

Treasury Management Activity 2019/20: April to September 2019

The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management ("the Code"). The Code recommends that members are informed of treasury management activities. This report provides a brief update on treasury management activity between 1 April and 30 September 2019.

Economic context

The economic situation continues to be dominated by the uncertainty arising from the unknown impact of the UK's withdrawal from the European Union and the trade dispute between the worlds' two largest economies namely the USA and China. Despite this, the first quarter of 2019 showed relatively strong growth of 0.5% (1.8% year on year). However, it was considered that this was partly due to stockpiling ahead of the expected date for leaving the European Union and was followed by a contraction of 0.2% in the second quarter.

The uncertainty in the economy has influenced the forecast interest rates. The Bank of England has in recent times raised expectations of gradual increases in interest rates and this has been reflected in interest rate forecasts. Recent forecasts though have reduced this expectation. In their May forecast Arlinglose, the council's treasury advisers, were forecasting that the bank rate would see a 0.25% increase in March 2020 and September 2020. However, with the prevailing economic situation they have changed the forecast to reflect no change in the Bank Rate for the foreseeable future. However, there are risks to this forecast which could see rates moving in either direction.

Recent economic data has suggested that weaker economic growth has occurred, and is anticipated to continue, globally. One of the consequences of this together with the political uncertainty has been that Gilt yields have been volatile over the period and they have fallen to historically low levels. For example the 20 year Gilt yield fell from 1.35% to 0.88% from the end of June to the end of September.

Investment activity

Investments at 30 September 2019 totalled £595m and consisted of £18m in bank and local authority deposits and £577m in corporate and government bonds. The following table shows the investment activity between 1 April and 30 September 2019.

Bank and Local Authority Deposits	Call £m	Fixed £m	Other £m	Total £m
Balance 1 April 2019	46	61	-	107
Maturities	-47	-72	-	-119
New Investments	8	22	-	30
Balance 30 September 2019	7	11	-	18

Bonds	Local authority £m	Gilts £m	Others £m	Total £m
Balance 1 April 2019	33	84	199	316
Maturities and sales	-1	-2,125	-385	-2,511
New investments	0	2,265	507	2,772
Balance 30 September 2019	32	224	321	577

The period saw some significant volatility in the price of the Gilts held. This resulted in the opportunity being taken to sell some of the holdings to enhance the overall return on the investments and is reflected in the level of new investments during the period.

The current rate of return on the investment portfolio measured by Arlingclose is 1.37% which compares favourably with the benchmark 7 day money market rate that averaged 0.68% over the same period.

Borrowing activity

The council's capital programme includes a requirement to borrow to fund new capital investment. The table below summarises the borrowing activity which has taken place between 1 April and 30 September 2019.

