MID YEAR REVIEW 2019-20: TREASURY MANAGEMENT AND ANNUAL INVESTMENT STRATEGY

Cabinet	**14 November 2019**
Report Author	**Tim Willis, Deputy Chief Executive & Section 151 Officer**
Portfolio Holder	**Councillor Rob Yates, Cabinet Member for Financial Services and Estates**
Status	**For Decision**
Classification:	**Unrestricted**
Key Decision	**No**

Executive Summary:

This report summarises treasury management activity and prudential/ treasury indicators for the first half of 2019-20.

Recommendation(s):

That Cabinet:

- Approves this report and the prudential and treasury indicators that are shown.
- Approves the proposed changes to the 2019-20 Treasury Management Strategy Statement.
- Recommends this report to Council.

CORPORATE IMPLICATIONS	
Financial and Value for Money	The financial implications are highlighted in this report.
Legal	Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the council's finances. For this council, this is the Deputy Chief Executive, and this report is helping to carry out that function.
Corporate	Failure to undertake this process will impact on the council's compliance with the Treasury Management Code of Practice.
Equalities Act	There are no equity and equalities implications arising directly from

2010 & Public Sector Equality Duty	this report, but the council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these. It is important to be aware of the council's responsibility under the Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by council.

CORPORATE PRIORITIES (tick those relevant)✓	
Growth	✓
Environment	✓
Communities	✓

1 Background

1.1 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities have been required to prepare a Capital Strategy which is to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

1.2 Treasury management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is 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 operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

"The management of the local authority'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."

2 Introduction

2.1 This report has been written in accordance with the requirements of the CIPFA Code of Practice on Treasury Management (revised 2017).

2.2 The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

c) Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy (for the year ahead), a Mid-year Review Report and an Annual Report (stewardship reports), covering activities during the previous year.

d) 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.

e) 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 Governance and Audit Committee.

2.3 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 half of the 2019-20 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The council's capital expenditure (see also 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.

3 Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement (TMSS) for 2019-20, which includes the Annual Investment Strategy, Capital Strategy and Non-Treasury Investment Report, was approved by the council on 7 February 2019.

3.2 The 2019-20 TMSS referred to in section 3.1 above requires revision in the light of economic and operational movements during the year. The proposed changes are:

a) Reduce the upper limit on fixed rate borrowing with a maturity of between 5 and 10 years from 55% to 50%, to bring it in line with the upper limits for other maturity bands (section 7.2).

b) Increase both the Operational Boundary and Authorised Limit for External Debt (other long term liabilities) by £10m, to provide an increased allowance for the recognition of leases under International Financial Reporting Standard 16 (sections 4.4 and 4.5).

4 The Council's Capital Position (Prudential Indicators)

4.1 This part of the report is structured to update:

- The council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

4.2 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

The revised estimate includes net reprofiling of £4.4m General Fund and £4.0m HRA.

Capital Expenditure	2019-20 Original Estimate £m	Current Position – Actual at 30-09-19 £m	2019-20 Revised Estimate £m
General Fund	12.456	2.622	16.216
HRA	15.909	2.556	20.112
Total	**28.365**	**5.178**	**36.328**

General Fund 2019-20 budget: As at 30 September 2019 there had not yet been any significant spend on Office Accommodation (£3.0m), Homelessness Accommodation (£1.6m), Berth 4/5 Replacement (£1.5m) or Vehicle & Equipment Replacement Programme (£0.9m). Combined spend on these four projects was only £0.061m against an aggregate budget of £7.0m.

HRA 2019-20 budget: As at 30 September 2019, actual spend against the East Kent Housing managed budget of £5.7m and Thanet District Council managed budget of £14.4m was £0.330m and £2.226m respectively.

4.3 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and

unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2019-20 Original Estimate £m Total	Current Position – Actual at 30-09-19 £m	2019-20 Revised Estimate £m GF	2019-20 Revised Estimate £m HRA	2019-20 Revised Estimate £m Total
Total spend	**28.365**	**5.178**	**16.216**	**20.112**	**36.328**
Financed by:					
Capital receipts	6.758		6.573	2.401	8.974
Capital grants	4.780		6.354	2.023	8.377
Reserves	7.177		0.379	8.831	9.210
Revenue	0.945		0.025	0.448	0.473
Total financing	**19.660**		**13.331**	**13.703**	**27.034**
Borrowing need	**8.705**		**2.885**	**6.409**	**9.294**

4.4 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

We are on target to achieve the forecast Capital Financing Requirement.

