BOSTON BOROUGH COUNCIL

REPORT TO:	AUDIT AND GOVERNANCE COMMITTEE
DATE:	27 JANUARY 2020
SUBJECT:	TREASURY MANAGEMENT AND CAPITAL STRATEGY UPDATE – QUARTER 3 2019/20
REPORT AUTHOR:	CHIEF FINANCE OFFICER
EXEMPT REPORT?	NO

SUMMARY

The Council fully complies with the Chartered Institute of Public Finance and Accountancy Code of Practice on Treasury Management (2017). This report sets out the Treasury Management and relevant capital strategy activities of the Council for the period 1 April to 31 December 2019.

In terms of investment returns, the Council is expecting to achieve a total of £1,111,000 for 2019/20 comprising £997,000 gross distribution income from property fund holdings (i.e. before deduction of management fees) and £114,000 from cash investments. This compares favourably to the total gross annual budget of £911,000.

The Council is generally keeping cash investments short term up to a maximum of twelve months. As the financial climate changes, who we invest with and the amount invested, is under constant scrutiny, taking into account risk at any particular moment in time.

RECOMMENDATIONS

That members note the Treasury Management and Capital Strategy update position as at 31 December 2019.

REASONS FOR RECOMMENDATIONS

To effectively manage Treasury risk and protect Council capital.

ALTERNATIVES CONSIDERED

There are no alternative recommendations**.**

REASON FOR REPORT

To report the Council's Treasury Management performance in 2019/20 and in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2017 and generally accepted best practice.

Main Report:

1. Introduction

1.1 The CIPFA Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (annual, mid-year and/or quarterly reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1.2 This report sets out Treasury Management and relevant capital strategy performance up to 31 December 2019, and looks ahead to the remainder of the year.

1.3 The Treasury Management Strategy Statement (TMSS) for 2019/20, approved by Full Council in February 2019, incorporates the Council's Annual Investment Strategy, which outlines the Council's investment priorities ranked in order of importance:

- Security of capital;
- Liquidity; and
- Yield

1.4 The Council always aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep the majority of investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using its advisors' (Link Asset Services) suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

1.5 The Treasury Management Strategy Statement (TMSS) sets Prudential and Treasury Indicators which are relevant for the purposes of setting an integrated Treasury Management Strategy and are a requirement of the CIPFA Code of Practice in Treasury Management.

2. Economic Background

2.1 **UK. Economic Growth** in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 back up to +0.4% and quarter 4 expected to come in around zero. Political and Brexit uncertainty have dampened growth in 2019.

Despite political uncertainty ending with a decisive overall majority for the Conservative government in the December general election which clears the way for the UK to leave the EU on 31 January 2020, we still have much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020.

After the Monetary Policy Committee (MPC) raised Bank Rate from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until these remaining uncertainties over the likely type of Brexit become clear. If there was a no deal exit, it is likely that Bank Rate would be cut in order to support growth. However, if growth was to flag significantly in any event, the MPC could also cut Bank Rate in 2020. The Government has announced some major spending increases and is expected to make further commitments in the spring budget; these will provide some support to growth and will take some pressure off the MPC to act to stimulate growth by either cutting Bank Rate or implementing other monetary policy measures.

The MPC did have some concerns over the trend in wage inflation, which was on a rising trend, and peaked at a new post financial crisis high of 3.9% in June. Since then, however, it has been falling steadily back to 3.5% in October, (3 month average figure, excluding bonuses). Growth in employment picked up again to 24,000 in the three months to October, after a fall in the previous month's figures. However, this is still well below the 2018 average, although the unemployment rate remained at 3.8 percent, its lowest rate since 1975.

As for **CPI inflation** itself, this fell to 1.5% in October and November and is likely to remain between 1.5% and 2% over the next two years. If there was a no deal Brexit though, it could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

The strong wage inflation figure and the fall in CPI inflation is good news for **consumers** as their spending power is improving in this scenario as the difference between the two figures is now around 2.0%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

2.2 **World Growth.** The trade war between the US and China on tariffs is a major concern to financial markets and is depressing worldwide growth, as any downturn in China will spill over into impacting countries supplying raw materials to China. Concerns are focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during the first ten months of 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been weak which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during 2020 is expected to be weak.

