Report to Cabinet

Treasury Management Mid-Year Review Report 2019

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18 November 2019

Reason for Decision

The report advises Cabinet of the performance of the Treasury Management function of the Council for the first half of 2019/20, and provides a comparison of performance against the 2019/20 Treasury Management Strategy and Prudential Indicators.

Executive Summary

The Council is required to consider the performance of the Treasury Management function in order to comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). This report therefore sets out the key Treasury Management issues for Members' information and review and outlines:

- An economic update for the first six months of 2019/20;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators);
- A review of the Council's investment portfolio for 2019/20;
- A review of the Council's borrowing strategy for 2019/20;
- Why there has been no debt rescheduling undertaken during 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

Recommendations

That Cabinet approves and commends to Council the:

a) Treasury Management activity for the first half of the financial year 2019/20 and the projected outturn position

b) Amendments to both Authorised Limit and Operational Boundary for external debt as set out in the table at Section 2.4.5 of the report.

c) Amendments to the Capital Financing Requirement (CFR) as set out in the table at section 2.4.5

d) Addition to the Treasury Management Strategy 2019/20 with regards to specified investments as presented at Appendix 3.

Treasury Management Strategy Mid-Year Review Report 2019/20

1 Background

1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations is to ensure this cash flow is adequately planned, with surplus monies being invested with low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 As a consequence treasury management is defined as:

"The management of the local authority's 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. "

1.4 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. Within these new codes as from 2019/20, all local authorities have been required to prepare a Capital Strategy which is to provide the following:

a) a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;

b) an overview of how the associated risk is managed;

c) the implications for future financial sustainability.

The Council has traditionally prepared a Capital Strategy, but the requirements of the Prudential and Treasury Management Codes required a revised format and content to ensure alignment with both Codes. A report incorporating the new requirements was presented to the 2019/20 Budget Cabinet and Budget Council meetings.

2 Current Position

2.1 Requirements of the Treasury Management Code of Practice

2.1.1 Treasury Management reports must be prepared in accordance with the requirements of the CIPFA Code of Practice on Treasury Management (revised 2017).

2.1.2 The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

c) Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** (this report**)** and an Annual Report (stewardship report) covering activities during the previous year.

d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. In Oldham, this responsibility is delegated to the Director of Finance.

e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. In Oldham, the delegated body is the Audit Committee.

2.1.3 This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2019/20;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy and prudential indicators;
- A review of the Council's investment portfolio for 2019/20;
- A review of the Council's borrowing strategy for 2019/20;
- Why there has been no debt rescheduling undertaken during 2019/20;
- A review of the compliance with Treasury and Prudential Limits for 2019/20;

2.2 Economic Performance for the First Six Months of the Financial Year

<u>The United Kingdom (UK)</u>

2.2.1 This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October, with or without a deal. However, MP's blocked leaving on that date and the EU have agreed an extension to 31 January 2020. In addition, a General Election has been called for 12 December 2019.

2.2.2 Given these circumstances and the uncertainty about the outcome of the forthcoming General Election and the timing of Brexit, any interest rate forecasts are subject to material change as the situation evolves. If Parliament fully approves the Withdrawal Bill, then it is possible that growth could recover relatively quickly.

2.2.3 The Monetary Policy Committee (MPC) could then need to address the issue of whether to raise Bank Rate when there is very 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.

2.2.4 However, with Bank Rate 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.

2.2.5 The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took its 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.

2.2.6 The MPC meeting of 19 September re-emphasised concern about the downturn in world growth and expressed concern that the 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.

2.2.7 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.

2.2.8 It is however worth noting that the new Prime Minister has made 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.

2.2.9 As for inflation itself, CPI 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.

2.2.10 With regard to the labour market, despite the contraction in quarterly GDP growth of -0.2% quarter/quarter (q/q), (+1.3% year/year (y/y)), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that businesses are preparing to expand output and suggests there could be a return to positive growth in quarter 3.

2.2.11 Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, employers will still be having difficulty filling job vacancies with suitable staff.

