Appendix A

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review 2019/20

Report of Chief Finance Officer

1. Background

Capital Strategy

In December 2017 CIPFA (Chartered Institute of Public Finance and Accountancy) issued revised Prudential and Treasury Management codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intend to provide:

- 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

A report setting out our Capital Strategy was taken to Council on 27 February 2019.

Treasury Management

The Council operates a balanced budget, which broadly means that cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management services is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and, on occasion, any debt previously drawn may be restructure to meet Council risk or cost objectives.

Accordingly, 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."

2. Introduction

This report has been written in accordance with the requirements of CIPFA's Code of Practice for Treasury Management.

The primary requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

(iii) Receipt by full council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year Review Report and an Annual Report, covering activities during the previous year.

(iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(v) Delegation by the council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Budget and Performance Panel.

This mid-year report covers the following:

An economic update for the first part of the 2019/20 financial year

A review of the Treasury Management Strategy Statement and Annual Investment Strategy

- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators
- A review of the Council's investment portfolio for 2019/20
- A review of the Council's borrowing strategy for 2019/20
- A review of any debt rescheduling undertaken during 2019/20
- A review of compliance with Treasury and Prudential Limits for 2019/20
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3. Economic Background (provided by Link Asset Services)

This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, so far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. There has been a delay in the date for Brexit to 31 January 2020 and a general election has been called for 12 December. In such circumstances, any interest rate forecasts are subject to material change as the situation evolves

The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit.

As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, (July 2.1%), and is likely to shift only a little upwards over the rest of 2019/20. It does not therefore pose any immediate concern to the MPC at the current time.

In the political arena, if there is a general election soon, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the *expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.*

4. Interest Rate Forecast

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	1.20	1.30	1.50	1.60	1.70	1.70	1.80	1.90	2.00	2.00	2.10
10yr PWLB Rate	1.50	1.60	1.80	1.90	2.00	2.00	2.10	2.20	2.30	2.30	2.40
25yr PWLB Rate	2.10	2.30	2.40	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00
50yr PWLB Rate	2.00	2.20	2.30	2.40	2.50	2.60	2.60	2.70	2.80	2.90	2.90

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its last meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year.

The balance of risks to the UK

- *The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.*
- *The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also to the downside.*

5. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy (TMS) for 2019/20, which includes the Annual Investment Strategy, was approved by the Council on 27 February 2019. There are no policy changes to the TMS; the details in this report update the position in light of the updated economic position and budgetary changes already approved.

6. Investment Portfolio

The Council aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. As shown by forecasts in section 4, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.75% Bank Rate. Given this risk environment and the fact that increases in the Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

Officers confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30 September 2019.

