

## BARNSELY METROPOLITAN BOROUGH COUNCIL

This matter is not a Key Decision within the Council's definition and has not been included in the relevant Forward Plan

Report of the Executive Director, Core Services  
and Service Director, Finance (S151 Officer)

### TREASURY MANAGEMENT ACTIVITIES REVIEW - QUARTER ENDED 31<sup>st</sup> DECEMBER 2018

#### 1. Purpose of Report

- 1.1 This document reviews the Council's treasury management activities carried out during quarter 3 in accordance with statutory guidance.
- 1.2 In broad terms it covers the following:
  - The agreed Treasury Management Strategy for 2018/19;
  - Economic summary;
  - The Council's borrowing activity;
  - The Council's investment activity; and
  - Prudential and Treasury Indicators for 2018/19.

#### 2. Recommendations

- 2.1 It is recommended that members note:
  - **The borrowing and investment activities carried out during the quarter; and**
  - **The Prudential and Treasury Indicators set out in Appendix 1.**

#### 3. The Agreed Strategy for 2018/19

- 3.1 The Treasury Management Strategy identifies the key risks associated with the Council's borrowing and investment activities and sets out how those risks will be managed.
- 3.2 The focus of the borrowing strategy is to reduce the Council's exposure to interest rate and refinancing risk, whilst being mindful of the impact on its capital financing costs.
- 3.3 The purpose of the investment strategy is to invest any temporary cash balances prudently and to ensure this cash is available when needed. The Council is not dependent on the investment income earned; as such the pursuit of higher returns is a secondary priority.
- 3.4 The Council approved several changes to its investment counterparty limits in November to ensure that it can securely accommodate increased cash balances that have / will derive from the Glassworks project.

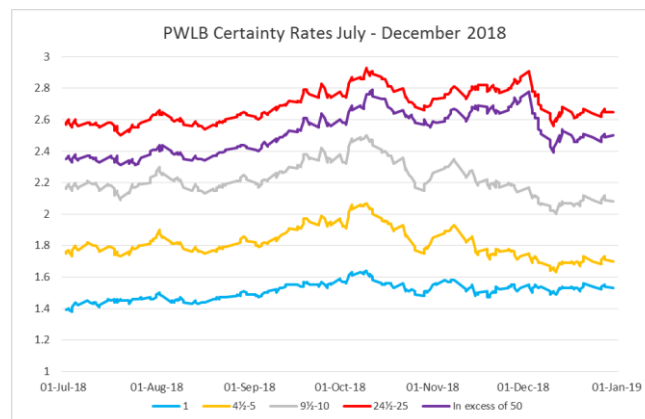
#### 4. Economic Summary

Highlights (see Appendix 2 for more details):

- *The base rate remained unchanged at 0.75% due to ongoing uncertainty around Brexit;*
- *As a result, interest rates eased off towards the end of the quarter (paragraph 4.2 refers);*
- *There is still an expectation that rates will increase over the short to medium term, on the belief that some form of agreement will be reached on Brexit;*
- *The Monetary Policy Committee (MPC) reaffirmed that the base rate would rise “at a gradual pace”.*

4.1 Since the base rate increase in August 2018 (from 0.5% to 0.75%), the MPC appears to be refraining from further action until the uncertainty around Brexit clears, voting unanimously to keep policy unchanged in November and December.

4.2 As a result, interest rates eased off towards the end of the quarter (as illustrated below):



4.3 There is still an expectation that rates will increase over the short to medium term, on the belief that some form of agreement will be reached on Brexit. Should this materialise the view from our advisors is that the base rate could be increased as soon as May 2019 (see appendix 2 for more details). The MPC have reaffirmed however that the base rate would rise “at a gradual pace”.

4.4 In the event of a no deal or disorderly Brexit, there is an expectation that the base rate may be reduced, however the Commons appear to be against any form of non-agreement exit therefore the chance of this happening is believed to be low.

## 5. Borrowing Activity

### Highlights:

- *The Council's gross debt increased by £89M during the quarter, as officers sought to mitigate its interest rate risk exposure;*
- *By the end of 2018/19, the Council's Capital Financing Requirement (CFR) is expected to reach £960M - down £7M from the original estimate;*
- *Based on current projections, the Council may need to borrow a further £180M over the next 2 years;*
- *Officers will monitor this position closely over the coming months in order to respond to any sudden changes in interest rates.*

### Movement on Gross Debt

5.1 As outlined below, the Council's gross debt increased by £89M during the quarter, as officers sought to mitigate its interest rate risk exposure:

Source	Balance on 30/09/2018 (£M)	New Debt (£M)	Debt Repaid (£M)	Balance on 31/12/2018 (£M)	Net Increase / (Decrease)
PWLB Borrowing	448.417	120.000	(0.941)	567.476	119.059
Other Long Term Loans	63.000	-	(8.000)	55.000	(8.000)
Temporary Borrowing	36.003	-	(22.000)	14.003	(22.000)
Long Term LA Loans	31.598	-	-	31.598	-
<b>Total Borrowing</b>	<b>579.018</b>	<b>120.000</b>	<b>(30.941)</b>	<b>668.077</b>	<b>89.059</b>
Other Long Term Liabilities	222.587	-	-	222.587	-
<b>Total Debt</b>	<b>801.605</b>	<b>120.000</b>	<b>(30.941)</b>	<b>890.664</b>	<b>89.059</b>

5.2 The Council borrowed a total of £120M during the quarter from the PWLB (including the £70M reported in November), bringing the total to date for 2018/19 to £160M. A breakdown of the remaining £50M is provided below:

Date	Loan Type	Principal (£M)	Interest Rate (%)	Term (Y)
30/10/2018	PWLB	10	2.58	46
02/11/2018	PWLB	10	2.56	46
14/11/2018	PWLB	10	2.60	46
26/11/2018	PWLB	10	2.64	44
14/12/2018	PWLB	8	2.56	31
18/12/2018	PWLB	2	2.56	36
<b>Total</b>		<b>50</b>	<b>2.59 (avg)</b>	<b>42.8 (avg)</b>

5.3 The Council repaid a total of £31M during the quarter including £22M of temporary borrowing. Other notable repayments include an £8M LOBO (Lender Option, Borrower Option) loan, following an opportunity to repay this early. As a result the Council has reduced its exposure to interest rate risk whilst making a small annual saving on its capital financing costs.

## Movement on the Capital Financing Requirement (CFR)

5.4 The CFR is essentially a measure of the Council's need to borrow to finance its capital expenditure. The Council monitors its CFR in relation to gross debt to determine the extent to which it is under (or over) borrowed.

5.5 The table below outlines the movement in CFR expected during 2018/19 and how this compares to the agreed strategy. The £7M variance primarily relates to slippage / re-phasing within the approved capital programme:

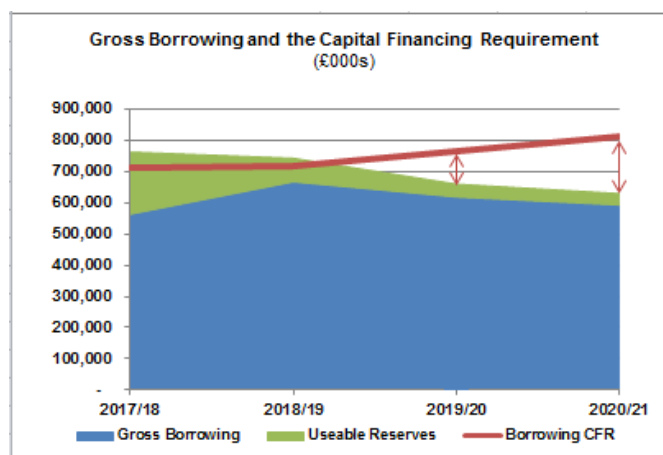
	<b>2018/19 Strategy (£M)</b>	<b>2018/19 Latest (£M)</b>	<b>Variance (£M)</b>
<b>Opening CFR</b>	<b>945.549</b>	<b>949.904</b>	<b>4.355</b>
Increase from in-year capital investment	32.192	19.296	(12.896)
Amounts set aside to repay debt	(10.465)	(9.417)	1.048
<b>Net Movement in CFR</b>	<b>21.727</b>	<b>9.879</b>	<b>(11.848)</b>
<b>Closing CFR</b>	<b>967.276</b>	<b>959.783</b>	<b>(7.493)</b>
General Fund	701.237	691.967	(9.270)
HRA	266.039	267.816	1.777

5.6 The following table shows the expected under-borrowed position at the end of the year and how this compares to the agreed strategy. The £109M variance primarily relates to the long term borrowing secured since January 2018, in response to a shift in interest rate expectations:

	<b>2018/19 Strategy (£M)</b>	<b>2018/19 Latest (£M)</b>	<b>Variance (£M)</b>
Closing CFR (From Table Above)	967.276	959.783	(7.493)
<b>Less PFI Schemes / Finance Leases</b>	<b>(236.348)</b>	<b>(240.676)</b>	<b>(4.328)</b>
<b>Borrowing CFR</b>	<b>730.928</b>	<b>719.107</b>	<b>(11.821)</b>
Gross Borrowing	(569.813)	(666.815)	(97.002)
<b>Under / (Over) Borrowed Position</b>	<b>161.115</b>	<b>52.292</b>	<b>(108.823)</b>
General Fund	152.134	42.677	(109.457)
HRA	8.981	9.615	0.634

