

Report of Chief Officer Financial Services

Report to Executive Board

Date: 25 November 2019

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2019/20

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Has consultation been carried out?	<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

1. Main issues

- 1.1 This report provides a review and update of the treasury management strategy for 2019/20.
- 1.2 The Council's level of external debt as at 31st March 2020 is forecast to be £2,237m, £74m lower than approved in February 2019. This lower forecast borrowing requirement is due to a number of balance sheet movements that lead to greater working capital available to temporarily fund the capital programme together with lower capital programme borrowing requirement.
- 1.3 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. To date £350m of PWLB has been taken so far in 2019/20 and the Treasury budget has been increased by £1m to cover the cost of long term funding to the end of 2019/20. Treasury activity is forecast to deliver a saving against budget of £0.4m.
- 1.4 The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

2. Best Council Plan Implications.

- 2.1 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.

3. Resource Implications.

- 3.1 The updated strategy 2019/20 is forecast to deliver a saving of £0.4m including taking longer dated funding at higher rates during the year. This has been offset by continuing to fund at rates lower than forecast from temporary borrowing and internal resources and by the addition of further £1m of budget provision to mitigate the increased long term borrowing costs incurred in the current year.

Recommendations

That Executive Board note:-

- a) The update on the Treasury Management borrowing and investment strategy for 2019/20.

1 Purpose of this report

- 1.1 The 2019/20 treasury management strategy was approved by Executive Board on 13th February 2019. This report provides a review and update of the strategy for 2019/20.

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 as amended 2017 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 2019/20

- 3.1.1 The current borrowing forecasts are shown in Table 1

Table 1

	2019/20 Feb 19 Report £m	2019/20 This Report £m
ANALYSIS OF BORROWING 2018/19		
Net Borrowing at 1 April	2,127	2,063
New Borrowing for the Capital Programme – Non HRA	167	162
New Borrowing for the Capital Programme – HRA	24	6
Debt redemption costs charged to Revenue (Incl HRA)	(15)	(20)
Reduced/(Increased) level of Revenue Balances	8	26
Net Borrowing at 31 March*	2,311	2,237
Capital Financing Requirement		2,517
* Comprised as follows		
Long term borrowing Fixed	1,603	2,078
Variable (less than 1 Year)	55	20
New Borrowing	184	169
Short term Borrowing	499	0
Total External Borrowing	2,341	2,267
Less Investments	30	30
Net External Borrowing	2,311	2,237
% borrowing funded by short term and variable rate loans	32%	8%

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 2019/20 to be £2,237m, £74m lower than in the report to Executive Board on 13th

February 2019. This lower forecast borrowing requirement is due to a number of balance sheet movements that lead to greater working capital available to temporarily fund the capital programme (£67m) together with a lower capital programme borrowing requirement (£7m). The global economic outlook is showing clear signs of cooling 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 the level 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.

