Treasury Management Report – Mid-year update 2019/20

BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (annual, mid-year or quarterly reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

2. ECONOMIC CLIMATE

2.1 In brief summary, Q2 2019/20 saw:

- Bank of England held Bank Rate at 0.75%; noting the deterioration in global activity and sentiment, they 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;
- The UK economy contracted by 0.2%; following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit;
- Brexit negotiations remained at an impasse; UK equities continued to underperform given the uncertainty, generally meaning investors are holding safe-haven government bonds/gilts instead.

3. INTEREST RATE FORECAST

3.1 The latest forecast for UK Bank Rate along with PWLB borrowing rates (certainty rate) from the Council's treasury advisors is set out in Table 1 below.

PWLB Rates

3.2 In a surprise move and without consultation or prior warning, from 9th October 2019 the Government has:

- Increased with immediate effect the interest rates offered on new Public Works Loan Board (PWLB) loans by doubling the margin applied from 1% to 2%. The 20bps discount for providing forward capital forecast data – known as the Certainty Rate – still applies (to which this Council is eligible).
- Legislated to increase the statutory limit on how much the PWLB can lend to eligible authorities, from £85bn to £95bn.

3.3 As the cost of borrowing has fallen to record lows, a number of local authorities have substantially increased their use of the PWLB in recent months. Some authorities have maximised their borrowing ability directly to invest in commercial property to produce a financial return to underpin front-line services, a practice that Government has expressed concerns over. It would appear that HM Treasury has carried out what MHCLG and CIPFA had implied should be avoided, namely addressed concerns on borrowing at a few outlying authorities by penalising the whole sector.

3.4 The maximum net amount of PWLB loans that can be outstanding at any time is subject to a statutory limit. At 31st March 2019, the amount outstanding stood at £77.9bn. With PWLB rates falling to record lows, it is estimated that c.£6.2bn of new loans had been raised in the first half of 2019/20. Raising the self-imposed statutory limit from £85bn to £95bn, combined with the rate increase, reduces the likelihood of a statutory limit breach.

3.5 The PWLB's new pricing structure - at 180 basis points above gilts for certainty rate loans - no longer necessarily represents good value for local authorities and opens up the potential for better overall terms and flexibility from market lenders.

3.6 The PWLB rates shown in Table 1 below are inclusive of the new increased margins and certainty rate discount.

Table 1: Interest Rate Forecast (%)

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	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	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	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

3.7 There are many risks to the forecast set out above, principally around the timing and pace of further rate rises. Budget estimates prudently include sensitivity analysis of the impact that a slower than forecast economic recovery would have upon the Council and any impact of changes to interest rates is reported through the Budget Monitoring process.

4. INVESTMENTS

4.1 The Treasury Management Strategy Statement (TMSS) for 2019/20, which includes the Annual Investment Strategy, was approved by Council in February 2019. It sets out the Council's investment priorities as being:

1. Security of Capital;
2. Liquidity; and then
3. Yield

4.2 The Council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity.

4.3 At 31st March 2019 investment balances totalled £48.044m, held in Money Market Funds, Call/Notice accounts, Certificates of Deposits, Local Authority loans and the CCLA Property Fund. This figure excludes third party loans and share capital. Due to the nature of various government funding streams and timing of capital expenditure, the average level of funds available for investment purposes during Q1 was £59.020m and for Q2 was £61.492m.

4.4 Table 2 below summarises the maturity profile of the Council's investment portfolio at the end of Q2 2019/20 (excluding third party loans):

Table 2 – Investment maturity profile at end of Q2 2019/20

		Maturity Period					
		0d	**0-3m**	**3-6m**	**5yrs ***	**Total**	
Product	**Access Type**	**£m**	**£m**	**£m**	**£m**	**£m**	**%**
Money Market Funds	Same-Day	15.790				**15.790**	***30.6***
Bank Call Account	Instant Access	0.200				**0.200**	***0.4***
Certificate of Deposits	Fixed Term / Tradeable		8.000	15.000		**23.000**	***44.6***
Local Authority Loans	Fixed Term		5.000			**5.000**	***9.7***
Pooled Property Fund	Redemption Period Applies				7.549	**7.549**	***14.7***
	Total	**15.990**	**13.000**	**15.000**	**7.549**	**51.539**	***100.0***
	%	***31.0***	***25.2***	***29.1***	***14.7***	***100.0***	

4.5 The scheduled date for the UK to leave the EU is now 31st January 2020 and there remains little political clarity as to whether a deal will be agreed by this date - the impending general election in December 2019 may change this - but there remains the possibility that the exit date could be deferred again.

4.6 Set out below are details of the amounts outstanding on loans and share equity investments classed as capital expenditure advanced to third party organisations at the end of Q2:

Table 3 – Third Party Loans

Loan Summary	**Amount (£m)**
University of Northampton (UoN) – **HM Treasury backed**	45.146
Northampton Town Rugby Football Club (NTRFC)	4.290
Unity Leisure	0.060
Total	**49.496**

4.7 Financial markets trade on confidence and certainty, and for some time now, both have been in short supply. Investment rates have increased from historical lows following bank base rate rises, but remain relatively low in short to medium-term durations, with limited pickup in value for longer durations.

