FLINTSHIRE COUNTY COUNCIL

DRAFT TREASURY MANAGEMENT

MID YEAR REPORT 2019/20

1.00 PURPOSE OF REPORT

1.01 To provide members with a mid-year update on matters relating to the Council's Treasury Management function.

2.00 BACKGROUND

2.01 Treasury management comprises the management of the Council's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2.02 The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.

2.03 The Council's policy is to appoint external consultants to provide advice on its treasury management function. In September 2016 Arlingclose Ltd were reappointed as the Council's advisors for a period of 3 years, following a competitive tendering exercise. This period has been extended a further 12 months as per the contract terms to September 2020.

2.04 The Council has adopted the 2017 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a treasury management strategy before the start of each financial year, a mid-year report, and an annual report after the end of each financial year.

2.05 In addition, the Welsh Government (WG) Guidance on Local Government Investments recommends that local authorities amend their investment strategies in light of changing internal or external circumstances.

2.06 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the WG Guidance.

2.07 The Council approved the 2019/20 Treasury Management Strategy at its meeting on 19th February 2019.

3.00 ECONOMIC & INTEREST RATE REVIEW APRIL – OCTOBER 2019.

Provided by Arlingclose Ltd the Council's Treasury Management advisors.

Economic background: UK Consumer Price Inflation (CPIH) fell to 1.7%

year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU. Mr Johnson prorogued Parliament which led some MPs to put forward a bill requiring him to seek a Brexit extension if no deal is in place by 19th October. The move was successful and, having been approved by the House of Lords, was passed into law. The Supreme Court subsequently ruled Mr Johnson's suspension of Parliament unlawful.

Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

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 depending on whether or not a deal is ultimately reached by 31st October.

Financial markets: After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

Credit background: Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ring-fenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ring-fenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

Outlook for the remainder of 2019/20

The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased dramatically.

There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance.

Parliament appears to have frustrated UK Prime Minister Boris Johnson's desire to exit the EU on 31st October. The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out for 2019 and the risk of this event remains for 2020. The risk of a general election in the near term has, however, increased.

Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy.

	Dec 19	Mar 20	Jun 20	Sept 20	Dec 20	Mar 21	Jun 21	Sept 21	Dec 21	Mar 22	Jun 22	Sept 22	Dec 22
Upside Risk (%)	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Interest Rate (%)	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside Risk (%)	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

4.00 BORROWING REQUIREMENTS AND DEBT MANAGEMENT

4.01 PWLB (Public Works Loans Board) Certainty Rate Update.

The Authority submitted its application to WG along with the 2019-20 Capital Estimates Return to access this reduced rate for a further 12 months from 1st November 2019.

4.02 The total long term borrowing outstanding totals £290.17 million.

4.03 Loans with the Public Works Loans Board are in the form of fixed rate (£255.8m) and variable rate (£10m), £18.95m is variable in the form of Lobo's (Lender's Option, Borrower's Option) and £5.42m are interest free loans from government.

The Council's average long term borrowing rate is currently 4.57%.

	Balance 01/04/2019 £m	Debt Maturing £m	New Debt £m	Balance 30/09/2019 £m
Long Term Borrowing	267.29	(0.04)	17.50	284.75
Government Loans	5.51	(0.10)	0.00	5.41
TOTAL BORROWING	272.80	(0.14)	17.50	290.16
Other Long Term Liabilities *	5.03	0.00	0.00	5.03
TOTAL EXTERNAL DEBT	277.83	(0.14)	17.50	295.19
Increase/ (Decrease) in Borrowing £m				17.36

** relates to finance leases in respect of Deeside Leisure Centre and Jade Jones Pavilion*

4.04 New long term borrowing has been arranged during 2019/20.

The Council has taken two new long-term loans from the Public Works Loans Board (PWLB) in 19/20:

£10m Equal instalment of Principle Loan at 1.65% for 15 years, and;
£7.5m Equal instalment of Principle Loan at 1.28% for 18 years.

The decision to take long term loans took into consideration our long term borrowing requirement resulting from our capital programme. As interest rates from central government borrowing were low at these points due to the volatility of gilt yields, the PWLB rates were at a level which meant that fixing long term offered financial value to the Council.

4.05 Loans at Variable Rates

The extent of variable rate borrowing the Council can potentially undertake is influenced by the level of Reserves and Balances. The interest rate on the Council's £10m variable rate loans averaged 0.9%.

The Council has determined that exposure to variable rates is warranted. It also assists with the affordability and budgetary perspective in the short-to-medium term. Any upward movement in interest rates and interest paid on variable rate debt would be offset by a corresponding increase in interest earned on the Council's variable rate investments. The interest rate risk associated with the Council's strategic exposure of £10m is regularly reviewed with our treasury advisor against clear reference points, this being a narrowing in the gap between short and longer term interest rates. If appropriate, the exposure to variable interest rates will be reduced by switching into fixed rate loans.

