



AGENDA NO: 8a

INDEPENDENT AUDIT COMMITTEE – 17 December 2019

2019/20 TREASURY MANAGEMENT MID-YEAR REPORT

REPORT BY NICOLA ALLEN

PURPOSE OF THE REPORT

The purpose of this report is to present the 2019/20 treasury management mid-year report for Devon and Cornwall, for comment.

1.0 Introduction

- 1.1 The Treasury Management Strategy for 2019/20 is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.
- 1.2 The Code also recommends a report on Treasury Management activities at least twice a year; a mid-year, and a year-end (outturn) report, and both of these are reported to the Independent Audit Committee. This report sets out the performance of the treasury management function for the period from 1 April to 30 September 2019.
- 1.3 Treasury management is defined as:

"The management of the PCC'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".
- 1.4 Operational treasury management activity is undertaken by the Alliance finance function, supported by the treasury advisors Arlingclose Limited, under the direction of the Chief Finance Officer (Treasurer), and in accordance with the strategy and practices approved by the PCC.
- 1.5 In the year to September all treasury activity complied with the PCC's Treasury Management Strategy, Investment Strategy and revised indicators as well as all relevant statute, guidance and accounting standards.

2.0 External Context

2.1 Quarter 2 GDP contracted by 0.2% following the 0.5% gain in quarter 1 which was distorted by stock piling ahead of Brexit. UK Consumer Price Inflation fell to 1.7% year/year in August from 2.0% in July, and the Bank Base Rate remained at 0.75%. A fuller explanation of the external context, as provided by the Treasury Management Advisors, Arlingclose Limited, is provided in Appendix 4.

3.0 Investment Activity

3.1 At 30 September 2019 the PCC had short term investments and cash equivalents of £46m. In the year to September balances ranged between £4.9m and £72m. In early July just before receiving the pension top up grant we borrowed a total of £7.2m over a period of 4 days to overcome the shortage in cash. The interest incurred amounted to £0.4k. The lenders were two Local Authorities.

3.2 The period-end investment position and the year-to-date change is shown at Appendix 1 Table 2.

3.3 Both the CIPFA Code and government guidance require funds to be invested prudently, with regard to the security and liquidity of investments before seeking the highest rate of return, or yield. The 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.

3.4 Investments are reviewed quarterly and benchmarked against other similar organisations by Arlingclose Limited. The benchmarking for quarter 2 is provided at Appendix 1 - Table 3. Compared with the average of Police and Fire Authorities Devon and Cornwall balances are higher.

4.0 Borrowing Activity

4.1 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.

4.2 At 30 September 2019 the forecast underlying need to borrow for capital purposes /CFR was £64.6m which is £4m more than estimated amount. This increase is not as a result of an increase in capital spend but a change to how the capital spend was funded last financial year. A decision was taken to increase the use of internal borrowing and reduce the earmarked reserve contributions. This decision was established by reviewing the level of reserves held at 31 March 2019 and the level of future reserves. As a consequence the closing CFR position for last year increased by the £4m which has been carried forward into 2019/20. Internal borrowing can be converted to external borrowing creating some flexibility which would not be the case if reserves were used (see Appendix 3 Table 10).

4.3 All long term external borrowing has been arranged with PWLB. The next loan to mature will be in 2025.

5.0 Performance Report

- 5.1 The financial performance of treasury management activities is measured both in terms of its impact on the revenue budget and its relationship to benchmark interest rates. The Arlingclose benchmarking is provided at Appendix 1 Table 3.
- 5.2 Interest receivable forecast for the year is £250k compared to a budgeted amount of £383k. There are a number of factors contributing to this reduction: money market return rates range from 0.61% to 0.73% compared to a budgeted rate of 0.90%. However, due to the volatility in the markets this could still be an optimistic position.
- 5.3 There has been a lot of volatility in the market over the last 7 months with Brexit scheduled for the 31 October. Arlingclose advice has been to keep our funds liquid. This advice has been adhered to. However, this has meant it has restricted us from investing in longer term investments which have better rates of return.
- 5.4 The capital programme was underspent relative to the monthly budgeted spending profile by £11m to September. A more accurate spending profile would have released additional funds for investment, increasing interest received and mitigating the impact of lower rates of return.

