ITEM NO	

REPORT TO EXECUTIVE

DATE	**10 December 2019**
PORTFOLIO	**Resources and Performance Management**
REPORT AUTHOR	**Asad Mushtaq**
TEL NO	**01282 477173**
EMAIL	**amushtaq@burnley.gov.uk**

2019/20 Treasury Management Mid-Year Report

PURPOSE

1. To report treasury management activity for the first half year of 2019/20 covering the period 1 April to 30 September 2019.

RECOMMENDATION

2. The Executive is requested to;

   - Note the treasury management activities undertaken during the period 1 April to 30 September 2019, and;

   Recommend that Full Council;

   - Endorse the mid-year update on Treasury Management Strategy for 2019/20 in compliance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.

REASONS FOR RECOMMENDATION

3. - To inform members of the treasury management activity in the first half of 2019/20 and to fulfil statutory and regulatory requirements.

SUMMARY OF KEY POINTS

4. **Background**
The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The first main function of treasury management operations is to ensure this cash flow is adequately planned, with surplus monies being

invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is to ensure the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending commitments. This management of longer term cash may involve arranging long or short term loans, or using cash flow surpluses, and, on occasions, any current debt may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

> "The management of the Council's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The monitoring requirements for treasury were set out in the report which included both the Treasury Management Strategy for 2019/20 and the Prudential and Treasury Indicators for 2019/20 – 2021/22, approved by Full Council on the 20 February 2019.

5. **Introduction**

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Strategy which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual Treasury Management Strategy - including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Scrutiny Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first six months of 2019/20;
- A review of the Treasury Management Strategy and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2019/20;
- A review of the Council's borrowing strategy for 2019/20;

- A review of any debt rescheduling undertaken during 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

6. **Economic Update (Provided by Link Asset Services)**

This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October, with or without a deal. At present, if the UK does soon achieve an agreed deal on Brexit, including some additional clarification wording on the Irish border backstop, then it is possible that growth could recover quickly. The MPC could then need to address the issue of whether to raise Bank Rate when there is very little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could falter and the MPC would be likely to cut Bank Rate in order to support growth.

The first half of 2019/20 has seen UK **economic growth** fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, (July 2.1%), and is likely to shift only a little upwards over the rest of 2019/20. It does not therefore pose any immediate concern to the MPC at the current time.

With regard to the **labour market,** despite the contraction in quarterly GDP growth of -0.2%q/q, (+1.2% y/y), in quarter 2, employment rose by 115,000 in the same quarter: this suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment has continued near to a 44 year low, edging up from 3.8% to 3.9% on the Independent Labour Organisation measure in June; however, that was caused by a rise in the participation rate to an all-time high. Job vacancies fell for a sixth consecutive month, hitting record levels, and indicating that employers are having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 1.8%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This could mean that the MPC will need to take action to raise Bank Rate if there is an agreed Brexit deal as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, if there is a general election soon, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

7. **Interest Rate Forecast (Provided by Link Asset Services)**

Increase in the cost of borrowing from the PWLB

On 9 October 2019 the Treasury and PWLB announced an increase in the margin over gilt yields of 100bps on top of the current margin of 80 bps which this authority has paid prior to this date for new borrowing from the PWLB. There was no prior warning that this would happen and it now means that every local authority has to fundamentally reassess how to finance their external borrowing needs and the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing. Representations are going to be made to HM Treasury to suggest that areas of capital expenditure that the Government are keen to see move forward e.g. housing, should not be subject to such a large increase in borrowing.

Whereas this authority has previously relied on the PWLB as its main source of funding, it now has to fundamentally reconsider alternative cheaper sources of borrowing. At the current time, this is a developmental area as this event has also taken the financial services industry by surprise. We are expecting that various financial institutions will enter the market or make products available to local authorities. Members will be updated as this area evolves.

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. This Authority may make use of this new source of borrowing as and when appropriate.

The Council's treasury advisor, Link Asset Services, has provided the following forecast.

This forecast includes the increase in margin over gilt yields of 100bps introduced on 9 October 2019.

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its last meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That is shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth.

The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

8. **Treasury Management Strategy update**

The Treasury Management Strategy (TMS) for 2019/20, which includes the Annual Investment Strategy, was approved by this Council on 20 February 2019. There are no policy changes to the TMS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

9. **The Council's Capital Position**

The table below shows the financing of the Original Capital Budget approved by Full Council on the 20 February 2019 and the latest Revised Capital Budget. The decrease is due to a combination of in year budget monitoring adjustments and reprofiling of capital expenditure into future years.

Capital	2019/20 Original Estimate £'000	2019/20 Revised Estimate £'000
Total Budget	**18,224**	**17,481**
Financed by:		
Capital receipts	2,575	2,810
Capital grants	7,391	5,511
Revenue	805	373
Total financing	**10,771**	**8,694**
Borrowing need	**7,453**	**8,787**

10. **Investment Portfolio 2019/20**

As shown by the forecasts in section 7, it is a very difficult investment market as rates are very low and in line with the current 0.75% Bank Rate. Given that increases in Bank Rate are likely to be gradual, investment returns are likely to remain low.