2.2.12 It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%.

2.2.13 As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

2.2.14 The latest Gross Domestic Products (GDP) statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward.

2.2.15 This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

2.2.16 In the political arena, depending on the outcome of the general election on 12 December 2019, it could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

United States of America (USA)

2.2.17 President Trump’s massive easing of fiscal policy in 2018 fueled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2, and is expected to fall further in Quarter 3.

2.2.18 The strong growth in employment numbers during 2018 has reversed into a falling trend during 2019, indicating that the economy is cooling, while inflationary pressures are also weakening The Fed finished its series of increases in interest rates to 2.25 – 2.50% in December 2018.

2.2.19 In July 2019, it cut rates by 0.25% as a ‘midterm adjustment’ but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates again in September to 1.75% - 2.00% and is thought likely to cut another 25 basis points (Bps) in December.

2.2.20 Investor confidence has been badly shaken by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth.

2.2.21 In the European Union it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

European Union (EU)

2.2.22 Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1 and then fell to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 4% year/year in June with car production down 10% year/year.

2.2.23 Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

2.2.24 The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in Eurozone (EZ) growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth.

2.2.25 At its March 2019 meeting it said that it expected to leave interest rates at their present levels “at least through the end of 2019”, but that was of little help to boosting growth in the near term. Consequently, it announced a third round of Targeted Longer Term Refinancing Operations (TLTROs); this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank’s eligible loans.

2.2.26 However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a resumption of quantitative easing purchases of debt. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and unsurprisingly, the ECB stated that governments will need to help stimulate growth by fiscal policy.

2.2.27 On the political front, Austria, Spain and Italy are in the throes of forming coalition governments with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

China and Japan

2.2.28 Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing.

2.2.29 Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

2.2.30 Progress also still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production.

2.2.31 The trade war with the US does not appear currently to have had a significant effect on GDP growth as some of the impact of tariffs has been offset by falls in the exchange rate and by transshipping exports through other countries, rather than directly to the US.

2.2.32 Japan has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

World Growth

2.2.33 The trade war between the US and China is a major concern to financial markets and is depressing worldwide growth, as any downturn in China will spill over into impacting countries supplying raw materials to China.

2.2.34 Concerns are focused on the synchronised general weakening of growth in the major economies of the world compounded by fears that there could even be a recession looming up in the US, though this is probably overblown.

2.2.35 These concerns have resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited responses available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks.

2.2.36 The latest Purchasing Managers' Index survey statistics of economic health for the US, UK, EU and China have all been sub 50 which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during the rest of this financial year is weak.

2.3 **Interest Rate Forecast**

2.3.1 The Council's treasury advisor, Link Asset Services, has provided the following forecast of interest rates over the period from September 2019 to March 2022. This forecast includes the increase in margin over gilt yields of 100bps introduced on 9 October 2019.

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

2.3.2 The above forecasts have been based on an assumption that there is some sort of muddle through to 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.

2.3.3 It has been little surprise that the MPC has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That's shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth".

2.3.4 Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

<u>Bond Yields / PWLB Rates</u>

2.3.5 There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields.

2.3.6 While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc.

2.3.7 This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

2.3.8 What we saw during the last half year up to 30 September, is a near halving of longer term PWLB rates to completely unprecedented historic low levels. (See paragraph 2.7.6-2.7.8 for comments on the increase in margin over gilt yields of 100bps introduced on 9 October 2019.) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but due to a correlation between US treasuries and UK gilts, which at various times has been strong but at other times weaker, in the UK. However, forecasting the timing of this and how strong the correlation is likely to be, is very difficult with any degree of confidence.

2.3.9 One potential issue for investors is that Japan continues to fail to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government.

2.3.10 Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt fueled boom which now makes it harder for economies to raise interest rates.

2.3.11 Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government’s bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.).

2.3.12 In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

<u>The Balance of Risks to the UK</u>

2.3.13 The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.

2.3.14 The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

2.3.15 One risk that is both an upside and downside risk is that all central banks are now working in very different economic conditions than before the 2008 financial crash. There has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for eleven years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could, therefore, over or under-do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and Public Works Loan Board (PWLB) rates

2.3.16 There are a number of downside risks to current forecasts for UK gilt yields and PWLB rates as follows:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks,** for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

2.3.17 Upside risks to current forecasts of UK gilt yields and PWLB rates include:

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

2.4 Treasury Management Strategy Statement and Annual Investment Strategy Update

2.4.1 The Treasury Management Strategy Statement (TMSS) for 2019/20 was approved at the Council meeting on 27 February 2019. The underlying TMSS approved previously now requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out in the next sections of this report.

