

**BRIDGEND COUNTY BOROUGH COUNCIL**

**INFORMATION REPORT TO CABINET**

**21 JANUARY 2020**

**REPORT OF THE INTERIM HEAD OF FINANCE & SECTION 151 OFFICER**

**TREASURY MANAGEMENT – QUARTER 3 REPORT 2019-20**

**1. Purpose of the Report**

1.1 The purpose of this report is to:-

- Comply with the requirement of the Chartered Institute of Public Finance and Accountancy's 'Treasury Management in the Public Services: Code of Practice' (the Code) to produce interim Treasury Management Reports.
- Report on the projected Treasury Management Indicators for 2019-20.

**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 Treasury Management Report is integral to the delivery of the Corporate Improvement Objectives as the allocation of resources determines the extent to which the Corporate Objectives can be delivered.

**3. Background**

3.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council is exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

3.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy (TMS) before the start of each financial year. The CIPFA Code also requires

the Council to set a number of Treasury Management Indicators which are forward looking parameters and enable the Council to measure and manage its exposure to treasury management risks and these are included throughout this report. In addition, the Welsh Government issued revised Guidance on Local Authority Investments in November 2019 that requires the Council to approve an Investment Strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Welsh Government Guidance.

- 3.3 In 2017 CIPFA also 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 which 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 Capital Strategy and TMS should be read in conjunction with each other as they are interlinked as borrowing and investments are directly impacted upon by capital plans and were approved together by Council on 20 February 2019.
- 3.5 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

## **4. Current Situation / Proposal**

### **4.1 Economic Context**

- 4.1.1 The interest rate views incorporated in the Council's TMS 2019-20 were based upon officers' views supported by a forecast from Arlingclose. When the TMS 2019-20 was prepared in January 2019, due to the anticipated short time for a Brexit withdrawal deal to be agreed and the possibility of an extended period of uncertainty over the possible outcome, Arlingclose's central case scenario was

forecasting a 0.25% rise in the Bank Rate during 2019-20 to take official UK interest rates to 1.00% by December 2019.

4.1.2 The Bank Rate started the financial year at 0.75% and the current forecast is that the Bank Rate will remain at this level for the foreseeable future. Substantial risks to this forecast remain, arising primarily from the government's policy around Brexit and the transitional period.

## 4.2 External Debt and Investment Position

4.2.1 On 31 December 2019, the Council held £96.87 million of external long-term borrowing and £38.945 million of investments. The external debt and investment position for 1 April to 31 December 2019 is shown below in Table 1; more detail is provided in section 4.3 - Borrowing Strategy and Outturn, and section 4.4 - Investment Strategy and Outturn.

**Table 1: Council's external debt and investment position 1 April to 31 December 2019**

	<b>Principal as at 01-04-19 £m</b>	<b>Average Rate 01-04-19 %</b>	<b>Principal as at 31-12-19 £m</b>	<b>Average Rate 31-12-19 %</b>
<b>External Long Term Borrowing:</b>				
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
<b>Total External Long Term Borrowing</b>	<b>96.87</b>	<b>4.69</b>	<b>96.87</b>	<b>4.69</b>
<b>Other Long Term Liabilities (LTL)</b>				
Private Finance Initiative (PFI)*	17.00		16.83	
Other LTL	0.88		1.22	
<b>Total Other Long Term Liabilities</b>	<b>17.88</b>		<b>18.05</b>	
<b>Total Gross Long Term External Debt</b>	<b>114.75</b>		<b>114.92</b>	
<b>Treasury investments:</b>				
Banks	5.40	0.86	4.90	0.91
Building Societies	1.00	0.90	2.00	0.78
Local Authorities	21.00	0.96	22.50	0.91
Money Market Funds**	-	-	9.55	0.74
<b>Total treasury investments</b>	<b>27.40</b>	<b>0.94</b>	<b>38.95</b>	<b>0.86</b>
<b>Net Debt</b>	<b>87.35</b>		<b>75.97</b>	

\* (PFI) arrangement for the provision of a Secondary School in Maesteg 14.5 years remaining term

