

AUDIT & GOVERNANCE COMMITTEE
17 DECEMBER 2019

TREASURY MANAGEMENT MID YEAR REPORT

SUMMARY AND PURPOSE:

This report summarises the council's treasury management activity during the first half of 2019/20, as required to ensure compliance with CIPFA's Code of Practice for Treasury Management.

RECOMMENDATIONS:

The Audit & Governance Committee is asked to note the content of the Treasury Management Half Year Report for 2019/20.

BACKGROUND:

1. The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a Treasury Management semi-annual and annual reports.
2. The Authority's Treasury Management Strategy Statement for 2019/20 was approved at the County Council meeting on 5 February 2019. The investment and borrowing of cash exposes the Council to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

EXTERNAL CONTEXT:

3. Annex 1 contains commentary on the economic backdrop for 2019/20.

REGULATORY UPDATES:

5. **CIPFA Prudential and Treasury Management Codes:**

Following consultation, CIPFA released the 2018 Prudential Code and Guidance for practitioners during the summer of 2018. Under the prudential system, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to CIPFA's Code, which has been given legislative backing. Prudential limits apply to all borrowing, qualifying credit arrangements and other long-term liabilities – whether supported by government or entirely self-financed. The system is designed to encourage authorities that need and can afford to undertake capital investment to do so within a robust framework

MID YEAR REPORT:

6. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. Table 1 below summarises the Council's Balance Sheet position as at 31 March 2019, and shows a net borrowing position of £583m.
7. The Authority's current strategy is to maintain borrowing below the Capital Financing Requirement, sometimes known as internal borrowing. Internal borrowing allows the Council to utilise its internal cash balances on a temporary basis (i.e. working capital and usable reserves) which are not required in the short to medium term. This approach reduces market and credit risk for the investment portfolio and reduces borrowing costs. The Balance Sheet position as of 31 March is summarised in Table 1 below:

Table 1: Balance Sheet Summary

| | 31.3.19 Actual £m |
|-------------------------------------------|----------------------------------|
| General Fund CFR | 1,235.0 |
| Less: PFI Liabilities | 227.0 |
| Gross Borrowing Requirement | 1,008.0 |
| Less: usable reserves and working capital | 425.0 |
| Net borrowing requirement: | 583.0 |

8. Table 3 illustrates the movement from 31 March to 30 September 2019. The net borrowing requirement increased by £19m, from £635m to £654m. External borrowing reduced by £11m from £666m to £655m. During the period £30m of external longer term borrowing was undertaken with the Public Works Loan Board. Summarised in Table 2 below:

Table 2: New Borrowing to 30 September 2019

| Principal (£m) | Maturity Date | Term | Interest Rate | Type |
|-----------------------|----------------------|-------------|----------------------|-------------|
| 10.0 | 16-Sep-34 | 15 Years | 1.29% | E.I.P |
| 10.0 | 23-Sep-34 | 15 Years | 1.30% | E.I.P |
| 10.0 | 26-Sep-34 | 15 Years | 1.20% | E.I.P |

Table 3: Borrowing Position

| | 31.3.19 Balance £m | Movement £m | 30.9.19 Balance £m | 30.9.19 Weighted average rate % | 30.9.19 Weighted average maturity years |
|------------------------------------|--------------------------|----------------|--------------------------|---------------------------------------------|-----------------------------------------------------|
| Public Works Loan Board | 387 | 30 | 417 | 4.0% | 31 years |
| Long term commercial loan | 10 | | 10 | 5.0% | 34 years |
| Local authorities (short-term) | 255 | -52 | 203 | 0.8% | < 1 year |
| Surrey Police & Crime Commissioner | 14 | 11 | 25 | 0.7% | 0 days |
| Total borrowing* | 666 | -11 | 655 | | |
| Total Investments | -31 | 30 | -1 | | 0 days |
| Net Borrowing | 635 | 19 | 654 | | |

9. The Authority's main objective when borrowing has been to strike a balance between securing low interest rates and achieving cost certainty over the period for which funds are required. This position provides short term savings with the flexibility to secure longer dated loans as and when the level of funds available for internal borrowing reduces, or financial forecasts indicate that external borrowing rates may increase.

10. In furtherance of these objectives, no new long term borrowing was undertaken during the first half of 2019/20, internal borrowing was maximised and short term borrowing was utilised to manage cash flow. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

11. The "cost of carry" analysis performed by the Authority's treasury management advisor Arlingclose did not indicate any value in borrowing in advance for future years' planned expenditure and therefore none was taken.

Investment Activity

12. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the first half of 2019/20 the Authority's average daily level of investments was £42m compared to £39m for the first six months of 18/19.

13. The Council can place cash on deposit on the money market through brokers, directly with counterparties, through the use of call accounts, money market funds or direct deal facilities, or with the Debt Management Office (DMO). No new fixed term deposits have been agreed during 2019/20. All investments have been made through overnight money market funds.

14. The weighted average return on all investments the council received in the quarter to 30 September 2019 is 0.72%. This compares to the 0.57% average 7-day London Interbank Bid Rate (LIBID) for the same period.

Table 4: Investment Benchmarking

| | Average 7-day LIBID | Weighted return on investments |
|-------------------|------------------------|-----------------------------------|
| 2019/20 quarter 2 | 0.57% | 0.71% |
| 2019/20 quarter 1 | 0.57% | 0.75% |
| 2018/19 total | 0.63% | 0.51% |
| 2017/18 total | 0.21% | 0.22% |

15. Both the CIPFA Code and the government's Investment Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. In furtherance of these objectives, the Council's strategy of maximising internal borrowing has reduced the cash available for investment, and reduced the scope for making longer-term deposits.

