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| **REPORT OF:** | **CHIEF FINANCIAL OFFICER** |
| **TO:** | **ACCOUNTS & AUDIT COMMITTEE** |
| **DATES:** | **18TH MARCH 2019** |


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# TREASURY MANAGEMENT
# 2018/19 QUARTER 3 AND QUARTER 4 MONITORING REPORT

## PURPOSE OF REPORT

1. The purpose of this report is to advise the Committee of the treasury management activities of the Council. Due to inclement weather in January and the cancellation of the scheduled Accounts and Audit committee at that time, this report includes performance for quarter 3 and quarter 4 to date (11th March 2019).

## RECOMMENDATIONS

2. It is recommended that the Committee note the work on the Council's treasury management activities in the period 1st April to 11th March 2019.

3. The Committee is also recommended to note the technical breach of the approved Treasury Strategy and the action taken as a result.

## ISSUE

### Introduction

4. The Council's Treasury Management policy requires that at least twice a year, a report be submitted to the Policy and Resources Committee (previously Executive) on the Council's Treasury Management activities. It also represents good practice to report on treasury activities to the Accounts and Audit Committee. This report provides a summary view of the activity undertaken in the year to date in relation to the Council's debt and investment.

### Long Term Borrowing

5. At the beginning of this financial year, the Council held loans of £19.359m, comprised wholly of Public Works Loan Board (PWLB) debt. Technically, the sum of £1m was repayable on 31st March 2018 but as this repayment date was a bank holiday, the amount was not repaid until 3rd April 2018.

6. New borrowing in the sum of £2m (two separate £1m transactions) was undertaken in quarter 3 as detailed below:

- 7th November 2018 - £1m repayable on 31st March 2044 at a fixed rate of 2.78%
- 7th November 2018 - £1m repayable on 31st March 2064 at a fixed rate of 2.64%

7. In accordance with the approved Treasury Management Strategy Statement (TMSS) 2018/19, additional net borrowing for the year was forecast at £3.5m, being the underlying need to borrow to finance the Capital Programme. The above borrowing of £2m is within this forecast and supports the financing of programmed capital expenditure within the Council's Capital Financing Requirement (CFR) that cannot be met from other resources eg asset disposal receipts, grants, use of reserves. The strategy now applied to financing the Capital programme is that there will be no further borrowing to fund new projects due to the costs that would fall to the revenue budget,

8. The rates obtained are within the Council's advisors, Link Asset Services (LAS) 'trigger' level applicable to each loan period, being 2.90% (2.78% achieved) and 2.70% (2.64% achieved) respectively.

9. As a result the Council had PWLB loan debt of £20.359m at the end of the third quarter at an average cost reduced from 3.16% to 3.11%. An analysis of this long-term debt is provided at **Appendix A** with a maturity profile provided at **Appendix B**.

**Temporary (or Short-term) Borrowing**

10. Temporary borrowing relates to loans which are repayable:-

    a) Without notice or
    b) At less than 12 months' notice or
    c) Within 364 days of the date of borrowing.

    During the period to date, the Council has not undertaken any short-term borrowing.

**Temporary (or Short-term) Investments**

11. The Council's cashflow position is generally such that it has scope to undertake the short-term investment of surplus funds, i.e. as represented by balances, reserves etc. The Council started the year with investments of £14.0m. The balance of investments as at 11th March 2019 was £20.5m. Table 1 summarises the investment transactions that have taken place since the beginning of the year:-

**Table 1: Analysis of Investments at 11th March 2019**

| | £m | No. |
|---|---|---|
| Opening Balance of Investments | 14.000 | 11 |
| New Investments | 194.000 | 79 |
| Investments Realised | (187.500) | 77 |
| **Balance of Investments at 31st December 2018** | **20.500** | **13** |

**Note:** The amounts and volumes shown above for 'New Investments' and 'Investments Realised' reflect cumulative values for transactions in the year to date as illustrated by way of the following example:

- Make a new investment of £2m (counts as 1 new investment);
- Recall £0.5m from this investment (counts as the realisation of original investment of £2m and the making of 1 new investment of £1.5m);
- In summary this would be shown as 2 'new' investments with a combined value of £3.5m and 1 'realised' investment of £2m;
- The reported net position would be 1 outstanding investment with a current balance of £1.5m.

