MID-YEAR TREASURY MANAGEMENT STRATEGY REVIEW 2019/20

1 Original Strategy for 2019/20

1.1 The Treasury Management Strategy for 2019/20 was approved by Executive Board on 14th March 2019.

The broad strategy continued the approach of looking to minimise borrowing costs, in the context of the Council's long-term debt being considerably lower than its accumulated Capital Financing Requirement, with the difference covered by the use of short-term borrowing and any available balances. This approach had generated savings on interest costs over the last few years.

At the time, it was expected that interest rates could increase slowly, so it was noted that it might be possible that it could become appropriate to take out more long-term borrowing.

1.2 The Original 2019/20 Investment Limits were set by reference to amount, duration and credit rating – and distinguished between Unsecured Deposits, which would be subject to greater risk of credit loss, and Secured Deposits, where there was less risk. The limits set were largely comparable to those applying in previous years.

2 Economic Review 2019/20

2.1 The UK economy's performance and interest rate expectations have continued to be heavily shaped by the uncertainty over the British exit from the European Union. There has been a falling off in economic growth, and the first estimate of Q2 GDP growth showed the UK economy contracted by 0.2%, following the 0.5% gain in Q1 (which reflected stockpiling ahead of Brexit). However, employment levels remain at a record high.

2.2 The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment, and confirmed that monetary policy decisions related to Brexit could be in either direction.

2.3 Our treasury advisor Arlingclose now expects Bank Rate to remain at 0.75% for the foreseeable future but notes that there are significant risks of a fall in rates, dependant on Brexit outcomes and the evolution of the global economy.

3 Treasury Performance to date

3.1 Thus far, cash balances have typically averaged between £15M and £25M. These levels have been supported by short-term borrowing (at rates averaging around 0.9%). No further long-term borrowing has been taken, while short-term borrowing levels have fluctuated, currently standing at around the same level as the start of the year.

3.2 Investments have continued to be made with a limited range of banks, building societies and Money Market Funds, along with other local authorities, and the Government's Debt Management Office (DMO), earning interest at low levels. Average interest earned on balances was around 0.67% in the first half of the year. It is likely that investment returns will remain low in the second half of the year.

4 Investment and Borrowing Strategy for the rest of the year

4.1 Both the CIPFA Code and government guidance require that funds be invested prudently, and with regard to security and liquidity, before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

4.2 The Council's Investment Criteria allow investment in a range of other organisations and structures, but there are limited opportunities for straightforward trading in Secured Deposits, and as priority is given to maintaining liquidity, short-dated and simpler options are mainly used. Investments are made in: fixed term deposits and instant access accounts with banks and building societies; instant access Money Market Funds; and fixed term deposits with local authorities and the UK Government's Debt Management Office. It is expected that these will continue to be the main investment options taken up across the remainder of the year.

4.3 In order to maintain the professional client status with its providers of financial services, the Council is required to hold a minimum investment balance of £10M. Consequently, the Council has long-term funds available that are not required to meet any liquidity need. These funds should therefore be considered for investment with a greater emphasis on achieving higher returns.

For such monies the Council could explore investment in a property fund. These are Pooled Fund investments investing in a diversified portfolio of UK commercial property, receiving income by way of dividends. These funds also give the opportunity for capital growth.

Such funds can result in increased yields, but due to their exposure to fluctuations in the property market should be considered as a long-term investment (advised minimum of 5 years), to give the best opportunity for capital appreciation.

4.4 It is proposed that the Investment Criteria only be amended to allow for the long-term investment in property funds. The existing criteria should remain for all other investments.

4.5 The Council's key objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans, should long-term plans, change is a further, secondary objective.

4.6 It is proposed that the Borrowing Strategy also remain unchanged, with the Council looking to take new borrowing as determined by cash flow requirements and by reference to movements in actual and projected long-term interest rates.

5 Risk Management

5.1 The Council's main objective for the management of its investments is to give priority to the security and liquidity of its funds before seeking the best rate of return. Therefore, most surplus cash is held in short-term investments with government bodies, and with highly rated banks and pooled funds. In addition, the Council can hold investments that entail a slightly higher level of risk, such as unrated building society deposits, but such risks are mitigated by limiting the amount and duration of exposure.

5.2 The Council's main objective for the management of its debt is to ensure its long-term affordability. The largest part of its loans is from the PWLB at long-term fixed rates of interest.

5.3 Another significant element of the Council's long-term debt is £18M of loans from banks and other institutions. £13M worth are "lender's option, borrower's option" (LOBO) loans, under which the Lender can, at pre-determined times, exercise an Option to increase the rate payable on the debt, and the Borrower has the Option to either accept the proposed increase or repay the whole loan.

These loans have interest rates fixed at levels that were relatively low when they began, but if the Lender Option is exercised, the Borrower has to deal with whatever interest rates turn out to be at that later date. This exposes the Council to some risk of rising long-term interest rates, but that is mitigated by the fact that £5M of this debt (forming a large part of the lowest interest rate elements) can only be "called" once in every five years. Current projected future interest rates suggest LOBOs are unlikely to be called in the next 5 years.

5.4 A combination of short duration investments and long duration debt exposes the Council to the risk of falling investment income during periods of low interest rates. However, the risk of low investment returns is viewed as of lower priority compared to the benefits of optimising the security and liquidity of investments, and the savings made on borrowing costs. Also, though the Council has no long term investments, at this stage, it is hedged against the investment return risk by its short term debt holdings.

6 Indicators and Limits

6.1 The originally approved Indicators were set at cautious levels and can remain unchanged.