Brent	**Audit & Standards Advisory Committee** 26th September 2019
	Report from the Director of Finance

2019/20 MID-YEAR TREASURY REPORT

Wards Affected:	All
Key or Non-Key Decision:	Non-key
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	Open
No. of Appendices:	1. Treasury Management Indicators
Background Papers:	Treasury Management Strategy – Report to Full Council as part of the Budget Report – February 2019.
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1.0 Purpose of the Report

1.1 This report updates Members on treasury activity for the first half of the financial year 2019-20.

2.0 Recommendation(s)

2.1 The Committee is asked to note the 2019/20 mid-year Treasury report.

3.0 Detail

Background

3.1 The Council's Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

3.2 The Code also recommends that Members are informed of Treasury Management activities at least twice a year. This update report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

3.3 Treasury Management is defined as: "The management of the local authority's 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."

3.4 In addition to reporting on risk management, the Code requires the Authority to report on any financial instruments entered into to manage treasury risks.

Economic Background

3.5 GDP growth in the first calendar quarter for 2019 increased from 0.2% in Q4 2018 to 0.5%. Stockpiling ahead of the uncertain Brexit date has been the main driver of this increase however this has not been maintained. Economic growth stalled in Q2 with a growth rate of -0.2%. The trade war between the US and China has also contributed to sluggish global growth. The outlook for the UK economy remains challenging to predict following the extension of the Brexit deadline.

3.6 Consumer Price Index (CPI) has increased to 2.1% in July and is expected to decline further below the MPC's 2% target in the near term, largely due to lower than expected retail prices. The unemployment rate remains at a low of 3.9% with the employment rate at 76.1%, the joint highest since comparable records began in 1971. Wages excluding bonuses grew by 3.9% which when adjusted for inflation shows real wages were up 1.9%

3.7 Gilt yields have displayed significant volatility on the back of ongoing economic and political uncertainty in the UK and Europe. The economic outlook will continue to depend significantly on the nature and timing of the EU withdrawal. The movement in rates at which local authorities can borrow from the Public Works Loans Board (PWLB) on maturity loans is shown in the table below:

PWLB Rates %

Period	Mar-18	Sep-18	Mar-19	Aug-19
1 year	1.67	1.75	1.68	1.44
5 year	2.09	2.18	1.77	1.28
10 year	2.46	2.57	2.09	1.44
20 year	2.75	2.91	2.56	1.96

3.8 The interest rate the Council receives on money market funds has remained stable and outperformed local authority deposits over the three-month period (to the end of Aug 19) whilst providing added liquidity benefits.

Debt Management

3.9 The Authority continues to qualify for borrowing at the ‘Certainty Rate’ (0.20% below the PWLB standard rate). This is reviewed on an annual basis and has been confirmed as applying until 31 October 2019.

3.10 Alternative sources of long term funding to long-dated PWLB borrowing are available, but the Council will continue to adopt a cautious and considered approach to funding from the capital markets. The affordability, simplicity and ease of dealing with the PWLB represents a strong advantage but the Council. Due to its prudent policies and strong balance sheet, the Council is in a position to consider alternatives, and has already begun this process with the implementation of the borrowing strategy work which will be reported back to this Committee at the end of the year. As can be seen in the table below no new long term loans have needed to be raised so far this year:

	Balance on 01/04/2019 £m	**Debt repaid* £m**	**New Borrowing £m**	**Balance on 31/08/2018 £m**
Short Term Borrowing	**0**	10	10	**0**
Long Term Borrowing	**396**	2	0	**394**
TOTAL BORROWING	**396**	**12**	**10**	**394**
Ave Rate of Long Term Borrowing %	**4.78**	2.60	0.8	**4.79***

** £25m of the PWLB loans are referred to as EIP, whereby the Councils pays down the loans in half-yearly equal installments over the lifetime of the loan. The marginal increase in the average interest rate can be attributed to the Council paying back its EIP loans. This is because the EIP loans have a much lower average interest rate of 2.58% compared with the rest of the debt, which is 4.97%.*

3.11 In recent years the use of internal resources in lieu of borrowing has continued to be the most cost effective means of funding capital expenditure. This has lowered overall treasury risk by reducing external debt and reduces the potential interest costs. However, the Council’s internal resources will be reduced during this financial year so further capital expenditure may have to be financed from new borrowing. Affordability remains an important influence on the Council’s borrowing strategy. Borrowing options, including the potential to agree forward funding and the timing of such borrowing has been assessed and the Council is working with external treasury advisors to review whether the debt capital markets can provide a more cost effective source of finance to the Public Works Loan Board.

