COUNCIL CABINET
13 November 2019

ITEM 14

Derby City Council

Report sponsor: Paul Simpson, Strategic Director of Corporate Resources
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Treasury Management Mid-Year Report 2019/20

1.0 Purpose

1.1 The Council is required under the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the "CIPFA TM Code") to approve the treasury management mid-year and outturn reports.

1.2 This mid-year report outlines the Treasury Management activity for the period 1 April 2019 to 30 September 2019, comprising:

- Summary of the Financial Markets to date in 2019/20
- Forecast Outturn 2019/20
- Borrowing Activity
- Deposits
- Prudential Indicators.

2.0 Summary

2.1 The Treasury Management forecast outturn for 2019/20 is a net underspend of £0.9m as at 30 September 2019. This is mainly because Minimum Revenue Provision (MRP) is less than originally forecast due to reduced unsupported borrowing in 2018/19, as a result of slippage in capital expenditure in 2018/19.

2.2 At the end of September 2019, total debt is £430.955m and total investments are £71.433m compared to £443.572m and £67.838m as at 31st March 2018. No new borrowings have been made or are anticipated to be made in the year. Total debt has reduced by £12.618m including the repayment of PWLB debt totalling £11.038m.

2.3 All Treasury Management activities of the Council up to 30 September 2019 have complied with Prudential Indicators. With the exception of breaching the maximum balance to be held with Lloyds, our main bank, on one occasion. Further details can be found in section 12.1. The Council is required to comply with its Treasury Management Strategy agreed annually by Council.

2.4 Treasury Management advice to the Council up to 30 September 2019 has been provided by Arlingclose. Their services includes economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other treasury matters as and when required.

3.0 Recommendations

3.1 For Cabinet to note the forecast outturn position of £0.9m underspend.

3.2 For Cabinet to note the position statement on Treasury Management Activity, and compliance against the Prudential Indicators, for the period 1 April 2019 to 30 September 2019.

3.3 For Cabinet to recommend to full Council that they approve the Treasury Management mid-year report.

4.0 Reasons

4.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the “CIPFA TM Code”), it is considered good practice for Council (see earlier comment) to note the progress and monitor performance at least twice a year of the Council’s treasury management activity.

5.0 Background

5.1 The Council’s treasury management strategy for 2019/20 was approved by Full Council on 27th 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 are therefore central to the Council’s treasury management strategy.

5.2 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority’s Capital Strategy, complying with CIPFA’s requirement, was approved by full Council on 27th February 2019.

6.0 The Financial Markets to date in 2019/20

6.1 The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and 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 or a subsequent date.

6.2 The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

6.3 Public Works Loan Board (PWLB) rates available to the Council are currently based on gilts plus 0.80%. Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

6.4 Earlier this month, the PWLB made a surprise increase in PWLB Borrowing Rates of 100 basis points (1%) on loans secured through the PWLB. This increase partly reflects gilt market performance, HM Treasury PWLB Cap and concerns from HM Treasury on the significant increase in PWLB borrowing for commercial investments undertaken by local authorities.

6.5 The information relating to the overall global position of the UK financial markets is provided by Arlingclose, our treasury advisors, who continue to update the Council with on-going market activity and interest rates.

7.0 Local Context

7.1 On 31st March 2019, the Authority had net borrowing of £284.133m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £m
General Fund CFR	400.841
HRA CFR	233.878
Total CFR	**634.719**
Less: Other debt liabilities *	(91.224)
Borrowing CFR	**543.495**
Less: Usable reserves	(222.483)
Less: Working capital	(36.879)
Net borrowing	**284.133**

*Finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

7.2 The Council’s current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing. This is because external borrowing is more expensive than the interest rate that the Council can secure on its investments. It also reduces risk and keeps net interest costs low.

7.3 This policy is consistent with the Council’s Treasury Management Policy. The treasury management position at 30th September 2018 and the change during the period is show in Table 2 below.

