CAERDYDD
CARDIFF

DINAS A SIR CAERDYDD
CITY AND COUNTY OF CARDIFF

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SUPPLEMENTAL PAPERS

Item	**Description and Page Number(s)**
7	**Treasury Management Mid - Year Report 2019-20 – Appendix 1 Treasury Management Report** *(Pages 3 - 12)*

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This document is available in Welsh / Mae'r ddogfen hon ar gael yn Gymraeg

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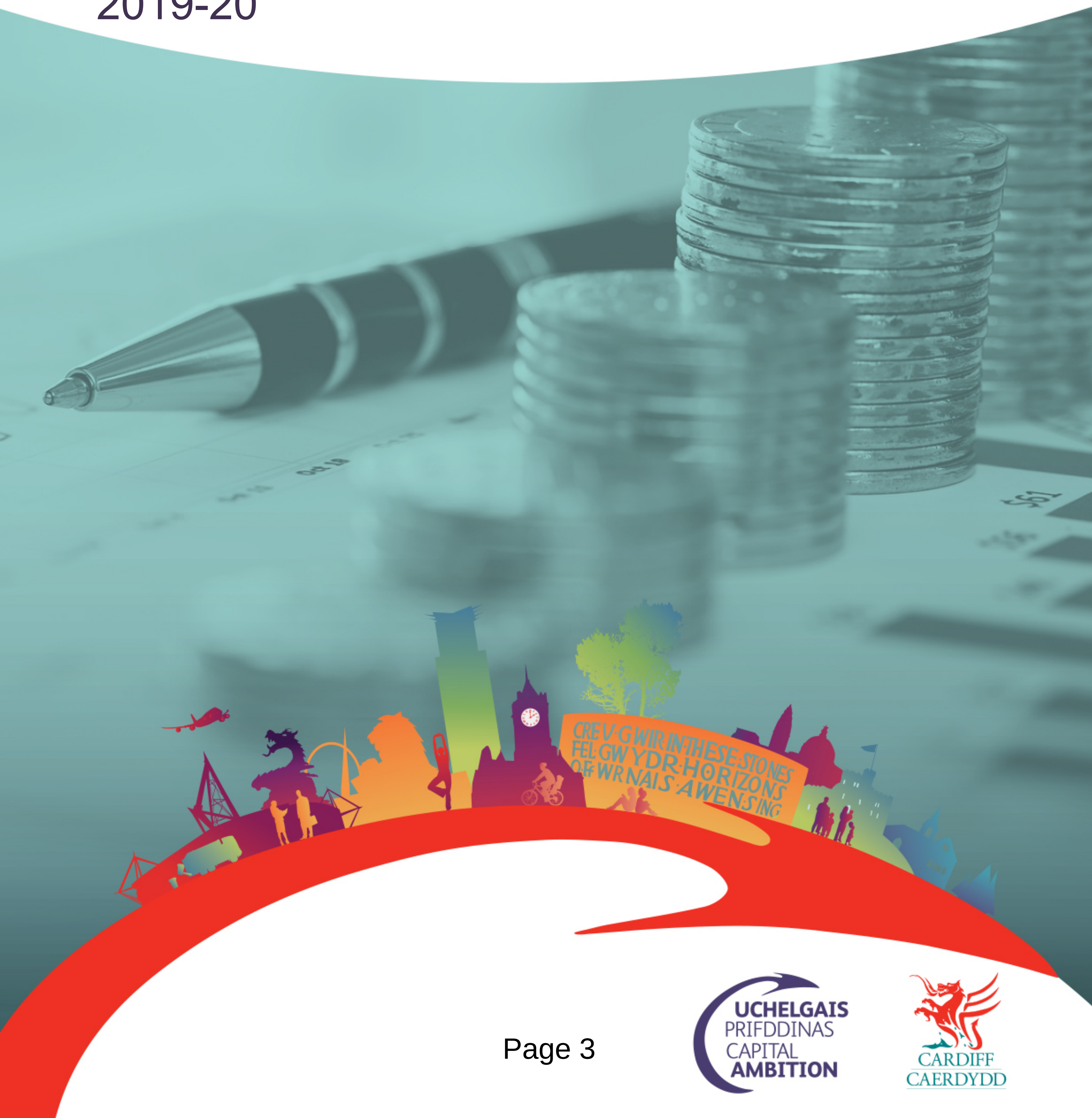
Annexes B & C to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Appendix 1

Treasury Management Mid-Year Report

2019-20



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Introduction

1.1 Treasury management activities are the management of an organisation'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.

