BRIDGEND COUNTY BOROUGH COUNCIL

REPORT TO AUDIT COMMITTEE

14 NOVEMBER 2019

REPORT OF THE INTERIM HEAD OF FINANCE & SECTION 151 OFFICER

TREASURY MANAGEMENT – HALF-YEAR REPORT 2019-20

1. Purpose of the Report

1.1 The purpose of the report is to update Audit Committee on the mid-year review and half-year outturn position for treasury management activities and treasury management indicators for 2019-20 and to highlight compliance with the Council's policies and practices which have been reported to Cabinet and Council.

2. Connection to Corporate Improvement Objectives/Other Corporate Priorities

2.1 This report assists in the achievement of the following corporate priority:

- Smarter use of resources – ensuring that all its resources (financial, physical, human and technological) are used as effectively and efficiently as possible and support the development of resources throughout the community that can help deliver the Council's priorities.

2.2 The work of the Audit Committee supports corporate governance and assists in the achievement of all corporate and service objectives. Prudent treasury management arrangements will ensure that investment and borrowing decisions made by officers on behalf of the Council contributes to smarter use of financial resources and hence assists in the achievement of Corporate Priorities.

3. Background

3.1 Audit Committee has been nominated to be responsible for ensuring effective scrutiny of the Treasury Management Strategy (TMS) and policies. During the 2019-20 financial year to date, in addition to the regular treasury management reports to Cabinet and Council, Audit Committee received the Annual Treasury Management Outturn Report 2018-19 in June 2019.

3.2 The Council's treasury management activities are regulated by the Local Government Act 2003 which provides the powers to borrow and invest as well as providing controls and limits on this activity. The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 as amended, develops the controls and powers within the Act. This requires the Council to undertake any borrowing activity with regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities and to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services (TM Code). The Council is required to operate the overall treasury function with regard to the TM Code and this was formally adopted by the Council in February 2012. This includes a requirement for the Council to approve a TMS before the start of each financial year which sets out the Council's and Chief Financial Officer's responsibilities, delegation, and reporting arrangements. Council approved the TMS 2019-20 on 20 February 2019.

3.3 In 2017 CIPFA published a new version of the Prudential Code for Capital Finance in Local Authorities (the Prudential Code). The updated Prudential Code includes a new requirement for Local Authorities to provide a Capital Strategy, which is a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The definition of investments in the revised 2017 CIPFA Code now covers all the financial assets of the Council as well as other non-financial assets that the Authority holds primarily for financial return. The Council's Capital Strategy 2019-20, complying with CIPFA's requirement, includes the Prudential Indicators which in previous years were included in the TMS, along with details regarding the Council's non-treasury investments.

3.4 The Welsh Government (WG) issued revised Guidance on Local Authority Investments in April 2010, which requires the Council to approve an Investment Strategy prior to the start of each financial year and this is included in the TMS.

3.5 In March 2018, the Welsh Government also published an amendment to the Local Authorities (Capital Finance and Accounting) (Wales) Regulations, which enables the Council to invest in certain instruments which were previously treated as capital expenditure (for example Money Market Funds (MMF)) without the potential revenue cost of Minimum Revenue Provision (MRP) and without the proceeds from sale being considered a capital receipt.

4. Current Situation/Proposal

4.1 The Council has complied with its legislative and regulatory requirements during the first half of 2019-20. The TMS 2019-20 and the Half Year Outturn were reported to Council on 20 February and 23 October 2019 respectively. In addition, a quarterly monitoring report was presented to Cabinet in July 2019.

4.2 A summary of the treasury management activities for the first half of 2019-20 is shown in **Appendix A**. The Council has not taken long-term borrowing since March 2012 and it is not expected that there will be a requirement for any new long term borrowing in 2019-20. Favourable cash flows have provided surplus funds for investment and the balance on investments at 30 September 2019 was £43.75 million with an average rate of interest of 0.85%. The first table in section 4 in **Appendix A** details the movement of the investments by counterparty types and shows the average balances, interest received, original duration and interest rates for the first half of 2019-20.

4.3 The TM Code requires the Council to set and report on a number of Treasury Management Indicators. The indicators either summarise the expected activity or introduce limits upon the activity. Details of the estimate for 2019-20 set out in the Council's TMS are shown in section 6 in **Appendix A** and these show that the Council is operating in line with the approved limits.

4.4 The Council defines high credit quality as organisations and securities having a credit rating of A- or higher and **Appendix B** shows the equivalence table for credit ratings for Fitch, Moody's and Standard & Poor's and explains the different investment grades.