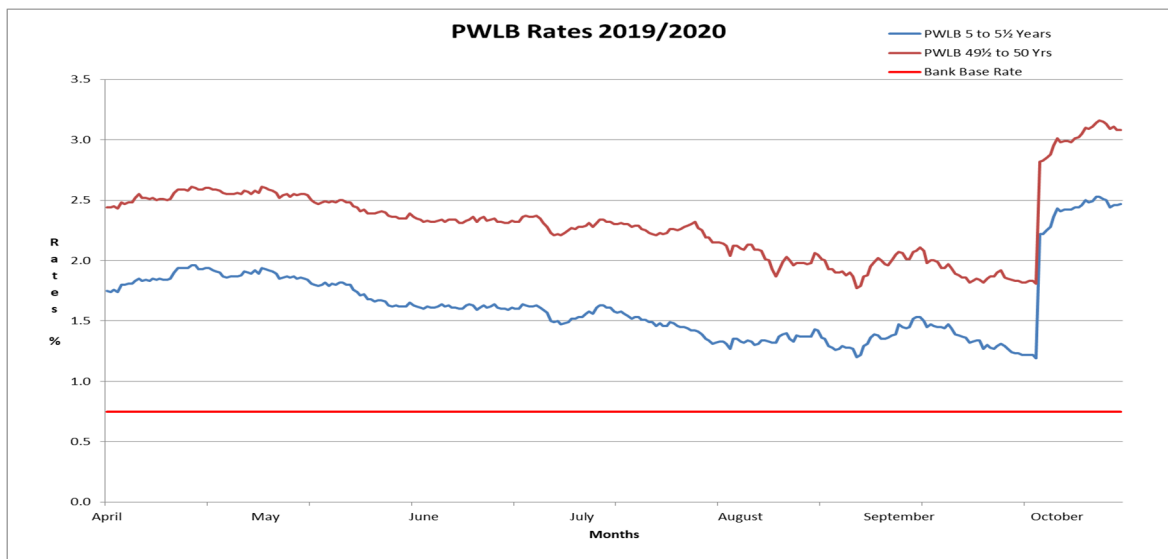
- 3.1.4 Growth in the EU has fallen from 1.8% in 2018 to less than 1.0% currently. Although the ECB had ended its QE programme at the end of 2018 the faltering world economy has prompted them to restart this programme and it has cut its policy rate from (minus) -0.4% to -0.5% Further the ECB has also been providing cheap medium terms borrowing to EU banks. Purchasing Managers Index surveys in the US, EU, UK and China gives forward indicator of a downturn in growth.
- 3.1.5 The United States policy of fiscal easing in 2018 resulted in temporarily boosting growth to 2.9% (annualised). However this boost is beginning to unwind and growth in Q2 was 2.0% and is expected to fall further in Q3. The FOMC (Federal Open Markets Committee) increased rates to a range of 2.25%-2.50% during 2018. However in 2019 the FOMC has cut rates twice the last cut being in September to a range of 1.75% to 2.00% and it has ended its unwinding of Quantitative Easing (QE). The long term impact of a series of protectionist trade tariffs against some of its major trading partners (China, EU, and Canada) is thought to have been a factor in depressing world growth with Germany in the EU being particularly impacted. There is now a concern that the US, the world's largest economy, could be heading for recession and this has played in part in the significant fall in government bond yields in developed countries.
- 3.1.6 United Kingdom Gross Domestic Product (GDP) growth in Q1 and Q2 has weakened further (-0.2% in Q2) largely as a result of weaker world growth prospects and uncertainty around Brexit. The impact of the resolution to this latter factor could significantly determine whether the next movement in base rate is up or down. Inflation has been hovering around the MPC target of 2% this year however this fell unexpectedly to 1.7% in August. This is against a backdrop of unemployment continuing to fall and this indicator now stands at a low of 3.8% whilst rising average wage growth of 3.9% year on year in June and 3.8% in July indicates an expanding capacity in household balance sheets.
- 3.1.7 On 9th October the Debt Management Office of HM treasury announced with no prior warning that with immediate effect, the rates available from the PWLB in all periods would be increased by 100bp (1%). The effect of this is to increase the cost of borrowing from the PWLB back to the high point for PWLB rates seen in 2018/19. The margin over gilt yield that the Council will now pay on all new PWLB borrowing will be approximately 180bp over the gilt par yield curve. This means that for every £10m borrowed from PWLB the Government will return a surplus of £180,000 compared to the Governments own cost of raising debt.
- 3.1.8 During the early part of 2019/20 £150m of PWLB was taken as market rates steadily declined and in August a proposal was agreed to de-risk the Treasury Management short term external exposure forecast to 31/03/2020. The proposal resulted in taking £220m long term PWLB loans at an average rate of 1.59%. This

effectively eliminated the short term portfolio at that time. The above strategy has therefore minimised the Impact of the 1% increase in PWLB rates by locking in the existing short term borrowing requirement up to that point into longer term borrowing before the rate increase was applied. This strategy has now been paused following the PWLB change detailed in 3.1.7 however the markets continue to be monitored for further opportunities.