Lucinda Hines
Head of Technical Accounting

Nicola Allen
Treasurer to the OPCC

Appendices

Appendix 1 – Investments

Appendix 2 – Treasury Management Indicators

Appendix 3 – Prudential Indicators

Appendix 4 – Economic Update provided by Arlingclose Ltd

TREASURY MANAGEMENT INDICATORS

Appendix 2

Table 1: Investment Limits

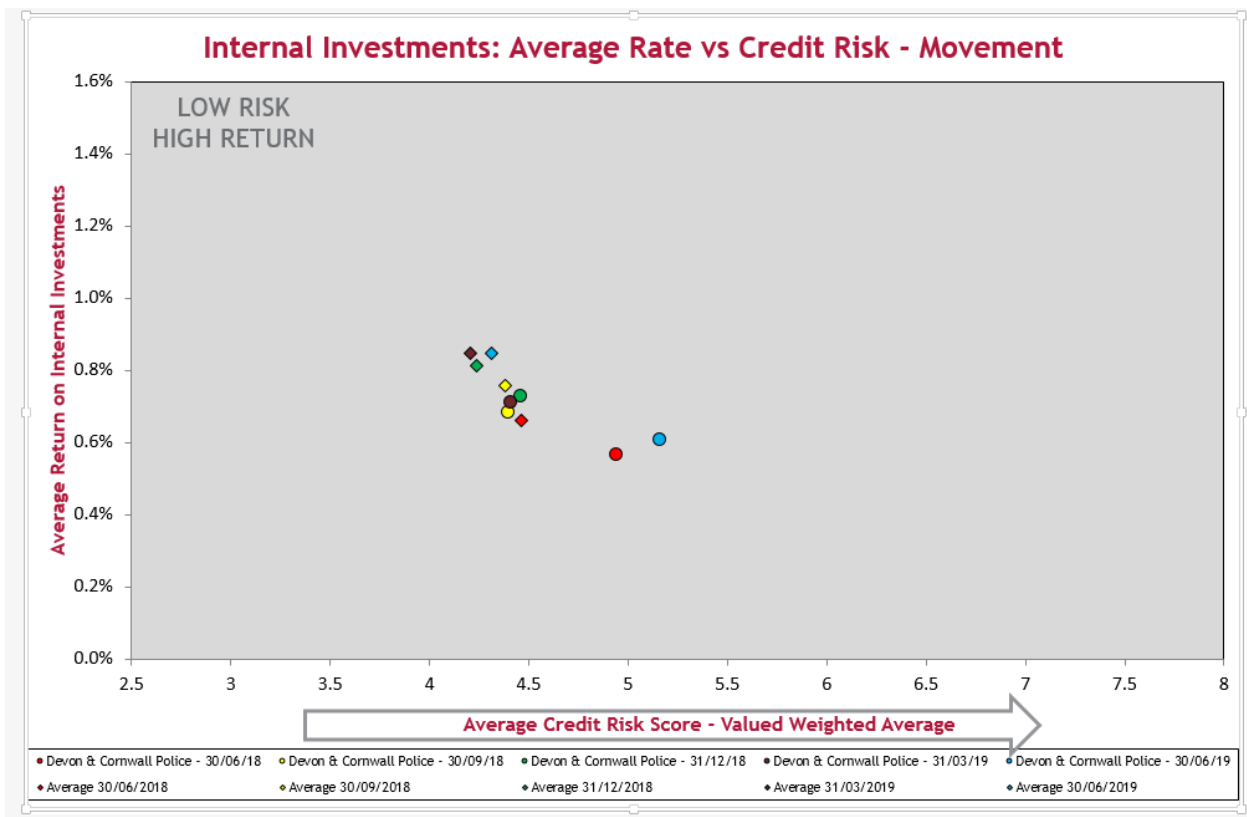
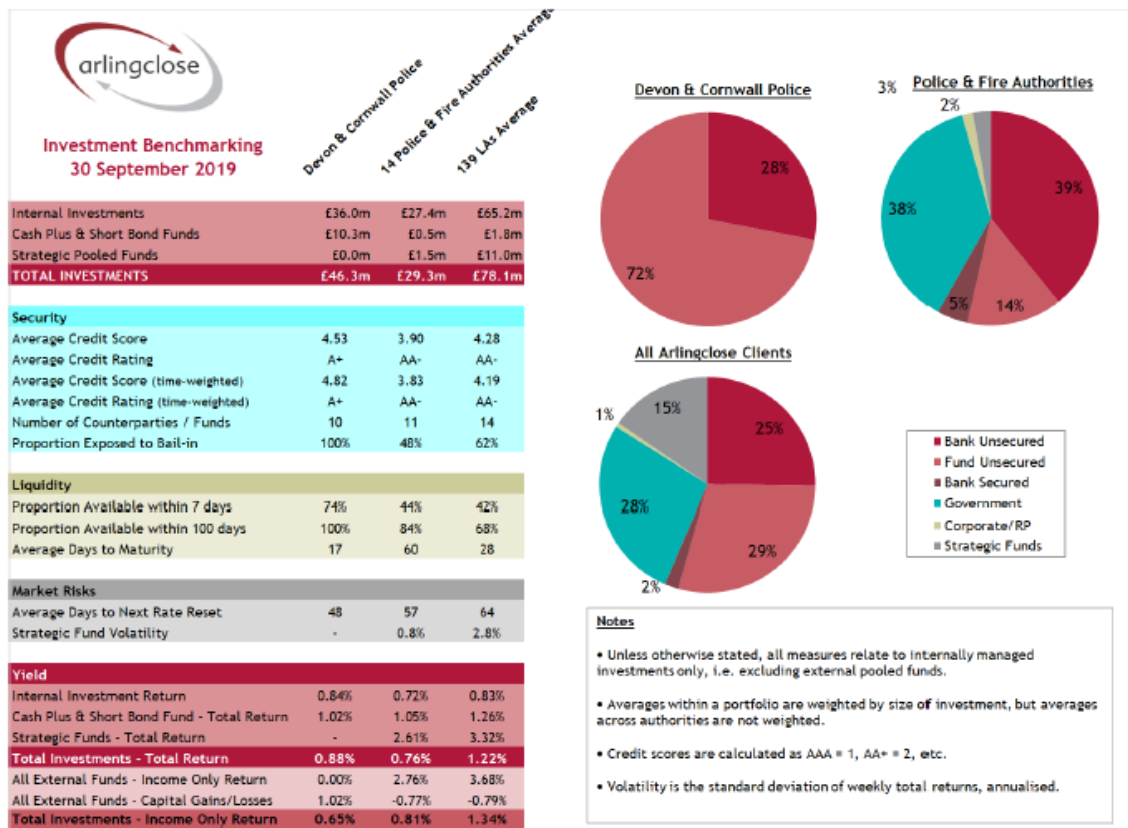
	2019/20 Cash Limit	30.09.19 Actual	Complied?
Any single organisation, except the UK Government	£12m each (£6m unsecured funds)	£6m unsecured	Yes
Any group of organisations under the same ownership	£12m per Group (£6m unsecured funds)	£6m unsecured	Yes
Any group of pooled funds under the same management	£6m per manager	£6m per manager	Yes
Negotiable instruments held in a broker's nominee account	£24m per Broker	£0m	Yes
Limit per non-UK country	£12m per country	£0m	Yes
Registered providers	£20m in Total	£0m	Yes
Unsecured investments with building societies	£12m in Total	£0m	Yes
Money Market Funds	£32m in Total	£29m in Total	Yes
Bank Account	£1.25m	£1.13m	Yes

