

## **AUDIT AND GOVERNANCE COMMITTEE**

**26<sup>th</sup> JULY 2019**

### **TREASURY MANAGEMENT – FIRST QUARTERLY REVIEW 2019/2020**

#### **Report of the Executive Director of Corporate Services**

#### **1. Purpose of Report**

- 1.1 To report on the Treasury Management (TM) performance to date for the first quarter of 2019/2020.

#### **2. Description of Decision (Recommendations)**

- 2.1 The Committee is requested to:
- Note the Treasury Management performance during Quarter 1 of 2019/2020.
  - Note the Lending List Criteria at Appendix B and the Approved Lending List at Appendix C.

#### **3. Introduction**

- 3.1 This report sets out the Treasury Management performance to date for the first quarter of the financial year 2019/2020, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Council.

#### **4. Summary of Treasury Management Performance for 2019/2020 – Quarter 1**

- 4.1 The Council's Treasury Management function continues to look at ways to maximise financial savings and increase investment return to the revenue budget, whilst maintaining a balanced risk position. Public Works Loan Board (PWLB) rates continue to be volatile, in part linked to continued uncertainty over the outcome of Brexit negotiations. No new borrowing has been taken out to date during 2019/2020 but the position continues to be monitored closely.
- 4.2 One option to make savings is through debt rescheduling; however, no rescheduling has been possible in 2019/2020 as rates have not been considered sufficiently favourable. The Council's interest rate on borrowing is very low, currently 3.02%, and, as such, the Council already benefits from this lower cost of borrowing and also from the ongoing savings from past debt rescheduling exercises. Based on advice from the Council's treasury advisor, performance continues to see the Council's rate of borrowing compare favourably to other authorities.
- 4.3 Treasury Management (TM) Prudential Indicators are regularly reviewed and the Council is within the limits set for all of its TM Prudential Indicators. The statutory limit under section 3 (1) of the Local Government Act 2003, which is required to be reported separately, (also known as the Authorised Borrowing Limit for External Debt) was set at £673.627m for 2019/2020. The Council's maximum external debt during the

financial year to 30<sup>th</sup> June 2019 was £452.196m and is within this limit. More details of all of the TM Prudential Indicators are set out in section A2 of Appendix A for information.

- 4.4 The Council's investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions which will benefit the Council.
- 4.5 As at 30<sup>th</sup> June 2019, the funds managed by the Council's Treasury Management team have achieved a rate of return on its investments of 0.98% compared with the benchmark 7 Day LIBID (London Interbank Bid) rate of 0.57%. Performance is significantly above the benchmark rate, whilst still adhering to the prudent policy agreed by the Council, in what remains a very challenging market.
- 4.6 More detailed Treasury Management information is included in Appendix A for Members' information.
- 4.7 The regular updating of the Council's authorised lending list is required to take into account financial institution mergers and changes in institutions' credit ratings since the last report. The updated Approved Lending List is shown in Appendix C for information.

## **5. Recommendation**

- 5.1 Members are requested to note the Treasury Management performance for the first quarter of 2019/2020.
- 5.2 Members are requested to note the Lending List Criteria at Appendix B and the Approved Lending List at Appendix C.

**Detailed Treasury Management Performance – Quarter 1 2019/2020**

**A1 Borrowing Strategy and Performance – 2019/2020**

- A1.1 The Borrowing Strategy for 2019/2020 was reported to Cabinet on 13<sup>th</sup> February 2019 and approved by full Council on 6<sup>th</sup> March 2019.

The Borrowing Strategy is based upon interest rate forecasts from a wide cross section of City institutions. The view when the Treasury Management Policy and Strategy was drafted was that there would be further increases to the current 0.75% Bank of England (BoE) Base Rate of 0.25% by June 2019, early/late 2020 and further increases to 2.00% by March 2022. PWLB borrowing rates were expected to rise, albeit gently, during 2019/2020 across all periods but could be subject to exceptional levels of volatility due to continued uncertainty over the outcome of Brexit negotiations and geopolitical developments throughout the world.

