READING BOROUGH COUNCIL
REPORT BY EXECUTIVE DIRECTOR OF RESOURCES

TO:	**AUDIT & GOVERNANCE COMMITTEE**		
DATE:	**19th September 2019**		
TITLE:	**TREASURY MANAGEMENT HALF YEARLY REPORT**		
LEAD COUNCILLOR:	**CLLR EMBERSON**	**PORTFOLIO:**	**CORPORATE & CONSUMER SERVICES**
SERVICE:	**FINANCE**	**WARDS:**	**BOROUGHWIDE**
AUTHOR:	**MATT DAVIS**	**TEL:**	**0118 937 2954**
JOB TITLE:	**ASSISTANT DIRECTOR OF FINANCE**	**E-MAIL:**	**Matt.davis@reading.gov.uk**

1. EXECUTIVE SUMMARY

1.1 The purpose of this report is to update Members on the activity of the Treasury Management function for 2019/20 as at 31st August 2019.

1.2 The report complies with CIPFA's Code of Practice on Treasury Management which requires that the Council receives a report on its Treasury Management activity at least twice a year. Specifically this report includes:

- a review of the Council's financial investment portfolio for 2019/20 as at 31st August 2019;
- a review of the Council's borrowing strategy for 2019/20;
- a review of compliance with the Council's Treasury and Prudential Limits for the first five months of 2019/20; and
- an economic update for the first part of the financial year.

1.3 The Council has complied with all elements of its Treasury Management Strategy Statement (TMSS) as agreed by Council in February 2019.

2. RECOMMENDED ACTIONS

That the Audit & Governance Committee:

2.1 Note the performance of the Treasury Management function for the five months to 31st August 2019 and the key issues emerging;

APPENDICES

Appendix 1: Commentary on the economic backdrop for 2019/20.
Appendix 2: Approved counterparties and limits

3. BACKGROUND

3.1. The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

4. BORROWING

4.1. As at 31st August 2019 net borrowing was £337m, a decrease of £10m on the position at 31 March 2019. The decrease reflects the forecast pattern of the Authority's cash-flows.

Table 1: Net borrowing position at 31st August 2019

	31 Mar 2019 £m	**31 Aug 2019 £m**
Total gross borrowing	399	406
Total cash invested	(52)	(69)
Net borrowing	**347**	**337**

4.2. As interest rates remain historically low, the Authority's main objective when borrowing is to strike a balance between securing low interest rates and achieving cost certainty over the period for which funds are required. This position provides short term savings with the flexibility to secure longer dated loans as and when financial forecasts indicate that external borrowing rates may increase.

4.3. The Base Rate was raised to 0.75% in August 2018 and has been maintained at this level since. The Bank of England's Monetary Policy Committee has expectations of a slow rise in interest rates over the next few years. Appendix 1 provides further commentary on the economic backdrop for 2019/20.

4.4. The Council's underlying need to borrow for capital purposes is measured by its Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investment below their underlying levels, sometimes known as internal borrowing. In recent years this strategy has helped minimise the Council's net financing costs. Table 2 below sets out the CFR on the Council's Balance Sheet at 31.03.19, prior to Audit.

Table 2: Capital Financing Requirement at 31.03.19

	General Fund £m	HRA £m	Total 31 Mar 2019 £m
CFR	364	192	556
Less PFI liabilities	(26)		(26)
CFR / Underlying Borrowing Requirement	**338**	**192**	**530**
Less usable reserves and working capital	(158)		(158)
Net borrowing requirement	**180**	**192**	**372**