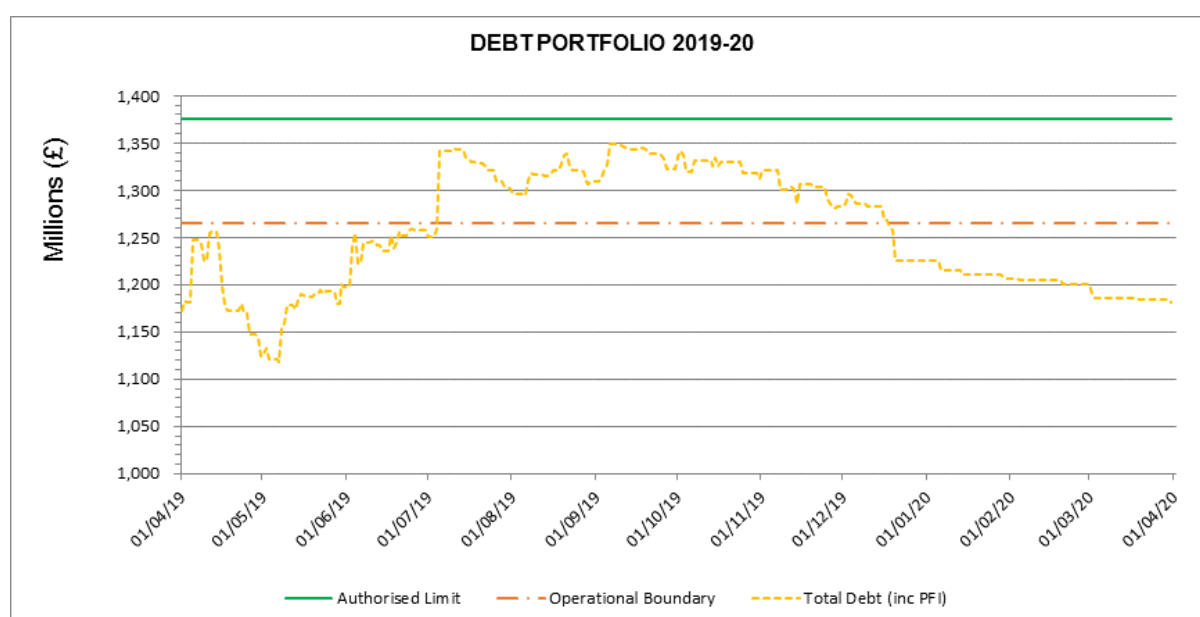
<u>Borrowing</u>	Public Works Loan Board Fixed	Public Works Loan Board Variable	Other Local authorities	Police, Fire & Lancashire District Councils	Total
	£m	£m	£m	£m	£m
1 April 2019	236	126	603	71	1,036
New Borrowing	70	0	520	301	891
Maturities	0	0	-472	-279	-751
30 September 2019	306	126	651	93	1,176
Public Finance Initiative (PFI) Liability	-	-	-	-	147
Total					1,323

Total borrowing at the end of September was £1,323m including the financing of £147m of assets through remaining Public Finance Initiative schemes. The outstanding borrowing has increased by £140m in the period.

With the low interest rates anticipated to continue, borrowing taken has principally been short term in nature, in line with the recent strategy. However, the Public Works Loan Board rates are linked to the Gilt yields. The period has seen Gilt yields, and therefore the Public Works Loan Board rates fall to historically low levels. Therefore, some £70m of fixed term loans were taken in the period to provide some certainty of future cost. The average interest rate of the loans taken during the year is 1.8%; which is lower than the 2.7% provision made in the Medium Term Financial Strategy for fixing

some debt on a long term basis. The strategy is to take up to £100m, for which budget provision has been made in the Medium Term Financial Strategy, based on the future maturities of long term debt and the desire to keep a balanced debt portfolio between long term fixed and short term borrowing to manage interest rate risk and provide a degree of budget certainty. There is no evidence of a short term liquidity problem and this was not a factor in the decision. Opportunities to take further fixed term loans will continue to be evaluated.

Borrowing is undertaken within the framework set by the Authorised and Operational Limits. The following graph shows the level of debt for the current financial year compared with the prudential indicator operational and authorised boundaries. It is expected that the debt may exceed the operational limit on occasions but it should not exceed the Authorised Limit. The debt shown from 30 September represents the debt position if no maturing debt was replaced rather than an estimate of the expected position.



Total debt during the year has remained below the authorised limit but has exceeded the operational limit. The operational limit has been exceeded partly due to the opportunity to take long term borrowing at low rates which needed to be taken before existing debt matured. There is a possibility that borrowing rates may fall further in the remainder of the year and the opportunity to secure advantageous rates may be lost due to the timing of existing debt maturing aligned to our authorised limit. Although it is not anticipated that this is a likely scenario, with the significant economic and political uncertainty that exists, it is recommended that an increase in the Authorised Limit for 2019/20 will enable the council to be in a position to take advantage of any unusual fall in rates. An increase from £1,375m to £1,600m is therefore requested and is reflective of the anticipated need to borrow in future years.

The current interest rate payable on debt measured by Arlingclose is 1.71%. The most recent benchmarking figure available of the average rate for all Arlingclose clients (as measured on 31 March 2019) is 3.65%.

Non-treasury investment strategy

A non-treasury investment strategy was approved by the Full Council in February 2019. This enabled the investment in bonds for commercial purposes where cash-flow permits. In accordance with this, a number of other local authority loans were purchased from a bank. The cost of these at 30 September was £82m. As the assets are considered to be a trading activity, any change in the market value of the assets as at 31 March 2020 will be charged or credited to the revenue account.