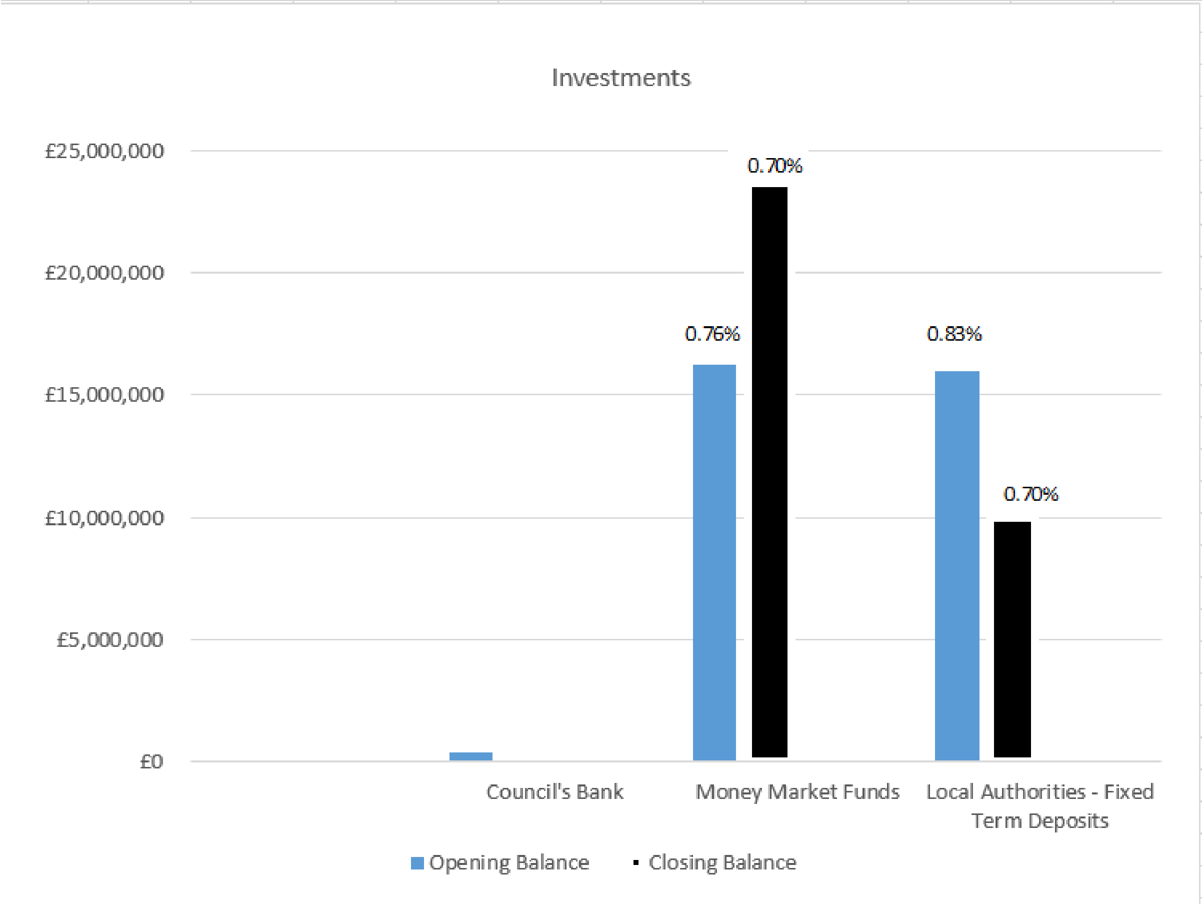
The average level of funds available for investment purposes over the six month period was **£32.9M**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept and business rate related payments, the receipt of grants and progress on the Capital Programme.

In terms of performance against external benchmarks, the return on investments compared to the 7 day LIBID and bank rates at the end of the period is as follows. This is viewed as reasonable performance, given the need to prioritise security of investments, and liquidity (i.e. making sure that the Council's cashflow meets its needs):

Base Rate	0.75%
7 day LIBID	0.57%
Lancaster City Council investments	0.74%

Investment Balances – quarter ended 30 September 2019

At the start of the year investments totalled £32m rising to £34m by 30 September. Fixed term investments with local authorities fell to £10m whilst Money Market Fund balances increased to £24m.



Other Investments	Term	Maturity Date	Opening 1.4.19 £	Closing 30.9.19 £	Indicative Rate (YTD)	Current Fixed Rate	Interest to Date £
Call Accounts							
Natwest (Cash Manager Plus)			385,684	97,162		0.01%	262
Money Market Funds							
Blackrock Sterling Liquidity First Fund			6,000,000	5,650,000	0.68%		20,285
Blackrock Sterling Government Liquidity Fund			0	0	0.62%		1,900
Insight			0	0	0.71%		5,491
LGIM			4,230,000	6,000,000	0.71%		20,654
Aberdeen Life Investments			6,000,000	6,000,000	0.73%		22,629
Goldman Sachs			0	6,000,000	0.68%		8,343
Fixed Term Deposits							
Thurrock Council	92 days	07/05/2019	5,000,000	0		0.90%	4,438
Thurrock Council	184 days	07/11/2019	0	5,000,000		0.85%	17,117
North Ayrshire Council	89 days	21/05/2019	5,000,000	0		0.90%	6,164
Barking & Dagenham Council	92 days	28/05/2019	5,000,000	0		0.90%	7,454
Barking & Dagenham Council	92 days	28/08/2019	0	0		0.78%	9,403
Barking & Dagenham Council	123 days	27/01/2020	0	5,000,000		0.78%	534
Northamptonshire County Council	363 days	01/04/2019	1,000,000	0		0.70%	19
Glasgow City Council	31 days	01/08/2019	0	0		0.80%	3,397
Sub-total			**32,615,684**	**33,747,162**			**128,090**
						Budgeted income	**130,150**
							(2,060)

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMS is meeting the requirement of the treasury management function.

