Leicester
City Council

WARDS AFFECTED:
ALL WARDS (CORPORATE ISSUE)

OVERVIEW SELECT COMMITTEE **28th November 2019**

MID-YEAR REVIEW OF TREASURY MANAGEMENT ACTIVITIES 2019/20

Report of the Director of Finance

1. Purpose of Report

1.1 This report reviews how the Council conducted its borrowing and investments during the first six months of 2019/20.

2. Summary

2.1 Treasury management is the process by which our borrowing is managed, and our cash balances are invested. Whilst there are links to the budget, the sums in this report do not form part of the budget. To the extent that the Council has money it can spend, this is reflected in the annual budget report. Cash balances reported here cannot be spent, except to the extent already shown in the budget report and accounts.

2.2 The Council has incurred debt to pay for past capital expenditure

2.3 The Council also has cash balances. These are needed for day to day expenditure (e.g. to pay wages when they are due). A substantial proportion can only be used to repay debt but (because of Government rules) we have been unable to use them to repay debt. Thus, they are held in investments.

2.4 The report commences with an overview of treasury management, including loans and investments at key dates. It then reviews the credit worthiness of investments and implementation of our strategy, provides outcomes on key performance measures and concludes by reviewing compliance against limits set by the Council.

2.4 2019/20 has seen only modest economic growth in the UK and elsewhere. However, there are risks and these are discussed further in section 5.

2.5 We continue to monitor the impact of the “bail in” requirements whereby major depositors could be forced to inject funds into banks which are running into trouble, introduced earlier in the year. This is further discussed below.

2.6 To protect against possible problems arising from a “no deal” Brexit, we are increasing the level of investments with money market funds domiciled in the UK. This is not because we are concerned about credit worthiness but ensures we can access funds if there are problems with settlement systems immediately after Brexit.

3. Recommendations

3.1 Members of the Overview Select Committee are recommended to note the report and make comments to the Director of Finance and the Executive as they wish.

4. Overview of Treasury Management

Main elements of Treasury Management

4.1 There are two main elements to treasury management. The first is managing our borrowings which have been taken out to finance capital expenditure. Most capital schemes are now financed by grant, and only a limited number of schemes are financed by borrowing (generally those which pay for themselves). In the past the Government expected us to borrow but allowed for the cost of borrowing in our grant settlement, and we still have a lot of debt which was taken to meet this capital expenditure.

4.2 Historic debt can sometimes be restructured to save money, i.e. repaying one loan and replacing it with another, and this is always given active consideration. In recent years, Government rule changes have normally made it prohibitively expensive to repay loans borrowed from the Public Works Loans Board.

4.3 Changes were recently announced increasing the interest rates charged on PWLB loans by 1%, partly as a response to high levels of borrowing by authorities funding commercial acquisitions. Nationally, this is having a significant impact on the investment plans of many local authorities. However, the Council has no plans to borrow in 2019/20 and it is unlikely that the Council will need to borrow over the medium term.

4.4 The revenue budget approved by the Council for each financial year includes provision for the interest payable on this borrowing. It also includes a provision for repaying the borrowing over a number of years (broadly speaking over the economic life of the assets acquired).

4.5 The second element is cash management which involves managing the Council’s investments to ensure the optimum amount of money is in the bank account on a day-to-day basis – so that there is enough money in the account to cover the payments made on the day, but no more (cash held in the bank account earns negligible interest).

4.6 The Council has substantial investments, but this is not “spare cash”. There are three reasons for the level of investments: -

(a) Whilst the Government no longer supports capital spending with borrowing allocations, we are still required to raise money in the budget each year to repay debt. Because of the punitive rules described above, we are not usually able to repay any debt, and therefore have to invest the cash;

(b) We have working balances arising from our day to day business (e.g. council tax received before we have to pay wages, and capital grants received in advance of capital spending);

(c) We have reserves, which are held in cash until we need to spend them. We expect reserves to fall over the next few years. The reserves position was described in the budget report.

Treasury Management Policy and Monitoring

4.7 The activities to which this report relates are governed by the Treasury Strategy for 2019/20 which was approved by the Council on 20th February 2019. This establishes an outline plan for borrowing and investment. The strategy is drawn up in the light of the Council's expected borrowing requirements, its expected cash balances, the outlook for interest rates and the credit worthiness of the banks with whom the Council might invest its cash balances.

4.8 A twice-yearly report is submitted to your Committee reviewing the treasury activity undertaken in the year. This report is the mid-year report for 2019/20

Loans and Investments at Key Dates

4.9 Table 1 below shows the loans (money borrowed by the Council) and investments (money invested by the Council) as at 31/03/2019 and 07/10/2019. The rates shown are the averages paid and received during 2019/20.