1.2 The Council carries out its treasury management activities in accordance with a Treasury Management Code of Practice for public services, updated by CIPFA in 2017. This requires the Council to set out the policies and objectives of its treasury management activities and adopt four Clauses of Treasury Management (replicated in **Annexe A**).

1.3 Council received a report in February 2019 on the Council's Treasury Management Strategy for 2019/20. During 2019/20, Audit Committee has received periodic updates on the position and performance of treasury management and the issues included in the report below. In addition Council received in September 2019 the Annual Outturn Report for treasury management for 2018/19.

1.4 In accordance with Council policy, this report provides members with a mid-year update as at 30 September 2019 and covers:-

- the economic background to treasury activities
- investments
- borrowing
- debt rescheduling
- compliance with treasury limits and prudential indicators
- Treasury Strategy update for remainder of the year.

1.5 Annexe E includes a glossary which defines key terms used in this report.

Economic Background

2.1 UK growth fell in the first half of the year due primarily to Brexit uncertainty, trade concerns as well as a negative outlook for other world economies. Whilst such uncertainty remained, the Bank of England maintained the base rate at 0.75% and any move in rates is likely to be dependent on clarity on what is going to happen after Brexit. As for inflation itself, the Consumer Price Index has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern at the current time.

2.2 With these factors in mind, the table below shows the Council's treasury management advisors latest forecast for bank rate and Public Works Loan Board (PWLB) borrowing rates. These are based on an assumption of an agreed Brexit deal at some point, so would need to be re assessed over the next few weeks. The forecasts show an increase in Bank Rate during December 2020.

	Actual 30/09/2019	March 2020	March 2021	March 2022
Bank Rate	0.75%	0.75%	1.00%	1.25%
5yr PWLB rate*	1.07%	2.50%	2.80%	3.10%
10yr PWLB rate*	1.27%	2.80%	3.10%	3.40%
25yr PWLB rate*	1.83%	3.40%	3.70%	4.00%
50yr PWLB rate*	1.67%	3.30%	3.60%	3.90%

* The forecasts include a 1% increase effective from 09 October 2019 as a result of a HM Treasury policy change (see later in report)

2.3 PWLB rates are based on gilt yields and are thus subject to volatility caused by the uncertainties highlighted above. Borrowing rates have reduced in recent years as part of a bond buying programme by the Bank of England (Quantitative Easing) as well as global and UK economic uncertainty. Geopolitical events, risks to economic growth caused by trade wars and a perception that inflation is under control and is to remain subdued has resulted in government bond yields in the developed world falling significantly during 2019. In some cases, bond yields up to ten years in the Eurozone have actually turned negative. What we have seen during the last half year is a near halving of longer term PWLB rates to unprecedented historic low levels.

Investment

3.1 The management of the Council's cash flows may involve temporary lending of surplus funds to low risk counterparties or temporary borrowing pending receipt of income.

3.2 The Council's investment priorities remain the security and then liquidity of its Treasury investments. The Council also aims to achieve the optimum return appropriate to these priorities.

3.3 The Council invests with financial institutions in accordance with criteria approved in its Treasury Strategy. The categories, names, periods and size limits on this list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers. Based primarily on Fitch credit criteria and a number of other factors which the Council takes into account, lending to these institutions is subject to time and size limits and credit worthiness continues to be carefully monitored. There have been no changes made or required to be made to the list of eligible counterparties included as part of the 2019/20 Treasury Management Strategy approved by Council, but these will be reviewed in the 2020/21 Strategy.

3.4 Following the introduction of The Markets in Financial Instruments Directive (MiFID) in January 2018, the Council opts to be classified as a professional client rather than a retail client by financial institutions.

Investments returns are likely to remain low during 2019 and the approach of deferring external borrowing by using temporary cash balances has served well over the last few years. However, caution should be adopted to avoid incurring higher borrowing costs in the future when new borrowing is unavoidable.