After raising the Bank Rate from 0.5% to 0.75% in August 2018, the BoE Monetary Policy Committee (MPC) are unlikely to make further changes until the outcome of Brexit negotiations is known. The original withdrawal deadline of 29<sup>th</sup> March was put back in the hope that progress could be made on a proposal that would be approved by Parliament. The Government is also in the midst of a leadership election with both remaining candidates declaring their intention for Brexit to happen by 31<sup>st</sup> October 2019, even if there is no deal. With the possibility of no withdrawal option receiving majority support, the chance of a general election has risen which itself could trigger further market instability.

In response to growing concerns, the BoE Governor has indicated that in the event of a no deal Brexit, the MPC could vote to cut the Bank Rate to support growth and analysts predict a possible fall of 0.50% from 0.75% to 0.25%.

Link Asset Services, the Council's treasury advisors, have revised their Base Rate forecasts and have pushed back the timing of the next increase from the first to the third quarter of 2020. This is based on a central assumption that some form of deal can be reached and if that proves not to be the case then both Base Rate and PWLB rate forecasts will change.

The economy posted stronger than expected growth during the first three months of 2019 but this is most likely a result of activity being brought forward ahead of the original 29<sup>th</sup> March Brexit deadline. Analysts expect GDP in the second quarter to fall based on market surveys and official data. CPI inflation in May 2019 stood at 2.0%, the BoE target, and is expected to remain around this level over the next two years. Were there to be a no deal Brexit, it could rise due to increased costs resulting from a weakening in Sterling.

Current forecasts from Link Asset Services predict a gradual rise in PWLB rates reaching 1.70%, 2.00%, 2.60% and 2.50% for 5, 10, 25 and 50-year durations by 31<sup>st</sup> March 2020. High levels of volatility in PWLB rates and bond yields are expected to continue during 2019 and 2020 particularly due to the continued Brexit uncertainty.

The following table shows the average PWLB rates for Quarter 1 to date.

<b>2019/2020</b>	<b>Qtr 1* (Apr - June) %</b>
7 days' notice	0.57
1 year	1.46*
5 years	1.54*
10 years	1.85*
25 years	2.41*
50 years	2.26*

\*rates take account of the 0.2% discount to PWLB rates available to eligible authorities that came into effect on 1<sup>st</sup> November 2012.

A1.2 The strategy for 2019/2020 is to adopt a pragmatic and flexible approach in identifying the low points in the interest rate cycle at which to borrow, and to respond to any changing circumstances to seek to secure benefit for the Council. A benchmark financing rate of 3.50% for long-term borrowing was set for 2019/2020 in light of the views prevalent at the time the Treasury Management policy was set in March 2019. Due to high levels of volatility in the financial markets, with borrowing rates still forecast to remain low over the short term, no new borrowing has been undertaken in the current financial year up to 30<sup>th</sup> June 2019, but the Treasury Management team continues to closely monitor PWLB rates to assess the value of possible further new borrowing in line with future capita programme requirements.

A1.3 The Borrowing Strategy for 2019/2020 made provision for debt rescheduling but due to the proactive approach taken by the Council in recent years, and because of the very low underlying rate of the Council's long-term debt, it would be difficult to refinance long-term loans at interest rates lower than those already in place.

Rates have not been sufficiently favourable for rescheduling in 2019/2020 so far and the Treasury Management team will continue to monitor market conditions and secure early redemption if appropriate opportunities should arise.

The Council successfully applied to access PWLB loans at a discount of 0.20%. This 'certainty rate' is available for those authorities that provide "improved information and transparency on their locally determined long-term borrowing and associated capital spending plans". The discount came into effect on 1<sup>st</sup> November 2012 and the Council has been successful in extending its access to the PWLB certainty rate until at least 31<sup>st</sup> October 2019.