12. The 13 investments comprising the balance of £20.5m were placed with the following sectors:

| | £m | % | |
|---|---|---|---|
| a. Local Authorities | 10.5 | 51.22 | (Principal Councils (4)) |
| b. UK Banks | 5.5 | 26.83 | (Lloyds (3) / Santander (2)) |
| c. Non UK Banks | - | - | - |
| d. Building Societies | 4.5 | 21.95 | (Coventry (2) / Nationwide (2)) |
| | **20.5** | **100.00** | |

13. Unlike interest rates for long-term borrowing, rates for short-term investments are generally linked more closely to the prevailing Bank of England rate. As Members will be aware the Bank Rate had remained at 0.50% since 2nd November 2017 until 2nd August 2018, when it increased to 0.75%. In terms of the relative performance of the Council's investment portfolio, the average return on investments in the year to date is 0.70%, which is above the budgeted rate of return of 0.40%. The underlying strategy remains one of protecting the capital invested whilst optimising, not maximising, returns on investment. The investment rates on offer have remained low during the year primarily as a consequence of general economic conditions and the access that financial institutions have to low cost funds.

14. Two separate transactions in the sum of £4m (£2m per transaction) have been placed with one Local Authority (LA). These sums are included in the total investment figure of £10.5m within this sector of the market. Whilst the LA sector is not limited to a maximum investment exposure of 75% of total investments (unlike Banks/Building Societies), the Council has set individual counterparty limits, being £3m for all LAs respectively, save for the call account arrangement with Lancashire County Council, which is £6m. The sum of these two investments therefore breaches the Council's TMSS and Annual Investment Strategy (AIS).

15. Upon identification, the Councils Chief Financial Officer (CFO) initiated an internal review of process and procedures and it was identified that key control information (namely individual counterparty limit(s) within the LA sector) had been omitted from daily treasury management documentation. This has now been addressed.

16. All stakeholders have been notified of the situation and reminded of their responsibilities in accordance with the Code of Practice on Treasury Management, Treasury Management Practice Notes (TMPs), the approved TMSS and AIS.

17. At the point of investment the Chief Financial Officer reviewed the borrowing authority's latest Statement of Accounts and External Auditor's report. A further assessment of risk was made with regard to this investment level when the breach was identified and the d4cuiison to maintain the relationship with the counterparty was taken, no recall of funds was therefore made. One of the two transactions in the sum of £2m is due to mature and be repaid on 15th March 2019.

18. The CFO also carried out a review of the individual counterparty limits to consider both increases and reductions, however, it was concluded that the limits should remain unchanged.

19. Total investments comprised fixed term deposits of £16.0m ranging between 4 months to 364 days in duration for amounts between £1m to £2m at interest rates of 0.75% and 1.08% and instant access deposits of £4.5m at a rate of 0.50%.

20. At the time of writing Brexit continues to dominate the headlines. Typical investment approaches have been offered by LAS based on scenarios of 'Deal' or 'No Deal':

'*<u>Deal' Scenario</u>*

21. A balanced approach to investment activity is advised and this reflects the existing positon of the Council. Modest interest rate increases are forecast with counterparty credit ratings remaining stable.

*<u>'No Deal' Scenario</u>*

22. A more defensive approach to investments is recommended with a focus on shorter-term deposits. Credit rating agencies may review (downgrade) the UK sovereignty rating and also the outlook for UK Banks, as was the case following the EU referendum in 2016. The UK sovereignty rating is no longer considered within our minimum ratings criteria as it is currently below our threshold. This removal was approved by Council on 14th July 2016. The more immediate consideration is the potential impact on the credit ratings of UK banks and our minimum ratings criteria and thus a reduction in available credit-worthy counterparties for the investment of surplus funds.