3.5 At the 30 September 2019, investments stood at £98.6 million. These temporary funds fluctuate daily and arise for a number of reasons, including the timing differences between the receipt of grant and other income and the utilisation of these funds on salaries and other operating costs. It includes the level of reserves, provisions, and other balances. It is also affected by the timing of borrowing and capital expenditure transactions. **Annexe B** shows with whom these investments were held as at 30 September 2019. All investments are deemed recoverable.

3.6 A selection of performance indicators and benchmarking charts, is included in **Annexe C** as follows:-

- **Counterparty exposure** displays actual investment against the maximum permitted directly with an organisation. This demonstrates that we are not exceeding any exposure limits.
- **Remaining maturity profile of investments**. This shows the duration of investments over time. The Council will take advantage of longer term rates where reasonable to do so.
- **Investments by institution.** This expresses the investments held with different institutions as a percentage of the total and shows diversification is sought where possible.
- **Geographic spread of investments** as determined by the country of origin of relevant organisations. All countries are rated AA and above as per our approved criteria and are licensed to take UK deposits. Investments are in Sterling only.
- **Investments by Financial Sector.** The majority of investments continue to be with banks.

3.7 Whilst a difficult figure to forecast due to the uncertainty of the markets, cash flows and the number of variables that impact on the figure, the forecast level of interest receivable from treasury investments for 2019/20 is £900,000. The return achieved since the start of the year is 0.87% compared to the benchmark 7 day London Interbank Bid Rate (LIBID) of 0.57% and 3 month LIBID 0.66%

Borrowing

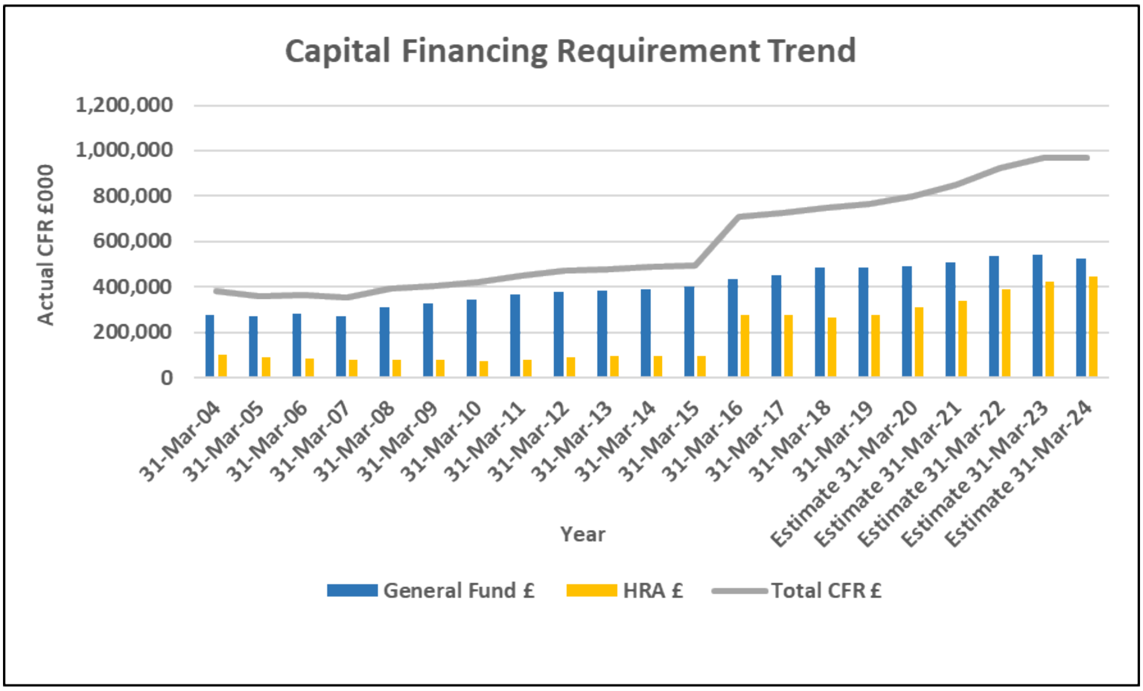
4.1 Long term borrowing is undertaken to finance the Council's Capital Programme and the main sources of borrowing currently are the PWLB and the Money Markets. The Council does not separate General Fund and Housing Revenue Account borrowing as all borrowing is the liability of the Council i.e borrowing is 'pooled'.

