worcestershire
countycouncil

AGENDA ITEM 9

CABINET
20 DECEMBER 2019

TREASURY MANAGEMENT MID-YEAR UPDATE TO 30 SEPTEMBER 2019

Relevant Cabinet Member
Mr S E Geraghty

Relevant Officer
Chief Financial Officer

Recommendation

1. **The Cabinet Member with Responsibility for Finance (who is also the Leader of the Council) recommends that Cabinet:**

   (a) **notes this report, recognising that the Council is operating within its approved Treasury Management Strategy; and**

   (b) **endorses his conclusions that the Treasury Management activities continue to be cost effective.**

Introduction

2. This mid-year report to 30 September 2019 has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2019/20 financial year
- 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 compliance with Treasury and Prudential Limits for 2019/20.

Economic Update provided by Link Asset Services – The Council's Independent Treasury Advisors

3. The Council employs Link Asset Services as its treasury management advisor and officers hold regular meetings with them concerning existing and future potential economic circumstances regarding both investments and short/long-term borrowing. This supplements the Council's own in-house team of qualified finance staff.

4. There are a number of national circumstances that are causing a degree of economic uncertainty including the general election on 12 December 2019, and any interest rate forecasts are subject to material change as the situation evolves. If the UK is able to achieve a deal on Brexit then it is possible that growth could recover relatively quickly. The Bank of England's Monetary Policy Committee (MPC) could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than

currently and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy.

5. The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September re-emphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the MPC left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

6. As for inflation itself, 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 to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

Interest Rate Forecast

7. The Council's treasury advisor, Link Asset Services, has provided the following forecast in Table 1 below. This forecast includes the increase in margin over gilt yields of 100bps introduced on 9 October 2019.

Table 1: Interest Rate View – Link Asset Services

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

8. The above forecasts have been based on an assumption of an agreed deal on Brexit at some point in time. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

Council's Investment Portfolio as at 30 September 2019

9. 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 above, 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 relatively low compared to more usual market conditions.

10. Against this backdrop, the Council held £79 million of investments as at 30 September 2019 (£56.7 million at 31 March 2019) and the investment portfolio yield for the first 6 months of the year is 0.80% against a benchmark (7-day LIBID) of 0.57%. Gross income from treasury investments for the first 6 months of the financial year was £0.3 million, which is equal to the target for the whole financial year. (Details of Investments held as at the end of September can be found in Appendix 2).

Council's Borrowing Strategy as at 30 September 2019

11. The Council's borrowing activity for the first 6 months of the financial year can be summarised as follows. Loans in italics were taken early in October, before the Public Works Loan Board (PWLB) rate rise as detailed in Table 2 below:

a) New Loans Taken:

Table 1: New loans taken in 2019/20

Taken	£m	Rate (%)	Council's target rate (%)	Maturity date:
11 April	10.000	2.34	2.80	2 August 2059
4 October	10.000	1.71	2.80	2 August 2057
7 October	7.500	1.79	2.80	2 August 2042
7 October	7.500	1.67	2.80	2 August 2058

b) £15.6 million of debt matured between 1 April and 30 September 2019
c) There was £454.7 million of debt outstanding as at 30 September 2019 at an average rate of 3.54%.

12. On 9 October 2019 HM Treasury and the PWLB announced an increase in the margin over gilt yields of 100bps on top of the current margin of 80 bps, which this authority has paid prior to this date for new borrowing from the PWLB.

13. There was no prior warning that this would happen, and it now means that every local authority has to fundamentally reassess how to finance their external borrowing needs and the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing. The Council will review its capital financing plans as a consequence and bring any significant amendments to a future Cabinet meeting.

14. Representations are going to be made to HM Treasury to suggest that areas of capital expenditure that the Government are keen to see move forward e.g. infrastructure, should not be subject to such a large increase in borrowing.

15. The Council took its latest £25 million tranche of borrowing just before the rate rise (in italics above), had it not done so there would have been an extra £0.3 million recurring cost every year from this borrowing.

16. Whereas the Council has previously relied on the PWLB as its main source of funding, it will now need to consider alternative cheaper sources of borrowing. At the current time, this is a developmental area as this event has also taken the financial services industry by surprise. We are expecting that various financial institutions will enter the market or make products available to local authorities. Members will be updated as this area evolves. For comparison, borrowing rates for the 6 months preceding the rise are available as Appendix 4. Please note, the borrowing taken in early October is not included.

17. It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. This Authority may make use of this new source of borrowing as and when appropriate.