23. With regards to debt, there remains volatility in the market with the advice that the Council remain organised to respond quickly relative to planned borrowing need based on an assessment of the recommend trigger levels.

24. As Brexit negotiations continue, the Council will continue to review this position and the implications for the 2019/20 Treasury Management Strategy Statement and Annual Investment Strategy to be presented to Council in March 2019.

25. Treasury management activities are undertaken within the Council's agreed Treasury Management Policy and where necessary, advice is sought from LAS. The revenue budgets associated with Treasury management activity, namely debt charges (comprising interest and provision for principal repayment) and investment income are monitored on an ongoing basis and reported to Management Team and Policy and Resources Committee. The revised budgets for these items, as reported to Policy and Resources Committee in December 2018 are £1.090m *(£1.466m)* and £90k *(£60k*) respectively *(approved original budget estimates in brackets).*

26. Variations from approved budget to revised budget arise principally from a combination of the following:-

- Debt Charges - £1.090m – a delay in borrowing activity with sums below that originally forecast and at interest rates below original estimates.
- Investment Income - £0.090m - reflects an increase in the Council's average 'core cash' position available (primarily due to slippage on the Capital Programme) for investment and investing at increased rates that 'price in' actual and forecast (increased) changes to the Bank Rate.

27. In comparing the Debt Charge to the out-turn position last year, the General Fund revised budget for debt charges in 2017/18 was £1.113m comprising £665,120 for interest on debt, £431,830 for the Minimum Revenue Provision (MRP) and £16,360 for premia payable as a result of debt restructuring exercises in previous years. Actual debt charges for the year were £1.064m (including MRP and premia), being an underspend of 349,800 when compared to the budget. Similarly to this current year, this reflected the 'timing' impact of when, due to movements in interest rates, actual borrowing was taken from the PWLB which differs from that assumed in the budget.

28. The Annual Treasury Management Strategy for 2018/19 was approved by Council in March 2018. This set out the framework against which the treasury management function is carried out and updates against this are reported to this Committee quarterly. A copy of the 2018/19 strategy is available to view here (item 11 refers).

**IMPLICATIONS**

**Policy**

29. Treasury Management activities are carried out in accordance with the Annual Treasury Management Strategy which is produced in compliance with the requirements of the Council's Treasury Management policy.

**Financial**

30. The financial implications are given in the report.

**Legal**

31. In accordance with the Local Government Act 2003, Members are required to approve the Annual Treasury Management Strategy incorporating the Annual Investment Strategy, the prudential indicators, and the authorised limit for external debt. The Strategy for the current year was approved by Council in March 2018.

**Risk Management**

32. In the period to date there has been a breach of the Council's approved TMSS/AIS. Controls have been reviewed and strengthened. Acting outside of the approved governance framework and Code of Practice for Treasury management, may put the Council's deposits at risk. The Council's approach to investment activity remains one of security, liquidity and the yield.

33. Councillors will be aware of the uncertainty in the financial markets and the economy as a whole and the potential risks this may have in general. In this context, Councillors should note that treasury activities are undertaken within the Council's Treasury Management Policy and risk is managed through the application of requirements of Treasury Management Practice Notes (TMPs). Updated TMP documents will be presented to Council in 2019/20 to reflect operational changes and also the impact of the Brexit outcomes on the Council's minimum ratings criteria and availability of creditworthy counterparties.

34. From 1st January 2019, the largest UK banks must separate core retail banking from investment banking. This is known as 'ring-fencing'. For Pendle, it is anticipated that instruments approved in the Annual Investment Strategy (AIS) eg fixed term deposits will be placed with the ring-fenced entity (RFB) as opposed to non-ring-fenced bank (NRFB) although this can vary by institution.

35. Any new entity created as a result of ring-fencing will be subject to evaluation by the external rating agencies and must therefore satisfy our minimum rating criteria before a transaction is considered.

