BRIEFING PAPER

REPORT to :	Audit and Governance Committee
LEAD OFFICER:	Director of Finance and Customer Services
DATE:	14th January 2020

WARD/S AFFECTED: All

TREASURY MANAGEMENT REPORT – 2019/20

Based on monitoring information for the period 1st September – 30th November 2019

1. PURPOSE
To allow scrutiny of the Treasury Management function.

2. RECOMMENDATIONS
It is recommended that Audit and Governance Committee notes the Treasury Management position for the period, and the draft Treasury Management Strategy for 2020/21, appended to this report.

3. BACKGROUND
3.1 The Treasury Management Strategy for 2019/20, approved at Executive Board in March 2019, complies with the CIPFA Code and with Ministry for Housing Communities and Local Government (MHCLG) Guidance on Investments.

The CIPFA Code, the Investment Guidance issued by MHCLG, and the Internal Audit & Assurance reviews of Treasury Management activities, all recommend a strong role for elected members in scrutinising the Treasury Management function of the Council.

3.2 This report summarises the interest rate environment for the period and the borrowing and lending transactions undertaken, together with the Council's overall debt position. It also reports on the position against Treasury and Prudential Indicators established by the Council.

3.3 A glossary of Treasury Management Terms is appended to this paper.

4. KEY ISSUES

4.1 Bank of England Bank Rate
The Bank of England's Bank Rate held steady at 0.75%, having increased in August 2018.

4.2 Investments Made and Interest Earned
The graph in Appendix 1 shows the weekly movement in the totals available for investment, both

actuals to date and projections for the rest of the year (adjusted for anticipated borrowing). These balances have fluctuated across the period, but have ranged around £20M. It is intended that these will reduce further in future in the range of £10 M and £20 M.

Investments made in the period were mainly in "liquid" (instant access) deposits, either bank "call accounts" or Money Market Funds (MMFs). During the period, the Council has opened additional MMFs with the aim of achieving slightly higher returns on investments in such funds and mitigating risk. The Council is now spreading its holdings more broadly across all MMFs available to manage risk. The new MMFs opened are UK domiciled, which should help reduce the liquidity risk in the event of a no deal Brexit. Returns on such MMFs holdings had increased a little by the end of the period, to around 0.68%. Bank account rates vary, paying between 0.20% and 0.5%.

During the period the Council opened a 32 day notice account and deposited £3M earning interest at 0.90%.

For limited periods, funds were also placed with the Government's Debt Management Office (at 0.5%). The other fixed term investments made were:

Start Date	End Date	Counterparty	Amount £	Rate
24-Oct-19	18-Feb-20	Thurrock Council	£3,000,000	0.75%

At 30th November, the Council had approximately £16.0 M invested, compared to £18.0 M at the start of the period. Appendix 2 shows the breakdown of the closing investment balance.

The Council's investment return over the period was approximately 0.66%.

For comparison, benchmark LIBID (London Interbank Bid) rates were
(a) 1 month lending - stable at around 0.6%
(b) 3 month lending - increasing a little over the period, averaging 0.66% and ending at 0.67%

4.3 Borrowing Rates

The cost of long term borrowing through the PWLB (Public Works Loan Board) is linked to central government's own borrowing costs. These rates saw a 1% increase in October, to an average rate of 2.7%, as the Government increased the margin it charges over its own borrowing costs, now making it a relatively expensive borrowing option.

The cost of short term borrowing, based on loans from other councils, continued to fall slightly over the period. By the end of the period, loans from 3 months out to a year were priced between 0.75% to 1.0%.

The Council is currently using short term borrowing, but should we need to borrow over the longer term this may be more expensive. It is uncertain as to how the long term borrowing market will develop, but should the need arise, we will review the options available.

Though the medium term trend in interest rates has been, and is expected to continue, slowly upwards, it is expected that rates will remain constant in the coming months.

4.4 Short Term Borrowing in the 3 month period

The Council's CFR (Capital Financing Requirement) is the key measure of the Council's borrowing **need** in the long term. It is

(a) the accumulated need to borrow **to finance capital spend** (not funded from grants, etc.)
less
(b) the accumulated Minimum Revenue Provision (MRP) charges already made - councils must make a prudent MRP charge in their accounts each year, to finance their debt -
less

(c) any capital receipts applied to finance outstanding debt.

and therefore tends to increase if capital spend financed from borrowing exceeds MRP.

The Council's **actual** long term debt is significantly below the CFR – the gap has widened as long term debt has been repaid. We have been using "internal borrowing" from available revenue cash balances to partly cover this gap. The remaining gap has been covered by taking enough short term borrowing to ensure that the Council has sufficient funds to pay its liabilities and commitments, and to anticipate future borrowing needs. This has resulted in net interest savings.

Up to the end of November, there was an increase in short term borrowing of £5M, as loans of £17M were repaid and £22M of new loans were taken (listed below).