4.5 CIPFA's Code of Practice for Treasury Management requires all local authorities to conduct a mid-year review of its treasury management policies, practices and activities. The outcome of this review is that no changes to the TMS 2019-20 are required at this time.

5. Effect upon Policy Framework & Procedure Rules

5.1 As required by Financial Procedure Rule 20.3 within the Council's Constitution, all investments and borrowing transactions have been undertaken in accordance with the TMS 2019-20 as approved by Council with due regard to the requirements of the CIPFA's Code of Practice on Treasury Management in the Public Services.

6. Equality Impact Assessment

6.1 There are no equality implications arising from this report.

7. Well-being of Future Generations (Wales) Act 2015 Implications

7.1 The well-being goals identified in the Act were considered in the preparation of this report. As the report is for information only and is retrospective in nature it is considered that there will be no significant or unacceptable impacts upon the achievement of well-being goals/objectives as a result of this report.

8. Financial Implications

8.1 The financial implications are reflected within the report.

9. Recommendation

9.1 It is recommended that the Committee:

- Note the treasury management activities for 2019-20 for the period 1 April 2019 to 30 September 2019 and the projected Treasury Management Indicators for 2019-20 which were all reported to Council on 23 October 2019.

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04 November 2019

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Background documents:

Treasury Management Strategy 2019-20

SUMMARY OF TREASURY MANAGEMENT ACTIVITIES
1 APRIL 2019 TO 30 SEPTEMBER 2019

1. External Debt and Investment Position 1 April to 30 September 2019

1.1 The Council's external debt and investment position for 1 April to 30 September 2019 is shown below in table 1; more detail is provided in section 3 (Borrowing Strategy and Outturn) and section 4 (Investment Strategy and Outturn):

Council's external debt and investments 1 April to 30 September 2019

	Principal 01-04-19 £m	Average Rate 01-04-19 %	Principal 30-09-19 £m	Average Rate 30-09-19 %
External Long Term Borrowing:				
Public Works Loan Board	77.62	4.70	77.62	4.70
Lender's Option Borrower's Option	19.25	4.65	19.25	4.65
Total External Borrowing	**96.87**	**4.69**	**96.87**	**4.69**
Other Long Term Liabilities (LTL):				
Private Finance Initiative (PFI)*	17.00		16.83	
Other LTL	0.88		1.22	
Total Other Long Term Liabilities	**17.88**		**18.05**	
Total Gross External Debt	**114.75**		**114.92**	
Treasury Investments:				
Banks	5.40	0.86	4.10	1.03
Building Societies	1.00	0.90	2.00	0.92
Local Authorities	21.00	0.96	20.50	0.92
Money Market Fund**	-	-	17.15	0.72
Total Treasury Investments	**27.40**	**0.94**	**43.75**	**0.85**
Net Debt	**87.35**		**71.17**	

* (PFI) arrangement for the provision of a Secondary School in Maesteg 14.75 years remaining term
**the fund provides instant access

1.2 Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the WG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, or as equity investments and loans to the Council's subsidiaries. Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with the TMS. The Council's existing non-treasury investments relate to investment properties and the balance as at 31 March 2019 was £4.63 million.

1.3 It should be noted that the accounting practice required to be followed by the Council requires financial instruments in the accounts (debt and investments) to be measured in a method compliant with International Financial Reporting Standards (IFRS). The figures shown in the above table and throughout the report are based on the actual amounts borrowed and invested and so may differ from those in the Statement of Accounts, which include accrued interest or are stated at fair value in different instances.

1.4 The Council's treasury management advisors are Arlingclose. The current services provided to the Council include:-

- advice and guidance on relevant policies, strategies and reports
- advice on investment decisions
- notification of credit ratings and changes
- other information on credit quality
- advice on debt management decisions
- accounting advice
- reports on treasury performance
- forecasts of interest rates
- training courses

2. External Context

2.1 The interest rate views incorporated in the Council's TMS 2019-20, were based upon officers' views supported by a selection of City forecasts provided by Arlingclose. When the TMS 2019-20 was prepared in January 2019 it was forecast that the Bank Rate would rise by 0.25% during 2019-20 to 1.00% by December 2019.

2.2 The Bank Rate started the financial year at 0.75% and the current forecast is that the Bank Rate will remain at this level beyond the end of the financial year. Arlingclose believe that policymakers are unlikely to raise the Bank Rate unless there is some certainty of a Brexit withdrawal agreement.

3. Borrowing Strategy and Outturn for 1 April to 30 September 2019

3.1 The Council's primary objective for the management of its debt is to ensure its long term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board (PWLB) at long term fixed rates of interest.