2.4.2 An decrease is required to both the overall Authorised Limit (the "affordable borrowing limit" required by Section 3 of the Local Government Act 2003 above which the Council does not have the power to borrow) and Operational Boundary (the expected borrowing position of the Council during the year) for external debt. This indicator is made up of external borrowing and other long-term liabilities, Private Finance Initiatives (PFI) and Finance Leases. The revision to the limits aligns to the reduction in the Capital Financing Requirement as outlined at paragraph 2.4.4 and 2.4.5 below.

2.4.3 The Council has the following PFI and Public Private Partnership (PPP) Schemes each contributing to the Other Long Term Liabilities element of the Authorised Limit and the Operational Boundary:

- Gallery Oldham and Library
- Sheltered Housing (PFI2)
- Radclyffe and Failsworth Secondary Schools
- Chadderton Health & Well Being Centre
- Street Lighting
- Housing (PFI4)
- Blessed John Henry Newman RC College (Building Schools for the Future)

2.4.4 It will be necessary to reduce the Capital Financing Requirement (CFR) by £7.347m. Whilst approved capital expenditure/ funding carry forwards from 2018/19 caused an initial increase, this is more than offset by estimated re-phasing and re-alignment and other anticipated adjustments in the 2019/20 capital programme resulting in the reduced CFR.

2.4.5 Members are therefore requested to approve the key changes to the 2019/20 prudential indicators as set out in the table below which show the original and recommended revised figures:

Prudential Indicator 2019/20	Original £'000	Recommended Revised Prudential Indicator £'000
Authorised Limit	545,000	538,500
Operational Boundary	525,000	518,500
Capital Financing Requirement	525,005	517,658

2.5 The Council's Capital Position (Prudential Indicators)

2.5.1 This section of the report presents the Council's capital expenditure plans and their financing, the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow together with compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

2.5.2 The table below shows the half year position and the revised budget for capital expenditure (as per table 2 of the month 6 Capital Investment Programme monitoring report). It therefore highlights the changes that have taken place and are forecast since the capital programme was agreed at the Council meeting on 27 February 2019.

Capital Expenditure by Service	2019/20 Original Estimate £'000	2019/20 Revised Estimate £'000
Corporate & Commercial Services	9,212	0
Corporate Services	0	3,336
Children's Services	0	18,886
Health & Adult Social Care Community Services	2,682	0
Community Services & Adult Social Care	0	2,024
Reform	100	39
People & Place	54,403	34,413
Capital General	5,000	0
HRA	4,235	1,854
Commercial Activities / Non Financial Investments	8,700	4,500
Closing balance	84,332	65,052

2.5.3 The above table shows a decrease in the capital programme of £19.280m to the month 6 budgeted position with current forecast spend of £65.052m. During the summer months the Council undertook the Annual Review of the Capital Programme in line with practice of recent years. The review identified a requirement for significant re-profiling across a number of schemes. The majority of the re- phasing moved significant expenditure (£12.655m) from 2019/20 into the later years of the capital programme. The budget variations largely relate to a revision to the Oldham Coliseum and Heritage Centre, Transport Schemes, and the re-phasing of the Schools Capital Programme, mainly due to planning related issues.

Changes to the Financing of the Capital Programme

2.5.4 The table below draws together the main strategy elements of the capital expenditure plans (above) highlighting the original supported (£57.619m) and unsupported elements i.e. requiring borrowing (£26.713m), and the expected financing (revised position) arrangements of this capital expenditure. The borrowing need element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

2.5.5 The overall net reduction in the capital programme has resulted in a change in the mix of funding sources required in 2019/20; a decrease in all financing types reducing the forecast borrowing need by £7.275m from £26.713m to £19.438m.