New loans taken in the period

Start Date	End Date	Counterparty	Amount £	Rate
27/09/2019	29/06/2020	Fylde Borough Council	2,000,000	0.73%
30/09/2019	30/03/2020	Tendring District Council	4,000,000	0.74%
31/10/2019	31/01/2020	Erewash Borough Council	1,000,000	0.65%
31/10/2019	30/04/2020	Gwent Police Authority	5,000,000	0.75%
31/10/2019	30/04/2020	Vale of Glamorgan Council	2,000,000	0.75%
12/11/2019	12/05/2020	Tendring District Council	1,000,000	0.74%
26/11/2019	26/05/2020	West Yorkshire Combined Authority	7,000,000	0.78%
			22,000,000	

Future deals already agreed by end of period

Start Date	End Date	Counterparty	Amount £	Rate
06/01/2020	04/01/2021	Workingham Borough Council	5,000,000	0.95%
30/01/2020	30/07/2020	Tendring District Council	1,000,000	0.80%
19/02/2020	17/02/2021	East Suffolk Council	5,000,000	0.95%
28/02/2020	26/02/2021	Gwent Police Authority	5,000,000	1.00%
			10,000,000	

4.5 Current debt outstanding -

	31st Aug 2019		30th Nov 2019	
	£000	£000	£000	£000
TEMPORARY DEBT				
Less than 3 months	10,000		6,000	
Greater than 3 months (full duration)	27,000		36,000	
		37,000		42,000
LONGER TERM DEBT				
Bonds	18,000		18,000	
PWLB	135,885		133,768	
Stock & Other Minor Loans	263		263	
		154,148		152,031
Lancashire County Council transferred debt		14,738		14,443
Recognition of Debt re PFI Arrangements		64,844		63,986
TOTAL DEBT		**270,301**		**272,460**

Less: Temporary Lending	- fixed term	(1,000)	(3,000)
	- instant access	(17,029)	(13,148)
NET DEBT		**252,272**	**256,312**

The key elements of long term borrowing set out above are:

(a) £18M classed as bonds, borrowed from the money markets, largely in the form of "LOBO" (Lender Option, Borrower Option) debt. The individual loans remaining range from 4.35% to 4.75%, at an average of around 4.4%

(b) £133.8M borrowed from the PWLB at fixed rates, at an overall average rate of around 4%. Loans repayable on maturity range from 3.06% to 7.875%, and EIP (Equal Instalment of Principal) loans from 1.7% to 3.77%.

(c) Debt managed by Lancashire County Council after Local Government Reorganisation, which is repaid in quarterly instalments across the year, charged provisionally at 2%.

(d) Debt recognised on the balance sheet as a result of accounting adjustments in respect of bringing into use school buildings financed through Public Finance Initiative (PFI) arrangements. The Council's effective control over, and use of these assets is thereby shown "on balance sheet", with corresponding adjustments to the debt. This does not add to the costs faced by the Council Tax Payer as these payments made to the PFI contractor are largely offset by PFI grant funding from the Government.

4.6 Refinancing of Building Schools for the Future (BSF) – Private Finance Initiative (PFI) Phase 2

Most PFI contracts contain standard provisions stating that if the debt used to finance the initial construction phase of a project can be refinanced at a lower cost, then the benefit (after transaction costs, advisory fees and disbursements) is split between the Council and the PFI Contractor. In these arrangements, the debt to be refinanced is often referred to as Senior Debt and the providers of it are known as Senior Funders.

The interest rate charged to the PFI Contractor broadly comprises two elements:

- The underlying interest (swap) rate;
- A profit margin charged by the Senior Funder.

Refinancing opportunities generally exist where the market rate for the profit margin element falls below that currently charged by the incumbent Senior Funder. However, any refinancing exercise attracts significant early redemption penalties as well as legal and advisory fees. The reduction in margins must therefore be significant enough to offset these costs.

It is common for this debt to be refinanced sometime after the completion of construction because the risks involved in the project generally reduce at this point which means that the initial loans can be replaced by loans at a lower rate of interest.

The Council was approached by the PFI Contractor in 2017 to work with them to refinance the two PFI schemes because of the historically low level of interest rates that have prevailed for the past few years.

Based upon their preliminary work, the PFI contractors advised the Council that the terms being offered by prospective funders would result in a net gain which would provide the Council with the following benefits;

- A share of the gain attributable to the Council as granting authority, as defined by sharing provisions in the initial Project Agreement in 2010, with any benefit from the refinancing to be split between the Council and the Project Company on the basis agreed at the time of the original PFI contract

- As the Council is also a shareholder in the Project Company (directly owning 9% of the shares in the Holding Company, and also 5% in the Local Education Partnership (LEP) who in turn own 10% of the shares in the Holding Company), the Council would receive 9.5% of the benefit identified above as accruing to the Project Company.

Further to the Executive Board report in July 2017, and following the success of the refinancing of the Phase 1 Scheme (Pleckgate High School) in February 2019, the Council has worked with the PFI contractor and successfully concluded the Phase 2 Scheme (Witton Park High School and Blackburn Central High School with Crosshill) on 21st November 2019.

The refinancing of the Phase 2 Scheme has resulted in a financial benefit for the Council comprising;

Share of gain to the Council as granting authority £847,000
Share of gain to the Council as shareholder in the Project Company £124,000
TOTAL £971,000

These gains are stated after deduction of the costs for all financial and legal advisers engaged on the project, including those who were appointed to support the Council.