\*\*the fund provides instant access

4.2.2 Where a Council finances capital expenditure by debt, it must put aside revenue resources to repay that debt in later years and this amount charged to revenue is called the Minimum Revenue Provision (MRP). The Local Authority (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2008 requires the Council to produce and approve an annual Minimum Revenue Provision (MRP)

Statement before the start of the financial year that details the methodology for the MRP charge and this is detailed in the Council's Capital Strategy. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. This strategy is prudent as investment returns are low and counterparty risk is relatively high. The Council is forecasting an increased CFR due to the amount of prudential borrowing in the capital programme and the MRP policy approved by Council in September 2018.

- 4.2.3 The liability benchmark has been calculated and compares the Council's actual borrowing against an alternative strategy, showing the lowest risk level of borrowing. Table 2 below has been produced using estimates of capital spend and forecasts on usable reserves for the current financial year. These estimates highlight that the Loans CFR, which is the Council's need to borrow to fund capital expenditure, is increasing in line with the capital programme as highlighted in paragraph 4.2.2 above. The Loans CFR ignores cash balances and may be too high if the authority benefits from long term positive cash flows which this Council does benefit from. The benchmark assumes that cash and investment balances are kept to a minimum level of £10 million at each year-end to maintain sufficient liquidity but minimise credit risk. It shows a liability benchmark of £111 million at the end of the financial year. The Council will have debt above or below this amount, which will leave it with excess cash or a borrowing need respectively. The Council feels it is prudent to maintain an under-borrowed position.

**Table 2: Liability benchmark**

	<b>2018-19 Actual £m</b>	<b>2019-20 Estimate TMS 2019-20 £m</b>	<b>2019-20 Projection £m</b>
Loans CFR	155	161	165
Less: Usable reserves	-77	-55	-58
Working capital	-5	-	-6
Plus: Minimum investments	10	10	10
<b>Liability Benchmark</b>	<b>83</b>	<b>116</b>	<b>111</b>

### 4.3 Borrowing Strategy and Outturn

4.3.1 At 31 December 2019, the Council held £96.87 million of long-term loans as part of its strategy for funding previous years' capital programmes. The TMS 2019-20 forecast that the Council would need to borrow £16 million in 2019-20. It is now forecast that there will be no long term borrowing requirement in 2019-20 due to additional grants being received in the last quarter of 2018-19 and a change in the capital programme for 2019-20. More detail is provided in the Capital Strategy 2019-20 and the Capital Monitoring report.

4.3.2 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans, should the Council's long-term plans change, is a secondary objective. Therefore the major **objectives** to be followed in 2019-20 are:

- to minimise the revenue costs of debt
- to manage the Council's debt maturity profile i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing
- to effect funding in any one year at the cheapest cost commensurate with future risk
- to monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movement
- to reschedule debt if appropriate, in order to take advantage of potential savings as interest rates change
- to optimise the use of all capital resources including borrowing, both supported and unsupported, usable capital receipts, revenue contributions to capital and grants and contributions

4.3.3 Given the recent significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy. With short-term interest rates currently much lower than long term rates, it is likely to be more cost effective in the short term to either use internal resources or take out short term loans instead.

4.3.4 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 taken out with the Public Works Loan Board (PWLB) at long term fixed rates of interest but we will also investigate other sources of finance, such as Welsh Government and local authority loans and bank loans that may be available at more favourable rates.

4.3.5 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. 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.

4.3.6 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, with 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. 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%.

4.3.7 The Treasury Management indicator shown in Table 3 below is for the **Maturity Structure of Borrowing** and is set for the forthcoming financial year to control the Council's exposure to refinancing risk with respect to the maturity of the Council's external borrowing, 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. It is the amount of projected borrowing maturing in each period as a percentage of total projected borrowing. The upper and lower limits on the maturity structure of borrowing set out in the TMS 2019-20 and the projection for 2019-20 is:

**Table 3: Treasury Management Indicator Maturity Structure of Borrowing 2019-20**

<b>Refinancing rate risk indicator Maturity structure of borrowing 2019-20</b>	<b>TMS 2019-20 Upper limit %</b>	<b>TMS 2019-20 Lower limit %</b>	<b>Projection 31-3-20 %</b>
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

The 19.87% shown in Table 3 above relates to the £19.25 million LOBO loans which may be re-scheduled in advance of their maturity date of 2054, as detailed in paragraph 4.3.6. 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

option/call dates in 2019-20, so the maturity date is actually uncertain but is shown in the “Under 12 months” category as per the Code

#### **4.4 Investment Strategy and Outturn**

4.4.1 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

4.4.2 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.