4.06 Internal Borrowing and Short Term Borrowing

Given the significant cuts to local government funding putting pressure on Council finances, the borrowing strategy is to minimise debt interest payments without compromising the longer-term stability of the portfolio. With short-term interest rates currently lower than long-term rates, it has been more cost effective in the short-term to use internal resources, and to borrow short-term instead.

The differential between the cost of new longer-term debt and the return generated on the Council's temporary investment returns was significant at around 1.06%.

The use of internal resources in lieu of borrowing has therefore continued to be used over the period as the most cost effective means of funding capital expenditure. This has lowered overall treasury risk by reducing both external debt and temporary investments.

Short term borrowing was undertaken as necessary. The total short term borrowing as at 30th September 2018 was £19m with an average rate of 0.76%.

The Council's capital expenditure plans will continue to be monitored throughout 2019/20 to inform and assess the Council's long term borrowing need. This is to ensure that the Council does not commit to long term borrowing too early and refinance unnecessarily which will be costly and have significant revenue implications. The continued use of short-term borrowing will assist with such. This will be balanced against securing low long term interest rates currently being forecast and assessing the affordability of long-term borrowing in the short term against the savings made over the life of the loan.

4.07 Lender's Option Borrower's Option Loans (LOBOs)

The Authority holds £18.95m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. The option to change the terms on £18.95m of the Council's LOBOs was not exercised by the lender. The Authority acknowledges there is an element of refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options.

4.08 Debt Rescheduling

The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Authority's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

The Corporate Finance Manager, in conjunction with the Council's treasury advisors will continue to review any potential opportunities for restructuring the Council's debt in order to take advantage of potential savings as interest rates change and to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility).

5.0 INTERIM INVESTMENT AND PERFORMANCE REPORT

5.01 The Welsh Government's Investment Guidance gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles.

5.02 The maximum investments the Authority had on deposit at any one time totalled £50.5m. The average investment balance for the period was £26.7m and the average rate of return was 0.65%, generating investment income of £89k.

5.03 Investments have been made with UK banks, building societies and other Councils up to periods of 35 days, as well as utilising investment opportunities afforded by money market funds and the Debt Management Office Deposit Account.

5.04 The average of long and short term borrowing was £288.0m generating interest payable of £6.73m in line with budget forecasts (to date).

	Investments		Borrowing	
	Interest received £'000	Interest rate %	Interest paid £'000	Interest rate %
Actual	89.0	0.65	6,732	4.57
Budget	40.0	0.80	6,950	4.46
Difference	49.0		218	

Year-end projections are as follows:

	Investments		Borrowing	
	Interest received £'000	Interest rate %	Interest paid £'000	Interest rate %
Actual	130	0.65	13,713	4.57
Budget	80	0.80	13,900	4.46
Difference	50		187	

5.05 Credit Risk (security)

Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A- across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

5.06 Liquidity

In keeping with the WG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds.

5.07 Yield

The Council sought to optimise returns commensurate with its objectives of security and liquidity. The Council's investment yield is outlined in 5.02.

6.00 REGULATORY UPDATES

6.01 The Welsh Government is consulting on proposed changes to its Statutory Guidance on Local Government Investments to be effective from the 2020/21 financial year. This involves a complete re-write along the lines of the guidance issued last year by the Ministry of Housing, Communities and Local Government (MHCLG) for local authorities in England.

The definition of investments is widened to include "all of the financial and non-financial assets a local authority has invested money into primarily or partially for the purpose of generating a surplus including investment property" providing it has been made using the power to invest contained in the Local Government Act 2003. In addition, loans to wholly-owned companies or associates, to a joint venture, or to a third party count as investments, irrespective of the purpose or legal power used.

6.02 **Readiness for Brexit**: The scheduled leave date for the UK to leave the EU is now 31st January 2020 and there remains little political clarity as to whether a deal will be agreed by this date and there is the possibility that the exit date is pushed back yet again. As the date approaches the Authority will ensure there are enough accounts open at UK domiciled banks and Money Market Funds to hold sufficient liquidity required in the near term and that its account with the Debt Management Account Deposit Facility (DMADF) remains available.

7.00 COMPLIANCE

7.01 The Council can confirm that it has complied with its Prudential Indicators for the period April to September 2019. These were approved on 19h February 2019 as part of the Council's 2019/20 Treasury Management Strategy.

