

London Borough of Barnet
Treasury Management Strategy Statement
and Annual Investment Strategy
Mid-year Review Report 2018/19

1 Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management role is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity as a priority alongside optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

“The management of the local authority's investments and 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 Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was adopted by this Council on 3 January 2003.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Policy and Resources Committee:

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2018/19 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);

- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

3. Summary

In the first six months of the year there has been no new borrowing and cash balances have been invested in accordance with the investment strategy set out in the TMSS. Cash balances as at 30 September 2018 were £76.4 million (£95.5 million as at 31 March 2018).

As detailed in appendix 1, it is proposed to change the investment strategy to permit loans to local organisations. This change requires Council approval.

3 Economics and interest rates

3.1 Economics update

The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3-month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.) Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

In the political arena, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

3.2 Interest rate forecasts

The Council's treasury advisor, Capita Asset Services, has provided the following forecast of interest rates for borrowing:

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

The forecast across all time periods is for gradual increases of between 0.6% and 0.85% in the 30-month period.

The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and to get inflation up consistently to around monetary policy target levels.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases in the Fed. Funds Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

- UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

For LB Barnet with its significant capital expenditure plans and future borrowing requirements as set out in the 2018/19 TMSS, the expectation of interest rate increases but uncertainty as to extent and timing has implications for borrowing decisions. The current policy of borrowing short term will be kept under review.

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved by this Council on 6 March 2018. There is one proposed change to the TMSS discussed below; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5 The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed as part of the Budget.

Capital Expenditure	2017-18	2018-19 as	2018-19	2018-19
	Actual	shown in	Revised	Period 5
	£'000	TMSS	budget	Projection
		£'000	£'000	£'000
Non-HRA	115,514	312,598	282,962	250,876
HRA	49,378	80,312	41,512	39,930
Total	164,892	392,910	324,474	290,806

Forecast capital expenditure for 2018-19 as at Month 5 totals £290.8 million, which is £33.7 million lower than the last approved budget. Details are given within month 5 Financial Monitoring report. The main variances are slippage on Housing Needs and Resources (£18.0 million) and Open Door Homes loan (£31.9 million), offset by additional expenditure on the direct acquisition of residential properties (£13.8 million).

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2017-18	2018-19 as	2018-19	2018-19
Financing	Actual	shown in	Revised	Period 5
		TMSS	budget	Projection
		£'000	£'000	£'000
Capital receipts	32,706	84,570	51,662	51,698
Capital Grants	60,886	45,837	53,138	52,530
Capital Reserves	7,598	48,458	18,474	16,284
Revenue	40,187	37,215	39,175	35,757
Total Financing	141,377	216,080	162,449	156,269
Borrowing requirement	23,515	176,830	162,025	134,537
	164,892	392,910	324,474	290,806

Projected changes for the capital programme have resulted in a reduced new borrowing requirement of £27.5 million compared with the revised budget.

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, how this has changed compared with the estimate contained within the TMSS and the debt headroom based on the operational boundary for debt.

	31 March 2018 Actual	2018-19 as shown in TMSS	2018-19 Revised Estimate
Prudential Indicator - Capital Financing Requirement			
	£'000	£'000	£'000
CFR - Non Housing	258,532	458,979	373,058
CFR - Housing	200,634	225,466	209,731
Total CFR	459,166	684,445	582,789
Net movement in CFR		225,279	123,623
Prudential Indicator - the operational boundary for external debt			
	Actual - as at 30 Sept 2018	TMSS Projection	Revised Projection
	£'000	£'000	£'000
Borrowing	304,080	495,496	380,703
Other Long term liabilities	15,974	15,288	15,601
Total debt (yearend position)	320,054	510,784	396,304
TMSS Operational boundary		584,445	584,445
Debt headroom available		73,661	188,141

Due to slippage in the capital programme as noted above, the projected year end CFR has reduced by £101.7 million to £582.8 million.

The impact on projected debt is that the current forecast year-end borrowing is £396.3 million, which is an increase in the year of £76.2 million, much lower than the original increase projected of £190.7 million. It would not be a surprise if further slippage in the capital programme resulted in less year-end debt than projected above. Further details of the net debt position are given below.

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total

of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

Estimate of the net debt position	31 March 2018 Actual £'000	As at 31 August 2018 £'000	2018-19 Revised Estimate £'000
Borrowing	304,080	304,080	380,703
Other long-term liabilities	15,974	15,974	15,661
Treasury investments	-95,500	-84,400	-45,500
Net debt	224,554	235,654	350,864
CFR	459,166		582,789

The Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2018-19 original indicator £'000	current position 30 September 2018 £'000	2018-19 Revised Estimate £'000
Borrowing	659,157	304,080	380,703
other long-term liabilities	25,288	15,974	15,661
Total	684,445	320,054	396,364

** Includes on balance sheet PFI schemes and finance leases etc.*

The projected year end position is significantly lower than the authorised limit for external debt.

6 Investment Portfolio 2017/18

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in section 3.2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short-term strategy. Given this risk environment and the fact that increases

in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

The Council held £84.4 million of investments as at 31 August 2018 (£95.5m at 31 March 2018) and the investment portfolio yield for the first six months of the year is 0.68% against a 7-day LiBID benchmark) of 0.48%.

A full list of investments held as at 31st August 2018 is in appendix 1:

The Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19.

