Stevenage BOROUGH COUNCIL

Part I – Release to Press

Meeting:	**Audit Committee / Executive / Council**	**Agenda Item:**
Portfolio Area:	Resources	
Date:	**12 November / 20 November / 11 December 2019**	

2019/20 MID YEAR TREASURY MANAGEMENT REVIEW

NON-KEY DECISION

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1. PURPOSE

1.1 To update members on the Treasury Management activities in 2019/20 and review effectiveness of the 2019/20 Treasury Management and Investment Strategy including the 2019/20 prudential and treasury indicators.

2. RECOMMENDATIONS

2.1 That subject to any comments from Executive and the Audit Committee, recommend to Council to approve the 2019/20 Treasury Management Mid-Year review.

2.2 That subject to any comments from Executive and the Audit Committee, recommend Council to approve the latest approved Countries for investments (Appendix D).

2.3 That the updated authorised and operational borrowing limits are approved (paragraph 4.4.7)

2.4 That the updated MRP policy is approved (paragraph 4.4.10 and Appendix E)

3. BACKGROUND

3.1. This report covers one of three reporting requirements under the Prudential and Treasury Management Code of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), the other reports being;

- Annual Treasury Strategy (in advance of the year) (last reported to Council 27 February 2019)
- Annual Treasury Management Review after the year end (2018/19 was reported to Council 16 October 2019)

3.2 In December 2017, CIPFA revised the Code to require, all local authorities to report on:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

These elements are covered in the annual Capital Strategy reported to Council in February each year.

3.3 This report summarises:

- Capital expenditure and financing for 2019/20;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Reporting of the required prudential and treasury indicators, including the impact of the expenditure on the Council's underlying indebtedness (the Capital Financing Requirement);
- Update on the Treasury Management Strategy Position;
- An economic update for the first part of 2019/20.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 The Council's Capital Expenditure and Financing 2019/20

4.1.1 Capital expenditure[1] can be financed either by capital resources the Council has on its balance sheet (e.g. capital receipts & capital grants) or by making a revenue contribution to capital. If sufficient capital resources are not available to fund the expenditure the council would need to borrow to meet the funding gap. This borrowing may be taken externally in new loans or internally from cash balances held by the council (see also 4.3.3). The need to borrow is measured and reported through the prudential indicators.

4.1.2 The Treasury Management Strategy and Prudential Indicators for 2018/19 were originally approved by Council on the 27 February 2019. Since then, capital budget changes have been approved and the Prudential Indicators updated in the 2018/19 Annual Treasury Management Review (approved by Council 16 October 2019). The Treasury Management Mid-Year Review Indicators have

[1] Council expenditure can be classified as capital when it is used to purchase assets with a life of more than one year, exceeds £5,000 in value and meets the guidelines laid out in CIPFA accounting practises.

been updated based on the 1st quarter capital programme reported to Executive (11 September 2019).

4.1.3 Table One (shown below) shows the original capital programme, the revised capital programme (approval Executive 11 September 2019) and financing.

Table One: 2019/20 Capital Expenditure and Financing		
	2019/20 Original Capital Strategy (Council February 2019) £'000	**2019/20 Revised Mid-Year Review (1st Quarter Capital Strategy - Executive September 2019) £'000**
Capital Expenditure:		
General Fund Capital Expenditure	32,217	31,423
HRA Capital Expenditure	47,792	33,706
Total Capital Expenditure	**80,009**	**65,129**
• Capital Receipts	(12,537)	(7,383)
• Capital Grants / Contributions	(10,432)	(12,360)
• Capital Reserves	(1,606)	(2,427)
• Revenue contributions	(13,951)	(13,142)
• Major Repairs Reserve	(22,210)	(9,018)
Total Resources Available	**(60,736)**	**(44,330)**
Capital Expenditure Requiring Borrowing	**(19,273)**	**(20,799)**

4.2 The Council's overall borrowing position.

4.2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR)[2]. Whether physical borrowing is taken out depends on the level of cash balances held by the Council. The treasury service, manages the Council's cash position to ensure sufficient cash is available to meet the capital payments, based on the Capital Strategy and Treasury Management Strategy. This may be through internal borrowing from utilising cash balances held by the Council in the short to medium term or external borrowing such as using the Government, through the Public Works Loan Board (PWLB) or the money markets).