Capital Expenditure	2019/20 Original Estimate £'000	2019/20 Forecast Position £'000
General Fund Services	71,397	58,698
Housing Revenue Account	4,235	1,854
Commercial Activities and Non-Financial Investments	8,700	4,500
Total spend	**84,332**	**65,052**
Financed by:		
Capital receipts	(19,042)	(13,889)
Capital grants	(34,661)	(29,866)
Revenue	(67)	(5)
HRA	(3,849)	(1,854)
Total financing	(57,619)	(45,614)
Borrowing need	**26,713**	**19,438**

<u>Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt andthe Operational Boundary</u>

2.5.6 The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. As previously mentioned in paragraph 2.4.4 the CFR needs to decrease by £7.347m. It also shows the expected debt position over the period (the Operational Boundary). This indicator has decrease to reflect the revisions to the forecast year end position of the capital programme.

	2019/20 Original Estimate £'000	2019/20 Revised Estimate £'000
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	525,005	517,658
CFR – housing	0	0
Total CFR	**525,005**	**517,658**
Net movement in CFR		**(7,347)**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	290,000	282,500
Other long term liabilities	235,000	236,000
Total debt 31 March	**525,000**	**518,500**

Limits to Borrowing Activity

2.5.7 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose.

2.5.8 Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

2.5.9 The CFR calculation is shown in the table below and the Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator as there is £113.410m headroom between total debt and the CFR.

	2019/20 Original Estimate £'000	2019/20 Revised Estimate £'000
Gross borrowing	167,849	168,635
Plus other long term liabilities*	235,396	235,613
Total Debt	**403,245**	**404,248**
CFR* (year end position)	525,005	517,658
Headroom	**121,760**	**113,410**

*- includes on balance sheet PFI schemes and finance leases

2.5.10 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. Presented in the table below is the original and the revised Authorised Limit.

Authorised limit for external debt	2019/20 Original Indicator	2019/20 Revised Indicator
rrowing	305,000	297,500
Other long term liabilities*	240,000	241,000
Total	**545,000**	**538,500**

* - Includes on balance sheet PFI schemes and finance leases.

2.6 Investment Portfolio 2019/20

2.6.1 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 set out in Section 2.3, 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 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 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 low.

2.6.2 The Council held £114.330m of investments, including property funds as at 30 September 2019 (£84.900m at 31 March 2019). A full list of investments as at 30 September is included at Appendix 1. A summary of investments by type is included in the table below.

2.6.3 The Council ensures enough funds are kept in either instant access accounts and/ or on-call accounts to meet its short term liquidity requirements. As at 30 September the Council held £31.330m in Money Market Funds and £32.500m in Notice Accounts that range from 32 to 180day notice period.

Investment Type	Total £'000 at 30 September 2019
Property	15,000
Fixed (Term Deposits) Bank / Building Society	10,500
Fixed (Term Deposits) LA's / Public Bodies	25,000
Notice Accounts	32,500
Money Market Funds	31,330
Total	**114,330**

2.6.4 The Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2019/20.

2.6.5 The Council's investment strategy looks to achieve a return on its investment of London Interbank Bid Rate (LIBID) plus a 5% mark up. The Council will maintain sufficient cash reserves to give it its necessary liquidity and may place investments up to 10 years if the cash flow forecast allows and the credit rating criteria is met. Performance against this benchmark was as follows:

Benchmark	Benchmark Return LIBID +5%	Council Performance
7 days	0.60%	0.76%
1 month	0.63%	0.87%
3 months	0.69%	0.99%
6 months	0.77%	0.87%
1 year	0.87%	1.07%
Average Return first 6 months		**0.91%**

2.6.6 The Council's performance on its cash investments exceeded its target on all benchmarks as can be seen in the table above.

2.6.7 It is important to be able to maximise investment income to support the overall financial position of the Council. During the year the Council has been continually looking at alternative investment opportunities within treasury management to provide additional income. At this moment in time no deal has passed the due diligence process, but opportunities will continue to be assessed. It is important to note that any investments are only undertaken after an appropriate due diligence exercise and having regard to the Treasury Management principles of security, liquidity, yield and ethical investments.

