

BARNSELY METROPOLITAN BOROUGH COUNCIL

This matter is not a Key Decision within the Council's definition and has not been included in the relevant Forward Plan

Report of the Executive Director, Core Services
and Service Director, Finance (S151 Officer)

TREASURY MANAGEMENT UPDATE - QUARTER ENDED JUNE 2019

1. Purpose of Report

- 1.1 This document reviews the treasury management activities carried out by the Council during the quarter ended June 2019, in accordance with statutory guidance.
- 1.2 In broad terms it covers the following:
- The overarching strategy for 2019/20;
 - An economic summary for the quarter;
 - An update on the Council's borrowing and investment activities;
 - The Council's Prudential and Treasury Indicators.

2. Recommendations

- 2.1 It is recommended that Members note:
- **The latest expectations for interest rates (as outlined in section 4);**
 - **The activities undertaken during the quarter to support the Council's borrowing and investment strategies (as outlined in sections 5-6), and**
 - **The Prudential and Treasury Indicators set out in Appendix 1.**

3. The Agreed Strategy for 2019/20

- 3.1 The Treasury Management Strategy identifies the key risks associated with the Council's borrowing and investment activities and sets out how those risks will be managed.
- 3.2 The Council's borrowing strategy is about actively reducing its exposure to interest rate risk, whilst maintaining a small under-borrowed position in order to keep its financing costs to a minimum.
- 3.3 The Council's investment strategy is about minimising credit risk and maintaining sufficient liquid funds in order to meet its ongoing spending commitments. As such the pursuit of higher investment returns is a secondary objective.

4. Economic Summary

Highlights:

- **Continued economic uncertainty resulted in a downward trend in borrowing rates during the quarter;**
- **Rates are still expected to rise over the medium term; however the rate of increase anticipated is now much slower.**

4.1 Interest rates are a key driver of the Council's treasury management activities and as such are monitored by officers on a regular basis. This section covers both the recent movements in, and future outlook for interest rates, to provide context for the activities undertaken to date and planned for the near future.

4.2 Due to the continued economic uncertainty, the UK base rate remained unchanged during the quarter at 0.75%. In the event of an orderly EU exit this rate is expected to increase (as early as September 2020), although the prospect of a no-deal exit appears to have increased as a result of the change in Prime Minister.

4.3 As illustrated in the chart below, there was a downward trend in PWLB* borrowing rates during the quarter, which reflects the general uncertainty that currently exists:



4.4 That said, rates are still expected to rise over the medium term (see table below from the Council's advisors), however the rate of increase anticipated is now much slower:

	Latest Interest Rate Projections (Link Asset Services)							
	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Base rate	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.25%
5 year PWLB	1.41%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%
10 year PWLB	1.68%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
25 year PWLB	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%
50 year PWLB	2.16%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%

* The Public Works Loan Board (PWLB) is an Executive Agency of HM Treasury whose primary function is to lend money to local authorities.

5. Borrowing Activity

Highlights:

- **No long term borrowing was carried out during the quarter, particularly in light of the recent change in interest rate environment;**
- **The Council is on track to achieve its exposure targets in 2019/20, therefore no borrowing is planned for the immediate future;**
- **However, based on current projections, the Council may be need to borrow up to £215M by the end of 2021/22 (£68M of which may arise in 2019/20);**
- **Officers will monitor this position closely throughout the year in the context of the prevailing interest rate environment, and explore any opportunities to fix out this borrowing requirement.**

5.1 As outlined previously (see paragraph 3.2), the Council's borrowing strategy is to actively reduce its exposure to interest rate risk, whilst maintaining a small under-borrowed* position to keep its financing costs to a minimum.

5.2 No long term borrowing was undertaken during the quarter (appendix 2 refers), particularly in light of the recent change in interest rate environment (see section 4). In addition, the Council is on track to achieve its exposure targets for 2019/20 (paragraphs 5.5-5.6 refer), and is currently managing a substantial amount of temporary cash (section 6 refers). As such, no long term borrowing is planned for the immediate future.