4.2 Where capital expenditure has been incurred without a resource to pay for it immediately e.g. via capital receipts, grants or other contributions, this will increase what is termed the Council's Capital Financing Requirement (CFR) or its need to undertake borrowing. The Council is required to make an annual prudent provision for the repayment of historic capital expenditure from its revenue budget and set this at a level that considers previous and future borrowing commitments as well as the period over which the benefits of capital expenditure are expected. This reduces the CFR. Calculation of the CFR is summarised in the following table and results in the need to borrow money.

	Opening Capital Financing Requirement (CFR)
+	Capital expenditure incurred in year
-	Grants, contributions, reserves and receipts used for capital expenditure
-	Prudent Minimum Revenue Provision & Voluntary Repayment
=	*Closing Capital Financing Requirement (CFR)*

4.3 The CFR forecast is subject to the timing of capital expenditure, capital receipts and new schemes that may be considered for approval in future years. It can be seen that the Council's underlying need to borrow is increasing and will need to be repaid from future revenue budgets either from savings, revenue income or Council Tax and Housing Rents.

4.4 The historic trend in the CFR is shown with the increase in 2015/16 reflecting the Housing Revenue Account subsidy buyout as reported previously.



4.5 At 30 September 2019, the Council had £726.2 million of external borrowing predominantly made up of fixed interest rate borrowing from the PWLB payable on maturity.

31-Mar-19			30-Sep-19	
£m	**Rate (%)**		**£m**	**Rate (%)**
660.9		Public Works Loan Board	663.9	
51		Market (Lender Option Borrower Option)	51	
4.5		Welsh Government	6.2	
5.5		Other	5.1	
721.9	**4.53**	**Total External Debt**	**726.2**	**4.51**

New borrowing undertaken during the first half of the year

4.6 Interest free loans of £2.81 million from Welsh Government have been received for Town Centre Schemes and £5 million of the Councils borrowing requirement has requirement has been taken from the PWLB in the first half of the year. To note a further £5 million of borrowing was undertaken in the first week of October and this is not included in the table above or charts in this report.

Maturing Loans in year to date

4.7 **Annexe D** shows the maturity profile of the Council's borrowing as at 30 September 2019. Loans of £3.43 million have been repaid in the first half of this year, a further £0.69 million is due to be repaid by 31 March 2020. Unless the Council's Lender Option Borrower Option loans (LOBO's) are required to be repaid early, very little debt matures within the next 10 years.

4.8 (LOBO) products are loans to the Council where the lender can request a change in the rate of interest payable by the Council on pre-determined dates. The Council at this point has the option to repay the loan.

4.9 The Council has 6 such loans totalling £51 million. Apart from the option to increase rates, these loans are comparable to PWLB and have no other complications such as variation in interest rates or complex terms.

4.10 Interest rates on these loans range between 3.81% and 4.35% which are not unreasonable and are below the Council's average rate of interest payable. Details of the loans are shown in the following table.

£m	Potential Repayment Date	Option Frequency	Full Term Maturity
6	21/11/2019	6 months	21/11/2041
6	21/11/2019	6 months	21/11/2041
6	21/11/2019	6 months	23/05/2067
6	02/03/2020	6 months	23/05/2067
22	23/11/2020	5 years	23/11/2065
5	16/01/2023	5 years	17/01/2078

4.11 LOBO's to the value of £24 million are subject to the lender potentially requesting a change in the rate of interest payable every six months, which could trigger early repayment. This is deemed unlikely and any risk is a manageable refinancing risk as LOBOs in total, form a relatively low proportion of the Council's overall borrowing at 7.0%.

Borrowing Strategy

4.12 The borrowing strategy outlined in the February 2019 budget report indicated that:-

Whilst investment rates remain lower than long term borrowing rates, internal borrowing will be used to minimise short-term costs

External borrowing (short, medium and long term) will be taken for the balance of the Council's borrowing requirement, with timing delegated to the Council's Section 151 Officer. This will aim to keep internal borrowing to approximately £80 million, subject to balance sheet capacity and future interest rate forecasts.

