

2019/20 Treasury Management Mid-Year Performance Report and Strategy Update

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Purpose of Report

1. This report has been prepared for Council to approve the mid-year Treasury Management Strategy Statement and Investment Strategy for 2019/20. The report provides up to date market context information and year to date treasury performance data. There are no changes to the strategy or operating parameters that were agreed by Full Council in February 2019. The Audit Committee noted progress and approved the updated strategy report on 24 October 2019 for recommendation to Full Council.

Recommendations

2. The Audit Committee recommends that Council approve the updated Treasury Management Strategy Statement and Investment Strategy for 2019/20.

Introduction and Background

3. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services Code of Practice requires the Council to approve an annual Treasury Management Strategy, report treasury performance mid-year and at the year end.
4. The Council has invested substantial sums of money and is therefore 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 risk is therefore central to the treasury management strategy.
5. In line with the requirements of the Prudential Code, Council approved a Capital Strategy in February 2019. This is a summary document covering capital expenditure and financing, treasury management and non-treasury investments.
6. Council also approved an Investment Strategy in February 2019, in line with MHCLG Statutory Investment Guidance. The Investment Strategy focuses on two investment types which are commercial investments and investments made for service purposes.
7. This report provides information on the performance of the Council's Treasury Investments for the first six months of the 2019/20 financial year. The performance of the Council's Commercial Investments which are part of the Commercial strategy are reported separately through 6-monthly update reports therefore that detail is not included in this report. On this basis it is worth noting that whilst the treasury income and cost implications of commercial investment acquisitions are included within this report, the investment property income is not. The S151 Officer proposes to develop a consolidated report in future to provide councillors with the full picture in one place.

8. CIPFA has defined Treasury Management as: “the management of the organisation’s 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.”
9. The Council has delegated responsibility for the oversight and monitoring of its treasury management policies and practices to Audit Committee, and for the execution and administration of treasury management decisions to the S151 Officer who will act in accordance with the organisation’s policy statement and Treasury Management Practices (TMPs), and CIPFA’s standard of Professional Practice on Treasury Management.
10. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Specific risks are identified in the Council’s approved Treasury Management Practices. The risks include:
 - Liquidity Risk (Adequate cash resources)
 - Market or Interest Rate Risk (Fluctuations in the value of investments and borrowing).
 - Inflation Risks (Exposure to inflation)
 - Credit and Counterparty Risk (Security of Investments).
 - Refinancing Risks (Impact of debt maturing in future years).
 - Legal & Regulatory Risk (Compliance with statutory and regulatory requirements).
 - Management Practices for non-treasury investments.
11. The Local Government Act 2003 requires the Council to ‘have regard to’ the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council’s policies for managing its investments and for giving priority to the security and liquidity of those investments.
12. When the strategy for 2019/20 was written it took into account the Council’s current treasury position and drew upon the forecasts for interest rates provided by the Council’s treasury advisors, Arlingclose, leading to the proposed Prudential Indicators included. This has been updated with the most recent forecast as at September 2019.
13. The updated Treasury Management Strategy is attached at Appendix 1.
14. The remainder of the report provides information on:
 - Regulatory updates
 - Treasury Management Position
 - Current Borrowing
 - Treasury Investment Activity
 - Pooled Fund Investments
 - Non Treasury Investments

Regulatory Update

15. The regulatory change that impacted on the accounting treatment of investments, and therefore the treasury investments, is IFRS 9 which is the new accounting standard for financial instruments. The standard applied to local authorities from the 2018/19 financial year.

