

Report of Chief Officer Financial Services

Report to Executive Board

Date: 21st November 2018

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2018/19

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Is the decision eligible for Call-In?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

Summary of main issues

1. This report provides a review and update of the treasury management strategy for 2018/19.
2. The Council's level of external debt as at 31st March 2019 is forecast to be £2,116m, £76m higher than approved in February 2018. This higher forecast borrowing requirement is due to a number of balance sheet movements that lead to less working capital available to temporarily fund the capital programme offset partially by a lower capital programme borrowing requirement.
3. In line with the agreed treasury strategy set in February, the Council has continued to take advantage of lower costs of borrowing by acquiring longer dated debt and thereby reducing exposure to short term fluctuations in the debt markets. Treasury activity is forecast to deliver £0.3m of savings.
4. The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

Recommendations

That Executive Board note:-

5. The update on the Treasury Management borrowing and investment strategy for 2018/19.

1 Purpose of this report

1.1 The 2018/19 treasury management strategy was approved by Executive Board on 7th February 2018. This report provides a review and update of the strategy for 2018/19.

2 Background information

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities (amended 2009 and 2011) in particular:

- The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of prudential indicators.
- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least three times a year.

3 Main issues

3.1 Review of Strategy 2018/19

3.1.1 The current borrowing forecasts are shown in Table 1

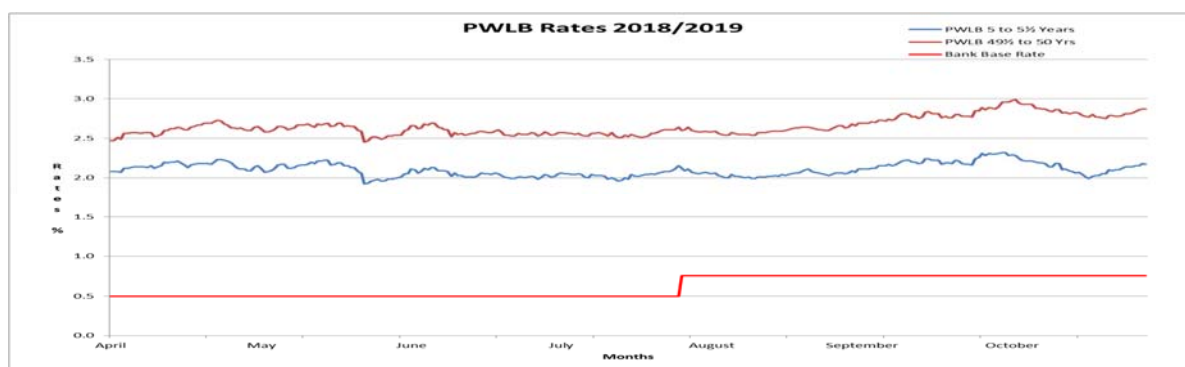
Table 1

	2018/19 Feb 18 Report £m	2018/19 This Report £m
ANALYSIS OF BORROWING 2018/19		
Net Borrowing at 1 April	1,923	1,954
New Borrowing for the Capital Programme – Non HRA	143	141
New Borrowing for the Capital Programme – HRA	2	2
Debt redemption costs charged to Revenue (Incl HRA)	(22)	(18)
Reduced/(Increased) level of Revenue Balances	(6)	37
Net Borrowing at 31 March*	2,040	2,116
Capital Financing Requirement		2,337
* Comprised as follows		
Long term borrowing		
Fixed	1,459	1,639
Variable (less than 1 Year)	65	15
New Borrowing	117	162
Short term Borrowing	409	310
Total External Borrowing	2,050	2,126
Less Investments	10	10
Net External Borrowing	2,040	2,116
% borrowing funded by short term and variable rate loans	29%	23%

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing PFI and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes. The above reflects only the borrowing element of the CFR