2.6.8 It is essential to have flexibility to be able to take advantage of opportunities for new investments that may become available. Therefore, a revision to the non-specified investment category within the Treasury Management Strategy is proposed and as set out at Appendix 3. The addition is investments in debt financing to deliver economic growth across the borough and with the Greater Manchester area. This addition allows the Council to investigate and possibly invest in alternative investments. Member must note that these investments will only be initiated after a detailed and substantial due diligence process.

2.6.9 The current investment counterparty criteria selection approved in the TMSS and included at Appendix 3 is meeting the requirement of the treasury management function.

2.6.10 Treasury Management Practice 11 – Use of External Service Providers, has been updated to include a new independent broker, Imperial Treasury Services. This new broker will allow the Council to use a wider range of providers for the day to day management of the Treasury function.

Property Fund

2.6.11 In the first six months of the year the Councils investment within the Churches, Charities and Local Authorities (CCLA) property fund has generated a return of (4.24%) and it is anticipated that this revenue return will continue throughout the year. As advised within the TMSS, due to the anticipated fluctuations in price this is an investment with a minimum time horizon of 5 years.

2.6.12 Due to the uncertainty surrounding Brexit, the property fund has seen a decline in the value due mainly to valuer caution rather than any significant increase in pressure to sell properties. In contrast, occupier trends continued to strengthen, and dividends received stay at a similar rate.

2.7 Borrowing

2.7.1 It is proposed in this report that the Council's CFR for 2019/20 is revised to £517.658m and this denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

2.7.2 The table within paragraph 2.5.8 shows the Council has expected year end borrowings of £404.248m and will have utilised £113.410m of cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

2.7.3 Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR), new external borrowing of £20m was undertaken from the PWLB in August 2019. The table below shows the new borrowing and highlights that borrowing was undertaken at the bottom range of interest rate.

Loan Ref	Amount £'000	Start Date	Maturity Date	Term (Years)	Rate %
509754	10,000	20/08/19	20/08/69	50	1.72%
509755	5,000	20/08/19	20/08/49	30	1.81%
509756	5,000	20/08/19	20/08/39	20	1.74%
Average				**33.33**	**1.75%**

2.7.4 The Council applied in September 2019 for the certainty rate reduction. This entitles the Council to receive a 20 basis point rate reduction on the prevailing rate of PWLB on any borrowing undertaken from 1 November 2019 to 31 October 2020.

2.7.5 Current PWLB certainty rates are set out in the following table and show for a selection of maturity periods over the first half of 2019/20, the range (high and low points) in rates and the average rates over the period. In addition, Appendix 2 tracks the movement in the PWLB certainty rate over the period April to September 2019 across the same range of loan terms as is used in the table below.

Maturity Rates	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/19	1.66%	1.74%	2.08%	2.61%	2.44%
30/09/19	1.48%	1.27%	1.50%	2.03%	1.87%
Low	1.17%	1.01%	1.13%	1.73%	1.57%
Date	03/09/19	03/09/19	03/09/19	03/09/19	03/09/19
High	1.58%	1.73%	2.07%	2.58%	2.41%
Date	15/04/19	17/04/19	17/04/19	17/04/19	17/04/19
Average	1.40%	1.37%	1.62%	2.20%	2.07%

Increase in the cost of borrowing from the PWLB

2.7.6 Notification was received from HM Treasury on 9 October 2019 regarding future PWLB rates. PWLB rates had been priced on the current gilt rates plus 100bps (1%) with effect from 9 October 2019 rates will now be based on gilt rates plus 200bps (2%). This will have an immediate effect on the cost of borrowing using PWLB loans.

2.7.7 Members will be aware that there has been adverse commentary in the media regarding the increase in PWLB rates and the possibly effect it may have on capital projects. It is likely that the sector may make representations to HM Treasury to suggest that areas of capital expenditure that the Government is keen to see move forward e.g. housing, should not be subject to such a large increase in borrowing.

2.7.8 As a result of the increase in the PWLB rate, the Council is expecting that various financial institutions will enter the market or make products available to local authorities. It is possible that the Municipal Bond Agency (Members will recall that the Council invested in the Municipal Bonds Agency to take advantage of beneficial rates when a bond is launched) will be offering loans to local authorities in the future. The Council may make use of these new sources of borrowing as and when it is appropriate. Members will be updated as this area evolves.