The average daily level of funds deposited during the financial year to date is £17.3m, compared with £14.7m for the same period in 2018/19. The actual value of funds deposited on the 30 September was £21.247m. These funds have been available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

There were 3 investments carried forward from 2018/19 totalling £8.4m, of which £5.4m was with our bank HSBC, £1m was in fixed term deposits with Goldman Sachs, and £2m in a 95 day notice account with Santander.

There have been 8 new investments made during the period 1 April to 30 September 2019 totalling £12m, as well as a daily average of £10.1m being invested with HSBC's deposit account, earning 0.60% interest. The table below shows the amount deposited, and the rate of return against the market benchmark.

Counterparties	Date of Investment	Investment Made £m	Return	Benchmark
Bank of Scotland (95 Day Notice)	20/05/2019 – 16/08/2019	1.0	1.10%	0.66%
Bank of Scotland (32 Day Notice)	09/07/2019-16/08/2019	1.0	0.95%	0.60%
Bank of Scotland (12 month Fixed)	09/07/2019	2.0	1.25%	0.84%
Bank of Scotland (12 month Fixed)	16/08/2019	2.0	1.10%	0.84%
HSBC (31 Day Notice)	29/07/2019	1.0	0.90%	0.60%
HSBC (31 Day Notice)	17/09/2019	1.0	0.90%	0.60%
Santander (3 month Fixed)	09/08/2019	2.0	0.90%	0.66%
Santander (6 month Fixed)	09/08/2019	2.0	1.00%	0.74%

The Council has an approved list of counterparties which governs treasury management investment activity. This list is a restricted list taking into consideration the credit rating of the institution concerned and there are also limits on the amount which can be invested with any particular institution from a particular sector e.g. building society, bank etc. and also any group of institutions within an overall banking group. As part of the daily operations of the treasury management dealings, in consultation with guidance from Link Asset Services and the money market brokers, decisions are taken by the Head of Finance & Property Services, temporarily suspending/revising operations with individual counterparties. The latest deposit counterparties list was approved by the Full Council on 20 February 2019.

The current investment counterparty criteria selection approved in the TMS is meeting the requirement of the treasury management function.

The table below shows the maximum amount invested with any of the counterparties at any one time during the period April 2019 to 30 September 2019 against the maximum limits approved in the 2019/20 Treasury Management Strategy.

Counterparties	Maximum Limits £m	Highest level of Investment 2019/20 (£m)
HSBC	25.0	19.7
Bank of Scotland	4.0	4.0
Goldman Sachs	4.0	1.0
Santander UK plc	4.0	4.0

11. **Property Funds**

The council made 2 investments totalling £2m in property funds in 2018/19 for the purpose of increasing and diversifying our risk in investment income receivable and to help alleviate future revenue budget pressures. Dividends received in the 3 month period April to June 2019 amounted to £16,756, earning an average yield of 3.35%.

12. **<u>Borrowing</u>**
The Council's capital financing requirement (CFR) for 2019/20 is £36.760m. The CFR denotes the Council's underlying need to borrow for capital purposes. Below is a summary of the Councils' external indebtedness, as at 1 April 2019, and as at 30 September 2019.

Borrowing	1 Apr 19 £'000	30 Sept 19 £'000	Change Apr – Sept £'000
Public Works Loan Board	23,073	33,663	10,590
Temporary Market Loans	11	11	-
Total	**23,084**	**33,674**	**10,590**

PWLB Loans – Due to the overall financial position and the capital financing requirement, new external borrowing of £12m was undertaken from the PWLB during the period 1 April 2019 to 30 September 2019.

There was one loan of £1.410m repaid during the same period.

Temporary Market Loans – There has been no movement in temporary market loans during the period 1 April 2019 to 30 September 2019.

13. **<u>Debt Rescheduling</u>**
There have been no debt rescheduling opportunities in the current economic climate and consequent structure of interest rates. Therefore, no debt rescheduling was undertaken during the first six months of 2019/20.

14. **<u>Compliance with Treasury & Prudential Limits</u>**
It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy.

During the financial year to date the Council's treasury management activities operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy in compliance with the Council's Treasury Management Practices.

An extract of the Prudential and Treasury Indicators are shown in Appendix 1.

15. **<u>Interest Payable on External Borrowing / Interest Receivable</u>**
Provision is made in the revenue budget to meet the net interest payable on external borrowing. The figure in the original budget for 2019/20 was set at £987,328.

During revenue budget monitoring this budget has been revised up to £1,062,521 as a result of increasing the budget requirement for PWLB interest paid in the year, due to new borrowing for capital expenditure.

The total interest receivable on temporary deposits for the period 1 April 2019 to 30 September 2019 amounted to £88,203 and an additional £16,756 was received in dividends on Property Funds for the period 1 April 2019 to 30 June 2019. The budget for the year for interest and dividend receipts was set at £139,845 and is therefore forecast to be achieved.

FINANCIAL IMPLICATIONS AND BUDGET PROVISION

16. None arising as a direct result of this report.

POLICY IMPLICATIONS

17. Compliance with the revised CIPFA Code of Practice on Treasury Management.

DETAILS OF CONSULTATION

18. None

BACKGROUND PAPERS

19. None.

FURTHER INFORMATION	
PLEASE CONTACT:	**Asad Mushtaq – Head of Finance and Property**