Table 2: Treasury Management Summary

	31 March 2019 Balance £m	Movement £m	30 Sept 2019 Balance £m	30.9.19 Rate %
Long-term borrowing Short-term borrowing	340.070 11.901	-1.855 -10.763	338.215 1.138	4.41% 0.58%
Total borrowing	**351.971**	-12.618	**339.353**	**4.40%**
Long-term investments Short-term investments Cash and cash equivalents	0.000 20.000 47.838	0.000 0.000 3.595	0.000 20.000 51.433	0.00% 0.84% 0.73%
Total investments	**67.838**	3.595	**71.433**	**0.76%**
Net Borrowing	**284.133**		**267.920**	

7.4 Net borrowing has decreased during the year to 30 September 2019. This is due to the repayment of PWLB and other debt.

8.0 Forecast Outturn 2019/20

8.1 The Council budgets for the net cost of its Treasury Activities (Borrowing and Investments) through its Treasury Management Budget. At 30 September, this was forecasting an underspend of £0.9m. This underspend is mainly due to a reduction in the Minimum Revenue Provision (MRP) charges. MRP charges for unsupported borrowing commence the year after the capital spend is incurred or the year after the asset becomes operational if later, therefore slippage in capital expenditure in 2018/19 has reduced the forecast MRP charges in 2019/20.

8.2 It is proposed any underspend on Treasury Management is to be transferred to the Treasury Management Reserve, to help smooth future volatility in the treasury management costs and to fund potential project support costs in 2019/20, associated with potentially changing bank account provider following the banking services tender.

9.0 Treasury Borrowing Activity

9.1 At the 30 September 2019, the total external debt portfolio of the Council (including HRA debt and other long- term liabilities) was £430.955m, as a result of its strategy for funding previous years' capital programmes. The analysis of external debt outstanding at 30 September 2019 is shown in Table 3 below:

Table 3: External Debt

	£m	£m
	As at 31 March 2019	**As at 30 Sept 2019**
External Borrowing:		
- Fixed Rate PWLB	303.288	292.250
- Fixed Rate Market (LOBO)*	20.000	20.000
- Other Local Authorities	25.000	25.000
- Local Enterprise Partnership (LEP)	1.417	0.000
- SALIX Energy Efficiency	1.532	1.371
- University of Derby	0.733	0.733
Total External Borrowing	**351.970**	**339.353**
Other Long-term Liabilities:		
- Transferred Debt from other Local Authorities	0.405	0.405
- PFI Financing	90.801	90.801
- Finance Lease Liabilities	0.396	0.396
Total Gross External Debt	**443.572**	**430.955**

**LOBO loans converted to standard fixed rate loans*

9.2 The University of Derby and SALIX loans are at 0% interest; taking the interest free loans helps maintain our cash levels available for investment whilst having no cost to the Council.

9.3 The LEP loans have been repaid in year, following advice from our financial advisors. This is because the interest charged was more expensive than current borrowing rates and terminating the loans early did not incur a financial penalty.

9.4 Should the Council need to borrow, it will strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

9.5 In keeping with these objectives, no new borrowing was undertaken, while £10.850m of existing loans were allowed to mature without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

9.6 At the start of the financial year, the Council held £20m of Lender's Option Borrower's Option (LOBO) loans where the lender (Royal Bank of Scotland Plc) has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. However, on 2 July 2019 RSB sold these loans to another institution and at this point the option to amend the interest rate was removed from the loan agreement. These loans will now be held until maturity.

10.0 Treasury Investment Activity

10.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period to 30 September 2019, the Council's daily investment balance ranged between £67.838m and £109.255m due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury Investment Summary

Counterparty	31 March 2019 Balance £m	Net Movement £m	30 Sept 2019 Balance £m
Banks & building societies (unsecured)	1.373	-0.135	1.238
Local authorities	43.000	-3.500	39.500
Money Market Funds	23.465	7.230	30.695
Total investments	**67.838**	**3.595**	**71.433**

10.2 The investment activity to the 30 September 2019 together with a comparison for the previous year is summarised in Table 5 below:

Table 5: Treasury Investment Activity

	2018/19	2019/20 to Sept 2019
Number of fixed-term deposits made	41	24
Number of instant access and money market accounts used	11	10
Number of deposits/withdrawals from money market funds/ call accounts	72	57
Value of deposits/ investments held at 31 March	£67.838m	£71.433m
Average size of deposit/ investment portfolio	£93.098m	£81.359m
Average size of Lloyds Balance (operational)	£8.999m	£9.975m
Total interest earned on deposits/ investments (including Lloyds)	£0.661m	£0.363m
Average Return on deposits/ investment portfolio	0.57%	0.68%

10.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

10.4 The credit risk and return metrics for the Council investments extracted from Arlingclose's quarterly investment benchmarking is shown in Table 6.