2.8 **Debt Rescheduling**

2.8.1 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

2.8.2 The 100bps increase in PWLB rates from 9 October 2019 only applied to new borrowing rates, not to premature repayment rates.

2.9 **Overall Position at the Mid –Year 2019/20**

2.9.1 The position at the mid-year 2019/20 shows that the Council is continuing to follow recommended practice and manage its treasury affairs in a prudent manner.

2.10 **Other Key Issues**

Claim against Barclay Bank

2.10.1 The Council is currently involved in legal action against Barclays Bank with regards to certain Lender Option Borrower Option (LOBO) transactions. This is based on the Bank's involvement in manipulation of the LIBOR benchmark rate and the subsequent impact on the Council's financial position. This matter is on-going.

2.10.2 The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. Training was provided to Audit Committee on 1 October 2019. The training was facilitated by the Council's External Treasury Advisors, Link Asset Services.

3 Options/Alternatives

3.1 In order that the Council complies with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management the Council has no option other than to consider and approve the contents of the report. Therefore, no options/alternatives have been presented.

4 Preferred Option

4.1 As stated above the preferred option is that the contents of the report are approved.

5 Consultation

5.1 Consultation has taken place with Link Asset Services (the Councils Treasury Management Advisors), and senior officers. The report has also been included as an agenda item for the meeting of the Audit Committee on 14 November to enable scrutiny. Cabinet will consider the report before commending it to Council for approval.

6 Financial Implications

6.1 All included within the report.

7 Legal Services Comments

7.1 None.

8 Co-operative Agenda

8.1 The Council ensures that any Treasury Management decisions comply as far as possible with the ethos of the Cooperative Council.

9 Human Resources Comments

9.1 None.

10 Risk Assessments

10.1 There are considerable risks to the security of the Authority's resources if appropriate treasury management strategies and policies are not adopted and followed. The Council has established good practice in relation to treasury management which has previously been acknowledged in both Internal and the External Auditors' reports presented to the Audit Committee.

11 IT Implications

11.1 None.

12 Property Implications

12.1 None.

13 Procurement Implications

13.1 None.

14 Environmental and Health & Safety Implications

14.1 None.

15 Equality, community cohesion and crime implications

15.1 None.

16 Equality Impact Assessment Completed?

16.1 No.

17 Key Decision

17.1 Yes

18 Key Decision Reference

18.1 FCS -07-19

19 Background Papers

19.1 The following is a list of the background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents, which would disclose exempt or confidential information as defined by that Act.

File Ref:	Background papers are contained with Appendices 1, 2 & 3.
Officer Name:	Anne Ryans
Contact No:	0161 770 4902

20 Appendices

Appendix 1	Investments as at 30 September 2019
Appendix 2	Borrowing as at 30 September 2019
Appendix 2A	PWLB Certainty Rate Variations 2019/20
Appendix 2B	Comparison of Borrowing parameters to actual external borrowing - Table
Appendix 2C	Comparison of Borrowing parameters to actual external borrowing - Graph
Appendix 3	Investment Counterparty Criteria