3.2 With short-term interest rates lower than long term rates, it is likely to be more cost effective in the short term to either take out short term loans or use internal resources. Short term and variable rate loans expose the Council to the risk of short term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates as shown in the treasury management indicators in section 6. However, with long term rates forecast to rise in the coming years, any such short term savings will need to be balanced against the potential longer-term costs. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis.

3.3 The £19.25 million in table 1 above relates to Lender's Option Borrower's Option (LOBO) loans which have a maturity date of 2054, however these may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, the lender exercising their option to increase rates at one of the bi-annual trigger points and therefore the Council being given the option to accept the increase or to repay the loan without incurring a penalty. The lender did not exercise their option on 22 July 2019 and the next trigger point is 22 January 2020. Again the lender is unlikely to exercise their option in the current low interest rate environment, however, an element of refinancing risk remains. The Council would take the option to repay these loans at no cost if it has the opportunity to do so in the future.

The current average interest rate for these LOBO's is 4.65% compared to the PWLB Loans average interest rate of 4.70%.

3.4 The last time the Council took out long term borrowing was £5 million from the PWLB in March 2012 and, as detailed above, the current forecast is that there will be no requirement for new long term borrowing in 2019-20. It is interesting to note, however, that in the middle of October the UK government raised the cost of borrowing from the PWLB by 1% with immediate effect. Whilst this Council has not needed to borrow for a number of years, with the reduction in capital receipts availability going forward, this may be the only option, so it is worth noting the potential increased revenue costs associated with this.

3.5 Alternatively, the Council may arrange forward starting loans during 2019-20 where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Council may take out short term loans (normally for up to one month) to cover unexpected cash flow shortages. Market conditions have meant that there has been no loan rescheduling so far this year however, in conjunction with Arlingclose, the loan portfolio will continue to be reviewed for any potential savings as a result of any loan rescheduling.

3.6 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This is known as Internal Borrowing. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

4. Investment Strategy and Outturn 1 April to 30 September 2019

4.1 Both the CIPFA Code and the WG Guidance require the Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, balancing the risk of incurring losses from defaults against receiving unsuitably low investment income.

The major objectives during 2019-20 are:-

- To maintain capital **security**
- To maintain **liquidity** so funds are available when expenditure is needed

- To achieve the **yield** on investments commensurate with the proper levels of security and liquidity

4.2 The Annual Investment Strategy incorporated in the Council's TMS 2019-20 includes the credit ratings defined for each category of investments and the liquidity of investments. The Council's investments have historically been placed in mainly short term bank and building society unsecured deposits and local and central government. However, investments may be made with any public or private sector organisations that meet the minimum credit criteria and investment limits specified in the Investment Strategy. The majority of the Council's surplus cash is currently invested in Money Market Funds and with other local authorities but the Council will continue to look at investment options in line with the limits detailed in the Investment Strategy.

4.3 Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's to ensure that this lies within our agreed minimum credit rating. **Appendix B** shows the equivalence table for these published ratings and explains the different investment grades. Where available the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. In the current climate, relying mainly on credit ratings is considered to be inappropriate and the Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard is therefore given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

4.4 On a day to day basis, the Council potentially has positive cash balances arising from the cash flow e.g. timing differences between grants being received and making various payments. These are invested on the market via brokers, direct with the institution or held in deposit accounts or a money market fund with instant access. The Council usually invests for a range of periods dependent on cash flow requirements and the interest rates on offer having regard to the Investment Strategy.

4.5 The Council's primary objective for the management of its investment portfolio is to give priority to the security and liquidity of its funds before seeking the best rate of return. As shown in the tables below, the majority of investments have been held as short term investments with UK Local Authorities and banks of high credit quality. This has therefore resulted in more of the investment portfolio being moved into investment instruments with lower rates of return but higher security and liquidity.

4.6 Occasionally, investments are placed with the UK Debt Management Office (DMO - Executive Agency of UK Government) but only for very short term deposits and after all other options have been explored. The interest rates offered by this facility are lower than most other counterparties but this is commensurate with the high level of security and reduced risk offered. It provides another option when examining potential investments and ensures compliance with the Council's investment objective that security takes priority over yield. There were no deposits outstanding at 30 September 2019.

4.7 Favourable cash flows have provided positive cash balances for investment and the balance on investments at 30 September 2019 was £43.75 million as shown in Table 2 below which details these investments by counterparty type.