A1.4 The Council's treasury portfolio position at 30<sup>th</sup> June 2019 is set out below:

		<b>Principal (£m)</b>	<b>Total (£m)</b>	<b>Average Rate (%)</b>
<b>Borrowing</b>				
Fixed Rate Funding	PWLB	298.7		
	Market	39.6		
	Other	9.3	347.6	3.20
Variable Rate Funding	Temporary / Other		27.6	0.65
<b>Total Borrowing</b>			<b>375.2</b>	<b>3.02</b>

## A2 Treasury Management Prudential Indicators – 2019/2020

A2.1 All external borrowing and investments undertaken in 2019/2020 have been subject to the monitoring requirements of the Prudential Code. Under the Code, Authorities must set borrowing limits (Authorised Borrowing Limit for External Debt and Operational Boundary for External Debt) and must also report on the Council's performance for all of the other TM Prudential Indicators.

A2.2 The statutory limit under section 3(1) of the Local Government Act 2003 (which is also known as the Authorised Borrowing Limit for External Debt) was set by the Council for 2019/2020 as follows:

	£m
Borrowing	598.239
Other Long-Term Liabilities	<u>75.388</u>
<b>Total</b>	<b><u>673.627</u></b>

The Operational Boundary for External Debt was set as shown below: -

	£m
Borrowing	573.239
Other Long-Term Liabilities	<u>75.388</u>
<b>Total</b>	<b><u>648.627</u></b>

The Council's maximum external debt in respect of 2019/2020 (to 30<sup>th</sup> June 2019) was £452.196m and is within the limits set by both these key indicators.

A2.3 The table below shows that all other Treasury Management Prudential Indicators have been complied with:

Prudential Indicators		2019/2020 (to 30/06/19)	
		Limit £'000	Actual £'000
<b>P9</b>	<b>Upper limit for fixed interest rate exposure</b>		
	Net principal re fixed rate borrowing / investments	485,000	268,041
<b>P10</b>	<b>Upper limit for variable rate exposure</b>		
	Net principal re variable rate borrowing / investments	48,000	27,640
<b>P11</b>	<b>Maturity Pattern</b>	Upper Limit	
	Under 12 months	50%	9.18%
	12 months and within 24 months	60%	1.65%
	24 months and within 5 years	80%	4.13%
	5 years plus	100%	85.08%
	A lower limit of 0% for all periods		
<b>P12</b>	<b>Upper limit for total principal sums invested for over 365 days</b>	75,000	0

### A3 Investment Strategy – 2019/2020

A3.1 The Investment Strategy for 2019/2020 was approved by Council on 6<sup>th</sup> March 2019. The general policy objective for the Council is the prudent investment of its treasury balances. The Council's investment priorities in order of importance are:

- (A) The **security** of capital;
- (B) The **liquidity** of its investments and then;
- (C) The Council aims to achieve the **optimum yield** on its investments but this is commensurate with the proper levels of security and liquidity.

A3.2 As at 30<sup>th</sup> June 2019, the funds managed by the Council's in-house team amounted to £179.296 million and all investments complied with the Annual Investment Strategy. This includes monies invested on behalf of all other external organisations. The table below shows the return received on these investments compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	<b>2019/2020 Actual to 30/06/19 %</b>	<b>2019/2020 Benchmark to 30/06/19 %</b>
Return on investments	0.98	0.57

A3.3 Investments placed in 2019/2020 have been made in accordance with the approved investment strategy and comply with the Counterparty Criteria in place, shown in Appendix B, which is used to identify organisations on the Approved Lending List.

A3.4 Investment rates available in the market remain lower than those achieved in previous years, although there has been some upward movement since the Bank of England Monetary Policy Committee announced the 0.25% increase in the base rate to 0.75% on 1<sup>st</sup> August 2018.

A3.5 Due to the continuing high volatility within the financial markets, particularly in the Eurozone, advice from our Treasury Management advisers is to continue to restrict investments to shorter term periods.

A3.6 Advice also continues that the above guidance is not applicable to institutions considered to be very low risk, mainly where the government holds shares in these organisations (i.e. RBS) and therefore have the UK Government rating applied to them, or separately in respect of Money Market Funds which are AAA rated.

A3.7 The regular updating of the Council's authorised Lending List is required to take into account financial institution mergers and changes in institutions' credit ratings. Any changes are reflected on the Approved Lending List shown in Appendix C.