Any external borrowing is likely to be at fixed rates to meet the long term borrowing policy aims and given the forecasts in rates highlighted above.

4.13 As shown in the interest rate forecasts set out in paragraph 2.2, long term borrowing rates are higher than investment rates which means that the cost of undertaking new borrowing would have a negative impact on the revenue budget. External borrowing may be deferred in order to minimise short term costs by using temporary cash balances to meet the Capital Financing Requirement rather than placing in an investment. This is termed 'internal borrowing'. However deferring borrowing is only a short term measure and could expose the Council to higher borrowing rates and costs in the future. The Council has taken an approach of regularly undertaking external borrowing for an element of any borrowing requirement to mitigate any such risk.

4.14 If no further PWLB or Market borrowing is undertaken, the value of external loans at 31 March 2020 will be £731 million. At the same point, the Council's need to borrow for capital expenditure purposes, its Capital Financing Requirement (CFR), is currently forecast to be circa £786 million (General Fund £477 million and HRA £309 million). Without any further borrowing this financial year internal borrowing would be £56 million.

4.15 The estimated total interest payable on borrowing for 2019/20 is £32.8 million which includes interest payable by the Housing Revenue Account.

PWLB Rate Change

On the 9th October 2019, PWLB changed their lending policy with immediate effect, increasing the interest rate at which local authorities can borrow from them. An extract from their letter to all local authorities is below:

PWLB lending is offered at a fixed margin above the Government's cost of borrowing, as measured by gilt yields. The Treasury raised the margin over gilts to 100bps (one percentage point) in 2010, to better reflect the availability of capital finance, and lowered it to 80bps over gilts in 2013 for qualifying authorities.

Some local authorities have substantially increased their use of the PWLB in recent months, as the cost of borrowing has fallen to record lows. HM Treasury is therefore restoring interest rates to levels available in 2018, by increasing the margin that applies to new loans from the PWLB by 100bps (one percentage point) on top of usual lending terms.

This restoration of normal PWLB lending rates will apply to all new loans with immediate effect. The Government will monitor the impact of this change and keep rates policy under review.

The impact of this change on the Council will continue to be monitored closely including any wider local authority feedback, representations and alternative options for borrowing.

Debt Rescheduling

5.1 No debt rescheduling or early repayment of debt has been undertaken to date in 2019/20. The main obstacle remains the level of premium (penalty) that would be chargeable on early repayment by the PWLB. Of the existing PWLB loans of £664 million, £439 million are eligible for early repayment. However this would incur a premium of £445 million as at 30 September 2019. This premium is payable primarily because:-

- Interest rates on loans of equivalent maturities compared to those held are currently lower
- A penalty rate or lower early repayment rate was introduced by HM Treasury in November 2007, which increased the cost of premiums and reduced the flexibility of Local Authorities to make savings. This remains

an obstacle in the ability of local authorities to manage debt more effectively.

5.2 Whilst the cost of Premiums can be spread over future years, options for restructuring that have been considered result in an adverse Net Present Value (NPV). Whilst there may have been short terms savings, these were outweighed by potentially longer term costs and not deemed cost effective.

Compliance with treasury limits and prudential indicators

6.1 During the financial year to date, the Council has operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy in February 2019. The treasury and capital prudential indicators will be updated as part of the 2020/21 Capital and Treasury Strategies in the Budget Report to Council in February 2020. Following Housing Finance Reform in 2015/16 an indebtedness cap was introduced for the Housing Revenue Account of £316.5 million. This was removed in 2019/20 by HM Treasury and WG. Affordability of additional investment will need to be monitored closely as part of the Treasury Strategy and HRA Business Planning process.

Treasury strategy for the remainder of 2019/20

7.1 The Treasury Strategy approved in February 2019 remains valid. The use of temporary cash balances instead of borrowing to pay for capital expenditure continues to result in short term savings. The impact on borrowing options and interest rates following the announcement of the PWLB rate change on October 9 2019 will continue to be monitored.

<u>Annexes</u>

Annexe A – Treasury Management Policy and Four Clauses of Treasury Management
Annexe B – Investments at 30 September 2019
Annexe C – Investment Charts at 30 September 2019
Annexe D – Maturity Analysis of Borrowing as at 30 September 2019
Annexe E – Glossary of Treasury Management terms

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