7. Borrowing

The Council's capital financing requirement (CFR) for 2019/20 was £85.82m as set out at **Annex A.** The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council currently has borrowings of £62.13m and has utilised £23.67m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

Members are currently being asked to approve the acquisition of an investment property for a commercial return. In order to facilitate this, and to build in sufficient flexibility to make further potential acquisitions during this financial year, the Capital Financing Requirement, Operational Boundary and Authorised limit for external debt have been increased as set out in **Annex A.**

8. Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

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9. Compliance with Treasury and Prudential Limits

During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy and in compliance with the Council's Treasury Management Practices.

It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The mid-year position in respect of the Council's approved Treasury and Prudential Indicators (affordability limits) which include the impact of the recommended investments appended **at Annex A.**

10. Other Issues

Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or to other types of investment instruments this change in risk appetite and policy should be brought to members' attention in treasury management update reports. There are no such changes to report.

ANNEX A

PRUDENTIAL INDICATORS - MID YEAR REVIEW

There details in this annex update relevant prudential indicators to reflect the impact of the recommended investments

Prudential Indicator for Capital Expenditure

This table shows the current estimates for the General Fund and Housing Revenue Account capital programmes, compared to the original estimates

Capital Expenditure by Service	2019/20 Original Estimate £m	2019/20 Quarter 2 Position £m
Communities and Environment	4.38	4.88
Economic Growth and Regeneration	2.14	2.05
Corporate Services	0.23	0.31
Development Pool	2.45	2.45
Total for General Fund	**9.20**	**9.69**
Council Housing (HRA)	**4.77**	**4.77**
Commercial activities/non-financial investments	**0.00**	**14.86**
Total Capital Expenditure	**13.97**	**29.32**

Changes to the Financing of the Capital Programmes

This table shows the changes in the financing of the capital programmes, and the level of borrowing required.

Capital Expenditure	2019/20 Original Estimate £m	2019/20 Quarter 2 Position £m
Total capital expenditure	**13.97**	**29.32**
Financed by:		
Capital receipts	0.49	0.59
Capital grants	2.44	1.12
Capital reserves	5.13	7.22
Revenue	0.00	0.00
Total Financing	**8.06**	**8.93**
Borrowing Requirement	**5.91**	**20.39**

Changes to the Capital Financing Requirement

The following table shows the changes in the financing of the capital progreammes, and the level of borrowing required. The latter is recommended to increase by £14.86m.

Capital Financing Requirement	2019/20 Original Estimate £m	2019/20 Quarter 2 Position £m
General Fund	47.49	47.53
HRA	38.31	38.29
Commercial activities/non-financial investments	0.00	14.86
Total Capital Financing Requirement	**85.80**	**100.68**
Net movement in CFR	**3.30**	**14.86**

Limits to Borrowing Activity

A key control over treasury management activity is to ensure that over the medium term, net borrowing (borrowings less investments) will only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total capital financing requirement.

The tables below shows that extra debt is being taken on so formal changes are being recommended to the original approved indicators as set out below.

External Debt v Borrowing Need (CFR)	2019/20 Original Estimate £m	2019/20 Quarter 2 Position £m
External Debt	63.17	63.17
Other long term liabilities	-1.04	-1.04
Total Debt	**62.13**	**62.13**
Compared to current approved:		
Capital Financing Requirement	**85.80**	**100.68**
Operational Boundary:-		
Debt	**85.80**	**85.82**
Commercial activities/non-financial investments	**0.00**	**14.86**
Authorised Limit:-		
Debt	**102.00**	**102.00**
Commercial activities/non-financial investments	**0.00**	**15.00**

Definitions:

Operational Boundary

The limit beyond which external debt is not normally expected to exceed is known as the operational boundary.

Authorised Limit for External Debt

A further prudential indicator controls the overall level of borrowing. This is the authorised limit which represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, whilst not desired, could be afforded in the short term, but it is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements.

Affordability

The indicator below shows the proportion of financing costs to net revenue stream

Ratio of Financing Costs to Net Revenue Stream	2019/20		2020/21	2021/22
	Original Estimate %	Quarter 2 Position %	Estimate %	Estimate %
General Fund	17.7	16.8	16.6	17.4
HRA	21.5	20.9	20.3	19.5
Commercial activities/non-financial investments	0.00	0.00	3.1	2.8