4.10 No new loans have been borrowed and no debt restructuring has taken place.

4.11 Investments have increased by £20m from £273m to £293m. This is normal at the mid-year point: cash flow out of the authority tends to be weighted to the second half of the year.

Table 1- Loans & Investments

	Position at 31/03/2019 Principal £M	Position at 07/10/2019 Principal £M	Average Rate
Long Term Fixed Rate Loans			
Public Works Loan Board (PWLB)	134	134	4.2%
Market	25	25	4.4%
Variable Rate Loans			
Bank Loans	20	20	4.1%
Gross Debt	**179**	**179**	**4.2%**
Treasury Investments			
Banks and Build Soc	33	58	
Other Local Authorities	172	158	
Government Debt Management Office	4	0	
Money Market Funds	55	67	
Property Funds	8	8	
Total Treasury Investments	**272**	**291**	**1.0%**
Investment Strategy Loans	1	2	
Total Investments	**273**	**293**	1.0%
NET INVESTMENTS	**85**	**114**	

4.12 The investments include £8m in property unit trusts. These are unit trusts which invest in property (as opposed to more traditional unit trusts that invest in shares). The returns included in the table above do not include any movements in the value of these investments. This is because these investments are bought and sold in secondary markets, but transactions are infrequent and so there is no firm quoted price for these investments. Value changes will be reflected in our accounts.

5. Credit Worthiness of Investments & Interest Rate Outlook

5.1 2019/20 showed a weaker economic environment within the world economy due, in part, to tensions between the USA and its trading partners. Within the Eurozone many of the economic and financial tensions that followed the crisis of 2008 have eased but significant underlying issues remain. Tensions between the USA and trading partners remain a source of uncertainty. The full impact of the UK's exit from the EU on the economy remains to be seen.

5.2 The core expectation of the Council's treasury advisors, Arlingclose, is for the Bank Rate to remain at its current level of 0.75% until at least 2023. Inflationary pressures, possibly following future devaluations in the value of the pound, could carry the risk of higher interest rates. On the other hand, risks around Brexit could argue for bank rate increases to be moderated in order to support the UK economy.

5.3 The governments of the largest world economies, including the UK, have implemented measures to make banks less likely to fail but also to reduce the impact on the financial system and on tax payers if they do fail. The measures for dealing with a failing bank see investors who have lent or deposited money (which includes us) taking significant losses before there is any tax payer support ("bail in"). Our assessment of risk is based both on the risk that banks fail (as measured by credit ratings) and also on the level of losses that we might face should the banks require capital support to prevent failure. The view of Fitch, the credit rating agency, is that major UK banks are well positioned to deal with any pressures that might emerge from Brexit.

5.4 These developments were reflected in the Council's approach to managing credit risk in its Treasury Strategy for 2019/20. It has adopted a cautious stance over the whole period covered by this report and has only directly lent to strong UK banks, other local authorities and the UK Government. Other lending has been part of pooled funds (see 5.5 below).

5.5 The Council has an indirect exposure to non-UK banks through its investment in money market funds. Money market funds are like "unit trusts" but rather than investing in company shares these funds invest in interest bearing investments such as bank deposits. When we open such funds, they are vetted to ensure that they have strong investment and risk management processes to ensure a high level of credit worthiness in the underlying investments, and we receive advice from our treasury advisor, Arlingclose. Investing in this way helps manage credit risk by having a high level of diversification amongst the underlying banks and institutions to whom money is lent. Interest rates on these funds are low, because we have immediate access to the funds. Some of our money needs to be immediate access (like individuals will usually keep some money in a current account). Rates are, however, better than alternatives such as the Government's Debt Management Office. In the short term, we are increasing the proportion held in UK based funds to ensure we can access funds if there are technical problems immediately after Brexit.

5.6 The Council has an investment strategy which permits investment in local commercial opportunities. These investments are managed within the Council's framework for managing capital expenditure and are not considered in detail within this report. However, these investments are included at table 2 below, because the strategy puts to work cash balances which would otherwise be invested in low interest paying deposits.

5.7 The Treasury Strategy 2019/20 permits investment in property funds. Investments of £8m have been made in two funds, the Lothbury Property Trust and the Threadneedle Property Unit Trust. No further investments are likely to be made during in 2019/20 owing to uncertainties around Brexit.

6. <u>Implementation of Borrowing & Investment Strategy</u>

6.1 The strategy approved by Council for 2019/20 envisaged using cash balances instead of borrowing, and this strategy has been adhered to.

6.2 Given that the Council continues to have a high level of investments, active consideration is given to the possible early redemption of a limited amount of debt. This, however, is not straightforward as debt repayment usually involves the payment of a premium. The level of such premia payable is generally high and premature debt redemption is usually not financially viable.