3.12 The persistence of low interest rates (see para 3.7) means that it would be uneconomic to reschedule PWLB debt, because early retirement of the loan would incur a heavy penalty, to compensate the PWLB for having to lend the money on at lower rates. For example, the Council’s most expensive loan is £3.05m at a rate of 8.875%, to repay it would cost £0.777m, a 25% premium on the value of the loan before the cost of re-financing. In short, the cost of re-financing our loans under the Government’s approach means is not economical. This analysis might change if interest rates returned to historically normal levels.

Investment Activity

3.13 The Council gives priority to security and liquidity and aims to achieve a yield commensurate with these principles.

	Balance on 01/04/2019 £m	Investments Made £m	Investments Repaid £m	Balance on 31/08/2019 £m
Short Term Investments	**103**	292	310	**85**

3.14 There was a £18m downward movement in short-term investments which is expected to continue in the coming years as the capital programme is progressed. The investment balances are expected to drop significantly over the next 6 months with the impending purchase of the 235 Gloucester & Durham units in South Kilburn. The year to date capital spend for 19-20 currently stands at £30.1m with a forecast of £297m for the full year. This is having a significant impact on our cash available for investment and as noted in para 3.11 the use of internal balances to fund capital expenditure may not be sustainable over the medium to long term.

3.15 The Council has undertaken a detailed analysis of its cash flows, examining the pace at which we are reducing our cash reserves. The analysis was based on forecast capital commitments, incoming resources and seasonal variations. The latest analysis suggests the council will need to borrow towards the end of 2021, to a certain extent limiting our ability to use financial products that generate higher financial returns, as they would require longer time horizons. The Council is reviewing its borrowing options which may include short term loans, PWLB borrowing, forward borrowing and other market loans. At a meeting in September 2018, Cabinet endorsed an updated borrowing strategy that included a recommendation to commence negotiations to agree a forward funding loan of up to £40m. As noted in 3.11, the Council is currently undertaking an exercise with external Treasury Advisors to review whether forward borrowing is the most appropriate form of funding for our expected capital expenditure and existing debt portfolio.

3.16 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2019/20. In accordance with the policy, new investments can be made with the following classes of institutions:

- A- or above rated banks;
- AAA rated Money Market Funds;
- Other Local Authorities;
- Housing Associations;
- UK Debt Management Office;
- Corporate Bonds
- Collective Investment Schemes (Pooled Funds)

- Real Estate Investment Trusts

A short summary of the investment products available to the council along with an indication of relative risk is provided below:

3.17 The table below shows the different assets classes available to the council for its investment portfolio together with the major driver of the return and a summary of the key risks for each asset class.

Asset Classes (approx. return)	**Cash (0.7%)**	**Bonds (2.5%)**	**Equities (4.1%)**	**Property (4.8%)**
Income driven by	Short term interest rates	Medium term interest rates	Dividends / share prices	Rental income / vacancies
Key Risk(s)	Bank defaults	Company defaults	Company performance and perception of future performance	Property prices, least liquid asset class

3.18 The Council is presently situated towards the left side of the table as the treasury investment portfolio is predominantly held in the short term cash asset class, typically with other Councils.

3.19 An option available to the Council would be to increase the duration of fixed cash deposits in order to obtain a higher rate. Currently, it would be possible to earn between 1.65% - 2% on a 2-year deposit with a Housing Association.

3.20 The Council could obtain similar rates through fixed deposits with Banks and Building Societies however the Council's treasury advisors do not recommend depositing with any UK banks or building societies for more than 6 months on an unsecured basis.

3.21 Detailed consideration of the other asset classes would need to be undertaken by the Council prior to investment in conjunction with its treasury advisors. However, it is fair to say that that Equities and Property classes tend to be considered over a longer time frame, which may not be suitable for the Council given its significant capital spending plans.

Risks

3.22 Regardless of the approach taken, the Council will be required to manage significant risks in relation to its treasury investment portfolio. Some key risks are: -

- Liquidity risk - that is the council having funds tied up in long-term investments when it needs to use that money. Increasing the duration of fixed cash deposits increases liquidity risk, however this can be mitigated through good cash flow management.