**Health and Safety**

36. There are no health and safety implications arising directly from the contents of this report.

**Sustainability Implications**

37. There are no sustainability implications arising directly form this report.

**Community Safety:**

38. There are no community safety issues arising directly from the contents of this report.

**Equality and Diversity:**

39. There are no equality and diversity implications arising from the contents of this report.

**APPENDICES**

**Appendix A** – PWLB long-term debt as at 11th March 2019.
**Appendix B** – Maturity profile of PWLB long-term debt as at 11th March 2019.
**Appendix C** – Approved Counterparty Lending List as at 14th January 2019.

**LIST OF BACKGROUND PAPERS**

None

# PWLB Long-term Debt Portfolio

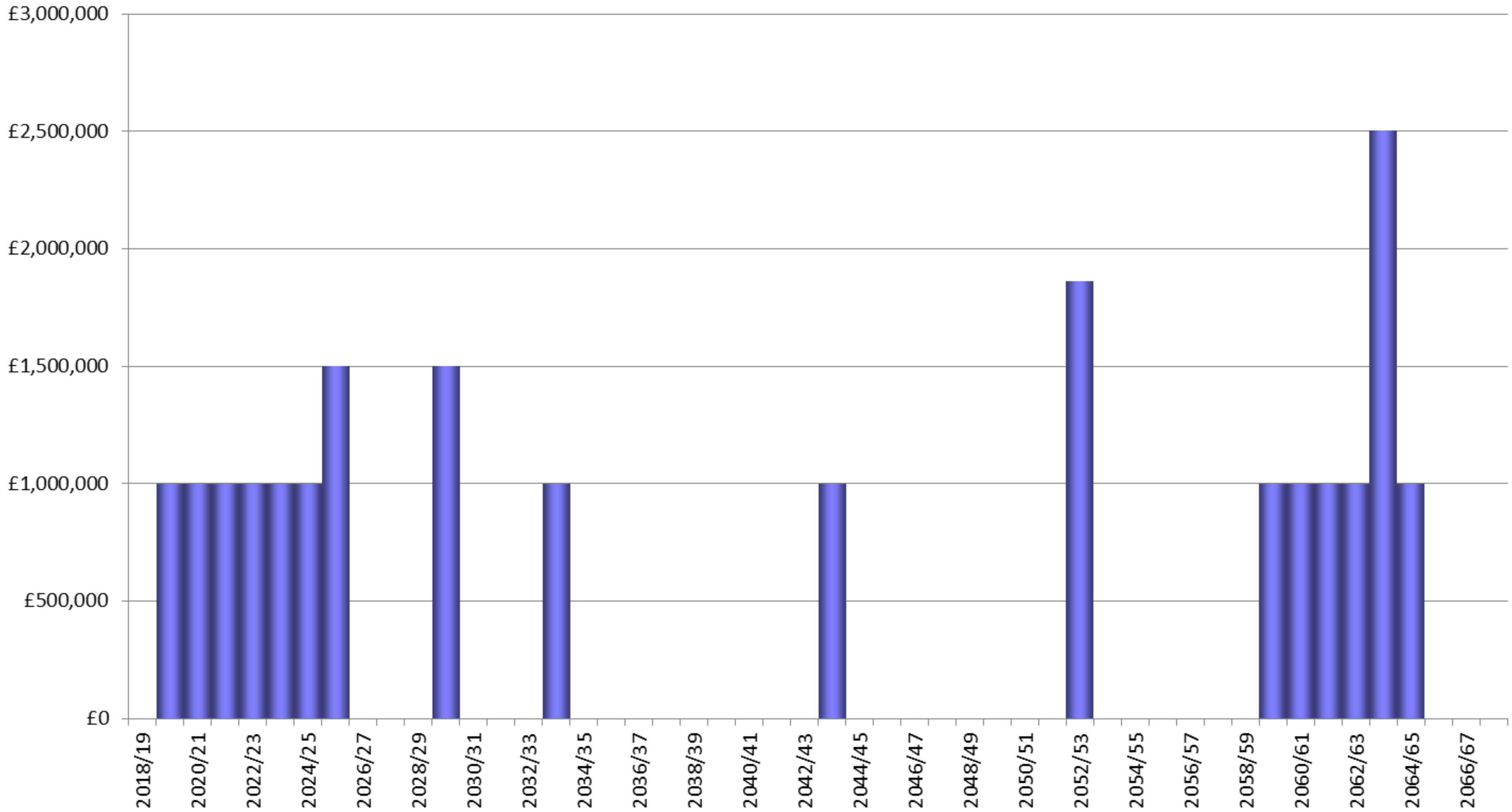
Position as at 11/03/19

| Start Date | Maturity Date | Years to Maturity | Total Debt 11/03/2019 | Interest Rate | Annual Interest Payable |
|---|---|---|---|---|---|
| | | Years | £ | % | £ |
| 23-Jul-07 | 31-Mar-53 | 34.00 | 1,859,166 | 4.75% | 88,310 |