7.02 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the period April – September 2019. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

8.00 OTHER ITEMS

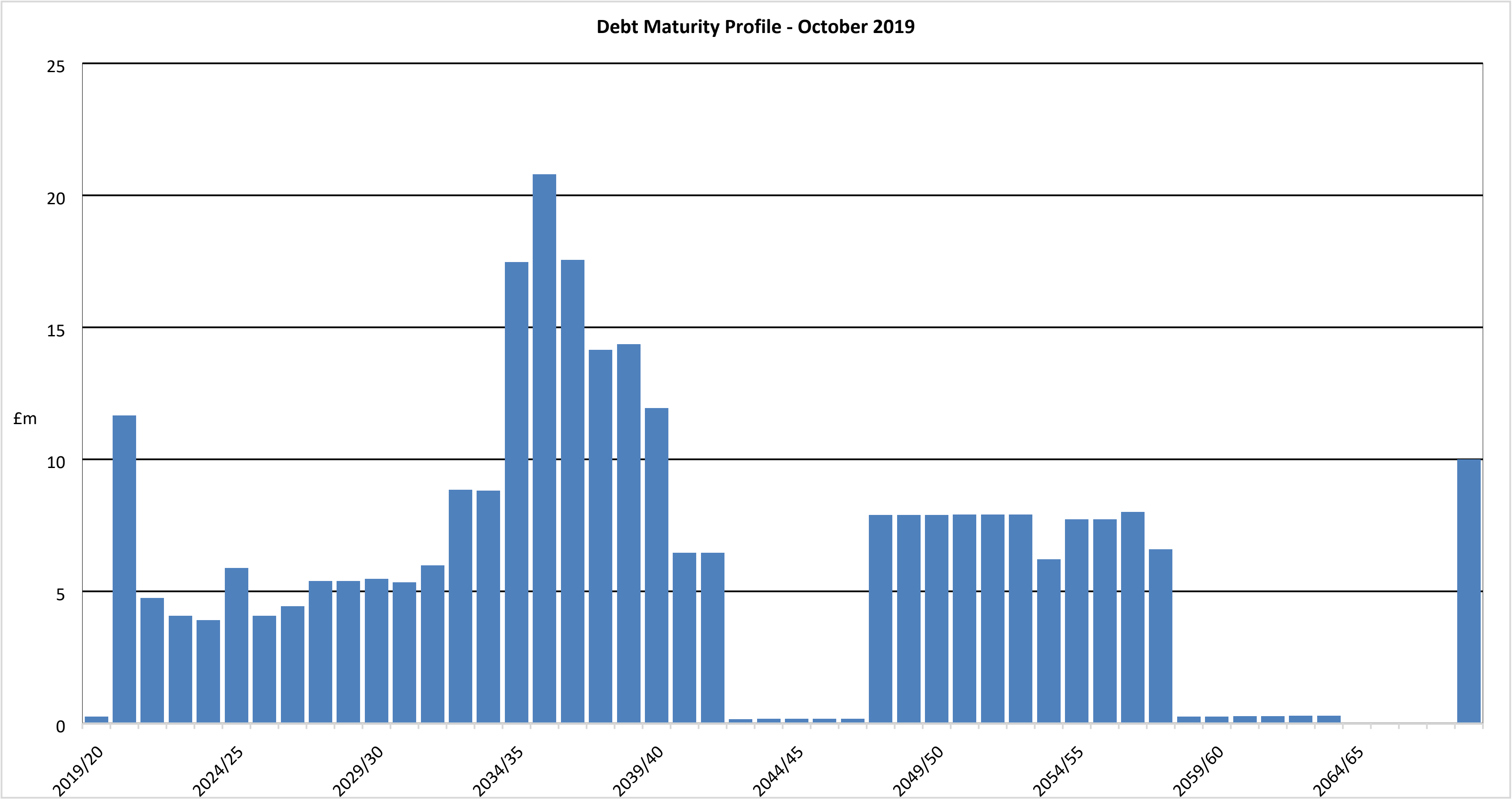
8.01 Other treasury management related activity that took place during April – September 2019 includes:

- The Treasury Management Annual Report 2018/19 was reported to Audit Committee on 10th July 2019, Cabinet on 24th September 2019 will be reported to Council on 22nd October 2019.
- The Quarter 1 Treasury Management update was reported to the Audit Committee.
- The Council continues to be a member of the CIPFA Treasury Management Forum and the TM Network Advisory Group.

9.00 CONCLUSION

9.01 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first half of 2019/20.

9.02 As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.


Debt Maturity Profile - October 2019
25
20
15
£m
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5
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2019/20
2024/25
2029/30
2034/35
2039/40
2044/45
2049/50
2054/55
2059/60
2064/65