ADUR & WORTHING
COUNCILS

Joint Governance Committee
26 November, 2019
Agenda Item 6

Joint Strategic Committee
3 December, 2019
Agenda Item xx

Key Decision : No
Ward(s) Affected:

MID YEAR REVIEW OF TREASURY MANAGEMENT 2019-20, ADUR DISTRICT COUNCIL AND WORTHING BOROUGH COUNCIL

REPORT BY THE DIRECTOR FOR DIGITAL AND RESOURCES

EXECUTIVE SUMMARY

1. PURPOSE

1.1 This report asks Members to note the Treasury Management mid-year performance for Adur and Worthing Councils at the 30 September 2019, as required by regulations issued under the Local Government Act 2003.

2. RECOMMENDATIONS

2.1 The Joint Governance Committee is recommended to:

i) note this report and refer any comments or suggestions to the Joint Strategic Committee meeting on the 3rd December 2019.

ii) to note the proposed amendment of the Treasury Management Strategy Statement and the Annual Investment Strategy to remove the limitation on investments in Money Market Funds of £5m or 30% of investments for more than a week (see paragraph 6.4).

2.3 The Joint Strategic Committee is recommended to note this report and to recommend to Adur and Worthing Councils the approval of the proposed amendment of the Treasury Management Strategy Statement as set out in paragraph 6.4

3. CONTEXT

3.1 This report summarises the treasury management activities and portfolio for both Adur and Worthing Councils for the half year to 30 September 2019.

3.2 This is one of 3 treasury management reports that are required to be presented during the financial year (see Para. 4.1.3).

3.3 **Capital Strategy**

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities have been required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out our Capital Strategy was approved by the full Councils on 18th July 2019 (Adur) and 23rd July 2019 (Worthing).

3.4 **Treasury Management**

The Councils operate balanced budgets, which broadly means cash raised during the year will meet their cash expenditure. Part of the treasury management operation 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 Councils' capital plans. These capital plans provide a guide to the borrowing need of the Councils, essentially the longer term cash flow planning to ensure the Councils can meet their 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."

3.5 The Councils' Treasury Management Strategy and Annual Investment Strategy place the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Councils' priorities set out in Platforms for our Places.

4. ISSUES FOR CONSIDERATION

4.1 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 Councils' treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Councils will seek to achieve those policies and objectives.

3. Receipt by the full Councils 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 Councils 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 Councils of the role of scrutiny of treasury management strategy and policies to a specific named body. For these Councils the delegated bodies are the Joint Governance Committee and the Joint Strategic Committee.

4.2 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 Councils' capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Councils' investment portfolios for 2019/20;
- A review of the Councils' borrowing strategy for 2019/20;
- A review of any debt rescheduling undertaken during 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

5. THE ECONOMY AND INTEREST RATES

The following commentary has been supplied by ***Link Asset Services Ltd****, the professional consultants for the Councils' shared treasury management services provider. The context is significant as it describes the backdrop against which treasury management activity has been undertaken during the year.*

5.1 Economics update

5.1.1 **UK.** This 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. However, in September, his proroguing of Parliament was overturned by the Supreme Court and Parliament carried a bill to delay Brexit until 31 January 2020 if there is no deal by 31 October. MPs also voted down holding a general election before 31 October, though the date has now been set for the 12th December 2019. 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 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.

5.1.2 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.

5.1.3 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 re-emphasised 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.

5.1.4 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.

5.1.5 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 take action 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.

5.1.6 In the **political arena**, the general election 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.

5.2 Interest rate forecasts

5.2.1 The Council's treasury advisor, Link Asset Services, has provided the following forecast, which includes the recent increase in margin over gilt yields of 100bps.

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.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That's shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where 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". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

5.2.2 **Bond yields / PWLB rates.** There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

5.2.3 What we saw during the last half year up to 30 September is a near halving of longer term PWLB rates to completely unprecedented historic low levels. (See paragraph 4.2.1 for comments on the increase in margin over gilt yields of 100bps introduced on 9.10.19.) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but due to a correlation between US treasuries and UK gilts, which at various times has been strong but at other times weaker, in the UK. However, forecasting the timing of this and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence.