4.4.3 The Council holds surplus funds representing income received in advance of expenditure plus balances and reserves and as shown in Table 1 above the balance on investments at 31 December 2019 was £38.945 million. Table 4 below details these investments by counterparty type. The average investment rate in the period 1 April to 31 December 2019 was 0.87% and was 0.71% at 31 December 2019 (as set out in Table 1).

**Table 4: Investments Profile 1 April to 31 December 2019**

Investment Counterparty Category	Balance 01 April 2019 (A) £m	Investments raised (B) £m	Investments Repaid (C) £m	Balance 31 Dec 2019 (A+B-C) £m	Investment income received** Apr-Dec 2019 £'000	Average original duration of the investment Days	Weighted average investment balance Apr-Dec £m	Weighted average interest rate Apr-Dec %
Government DMO	-	44.70	44.70	-	16.43	5	1.81	0.50
Local Authorities	21.00	27.50	26.00	22.50	168.23	298	21.89	0.97
Banks (Fixed Maturity)	4.00	4.00	4.00	4.00	23.43	201	3.33	1.02
Building Societies	1.00	4.00	3.00	2.00	2.07	138	3.87	0.91
Banks Instant Access/ Notice account*	1.40	36.87	37.37	0.90	16.79	n/a	5.61	0.85
Money Market Fund (instant access)*	-	75.15	65.60	9.55	73.98	n/a	15.23	0.73
<b>Total/Average</b>	<b>27.40</b>	<b>192.22</b>	<b>180.67</b>	<b>38.95</b>	<b>300.93</b>	<b>160</b>	<b>51.73</b>	<b>0.87</b>

\* 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

4.4.4 The Treasury Management indicator shown below in Table 5 is for **Principal Sums Invested for periods longer than a year**. Where the Council invests, or plans to invest, for periods longer than a year, an upper limit is set for each forward financial year period for the maturing of such investments. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of long term investments. The limit on the long term principal sum invested to final maturities beyond the period end are set out in the TMS 2019-20.

**Table 5: Treasury Management Indicator Principal Sums Invested for periods longer than a year**

Price risk indicator	TMS 2019-20 £m	Projection 31-3-20 £m
Limit on principal invested beyond financial year end	15	4

All investments longer than 365 days (non-specified) will be made with a cautious approach to cash flow requirements and advice from Arlingclose will be sought as necessary.

4.4.5 There are two long term investments (original duration of 12 months or more) outstanding at 31 December 2019 totalling £4 million with Local Authorities, maturing in 2020-21. All other investments at 31 December 2019 were short term deposits including MMFs, Local Authorities, instant access and notice



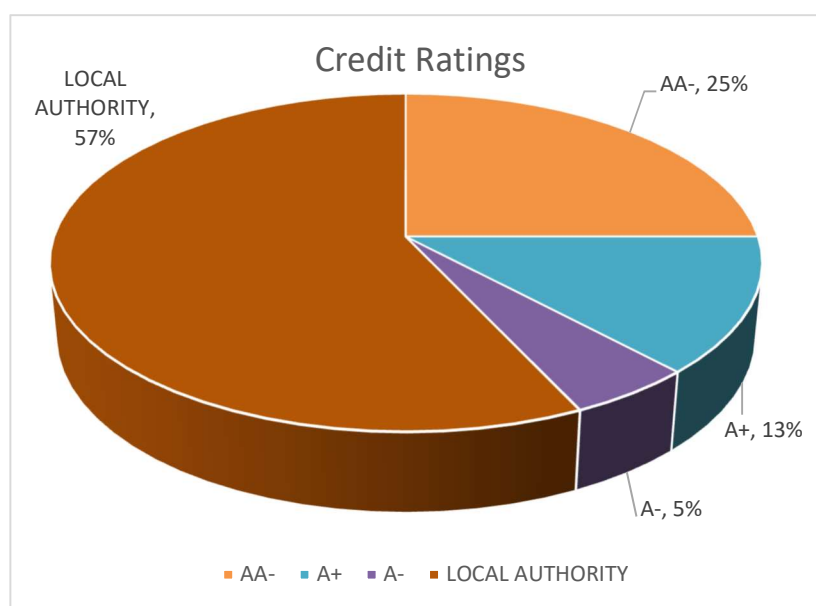
accounts. Table 6 below details these investments by counterparty type based on the remaining maturity period as at 31 December 2019:

**Table 6: Investments Outstanding Maturity Profile 31 December 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	Total £m	Total %
Local Authorities		8.50		14.00	22.5	58%
Banks	0.90	2.00		2.00	4.9	12%
Building Societies				2.00	2	5%
Money Market Fund	9.55				9.55	25%
<b>Total</b>	<b>10.45</b>	<b>10.50</b>	<b>0.00</b>	<b>18.00</b>	<b>38.95</b>	<b>100%</b>

4.4.6 Investment decisions are made by reference to the lowest published long-term credit rating from a selection of external rating agencies to ensure that this lies within the Council's agreed minimum credit rating. Where available the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account. **Appendix A** shows the equivalence table for credit ratings for three of the main rating agencies Fitch, Moody's and Standard & Poor's and explains the different investment grades. The Council defines high credit quality as organisations and securities having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

4.4.7 The pie chart below summarises Table 6 by credit ratings and shows the £38.945 million investments at 31 December 2019 by percentage outstanding. Most Local Authorities do not have credit ratings and the £2 million invested with an A- rated building society was an approved counterparty by Arlingclose whilst the remainder of the investments all had a credit rating of A or above.



#### 4.5 Interest Rate Exposures – Borrowing and Investments

4.5.1 The Council is exposed to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the Council depending on how variable and fixed interest rates move across differing financial instrument periods. Short term and variable rate loans expose the Council to the risk of short term interest rate rises and are therefore subject to the Treasury Management indicator in Table 7 below to manage **Interest Rate Exposures**.

**Table 7: Treasury Management Indicator Interest Rate Exposures**

Interest rate risk indicator	Indicator £'000	Actual 31-12-19 £'000
One year revenue impact of a 1% rise in interest rates	(140)	(83)
One year revenue impact of a 1% fall in interest rates	315	264

4.5.2 This indicator has been set as an indicator (not a limit) to measure the net 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. This is calculated at a point in time on the assumption that maturing loans and investments will 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. Interest rates can move by more than 1% over the course of a year, although such instances are rare.

4.5.3 The figures for the 1% fall in interest rates indicator are not the same figures as the 1% rise in interest rates (but reversed) as the borrowing relates to variable LOBO loans where it is assumed that the lender would not exercise their option if there was a fall in interest rates. All other borrowing does not have a rate reset in the next year and is with the PWLB at fixed rates.

## **5. Effect upon Policy Framework and 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.

## **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 Cabinet:
- Note the Council's treasury management activities for the period 1 April 2019 to 31 December 2019;
  - Note the projected Treasury Management Indicators for 2019-20 against the ones approved in the Treasury Management Strategy 2019-20.

**Gill Lewis**  
**Interim Head of Finance and Section 151 Officer**  
**10 January 2019**

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**Background documents:**  
Treasury Management Strategy 2019-20

## APPENDIX A

**Credit Rating Equivalence Table**

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

Standard & Poor's (S&P), Moody's and Fitch are the three most significant rating agencies in the world. These agencies rate the creditworthiness of countries and private enterprises.

"AAA" or Aaa" is the highest rating across all three rating agencies and indicates the highest level of creditworthiness. A "D" rating ("C" rating from Moody's) indicates poor creditworthiness of a company or government. A difference is made between short-term and long-term ratings.