3. Interest Rate Forecast

3.1 The Council's treasury advisor (Link Asset Services) has provided the following forecast:

Link Asset Services Interest Rate View	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

3.2 After the August 2018 increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the MPC has put any further action on hold, probably until such time as the fog of Brexit becomes clearer. While the general election in December 2019 has provided political certainty leading to implementation of the UK leaving the EU on 31.01.20, there is still much uncertainty on what sort of trade deal may be agreed by the end of 2020 and its likely impact on the UK economy. ***The above forecast, and other comments in this report, are based on a central assumption that there will be some form of muddle through agreement on a reasonable form of Brexit trade deal.*** Bank Rate forecasts will have to change if this assumption does not materialise e.g. a no deal Brexit could prompt the MPC to immediately cut the Bank Rate. All other forecasts for investment and borrowing rates would also have to change.

3.3 The balance of risks to the UK

- the overall balance of risks to economic growth in the UK is probably even, but dependant on a successful outcome of negotiations on a trade deal;
- the balance of risks to increases in Bank Rate are shorter term PWLB rates are broadly similarly to the downside;
- in the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

4. Investment Income

4.1 The Base Rate has remained at 0.75% since August 2018.

4.2 The Council budgeted to receive £711,000 in net investment income in 2019/20 comprising £619,000 from Property Funds (£819,000 gross, with £200,000 of management fees), and £92,000 from cash investments (Property Fund Income included in the original budget was based on its net position i.e. Gross Returns less Management Fees). Future years' budgets and reports will show the gross position for income returns with management fees reported separately.

At 31 December 2019, total investment income for the year is estimated to be £1,111,000 comprising £997,000 gross from Property Funds and £114,000 from cash investments. Property fund management fees for 2019/20 are estimated at £211,000.

In 2019/20, cumulatively to 31 December 2019, the Council achieved an average gross revenue return (before deduction of management fees) of 4.96% from the Property Fund purchases (3.92% after fees)

Treasury (cash) Investments achieved an average rate of 0.76%. This rate includes returns on investments placed on call with HSBC and CCLA: these rates being lower than investments placed for 3 months and 1 year.

The average interest rates achieved so far on the Council's cash investments are shown in Table 2 below. The table shows that overall performance generally compares favourably to the benchmark rates.

Table 2 – Benchmarked rates of return

Benchmark	Benchmark Return	Council Performance
3 month	0.67%	0.90%

12 month	0.86%	1.13%

4.3 Table 3 details the cash investments held by the Council at 31 December 2019. Investments are made in line with both Link's creditworthiness guidance and the duration limits applied to each colour banding.

Table 3 – Counterparty list and Investments held at 31 December 2019

Institutions with Cash held	Amount £'000	Duration	Rate	Most recent Link Asset Services Colour Rating
HSBC	1,740	Call	0.43%	Orange (12 months)
CCLA	3,000	Call	0.71%	Yellow 5 Years
Santander	3,000	95 day notice	0.85%	Red – 6 months
Barclays	3,000	95 day notice	0.95%	Red – 6 months
LLoyds	750	1 year	1.25%	Orange (12 months)
	750	1 year	1.10%	
	250	1 year	1.25%	
Bank of Scotland	1,000	1 year	1.10%	Orange (12 months)
Total	**13,490**			

4.4 The Council's Treasury Management Strategy states investments are limited with any one institution to no more than £3m invested per institution, and £5m per counterparty 'group'. On 35 working days residual balances in excess of the £5m limit were deposited in the Council's current bank account (HSBC) for cash flow reasons (in accordance with para 7.3 of the Treasury Management Strategy).

4.5 The average level of funds available for investment from 1 April to 31 December 2019 was £14.610m. Of this, an average of £7.013m was available on a temporary basis, the level dependent on the timing of precept and business rate pool payments, receipt of grants and capital programme spend.

5 Capital Strategy and Property Fund Valuation

5.1 Detailed below are the property fund investments held by the Council, the valuation date for all funds being 31 December 2019.

