REPORT TO AUDIT AND STANDARDS COMMITTEE
28 OCTOBER 2019

TITLE OF REPORT: **Treasury Management – Performance to 30 September 2019**

REPORT OF: **Darren Collins – Strategic Director, Corporate Resources**

Purpose of the Report

1. The purpose of this report is to review Treasury Management performance for the six months to 30 September 2019, covering investments and borrowing. This is consistent with approved performance management arrangements.

Background

2. The mid-year performance of the Treasury Management Service is reported in line with CIPFA's Code of Practice on Treasury Management and the Council's Treasury Policy Statement and Treasury Strategy which was approved by Council on 19 March 2019.

3. The Council operates a balanced approach, and this means broadly 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.

4. The second main function of the treasury management service 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.

5. Accordingly, treasury management is defined as:

   "The management of the Council's 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."

6. The primary objective of the investment strategy is to safeguard the Council's assets with a secondary objective of obtaining an optimum rate of return on investments and minimising the costs of borrowing.

Investment Performance

7. The latest projection of gross investment income for 2019/20 based on interest earned to date and expected interest to March 2020 is £0.699m, compared to the original estimate of £0.691m.

8. This gross investment interest is adjusted to account for £0.373m interest payable to third parties and interest receivable of £1.995m from various third parties, the most significant of which is Newcastle International Airport. This gives a projected

net interest to the General Fund 2019/20 of £2.321m compared to the budget of £2.145m. The current variance to budget is mainly as a result of higher levels of interest received on loans to third parties than anticipated when the 2019/20 budget was set.

Rate of Return

9. The average rate of return is monitored for each investment type that the Council enters into and these are used to calculate an average rate of return for the Council for the year to date. The current rate of return is 0.97%, which is greater than the original estimate of 0.93%

10. The quarterly LINK Asset Services Investment Benchmarking report assesses both the rate of return and the risk of the counterparty to calculate a weighted average rate of return, which is used for comparison across Local Authorities. In the most recent report received, June 2019, the Council achieved a weighted average rate of return of 1.00% on its investments for Quarter 1 2019/20 which is in excess of the risk adjusted expectations (0.89% to 0.99%) defined in the Benchmarking Report for our Group.

11. The rate of return would be expected to decrease during the year as investment balances reduce and current deposits are replaced with shorter, lower yielding deposits.

12. It is a 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 current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short-term strategy. Given this risk environment and the fact that increases in 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.

Brexit and the Economy

13. The Bank of England's 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 19 September, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth.

Borrowing

14. The total borrowing for the Council and HRA as at 30 September 2019 was £665.224m, which was within the operational borrowing limit of £865m. This borrowing is made up of £610.524m Public Works Loans Board (PWLB) loans and £54.7m market loans.

15. The Treasury Strategy estimates for the 2019/20 financial year were based on a borrowing requirement of £86.564m. To date this year the Council has taken £10m long term borrowing from the PWLB. The timing of further borrowing will depend on a combination of cash flow requirements to support the capital programme and achieving preferential borrowing rates at the time.

16. The current forecast for interest payable on borrowing is allocated to the General Fund and the Housing Revenue Account (HRA) as shown in the following table:

	General Fund	**HRA**
Interest Payable	£11.234m	£13.540m
Average rate of interest	3.29%	4.06%

This represents a gross saving of £1.906m on the original estimate, of which £1.502m is a saving for the General Fund and £0.404m is for the HRA.

PWLB Government Intervention

17. The Government recognises that the freedoms for local authorities to borrow under the Prudential Framework are fundamental to supporting local capital strategies and authorities' organisational objectives, including regeneration, supporting local growth and service delivery. The PWLB supports this activity by on-lending Government borrowing from the capital markets to local authorities to deliver capital investment.

18. The maximum net amount of PWLB loans that can be outstanding at any time is subject to a statutory limit. In order to ensure that lending continues to be available for local authorities that need it, the Government has legislated to increase the lending limit from £85bn to £95bn.

19. PWLB lending is offered at a fixed margin above the Government's cost of borrowing, as measured by gilt yields. The Treasury raised the margin over gilts to 100bps (one percentage point) in 2010, to better reflect the availability of capital finance, and lowered it to 80bps over gilts in 2013 for qualifying authorities.

20. HM Treasury advised on 9th October 2019 that they would restore interest rates to levels available in 2018, by increasing the margin that applies to new loans from the PWLB by 100bps (one percentage point) on top of usual lending terms, with immediate effect.

21. The Government will monitor the impact of this change and keep rates policy under review.

Summary of Mid-Year Performance

22. The projected net impact of investment and borrowing activity on the revenue budget in 2019/20 is an underspend of £2.107m, comprising £1.678m General Fund and £0.429m HRA.

General Fund	Estimate £m	Projected Outturn £m	Variance £m
Investments	(2.145)	(2.321)	(0.176)
Borrowing	12.736	11.234	(1.502)
Premia	0.462	0.462	0.000
Net Position	11.053	9.375	(1.678)

23. Investment returns are likely to remain relatively low during 2019/20 and beyond and interest rates are expected to be below long term borrowing rates therefore value for money considerations indicate that best value can be obtained by delaying new external borrowing and by using internal cash balances to finance new capital expenditure in the short term (this is referred to as internal borrowing).

24. The current approach of borrowing internally provides benefits in terms of reduced credit risk, as the Council has less cash invested than if it had gone to the markets and borrowed externally. This means that cash balances and investment returns, are historically low resulting in reduced levels of income, which is significantly outweighed by the savings achieved from avoiding external borrowing. The additional element of interest rate risk will continue to be monitored.

Recommendation

The Committee is requested to note the Treasury Management Performance to 30 September 2019, prior to submission to Cabinet.