5.3 However, based on current projections, the Council may need to borrow up to £215M by the end of 2021/22, with the majority of this requirement arising next year:



* The term under-borrowed refers to the temporary use of internal cash resources (e.g. earmarked reserves or grants received in advance of expenditure) to support its borrowing requirement, which enables the Council to defer an element of long term borrowing until its spending commitments occur (thereby reducing credit risk and any cost of carry).

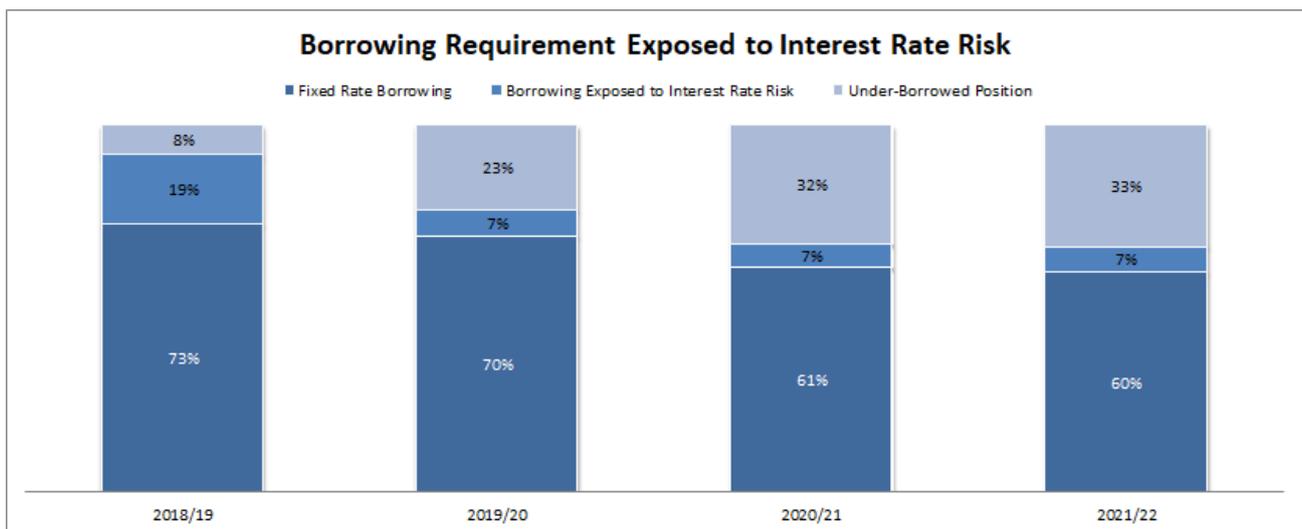
5.4 As outlined below and in paragraph 5.3, the Council’s borrowing requirement is significantly influenced by its planned capital investment, maturing loans and use of reserves throughout the period. Whilst the timing of maturing loans is known the rest is subject to change, and as such will be monitored closely throughout the year in the context of the prevailing interest rate environment:

Projected external borrowing requirement through to 2021/22	£M
Planned capital investment	148.777
Maturing loans / support from useable reserves	118.615
Amounts set aside to repay debt	(12.189)
Loans secured but not yet drawn down	(40.000)
Total	215.203

5.5 As a minimum, the Council has committed to reducing its exposure to interest rate risk over the period to within 30% of its borrowing requirement, which includes any external borrowing which is subject to interest rate risk (based on the Council’s temporary, variable rate and LOBO loans), and the Council’s under-borrowed position - which at some point will need financing through external borrowing.

5.6 As shown in the chart at paragraph 5.3, the Council may have a borrowing requirement of some £68M in 2019/20; however it will stay within its target of 30% irrespective of how this is financed, owing to the £148M fixed out last year. In light of the current interest rate environment, officers would if required look to draw down on the Council’s investments in the first instance (in order to meet this borrowing requirement), but may look to change this approach should the expectations around future interest rate rises change.