3.1.9 The Council will continue to seek to mitigate the impact of this increase by considering raising debt from other sources.

3.1.10 The general trend in interest paid on debt is downwards 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. It should be noted that PWLB rates reached new all-time lows during this financial year however see 3.1.7 above. The 5 year to 5½ year PWLB had declined over the year to date from a starting point in April of 1.75%, to a high of 1.96% in mid-April and then to a low of 1.19% in early October, before the margin increase imposed on 9th October and is currently set at 2.47%. Similarly, the 49½-50 year rate has moved from a starting point in April of 2.44% to a high point in mid-April of 2.61% and then to a low of 1.77% in early September, this rate likewise has been increased by the margin change imposed on 9th October and is currently set at 3.08%. Please note the Council is entitled to a reduction of 20bp on all PWLB rates, including those listed above, reflecting eligibility for PWLB certainty rates.

Chart 1



3.1.11 Market expectations of Bank Rate movements in the UK have been pushed back slightly as the wider economic picture has emerged. The last rate movement was a raise to 0.75% in August 2018. The next rate movement up or down is balanced at the moment but a further rise is anticipated in Quarter 3, 2020 although this will very much depend on the final shape of Brexit. 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	2019/20	2020/21	2021/22	2022/23	2023/24
Exec Board Feb 19	1.25	1.50	1.75	n/a	n/a
Now	1.25	1.50	1.75	2.25	2.50

3.1.12 The current borrowing strategy continues to fund the borrowing requirement of the capital programme from short dated loans and internal cash balances in the first instance but opportunities to lock into longer term funding are being actively pursued. There will come a point when rates begin to rise and more expensive longer dated funding will be required. Markets will continue to be monitored with a view to securing longer term debt at the appropriate time.

Table 4 below details the long term funding activity undertaken during 2019/20 which consists of £350m of new PWLB funding as detailed in 3.1.8 due to volatility in the markets during the summer providing opportunities to take on long term funding.

Table 4

Repayments and Funding 2019/20							
Date	Repayments			New Replacement Borrowing			
	Amount (£m)	Original Rate (%)	Discount Rate	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB				PWLB			
15/07/2019	26.4	3.83%	n/a	04/06/2019	30	16	2.08%
				04/06/2019	20	50	2.16%
				05/07/2019	25	15	1.87%
				05/07/2019	25	50	2.01%
				06/08/2019	50	50	1.99%
				09/08/2019	50	40	1.86%
				16/08/2019	25	10	1.30%
				16/08/2019	25	40	1.84%
				19/08/2019	25	11	1.31%
				19/08/2019	25	40	1.76%
				05/09/2019	25	12	1.24%
				05/09/2019	25	41	1.60%
Sub Total	26.4				350		
Market Loans				Market Loans			
Sub Total	0				0		
Total	26.4			Total	350		

* known maturities that are yet to occur

3.1.13 The Council has acquired longer term funding for its prior year debt, but there still remains a longer term funding need for this and future years. As a result the amount of debt that the Council is funding from short term loans and its balance sheet is forecast to decrease to £390m. Of this £390m, £168m is expected to be funded by external short term borrowing which together with LOBO options of £60m in 2020/21 results in an external debt volatility of 10%. 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.

- 3.1.14 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 £2.097bn has an average maturity of just over 38 years if all debts run to maturity. Approximately 11% 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 15 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 82% or £1,668m matures in periods greater than 10 years.
- 3.1.15 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 deliver a saving of £0.4m in 2019/20.
- 3.1.16 The Council has £215m of loans with Barclays of which £110m are the subject of a class action initiated by a total of 7 Councils. These LOBOs contained clauses that referenced London Inter Bank Overnight Rate (LIBOR) at a time when Barclays were subsequently convicted and fined for fraudulently fixing LIBOR. This is an ongoing action and further details will be reported as appropriate as the action progresses.

3.2 Borrowing Limits for , 2019/20, 2020/21 and 2021/22

- 3.2.1 The Council is required to set various limits for 2019/20, 2020/21 and 2021/22 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2017). 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 2019/20. 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 2019/20 were approved by Council on 13th February 2019 and remain unchanged.