## Future Outlook

5.7 The chart below shows the expected movements on gross borrowing, useable reserves and the borrowing CFR between 2017/18 and 2020/21. As the chart illustrates the Council was significantly under-borrowed in 2017/18, however this position was supported by useable reserves. The Council will ultimately need to borrow as these reserves are utilised:



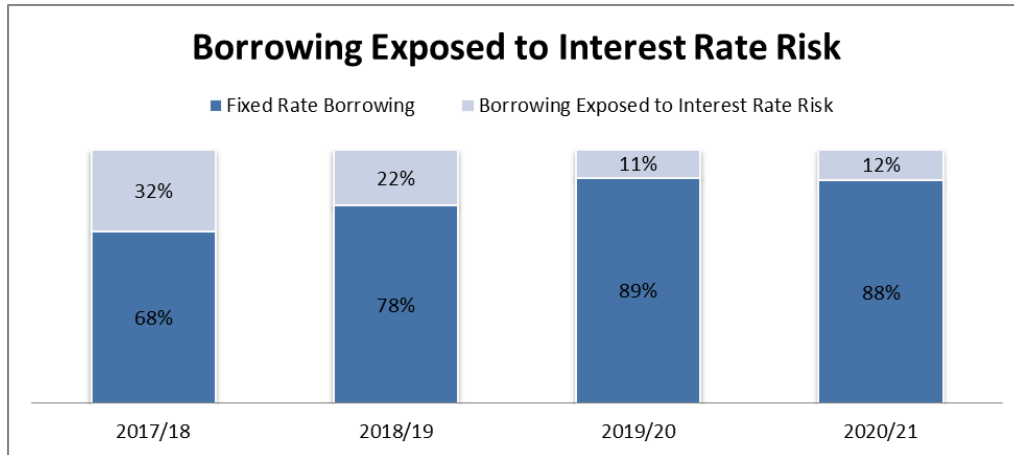
	2017/18 Actual (£M)	2018/19 Estimate (£M)	2019/20 Estimate (£M)	2020/21 Estimate (£M)
Borrowing CFR	710.250	719.107	762.022	809.236
Gross Borrowing	(563.213)	(666.815)	(618.478)	(592.576)
<b>Under / (Over) Borrowed Position</b>	<b>147.037</b>	<b>52.292</b>	<b>143.544</b>	<b>216.660</b>
Support from Useable Reserves	(147.037)	(52.292)	(40.606)	(36.226)
<b>External Borrowing Requirement</b>	-	-	<b>102.938</b>	<b>180.434</b>

5.8 Based on current projections, the Council may need to borrow a further £180M over the next 2 years, which is a combination of planned capital investment (to be funded from borrowing), maturing loans and use of reserves. A breakdown of which is provided below:

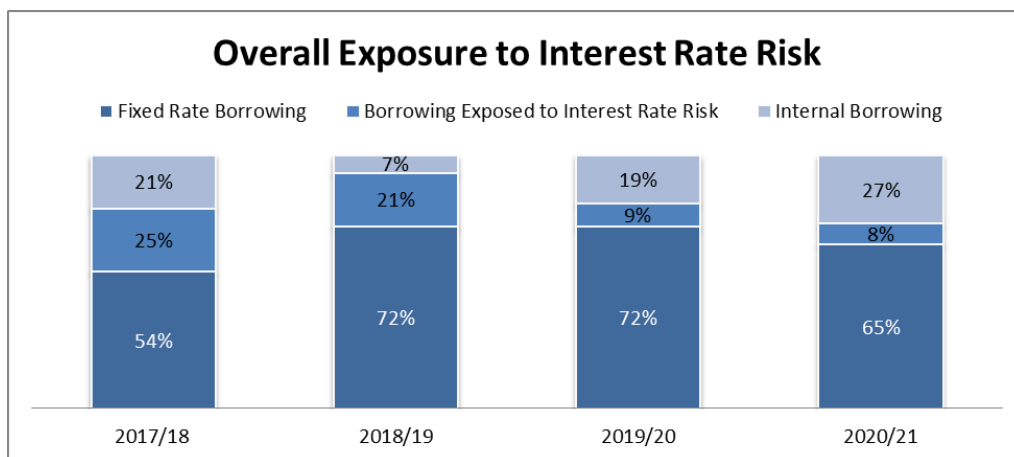
	Estimate (£M)
Planned Capital Investment (Net of Amounts Set Aside to Repay Debt)	98.986
Maturing Loans	150.637
Use of Reserves	110.811
Loans Secured In Year / Yet to be Drawn Down	(180.000)
<b>External Borrowing Requirement</b>	<b>180.434</b>

5.9 This table excludes loans with an uncertain maturity date (for instance the Council's LOBOs) which amount to £59M. If interest rates were to increase suddenly, replacing this debt would come at an additional cost, although the likelihood of these loans being recalled is considered to be fairly low.