The Council's budgeted investment return for 2018/19 is £1.7 million and performance for the year to date is significantly below budget with a projection of £0.4 million. Cash balances are being minimised to avoid taking on additional debt as was projected in the TMSS. The recent increase in bank rate offers the scope to earn additional interest.

The treasury team continues to abide by the counterparty limits set out in the TMSS. Daily reports on credit rating are received and monitored. The treasury portfolio is signed off daily by the Head of Treasury and all deals are approved by Capita before completion.

Investment Counterparty criteria

Although the current treasury plan is to minimise investment balances (and therefore minimise borrowing needs) there will always be core cash balances due to the prudence built into treasury forecasting and the need to ensure liquidity. As demonstrated above, treasury balances invested in traditional cash and money market instruments are generating minimal returns. The investment strategy currently allows investment in a wide range of non-cash asset classes; bonds, property, commodities (gold) and equity via collective funds. Depending on the structure of the investment, individual limits of £10 million or £25 million are permitted.

As yet no investments have been made in non-traditional asset classes. However, opportunities will be investigated to make selective investments in long term bonds, property and low risk multi asset funds. When making these types of investments the emphasis will remain on low volatility and liquidity. Individual investments into non-traditional collective funds will not exceed £5 million. Advice is taken from Capita Treasury Solutions in structuring and allocating treasury investments.

It is proposed to include a new classification of investment within the TMSS "Loans to organisations delivering community benefits". The purpose of this category is described in the paragraph below that has been inserted into the TMSS:

"The Council will allow loans (as a form of investment) to be made to organisations operating in the borough that bring community benefits. The Council will undertake due diligence checks to confirm the borrower's creditworthiness before any sums are advanced and will obtain appropriate level of security or third party guarantees for loans advanced. The Council would expect a return commensurate with the type, risk and duration of the loan. A limit of £25 million per counterparty (and £50 million in aggregate) for this type of investment is proposed with a duration commensurate with the life of the asset and Council's cash flow requirements. All loans would need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels."

7 Borrowing

As indicated above the current projected capital programme for 2018-19 requires additional borrowing of £76.2 million. Over the three years of the TMSS to March 2021, additional debt of £241.1 million was projected in the TMSS. As at September 2018 no new debt has been raised and cash balances of £76.4 million remain significant. The unreliability of the capital expenditure plans makes debt planning uncertain. Until clarity of new borrowing needs is achieved, additional funding will focus on short maturity debt.

With Link's projections in section three indicating that PWLB borrowing interest rates will gradually rise, consideration has been given to locking in borrowing rates to provide protection against increases in future costs. There are two reasons for not doing so; firstly the unpredictability of the scale and timing of the capital programme and secondly the cost of carrying excess cash with short term interest rate on high security investments yielding less than 0.75%.

Opportunities to lock in future borrowing rates are not available through the PWLB but a number of insurance companies are interested in such arrangements, particularly for long term (20 year plus) debt. The upward trend in rates is expected to continue as shown in 3.2. Therefore, as soon as capital expenditure projections are seen as robust it would be prudent to fund, or at least part fund, to reduce the risks of increasing funding costs.

8 Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

9 Other

N/A

Investment Portfolio as at 31 August 2018

The table below lists the Council's treasury investments as at 31 August 2018.

	Principal	Interest	Start	Maturity	Lowest	Historic
	(£'000)	Rate	Date	Date	long-term	risk of
Money Market Fund		(%)			rating	Default
MMF Federated Investors	25,000	0.66			AAA	0.000
MMF Standard Life	2,000	0.63			AAA	0.000
Total Money Market	27,000					
Local Authority Deposits						
THURROCK BOR COUNCIL	5,000	0.75	10-Nov-17	09-Nov-18	AA	0.005
BABERGH DISTRICT COUNCIL	4,000	0.70	20-Aug-18	20-Sep-18	AA	0.001
LONDON BOR OF SOUTHWARK	5,000	0.95	28-Mar-18	02-Jan-19	AA	0.008
SURREY HEATH BOR COUNCIL	5,000	0.75	16-Apr-18	16-Oct-18	AA	0.003
Total Local Authority	19,000					
Banks						
LLOYDS BANK	5,000	0.68	22-Jun-18	31-Oct-18	A+	0.009
LLOYDS BANK	5,000	0.85	02-Feb-18	04-Feb-19	A+	0.023
LLOYDS BANK	5,000	1.00	19-Jun-18	19-Jun-19	A+	0.043
AUSTRALIA & NEW ZEALAND BANK	4,000	0.66	22-Jun-18	31-Oct-18	AA-	0.004
AUSTRALIA & NEW ZEALAND BANK	5,000	0.96	06-Aug-18	06-Dec-18	AA-	0.007
AUSTRALIA & NEW ZEALAND BANK	5,000	0.63	15-Jun-18	28-Sep-18	AA-	0.002
SUMITOMO MITSUI BCE	4,400	0.75	20-Jul-18	22-Oct-18	A	0.008
SUMITOMO MITSUI BCE	5,000	0.77	16-Jul-18	16-Nov-18	A	0.011
Total Banks	38,400					
Total Investments	84,400	0.75				0.007

In addition to the above, the Council's pension fund has cash balances of £4.9 million, mostly invested with Standard Life money market fund.