- 3.1.2 Table 1 above shows that net external borrowing is now forecast at the end of 2018/19 to be £2,116m, £76m higher than in the report to Executive Board on 7th February 2018. This higher forecast borrowing requirement is due to a number of balance sheet movements that lead to less working capital available to temporarily fund the capital programme (£89m) offset partially by a lower capital programme borrowing requirement (£13m). The economic outlook remains mixed due to domestic and international pressures across many of the major economies. China is continuing to slow down despite increasing central bank stimulus with continuing concerns over excess industrial capacity, unsold stock of property and increasing levels of non-performing loans in the banking and credit system. Likewise despite significant monetary and fiscal stimulus Japan continues to struggle to stimulate growth and raise inflation to its 2% target.
- 3.1.4 The absence of inflationary pressure in Europe has seen GDP struggling to reach 2% and growth posted 0.4% in Q2 (forecast 2.0% for 2018). Data from Germany has been mixed and the imposition of US tariffs could have a negative impact.
- 3.1.5 The United States continued a policy of fiscal easing which resulted in temporarily boosting growth from 2.2% in Q1 to 4.2% in Q2 (annualised) but at the cost of increasing the deficit and increasing inflation which is heading towards 3%. In response the FOMC (Federal Open Markets Committee) has increased rates 4 times in 2018 to a current range of 2.00%-2.25% and with expectations of a further 4 increases in 2019. The long term impact of a series of protectionist trade tariffs against some of its major trading partners (China, EU, and Canada) has yet to materialise.
- 3.1.6 United Kingdom Gross Domestic Product (GDP) growth in Q1 and Q2 has remained weak however this has not prevented the Monetary Policy Committee (MPC) from increasing its Bank Rate to 0.75% in August. The MPC has indicated that Bank rate would need to be in the region of 1.5% by March 2021 if it is to hit its 2% inflation target (currently 2.4%) and markets are pricing in the next increase for the 2nd half of 2019. This is against a backdrop of falling unemployment, now at a 43 year low of 4% and rising average wage growth of 2.9% in July. The increase in CPI inflation is partly related to the recent drop in the value of the pound against both the Dollar and the Euro. This fall is related to continuing uncertainty on the outcome of Brexit negotiations.
- 3.1.7 The general trend in interest paid on debt is upwards across all maturity periods. Chart 1, shows how the cost of longer term borrowing from the Government through Public Works Loan board (PWLb) loans has performed since the start of the financial year. The 5 year to 5½ year PWLB has moved upwards from a starting point in April of 2.08%, to a low of 1.92% at the end of May and then to a high of 2.31% in early October, currently it is in the region of 2.30%. Similarly, the 49½-50 year rate has moved from a starting point in April of 2.47% to a low point in late May of 2.45% and then to a high of 2.89% in late September, this rate is currently in the region of 2.88%. Please note the Council is entitled to a reduction of 20bp on all PWLB rates, including those list above, reflecting eligibility for PWLB certainty rates.

Chart 1



3.1.8 Market expectations of Bank Rate movements in the UK have been brought forward as the wider economic picture has emerged. The first rise in rates occurred in November 2017 as widely predicted, with a second rate rise to 0.75% occurring in August 2018. The impact of a rise on the economy is subject to much debate but further rises are expected to be gradual and over a number of years reflecting the state of the economy. Table 3 below shows current assumptions for budget purposes based on these market expectations.

Table 3

Budget Rate Assumptions	2017/18	2018/19	2019/20	2020/21
Exec Board Feb 18	0.85	1.00	1.25	1.50
Now	0.85	1.25	1.50	1.75

3.1.9 The current borrowing strategy continues to fund the borrowing requirement of the capital programme from short dated loans and internal cash balances. There will come a point when rates begin to rise and more expensive longer dated funding will be required. The Chief Officer - Financial Services will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time.

The current strategy also allows for taking advantage of lower longer-term funding to manage the Council's exposure to fluctuations in funding costs. Table 4 below details the long term funding activity undertaken during 2018/19 which consists of £100m of new PWLB funding as volatility in the markets during the summer provided opportunities to take on long term funding.

Table 4

Repayments and Funding 2018/19							
Date	Repayments			New Replacement Borrowing			
	Amount (£m)	Original Rate (%)	Discount Rate	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB				PWLB			
				05/04/2018	20	50	2.27%
				31/05/2018	50	50	2.25%
				14/08/2018	30	50	2.35%
Sub Total	0				100		
Market Loans				Market Loans			
15/06/2018	26	3.57%	n/a				
16/10/2018 *	10	1.35%	n/a				
05/12/2018 *	5	2.20%	n/a				
Sub Total	41				0		
Total	41			Total	100		

* known maturities that are yet to occur

3.1.10 The strategy of deferring long term borrowing will increase the amount of debt that the Council is funding from short term loans and its balance sheet to a forecast £673m. Of this £673m, £471m is expected to be funded by external short term borrowing which together with LOBO options of £55m in 2019/20 results in an external debt volatility of 25%. This exposure will be influenced by historical capital programme slippage, the continued strength of the Council's balance sheet and the market for supplying short term funds remaining strong. To mitigate against the exposure to rising interest rates the Council remains in discussions to acquire forward funding which will give the Council the ability to lock in future funding at current rates, thereby allowing the Council to continue to take advantage of low short-term rates. The Council is evaluating a number of options with a view to bringing options back to Executive Board at an appropriate time.