Table 2: Investment Position

	31.03.19 Actual Portfolio £'000	30.09.19 Actual Portfolio £'000	Movement £'000
External Borrowing	(30,277)	(30,277)	0
Finance Leases	(243)	(243)	0
Total Gross External Debt	(30,520)	(30,520)	0
Treasury Investments:			
Short Term Investments	10,203	22,000	(11,797)
Cash and Cash Equivalents	13,943	24,131	(10,187)
Total Treasury Investments	24,146	46,131	(21,984)
Net Investments/(Debt)	(6,373)	15,611	(21,984)

TREASURY MANAGEMENT INDICATORS
Table 3: Benchmarking Information

Appendix 2



TREASURY MANAGEMENT INDICATORS

Appendix 2

Table 4: Security

The PCC has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

	2019/20	30.09.2019	Complied ?
	Target	Actual	
Portfolio average credit rating	A+	A+	Yes

Table 5: Liquidity

The PCC has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected variation in the cash flow:

	2019/20	30.09.2019	Complied?
	Target	Actual	
Minimum limit at less than 31 days duration	£9m	£28m	Yes
Minimum limit overnight	£3m	£34m	Yes

Table 6: Interest Rate Exposures

This indicator is set to control the PCC's exposure to interest rate risk.

	2019/20	30.09.19	Complied ?
	Limit	Actual	
Upper limit on 1 year revenue impact of a 1% rise in interest rates	£318k	£260k	Yes
Upper limit on 1 year revenue impact of a 1% fall in interest rates	£318k	£260k	Yes

Fixed rate borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

TREASURY MANAGEMENT INDICATORS

Appendix 2

Table 7: Maturity Structure of Borrowing

This indicator is set to control the PCC’s exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	2019/20		30.09.2019	Complied?
	Upper Limit	Lower Limit	Actual	
Under 12 months	10%	0%	0%	Yes
12 months and within 24 months	15%	0%	0%	Yes
24 months and within 5 years	25%	0%	0%	Yes
5 years and within 10 years	40%	0%	7%	Yes
10 years and above	100%	60%	93%	Yes

Table 8: Principal Sums Invested for Periods Longer than 365 days

The purpose of this indicator is to control the PCC’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:

	2019/20
Limit on principal invested beyond year end	£10m
Actual principal invested beyond year end	£0m
Complied?	Yes

PRUDENTIAL INDICATORS

Appendix 3

Table 9: Debt Limits

	2019/20	30.09.2019	Operational Boundary	Authorised Limit
	Estimate	Actual		
	£'000	£'000		
External Borrowing	42,277	30,277	40,520	43,520
Finance Leases	718	243		
Internal Borrowing	17,555	26,059		
Total Debt	60,550	56,579		

Table 10: Capital Financing Requirement (CFR)

	2019/20	30.09.2019	2019/20
	Estimate	Actual	Forecast
	£'000	£'000	£'000
Opening CFR	45,321	49,314	49,314
Capital expenditure to be funded by borrowing	16,983	8,093	16,983
Finance Leases	0	0	0
Less: Minimum Revenue Provision	(1,584)	(792)	(1,584)
Less: Finance Leases	(171)	(36)	(72)
Closing CFR	60,550	56,579	64,642

External Context

Economic background: UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU. Mr Johnson prorogued Parliament which led some MPs to put forward a bill requiring him to seek a Brexit extension if no deal is in place by 19th October. The move was successful and, having been approved by the House of Lords, was passed into law. The Supreme Court subsequently ruled Mr Johnson's suspension of Parliament unlawful.

Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October.

Financial markets: After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

Credit background: Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ringfenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.