5.10 The chart below shows the Council’s projected interest rate risk exposure between 2017/18 and 2020/21, assessed against its variable rate PWLB loans, temporary borrowing and LOBOs. This is already within the target set of 25% and is expected to reduce further in 2019/20 as the Council’s variable rate PWLB loans mature:



5.11 The chart below shows the Council’s projected interest rate risk exposure including any internal borrowing. This is currently within the target set of 35% however is expected to increase from 2019/20 in line with the Council’s future financing requirement and maturing loans:



5.12 The Council’s Borrowing Strategy is based on de-risking the Council’s position in relation to interest rate risk. In order to continue this approach, the Council’s 2019/20 Borrowing Strategy has lowered the targets for the above two indicators to the following:-

- Borrowing exposed to interest rate risk <15%
- Overall exposure to interest rate risk <30%

5.14 The Council's borrowing strategy considers several options to address its risk exposure including the following:

- **Fixed-rate borrowing from the PWLB** - whilst rates are still relatively low this continues to be a suitable option for the Council to consider. The Council has borrowed £140M from the PWLB during the year to date at an average rate of 2.60%.
- **Further deferred loans** - these allow the Council to borrow at a fixed rate - typically 0.15-0.20% above PWLB - and draw down the cash up to 4 years in advance, thus protecting the Council from any sudden interest rate rises whilst reducing cost of carry and counterparty risk. The Council has secured £40M to date and will continue to work with its advisors in order to identify any other potential lenders.
- **Loans from other local authorities** - the Council could look to replace some maturing debt with longer-term loans from other local authorities, which would help to spread refinancing risk.

5.15 Other options being considered in support of the borrowing strategy include:

- **LOBO refinancing** - Officers have recently taken an opportunity to refinance one of its LOBOs which has reduced the Council's exposure to interest rate risk whilst resulting in a small annual saving on its capital financing costs. Officers will continue to explore any opportunities to repay / re-negotiate its remaining LOBOs.
- **BSF refinancing** – the Council continues to refinance the Building Schools for the Future PFI programme in conjunction with the Local Education Partnership. This process will create additional savings for the Council as well as key partners which have already been factored into the Council's MTFs. Refinancing has already been completed for phases 1 and 2 and it was envisaged that phase 3 would be complete by the end of this financial year. However the process has been delayed because the LEP do not consider it has been the optimum time to achieve the desired level of savings mainly because of the impact of Brexit negotiations. A revised timeline will be established as soon as the position on Brexit has been clarified.

## 6. Investment Activity

### Highlights:

- *The Council's investments increased by £77M during the quarter, predominantly a result of the borrowing undertaken from the PWLB;*
- *Officers continued to prioritise security and liquidity in line with the approved strategy, however the majority of new investments were short term deposits;*
- *Officers continued to take advantage of the competitive rates offered by other local authorities.*

### Movement on Investments

6.1 As outlined below, the Council's investments increased by £77M during the quarter, predominantly a result of the borrowing undertaken from the PWLB:

Source	Balance on 30/09/2018 (£M)	New Investments (£M)	Redeemed Investments (£M)	Balance on 31/12/2018 (£M)	Net Increase / (Decrease) (£M)
Short Term Investments	68.000	157.500	(66.000)	159.500	91.500
Money Market Funds / Instant Access Accounts	35.500	146.900	(161.900)	20.500	(15.000)
<b>Total Investments</b>	<b>103.500</b>	<b>304.400</b>	<b>(227.900)</b>	<b>180.000</b>	<b>76.500</b>

6.2 Officers continued to prioritise security and liquidity in line with the approved strategy, however the majority of new investments were short term deposits, recognising that the borrowing undertaken from the PWLB will not be expended immediately.

6.3 Officers continued to take advantage of the competitive rates offered by other local authorities, which helps to boost returns whilst preserving the capital invested.

### Future Investment Strategy

6.4 As referred to in section 5, the Council has recently fixed out a large portion of its external borrowing requirement - specifically to de-risk the Glassworks Development - and plans to reduce this requirement further in light of the increasing interest rate volatility. Cash balances are therefore expected to reach £200M before ultimately being spent on planned capital investment.