16. The investment type impacted by the IFRS9 accounting standard is pooled funds, in which the Council has significant investments. The amount invested in pooled funds as at 30 September 2019 is £23.25m, from a total investment portfolio of £31.4m.
17. The accounting treatment of a Pooled Fund investment requires the fair value of the investment to be recognised in the accounts at year end. Therefore, at the end of each financial year an adjustment to the value of the investment is made to reflect the 'fair value' as at that date. Before these IFRS9 changes the accounting treatment allowed the in-year increase or decrease in the fair value of the investment to be transferred to the 'Available for Sale reserve' at year end. This accounting treatment meant that there was no effect on the general fund and the taxpayer. The new IFRS9 requirements changed the accounting treatment and removed the ability to transfer the in-year gain or loss due to the change in fair value of the investment to the Available for Sale Reserve.
18. The revised treatment is to take the change in value of the investment to the income and expenditure account meaning this impacts on the 'bottom line'. In order to mitigate this impact for a 5-year transitional period starting in April 2018, the MHCLG has introduced a statutory override meaning valuation changes can transfer to a 'pooled fund adjustment account'. It is assumed that after this transitional period any changes in valuation will represent an immediate gain or loss which will need to be reported against the budget and affect usable General Reserve balances.

Treasury Management Position - Summary

19. The treasury management position at 30th September 2019 and the change during the year is shown in the Table 1.

Table 1: Treasury Management Position - Summary

	31/3/19 Balance £m	Net Movement £m	30/9/19 Balance £m
Long-term borrowing			
Short-term borrowing	-19.50	-20.00	-39.50
Total borrowing	-19.50	-20.00	-39.50
Long-term investments	3.00	-	3.00
Short-term investments	4.00	-	4.00
Cash and cash equivalents	23.73	0.68	24.41
Total investments	30.73	0.68	31.41
Net Position	11.23	-19.32	-8.09

20. External borrowing has increased during the first six months of the year, reflecting the financing of planned capital expenditure, particularly in respect of investment property acquisition. In line with treasury advice, the Council continues to utilise short term borrowing, which is flexible and keeps our borrowing costs low. The increased income from investment properties acquired during the year was reflected in the mid-year Revenue Budget Monitoring report to District Executive on 7 November 2019, and is not included in this report.
21. The projected value of long term borrowing as at 31 March 2020 was reported to Audit Committee in February 2019 in the Annual Treasury Management Strategy report. The external borrowing requirement at the end of the 2019/20 financial year was anticipated to be £50m, therefore the increase in borrowing of £20m is in line with the projections previously reported and continue to remain valid.

22. The amount of external borrowing will be dependent on the commercial property purchases that are made in the remaining part of the financial year which may mean the borrowing may be more or less than £50m at year end. In addition, it may be advantageous to continue to meet the financing requirement using short term rather than long term borrowing, however this is kept under review to strike the appropriate balance between costs and cost certainty.

External Borrowing

23. The graph shows the movement in the external borrowing position for 2019/20. It provides the amount of external borrowing on the first day of each month for the April to September period and the value of borrowing at 30 September 2019 (£39.5m).



24. Table 2 summarises the external borrowing position for 2019/20. It includes the opening position in respect of external loans, loans repaid, new loans, the average interest rate and the position as at 30th September.

Table 2: External Borrowing Summary

	Amount	Average Interest rate
External loans as at 1 April 2019	19,500,000	0.86%
New Loans	56,500,000	0.85%
Loans Repaid	-36,500,000	
Total External loans as at 30 Sept 19	39,500,000	0.78%

25. The total value of borrowing repaid in the first six months of 2019/20 was £36.5m, which included £19.5m of short-term borrowing undertaken in the previous financial year. See table 3 for details.

Table 3: Loans repaid - 2018/19 borrowing

Lender	Date Borrowed	Maturity Date	No of Days	Interest Rate	Amount £
The Vale of Glamorgan Council	22/01/2019	01/04/2019	69	0.79%	1,500,000
Derbyshire County Council Pension Fund	15/02/2019	01/04/2019	45	0.90%	10,000,000
Coventry University	18/03/2019	18/04/2019	31	0.90%	8,000,000
				Total	19,500,000

26. The total value of new borrowing for the first six months of 2019/20 was £56.5m. £17m of the loans taken were repaid in the period, details of the loans are included in table 4.

