East Lothian Council

REPORT TO:	Audit and Governance Committee
MEETING DATE:	26 November 2019
BY:	Depute Chief Executive (Resources & People Services)
SUBJECT:	Treasury Management – Mid Year Review 2019-20

1 PURPOSE

1.1 To update the Committee on Treasury Management activity during the first half of 2019-20.

2 RECOMMENDATIONS

2.1 The Committee is asked to note the content of the report.

3 BACKGROUND

3.1 A main function of treasury management operations is to ensure that the cash flow is adequately planned, with cash being available when it is required. Surplus monies are invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

3.2 In addition, the treasury management service ensures the accounting and funding of the Council's capital plans. The approved capital plans provide a guide to the borrowing need of the Council, setting out the longer term cash flow planning to ensure the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, any debt previously incurred may be restructured, to meet Council risk or cost objectives.

3.3 Treasury management is defined as the management of the local authority's borrowing, 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. This report has been written in accordance with the requirements of the CIPFA Code of Practice on Treasury Management, with the mid-year report reviewed against the Treasury Management Strategy approved by Council in February 2019.

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

A. An economic update for the first part of the 2019-20 financial year;
B. A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
C. The Council's capital position (prudential indicators);
D. A review of the Council's investment portfolio for 2019-20;
E. A review of the Council's borrowing strategy for 2019-20;
F. A review of any debt rescheduling undertaken during 2019-20.

Part A – Economic Update

3.5 The first half of 2019-20 has seen UK economic growth reduce due to the continued economic uncertainty. The Monetary Policy Committee (MPC) has so far left the bank rate unchanged at 0.75% during 2019, and is unlikely to change until there is further clarity over the UK's departure from the European Union.

3.6 UK CPI inflation rate as at October 2019 is currently at the lowest level for some time at 1.5% (2.4% as at August 2018), with the next published statistics available mid-December. A broad inflationary target of 2% reflects current Government policy, with a drive to reduce this further through wider Monetary Policies. The continued economic uncertainty could see inflation rates rise and, with that increased costs.

3.7 In the first half of 2019-20 longer term PWLB borrowing rates fell to exceptionally low levels due to economic uncertainty, however, on 9 October 2019, the Treasury and PWLB announced a full 1% increase on all new borrowing. More details are set out in paragraph 3.21 of this report.

Part B – Review of Treasury Management Strategy Statement and Annual Investment Strategy

3.8 The Treasury Management Strategy Statement (TMSS) sets out the wider Treasury and Investment Strategy and includes a number of key treasury management indicators. Council approved the Strategy and relevant indicators on 26 February 2019. This report provides an update on the Treasury Management activity undertaken by the Council relative to the approved strategy taking account of the updated economic position and budgetary changes already approved.

3.9 Table 3.1 below provides a summary of the current position relative to approved indicators, with more details around the position on each indicator set out in the remainder of this report.

Table 3.1

Prudential Indicators 2019-20	**Approved** **£m**	**Current Estimated Prudential Indicator** **£m**
Capital Financing Requirement	468	475
Operational Boundary	468	475
Authorised Limit	518	518

Includes long term liabilities for PPP schemes and finance leases

Part C - The Council's Capital Position (Prudential Indicators)

3.10 The Council has already approved a range of indicators with more details around the current projections relative to approved indicators set out below.

Capital Expenditure and Financing of the Capital Programme

3.11 Table 3.2 below sets out the current projected outturns for the Council's capital investment programmes for 2019-20 relative to the approved budget as at 12 February 2019. The table sets out how the programme is financed, highlighting the supported and unsupported elements and the expected financing arrangements. The borrowing requirement increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR). This in part will be offset by any revenue charges for the repayment of debt.

Table 3.2

Capital Expenditure	**2019-20 Approved Budget £m**	**2019-20 Projected Outturn * £m**
General Services	52.1	47.5
HRA	32.9	32.7
Total capital expenditure	**85.0**	**80.2**
Financed by:		
Capital receipts	27.1	16.6
Capital Grants	15.7	18.9
CFCR	6.7	6.7
Total financing	**49.5**	**42.2**
Borrowing requirement	**35.5**	**38.0**

** Projected outturns as per financial update presented to Council on 29 October 2019*

Impact on Prudential Indicators

3.12 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Table 3.3 below, sets out the CFR and the expected debt position over the period, which is termed the Operational Boundary.