Other Investment Activity

16. Although not currently classed as treasury management activities and therefore not covered by the CIPFA Code, the Authority also holds £134m of investments in directly owned investment property (excluding assets under construction) and £334m in loans to and shareholdings in its subsidiaries.

17. It is projected that these non-treasury investments will generate £6.8m net investment income for the Authority in 2019/20 after taking account of direct costs and MRP.

Performance Report

18. The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget.

Table 5: Performance

| | 2019/20 Budget £m | 2019/20 Full year projection £m | Projected Over/ Under(-) £m |
|---------------------|-------------------------|------------------------------------------|--------------------------------------|
| Interest Payable | 8.5 | 7.4 | -1.1 |
| Interest Receivable | -0.1 | -0.5 | -0.4 |

Compliance Report

19. The Director of Finance is pleased to report that all treasury management activities undertaken during the first half of 2019/20 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below. All investments in the first half of the year were deposited in Money Market Funds.

Table 6: Investment Limits

| Type | Rating | Limit | Maximum During the Year | Value at 30/9/19 | Complied |
|---------------------------|------------|-------|-------------------------|------------------|----------|
| Aberdeen – MMF | AAA | £25m | £25m | £1.4m | ✓ |
| Insight – MMF | AAA | £25m | £25m | 0 | ✓ |
| JP Morgan – MMF | AAA | £25m | £25m | 0 | ✓ |
| Morgan Stanley – MMF | AAA | £25m | £25m | 0 | ✓ |
| Goldman Sachs – MMF | AAA | £25m | £25m | 0 | ✓ |
| Money Market Funds | AAA | | | £1.4m | ✓ |

20. Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 7 below. The Authorised Limit is a statutory limit set by Council which cannot be breached. The Operational Limit is the day to day limit which may be breached on occasions due to variations in cash flow.

Table 7: Debt Limits

| | External Debt 30.9.19 Actual | 2019/20 Operational Boundary | 2019/20 Authorised Limit | Complied |
|------------------|---------------------------------------------|---------------------------------------------|-----------------------------------------|-----------------|
| Borrowing | 655 | 1,108 | 1,696 | ✓ |

21. The highest level of external debt during the first six months of 2019/20 stood at £688m during April, significantly below the Authorised Limit and the Operational Boundary.

Treasury Management Indicators

22. The Authority measures and manages its exposures to treasury management risks using the following indicators.

23. **Security:** The Council analyses the investment portfolio at year end against historic default rates to estimate the maximum exposure to default, as shown in the table below:

| | Amount | Historical experience of default | Adjustment for market conditions | Estimated maximum exposure to default |
|-------------------------------------------------------|--------------|----------------------------------|----------------------------------|---------------------------------------|
| | £000s | % | % | £000s |
| | 30/09/2019 | 30/09/2019 | 30/09/2019 | 30/09/2019 |
| | (a) | (b) | (c) | (a x c) |
| Deposits with banks and financial institutions | | | | |
| Local Authorities | 0 | 0.00% | 0.00% | 0 |
| AAA rated counterparties | 1,400 | 0.00% | 0.00% | 0 |
| AA rated counterparties | 0 | 0.03% | 0.03% | 0 |
| A rated counterparties | 0 | 0.08% | 0.08% | 0 |
| Other counterparties | | | | |
| Total | <u>1,400</u> | | | <u>0</u> |

24. **Liquidity:** The Council currently restricts termed deposits to less than one year. In respect of liquidity, the Council also seeks to maintain the following:

- Bank overdraft of £100,000
- No minimum target relating to liquid short term deposits
- Weighted average life benchmark is expected to be less than 3 months.

As at 30 September 2019, all investments were held in Money Market Funds with instant access.

25. **Interest Rate Exposures:** This indicator is set to control the Authority's exposure to interest rate risk for external borrowing. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed was:

| | 30.9.19 Actual | 2019/20 Limit | Complied |
|------------------------------------------------|----------------|---------------|----------|
| Upper limit on fixed interest rate exposure | 100% | 100% | ✓ |
| Upper limit on variable interest rate exposure | 0% | 25% | ✓ |

26. **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

| | 30.9.19 Actual | Upper Limit | Lower Limit | Complied |
|--------------------------------|---------------------------|------------------------|------------------------|-----------------|
| Under 12 months | 36% | 50% | 0% | ✓ |
| 12 months and within 24 months | 0% | 50% | 0% | ✓ |
| 24 months and within 5 years | 1% | 50% | 0% | ✓ |
| 5 years and within 10 years | 0% | 75% | 0% | ✓ |
| 10 years and above | 63% | 100% | 25% | ✓ |

27. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

28. **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

| | 30.9.19 Actual | 2019/20 Limit |
|-------------------------------------------|---------------------------|----------------------------------|
| Principal invested for more than 365 days | 0% | 35% of value of investments held |
| Complied | ✓ | ✓ |

IMPLICATIONS:

Financial

29. The direct financial implications of this report are highlighted in table 6 and form part of the monthly budget monitoring report to Cabinet.

Equalities

30. There are no direct equalities implications of this report.

Risk management

31. See paragraphs 22-28

WHAT HAPPENS NEXT:

- a. The Treasury Team will monitor the UK and overseas banking sector and will continue to update this Committee as appropriate.
- b. In line with the requirements of CIPFA's Code of Practice for Treasury Management, a full-year report for 2019/20 will be brought to this Committee after financial year end.
- c. The Treasury Team will prepare the annual Treasury Management Strategy, which will be presented to this Committee on 6 February 2020 for approval.

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Sources/background papers:

Capital Budget and Treasury Management Strategy

2019/20 Prudential Indicators

CIPFA Code of Practice for Treasury Management in the Public Services
2017

The Prudential Code 2018