6.5 The current strategy was unsuitable for managing this scale of investment and therefore on the advice of officers, the Council approved several changes to its counterparty limits in November to ensure that it can securely accommodate increased cash balances going forwards. The Council will continue to invest its funds prudently in line with Government and CIPFA guidance. As such the increase in limits has been restricted to the securest products and institutions.



- 6.6 These changes have also been considered in view of several impending policy / regulatory changes, namely:-

**European Money Market Fund Reform** - this will see the Council's existing (non-government) Money Market Funds convert to a new LVNAV structure (Low Volatility Net Asset Value) by March 2019. The advice officers have received is that the changes will give investors added protection (compared to the existing funds in operation). As such, it is recommended that the organisation continues to invest in LVNAV funds and monitor the performance of these funds on a regular basis.

**IFRS9 Financial Instruments** - introduces a number of accounting changes that will apply to the 2018/19 accounts. As a result any potential losses on investment will need to be recognised in the Council's general fund, however based on the Council's existing portfolio, officers are not expecting the impact to be significant.

## **7. Performance Measurement / Compliance with Prudential and Treasury Limits**

- 7.1 The Council's Capital Financing budget is expected to underspend by around £1.5M in year through postponing borrowing and taking advantage of low cost temporary loans. However, as set out in the body of this report, the Authority is increasingly fixing out its borrowing in light of the anticipated interest rate rises, therefore these savings are one-off in nature.
- 7.2 During the quarter, the Council has operated within the prudential and treasury indicators set out in the agreed strategy and in compliance with its Management Practices (see Appendix 1 for more details).

## **8. Background Papers**

- Treasury Management Strategy and Policy Statement (Cab.7.2.2018/7)

## APPENDIX 1 - PRUDENTIAL AND TREASURY INDICATORS AS AT 31/12/2018

Prudential Indicators	Limit for 2018/19 (£M)	Quarter 3 Actual (£M)	Compliance with Indicator?
Average Debt to Operational Boundary	967.276	881.164	Yes
Maximum Debt to Authorised Limit	997.276	910.663	Yes
Capital Financing Requirement to HRA Debt Cap	301.000	277.096	Yes

Maturity structure of GF borrowing	Lower Limit (%)	Upper Limit (%)	Quarter 3 Actual (£M)	Quarter 3 Actual (%)	Compliance with Indicator?
Under 12 months	0	50	39.492	10	Yes
12 months to 2 years	0	25	36.033	9	Yes
2 years to 5 years	0	25	30.962	7	Yes
5 years to 10 years	0	25	14.075	3	Yes
10 years to 20 years	0	75	10.611	3	Yes
20 years to 30 years	0	75	23.808	6	Yes
30 years to 40 years	0	75	88.180	21	Yes
40 years to 50 years	0	75	171.715	41	Yes

Maturity structure of HRA borrowing	Lower Limit (%)	Upper Limit (%)	Quarter 3 Actual (£M)	Quarter 3 Actual (%)	Compliance with Indicator?
Under 12 months	0	25	31.945	13	Yes
12 months to 2 years	0	25	19.338	8	Yes
2 years to 5 years	0	25	14.564	6	Yes
5 years to 10 years	0	25	18.536	7	Yes
10 years to 20 years	0	75	8.571	3	Yes
20 years to 30 years	0	75	31.712	12	Yes
30 years to 40 years	0	75	104.220	41	Yes
40 years to 50 years	0	75	24.315	10	Yes

Treasury Indicators	Limit for 2018/19 (%)	Quarter 3 Actual (%)	Compliance with Indicator?
<b>GF</b>			
Upper limit of fixed interest rates based on gross debt	90	88	Yes
Upper limit of variable interest rates based on gross debt	25	12	Yes
<b>HRA</b>			
Upper limit of fixed interest rates based on gross debt	100	82	Yes
Upper limit of variable interest rates based on gross debt	25	18	Yes
	Limit for 2018/19 (£M)	Quarter 3 Actual (£M)	Compliance with Indicator?
Upper limit for principal sums invested over 365 days	20.000	-	Yes

## APPENDIX 2 - ECONOMIC COMMENTARY FROM LINK ASSET SERVICES

The Council's treasury advisors, Link Asset Services have provided the following commentary on the economic:

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	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%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

The flow of generally positive economic statistics after the quarter ended 30 June 2018 meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter.

At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008.

Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth.

That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature.

We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

### **Investment and borrowing rates**

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few year;
- Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.