4.2.2 The 2019/20 Capital Strategy identified the need for borrowing for financing elements of the capital programme. The Council has not undertaken any new external borrowing to date in 2019/20.

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[2] Capital Financing Requirement (CFR) represents the amount of debt the Council needs to/has taken to fund the capital programme after debt repayments and Minimum Revenue Provision (MRP) are taken into account

4.2.3 On 9 October 2019 the Treasury and PWLB announced an increase in the margin over gilt yields of 100bps[3] on top of the current margin of 80bps. The margin of 80bps had been used for all Council project appraisals including the HRA business plan, Wholly Owned Housing company and investment portfolio. There was no prior notification to the increase and it now means that every local authority has to reassess how to finance their external borrowing needs and the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing. Representations have been made to HM Treasury to suggest that areas of capital expenditure that the Government are keen to see move forward e.g. housing, should not be subject to such a large increase in borrowing. Council schemes are now being re-assessed in light of this unscheduled increased by the Treasury.

4.2.4 In 2019/20 the average cash holding between April and September was £63Million (£64Million April to September 2018/19). While investment returns are low the "internal" borrowing rate is significantly cheaper than the cost of external borrowing and remains a prudent use of the Council's cash balances, unless it is prudent to secure long term borrowing in accordance with the HRA business plan.

4.2.5 As at the 30 September 2019 the Council had total external borrowing of £205,351,003 (projected to increase to £225,747,601 by 31 March 2020 if all approved borrowing is taken as per the revised capital programme approved by Executive 11 September 2019.

4.2.6 The General Fund has £2,677,103 external borrowing with the PWLB. When expenditure is incurred on the purchase of commercial property the decision to take out the remaining balance of approved borrowing (£15million) will be reviewed. To accelerate the purchase process, agents were appointed. In the meantime other purchase options are also currently being pursued. Updates will be provided in the Capital Strategy updates reported to Executive.

4.2.7 The HRA has external borrowing of £202,674,000 with the PWLB, with the majority of the HRA debt (£194,911,000) taken out in March 2012 to finance the payment required to central government for self-financing. This debt was arranged over a number of loans at fixed rates and with varying maturities and is not impacted by the recent increase in PWLB rates.

4.2.8 The HRA borrowing includes £7,763,000 used to fund the pre 2012 decent homes programme. This debt was called 'supported borrowing' under the former HRA subsidy system but now forms part of the HRA debt portfolio. The remaining difference between the HRA debt portfolio and CFR at 31 March 2020 is the result of asset transfers from General Fund to the HRA (£1,598,500) and HRA internal borrowing prior to self-financing (£2,550,480).