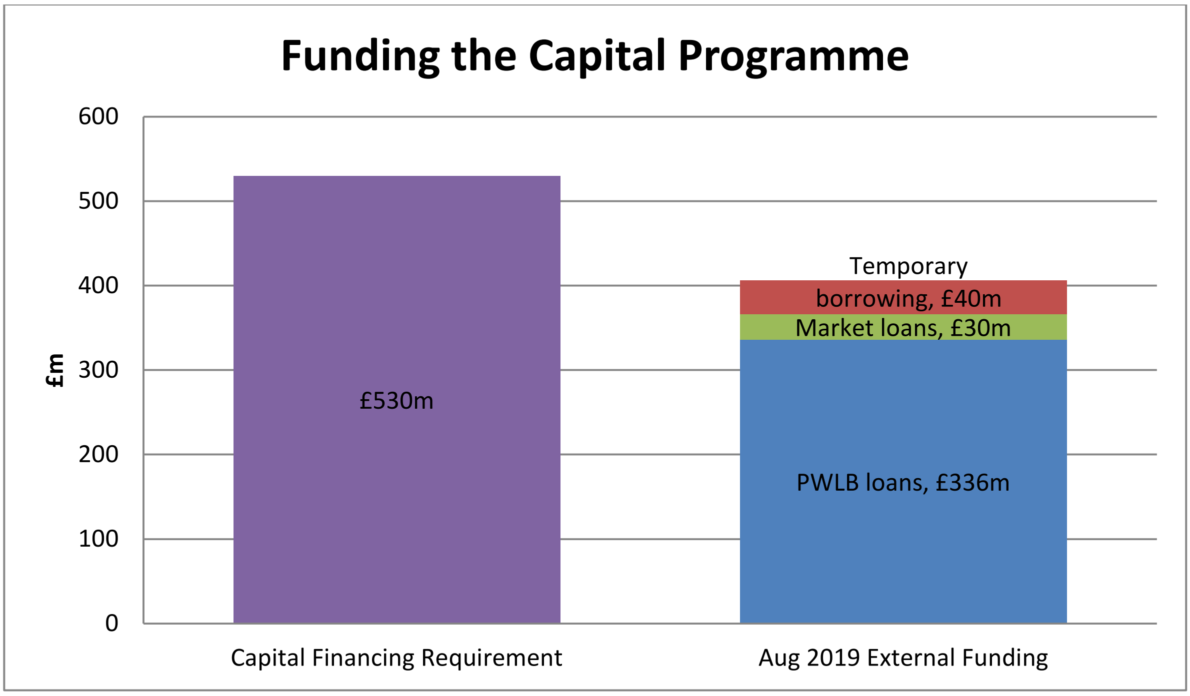
4.5. Table 3 below compares total external borrowing as at 31.08.19 to the position as at the end of the financial year 2018/19 and to the CFR available for borrowing after deducting PFI liabilities.

Table 3: Gross borrowing position

	31 Mar 2019 £m	31 Aug 2019 £m
PWLB	326	336
LOBO	25	25
Fixed term borrowing	5	5
Temporary borrowing – other LAs	43	40
Total Borrowing	**399**	**406**
CFR	530	530
Under borrowing	**131**	**124**

4.6. At £406m the Council's gross borrowing is well within the Prudential Indicator for external borrowing; £530m as set out in Table 3 above.

4.7. The graph below compares the Council's actual borrowing to its CFR after deducting PFI liabilities.



4.8. The Council sets both an annual Operational Boundary and Authorised Limit for borrowing. These limits are set above the CFR to accommodate day-to-day treasury operations and manage abnormal cash flows which may result in a temporary need to borrow. The Operational Boundary is the limit beyond which external borrowing is not normally expected to increase at any point during the year other than on a short term basis. The Authorised Limit is the limit beyond which external borrowing is prohibited.

4.9. Table 4 below sets out the level of borrowing held as at 31 Aug 2019 against both the Operational Boundary and Authorised Limit for external borrowing. This demonstrates that the Council is comfortably within these limits.

Table 4: Borrowing vs. boundary/limits

	£m
External Borrowing as at 31 Aug 2019	406
Operational Boundary	642
Authorised Limit	725

4.10. As anticipated in the Treasury Management Strategy for 2019/20, there is a forecast for new borrowing of up to £124m in 2019/20. To date the Council has so far undertaken £10m new borrowing. Officers will monitor market conditions and consult our treasury advisors when reviewing the need to borrow.

5. REPAYING BORROWING - MINIMUM REVENUE PROVISION

5.1. Full Council approved the Minimum Revenue Provision (MRP) Statement for 2019/20 as part of its Council Tax and Budget Setting report in February 2020. This will be reviewed by Council in February as part of its consideration of the Council's Treasury Management Strategy alongside consideration of the Medium Term Financial Strategy 2020/21 – 2022/23.

5.2. To date one investment property purchases have been made during 2019/20. Any further acquisitions will be in accordance with Counsel opinion and in line with the updated Treasury and Investment strategies being considered by Full Council in February 2020.

6. INVESTMENTS

6.1. The Council's Annual Investment Strategy forms part of its annual Treasury Management Strategy Statement (TMSS). The 2019-20 Strategy was approved by the Council on 26 February 2019. The objective of the Strategy is the prudent investment of balances to achieve optimum returns on investments subject to maintaining adequate security of capital and a level of liquidity appropriate to the Council's projected need for funds over time.