4.8 Investment balances are forecast to reduce by the financial year end as internal resources from temporary positive cashflow surpluses are applied to fund expenditure demands in lieu of fully funding the borrowing requirement (internal borrowing) on a net basis. This process effectively reduces the cost of carrying additional borrowing at a higher cost than the income that could be generated through short term investment of those balances, as well as reducing investment counterparty credit risk.

4.9 The Council's investments at the mid-year point outperformed the most comparable weighted duration benchmark by 68 basis points, largely due to an average dividend return of c.4.2% on the Council's investment held in the CCLA Property Fund. Any impact upon latest budget projections for the financial year are reported through the Budget Monitoring process.

Table 4: Benchmark Performance – Q2 2019/20

	Benchmark	Benchmark Return	Council Performance
Q1 (Last Qtr)	**3m LIBID**	0.68%	1.35%
Q2 (This Qtr)	**3m LIBID**	0.64%	1.32%
Q1+2 (Mid-Year)	**3m LIBID**	**0.66%**	**1.34%**

4.10 Leaving market conditions aside, the Council's return on investments is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument:

- Credit risk is the consideration of the likelihood of default and is controlled through the creditworthiness policy approved by Council.
- The duration of an investment introduces liquidity risk; the risk that funds can't be accessed when required.
- Interest rate risk; the risk that arises from fluctuating market interest rates.

4.11 These factors and associated risks are actively managed by the LGSS Finance Treasury team.

5. BORROWING

5.1 The Council can raise cash through borrowing in order to fund expenditure on its capital programme for the benefit of Northampton. The amount of new borrowing needed each year is determined by capital expenditure plans and projections of the Capital Financing Requirement, underlying borrowing requirement, forecast cash-backed reserves and both current and forecast economic conditions.

5.2 Overall borrowing outstanding has decreased during the first half of this year by £4.864m in line with scheduled debt repayments.

5.5 Table 5 below sets out the maturity profile of the Council's borrowing portfolio at the end of Q2. £225.521m is held with the PWLB, £16.466m from Market sources (Market loans/ Growing Places funding/ Homes & Communities Agency).

Table 5: Borrowing Maturity Profile – Q2 2019/20

Term Remaining	Borrowing	
	£m	**%**
Under 12 months	1.124	0.5
1-2 years	34.463	14.2
2-5 years	15.851	6.6
5-10 years	39.641	16.4
10-20 years	7.215	3.0
20-30 years	5.314	2.2
30-40 years	4.379	1.8
40 years and above	134.000	55.3
TOTAL	**241.987**	**100.0**

5.6 The Council does not hold any Lender Option, Borrower Option (LOBO) loans.

5.7 The Council is in an internally borrowed cash position and balances will need to be replenished at some point in the future (subject to expenditure demands). This strategy is prudent while investment returns are lower than the cost of servicing debt and also serves to mitigate counterparty risk. The Council therefore plans to maintain this internal borrowing position but will closely monitor those reserves, balances and cashflows supporting this approach.

6. BORROWING RESTRUCTURING

6.1 No borrowing rescheduling has been undertaken this year. Rescheduling opportunities are limited in the current economic climate. For PWLB loans, due to the spread between the carrying rate of existing borrowing and early redemption rates, substantial exit (premium) costs would be incurred. For market borrowing, the lender uses the certainty of the loans cashflow profile to hedge against forecast interest rate movements and so would pass the cost of unwinding these instruments onto the Council as an exit (premium) cost. Officers continue to monitor the position regularly.

7. TREASURY AND PRUDENTIAL INDICATORS

7.1 The Council's Treasury and Prudential Indicators (affordability limits) were approved alongside the TMSS. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the financial year to date the Council has operated within the Treasury and Prudential Indicators set out in the Council's TMSS:

Table 6: Treasury and Prudential Indicators

Prudential Indicator	2019/20 Indicator	2019/20 Q2
Authorised limit for external debt (Inc' Third Party Loans)	----- £335.000m -----	
Operational boundary for external debt (Inc' Third Party Loans)	----- £325.000m -----	
Capital Financing Requirement (CFR) (Inc' Third Party Loans and Finance Lease Liabilities)	£349.000m	£351.411m
Ratio of financing costs to net revenue streams: GF	7.82%	7.41%
Ratio of financing costs to net revenue streams: HRA	30.13%	29.81%
Principal sums invested > 365 days (Exc' third party loans)	£14.000m	£7.549m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 50% Min. 0%	0.5%
12 months to 2 years	Max. 50% Min. 0%	14.2%
2 years to 5 years	Max. 50% Min. 0%	6.6%
5 years to 10 years	Max. 50% Min. 0%	16.4%
10 years to 20 years	Max. 50% Min. 0%	3.0%
20 years to 30 years	Max. 60% Min. 0%	2.2%
30 years to 40 years	Max. 80% Min. 0%	1.8%
40 years and above	Max. 100% Min. 0%	55.3%