| 14-Jun-10 | 31-Mar-20 | 1.00 | 1,000,000 | 3.69% | 36,900 |
| 14-Jun-10 | 31-Mar-25 | 6.00 | 1,000,000 | 4.16% | 41,600 |
| 27-Mar-13 | 31-Mar-22 | 3.00 | 1,000,000 | 2.66% | 26,600 |
| 27-Mar-13 | 31-Mar-21 | 2.00 | 1,000,000 | 2.46% | 24,600 |
| 22-May-14 | 31-Mar-23 | 4.00 | 1,000,000 | 3.37% | 33,700 |
| 22-May-14 | 31-Mar-24 | 5.00 | 1,000,000 | 3.49% | 34,900 |
| 20-Aug-14 | 31-Mar-26 | 7.00 | 1,500,000 | 3.47% | 52,050 |
| 09-Jan-15 | 31-Mar-64 | 45.00 | 1,500,000 | 3.14% | 47,100 |
| 09-Jan-15 | 31-Mar-30 | 11.00 | 1,500,000 | 2.82% | 42,300 |
| 14-Aug-15 | 31-Mar-62 | 43.00 | 1,000,000 | 3.07% | 30,700 |
| 11-Feb-16 | 31-Mar-34 | 15.00 | 1,000,000 | 2.91% | 29,100 |
| 07-Jul-16 | 31-Mar-63 | 44.00 | 1,000,000 | 2.14% | 21,400 |
| 02-May-17 | 31-Mar-60 | 41.00 | 1,000,000 | 2.36% | 23,600 |
| 02-May-17 | 31-Mar-61 | 42.00 | 1,000,000 | 2.35% | 23,500 |
| 02-May-17 | 31-Mar-65 | 46.00 | 1,000,000 | 2.34% | 23,400 |
| 09-Nov-18 | 31-Mar-44 | 25.00 | 1,000,000 | 2.78% | 27,800 |
| 09-Nov-18 | 31-Mar-64 | 45.00 | 1,000,000 | 2.64% | 26,400 |
| **TOTAL** | | | **20,359,166** | | **633,960** |