Table 6: Credit Rating

	Credit Score*	Credit Rating	Bail-in Exposure	WAM** (days)	Rate of Return
31/03/2019	4.09	AA-	33%	33	0.79%
30/06/2019	4.30	AA-	57%	29	0.69%
Similar LAs	4.24	AA-	68%	50	1.57%
All LAs	4.31	AA-	62%	28	1.41%

*The lower the credit score the lower risk
** Weighted Average Maturity

10.5 The benchmarking shows that the Council's Weighted Average Maturity (WAM) for investments reduced by 4 days between 31st March 2019 and 30th June 2019. It is lower than other comparable authorities which demonstrates that the Council continues to pursue security and low risk. However, our low risk appetite can also be seen in the rate of return we have generated from our investments.

10.6 Bail-in exposure means the percentage of the portfolio that is held in investments where bail-in regulations apply. Bail-in legislation, ensures that large investors including local authorities will rescue failing banks instead of taxpayers. Call accounts and Money Market Funds are subject to bail-in, fixed term deposits with local Authorities are not subject to bail-in. The Council's exposure to bail-in has increased as we held a higher proportion of our investments with UK banks and MMF's at 30th June 2019 compared to 31st March 2019. The benchmarking only highlights the Council's exposure to bail-in; it does not consider the likelihood of a bail-in. Treasury Advisors continue to keep the Council informed of any emerging position surrounding banks and MMF's and changes impacting on the likelihood of bail-in and appropriate action would be taken.

11.0 Readiness for Brexit

11.1 The scheduled leave date for the UK to leave the EU was 31st October 2019 and significant uncertainty remains as to whether a deal will be agreed by this date, and there is the real possibility that the exit date is pushed back yet again. As 31st October approaches, the Authority has prioritised investments in UK domiciled banks and Money Market Funds to hold sufficient liquidity required in the near term and that its account with the Debt Management Account Deposit Facility (DMADF) remains available for use in an emergency.

12.0 Non-Treasury Investments

12.1 The definition of investments in the revised "CIPFA TM Code" now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. 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 for financial return. The Council's Non-Treasury Investments are shown in Table 7:

Table 7: Non Treasury Investments as at 30 September 2019

Type of investment	**Investment value £m**	**Return £m**	**Rate of Return %**
Directly owned investment property*	4.140	0.343	8.29%
Loans to local businesses	1.743	0.022	5.47%
Loans to subsidiaries (Derby Homes)**	2.973	0.160	5.38%

*Investment value and return taken from the 2018/19 statement of accounts to give an indication of 2018/19 position – this will not be known until the end 2019/20.
** This is the full year position as an annual interest is charged

13.0 Compliance Report

13.1 All but one treasury management activity undertaken up to 30 September 2019 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. On one specific date, we breached the £15m limit by £0.104m to be held with our bank, Lloyds. This is because we received more than £1m of unexpected income via CHAP's after the daily dealing had been completed. Compliance with specific investment limits are demonstrated in Table 8 below.

Table 8: Investment Limits

	2019/20 Maximum to date	**30/9/19 Actual**	**2019/20 Limit**	**Complied**
The Councils Banking Provider – Lloyds	£15.1m	£11.6m	£15m	☒
Any single organisation, except the UK Central Government (excluding the operational bank)	£10m	£10m	£10m	✓
Any group of pooled funds under the same management	£11.1m	£9.6m	£20m	✓
Money Market Funds (MMF)	£8m	£8m	£8m	✓

13.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 9 below.

Table 9: Debt Limits

	2019/20 Maximum £m	**30/09/19 Actual £m**	**2019/20 Operational Boundary £m**	**2019/20 Authorised Limit £m**	**Complied**

Borrowing	352.0	339.4	591.7	699.9	✓
PFI & finance leases	91.2	91.2	91.7	91.7	✓
Total debt	**443.2**	**430.6**	**683.4**	**791.6**	

14.0 Treasury Management Indicators

14.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

14.2 Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score 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.

14.3 Local Authorities are unrated, therefore fixed term deposits with Local Authorities have to be assigned a score. The score assigned is AAA=1, this means the investments are of the highest credit quality. This is due to Local Authorities not being subject to bail-in and having an insignificant risk of insolvency linked to its covenant strength.