5.7 To deliver against its strategy and targets throughout the period, it is anticipated that the Council will need to fix out up to £82M (of the £215M identified in paragraphs 5.3-5.4), with the majority of this requirement arising next year:



5.8 The options set out in the Council's borrowing strategy are as follows:

- **Further deferred loans** - these allow the Council to borrow at a fixed rate - typically 0.15-0.20% above PWLB - and draw down the cash up to 4 years in advance, thus protecting the Council from any sudden interest rate rises whilst reducing cost of carry and counterparty risk. The Council has secured £40M to date and will continue to work with its advisors in order to identify any other potential lenders.
- **Loans from other local authorities** - the Council could look to replace some maturing debt with longer-term loans from other local authorities, which would help to spread refinancing risk whilst reducing the cost of carry (the interest rates on these loans are typically much lower than the longer term PWLB loans).
- **Fixed-rate borrowing from the PWLB** - the Council borrowed £148M from the PWLB during 2018/19 at an average rate of 2.57%; whilst rates are still relatively low this continues to be a suitable option for the Council to consider.
- **Refinancing of existing debt** - Officers have recently taken an opportunity to refinance one of its LOBOs which reduced the Council's exposure to interest rate risk whilst resulting in a small annual saving on its capital financing costs. It has also refinanced its Building Schools for the Future PFI programme in conjunction with the Local Education Partnership, creating additional savings for the Council and key partners which have been factored into the Council's MTFS.

6. Investment Activity

Highlights:

- ***Security and liquidity remained the key investment priorities, with the majority of new investments placed in secure Money Market Funds and instant access accounts (appendix 2 refers);***
- ***Officers continued to take advantage of the competitive rates offered on short term local authority deposits.***

6.1 The Council's investment strategy is to ensure its cash balances are invested prudently and are available when needed to meet its spending commitments. In November 2018 the Council approved several changes to its counterparty limits to ensure that it could safely accommodate its increased cash balances going forwards - these limits have been incorporated into the 2019/20 strategy.

6.2 The key investment issues for the Council to manage in future are as follows:

1. **Money Market Fund (MMF) Reforms** - the Council's Money Market Funds converted to a new structure in early 2019, known as LVNAV funds. In order to maintain their status as LVNAV funds there are a number of requirements that must be satisfied. Whilst there are no issues foreseen at present (these funds typically operate well within the parameters set), officers will monitor the funds closely over the coming months to identify any potential risks going forwards.
2. **IFRS9 Financial Instruments** - this was a new accounting standard for 2018/19 which changed the way that certain investments were categorised and valued. It also required the Council to recognise any potential losses on investment through its General Fund. This resulted in a reduction in fair value of equity investments of £0.3M (no impact on the general fund) and a loss allowance of £0.5M. Officers will monitor this position on a regular basis to identify any further potential risks to the General Fund budget.
3. **Local Authority Creditworthiness** - a number of local authorities have been in the spotlight which has raised the question as to whether they are a safe investment. Whilst there are no issues foreseen as present (there are regulations in place to avoid local authorities going bankrupt), officers recognise the reputational risk associated with such investments.

6.3 To reflect the agreed strategy and challenges set out above, the majority of new investments are placed in secure Money Market Funds and instant access accounts (see appendix 2 for further details). In order to safely accommodate its increased cash balances, the Council has also placed a significant level of short terms deposits with reputable banks and other local authorities, which also helps to boost investment returns whilst the cash is needed to meet its spending commitments.

7. Performance Measurement / Compliance with Prudential and Treasury Limits

- 7.1 The Council's capital financing budget is projected to underspend by around £1M in year, as a result of deferring further long term borrowing. As referred to in section 5, the Council fixed out a significant proportion of its borrowing requirement in 2018/19, and is on track to meet its exposure targets in 2019/20. As such the plan is to defer further long term borrowing until the Council's reserves are depleted or interest rates are expected to rise quickly.
- 7.2 The Council has operated within the prudential and treasury indicators set out in the agreed strategy and in compliance with the Council's Treasury Management Practices (see Appendix 1 for more details).

8. Consultations

- 8.1 This report has been prepared using information supplied by Link Asset Services and approved by the Treasury Management Panel.

9. Financial Implications

- 9.1 The financial implications arising from the Council's treasury management activities (section 7 refers) are reported to Cabinet quarterly as part of the Council's Corporate Financial Performance Report.

10. Employee Implications

- 10.1 None arising from this report.

