Cherwell District Council

Accounts, Audit and Risk Committee

20 November 2019

Treasury Management Report – Q2 (September 2019)

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:

To note the contents of the Q2 (September 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 2019/2 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

Summary Position

3.1 At the end of September 2019 the Council had borrowing of £137m and investments of £48.2m - a net borrowing position of £88.8m (30/6/19 - £87.6).

Appendix 1 details the schedule of borrowing and investments as at 30 September 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 our 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 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.

3.6 The "cost of carry" analysis performed by the Council's treasury management advisor Arlingclose indicated during the reporting period that there was value in borrowing in advance for future years' planned expenditure, and therefore longer term/fixed rate borrowing has been increased to take of advantage of historically low interest rates.

3.7 All treasury management activities undertaken during the first 6 months 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 (see 3.10 and 3.13 below).

Investment performance for 6 months ended 30 September 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.

3.9 The table below shows the investment position during and at the end of the reporting period:

	Investment Amount £	Interest Rate	Interest Budget £	Interest Actual £	Variance £
Apr-Sept 2019	£24.9m (average)	0.70% (annualised)	76,875	87,153	10,278
As at 30/9/19	£48.2m	0.60%	-	-	-

Rate Benchmarking	Overnight	7-day	1-month
Average LIBOR rates Apr-Sept 2019	0.67%	0.69%	0.72%

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 due to recent new borrowing, offsetting the lower than forecast interest rates.

The Council's cash investments are held primarily for liquidity purposes and therefore only available for relatively short term deposits in a restricted selection of high quality instruments, which often generate sub-LIBOR returns. In particular, a large proportion of cash funds at the report date were held with the UK Debt Management Office (part of HM Treasury) which is highly secure but only pays a low rate of interest (0.50%).

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

3.10 Compliance with investment limits is shown in the table below:

	2019/20 Maximum	30/9/19 Actual	2019/20 Limit	Complied?
Any single organisation, except the UK Government	£5.0m	£3.9m	£5m	Yes
UK Central Government	£31.5m	£31.5m	Unlimited	Yes
Any group of organisations under the same ownership	£5.0m	£3.9m	£5m per group	Yes
Any group of pooled funds under the same management	£5.0m	£3.9m	£5m per manager	Yes
Money Market Funds	£10.0m	£7.2	£15m in total	Yes

Borrowing performance for 6 months ended 30 September 2019:

3.11 The Council funds part of its capital programme through external borrowing, and had total debt of £137m at the report date. Just under 55% 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, we will closely monitor the interest rate situation, and may seek to take a higher proportion of the debt at long term fixed rates. This may cost more in the short term but will provide certainty of cost and savings in the longer term.
It should be noted that the PWLB interest rates (which are linked to UK Gilt yields) were increased by an additional 1% across the board from 9 October 2019, making them relatively expensive and uncompetitive compared to other sources of funding.

3.12 The table below shows the borrowing position during and at the end of the reporting period:

	Borrowing Amount £	Interest Rate	Interest Budget* £	Interest Actual^ £	Variance £
Apr-Sept 2019	£109m (average)	1.55% (annualised)	1.257m	0.847m	0.410m
As at 30/9/19	£137m	1.53%	-	-	-

* Original interest budget reduced by £250k
^ Interest payable relates to externals loans only, excluding finance lease interest of £93k

Borrowing Benchmarking	3-year	5-year	10-year	20-year
Average PWLB Maturity rate Apr-Sept 2019	1.56%	1.57%	1.83%	2.34%

Interest payable for the full year is forecast to be significantly under budget, due in part to lower interest rates than forecast, but also due to lower than expected loan drawdowns from Graven Hill, and cashflow updates on the CQ2 development.

A full list of current borrowing is shown at Appendix 1

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

	2019/20 Maximum	30/9/19 Actual	2019/20 Operational Boundary	2019/20 Authorised Limit	Complied?
Borrowing / Total debt	£137m	£137m	£205	£225m	Yes

3.14 **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 September 2019, the Council holds £65.3m of investments in the form of shares (£22.9m) and loans (£42.4m – 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.

3.15 **Overall performance**

The overall performance for the 6 months to 30 September 2019 is as follows:

	Budget £k	**Actual £k**	**Variance £k**
Borrowing costs*	1,352	939	413
Treasury income	(77)	(87)	10
Non-treasury income	(1,501)	(1,870)	369
Total cost/(income)	**(226)**	**(1,018)**	**792**

*Borrowing costs include finance lease interest of £93k

The full year forecast is currently expected to achieve savings against budget of approximately £1.4m – this figure will be updated in future reports as events progress in terms of borrowing and interest rate activity.

3.16 Our treasury advisers, Arlingclose, provided the following economic report and interest rate forecast (their report is dated 1/10/2019 and does not therefore reflect the very latest political developments):

Economic report

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.

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. Parliament appears to have frustrated UK Prime Minister Boris Johnson's desire to exit the EU on 31st October. The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out for 2019 and the risk of this event remains for 2020. The risk of a general election in the near term has, however, increased.

UK economic growth has stalled despite a probable pickup in growth in Q3 2019. The ONS reported a Q2 growth rate of -0.2%. The MPC has downgraded its growth forecasts for future years.

While the potential for divergent paths for UK monetary policy remain in the event of a withdrawal agreement, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy.

Inflation remains around target, albeit displaying a surprising decline in August 2019. The tight labour market risks medium-term domestically-driven inflationary pressure. Slower global growth should reduce the prospect of externally driven inflationary pressure, although political turmoil could push up oil prices.

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

<u>Interest rate forecast</u>

Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are 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.

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.

We expect gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside. Volatility will continue to offer longer-term borrowing opportunities.

4.0 Conclusion and Reasons for Recommendations

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

5.0 Consultation

None

6.0 Alternative Options and Reasons for Rejection

6.1 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:
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Legal Implications

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

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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:
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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	CDC schedule of borrowing and investments at 30 September 2019 - EXEMPT
Background Papers	
None	
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