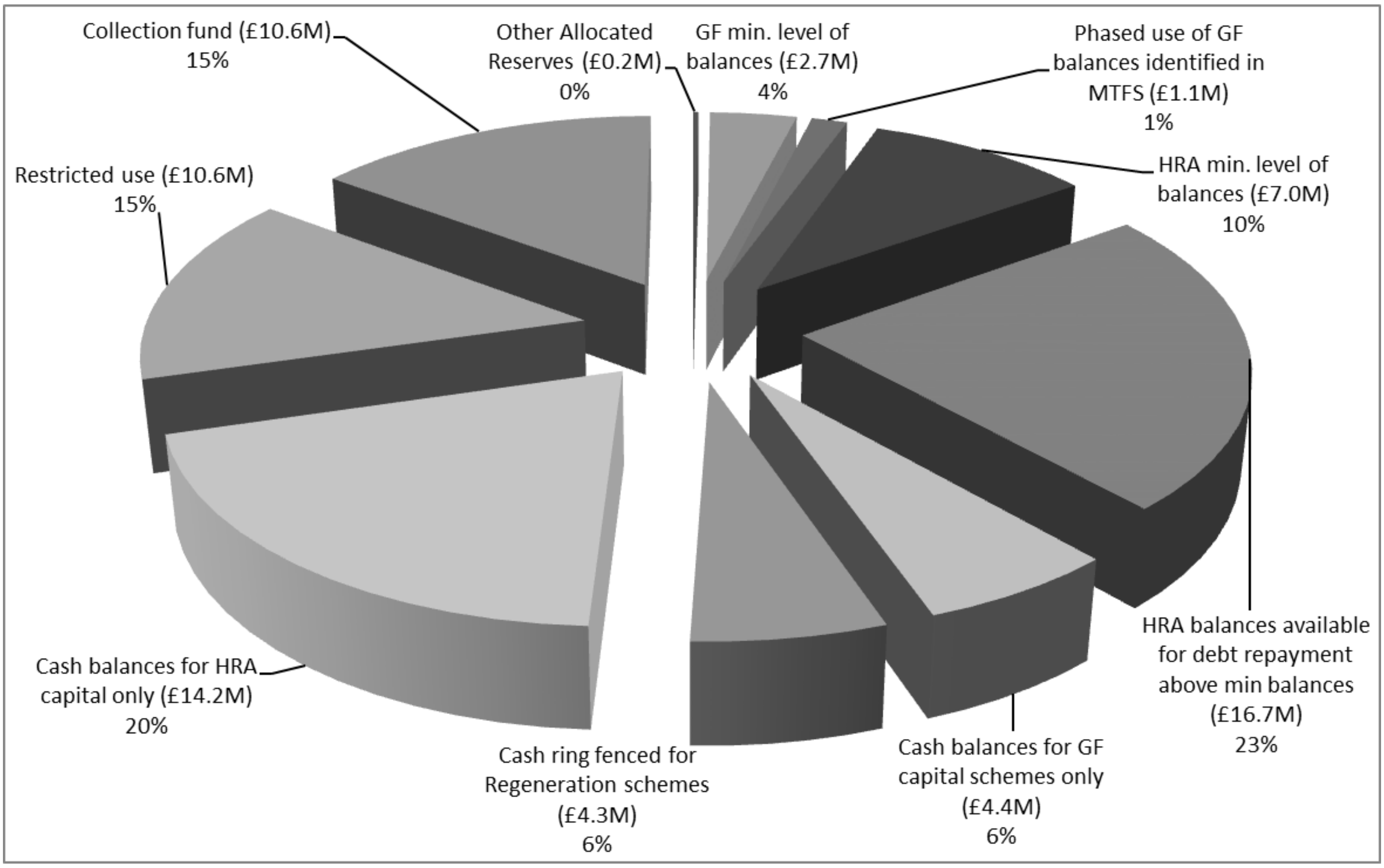
4.2.9 Since the lifting of the HRA Debt Cap, which was formerly £217,685,000, HRA borrowing limits are based on affordability rather than legislation. These limits are now reviewed as part of the annual HRA Business Plan review, the latest review of which is currently being undertaken.

[3] 100bsp is 100 basis points, the equivalent of 1%.

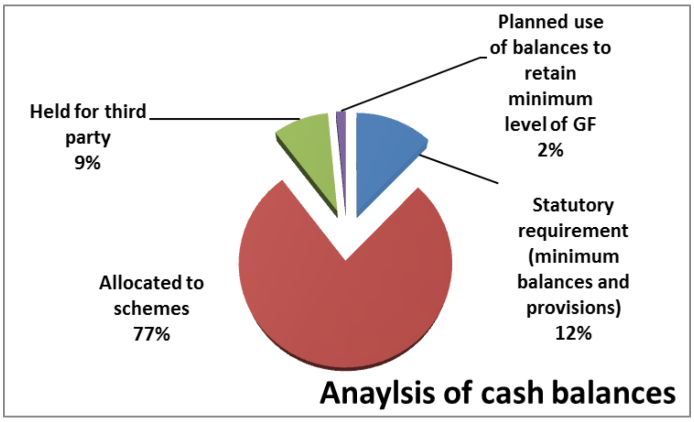
4.3 Cash balances and cash flow management

4.3.1 As at 1 April 2019 cash balances held by SBC totalled £54.1Million. Balances are forecast to increase as the lifting of the HRA debt cap means that budgeted use of resources to support the capital programme can be replaced with external borrowing. The revised cash balance expected to be held as at 31 March 2020 is £63.7Million. The breakdown of these cash balances is shown in the following chart