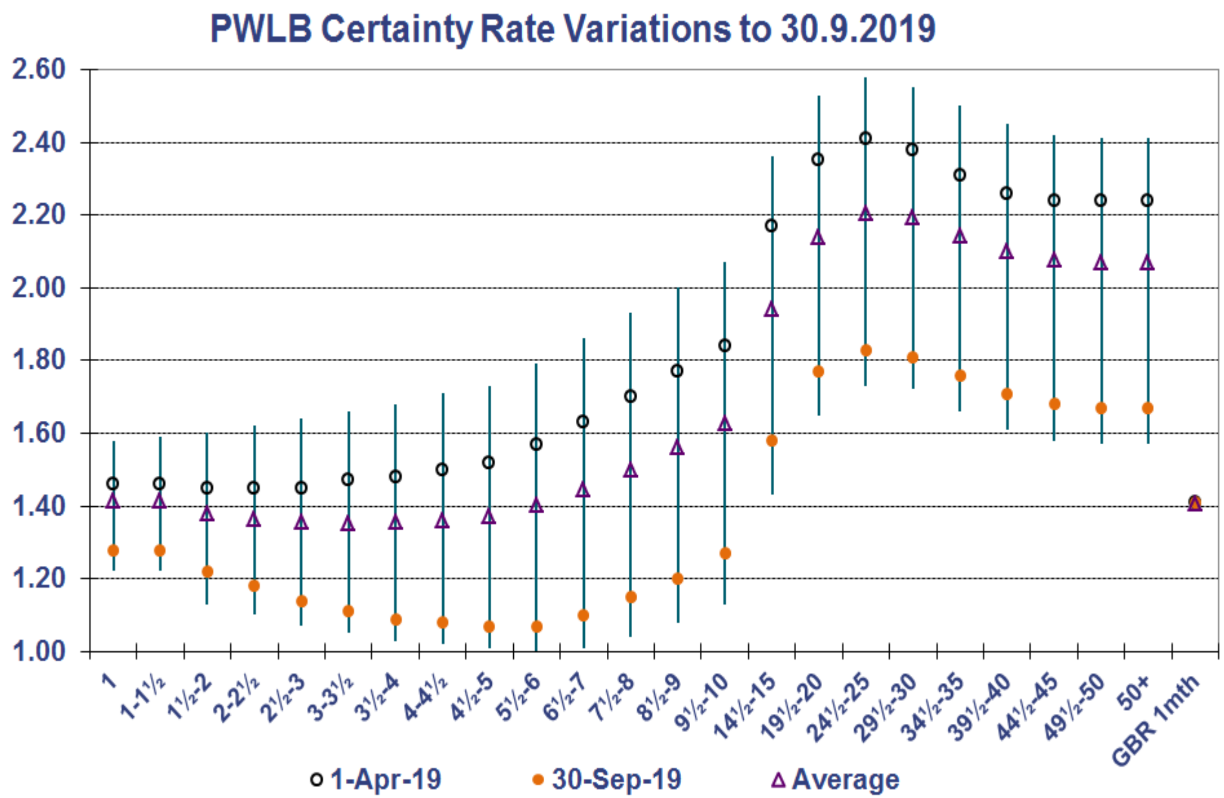
Appendix 1 Investments as at 30 September 2019

Investments	Type	30th September 2019 £'000	Interest Rate	Date of Investment	Date of Maturity
CCLA Property Fund	Property	15,000	4.24%	Prior Years	open
Total Property Fund		**15,000**			
Thurrock Council	Fixed	2,500	1.07%	05/10/2018	04/10/2019
Goldman Sachs	Fixed	3,000	0.80%	05/06/2019	07/10/2019
North Tyneside Council	Fixed	5,000	1.07%	11/10/2018	10/10/2019
Flintshire County BC	Fixed	5,000	0.75%	19/07/2019	21/10/2019
Nationwide Building Society	Fixed	2,500	0.81%	03/07/2019	03/12/2019
Rugby Borough Council	Fixed	5,000	0.80%	06/08/2019	06/02/2020
Goldman Sachs	Fixed	5,000	0.85%	06/09/2019	06/02/2020
Plymouth City Council	Fixed	5,000	0.80%	05/08/2019	05/03/2020
Thurrock Council	Fixed	2,500	0.76%	26/09/2019	06/04/2020
Total Fixed Investments		**35,500**			
Bank of Scotland plc	32 day call	2,500	0.95%	21/05/2019	open
Bank of Scotland plc	95 day call	12,500	1.10%	07/05/2019	open
Barclays	95 day call	7,500	0.95%	01/07/2019	open
Santander	95 day call	7,500	1.00%	14/11/2018	open
Santander	180 day cal	2,500	1.10%	10/09/2019	09/03/2020
Total Investments on call		**32,500**			
Federated Sterling Liquidity 3	MMF	3,540	0.74%	27/09/2019	01/10/2019
Standard Life Sterling Liquidity	MMF	17,790	0.74%	30/09/2019	01/10/2019
Federated Cash Plus Fund	MMF	10,000	0.90%	15/05/2019	01/10/2019
Total MMF		**31,330**			
Total		**114,330**			