A major factor causing changes in the value of the investments will be interest rate movements. To mitigate the risk of adverse movements, agreements were made in the period to buy Gilts at a future date as the impact would negatively correlate (have the opposite effect) with the impact on the investments. It is anticipated that the net change in the market value will be broadly neutral although there may be some limited variation by the year-end.

In addition, some corporate bonds and Gilts are held in the trading book which will also be subject to the same market value charge or credit to revenue. No market value changes have been recognised to date. It should be noted that the market values change on a daily basis and the charge or credit to the accounts will be based on the market value on the 31 March 2020.

Budget monitoring position

It was reported to Cabinet in September that there is a forecast underspend against the treasury management budget of £7m. This is primarily as a result of extra income received through the continuing volatility in the price of Gilts and other bonds enabling sales to be made which have generated a surplus. This represented the outcome of activity during quarter 1 and the quarter 2 position is being updated and will be reported at a future Cabinet meeting with the final outturn likely to be significantly different, and improved, from this last reported forecast, due to recent and continued market volatility.

The position is kept under regular review and discussed with the Director of Finance on a monthly basis.

Prudential Indicators

The Treasury Management Strategy included some prudential indicators which provide a framework for the operation and risk management of the Treasury Management function. These are shown below for 2019/20 with the latest available actual position.

Authorised and Operational Limits for debt

The 'authorised limit' is a prudent estimate of external debt, but allows sufficient headroom for unusual cash flow movements. During the year the Director of Finance approved the re-allocation of the Authorised Limit between the borrowing and other long term liabilities to provide some additional flexibility to take long term borrowing. This approval is in accordance with the Prudential Code.

	Initial limit	Revised limit	Actual
	£m	£m	£m
Borrowing	1,200	1,225	1,176
Other long term liabilities	175	150	147
TOTAL	1,375	1,375	1,323

The 'operational limit' for external debt is based on the same estimates as the authorised limit. However, although it reflects a prudent estimate of debt, there is no provision for unusual cash flow movements. In effect, it represents the estimated maximum external debt arising as a consequence of the council's current plans. As required under the Code, this limit will be carefully monitored during the year. The proposed operational limits for external debt are:

	Limit	Actual
	£m	£m
Borrowing	1,110	1,176
Other long term liabilities	155	147
TOTAL	1,265	1,323

As explained in the report the timing of taking long term loans has resulted in the level of borrowing being above the operational limit. It is anticipated that by the end of the financial year the level will be within the operational limits unless a decision is taken to borrow in advance for future needs as permitted by the Prudential Code.

Gross debt and the capital financing requirement

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the authority's total debt should be lower than its highest forecast capital financing requirement over the next three years. The county council's overall borrowing is in excess of the capital financing requirements however, in making this comparison certain borrowing is included in the total but does not count against the capital financing requirement. These include the shared investment scheme, premiums paid and the transferred debt. Once these sums are removed, the level of borrowing is within the capital financing requirement conditions.

Interest rate exposure

In order to control interest rate risk the council measures its exposure to interest rate movements. These indicators place limits on the overall amount of risk the council is exposed to. The one year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.

	Upper Limit	Actual
Upper limit on one-year revenue impact of a 1% rise in interest rates	£30m	£24m

Maturity structure of debt

Limits on the maturity structure of debt help control refinancing risk.

	Upper Limit	Actual
Under 12 months	75%	42%
12 months and within 2 years	75%	27%
2 years and within 5 years	75%	4%
5 years and within 10 years	75%	5%
10 years and above	75%	21%

Investments over 1 year

Limit on the level of long-term investments helps to control liquidity, although the majority of these investments are currently held in securities which may be readily sold. The limit is largely determined by the forecast of reserves and balances held at the year-end.

	Upper limit	Actual
Total invested over 1 year	£475m	£447m
Operational/forecast limit at 31 March 2020	£375m	£447m

The indicator excludes investments undertaken as part of the trading portfolio as they are not part of the in- year liquidity requirements.

Minimum Average Credit Rating

To control credit risk the council requires a very high credit rating from its treasury counterparties.

	Benchmark	Actual
Average counterparty credit rating	A	AA