Investments Profile 1 April to 30 September 2019

Investment Counterparty Category	Balance 01 April 2019 (A) £m	Investments Raised (B) £m	Investments Repaid (C) £m	Balance 30 Sept 2019 (A+B-C) £m	Interest Received ** £'000	Average Original Duration of the Investment Days	Weighted Average Investment Balance Apr - Sept 2019 £m	Weighted Average Interest Rate Apr-Sept 2019 %
Government DMO	-	44.70	44.70	-	1.35	2	0.54	0.50
Local Authorities	21.00	25.50	26.00	**20.50**	50.06	339	24.04	0.96
Building Societies	1.00	4.00	3.00	**2.00**	2.07	115	3.16	0.92
Banks (Fixed Maturity)	4.00	2.00	4.00	**2.00**	23.43	213	2.86	0.99
Banks Instant Access/Notice Period *	1.40	36.87	36.17	**2.10**	13.95	n/a	4.97	0.96
Money Market Fund (Instant Access)*	-	75.15	58.00	**17.15**	42.34	n/a	14.00	0.74
Total/Average	**27.40**	**188.22**	**171.87**	**43.75**	**133.20**	**167**	**49.57**	**0.89**

* An average duration is not shown as there is no original duration as instant access or notice period and money is added and withdrawn to/from these accounts as required by cash-flow

** Received in the Council's bank account not interest earned

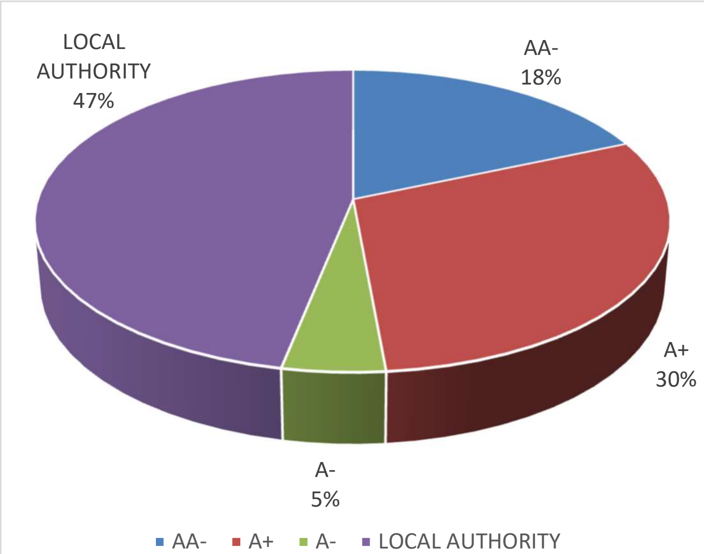
4.8 There were ten long-term investments (original duration of 12 months or more) outstanding at 30 September 2019 totalling £12 million with Local Authorities shown in table 3 below, maturing in 2020-21. All other investments at 30 September 2019 were short-term deposits (including instant access and notice accounts). Table 3 below details these investments by counterparty type based on the remaining maturity period as at 30 September 2019:

Investments Outstanding Maturity Profile 30 September 2019

Counterparty Category	Instant Access £m	Deposits Maturing Within 1 Month £m	Deposits Maturing Within 2-3 Months £m	Deposits Maturing Within 4-12 Months £m	Deposits Maturing Within 1-2 Years £m	Total £m
Local Authorities	-	4.00	4.50	-	12.00	20.50

Building Societies	-	-	2.00	-	-	2.00
Banks	0.10	2.00	-	2.00	-	4.10
Money Market Fund	17.15	-	-	-	-	17.15
Total	**17.25**	**6.00**	**6.50**	**2.00**	**12.00**	**43.75**

4.9 The Council defines high credit quality as organisations and securities having a credit rating of A- or higher. The pie chart below summarises the above table by credit ratings and shows the £43.75 million investments at 30 September 2019 by percentage outstanding. Most Local Authorities do not have credit ratings and the unrated building society (shown as 'BS NR' below) was approved by Arlingclose whilst the remainder of our investments all had a credit rating of A or above.



5. Review of the Treasury Management Strategy 2019-20

5.1 CIPFA's Code of Practice for Treasury Management requires all local authorities to conduct a mid-year review of its treasury management policies, practices and activities. As a result of this review it was not deemed necessary to make any changes to the TMS 2019-20.

6. Treasury Management Indicators 2019-20

Details of the estimate for 2019-20 set out in the Council's TMS and also the projected indicators for 2019-20 are shown below.

6.1 Treasury Management Indicators 2019-20

6.1.1 The following indicators (which are forward looking parameters) form part of the CIPFA Code of Practice on Treasury Management. They enable the Council to measure and manage its exposure to Treasury Management risks.