5.2.4 One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious.

5.2.5 Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt fuelled boom which now makes it harder for economies to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

5.3 Economic risks

5.3.1 The balance of risks to the UK

- 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.

One risk that is both an upside and downside risk is that all central banks are now working in very different economic conditions than before the 2008 financial crash. There has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for eleven years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could, therefore, over or under-do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.**Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new unlikely alliance of two very different parties will endure.

- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor, though more recently concerns have arisen over her health.
- **Other minority EU governments**. Austria, Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Italy, Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

5.3.3 **Upside risks to current forecasts for UK gilt yields and PWLB rates**

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- **The Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

6. TREASURY MANAGEMENT STRATEGY STATEMENT and ANNUAL INVESTMENT STRATEGY UPDATE

6.1 The Treasury Management Strategy Statement (TMSS) for 2019/20 was approved by the Joint Governance Committee on the 22nd January 2019 and by Adur Council on 28th February 2019 and by Worthing Council on 26th February 2019.

6.2 **Changes to Worthing Borough Council's prudential indicators**

6.2.1 On the 23rd April 2019 Worthing Council approved the amendment of the TMSS to increase the Operational Boundary and the Authorised Limit by £25m to accommodate the increase in the commercial property investment fund.

6.2.2 On the 23rd July 2019 Worthing Council approved the amendment of the TMSS to permit a loan of £5m to the Greater Brighton Metropolitan College. The Council agreed to add the College to the approved investments list, to increase the Operational and Authorised Boundaries by £5m and to amend the Minimum Revenue Provision appropriately.

6.2.3 Consequently the limits have been revised as follows:

Worthing Council's amended Operational Boundary & Authorised Limit

Prudential Indicators	Original £m	Revised £m
Authorised Limit	126.0	156.0
Operational Boundary	121.0	151.0

6.3 **Changes to Adur District Council's prudential indicators**

On the 25th April 2019 Adur Council approved the amendment of the TMSS to increase the Operational Boundary and the Authorised Limit by £25m to accommodate the increase in the commercial property investment fund. As a consequence of this change the limits have been amended as follows:

Adur District Council amended Operational Boundary & Authorised Limit

Prudential Indicators	Original £m	Revised £m
Authorised Limit	171.0	196.0
Operational Boundary	167.0	192.0

6.4 **Money Market Fund Limits**

The approved Strategy contains a limit for each Council of £5m or 30% of investments to be placed in Money Market Funds for more than 7 days. The purpose of the limit is to ensure that the Councils do not leave funds in the money markets when they could be invested for longer periods at higher rates with other institutions. However, this limit has been breached on more than one occasion since April due to:

a) the current policy of using some internal borrowing rather than external borrowing, which results in much lower investment balances;

b) the change in payment dates for precepts to West Sussex County Council and the PCC in 2019-20, so that the periods between the dates for receipt of Council Tax and Business Rates and precept dates are sometimes longer than in previous years which means the Council can be left with significant sums for more than 7 days;

c) Money Market Fund rates are often higher than rates available for 3-6 month investments.

The Chief Financial Officer and the Treasury Officers meet weekly to review the cash flows and longer term investments are made wherever possible. It is recommended that the limits on Money Market Fund investments are removed and use of these funds is left to the discretion of the CFO.