| | |
|---|---|
| Average cost of long-term debt | 3.11% |

**Appendix B**

## Pendle Borough Council - Long-term PWLB Debt Maturity Profile as at 11th March 2019



**APPENDIX C**

## APPROVED COUNTERPARTY LENDING LIST (updated 14/01/19)

| | | | | Fitch Ratings (@ 11th January per LAS Weekly Credit Rating List) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Counterparty** | **Type of Institution** | **Sovereign Rating** | **Long Term** | **Short Term** | **Viability** | **Support** | **Group Limit £M** | **Individual Limit £M** | **Maximum Duration (Mths / Days)** |
| | ***Pendle BC's Minimum Ratings Criteria*** | ***(per Fitch)*** | | ***A-*** | ***F1*** | ***BB+*** | ***5*** | | | |
| | **UK Banks** | | | | | | | | | |
| 1 | HSBC Bank PLC (Non Ring Fenced Bank) | Bank | (AA) | AA- | F1+ | a+ | 1 | 2.500 | 2.500 | up to 12 months |
| | HSBC Bank PLC (Ring Fenced Bank) | Bank | (AA) | AA- | F1+ | a | 1 | | 2.500 | up to 12 months |
| 2 | Barclays Bank PLC (Non Ring Fenced Bank) | Bank | (AA) | A+ | F1 | a | 5 | 2.500 | 2.500 | up to 6 months |
| | Barclays Bank UK PLC (Ring Fenced Bank) | Bank | (AA) | A+ | F1 | a | 1 | | 2.500 | up to 6 months |
| 3 | Santander UK PLC | Bank | (AA) | A | F1 | a | 2 | | 2.500 | up to 12 months |
| | Royal Bank of Scotland | | | | | | | 3.000 | | |
| 4 | NatWest Bank PLC (Ring Fenced Bank) | Bank | (AA) | A+ | F1 | a | 5 | | 2.500 | up to 364 days |
| 5 | The RBS PLC (Ring Fenced Bank) | Bank | (AA) | A+ | F1 | a | 5 | | 2.500 | up to 364 days |
| | Lloyds Banking Group plc | | | | | | | 5.000 | | |
| 6 | - Lloyds Bank PLC (Ring Fenced Bank) | Bank | (AA) | A+ | F1 | a | 5 | | 5.000 | up to 12 months |
| 7 | - Bank of Scotland PLC (Ring Fenced Bank) | Bank | (AA) | A+ | F1 | a | 5 | | 2.500 | up to 12 months |
| | **Other** | | | | | | | | | |
| 8 | Principal Local Authorities | All UK Principal Councils | (AA) | n/a | n/a | n/a | n/a | | 3.000 | up to 364 days |
| | | LCC Call-Account | (AA) | n/a | n/a | n/a | n/a | | 6.000 | up to 364 days |
| 9 | Debt Management Office - Deposit Facility | | (AA) | n/a | n/a | n/a | n/a | | Unlimited | up to 6 months |
| 10 | CCLA - PSDF | Money Market Fund | (AA) | | | AAAmmf | | | 1.000 | Liquid Funds |
| | **Building Societies** | | | | | | | | | |
| 11 | Nationwide | Building Society | (AA) | A | F1 | a | 5 | | 3.000 | up to 6 months |
| 12 | Coventry | Building Society | (AA) | A | F1 | a | 5 | | 2.500 | up to 6 months |
| 13 | Leeds | Building Society | (AA) | A- | F1 | a- | 5 | | 2.500 | up to 100 days |

**Additional Notes**

1 No investments should exceed 364 days

2 Where feasible:-

a) there should be no more than 75% of the Council's investments in any single sector w ith the exception of Principal Local Authorities

b) there should be no few er than 4 counterparties in use at any one point in time

If the above conditions are breached as a result of the maturity of fixed rate loans, action should be taken as soon as possible to comply w ith these requirements

3 Whilst UK Treasury Bills (max. of £2.5m) have been approved for investment purposes the preparatory w ork to enable the use of these has not been progressed.

4 Certificates of Deposit (maximum of £1m total investment) are now an approved means of investment (approved by executive August 2013) - counterparties currently remain limited to those above

5 PSDF MMF account is now operative - maximum of £1m - min. investment £25k - no investment may be made to this w ithout prior approval of CFO.

6 LCC maximum of £6m (excluding HACA balance) is subject to the investment w ith LCC not exceeding 50% of the total under investment (excluding Lloyds current account balance) at any time.

7 Monetary limits refer to principal sums invested.

8 Fitch investment grade ratings range from AAA to BBB, STC ratings range from F1+ to D, Viability ratings range from aaa to f.