London Borough of Barnet
Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review Report 2019/20

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 operations is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering 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 borrowing, 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

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised 2017).

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 2019/20 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council’s capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council’s investment portfolio for 2019/20;
- A review of the Council’s borrowing strategy for 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

Summary

In the six months the Council has new borrowing of £55 million. This comprised £80 million of long-term PWLB debt and the repayment of £25 million of short-term (six-month) debt. Invested cash balances have increased in the six months by £37.0 million to £102.3 million. The projected borrowing component of the capital programme has declined by £57.1 million to £131.4 million.

The Government has increased the margin charged by the PWLB over gilts by 1% to 1.8%. This occurred after the new borrowing discussed above. Opportunities to borrow outside of PWLB are being explored.

Economics and interest rates

3.1 Economics update

The first half of 2019/20 has seen UK **economic growth** fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

With regard to the **labour market,** despite the contraction in quarterly GDP growth of -0.2% q/q, (+1.3% y/y), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As 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. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to act to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

In the political arena, the first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. So far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. At the time of writing the whole Brexit situation is highly fluid and could change radically by the day. Given these circumstances and the likelihood of an imminent general election, any interest rate forecasts are subject to material change as the situation evolves. If the UK does soon achieve a deal on Brexit agreed with the EU then it is possible that growth could recover relatively quickly. The MPC could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. If there is a general election soon, 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 although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

3.2 Interest rate forecasts

The Council's treasury advisor, Link Asset Services, has provided the following forecast.

This forecast includes the increase in margin over gilt yields of 100bps introduced on 9th September 2019.

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit at some point in time. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

The Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. The suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth. During the half year up to 30 September there was a near halving of longer term PWLB rates to completely unprecedented historic low levels (see paragraph 7 for comments on the increase in margin over gilt yields of 100bps introduced on 9th September).

The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture. The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

For Barnet, with its significant capital programme, conditions remain favourable to borrow both short and long term either fixed or inflation linked. At the time of writing the 50-year PWLB rate was 2.94% indicating an underlying gilt yield of 1.14%. Opportunities to borrow outside of PWLB are being explored and greater variety in borrowing routes is likely to return. Short-term borrowing rates remain around 1%.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement, (TMSS), for 2019/20 was approved by this Council on 5th March 2019. There are no policy changes to the TMSS; 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 at the Budget.

Capital Expenditure	2018-19 Actual	2019-20 as shown in TMSS	2019-20 Revised budget	2019-20 Projection
	£'000	£'000	£'000	£'000
Non-HRA	209,316	275,563	439,920	293,924
HRA	33,047	78,143	40,748	50,885
Total	**242,363**	**353,706**	**480,668**	**344,809**

There was a substantial increase (£127.0 million) in the budgeted for capital expenditure after the approval of the TMSS relating to the carry forward of projections from the previous year. The current projection is lower than both the budget and estimate included within the TMSS. The main cause is a slippage to later years in the Thames Link station (£124.2 million). The HRA acquisition programme has brought forward expenditure of £11 million from next year.

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 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 Financing	2018-19 Actual	2019-20 as shown in TMSS	2019-20 Revised budget	2019-20 Projection
		£'000	£'000	£'000
Capital receipts	18,286	60,020	39,788	39,788
Capital Grants	68,879	57,956	260,195	135,967
Capital Reserves	29,315	20,837	17,010	17,010
Revenue	37,590	26,404	20,662	20,662
Total Financing	154,070	165,217	337,655	213,427
Borrowing requirement	88,293	188,489	143,013	131,382
	242,363	**353,706**	**480,668**	**344,809**

The slippage in Thames Link has seen grants deferred into 2020-21. The projected borrowing requirement is £57.1 million below that included within the TMSS.

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, which is termed the Operational Boundary, how this has changed compared with the estimate within the TMSS and the debt headroom based on the operational boundary for debt.