4.7 Payment of Employer Pension Contributions to the Lancashire Local Government Pension Fund

As an employer, the Council makes pension contributions to the pension fund that are based on amounts set by actuarial advice and notified by the Lancashire Local Government Pension Fund. The contributions we make consist of two elements;

- a current service payment which is a percentage rate applied to the salary costs of all employees who are currently in the scheme and
- a lump sum payment made as a contribution to the Council's share of the pension fund deficit; this payment is intended to eliminate the deficit over a number of years.

Employer contribution rates are set following a triennial valuation of the pension fund and apply for three years. The new rates, following the 2019 valuation, will commence from 1st April 2020. The pension fund has outlined a range of potential payment options for employers to consider including the following:

a) monthly payments of both elements in each of the three years;
b) a lump sum payment in April 2020, April 2021 and April 2022 of one or both elements for that year;
c) a lump sum prepayment in April 2020 of both elements for all three years;

The amounts involved are substantial but the flexible options offered by the Pension Fund do merit consideration as the Fund provides a discount on the prepayment resulting in a saving on the total amount that is to be paid over the following 3 years; this advance payment of contributions enables the Fund to invest and generate additional returns, whilst for the Council, the savings achieved from the discount is still greater than the costs of the borrowing made to facilitate the prepayment, given the low prevailing rates of interest.

The Council took the option to prepay the costs of the Pension Fund Deficit element in 2017 and so consideration will now be given to the options available as part of the current Budget Setting process with the resulting recommendations presented to Finance Council in February 2020 for consideration.

4.8 Performance against Prudential and Treasury Indicators

Appendix 3 shows the current position against the Prudential and Treasury Indicators set by the Council for the current year.

With regard to the movement in the key indicator, **Total Borrowing against the Authorised Borrowing Limit**, this is shown as the first graph in Appendix 4. Total borrowing at 30th November 2019 was £272.5M, which is below both our Operational Boundary (£326.1M) and our Authorised Borrowing Limit (£336.1M) for 2019/20.

This year we have remained within both our Operational Boundary – which is set for management guidance - and the (higher) Authorised Borrowing Limit. The Authorised Limit is the key Prudential Indicator - loans from the PWLB cannot be taken if this Limit is (or would be caused to be) breached.

This total debt includes the impact on the balance sheet of the recognition of assets that have been financed through PFI. The accounting adjustments are designed to show our effective long term control over the assets concerned, and the "indebtedness" arising from financing the cost of them. They do not add to the "bottom line" cost met by the Council Tax Payer.

The Council still holds a large part of its debt portfolio in loans of less than a year's duration - short term loans still represent a cheap way to funding marginal changes in its debt.

Interest Risk Exposures

Our **Variable Interest Rate Exposure** (see second graph at Appendix 4) ended the period at £38.9M, against the **limit** set for this year of £102.8M.

This indicator exists to ensure that the Council does not become over-exposed to changes in interest rates impacting adversely on its revenue budget. The limit is set to allow for short as well as long term borrowing, and takes:

(a) all variable elements of borrowing (including short term borrowing – up to 364 days – and any LOBO debt at risk of being called in the year), which is then offset by
(b) any lending (up to 364 days).

Our **Fixed Interest Rate Exposure** was around £139.0M, against the **limit** of £233.9M. This indicator effectively mirrors the previous indicator, tracking the Council's position in terms of how much of the debt will **not** vary as interest rates move. The historically low interest rates prevailing over recent decades led the Council to hold a large part of its debt in this way.

This limit was set to allow for the possibility of much higher levels of new long term, fixed rate borrowing. There are still significant levels of short term debt.

4.8 Treasury Management Strategy for 2020/21

The Council's proposed Treasury Management Strategy and Treasury Management Indicators for 2020/21 will be submitted to Executive Board in February 2020.

The content of the strategy remains largely similar to the previous year, taking into account the amendments made during the 2019/20 Treasury Management Strategy Mid-Year Review, approved by Executive Board on 14th November 2019.

Details of the proposed draft strategy are included in Appendix 6.

5. POLICY IMPLICATIONS

None

6. FINANCIAL IMPLICATIONS

The financial implications arising from Treasury Management activities are reflected in the Council's overall Budget Strategy, and in ongoing budget monitoring throughout the year.

7. LEGAL IMPLICATIONS
The report is in accordance with the CIPFA code and therefore is in accordance with the Financial Procedure Rules under the Council's Constitution.

8. RESOURCE IMPLICATIONS
None

9. CONSULTATIONS
None

10. STATEMENT OF COMPLIANCE
The recommendations are made further to advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation and an equality analysis and impact assessment has been considered. The recommendations reflect the core principles of good governance set out in the Council's Code of Corporate Governance.

VERSION:	**0.01**

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DATE:	19th December 2019
BACKGROUND PAPERS:	CIPFA Guidance - CLG Investment Guidance - Council Treasury Management Strategy approved by Executive Board 14th March 2019