3.1.11 The short term exposure will continue to be monitored and should be considered in the context of the stability of the current debt maturity profile. The Council's current long term debt of £1.669bn has an average maturity of just over 39 years if all debts run to maturity. Approximately 14% of the Council's long term debt has options for repayment, in the unlikely event that all these options were exercised at the next option date then the average maturity of long term debt would be lowered to approximately 33 years. This compares favourably for example with the average maturity of the UK Government debt portfolio of nearly 16 years. The existing profile of the Council's debt provides considerable certainty of funding costs. Prudential Indicator 16 in Appendix A shows the maturity profile of the Council's long term fixed debt and highlights that approximately 78% or £1,258m matures in periods greater than 10 years.

3.1.12 The strategy of continued use of existing balances, continued low short-term financing rates and taking the opportunity to lock in low longer term rates is forecast to be delivered under the budget with a saving of £0.3m.

3.2 Borrowing Limits for 2018/19, 2019/20 and 2020/21

3.2.1 The Council is required to set various limits for 2018/19, 2019/20 and 2020/21 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2009 and 2011). These limits including prudential indicators are detailed in Appendix A.

- 3.2.2 It is anticipated that the Council will continue to remain within the Authorised Limit for 2018/19. Both the Authorised Limit and Operational Boundary are made up of a limit for borrowing and a limit for other long term liabilities.
- 3.2.3 The Chief Officer - Financial Services has delegated authority to make adjustments between the two separate limits for borrowing and other long term liabilities, provided that the overall limit remains unchanged. Any such adjustments will be reported to the next available Council meeting following the change.
- 3.2.4 Borrowing limits for 2018/19 were approved by Council on 7th February 2018 and remain unchanged.
- 3.2.5 Members are asked to note that the HRA borrowing cap is due to be removed which will enable the Council to undertake borrowing to fund housing developments. The details of the proposals are awaited and are likely to result in borrowing limits being revised.

3.3 Investment Strategy & Limits

- 3.3.1 The Council's external debt is reduced by the availability of revenue balances. The Treasury policy also allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. At present the Council's surplus monies continue to be held in short periods until required. As market sentiment to counter-party risk improves, together with enhanced returns, surplus monies will be invested in accordance with the approved lending list. This lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's view of the credit worthiness of counterparties.
- 3.3.2 The investment strategy, as re-affirmed by Executive Board and full Council in February, allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend up to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good.

3.4 Prudential Code, Treasury Management Code and Investment Guidance

- 3.4.1 Members are asked to note that the Chartered Institute of Public Finance and Accountancy (CIPFA) has consulted upon changes to the prudential code and treasury management code. These codes have been updated and re-issued late in 2017/18 together with the Ministry of Housing, Communities and Local Government (MHCLG) guidance in relation to Investments and Minimum Revenue Provision (MRP). In line with guidance issued, these CIPFA codes and MHCLG guidance will be formally adopted before the end of March 2019 by ensuring that new strategies covering treasury investment, non-treasury investments (that cover for example property investments) and a capital strategy is developed and implemented.

4 Corporate Considerations

4.1 Consultation and Engagement

4.1.1 This report is an update on strategy as presented to Executive Board in February 2018, as such no consultation has taken place. However, consultation with the Council's treasury advisors takes place regularly throughout the year.

4.1.2 The borrowing requirement is an outcome of the capital programme. Consultation is undertaken by individual services in relation to capital investment schemes. A capital programme update report is included elsewhere on this agenda.

4.2 Equality and Diversity / Cohesion and Integration

4.2.1 Equality, diversity, cohesion and integration requirements are addressed as part of individual capital scheme and programme approvals. The borrowing to deliver these capital schemes is executed through treasury strategy and as such there are no further equality diversity cohesion and integration issues.

4.3 Council policies and Best Council Plan

4.3.1 Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Best Council Plan.

4.4 Resources and Value for Money

4.4.1 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where borrowing is supported the revenue costs are met by the Government, whilst for unsupported borrowing revenue costs are met either by the General Fund or HRA.

4.4.2 The updated strategy 2018/19 is forecasting a saving of £0.3m against the budgeted position despite taking higher rate longer dated funding during the year. This has been offset by funding at lower than forecast from temporary borrowing and internal resources.