Prudential Indicator - Capital Financing Requirement	31 March 2019 Actual	2019-20 as shown in TMSS	2019-20 Revised Estimate
	£'000	£'000	£'000
CFR – Non-Housing	346,825	510,861	444,480
CFR - Housing	200,634	243,982	223,361
Total CFR	547,459	754,843	667,841
Net movement in CFR		207,384	120,382

Prudential Indicator - the operational boundary for external debt	Actual - as at 30 Sept 2019	TMSS Projection	Revised Projection
	£'000	£'000	£'000
Borrowing	404,080	495,496	442,462
Other Long-term liabilities	15,489	15,288	15,116
Total debt (year-end position)	419,569	510,784	457,578
TMSS Operational boundary		654,843	654,843
Debt headroom available		**144,059**	**197,265**

Slippage in the capital programme has resulted in a projected year end debt balance of £457.6 million. This compares with borrowing as at 30 September 2019 of £419.6 million and a TMSS projection of £510.8 million.

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 CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and 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 2019 Actual	As at 30 September 2019	2019-20 Revised Estimate
	£'000	£'000	£'000
Borrowing	349,080	404,080	442,462
Other long term liabilities	15,489	15,489	15,116
Treasury investments	-65,350	-102,310	-35,350
Net debt	299,219	317,259	422,228
CFR	547,459		667,841

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	**2019-20 original indicator** £'000	**current position 30 September 2019** £'000	**2019-20 Revised Estimate** £'000
Borrowing	739,242	404,080	442,462
other long-term liabilities	20,601	15,489	15,116
Total	759,843	419,569	457,578

Both the current and year-end projected borrowing are well within the authorised debt limits.

6. Investment Portfolio 2019/20

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 £102.3 million of Treasury investments as at 30 September 2019 (£65.4 million at 31 March 2019) and the investment portfolio yield for the first six months of the year is 0.79% against a benchmark of 7-day libor of 0.57%. The value of Treasury investments above excludes the loan to Saracens (£1.8 million as at 30.9.2019) and advances to Open Door Homes and in respect of Brent Cross.

A full list of investments held as at 30 September 2019 is in appendix 1.

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2019/20.

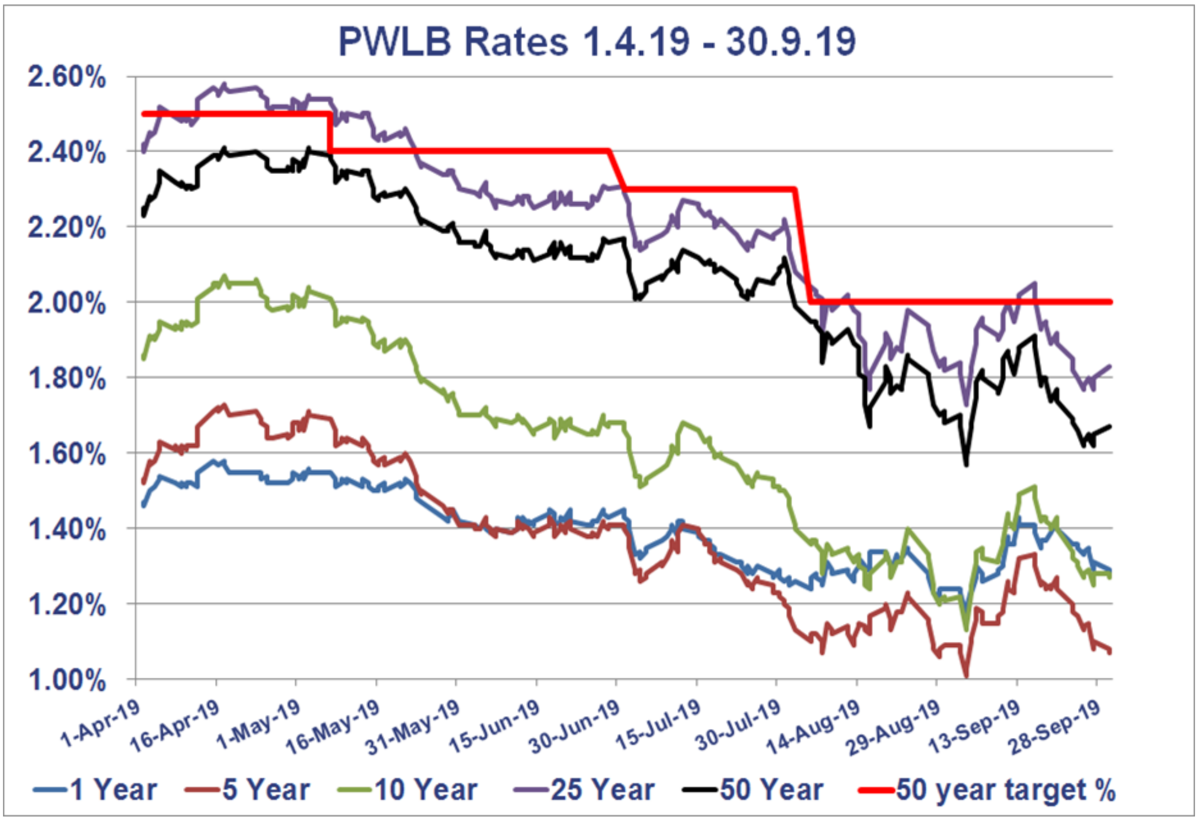
The Council's budgeted investment return for 2019/20 is £1.2 million, and performance for the year to date is £0.8 million above budget, mainly due to loan in respect of Brent Cross, Open Door and Saracens.