3.13 In summary, the Council is currently projecting to be slightly over the approved limits for both CFR and Operational Boundary. This is largely due to a combination of; reduction in the use of capital receipts during 2019-20 largely due to re-profiling of developers contributions to future years in line with anticipated expenditure commitments; as well as a restatement to the opening CFR balance within the 2018-19 annual accounts. Future year's Treasury indicators will be revised to take cognisance of 2019-20 projected outturn, however overall the Council is expected to remain well within the Authorised Limit.

Table 3.3

	2019/20 Approved Limits £m	**2019/20 Projected Outturn £m**
Prudential Indicator – Capital Financing Requirement		
CFR – General Services	260	273
CFR – HRA	208	203
Total CFR	**468**	**476**
Prudential Indicator – the Operational Boundary for external debt		
Borrowing	431	439
Other long term liabilities*	37	37
Total debt (year-end position)	**468**	**476**

** PPP arrangements and finance leases*

Limits to Borrowing Activity

3.14 One of the main key controls over the treasury activity is to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, (except in the short term), exceed the total of CFR in the previous 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 should the need arise.

3.15 Table 3.4 below sets out that the Council is currently managing to operate within this limit and maintains an under-borrowed position. The table states that at the end of this year the Council expects to have external borrowings of £383m and utilise £56m of cash flow funds (under-borrowing) in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate and remains consistent with the approved Treasury Management Strategy.

Table 3.4

	2019-20 Original Estimate £m	2019-20 Revised Estimate £m
External borrowing	397	383
Other long term liabilities*	37	37
Total external debt	434	420
CFR* (year end position)	**468**	**476**
Under-borrowing	**34**	**56**

** Includes on balance sheet PPP schemes and finance leases etc.*

3.16 The Authorised Limit is a statutory requirement which represents the limit beyond which borrowing is prohibited and sets an overall control on the level of borrowing. This limit reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. The approved Authorised Limit is £518 million, and as highlighted in the table above, the Council continues to operate well within approved limits, and therefore there is no change to the overall strategy required.

Part D - Investment Portfolio 2019-20

3.17 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 consistent with the Council's risk appetite. Wider loan interest rates remain low and in line with the current 0.75% Bank Rate. It is anticipated that any future increases in interest Bank rates will be gradual and given this, investment returns are likely to remain low.

3.18 Investment decisions during the first 6 months of 2019-20 are in accordance with the approved strategy. Table 3.5 below sets the investment activity during this period, with a summary set out below:

- Four short-term investments were made, with two being repaid during the period and the third investment maturing in the next six months.

- The fourth short term investment is in a 95 day notice account. Any remaining surplus cash balances are held in the Council's bank account.

Table 3.5

Date of Investment	Borrower	Amount	Interest rate	Date repaid
07/06/19	Nottingham City Council	£ 5m	0.75%	23/09/19
20/06/19	Central Bedfordshire Council	£ 5m	0.75%	20/09/19
28/08/19	Goldman Sachs	£ 5m	0.82%	Loan to be repaid on 28/11/19
28/08/19	Lloyds 95 day notice	£ 5m	1.10%	

3.19 An external investment management company, Investec, manages East Lothian Council Common Good funds and Charitable Trust funds in two separate portfolios. At 30 September 2019, the East Lothian Charitable Trust portfolio was valued at £3.543m, which represents an increase of £0.150m over the 6-month period. The performance of this portfolio for the first 6 months is slightly less than the benchmark.

3.20 The Common Good portfolio was valued at £3.612m an increase of £0.153m over the 6 month period. The expectation is that this portfolio should grow the fund and generate the best income at the minimal risk, the performance in the first 6 months is in line with this expectation given the current market conditions. The returns on these investments continue to be closely monitored during the year.