6.2. Table 5 below provides a breakdown of the Council's investments as at 31.08.19 compared to 31.03.19.

Table 5: Breakdown of investments

	31 Mar 2019 £m	**31 Aug 2019 £m**
Money Market Funds	18	27
CCLA property fund	15	15
Loan to Homes for Reading Ltd	18	25
Call Account	1	2
Total invested	**52**	**69**

6.3. Liquid balances are managed through Money Market Funds providing same day liquidity.

6.4. Other investments include the CCLA property fund and loans to Homes for Reading Ltd.

6.5. CCLA is a specialist investment management firm that acts on behalf of churches, charities and local authorities. The investment has produced quarterly returns ranging between 4% and 5%.

6.6. Although not currently classed as treasury management activities and therefore not covered by the CIPFA code, the Council also holds £42m of investments in directly owned investment property and £22m in loans to and shareholdings in its subsidiaries.

7. COMPLIANCE

7.1. During the financial year to August 2019, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 26 February 2019 as set out below.

Table 6: Prudential Indicators

PI ref	Indicator	2019/20 indicator	Actual as at 31.08.19	Indicator met
1	Capital Financing Requirement (CFR)	£540m GF £199m HRA	£364m GF £192m HRA	Met
2	Gross debt vs CFR less PFI liabilities	£124m under borrowed	£124m under borrowed	Met
3	Authorised limit for external debt	£725m	£406m	Met
4	Operational boundary	£642m	£406m	Met
5	HRA internal debt limit	£199m	£192m	Met

8. FINANCIAL IMPLICATIONS

8.1. Financial implications are contained in the body of this report

9. LEGAL IMPLICATIONS

9.1. The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. This report assists the Council in fulfilling its statutory obligation under the Local Government Act 2003 to monitor its borrowing and investment activities.

BACKGROUND PAPERS

- Treasury Management Strategy Statement for 2019/20 at Full Council 26 February 2019.
- CIPFA Code of Practice for Treasury Management in the Public Services 2017
- CIPFA The Prudential Code 2017

Appendix 1 – Economic background

Economy

A1 UK output data indicated surprising strength in July, to dampen recession fears. Industrial production unexpectedly rebounded, with a small 0.1% m/m pick up in July. Markets had been looking for another 0.1% contraction. Manufacturing output bounced, with a 0.3% increase, but there was a decline in the mining sector. On the year overall output contracted, but at a slower rate of 0.9%, with manufacturing down 0.6% y/y. Construction output grew by a slower than forecast 0.3% y/y, with all new work expanding but repair/maintenance work continued to fall. The trade gap widened slightly to £1.932bn in July, from a downwardly revised £1.771bn the previous month. The goods and services deficit grew from £0.132bn to £0.219bn.

A2 Despite the economic pick up in July, the monthly GDP figure was flat in the three months to July. The services sector remained subdued but output in both production and construction sectors declined, with a 1.1% fall in the manufacturing sector the main drag on the former. For July alone, GDP grew by a six month high 0.3%.

A3 The much awaited ECB policy meeting is expected to see interest rates cut to -0.50% and forward guidance strengthened. QE may not be included in this meeting, but the press conference is likely to signal that as coming in October. EZ industrial production is likely to be little changed, possibly posting a small monthly contraction, indicating that the sector is continuing to struggle into Q3. US core consumer price inflation may push higher, despite a slight easing in the monthly rate. Lower gasoline prices should pull the headline reading lower.

A4 The recent strength of US retail sales could come to something of a halt in August. Some of this will be down to the unsustainable growth the previous month, but the concerns raised by the trade war and the potential for a recession could be weighing on consumer sentiment.

A5 The 31st October deadline looms large, with near-term political developments in the UK remaining key over the coming days. Market sentiment will flex as these developments pan out, providing the potential for higher than normal levels of volatility in the near-term for both investment and borrowing rates.

Financial markets

A6 At 10 September, the better than expected UK data and improved risk appetite saw gilts and other global bonds sold recently. Gilt yields rose by 2-8.5 basis points on the day, but Brexit concerns should limit the extent to which gilts are sold off.

A7 The FTSE turned 0.64% lower yesterday as major internationally focussed stocks fell as Sterling was boosted by the unexpectedly robust data releases and a tempering of "no deal" Brexit worries. Sterling pushed to a six week high as fears of recession were kept in check, hitting a high of 1.2382, though it did lose some ground on the announcement that John Bercow, the Speaker, will be standing down.