7. THE COUNCILS' CAPITAL POSITION (PRUDENTIAL INDICATORS)

This part of the report is structured to update:

- The Councils' 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
- Compliance with the limits in place for borrowing activity

7.1 Prudential Indicator for Capital Expenditure

These tables show the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Adur District Council

	2019/20 Original Estimate	Actual at 30 Sept 2019	2019/20 Revised Estimate
	£m	£m	£m
HRA	8.420	2.483	6.793
Non HRA	3.304	4.472	9.237
Commercial property	18.228	22.028	49.868
Total capital expenditure	29.952	28.983	65.898

The change in the Adur revised capital expenditure estimate is due mainly to:

- HRA: reprofiling of major works contracts due to the increased priority of fire and other health and safety works

- Non HRA: re-profiling of budgets from 2018/19

- the addition of new schemes which have previously been reported to and approved by JSC

- an agreed increase in the commercial property strategy budget

Worthing Borough Council

	2019/20 Original Estimate	Actual at 30 Sept 2019	2019/20 Revised Estimate
	£m	£m	£m
Non HRA	7.749	4.397	17.319
Commercial property	16.835	33.346	50.304
Total capital expenditure	24.584	37.743	67.623

The increase in the Worthing revised capital expenditure estimate is due mainly to:

- reprofiling of budgets from 2018/19

- the addition of new schemes which have previously been reported to and approved by JSC

- an agreed increase in the commercial property strategy budget

7.2 **Changes to the Financing of the Capital Programme**

The tables below draw 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 tables increases the underlying indebtedness of the Councils 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.

Adur District Council

	2019/20 Original Estimate	2019/20 Revised Estimate
	£m	**£m**
Total Capital Expenditure	29.952	65.898
Financed by:		
Capital receipts	1.870	1.951
Capital Grants & contributions	1.491	6.036
Reserves & revenue contributions	4.482	3.447
Total financing	7.843	11.434
Borrowing requirement	22.109	54.464

Worthing Borough Council

	2019/20 Original Estimate	2019/20 Revised Estimate
	£m	**£m**
Total Capital Expenditure	24.584	67.623
Financed by:		
Capital receipts	1.000	0.503
Capital grants & contributions	1.706	2.280
Reserves & revenue contributions	0.210	0.270
Total financing	2.916	3.053
Borrowing requirement	21.668	64.570

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

The tables below show the CFR, which is the underlying external need to incur borrowing for a capital purpose. The tables also show the expected debt position over the period. "Other long term liabilities" includes finance leases, although the Councils do not currently have any finance leases.

Prudential Indicator - Capital Financing Requirement

As explained above, the capital expenditure forecasts have increased and therefore the CFR forecasts have also increased.

Prudential Indicator - the Operational Boundary for external debt

Adur District Council

	2019/20 Original Estimate	Actual at 30 Sept 2019	2019/20 Revised Estimate
	£m	**£m**	**£m**
Prudential Indicator			
Capital Financing Requirement			
CFR - HRA	62.473	60.103	60.630
CFR - Non-HRA	28.279	25.424	28.458
CFR – Commercial activities	74.025	59.717	87.285
Total CFR	164.777	145.244	176.373
Net movement in CFR	20.294	21.994	53.123
	Operational Boundary	**Actual Debt**	**Operational Boundary**
Borrowing	166.000	139.547	191.000
Other long term liabilities	1.000	0.000	1.000
Total debt	167.000	139.547	192.000

Worthing Borough Council

	2019/20 Original Estimate	Actual at 30 Sept 2019	2019/20 Revised Estimate
	£m	**£m**	**£m**
Prudential Indicator			
Capital Financing Requirement			
CFR – Non-HRA	54.916	46.810	57.429
CFR - Commercial activities	61.478	59.846	76.609
Total CFR	116.394	106.656	134.038
Net movement in CFR	19.981	35.982	63.364
	Operational Boundary	**Actual Debt**	**Operational Boundary**
Borrowing re Worthing Homes	10.000	10.000	10.000
Borrowing re GB Met	0.000	0.000	5.000
Other Borrowing	110.000	89.742	135.000
Other long term liabilities	1.000	0.000	1.000
Total debt	121.000	99.742	151.000

7.4 **Limits to Borrowing Activity: CFR and debt**

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 the next two financial years. This allows some flexibility for limited early borrowing for future years. The Councils have approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. The Chief Financial Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

Adur District Council

	2019/20 Original Estimate	Actual at 30 Sept 2019	2019/20 Revised Estimate
	£m	£m	£m
Borrowing	158.735	139.547	167.398
Other long term liabilities	0.000	0.000	0.000
Total debt	158.735	139.547	167.398
CFR	164.777	145.244	176.373

Worthing Borough Council

	2019/20 Original Estimate	Actual at 30 Sept 2019	2019/20 Revised Estimate
	£m	£m	£m
Borrowing	113.280	99.742	124.676
Other long term liabilities	0.000	0.000	0.000
Total debt	113.280	99.742	124.676
CFR	116.394	106.656	134.038

7.5 **Limits to Borrowing Activity: Authorised Limit and debt**

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.