14.4 Table 10 shows the target for the portfolio average credit score and the actual to 30 September 2018/19:

Table 10: Security Indicator - Portfolio average credit score

	Target	**Actual**
Portfolio average credit score	3.00	1.08

14.5 The actual credit score is below the target showing the exposure to credit risk for the year to date has been lower than the target set, due to higher credit quality investment being used over lower credit quality investment. This is as a result of using fixed term deposits with Local Authorities and high credit quality Money Market Funds (MMF's).

14.6 Interest rate exposure indicator: The other locally-set prudential indicator relates to interest rate exposure which allows the Council to manage the extent to which it is exposed to changes in interest rates. It shows the split of borrowing and investments between fixed and variable rates, and the maturity profile of long term loans. Fixed investments and borrowings are those where the rate of interest is fixed for the whole financial year or from the transaction date if later. Instruments that mature during the following financial year are classed as variable rate.

14.7 The split in respect of borrowing and investments as at 30 September 2019, and the comparative figures for the previous year, are shown in Table 11 below:

Table 11: Interest Rate Exposure

Interest rate risk indicator	30.9.19 Actual	2019/20 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	0.000m	0.145m	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	0.465m	0.500m	✓

14.8 This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest. Loans that will mature in the next 12 months have a significantly higher interest rate than currently available.

14.9 Maturity Structure of Borrowing: The actual maturity structure of borrowing as at 30 September 2019 has been compared to the loan maturity limit profile that was approved in the Treasury Management Strategy 2019/20. Table 12 shows that this indicator has been met as follows:

Table 12: Maturity Structure of Borrowing

Number of Years to Maturity	Upper limit per 2019/20 Strategy	Actual Profile of Borrowing at 30 September 2019
	%	%
Up to 1 year	10	0.13
Up to 2 years	20	0.13
Up to 5 years	30	6.91
Up to 10 years	50	10.81
Up to 20 years	70	30.11
Up to 30 years	80	43.92
Up to 40 years	95	85.49
Up to 50 years	100	100.00

14.10 Principal Sums Invested for Periods Longer than 365 days: 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 were:

Table 13: Principal Sums Invested for Periods Longer than 365 days

	2019/20 £m
Actual principal invested beyond year end	0.00
Limit on principal invested beyond year end	20.00
Complied?	✓

15.0 Economic Outlook for the remainder of 2019/20

15.1 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.

15.2 Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will continue to offer longer-term borrowing opportunities

16.0 Public/stakeholder engagement

16.1 None arising directly from this report.

17.0 Other options

17.1 None arising directly from this report.

18.0 Financial and value for money issues

18.1 As described in report

19.0 Legal implications

19.1 None arising directly from this report

20.0 Other significant implications

20.1 None arising directly from this report.

This report has been approved by the following people:

Role	Name	Date of sign-off
Legal		
Finance	Toni Nash: Head of Finance	
Service Director(s)	Simon Riley: Director of Financial Services	
Report sponsor	Paul Simpson, Strategic Director of Corporate Resources	
Other(s)		

Background papers:	
List of appendices:	Glossary of Treasury Management Terms

Glossary of Treasury Management Terms	
Term	**Description**
Bail-in	Investors take a loss on their investment to rescue a failing bank. It is alternative to a bail- out of a failing bank, where the loss is made good by the governments and taxpayers.
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate".
Call Accounts	A call account is a bank account for investment funds it has no fixed deposit period, provides instant access to funds and allows unlimited withdrawals and deposits.
Gilts	Gilts are a UK government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. Being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
London Interbank Bid Rate (LIBID)	The London interbank market is a wholesale money market in London where banks exchange monies. The bid rate is the rate London banks are willing to pay for deposits and other banks' unsecured funds from other banks in the London interbank market.
Money Market Fund (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Monetary Policy Committee (MPC)	The Monetary Policy Committee (MPC) is a committee of the Bank of England who decides what monetary policy action to take. The MPC sets and announces policy eight times a year.
Public Works Loan Board (PWLB)	The Public Works Loan Board (PWLB) is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments.
Weighted Average Maturity (WAM)	The average number of days remaining until the investment matures weighted by the value of each investment.