Table 4 – Property Fund Holdings as at 31 December 2019

Financial Institution	Purchase Cost £'000	Net Asset Value at 31 March 2019 £'000	Net Asset Value at 31 Dec 2019 £'000	In-year Gain /(Loss) to 31 Dec 2019 £'000
Black Rock UK Property Fund	4,500	4,581	4,523	(58)
Schroder UK Real Estate Fund	4,250	4,344	4,315	(29)

Threadneedle Property Unit Trust	4,239	4,102	4,028	(74)
M&G UK Property Fund	4,000	3,836	3,650	(186)
AEW	4,000	3,764	3,751	(13)
Total	**20,989**	**20,627**	**20,267**	**(360)**

5.2 The difference between purchase price (i.e. the amount invested) and net asset value reflects premiums paid or discount received against the Funds' 'Net Asset Value' at the settlement date together with the movement in fund valuations since acquisition. Fair values have decreased slightly during quarter 3, overall by 1.74% since 31 March 2019, mainly as a result of the ongoing economic uncertainties surrounding the Brexit process.

5.3 As reported in the 2019/20 mid-year review report, notification was received from M&G of a deferral of repayments requested by investors (a common tool used to manage liquidity in institutional property funds). It was invoked to protect investors as a whole from the impact of forced sales, in situations where redemption orders received exceed the level of available liquidity. Deferral is not a suspension as pricing continues as normal, distributions continue to be paid, subscriptions are permitted and secondary trading is permitted. It is expected that these repayments will be finalised by the end of 2020. The position will continue to be monitored and reported to the Committee.

6. Borrowing

6.1 At the start of the 2019/20 financial year, the Council's total long term borrowing was £16.449m. Total annual interest payments are estimated at £494,000.

6.2 No additional borrowing was undertaken during the nine months to 31 December 2019, and officers continue to monitor opportunities to replace the internally invested sums with long-term borrowing.

6.3 During the first six months PWLB rates were on a falling trend and longer rates reached historic lows. On 9 October, the Treasury increased the margin on PWLB rates by 100 bps (1%). Over the last quarter, rates have been on a rising trend. The 50 year PWLB target rate for new long term borrowing started the year at 2.50% and fell to a low of 2.00% before ending at 3.10%.