Table 4: 2019/20 new borrowing - Loans repaid

Lender	Date Borrowed	Maturity Date	No of Days	Interest Rate	Amount £
Leeds City Council	16/08/2019	17/09/2019	32	0.60%	5,000,000
Blaenau Gwent County Borough Council	30/08/2019	02/09/2019	3	0.57%	1,500,000
Blaenau Gwent County Borough Council	09/08/2019	30/08/2019	21	0.57%	3,000,000
Armagh City Banbridge and Craigavon Borough Council	22/07/2019	02/08/2019	11	0.65%	2,000,000
Police and Crime Commissioner for Staffordshire	22/07/2019	01/08/2019	10	0.65%	4,500,000
Blaenau Gwent County Borough Council	22/05/2019	03/06/2019	12	0.65%	1,000,000
				Total	17,000,000

27. The balance of £39.5m is the value of external borrowing as at 30 September 2019, the detail of the loans is included in the table 5. The table shows that we have prioritised the inter-authority lending market, with the short-term loan interest rates ranging from 0.68% to 1.05%.

Table 5: External borrowing as at 30 September 2019

Lender	Date Borrowed	Maturity Date	No of Days	Interest Rate	Amount £
North Ayrshire Council	01/04/2019	30/03/2020	364	1.05%	4,000,000
London Borough of Ealing	01/04/2019	30/03/2020	364	1.05%	2,000,000
Hampshire County Council	18/04/2019	17/04/2020	365	1.01%	5,000,000
Royal Borough of Kensington & Chelsea	18/04/2019	17/01/2020	274	0.95%	5,000,000
Essex County Council	19/09/2019	19/12/2019	91	0.70%	7,000,000
Thurrock Council	20/08/2019	20/11/2019	92	0.70%	5,000,000
Hertfordshire County Council	20/08/2019	20/11/2019	92	0.70%	6,000,000
The Vale of Glamorgan Council	18/04/2019	18/10/2019	183	0.80%	3,000,000
Police and Crime Commissioner for Staffordshire	27/09/2019	15/10/2019	18	0.68%	2,500,000
				Total	39,500,000

28. The above information in tables 2-5 show that the current strategy of utilising short-term inter-authority lending for the Council's treasury borrowing requirement means interest rates and costs are relatively low. This approach takes advantage of the low rates on offer, and accepts an element of interest rate risk at the point of re-financing. The S151 Officer and treasury staff will continue to keep this under review, and will consider utilising long term borrowing in future to minimise interest risk and provide cost certainty.

29. By comparison, treasury investment returns achieved (shown below) are higher than the cost of borrowing achieved, and the gross yield on commercial property investment (reported separately) is significantly higher than the current cost of borrowing.

External Borrowing Interest

30. The interest on borrowing (including brokerage fees) as at 30 September 2019 and the projected interest payable for 2019/20 are included in table 6.
31. Assumptions in respect of the interest payable on future borrowing are, if an existing loan matures in the remaining part of the financial year the borrowing is replaced at the same value and interest rate. The average rate payable on borrowing for the period to 30 September is 0.78%.
32. As detailed above the current amount of external borrowing is £39.5m, the interest on future borrowing assumes an increase of £10.5m to the projected year end borrowing estimate of £50m. The estimated interest rate applied to the increase is 0.90% which is higher than the average borrowing rate to date but the assumption is that the borrowing will be required for a year and generally a longer borrowing period attracts a higher interest rate.
33. The interest costs shown below applies to the total borrowing undertaken by the Council including in respect of commercial investments. It is worth noting that commercial investments have been benchmarked using a long-term borrowing cost which is significantly higher than is currently being achieved, representing a positive short term treasury gain (in addition to the investment income which is covered under separate reporting – next report due to District Executive in January 2020). Gross commercial investment income is significantly above the cost of borrowing, providing a healthy surplus as reported in the Month 6 Budget Monitoring Report to District Executive. In line with the financial strategy, it is planned to set aside this surplus in 2019/20 to the Investment Risk Reserve, strengthening financial resilience in respect of commercial activity.
34. Details of the current policy regarding borrowing is included in the previous section of the report.