**Counterparty Criteria**

The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisers.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

<b>Fitch / S&amp;P's Long Term Rating</b>	<b>Fitch Short Term Rating</b>	<b>S&amp;P's Short Term Rating</b>	<b>Moody's Long Term Rating</b>	<b>Moody's Short Term Rating</b>	<b><u>Maximum Deposit</u> £m</b>	<b><u>Maximum Duration</u></b>
AAA	F1+	A1+	Aaa	P-1	120	2 Years
AA+	F1+	A1+	Aa1	P-1	100	2 Years
AA	F1+	A1+	Aa2	P-1	80	2 Years
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	75	2 Years
A+	F1	A-1	A1	P-1	70	365 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	65	365 days
A-	F1 / F2	A-2	A3	P-1 / P-2	50	365 days
<b>Local Authorities</b> (limit for each local authority)					30	2 years
<b>UK Government</b> (including debt management office, gilts and treasury bills)					250	2 years
<b>Money Market Funds (CNAV, LVNAV and VNAV)</b> Maximum amount to be invested in Money Market Funds is £120m with a maximum of £50m in any one fund.					120	Liquid Deposits
<b>Local Authority controlled companies</b>					40	20 years

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AA will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of 2 years.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above. These new limits are as follows:

### **Country Limit**

It is proposed that only non-UK countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £50m which can be invested in other countries provided they meet the above criteria. A separate limit of £250m will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

<b>Country</b>	<b>Limit £m</b>
UK	250
Non-UK	50

### **Sector Limit**

The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below:

<b>Sector</b>	<b>Limit £m</b>
Central Government	250
Local Government	250
UK Banks	250
Money Market Funds	120
UK Building Societies	100
Foreign Banks	50

### **Group Limit**

Where institutions are part of a group of companies e.g. Lloyds Banking Group and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the UK continues to have a sovereign credit rating of AA; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix C.



## Approved Lending List

## Appendix C

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
<b>UK</b>	AA	-	Aa2	-	AA	-	250	2 years
<b>Lloyds Banking Group</b>							Group Limit 70	
Lloyds Bank Plc (RFB)	A+	F1	Aa3	P-1	A+	A-1	70	365 days
Lloyds Bank Corporate Markets plc (NRFB)	A	F1	A1	P-1	A	A-1	70	365 days
Bank of Scotland Plc (RFB)	A+	F1	Aa3	P-1	A+	A-1	70	365 days
<b>Royal Bank of Scotland Group</b> (See Note 1)							Group Limit 80	
The Royal Bank of Scotland Plc (RFB)	A+	<b>F1</b>	A1	P-1	<b>A</b>	<b>A-1</b>	80	2 years
National Westminster Bank Plc (RFB)	A+	<b>F1</b>	A1	P-1	<b>A</b>	<b>A-1</b>	80	2 years
NatWest Markets plc (NRFB)	A	<b>F1</b>	Baa2	P-2	<b>A-</b>	A-2	80	2 years
Santander UK plc	A+	F1	Aa3	P-1	A	A-1	65	365 days
Barclays Bank plc (NRFB)	A+	F1	A2	P-1	A	A-1	65	365 days
Barclays Bank plc (RFB)	A+	F1	A1	P-1	A	A-1	65	365 days
Clydesdale Bank *	<b>A-</b>	F2	Baa1	P-2	BBB+	A-2	0	
Co-Operative Bank Plc	B	B	<b>B3</b>	NP	-	-	0	
Goldman Sachs International Bank	A	F1	A1	P-1	A+	A-1	65	365 days
HSBC Bank plc (NRFB)	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
HSBC UK Bank plc (RFB)	AA-	F1+	-	-	AA-	A-1+	75	2 years
Nationwide BS	A	F1	Aa3	P-1	A	A-1	65	365 days
Standard Chartered Bank	A+	F1	A1	P-1	A	A-1	65	365 days
Top Building Societies (by asset value)								
Nationwide BS (see above)								
Coventry BS	<b>A-</b>	F1	A2	P-1	-	-	65	365 days
Leeds BS	A-	F1	A3	P-2	-	-	50	365 days
Nottingham BS **	-	-	Baa1	P-2	-	-	0	
Principality BS **	BBB+	F2	Baa2	P-2	-	-	0	