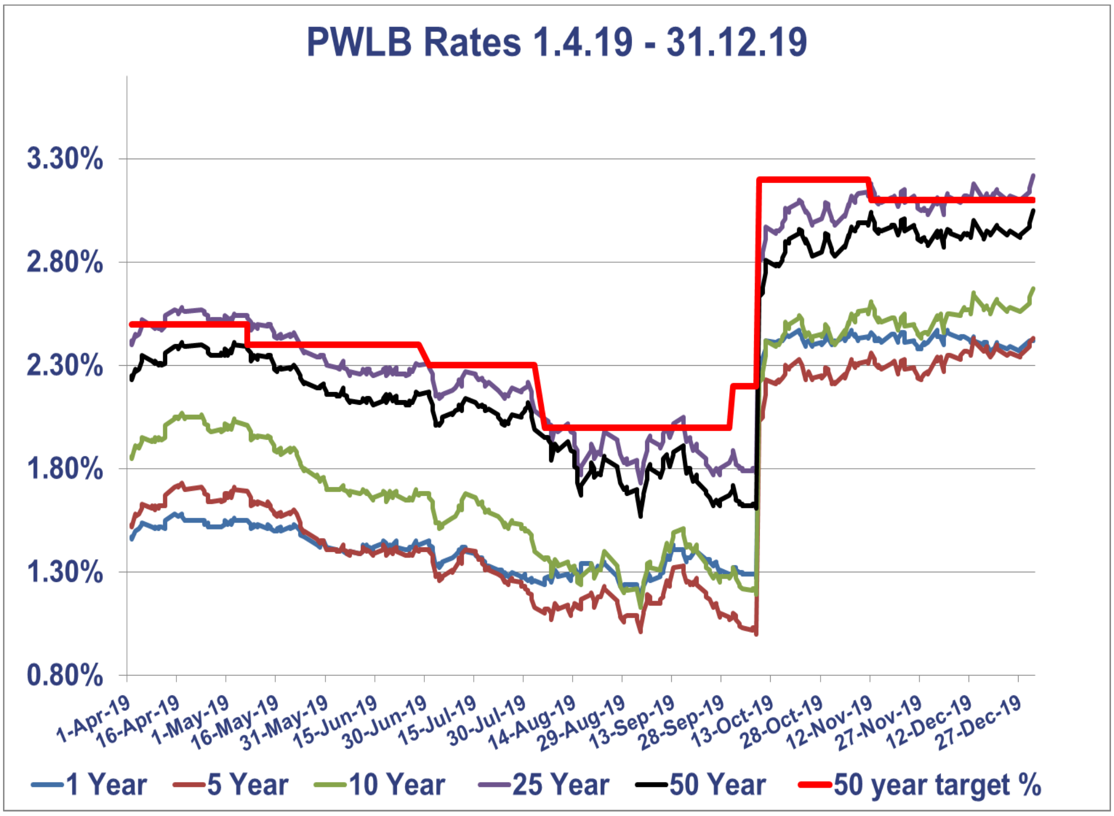

Table 6 – PWLB rates

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.43%	2.67%	3.22%	3.05%
Date	21/10/2019	13/12/2019	31/12/2019	31/12/2019	31/12/2019
Average	1.70%	1.64%	1.88%	2.45%	2.31%

7. Compliance with Treasury and Prudential Limits

7.1 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, are included in the approved TMSS.

7.2 During the quarter ended 31 December 2019, the Council has operated within the treasury and prudential indicators set out in the Council's TMSS and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix A.

8. Other

8.1 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 other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports. There has been no change in the Council's risk appetite from that reported previously.

Review Date:

Regular reporting is undertaken in the quarterly Governance Reports, and Annual Treasury Management Reports are produced each year. Any significant treasury issues arising will be reported to the Audit and Governance Committee.

CONCLUSION

Treasury Management continues to require close attention given the current financial climate. Officers will continue to be vigilant and report any significant issues to this Committee.

FINANCIAL IMPLICATIONS

The entire report

LEGAL IMPLICATIONS

The General Power of Competence (GPOC) in the Localism Act 2011 allows Councils a broad freedom in their operations.

Councils have the general power to borrow under Section 1 of the Local Government Act 2003.

The power to invest is set out in the Local Government Act 2003, Section 12, which gives the Council the power to invest for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs.

The power that allows councils to spend for capital purposes is included in the Local Government Act 2003.

ANY OTHER IMPLICATIONS

Risk Management

The Code of Practice sets out the framework for controlling the risks associated with treasury management decisions for borrowing and investing. Ultimately investment and borrowing decisions are made in accordance with the Council's Treasury Management Strategy. The overriding priority is that the security of a deposit takes precedence over a return on investment.

The Prudential and Treasury Indicators control the limits for investing and borrowing, to ensure that any borrowing is affordable and sustainable and long term borrowing is for capital purposes only.

Impact on Performance
There is a requirement to try and balance the risks and rewards from investing our available cash resources, as outlined within the Treasury Management Strategy 2019/20.

CONSULTATION

No consultation undertaken.

APPENDICES

Appendices are listed below and attached to the back of the report: -

APPENDIX A	Prudential and Treasury Indicators

BACKGROUND PAPERS
Background papers used in the production of this report are listed below: -

Document title	**Where the document can be viewed**
Treasury Management Strategy Statement for 2019/20	*As part of the MTFS reported to Full Council 28 February 2019.* *https://moderngov.boston.gov.uk/documents/s6292/Appendix%208%20-%20Treasury%20Management%20Strategy%20201920%20-%20202324.pdf*

CHRONOLOGICAL HISTORY OF THIS REPORT

A report on this item has not been previously considered by a Council body.

Appendix A

Prudential and Treasury Indicators

PRUDENTIAL/TREASURY INDICATOR	**2019/20**	**2019/20**	**Notes**
	Original Estimate	**Projected Outturn**	
	£'000	£'000	
Capital Expenditure	6,366	5,685	
Capital Financing Requirement as at 31 March	20,459	20,419	
Annual Change in Capital Financing Requirement	0	(40)	
In year Borrowing Requirement	0	0	
Ratio of financing costs to net revenue stream	***%***	***%***	
General Fund	*(5.43)*	*(5.47)*	
Authorised Limit for external debt			
Borrowing and other Long term liabilities	25,000	25,000	
Operational Boundary for external debt -			
Borrowing	22,000	22,000	
Gross External Debt	(16,449)	(16,449)	
Investments	9,370	11,864	
Net Borrowing	(7,079)	(4,585)	