Chart One: Cash Balances expected as at 31 March 2020



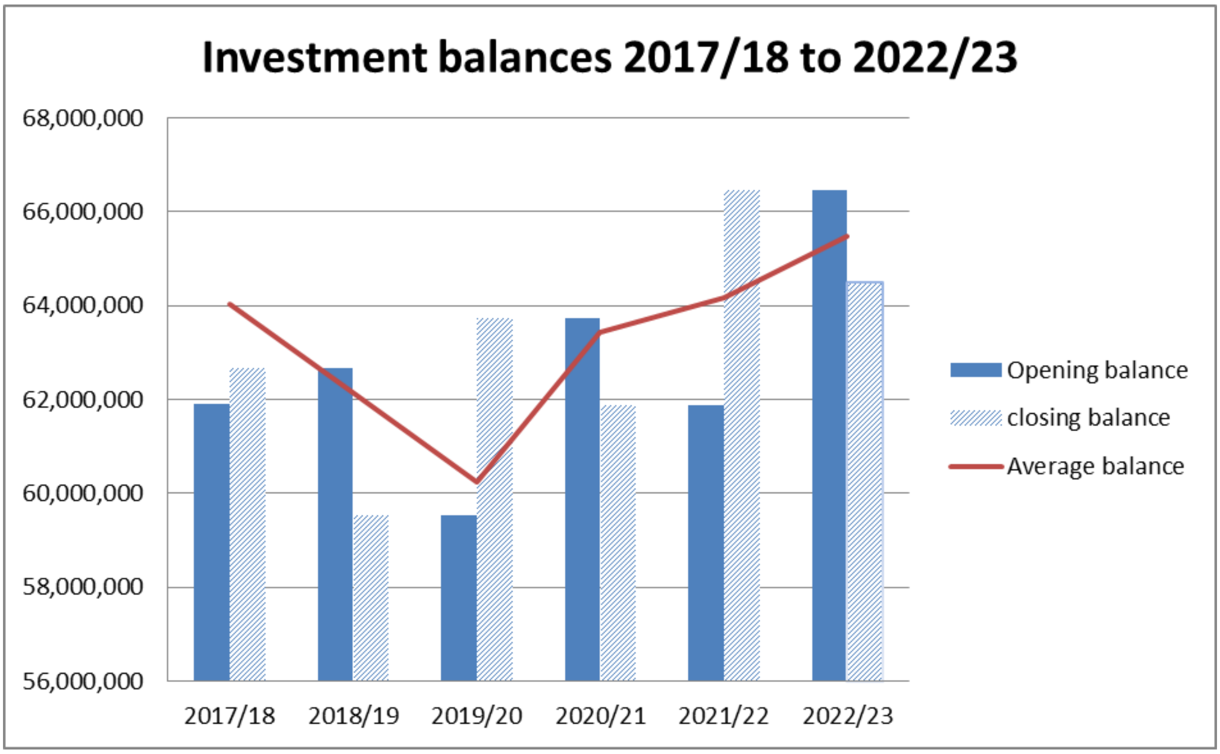
4.3.2 These cash balances can be further analysed between allocated, held for statutory requirements and held for third parties. This identifies that of the £72Million, all cash resources have been allocated, so unless allocated reserves are no longer needed in the future, there are **currently no cash resources available** for new projects. In addition the capital strategy requires external borrowing and currently £401k of General Fund capital schemes are on hold pending matching capital receipts.



4.3.3 While cash balances are high waiting for the schemes to be delivered Currently balances are expected to be £63.7Million by 31 March 2020 (cash balances £71.8M less internal borrowing of £8.1M), but is dependent on current spending projections and approved borrowing included in the capital strategy and current HRA business plan (General Fund - £14.053million and HRA - £6.746Million) for 2019/20. Decisions as to when this borrowing is actually taken will be considered based on cash balances and anticipated interest rates.

4.3.4 The forecast investment balances to 2022/23 has been updated to reflect the changes in funding the HRA capital programme and the use of external borrowing instead of revenue contribution.

Chart Three: Investment Balances forecast



4.4 Prudential Indicators

4.4.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators, (which affordability limits), are included in the approved Treasury Management Strategy and an update on those indicators is included in this report. During the year to date, the Council has operated within the treasury and prudential indicators set out in that strategy. Further explanation of key prudential indicators is given below and is also shown in Appendix A.

4.4.2 **Borrowing and the 2019/20 Capital Financing Requirement (CFR)** - The Council's underlying need to borrow for capital expenditure is referred to as the Capital Financing Requirement (CFR). The Council's original estimate and latest CFR for the year is shown below. The estimate of the CFR for 2019/20 has been updated for the capital strategy approved by Members (11 September 2019 Executive) and for early discussion with external auditors regarding the accounting treatment of the Queensway lease. Further updates may be required pending completion of the external audit.