Part E – Borrowing Strategy 2019-20

3.21 On 9 October 2019, the Treasury and PWLB announced a 1% increase in the PWLB rate for all new borrowing, with immediate effect and without any warning. In recent years, the Council has predominately used PWLB as its main source of funding partly due to the level of risk and interest rates available. An anticipated increase in interest rates had already been included within future capital investment plans, and therefore this increase is unlikely to impact in this financial year. Going forward however, the Council may need to consider further both the affordability of capital investment plans and potentially seek alternative sources of borrowing in order to achieve the best rates and terms. Whilst it remains unclear as to any further increase in borrowing rates, the Council's treasury advisor, Link Asset Services is currently forecasting that all PWLB rates are likely to increase over the next few years.

3.22 Table 3.6 below sets out the new external borrowing taken in the first 6 months of the financial year. Furthermore, due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR, currently £476m), it is anticipated that additional new external borrowing of £24m is required during the second half of this financial year.

Table 3.6

Date of Loan	Lender	Amount	Interest rate	Loan Term	Maturity Date
16/08/19	PWLB	£ 5m	1.82%	20 years	15/08/39
16/08/19	PWLB	£ 5m	1.91%	30 years	15/08/49
16/08/19	PWLB	£ 5m	1.81%	50 years	16/08/69

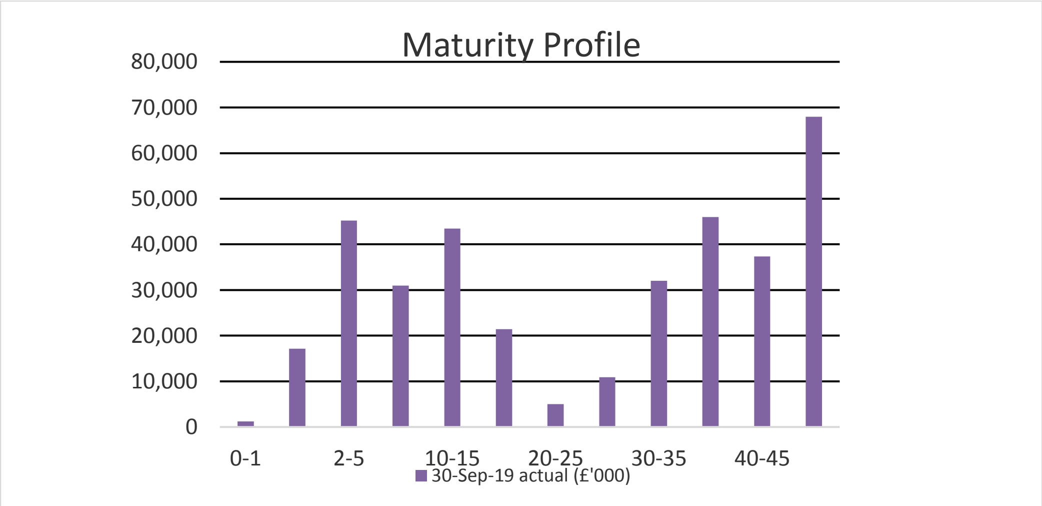
3.23 Two PWLB loans matured during the first six months and were repaid as set out in Table 3.7 below, and no short term loans taken or repaid during this time.

Table 3.7

Date repaid	Principal	Maturity	Interest rate
24/09/19	£5m	9 years	4.04%
24/09/19	£10m	9 years	4.06%

Current Loan Maturity Profile

3.24 The graph below sets out the current loan maturity profile for the Council, which remains consistent with the approved Strategy.



Part F – Debt Rescheduling

3.25 Debt rescheduling opportunities have been very limited in the current economic climate and as such, no debt rescheduling has therefore been undertaken to date in the current financial year. The increase in PWLB rates only applies to new borrowing, not to premature repayment rates.

4 POLICY IMPLICATIONS

4.1 There are no direct policy implications associated with this report however the Council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 INTEGRATED IMPACT ASSESSMENT

5.1 The subject of this report has been considered and given there is no change in policy direction, there is no requirement to undertake any further impact assessment.

6 RESOURCE IMPLICATIONS

6.1 Financial - There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.

6.2 Personnel - none

6.3 Other – none

7 BACKGROUND PAPERS

7.1 Treasury Management Strategy 2019/20 to 2023/24 – East Lothian Council 26 February 2019

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