Adur District Council

	2019/20 Original Indicator	Actual debt at 30 Sept 2019	2019/20 Revised Indicator
Authorised Limit for external debt	**£m**	**£m**	**£m**
Borrowing	170.000	139.547	195.000
Other long term liabilities	1.000	0.000	1.000
Total	171.000	139.547	196.000

Worthing Borough Council

	2019/20 Original Indicator	Actual debt at 30 Sept 2019	2019/20 Revised Indicator
Authorised Limit for external debt	**£m**	**£m**	**£m**
Borrowing re Worthing Homes and GB Met	10.000	10.000	15.000
Other Borrowing	115.000	89.742	140.000
Other long term liabilities	1.000	0.000	1.000
Total	126.000	99.742	156.000

8 INVESTMENT PORTFOLIO 2019/20

8.1 Investment performance – Adur District Council

In accordance with the Code, it is the Councils' priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Councils' risk appetite. As shown by forecasts in section 5.2, 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.

Adur District Council held £14.665m of investments for varying durations as at 30 September 2019, (£10.6m at 31 March 2019) and the investment portfolio yield for the first 6 months of the year is 0.94% p.a. against benchmark rates of 0.83% for 12 month deposits and 0.73% for 6 month deposits (supplied by Link Asset Services). This rate excludes the investment in the Local Authorities' Property Fund, which returned 4.2% p.a. over the 6 months. The investment in that fund was increased from £1m to £3m at the end of April

2019. The portfolio is shown below. Adur District Council's budgeted investment return for 2019/20 for both the General Fund and the HRA is £268k and the current forecast will result in an under achievement of about £53k, due to poor interest rates available in the market and the use of internal borrowing to fund capital projects. This strategy results in a saving in the interest payable budget which is currently expected to underspend by £125,000 by the year end.

Investment portfolio – Adur District Council

Counterparty	Issue Date	Maturity Date	Principal	Current Interest Rate	Long Term Rating
Blackrock MMF	n/a	n/a	£10,000	var	AAA
CCLA MMF	n/a	n/a	£360,000	var	AAA
Coventry Building Society	13.06.19	12.06.20	£1,000,000	1.00%	A-
Federated Investments MMF	n/a	n/a	£2,760,000	var	AAA
Goldman Sachs Intern'l Bank	17.04.19	17.04.20	£1,000,000	1.08%	A
Goldman Sachs Intern'l Bank	25.04.19	27.04.20	£1,000,000	1.07%	A
Goldman Sachs Intern'l Bank	08.05.19	08.11.19	£1,000,000	0.95%	A
Handelsbanken	n/a	n/a	£10,000	0.50%	AA
Invesco MMF	n/a	n/a	£500,000	var	AAA
Lloyds Bank (RFB)	15.04.19	15.04.20	£1,000,000	1.25%	A+
Lloyds Bank (RFB)	01.05.19	01.05.20	£1,000,000	1.25%	A+
Lloyds Bank (RFB)	30.08.19	05.03.20	£1,000,000	0.85%	A+
Local Authority Property Fund	25.04.17	n/a	£3,000,000	var	n/a
Santander UK	27.09.19	05.10.20	£1,000,000	1.00%	A+
Boom Credit Union	06.03.15	n/a	£25,000	n/a	n/a
TOTAL			**£14,665,000**		

Investment performance – Worthing Borough Council

Worthing Borough Council held £12.180m of investments for varying durations as at 30 September 2019, (£9.8m at 31 March 2019). The investment portfolio yield for the first 6 months of the year is 0.90% p.a. against benchmark rates of 0.83% for 12 month deposits and 0.73% for 6 month deposits. This rate excludes the investment in the Local Authorities' Property Fund, which returned 4.2% p.a. over the 6 months. The investment in that fund was increased from £0.5m to £1.5m at the end of April 2019.