4.4.3 The HRA Business Plan will be reported to the November Executive and will include new proposed borrowing following the lifting of the HRA debt cap. The CFR and prudential indicators included in this report have been updated to reflect these proposed changes.

Table Two : Capital Financing Requirement 2019/20			
CFR Calculation	2019/20 Original: Annual TM Strategy (Approved Council February 2019) £'000	2019/20 Revised: Annual TM Review of 2018/19 (Approved Council October 2019) £'000	2019/20 Revised: Mid-Year Review (Executive November 2019) £'000
Opening Balance	**223,488**	**221,941**	**235,869**
Closing Capital Financing Requirement (General Fund)	35,841	35,841	41,967
Closing Capital Financing Requirement (Housing Revenue Account)	210,729	210,729	214,224
Closing Balance	**246,570**	**246,570**	**256,191**
Increase/ (Decrease)	**23,082**	**24,629**	**20,322**

4.4.4 Total debt repayments made in the first half of 2019/20 relating to principle on PWLB General Fund loans were £131,579 (paid in August). A further repayment of £131,579 will be made in February 2020 in relation to General Fund debt.

4.4.5 The Council could further reduce its CFR by:

- The application of additional capital financing resources (such as unapplied capital receipts) if available; or
- Charging more than the statutory revenue charge (Minimum Revenue Provision (MRP)) each year through a Voluntary Revenue Provision (VRP) which would increase the cost to the General Fund

4.4.6 The **net borrowing position** of the Council at 31 March 2020 is estimated to be **£177.6M** (total borrowings/loans of £241.3M less total investments held of £63.7M). This updated position includes anticipated new borrowing included in the updated HRA business plan, reported to Executive in December.

4.4.7 The **operational boundary and authorised limit** refer to the borrowing limits within which the treasury team operate. To date there have been **no breaches** of either limit in 2019/20.).

4.4.8 As raised in the Treasury Management report to Council, at the time of publication of this report the external audit of the 2018/19 accounts had yet to be completed. Borrowing limit changes are required following the audit due to technical accounting treatment requirements and this has been reflected in changes to the opening CFR (para 4.4.2). Any further changes following the completion of the external audit will be reported to Members in subsequent reports. These changes do not increase any borrowing, and do not increase interest costs or MRP costs to the General Fund. The changes just relate to technical accounting treatment and there have been no breaches in the operational or authorised borrowing limits in 2018/19.

4.4.9 Further to the lifting of the debt cap and treatment of the Queensway lease, both limits have been updated and officers propose a revision of the operational and authorised borrowing limits as shown in Appendix A.

4.4.10 **Minimum Revenue Provision** (MRP)[4] – In 2019/20 the MRP charged to the General Fund will be £622,324, based on previous years' borrowing. As mentioned previously Officers have undertaken a MRP review, specifically asset lives used in calculating MRP. Based on revised asset lives an underpayment of £11,812 has arisen and officers propose a voluntary MRP is made in 2019/20. As the current MRP policy is applied retrospectively the other changes to MRP will be implemented in 2020/21 and have been incorporated into the 2020/21 budget setting process.

4.4.11 MRP needs to be made regardless of whether actual external borrowing has been taken and hence differs from the treasury management arrangements, the latter considers utilising cash balances when borrowing rates are higher than investment interest rates.

4.4.12 In the Annual Treasury Management Review of 2018/19, approved by Council in October 2019, Officers recommended that the MRP policy should be reviewed in light of the investments being made and possible extension to the useful life of certain assets. The review has been concluded and took into account the freehold/leasehold classification of the asset and investment decisions relating to that asset. The updated MRP policy is shown in Appendix E. Should Members approve the change, the additional income will be available to support regeneration schemes in the future. The updated MRP policy will become operational from 2020/21 with budget changes incorporated into the 2020/21 budget setting process for the General Fund (HRA is unaffected by MRP).

4.4.13 The **ratio of financing costs to net revenue stream** is equal to General Fund interest costs divided by the General Fund net revenue income from Council Tax and RSG/NDR. For 2019/20 this indicator has changed due to changes to MRP, re profiling of garages business plan and the revised capital programme figures are shown in Appendix A.

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[4] MRP- The Council must base its borrowing decisions in accordance with the Prudential Code which requires the Council to demonstrate a need to borrow and to show the cost of that borrowing for the General Fund is affordable. The Council's MRP policy, as required by CIPFA guidance, is approved annually by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement and the life of the assets for which borrowing was required.