18. Further detail of Council Debt as at the 30 September 2019 can be found in Appendix 3.

Compliance with Treasury and Prudential Limits for 2019/20

19. Original and latest projections for external debt and the Capital Financing Requirement, against the Operational Boundary and Authorised Limit are shown in Table 3 below:

Table 2: Prudential Indicator Monitoring

	2019/20 Original Estimate £m	**Current Position £m**	**2019/20 Revised Estimate £m**
Prudential Indicator – Capital Financing Requirement			
CFR	635.2	612.0	612.0
Prudential Indicator – the Operational Boundary for external debt			
Borrowing	640.0	640.0	640.0
Other long term liabilities	10.0	10.0	10.0
Prudential Indicator – the Authorised Limit for external debt			
Borrowing	660.0	660.0	660.0
Other long term liabilities	13.0	13.0	13.0
Total debt (year end position)	477.7	479.7	474.1

20. The Council is well within the Limits for outstanding debt and is projected to remain so for 2019/20.

21. The Maturity Profile for the Council's debt compared with the prudential indicators for the Maturity Structure of Borrowing as at the 30 September 2019 is in Table 4 below:

Table 4: The Maturity Profile for the Council's debt

Maturing within	£m	% of Total Debt	% Lower/Upper Limit for Debt
1 year	42.254	9.3	0-25
1 – 2 years	23.855	5.3	0-25
2 – 5 years	34.244	7.5	0-50
5 – 10 years	50.429	11.1	0-75
10 years and over	303.893	66.8	25-100
Total	**454.675**	**100.0**	

22. The Council remains comfortably within its limits for the Maturity Structure of Borrowing and is anticipated to remain so for the foreseeable future.

23. The Chief Financial Officer and the Cabinet Member with Responsibility for Finance confirm that the management of debt and short-term investments continues to be cost effective.

Legal Implications

24. Legal advice will be provided to support any changes in service delivery in accordance with the requirements of the Council's policies and procedures.

Financial Implications

25. Members are required under Section 25 of the Local Government Act 2003 to have regard to the Chief Financial Officer's report when making decisions about the budget calculations for each financial year. This is undertaken through the approval of the annual budget in February each year.

26. Section 25 of the Act also covers budget monitoring and this process monitors the robustness of budgets, adequacy of reserves and the management of financial risk throughout the year. This Cabinet report highlights forecast variances arising from current financial performance and the possible impact of existing pressures on future expenditure so that appropriate action may be taken.

27. In discharging governance and monitoring roles, Members are asked to consider the issues arising and the potential impact on the budget as well as the financial risks arising.

28. The Council's procedures for budget monitoring is reinforced through close financial support to managers and services on an ongoing basis to ensure processes and controls are in place to enable tight financial control.

HR Implications

29. There are no HR considerations as Council's treasury management budgets are operational financial budgets and do not include any staffing costs. Further, there are no proposals to alter any staffing arrangements employed in the management of these services.

Equality Duty Considerations

30. The Council will continue to have due regard to proactively addressing the three elements of the Public Sector Equality Duty in all relevant areas – in particular the planning and delivery of our services. The Council will continue to assess the equality impact of all relevant transformational change programmes and will ensure that Full Council has sufficient equalities assessment information to enable it to have due regard to the three elements of the Equality Duty when considering any changes to the budget. The Council will continue to ensure best practice is followed with regard to these requirements.

Risk Implications

31. The Cabinet report includes recommendations regarding endorsing the Council's activity to date for 2019/20 which specifically relates to managing interest rate risk and any risk of default in repayment of investments.

Privacy and Public Health Impact Assessment

32. This report is about confirming the treasury management activity at this stage of the year reflecting the cash implications of existing Cabinet decisions and policies.

33. Taking this into account, it has been concluded that there are no specific health impacts as a result of new decisions arising from this Cabinet report.

34. A similar assessment has been undertaken with regard to privacy/data protection and has confirmed that there is no impact anticipated as a result of this report.

Supporting Information (available electronically)

- **Appendix 1 –** Treasury and Prudential Indicators as at 30 September 2019
- **Appendix 2** – Investment Portfolio as at 30 September 2019
- **Appendix 3** – Borrowing Portfolio as at 30 September 2019
- **Appendix 4** – Borrowing rates 1 April to 30 September 2019

Contact Points

County Council Contact Points

County Council: 01905 763763

Worcestershire Hub: 01905 765765

Specific Contact Points for this Report

Michael Hudson, Chief Financial Officer, 01905 84**5560**, mhudson@worcestershire.gov.uk

Stephanie Simcox, Head of Finance, 01905 84**6342** ssimcox@worcestershire.gov.uk

Mark Sanders, Chief Accountant, 01905 84**6519**, mssanders@worcestershire.gov.uk

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

Previous Cabinet Resources Reports