Table 6: External borrowing interest projection

	Interest £	Brokerage £	Total £
Interest to 30 September 2019			
Borrowing Repaid	8,454		8,454
Current Borrowing	96,830	22,248	119,078
	105,284	22,248	127,532
Interest due 1 October - 31 March			
Current Borrowing	99,614		99,614
Future Borrowing (Estimate)	88,357	16,320	104,677
	187,971	16,320	204,291
2019/20 Projected Total	293,255	38,568	331,823

Public Works Loans Board – Interest Rate Rise

35. The Public Works Loan Board (PWLB) is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The function of the PWLB is to lend money from the National Loans Fund to local authorities, and to collect the repayments.
36. PWLB rates have been historically low in recent times meaning borrowing from the loan facility has increased significantly with local authorities using the borrowing to invest in commercial property to produce a financial return to invest in services.
37. Between April and early October 2019 the interest rate on a new 50-year maturity loan peaked at 2.61% (early May) but the rate dropped to a low of 1.77% in early September.
38. On Wednesday 9th October the PWLB announced a whole percentage point increase in the rate of borrowing on new loans, meaning the rate for a 50-year new maturity loan from 1.81% to 2.82% overnight.
39. The Council have a continuing need to borrow, the borrowing strategy includes the PWLB and a number of other options. The Council's treasury management advisors are in regular contact with officers providing advice on the options available and therefore ensuring the borrowing costs are kept to a minimum.

Treasury Investment Activity

40. The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the first six months of the financial year the Council's investment balance has ranged between £31 million and £46 million.

Breakdown of investments as at 30 September 2019

Table 7: Investments as at 30 September 2019

Date Invested	Counterparty	Nominal Amount £	Interest Rate	Maturity Date
11/11/16	Northumberland County Council	1,000,000	1.00%	11/11/20
09/02/17	Liverpool City Council	2,000,000	0.92%	11/11/19
	Corporate Bonds			
20/10/16	Santander UK Plc *Covered*	1,000,000	1.04%	14/04/21
10/11/16	National Australia Bank *Covered*	1,000,000	1.10%	10/11/21
	Floating Rate Notes (FRN's)			
16/01/17	Lloyds Bank Plc *Covered*	1,600,000	0.99%	16/01/20
16/01/17	Lloyds Bank Plc *Covered*	400,000	0.98%	16/01/20
	Money Market Funds			
Various	Aberdeen (previously Standard Life)	1,160,000	0.75%	Not fixed
	Total Internal Investments	7,000,000	0.95%	
	Property & Pooled Funds			
Various	Payden Fund VNAV	1,000,000	0.94%	Not fixed
Various	Royal London Cash Plus Fund	1,000,000	1.42%	Not fixed
Various	CCLA Property Fund	5,000,000	5.26%	Not fixed
Various	Investec Diversified Income Fund	5,000,000	4.35%	Not fixed
Various	Schroder Income Maximiser Fund	6,250,000	9.11%	Not fixed
Various	Colombia Threadneedle Equity Income Fund	5,000,000	2.52%	Not fixed
	Total External Investments	23,250,000	3.54%	
	Total Investments	31,410,000	2.84%	