4.4.14 The treasury management indicators for 2019/20 onwards have been calculated based on the 1st quarter capital programme reported to Executive 11 September 2019. There will be subsequent updates to the capital programme including the capital bidding process for the period 2020/21 to 2024/25 and as such the data relating to future years is indicative only and will be subject to change. The full list of Treasury Prudential Indicators is shown in Appendix A.

4.5 Update on Treasury Management Strategy Position 2019/20

4.5.1 The Council's debt and investment position is managed by the treasury management section to ensure adequate liquidity for revenue and capital activities. In addition, investment decisions are based on the security of the investments and spread over a number of counter parties to manage the Council's exposure to risk.

4.5.2 The Council's **average investment returns** are modest due to historically low Bank of England Base Rate which is currently 0.75% and the risk appetite in the treasury management strategy. As at 30 September 2019 the 2019/20 average rate of interest being earned on investments was 0.98% (compared to 0.86% earned in 2018/19). This exceeded the 7 day LIBID benchmark rate of 0.57% (source: LINK Asset Services 30-9-19).

4.5.3 While costs for loans of between eight and ten years are around 2.38% - 2.50% (as at 17 October 2019 post PWLB increase) it is still prudent to utilise the Council's cash balances (as shown in paragraph 4.3.1) for short-term internal borrowing. However, PWLB borrowing costs have increased and are forecast to increase and officers will be determining whether it may be prudent to take some borrowing at lower interest rates based on the forecast reduction of future cash balances and borrowing identified in the HRA business plan. The decision and timing of when to borrow is being monitored by officers.

4.5.4 The Council's treasury position for the first half of year was as follows;

Table three Treasury Position 2019/20

	30 Sep 2019 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 Mar 2020 Principal £'000s	Rate / Return %	Average Life (Yrs)
Fixed rate loans - PWLB	205,351	3.37	15	205,220	3.37	16
Queensway Lease				13,928		
General Fund Prudential Borrowing				13,651		
HRA Borrowing				8,556		
Total Borrowing	**205,351**	**3.37**	**15**	**241,354**	**3.37**	**16**
CFR				257,441		
Over/(under) borrowing*				(16,087)		
Investments Portfolio	**61,750**	**0.98**		**63,741**	**0.93**	

** financed by internal borrowing*

4.5.5 The maturity structure of the debt portfolio was as follows (see also Appendix B):

Table four Maturity of Debt Portfolio for 2018/19 and 2019/20		
Time to maturity	**31 March 2019 Actual £'000's**	**30 September 2019 Actual £'000's**
Maturing within one year	263	263
1 year or more and less than 2 years	263	263
2 years or more and less than 5 years	527	395
5 years or more and less than 10 years	28,556	28,556
10 years or more	175,874	175,874
Total	**205,483**	**205,351**

4.5.6 There are two investments with **maturities over one year** as detailed below:

Counterparty	Country	Rating	Deposit amount	Start date	Maturity on
Great Yarmouth BC	UK	AA	2,000,000	16/05/2018	17/05/2021
Barnsley Metropolitan Borough Council	UK	AA	2,700,000	15/09/2017	15/09/2021
			4,700,000		

4.5.7 All other investments held during the first half of 2019/20 are due to mature within one year. A summary of the Council's exposure to fixed and variable rate investments is shown below in Table Five. (See also Appendix B).

Table Five : Fixed and Variable Rate Investment Totals		
	31 March 2019 Actual £'000's	**30 September 2019 Actual £'000's**
Fixed rate principal	46,210	42,000
Variable rate principal	7,925	19,750
Total	**54,135**	**61,750**

4.5.8 Since the last Treasury report, no further Money Market funds have been added to the portfolio, however a number of additional funds are being considered to increase the available pool of investment options.

4.5.9 There have been **no breaches** of treasury **counter party limits,** with the investment activity during the year conforming to the approved strategy. Any breach would be notified to the Chief Finance Officer. The Council has had no liquidity difficulties and no funds have been placed with the Debt Management

Office (DMO) during 2019/20, demonstrating that counterparty limits and availability for placing funds approved in the TM Strategy are working

4.5.10 The use of “Ultra Short Dated Bond” (USDB) funds was approved in February 2017. No investments have been made to date with USDB funds.