The Council needs to set the upper limits to its **Interest Rate Exposure** for the effects of changes in interest rates. There are two treasury management indicators that relate to both fixed interest rates and variable interest rates. These limits have been calculated with reference to the net outstanding principal sums and are set to control the Council's exposure to interest rate risk as shown in the table below. Fixed rate investments and borrowings for the purpose of this indicator are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or transaction date if later and all other instruments are classed as variable. The majority of the Council's investments are less than 12 months and even though interest rates may be fixed for the investment duration these would be classed as variable.

No.		TMS 2019-20 £m	Projection 31-03-2020 £m
	Total Projected Principal Outstanding on Borrowing 31 March 2020	96.87	**96.87**
	Total Projected Principal Outstanding on Investments 31 March 2020	20.00	**15.00**
	Net Principal Outstanding	**76.87**	**81.87**
1.	**Upper Limit on fixed interest rates (net principal) exposure**	135.00	**73.62**
2.	**Upper Limit on variable interest rates (net principal) exposure**	50.00	**13.25**

The Section 151 Officer will manage interest rate exposures between these limits in 2019-20.

The impact over one year on the revenue account of both a 1% rise and a 1% fall in all interest rates for borrowing net of treasury investments is shown below. This is calculated at a point in time on the assumption that maturing loans and investments would be replaced at rates 1% higher or lower than they would otherwise have been on their maturity dates, and that the treasury investment and borrowing portfolios remain unchanged over the coming year. Whilst interest rates can move by more than 1% over the course of a year, it is rare. The indicator below suggests that the Council would benefit by a greater reduction in interest should rates fall by 1% than set in the TMS, however rates are not expected to fall at present so this is an indication only.

Interest rate risk indicator	**Indicator £'000**	**As at 30/09/19**
One year revenue impact of a 1% rise in interest rates	(140)	(115)
One year revenue impact of a 1% fall in interest rates	315	344

6.1.2 A further indicator for Treasury Management measures the **Maturity Structure of Borrowing** and is the amount of projected borrowing that is fixed rate, maturing in each period as a percentage of total projected fixed rate borrowing.

This indicator is set to control the Council's exposure to refinancing risk and has been set to allow for the possible restructuring of long term debt where this is expected to lead to an overall saving or reduction in risk.

The 19.87% shown in the table below relates to £19.25 million Lender's Option Borrower's Option (LOBO) loans which may be re-scheduled in advance of their maturity date of 2054, as detailed in paragraph 3.3 of the main report. The Code requires the maturity of LOBO loans to be shown as the earliest date on which the lender can require payment, i.e. the call date of January 2019 so the maturity date is actually uncertain but is shown in the "Under 12 months" category as per the Code.

No	Maturity structure of fixed rate borrowing during 2019-20	TMS 19-20 Upper limit	TMS 19-20 Lower limit	Projection 31-03-20 %
3.	Under 12 months	50%	0%	**19.87%**
	12 months and within 24 months	25%	0%	**-**
	24 months and within 5 years	25%	0%	**-**
	5 years and within 10 years	40%	0%	**13.91%**
	10 years and within 20 years	50%	0%	**23.49%**
	20 years and above	60%	25%	**42.73%**

6.1.3 The **Upper Limit for Total Principal Sums invested longer than 1 year** indicator controls the amount of longer term investments which mature beyond the period end. This is set to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

No.		TMS 2019-20 (Limit) £m	Projection Principal Outstanding Over 1 year 31-03-20 £m
4.	**Upper Limit for Total Principal Sums Invested for more than 1 year**	15	**6**

APPENDIX B

Credit Rating Equivalence Table

Grade	Description	Fitch Long	Fitch Short	Moody's Long	Moody's Short	Standard & Poor's Long	Standard & Poor's Short
INVESTMENT GRADE	Extremely strong	AAA		Aaa		AAA	
	Very strong	AA+	F1+	Aa1		AA+	A-1+
		AA		Aa2	P-1	AA	
		AA-		Aa3		AA-	
	Strong	A+		A1		A+	A-1
		A	F1	A2		A	
		A-		A3		A-	A-2
	Adequate	BBB+	F2	Baa1	P-2	BBB+	
		BBB		Baa2		BBB	
		BBB-	F3	Baa3	P-3	BBB-	A-3
SPECULATIVE GRADE	Speculative	BB+		Ba1		BB+	
		BB		Ba2		BB	
		BB-	B	Ba3		BB-	B
	Very speculative	B+		B1		B+	
		B		B2		B	
		B-		B3	Not Prime (NP)	B-	
	Vulnerable	CCC+		Caa1		CCC+	
		CCC		Caa2		CCC	
		CCC-	C	Caa3		CCC-	C
		CC		Ca		CC	
		C				C	
	Defaulting	D	D	C		D	D