Mitigation – see Prudential Indicator 2 – Appendix 1

- Credit risk - the risk that a bank or other institution will not be able to pay back the money invested with it. For longer term investments, the council is more exposed to credit risk. Should a counterparty's credit worthiness change, the council may not be able to get all their money back or may face heavy penalties if it can do so.

  Mitigation – see Prudential Indicator 1 – Appendix 1

- Interest rate risk – the risk of the council's budget being affected by unforeseen changes in interest rates. Longer term cash deposits increase this risk and will negatively affect the council should interest rates rise. On the other hand, the council may benefit should interest rates fall.

  Mitigation – see prudential Indicator 3 – Appendix 1

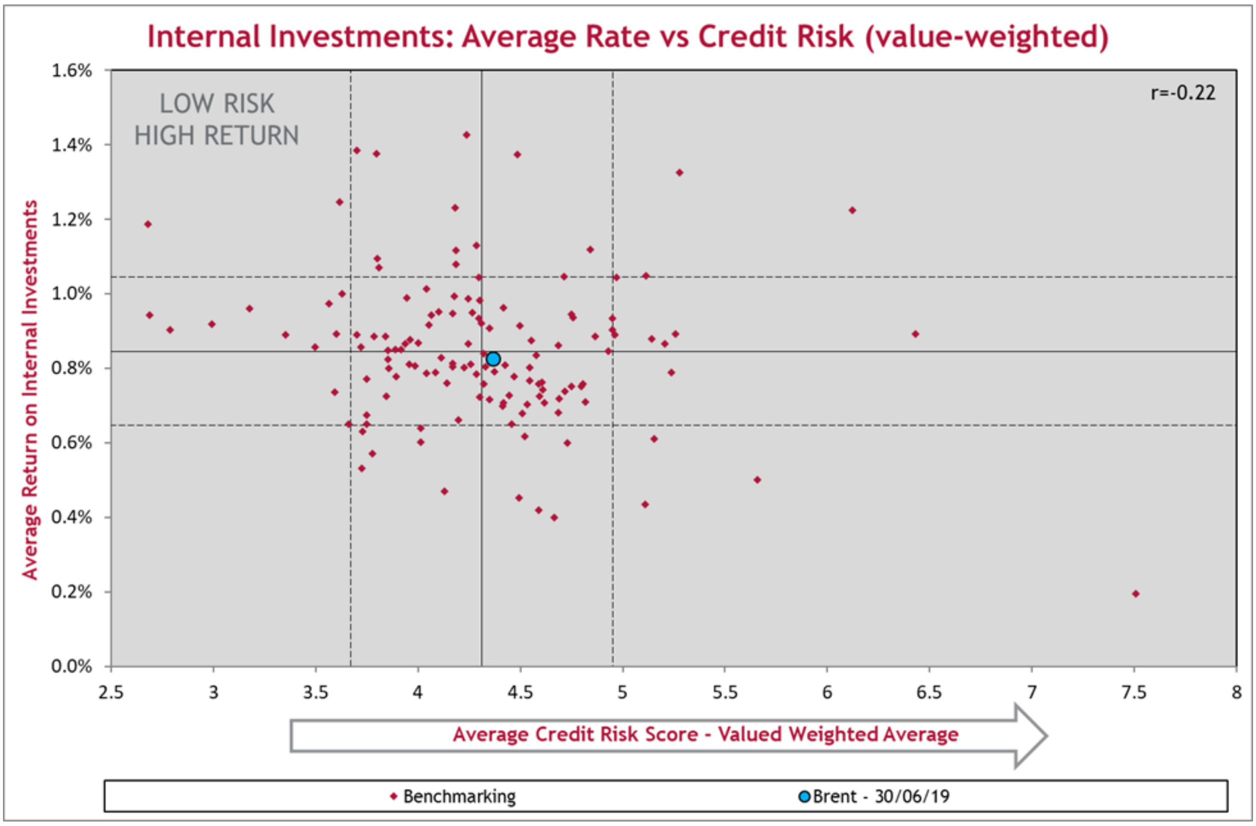
Internal Processes

3.23 The Council completes a thorough due diligence exercise when undertaking any new investment. An assessment of a wide range of credit factors for a counterparty are reviewed in conjunction with our treasury advisors. Ratings are obtained from the three major rating agencies. Ratio analysis provides an insight into the counterparty's liquidity, gearing and profitability. Based on their credit worthiness, an appropriate investment size and duration is determined that is permitted within the Treasury Management Strategy.