A8 European bourses also closed down on the session, with the STOXX 600 off by 0.3%, despite a surprising rise in German exports, as investors looked ahead to Thursday's ECB meeting, which is expected to add to stimulus. Defensive stocks, such as healthcare, felt the weight of sales. Wall Street was mixed, but little changed, with the Dow up 0.15%, the S&P flat on the day and the NASDAQ down 0.16%, on increased expectations of central bank stimulus around the world were offset by losses in the technology and healthcare sectors. Asia/Pacific markets were generally lower this morning as Chinese factor prices declines weighed on sentiment.

Credit background

A9 Credit Default Swap (CDS) index prices fell further over the past week. The European index fell by almost 9%, while its US equivalent was down by 5.09%. This general move down was also reflected at the individual level, where only Banco Commercial Portugues edged up…by only 0.31%. On the month, increases were similarly sparse, with this bank joined by four further entities. However, increases in these five entities were capped at just over 1.5%, with four of them below 1%. Underlying prices remain low with only two entities that we monitor with a price above 100bps. These are from either Italy or Portugal.

A10 Major equity markets registered another week in the black, this time led by shares in Japan. Late news of fresh Chinese policy support helped markets, as did expectations that the ECB may ease monetary policy at this week’s meeting. On the domestic front, the FTSE-100 was up just over 1%, while the bank’s sub-index rose by 1.56%. Individual gains were dominated by European names, while the fallers on the week were all based in the Middle East.

Interest Rates

A11 Link Asset's central case is for Bank Rate to rise once at Dec 2020. The August MPC meeting delivered the expected no change vote with a unanimous 9-0 vote, with the committee suggesting that the UK economy is likely to have stagnated in Q2. The MPC noted that the economy is operating against a backdrop of weaker global growth and ongoing trade tensions. As a consequence they downgraded growth expectations for 2019 and 2020, based on Brexit with a deal, warning that "no deal", withdrawal would have a greater dampening effect.

Interest Rate Forecasts								
Bank Rate	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Link	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%
Cap Econ	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	-	-

A12 The ongoing Brexit saga will ensure that any initial interest rate hike is delayed, even though a disorderly Brexit has been avoided for now. Mark Carney had previously suggested that the headwinds facing the UK economy might require the Bank to offer further support. The Inflation Report indicated that, even if a Brexit deal is achieved, the economy will slow in 2019/2020. Q2 GDP showed that the economy contracted, possibly enhancing the chances of a rate cut. Politics and Brexit, though, will set the interest rate agenda.

A13 The new Government's aggression towards Brexit and rising prospect of "no deal", along with growth concerns offered the possibility of a rate cut this year, but Prime Minister's Brexit defeat appears to have eased fears of a disorderly exit. Rate expectations are likely to remain volatile and have eased back, helped also by trade talks news, which have soothed concerns of a global recession and the surprising strength of the July UK output release.

Appendix 2 – Approved counterparties and limits

<table>
<tr><td colspan="2">Counterparty</td><td>Cash limit</td><td>Time limit</td></tr>
<tr><td rowspan="7">Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:</td><td>AAA</td><td rowspan="7">£20m each</td><td>10 years</td></tr>
<tr><td>AA+</td><td>5 years</td></tr>
<tr><td>AA</td><td>4 years</td></tr>
<tr><td>AA-</td><td>3 years</td></tr>
<tr><td>A+</td><td>2 years</td></tr>
<tr><td>A</td><td rowspan="2">1 year</td></tr>
<tr><td>A-</td></tr>
<tr><td colspan="2">The Council's current account, Lloyds Bank plc should circumstances arise when it does not meet the above criteria</td><td>£1m</td><td>next day</td></tr>
<tr><td colspan="2">UK Central Government (irrespective of credit rating)</td><td>unlimited</td><td>50 years</td></tr>
<tr><td colspan="2">UK Local Authorities (irrespective of credit rating)</td><td>£20m each</td><td>50 years</td></tr>
<tr><td colspan="2">UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher</td><td>£5m each</td><td>10 years</td></tr>
<tr><td colspan="2">UK Registered Providers of Social Housing whose lowest published long-term credit rating is BBB- or higher and those without credit ratings</td><td>£2m each</td><td>5 years</td></tr>
<tr><td colspan="2">UK Building Societies without credit ratings</td><td>£10m each</td><td>1 year</td></tr>
<tr><td colspan="2">Money market funds and other pooled funds (including the CCLA Property Fund)</td><td>Up to £20m each</td><td>n/a</td></tr>
<tr><td colspan="2" rowspan="3">Any other organisation, subject to an external credit assessment and specific advice from the Council's treasury management adviser</td><td>£5m each</td><td>3 months</td></tr>
<tr><td>£1m each</td><td>1 year</td></tr>
<tr><td>£100k each</td><td>5 years</td></tr>
</table>