4.5 Legal Implications, Access to Information and Call In

4.5.1 There are no legal, or access to information issues arising from this report. The report is subject to call in.

4.6 Risk Management

4.6.1 This report sets out the framework for the treasury strategy for the year ahead. The execution of strategy and associated risks are kept under regular review through:

- Monthly reports to the Finance Performance Group
- Quarterly strategy meeting with the Chief Officer Financial Services and the Council's treasury advisors
- Regular market, economic and financial instrument updates and access to real time market information

4.6.2 The above monitoring mitigates the directorate level risk of "Failure to recover money invested in other financial institutions" and in addition the Treasury Management Strategy is linked to the corporate risk on 'Financial Forecasting'.

5 Conclusions

- 5.1 The Council's level of net external debt at 31st March 2019 is anticipated to be £2,116m, £76m higher than expectations in February 2018.
- 5.2 Treasury Management activity is forecast to return a saving of £0.3m against budget. This is largely due to taking higher rate longer term funding at attractive rates in comparison to the budget provision offset by lower than anticipated costs of temporary borrowing and funding from internal resources.

6 Recommendations

That Executive Board note:-

- 6.1 The update on the Treasury Management borrowing and investment strategy for 2018/19.

7. Background documents¹

None

¹ The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.

Leeds City Council - Prudential Indicators 2018/19 - 2020/21

No.	PRUDENTIAL INDICATOR	2018/19	2019/20	2020/21
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS				
1	Ratio of Financing Costs to Net Revenue Stream General Fund - Excluding DSG (Note 1)	11.77%	12.00%	18.77%
2	HRA	11.43%	11.66%	11.48%
Impact of Unsupported Borrowing on Council Tax & Housing Rents				
3	increase in council tax B7(band D, per annum) (Note 2)	£ . P 8.45	£ . P 37.60	£ . P 70.11
4	increase in housing rent per week	0.01	0.10	0.32
5	Net external borrowing requirement (Net Debt and CFR)	2,116,000	2,297,000	2,430,000
x	External Borrowing CFR Forecast	2,337,022	2,522,379	2,659,357
x	OLTL CFR Forecast	588,424	564,543	538,377
x	Total CFR Forecast	2,925,446	3,086,922	3,197,734
The Net Borrowing Requirement should not exceed the capital financing requirement (Note 3)				
Estimate of total capital expenditure				
6	Non HRA	262,644	326,181	264,370
7	HRA	82,681	111,485	107,384
TOTAL		345,325	437,666	371,754
Capital Financing Requirement (as at 31 March)				
8	Non HRA	£'000 2,114,296	£'000 2,270,662	£'000 2,371,137
9	HRA	811,150	816,260	826,597
TOTAL		2,925,446	3,086,922	3,197,734
9a	Limit of HRA Indebtedness as implemented under self financing	721,327	721,327	721,327

No.	PRUDENTIAL INDICATOR	2018/19	2019/20	2020/21
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS				
		£'000	£'000	£'000
10	Authorised limit for external debt - (Note 5)			
	borrowing	2,450,000	2,500,000	2,500,000
	other long term liabilities	720,000	690,000	660,000
	TOTAL	3,170,000	3,190,000	3,160,000
11	Operational boundary - (Note 5)			
	borrowing	2,300,000	2,350,000	2,350,000
	other long term liabilities	700,000	670,000	640,000
	TOTAL	3,000,000	3,020,000	2,990,000
14	Upper limit for fixed interest rate exposure expressed as either:- Net principal re fixed rate borrowing / investments OR:- Net interest re fixed rate borrowing / investments	115%	115%	115%
15	Upper limit for variable rate exposure expressed as either:- Net principal re variable rate borrowing / investments OR:- Net interest re variable rate borrowing / investments	40%	40%	40%
17	Upper limit for total principal sums invested for over 364 days (Note 5) (per maturity date)	150,000	150,000	150,000
18	Net Debt as a percentage of Gross debt	99.5%	99.6%	99.6%

16	Maturity structure of fixed rate borrowing as at 31/03/2019	Lower Limit	Cumulative Upper Limit	Projected 31/03/2019
	under 12 months	0%	15%	0%
	12 months and within 24 months	0%	20%	2%
	24 months and within 5 years	0%	35%	11%
	5 years and within 10 years	0%	40%	9%
	10 years and within 20 years	25%	90%	79%
	20 years and within 30 years			
	30 years and within 40 years			
	40 years and within 50 years			
	50 years and above			
				100%

Notes.

- The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.
- The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.
- In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.
- Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.
- Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003, and the revised code in February 2010 and 2012

Prudential Code Monitoring 2018/19 - Debt