3.24 For local authority counterparties, an assessment is undertaken to evaluate the level of useable cash reserves and short and long term borrowing. Each authority's capital programme is reviewed to establish the authority's long term plans and understand the key drivers of their capital financing requirement, whilst highlighting any risks, such as significant and persistent overspends, extensive use of reserves to balance budgets for e.g.

Benchmarking to other councils

3.25 The graph below shows a comparison between Brent's investment portfolio and that of Arlingclose's (the council's treasury advisor) other Local Authority clients. Brent's portfolio has a very low risk profile compared with many of the others, which also equates to a lower yield. However, many authorities are to the right of Brent, obtaining similar yields for much higher risk.



Budgeted Income And Outturn

3.26 The Council's external interest budget for the year is £24.2m, and for investment income is £4.7m. The Council is likely to exceed this figure in 19-20 due to the enhanced income returns from subsidiary loans such as i4B. The average cash balances, representing the Council's reserves and working balances, were £94m during the period to 31 August 2019.

3.27 The UK Bank Rate remains at 0.75% since 02 August 2018. The short-term money market rates have experienced little fluctuation since the increase so have provided a stable return over the last year.

Icelandic Bank Investment Update

3.28 £0.2m of the original £10m deposit remains outstanding. It is expected that a further distribution will be made but this depends on the result of ongoing litigation.

LOBOs (Lender Option Borrower Options) - Update

3.29 The Council has a market loan portfolio comprising a total value of £85.5m. Of this, £70.5m are LOBOs with the remaining £15m made up of fixed rate loans. The majority of the loans were taken out before 2010 meaning that in the current low interest rate environment the likelihood of these loans being "called" by the bank, in terms of changing the rate, is low.

Compliance

3.30 Officers confirm that they have complied with its Treasury Management Indicators for 2019/20, which were set in February 2019 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

Summary

3.31 In compliance with the requirements of the CIPFA Code of Practice, this report provides Members with a summary report of the treasury management activity during the first half of 2019/20. As indicated in this report, none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

3.32 At the end of the year the outcome of the councils borrowing strategy work undertaken in conjunction with EY will be reported back to the committee for review and comment.

4.0 Financial Implications

4.1 These are covered throughout the report.

5.0 Legal Implications

5.1 There are no direct legal implications.

6.0 Equality Implications

6.1 No direct implications.

7.0 Consultation with Ward Members and Stakeholders

7.1 None.

8.0 Human Resources/Property Implications (if appropriate)

8.1 No direct implications.

<u>Report sign off:</u>

Minesh Patel
Director of Finance

Item 13, Appendix 1 | Treasury Management 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.

1. Credit risk indicator	Target	Actual
Portfolio average credit rating	A	A+

Liquidity : The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling [three] month period, without additional borrowing.

2. Liquidity risk Indicator	Target	Actual
Total cash available within 3 months	£50m	£85m

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

3. Interest rate risk indicator	Limit	Achieved
Upper limit on one-year revenue impact of a 1% rise in interest rates	£5m	£0.5m
Upper limit on one-year revenue impact of a 1% fall in interest rates	£5m	£0.5m

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current 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 borrowing will be:

4. Refinancing rate risk indicator	Upper Limit	Lower Limit	Actual Fixed Rate Borrowing as at 31/08/19	% Fixed Rate Borrowing as at 31/08/18	Compliance with Set Limits?
Under 12 months	40%	0%	31	8%	Yes
12 months and within 24 months	40%	0%	23	6%	Yes
24 months and within 5 years	40%	0%	37	9%	Yes
5 years and within 10 years	60%	0%	5	1%	Yes
10 years and within 20 years	75%	0%	23	6%	Yes
20 years and within 30 years	75%	0%	52	13%	Yes
30 years and within 40 years	75%	0%	213	54%	Yes
Over 40 years	75%	0%	11	3%	Yes

Time periods start on the first day of each financial year. LOBOs are classified as maturing on the next call date i.e. the earliest date that the lender can require 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 will be:

5. Principal sums invested for periods longer than a year:	Principal invested beyond 19/20 year end	Principal invested beyond 20/21 year end	Principal invested beyond 21/22 year end
Limit	£50m	£50m	£50m
Actual sums invested for longer than a year	£0m	£0m	£0m