6.3 We hold £20m of debt which is described as variable rate loans in table 1. These are technically "LOBOs" which are fixed rate but on which the lender may ask for a rate rise. We have the option to repay if they do. Members may be aware of some criticism of LOBOs nationally, principally in respect of authorities which have complex mechanisms for calculating interest rates. We do not: we would be pleased to receive a request for a rate rise as we would then take the opportunity to repay. To all intents and purposes, they are simply fixed rate loans. We will explore any viable options to repay these which present themselves

7. Key Performance Measures

7.1 The most important performance measures are the rate of interest on the Council's borrowings, the timing of borrowing decisions, the timing of decisions to prematurely repay debt and the return on investments. No new loans have been borrowed and no loans have been repaid.

7.2 The Council benchmarks its investments and the latest data for the investment portfolio is as at 30th September 2019.

7.3 Treasury investments comprise internally managed investments, and longer maturity externally managed funds.

7.4 The following table compares our performance against that of participating authorities. This information is available for internally managed investments (including money market funds) and externally managed funds. It is a "snapshot" of investments held at 30th September 2019. No comparative data is held for the local investment fund.

Table 2 – Key Performance Data

Investment	Leicester City Council Revenue return	All Authorities' Revenue return
Internally managed	0.91%	0.80%
Longer term investments	3.90%	3.7%
Investment Strategy	4.30%	n/a
Total	**1.02%**	**1.34%**

7.5 The average rate of interest on internally managed investments for participating authorities at 30th September is 0.8% whilst the Council's own rate is higher: 0.91%.

7.6 The average rate of interest on all investments for participating authorities at 30th September is 1.34% whilst the Council's own rate is 1.02%. This is mainly explained by other authorities having a higher proportion of investments in longer term investments and this is discussed further below.

7.7 The average rate of return on longer term investments (excluding capital gains and losses) is 3.7% for participating authorities at 30th September whilst the Council's own rate is 3.9%. This category will cover a wide range of investments and there an unavoidable element of "comparing apples with pears". As at 30th September the Council's own investments comprised units in property unit trusts. These carry less risk than some other investment types and the lower risk sometimes equates to a lower investment return compared to more adventurous funds.

7.8 Higher investment returns are always available if higher credit risk is accepted. However, the trade-off between risk and reward was considered when investment strategies were set for 2019/20 and in the current economic climate continues to be a most important consideration. The "return of the principal" is more important than the "return on the principal": our primary concern is to ensure that the funds invested will be repaid on time and in full. This remains our approach during the current financial year.

7.9 The benchmarking data also indicated that other authorities, on average, held longer term investments and that this contributed to the higher return achieved by the average authority. Given the uncertainties created by Brexit we are unlikely to make significant longer term investments over the remainder of 2019/20.

8. Use of Treasury Advisors

8.1 The Council are advised by Arlingclose Ltd. They advise on all aspects of treasury management, but their main focus is on providing advice on the following matters:

- the creditworthiness of banks
- the most cost effective ways of borrowing
- appropriate responses to Government initiatives
- technical and accounting matters.

9. Compliance with the Council's Treasury Strategy

9.1 As required by the statutory borrowing framework, the Council is required to set a number of prudential limits and indicators. These limits are set annually and can be found within the budget and Treasury Strategy.

9.2 For the operational implementation of the Council's Treasury Management Strategy the most important limits and indicators that need to be monitored throughout the year are:

- The authorised limit – the maximum amount of borrowing that the Council permits itself to have outstanding at any one time
- The operational limit – a lower limit to trigger management action if borrowing is higher than expected.
- The maximum proportion of debt that is fixed rate.
- The maximum proportion of debt that is variable rate.
- Limits on the proportion of debt maturing in a number of specified time bands
- Limits on sums to be invested for more than 364 days

9.3 These limits are monitored and have been complied with.

10. Financial and Legal Implications

10.1 This report is solely concerned with financial issues. Kamal Adatia, Legal Services, has been consulted as Legal Advisor and there are no legal issues.

11. Other Issues

OTHER IMPLICATIONS	YES/NO	Paragraph References Within Supporting information
Equal Opportunities	No	
Policy	No	

Sustainable and Environmental	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	
Corporate Parenting	No	
Health Inequalities Impact	No	

12. Background Papers

12.1 The Council's Treasury Management Strategy - "Treasury Strategy 2019/20" (Council 20th February 2019). The Council's Treasury Policy Document – "Framework for Treasury Decisions" – Council 20th February 2019.

13. Consultation

13.1 Arlingclose Ltd (the Council's Treasury Management advisers).

14. Author

14.1 The author of this report is David Janes, Treasury Manager, on extension 37 4058.

Alison Greenhill
Director of Finance.