No changes are proposed to the current counterparty policy.

7. Borrowing

As indicated above the current projected capital programme for 2019-20 envisages debt funded capital expenditure of £131.4 million. Over the three years of the TMSS to March 2022, additional debt of £269.6 million was projected in the TMSS. In the last six months, new 50-year PWLB fixed rate maturity debt of £80 million has been acquired at an average interest rate of 1.94%. It had been planned to borrow £160 million in stages to avoid excess cash, but following the increase in PWLB rates discussed below, the funding programme was suspended. Part of the cash was used to repay £25 million of short-term borrowing taken in the previous year.

The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date. PWLB rates have been on a falling trend during this period and longer rates have almost halved to reach historic lows. The 50-year PWLB target (certainty) rate for new long-term borrowing fell from 2.50% to 2.00% during this period jjustifying postponement of borrowing decisions.



Increase in the cost of borrowing from the PWLB

On 9 October 2019 the Treasury and PWLB announced an increase in the margin over gilt yields of 100bps on top of the current margin of 80 bps which this authority has paid prior to this date for new borrowing from the PWLB. There was no warning that this would happen and it now means that every local authority should fundamentally reassess how to finance their external borrowing needs and the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing.

Whereas this authority has relied since 2008 on the PWLB as its main source of funding, it now will reconsider alternative cheaper sources of borrowing. At the current time, this is a developmental area as this event has also taken the financial services industry by surprise. We are expecting that various financial institutions will enter the market or make products available to local authorities. Members will be updated as this area evolves.

Discussions have taken place with the Municipal Bond Agency who are evaluating the opportunity to issue 20-year debt on behalf of local authorities in early 2020. Insurance companies are already starting to express interest with the proposed margin over gilts lower than PWLB but greater than those on offer prior to the increase in PWLB margins. With cash balances in excess of £100 million there is no immediate need to borrow.

Appendix 1

	Principal (£'000)	Interest Rate %	Start Date	Maturity Date	Lowest long-term rating	Historic default risk %
Money Market Fund						
MMF Federated Investors	25,000	0.74			AAA	0.000
MMF Invesco	900	0.71			AAA	0.000
MMF Aviva	5,010	0.72			AAA	0.000
Total Money Market	**30,910**					
Banks						
Australia & New Zealand	5,800	0.88	20-Jun-19	31-Oct-19	AA-	0.002
Australia & New Zealand	7,500	0.82	05-Aug-18	29-Nov-19	AA-	0.004
Sumitomo Mitsui	10,000	0.76	15-Aug-19	31-Jan-20	A	0.018
Sumitomo Mitsui	10,000	0.77	20-Aug-19	20-Nov-19	A	0.007
Sumitomo Mitsui	5,000	0.77	27-Aug-19	29-Nov-19	A	0.009
LLOYDS BANK	6,500	0.97	21-Jun-19	29-Nov-19	A+	0.009
LLOYDS BANK	6,600	0.82	13-Aug-19	23-Dec-19	A+	0.012
LLOYDS BANK	10,000	0.85	15-Aug-19	28-Feb-20	A+	0.022
Santander	10,000	0.79	27-Aug-19	28-Feb-20	A	0.022
Total Banks	**71,400**					
Total Investments	**102,310**	**0.00**				**0.007**