4.5.11 The updated list of “Approved Countries for Investments” is detailed in Appendix D.

4.5.12 **Money Market Fund Regulatory Change** took place in early 2019, and Liquidity (non-government) Funds have been converted from Constant Net Asset Value (CNAV) funds to Low Volatility Net Asset Value (LVNAV) pricing. Government-type funds will remain as “CNAV” funds under the new regulations. This change has not impacted on the existing treasury Management strategy.

4.5.13 As part of the Council regeneration programme and financial security objectives officers have establishing special purpose vehicles (SPV) to deliver regeneration in the town and to improve the offer in the private rented sector. These SPV’s have included a Limited Liability partnership and a wholly owned company. As completely separate legal entities the board of Directors of the SPV needed to delegate authority for the treasury management function to the Council, for officers to invest monies on behalf of the SPV’s subject to Director’s delegation. Any sums invested on behalf of theses SPV’s are to be done in accordance with the Councils own treasury management policies.

4.6 Economic Review & Interest Rate Outlook

4.6.1 **UK Growth**

The first half of 2019/20 saw a slowdown in UK economic growth due to Brexit uncertainty. In its Inflation Report of 1 August, the Bank of England was downbeat about the outlook for the UK economy. The Monetary Policy Committee (MPC) meeting of 19 September reemphasised their concern about the downturn and that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy.

4.6.2 **Inflation and Bank Rate**

CPI has been close to the Bank of England’s target of 2% during 2019, but fell to 1.7% in August. It is thought 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. The MPC has left Bank Rate unchanged at 0.75% in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC indicated concern about the outlook for both the global and domestic economies. The September MPC meeting showed increased concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

4.6.3 **Wage inflation**

Unemployment continued at 3.8% based on the Independent Labour Organisation measure in July and the participation rate was 76.1%. With unemployment continuing to fall, employers still have difficulty filling job vacancies with suitable staff. Wage inflation picked up to 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%.

4.6.4 **Eurozone Economy**
The downturn in Eurozone 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. At its March meeting it said that it expected to leave interest rates at their present levels "at least through to the end of 2019". 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. It is considered doubtful whether this loosening of monetary policy will have much impact on growth and the ECB stated that governments will need to help stimulate growth by fiscal policy.

4.6.5 **Brexit**
Parliament has carried a bill to delay Brexit until 31 January. At a local level, possible Brexit issues are raised through the Brexit working group. A Brexit action plan and Brexit risk register is maintained and officers are working with local businesses, community and voluntary groups.

4.6.6 The Council has registered with HMRC's Transitional Simplified Procedures to simplify import procedures should we procure goods from the EU post Brexit. Mitigation plans have been put in place for contracts which may be affected by Brexit and continuity plans have been reviewed for service areas including fuel supplies.

4.6.7 Officers have contacted treasury advisors who have advised that the placing of investments (including Amundii based in Luxembourg) are unaffected by Brexit.

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for 2019/20 to date. Any consequential financial impacts of the Strategy will be incorporated into the Capital Strategy updates and subsequent Quarterly budget monitoring reports.

5.2 Legal Implications

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy Indicators are intended to ensure that the Council complies with relevant legislation and best practice.

5.3 Risk Implications

5.3.1 The current policy of not borrowing externally only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. Should these conditions change the Council may need to borrow at higher rates which would increase revenue costs.

5.3.2 There is continued uncertainty regarding Brexit negotiations and the possibility of a "no deal" exit. SBC's approach to Brexit is that it is treated as a business continuity issue with appropriate cross-checking carried out with other members of the Hertfordshire Resilience Forum.

5.4 Equalities and Diversity Implications

5.4.1 This purpose of this report is to review the implementation of the Treasury management policy in 2019/20. Before investments are placed with counter parties the Council has the discretion not to invest with counter parties where there are concerns over sovereign nations' human rights issues.

5.4.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity; sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

BACKGROUND DOCUMENTS

BD1 Prudential Code Indicators and Treasury Management Strategy 2019/20 (27 February 2019 Council)

BD2 Annual Treasury Management Review of 2018/19 (16 October 2019 Council)

6 APPENDICES

- Appendix A – Prudential Indicators for Mid Year Review.
- Appendix B – Investment and Loan Portfolios
- Appendix C – Specified & Non-Specified Investment Criteria
- Appendix D – Approved Countries for Investments
- Appendix E – MRP Policy