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.

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.

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 2019, 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.

Climate Emergency

4.3.2 The Council declared a Climate Emergency at full Council in March 2019. As the Treasury Management strategy secures funding for the Council's capital programme the impact of the Council's activity and implications for the climate emergency will be considered in each individual capital programme and scheme project report.

4.4 Resources, procurement 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 2019/20 is forecast to deliver a saving of £0.4m including 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 and by the addition of further £1m of budget provision to mitigate the increased long term borrowing costs incurred in the current year.

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 2020 is anticipated to be £2,237m, £74m lower than expectations in February 2019.

5.2 Treasury Management activity is forecast to outturn a £0.4m saving against the 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 and by the addition of £1m of further budget provision to mitigate the increased long term borrowing costs incurred in the current year.

6 Recommendations

That Executive Board note:-

6.1 The update on the Treasury Management borrowing and investment strategy for 2019/20.

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 2019/20 - 2021/22

No.	PRUDENTIAL INDICATOR	2019/20	2020/21	2021/22
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS				
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund (Borrowing Only)	13.07%	18.48%	20.84%
1b	General Fund (Borrowing and Other Long Term Liabilities)	22.09%	27.46%	29.84%
2	HRA	11.59%	11.37%	11.33%
5	Gross external borrowing requirement (Gross Debt and CFR) The Net Borrowing Requirement should not exceed the capital financing requirement (Note 3)	2,831,543 OK	2,970,377 OK	3,097,892 OK
	Estimate of total capital expenditure			
6	Non HRA	324,150	390,203	241,267
7	HRA	96,722	138,369	140,327
	TOTAL	420,872	528,572	381,594
	Capital Financing Requirement (as at 31 March)	£'000	£'000	£'000
8	Non HRA	2,270,926	2,382,857	2,479,412
9	HRA	810,420	841,377	876,084
	TOTAL	3,081,346	3,224,234	3,355,496

No.	PRUDENTIAL INDICATOR	2019/20	2020/21	2021/22
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS				
		£'000	£'000	£'000
10	Authorised limit for external debt - (Note 5) borrowing other long term liabilities TOTAL	2,600,000 690,000 3,290,000	2,800,000 660,000 3,460,000	3,000,000 580,000 3,580,000
11	Operational boundary - (Note 5) borrowing other long term liabilities TOTAL	2,450,000 670,000 3,120,000	2,650,000 640,000 3,290,000	2,850,000 560,000 3,410,000
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	98.7%	98.8%	98.8%

16	Maturity structure of fixed rate borrowing as at 31/03/2019	Lower Limit	Cumulative Upper Limit	Projected 31/03/2020
	under 12 months	0%	15%	0%
	12 months and within 24 months	0%	20%	3%
	24 months and within 5 years	0%	35%	10%
	5 years and within 10 years	0%	40%	5%
	10 years and within 20 years			
	20 years and within 30 years	25%	90%	82%
	30 years and within 40 years			
	40 years and within 50 years			
	50 years and above			
				100%

otes.

- The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the External Borrowing costs only and Borrowing and Other long term Liabilities (PFI and leasing)
- The Changes to the Prudential Code 2017 retired the Indicator 3 and 4 on the incremental impact of New Capital decision on HRA and GF as well as Indicator 13 the need to explicitly adopt the Code of Practice. In addition Indic relating to the MHCLG imposed HRA borrowing debt ceiling has been recinded and is therefore no longer report
- In order to ensure that over the medium term gross borrowing will only be for a capital purpose, the Council should ensure that gross 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 and was changed from Net Borrowin borrowing under the update to the Codes in 2017.
- Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.
- Indicators 14 and 15 are no longer explicit within the updated codes however these have been but have been ret pending further review
- Indicator 17 relates solely to Treasury Management investments made under Section 12 of the Local Governeme

Prudential Code Monitoring 2019/20 - Debt