11. Regulatory Framework & Risk Assessment

- 11.1 The Council has adopted the statutory guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Ministry of Housing, Communities and Local Government (MHCLG), which seeks to ensure that its capital expenditure and borrowing are prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.
- 11.2 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of its Treasury Management advisers, has proactively managed the debt and investments over the year.
- 11.3 Treasury Management is subject to annual inspection from the Council's Internal Audit function, and Treasury Management risks are identified and monitored as part of the Council's overall approach to managing risk. The current assessment of Treasury Management systems is 'substantial', with no outstanding recommendations.

12. Background Papers

- 12.1 Various Financial Services working papers

APPENDIX 1 - PRUDENTIAL AND TREASURY INDICATORS

Prudential Indicators	Limit for 2019/20 (£M)	Quarter 1 Actual (£M)	Compliance with Indicator?
Average Debt to Operational Boundary	1,000.971	875.512	Yes
Maximum Debt to Authorised Limit	1,030.971	882.621	Yes

Maturity structure of GF borrowing	Lower Limit (%)	Upper Limit (%)	Quarter 1 Actual (£M)	Quarter 1 Actual (%)	Compliance with Indicator?
Under 12 months	0	50	45.965	11	Yes
12 months to 2 years	0	25	20.000	5	Yes
2 years to 5 years	0	25	36.194	9	Yes
5 years to 10 years	0	25	12.838	3	Yes
10 years to 20 years	0	75	8.391	2	Yes
20 years to 30 years	0	75	24.070	6	Yes
30 years to 40 years	0	75	82.466	21	Yes
40 years to 50 years	0	75	171.714	43	Yes

Maturity structure of HRA borrowing	Lower Limit (%)	Upper Limit (%)	Quarter 1 Actual (£M)	Quarter 1 Actual (%)	Compliance with Indicator?
Under 12 months	0	25	47.939	18	Yes
12 months to 2 years	0	25	0	0	Yes
2 years to 5 years	0	25	18.654	7	Yes
5 years to 10 years	0	25	16.962	6	Yes
10 years to 20 years	0	75	8.571	3	Yes
20 years to 30 years	0	75	31.712	12	Yes
30 years to 40 years	0	75	109.934	42	Yes
40 years to 50 years	0	75	31.816	12	Yes

Treasury Indicators	Limit for 2019/20 (%)	Quarter 1 Actual (%)	Compliance with Indicator?
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GF

Upper limit of fixed interest rates based on gross debt	100	91	Yes
Upper limit of variable interest rates based on gross debt	15	9	Yes

HRA

Upper limit of fixed interest rates based on gross debt	100	83	Yes
Upper limit of variable interest rates based on gross debt	20	17	Yes

	Limit for 2018/19 (£M)	Quarter 2 Actual (£M)	Compliance with Indicator?
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Upper limit for principal sums invested over 365 days	20.000	-	Yes
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APPENDIX 2 - MOVEMENT ON EXTERNAL BORROWING / INVESTMENTS

Movement on External Borrowing

As shown below, officers took out £10M of temporary loans during the quarter in order to manage the Council's day to day cash position, and made principal repayments totalling £3M:

	Balance on 01/04/2019 (£M)	New Borrowing (£M)	Principal Repaid (£M)	Balance on 30/06/2019 (£M)	Net Movement (£M)
PWLB borrowing	573.713	-	(0.949)	572.764	(0.949)
Other long term loans	55.000	-	-	55.000	-
Temporary loans	2.004	10.000	(2.000)	10.004	8.000
Long term local authority loans	29.458	-	-	29.458	-
Total external borrowing	660.175	10.000	(2.949)	667.226	7.051

Movement on Investments

As shown below, the majority of new investments were placed in secure Money Market Funds and instant access accounts (£114M), however officers continued to take advantage of the competitive rates offered on short term local authority deposits, placing new investments of (£65M):

	Balance on 01/04/2019 (£M)	New Investments (£M)	Redeemed Investments (£M)	Balance on 30/06/2019 (£M)	Net Movement (£M)
Short term deposits	156.500	65.000	(67.500)	154.000	(2.500)
Money Market Funds / instant access accounts	38.080	113.550	(129.930)	21.700	(16.380)
Total investments	194.580	178.550	(197.430)	175.700	(18.880)

Further details regarding the Council's borrowing and investment portfolios are available on request.