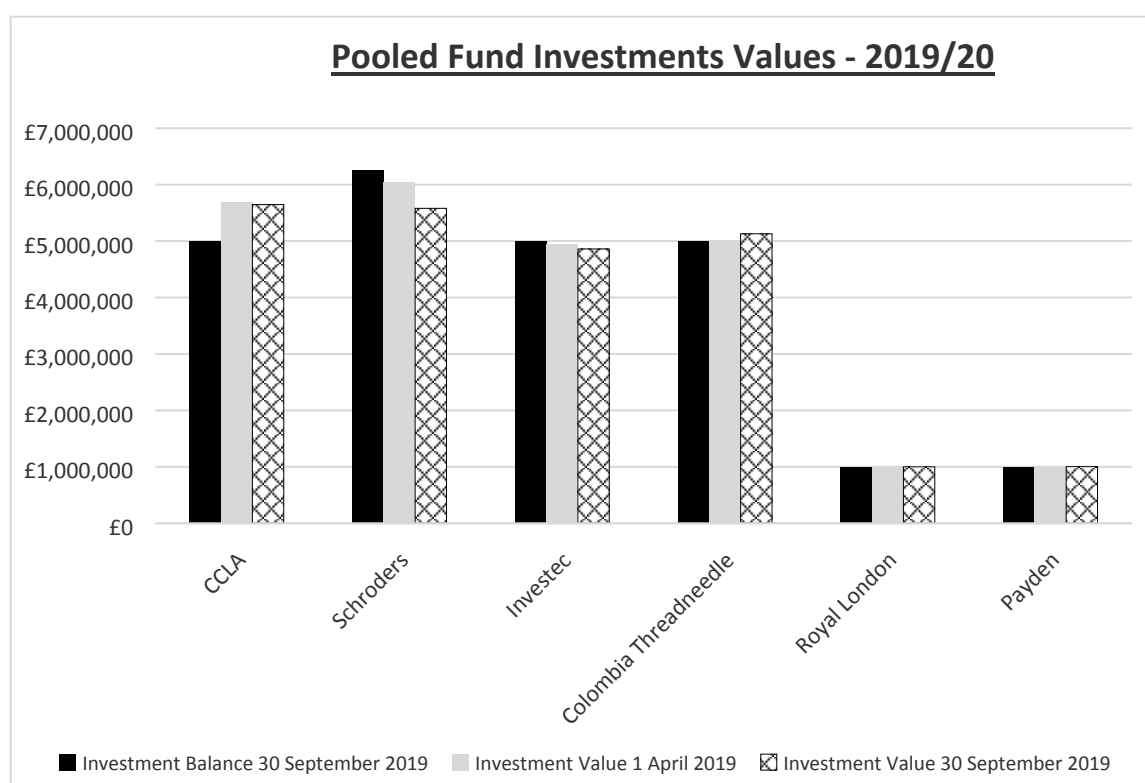
Note: Money Market Funds are instant access accounts so the rate displayed is a daily rate

***Covered Bond:** Debt securities issued by a bank or mortgage institution and are backed by a separate group of assets; in the event of failure of the issuer, the bond is covered. Covered bonds are subject to specific legislation to protect bond holders.

41. The Council has kept its strategic fund investments at £23.25m and it is estimated that the level of strategic investments as at 31 March 2020 will be between £25m and £30m.

Pooled Fund Investment - Values

42. The Council's pooled fund investments are held in externally managed funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. This fits with the objectives of the Council's overall Financial Strategy.
43. The investment balance as at 30 September 2019 and the value of each investment as at 1 April and 30 September is detailed in the chart below.



Note: Pooled fund investments are revalued to reflect the fair value of the investment, the second and third bars in the graph signifies this value at 1 April and 30 September. The first bar represents the nominal investment balance in each fund at 30 September.

44. The table 8 includes the opening and closing investment balances for each pooled fund investment. The investment fair value signifies the individual value of the investments after the year-end and mid-year valuation. The table shows that the 'fair value' of the portfolio has reduced by £461k (1.9%) between 1 April and 30 September, reflecting volatility in market value. The strategy works on the basis that invest values will go up and down but annual income return remains positive, and the Council would not plan to redeem the investment when its value is below the nominal balance unless this would be a prudent course of action.

Table 8: Pooled Fund Investments as at 30 September 2019

Investment	Investment Balance 30/09/2019 £	Investment Value 01/04/2019 £	Investment Value 30/09/2019 £
CCLA	5,000,000	5,690,293	5,646,759
Schroders	6,250,000	6,034,720	5,580,227
Investec	5,000,000	4,945,973	4,859,804
Colombia Threadneedle	5,000,000	5,008,789	5,128,690
Royal London	1,000,000	1,000,127	1,000,127
Payden	1,000,000	999,733	1,003,168
Total	23,250,000	23,679,635	23,218,775

Pooled Fund Investment – Income Return

45. The income generated from pooled fund investments for the first six months of 2019/20 and the rate of return is detailed in graph and table 9. This demonstrates that the investment in the Schroder Income Maximiser Fund has performed well in terms of income and rate of return on investment (but its market value has reduced as shown in the table above). Overall the return on pooled funds has positively averaged over 5% during the first six months of the financial year.