Prudential Indicator – the Operational Boundary for external debt

	2019-20 Original Estimate £m	Current Position – Actual at 30-09-19 £m	2019-20 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
CFR –General Fund	28.086		28.179
CFR – housing	26.337		26.356
Total CFR	54.423		54.535
Net movement in CFR	**7.140**		**7.252**
	2019-20 Original Indicator	**Current Position – Actual at 30-09-19**	**2019-20 Revised Indicato**

	£m	£m	r £m
Prudential Indicator - the Operational Boundary for External Debt			
Borrowing	63.000	29.180	63.000
Other long term liabilities*	20.000	1.978	30.000
Total debt	**83.000**	**31.158**	**93.000**

** Any 'on balance sheet' PFI schemes and finance leases etc (including the leisure centre deferred credit). Both the Operational Boundary and Authorised Limit Indicators include an estimate for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16). Once full details are known, the Operational Boundary and/or Authorised Limit may need to be revised further for approval. The impact of IFRS 16 has not been reflected in the Actual or elsewhere in this report, pending further information from CIPFA.*

4.5 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, borrowing will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019-20 and next two financial years. This allows some flexibility for limited early borrowing for future years. The council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2019-20 Original Estimate £m	Current Position – Actual at 30-09-19 £m	2019-20 Revised Estimate £m
Gross borrowing	42.175	29.180	40.643
Plus other long term liabilities*	1.937	1.978	1.808
Total gross borrowing	**44.112**	**31.158**	**42.451**
CFR (year end position)	54.423		54.535

The Section 151 Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2019-20 Original Indicator £m	Current Position – Actual at 30-09-19 £m	2019-20 Revised Indicator £m
Borrowing	68.000	29.180	68.000
Other long term liabilities*	25.000	1.978	35.000
Total	**93.000**	**31.158**	**103.000**

** Any 'on balance sheet' PFI schemes and finance leases etc (including the leisure centre deferred credit). Both the Operational Boundary and Authorised Limit Indicators include an estimate for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16). Once full details are known, the Operational Boundary and/or Authorised Limit may need to be revised further for approval.The impact of IFRS 16 has not been reflected in the Actual or elsewhere in this report, pending further information from CIPFA.*

5 Investment Portfolio 2019-20

5.1 In accordance with the Code, it is the council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the council's risk appetite. As shown by forecasts in Annex 1, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

5.2 The council held £44.530m of investments as at 30 September 2019 (£41.673m at 31 March 2019) and the investment portfolio yield for the first six months of the year is 0.82% against a benchmark (average 7-day LIBID rate) of 0.57%. The constituent investments are:

Sector	Country	Up to 365 days £m	366 days – 370 days £m	Total £m
Banks	UK	17.755	0.600	18.355
Money Market Funds	UK	26.175	0.000	26.175
Total		**43.930**	**0.600**	**44.530**

5.3 The Section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2019-20.

5.4 The council's budgeted investment return for 2019-20 is £0.370m (£0.185m half-year) and performance for the first half of the financial year is above budget at £0.195m.

5.5 Investment Risk Benchmarking

Investment risk benchmarks were set in the 2019-20 Treasury Management Strategy Statement (TMSS) for security, liquidity and yield. The mid-year position against these benchmarks is given below.

5.5.1 Security

The council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio.

The security benchmark for each individual period is:

	370 days	2 years	3 years	4 years	5 years
Maximum	**0.05%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

The Section 151 Officer can report that the investment portfolio was maintained within this overall benchmark for the first half of this financial year.

5.5.2 Liquidity

In respect of this area the council seeks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £10m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 1.0 year.

The Section 151 Officer can report that liquidity arrangements were adequate for the first half of this financial year.

This authority does not currently place investments for more than 370 days due to the credit, security and counterparty risks of placing such investments.

5.5.3 Yield

Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

The Section 151 Officer can report that the yield on deposits for the first half of the financial year is 0.82% against a benchmark (average 7-day LIBID rate) of 0.57%.

5.6 Investment Counterparty criteria

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

6 Borrowing

6.1 The council's capital financing requirement (CFR) original estimate for 2019-20 is £54.423m. The CFR denotes the council's underlying need to borrow for capital purposes. If the CFR is positive the council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The council has borrowings of £29.180 (table 4.5) and has utilised an estimated £25.243 of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

