline.

With the downside risks to the UK economy growing and little likelihood of current global trade tensions being resolved imminently and global growth recovering soon thereafter, our treasury advisor Arlingclose's central forecast is for that the Bank of England's MPC will maintain Bank Rate at 0.75% but will stand ready to cut rates should the Brexit process engender more uncertainty for business and consumer confidence and for economic activity.

	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	0.50	0.50	0.50
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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

Gilt yields have fallen to recent lows. Resolution of global political uncertainty would see yields rise but volatility arising from both economic and political events continue to offer longer-term borrowing opportunities for those clients looking to lock in some interest rate certainty.

4.0 Conclusion and Reasons for Recommendations

This report details the Treasury Performance for the Council for the period ending 30 June 2019.

5.0 Consultation

None

6.0 Alternative Options and Reasons for Rejection

The following alternative options have been identified and rejected for the reasons as set out below.

Option 1: To request further information on the performance reported.

7.0 Implications

Financial and Resource Implications

7.1 There are no financial implications arising directly from any outcome of this report.

Comments checked by:

Dominic Oakeshott, Assistant Director - Finance (Interim)

Dominic.oakeshott@cherwell-dc.gov.uk, 01295 227943

Legal Implications

7.2 There are no legal implications arising directly from any outcome of this report.

Comments checked by:

Richard Hawtin, Team Leader – Non-contentious Business

richard.hawtin@cherwell-dc.gov.uk, 01295 221695

Risk Management Implications

7.3 It is essential that this report is considered by the Audit Committee as it demonstrates that the risk of not complying with the Council's Treasury Management Policy has been avoided

Comments checked by:

Louise Tustian, Acting Performance and Communications Manager

louise.tustian@cherwell-dc.gov.uk. 01295 221786

8.0 Decision Information

Wards Affected

All wards are affected

Links to Corporate Plan and Policy Framework

Links to all areas of Corporate Plan

Lead Councillor

None

Document Information

Appendix No	Title
Appendix 1	Schedule of In-house investments - EXEMPT
Background Papers	
None	
Report Author	Ian Robinson – Finance Business Partner
Contact Information	Direct Dial: 01295 221762 ian.robinson@cherwell-dc.gov.uk