MMF – Money Market Fund

Appendix 2 Borrowing as at 30 September 2019

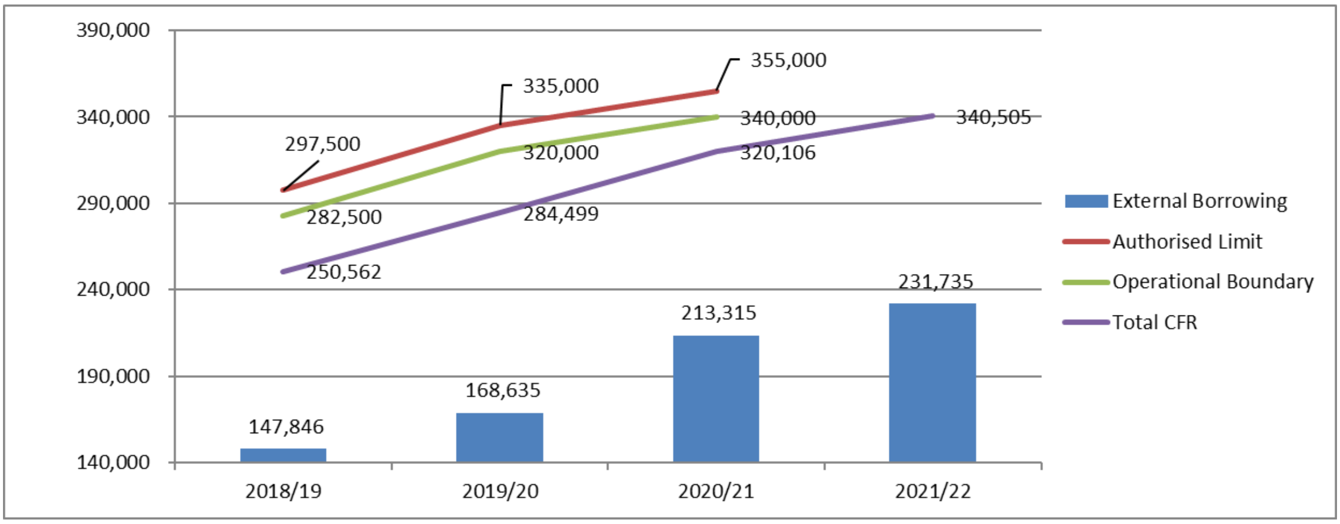
2A) PWLB Certainty Rate Variations 2019/20



2B) Comparison of borrowing parameters to actual external borrowing (Table)

CAPITAL FINANCING REQUIREMENTS				
	Actual **2018/19** **£'000**	Estimated **2019/20** **£'000**	Estimated **2020/21** **£'000**	Estimated **2021/22** **£'000**
CFR (including PFI and finance leases)				
General Fund CFR	493,880	517,658	543,109	553,817
Total CFR	**493,880**	**517,658**	**543,109**	**553,817**
CFR (excluding PFI and finance leases)				
General Fund CFR	250,562	284,499	320,106	340,505
Total CFR	**250,562**	**284,499**	**320,106**	**340,505**
External Borrowing	**147,846**	**168,635**	**213,315**	**231,735**
Deferred Liabilities	**246,610**	**235,613**	**224,411**	**213,578**
Total Debt	**394,456**	**404,248**	**437,727**	**445,314**
Authorised Limit	540,000	538,500	565,000	575,000
Authorised Limit ex Deferred Liabilities	290,000	297,500	335,000	355,000
Operational Boundary	525,000	518,500	545,000	555,000
Operational Boundary ex Deferred Liabilities	280,000	282,500	320,000	340,000

2C) Comparison of borrowing parameters to actual external borrowing (Graph)



Appendix 3 Investment Counterparty Criteria

Amendment to Non-Specified Investments: This addition allows the Council to take advantage of the availability of alternative investment options. The investment to be added to the strategy considers debt financing. This would aim to deliver economic growth across the borough and within the Greater Manchester area as well as a return for the Council.

	LINK Colour Band and Long Term Rating where applicable	Maximum Duration	Maximum Principal Invested per Counterparty £
Debt Financing	Internal Due Diligence and external advice	10 Years	£30m