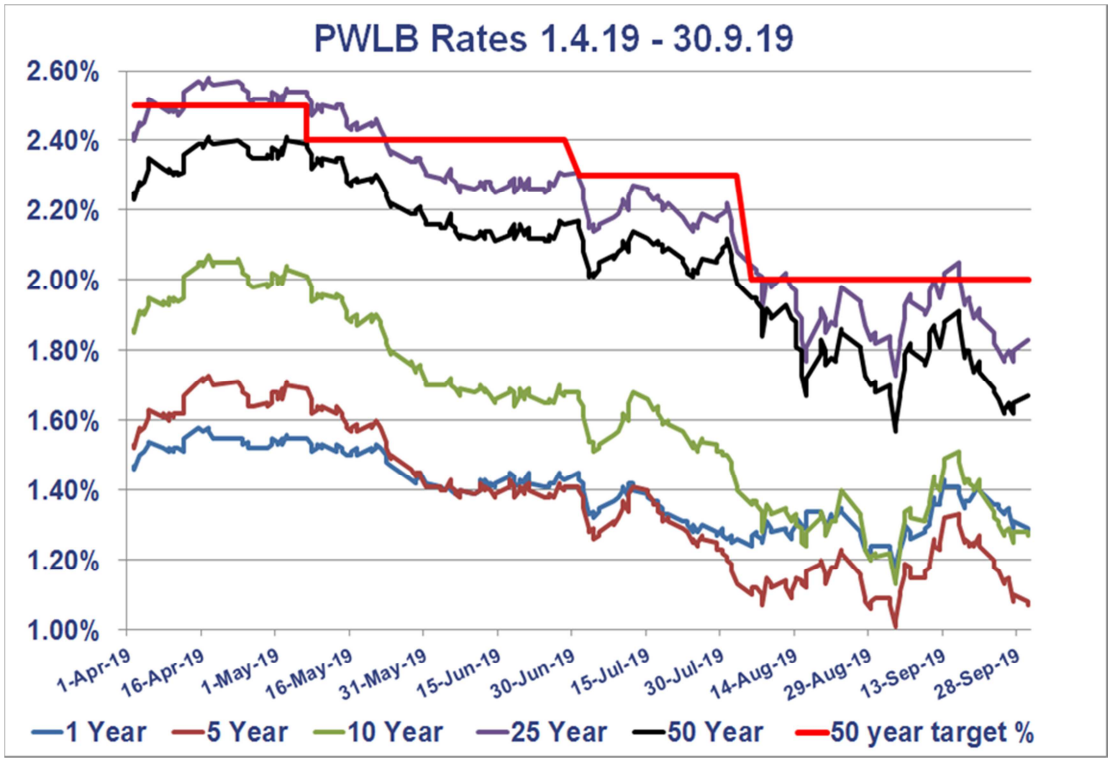
6.2 No new external borrowing was undertaken from the PWLB during the first half of this financial year.

6.3 £3.8m of council debt with the PWLB matured, and was repaid, on 1 October 2019.

6.4 Borrowing may be undertaken during the second half of this financial year and options will be reviewed in due course in line with market conditions.

6.5 The graph and table below show the movement in PWLB certainty rates for the first six months of the year to 30 September 2019.

6.6 PWLB certainty rates, half year ended 30th September 2019



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.01%	1.13%	1.73%	1.57%
Date	03/09/2019	03/09/2019	03/09/2019	03/09/2019	03/09/2019
High	1.58%	1.73%	2.07%	2.58%	2.41%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	17/04/2019
Average	1.40%	1.37%	1.62%	2.20%	2.07%

6.7 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. The council is currently under-borrowed to address investment counterparty risk and the differential between borrowing and investment interest rates. This position is carefully monitored.

6.8 The council's budgeted debt interest payable for 2019-20 is £1.498m (£0.749m half-year) and performance for the first half of the financial year is below budget at £0.552m. The revised estimate for 2019-20 is £1.155m.

7 Treasury Management Indicators

7.1 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2019-20 Original Indicator	2019-20 Revised Indicator
Non-HRA	10.9%	9.0%
HRA	5.7%	4.0%

7.2 Maturity Structures of Borrowing

These gross limits are set to reduce the council's exposure to large fixed rate sums falling due for refinancing.

	2019-20 Original Upper Limit	Current Position – Actual at 30-09-19	2019-20 Revised Upper Limit
Maturity structure of fixed rate borrowing			
Under 12 months	50%	31%	50%
1 year to under 2 years	50%	15%	50%
2 years to under 5 years	50%	11%	50%
5 years to under 10 years	55%	1%	50%
10 years to under 20 years	50%	29%	50%
20 years to under 30 years	50%	3%	50%
30 years to under 40 years	50%	7%	50%
40 years to under 50 years	50%	3%	50%
50 years and above	50%	0%	50%

The current position shows the actual percentage of fixed rate debt the authority has within each maturity span. None of the upper limits have been breached.

8 Options

8.1 The recommended option (to ensure regulatory compliance as set out in section 1 of this report) is that Cabinet:

- Approves this report and the prudential and treasury indicators that are shown.
- Approves the proposed changes to the 2019-20 Treasury Management Strategy Statement.
- Recommends this report to Council.

8.2 Alternatively, Cabinet may decide not to do this and advise the reason(s) why.

9 Next Steps

9.1 This report is to go to the Governance & Audit Committee on 3 December 2019 and council on 5 December 2019 for approval.

10 Disclaimer

10.1 This report (including annexes) is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

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Reporting to:	Madeline Homer, Chief Executive

Annex List

Annex 1	Economic Update, Interest Rate Forecast and Debt Maturity
Annex 2	Guidance on the Treasury Management Strategy Statement and Annual Investment Strategy – Mid Year Review Report 2019-20

Corporate Consultation Undertaken

Finance	Chris Blundell, Head of Financial and Procurement Services, Interim Head of Shared Services & Acting Section 151 Officer
Legal	Tim Howes, Director of Corporate Governance & Monitoring Officer