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Skipton BS **	A-	F1	Baa1	P-2	-	-	0	
West Bromwich BS **	-	-	Ba3	NP	-	-	0	
Yorkshire BS **	A-	F1	A3	P-2	-	-	50	365 days
<b>Money Market Funds</b>							120	Liquid
Prime Rate Stirling Liquidity	AAA				AAA		50	Liquid
Insight Liquidity Fund	AAA		-		AAA		50	Liquid
<b>Aberdeen Liquidity Fund (Lux)</b>	AAA		AAA		AAA		50	Liquid
Deutsche Managed Sterling Fund	AAA		Aaa		AAA		50	Liquid
Foreign Banks have a combined total limit of £50m								
<b>Australia</b>	AAA		Aaa		AAA		50	365 days
Australia and New Zealand Banking Group Ltd	AA-	F1+	Aa3	P-1	AA-	A-1+	50	365 days
Commonwealth Bank of Australia	AA-	F1+	Aa3	P-1	AA-	A-1+	50	365 days
National Australia Bank	AA-	F1+	Aa3	P-1	AA-	A-1+	50	365 days
Westpac Banking Corporation	AA-	F1+	Aa3	P-1	AA-	A-1+	50	365 days
<b>Canada</b>	AAA		Aaa		AAA		50	
Bank of Nova Scotia	AA-	F1+	Aa2	P-1	A+	A-1	50	365 days
Royal Bank of Canada	AA	F1+	Aa2	P-1	AA-	A-1+	50	365 days
Toronto Dominion Bank	AA-	F1+	Aa1	P-1	AA-	A-1+	50	365 days
<b>Finland</b>	AA+		Aa1		AA+		50	365 days
OP Corporate Bank plc	-	-	Aa3	P-1	AA-	A-1+	50	365 days
<b>Germany</b>	AAA		Aaa		AAA		50	365 days
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	AA-	F1+	Aa1	P-1	AA-	A-1+	50	365 days
Landwirtschaftliche Rentenbank	AAA	F1+	Aaa	P-1	AAA	A-1+	50	365 days
NRW Bank	AAA	F1+	Aa1	P-1	AA-	A-1+	50	365 days
<b>Netherlands</b>	AAA		Aaa		AAA		50	365 days
Bank Nederlandse Gemeenten	<b>AAA</b>	F1+	Aaa	P-1	AAA	A-1+	50	365 days
Coöperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank Nederland)	AA-	F1+	Aa3	P-1	A+	A-1	50	365 days

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Nederlandse Waterschapsbank N.V	-	-	Aaa	P-1	AAA	A-1+	50	365 days
<b>Singapore</b>	AAA		Aaa		AAA		50	365 days
DBS Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	365 days
Oversea Chinese Banking Corporation Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	365 days
United Overseas Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	365 days
<b>Sweden</b>	AAA		Aaa		AAA		50	365 days
Svenska Handelsbanken AB	AA	F1+	Aa2	P-1	AA-	A-1+	50	365 days
<b>USA</b>	AAA		Aaa		AA+		50	365 days
Bank of New York Mellon	AA	F1+	Aa1	P-1	AA-	A-1+	50	365 days
JP Morgan Chase Bank NA	AA	F1+	Aa1	P-1	A+	A-1	50	365 days
Wells Fargo Bank NA	AA-	F1+	Aa1	P-1	A+	A-1	50	365 days

## Notes

### Note 1

#### **Nationalised / Part Nationalised**

The counterparties in this section will have the UK Government's AA rating applied to them thus giving them a credit limit of £80m.

\* The Clydesdale Bank (under the UK section) is owned by National Australia Bank

\*\* These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the Prudential Regulation Authority (PRA) is classed as a UK bank for the purposes of the Approved Lending List.