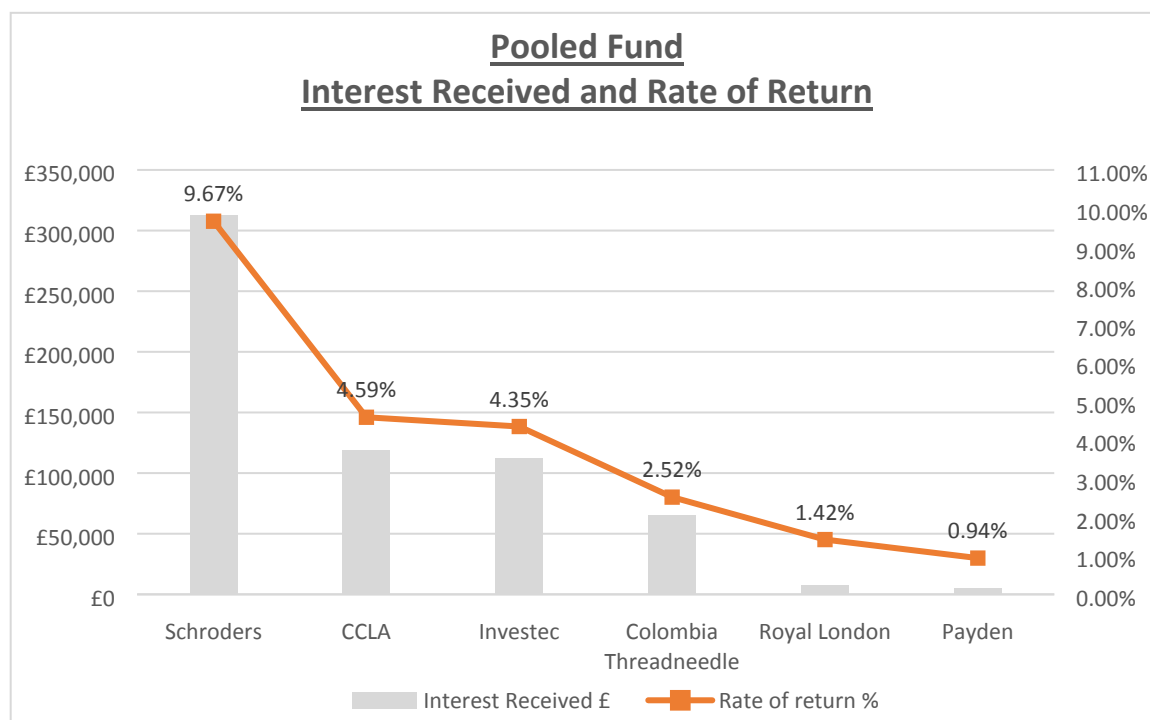


Table 9: Pooled Fund Investment Interest

Fund	Interest Received £	Rate of return %
Schroders	312,951	9.67%
CCLA	118,724	4.59%
Investec	112,619	4.35%
Colombia Threadneedle	65,204	2.52%
Royal London	7,315	1.42%
Payden	4,880	0.94%
Total	621,693	5.16%

Non-Treasury Investments

46. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.
47. In addition to its treasury investments, the Council also held £10.96m in other investments in the form of loans. The largest element of these loans represents the Council's loan invested as part of its commercial investment property portfolio.
- Loan to Community Organisation - £0.15m
 - Loan to Local Authority Partnership - £0.90m
 - Loan for Commercial Activities - £9.91m
48. The detail of the Council's total investment in commercial investment property is reported separately. As part of its Commercial Strategy, investment in property has increased significantly in the past two years, and this will continue to grow over the next 2-3 years. The value of investment properties held in the balance sheet as at 31 March 2019 (including some properties held for a substantial period of time) was £26.11m. This has increased by £26.85m during this year, to £52.96m as at 30 September 2019 (not including the loan shown in the previous paragraph).

Financial Implications

49. There are no additional financial implications in reviewing the attached treasury management strategy.

Background Papers: *Treasury Management Strategy 2019/20 (Full Council February 2019)*