The Council has also made a loan of £10m to Worthing Homes at 0.7% above the rate at which the funds were borrowed; this is treated as capital expenditure rather than a treasury investment.

Worthing's investment portfolio yield is slightly lower than Adur's because Adur has been able to place more fixed term investments due to its higher average balance of funds. Worthing needs to retain more of its cash in short term investments, including Money Market Funds, because it collects a larger amount of Council Tax and Business Rates, most of which is held temporarily. The portfolio is shown below.

Worthing Borough Council's budgeted investment income for 2019/20, excluding for the Worthing Homes loan, is £157k and and the current forecast will result in an under achievement of about £20k, due to poor interest rates available in the market and the use of internal borrowing to fund capital projects. This strategy results in a saving in the interest payable budget which is currently expected to underspend by £141,000 by the year end.

Investment Portfolio - Worthing Borough Council

Counterparty	Issue Date	Maturity Date	Principal	Current Interest Rate	Long Term Rating
CCLA MMF	n/a	n/a	£2,170,000	var	AAA
Coventry Building Society	10.07.19	05.02.20	£1,000,000	0.86%	A-
Federated Investments MMF	n/a	n/a	£2,830,000	var	AAA
Goldman Sachs Intern'l Bank	18.09.19	06.01.20	£1,500,000	0.82%	A
Invesco MMF	n/a	n/a	£130,000	0.50%	AAA
Lloyds Bank (RFB)	08.05.19	08.05.20	£1,000,000	1.25%	A+
Lloyds Bank (RFB)	19.06.19	19.06.20	£1,000,000	1.25%	A+
Lloyds Bank (RFB)	26.06.19	06.01.20	£1,000,000	1.00%	A+
Local Authority Property Fund	27.04.17	n/a	£1,500,000	var	n/a
Boom Credit Union	Various	n/a	£50,000	n/a	n/a
TOTAL			**£12,180,000**		

Investment Performance – Approved Limits

The Head of Financial Services confirms that the only breaches of the approved limits during the first six months of 2019/20 for Adur District Council or Worthing Borough Council within the Annual Investment Strategy were as described in 6.4 above.

8.2 **Investment counterparty criteria**

The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement is meeting the requirements of the Adur and Worthing treasury management function. The Annual Investment Strategy for Worthing was amended by the Council on the 23rd July 2019 to permit a loan of £5m to the Greater Brighton Metropolitan College (see 6.2.2).

9 BORROWING

9.1 The Capital Financing Requirement (CFR) denotes the Councils' underlying need to borrow for capital purposes. If the CFR is positive the Councils may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. For both Adur and Worthing Councils capital expenditure in 2019/20 is funded from grants, capital receipts, contributions, reserves and revenue contributions as well as borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring.

9.2 Adur District Council's revised CFR forecast for 2019/20 is £176.4m. The relevant table in 7.4 shows the Council has borrowings of £139.5m at 30 September 2019.

Worthing Borough Council's revised CFR for 2019/20 is £134.0m. The relevant table in 7.4 shows the Council has borrowings of £99.7m at 30 September 2019.

9.3 Due to the overall financial position and the underlying need to borrow for capital purposes, new external borrowing was undertaken as shown in the tables below. It is anticipated that further borrowing will be undertaken by both Councils during this financial year to fund capital expenditure, including the purchase of properties.

Adur District Council – new loans

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£6m	Fixed interest rate	1.82%	04/04/2037
PWLB	£1m	Fixed interest rate	2.17%	10/06/2059
PWLB	£1m	Fixed interest rate	1.65%	26/06/2029
PWLB (Property purchase)	£8m	Fixed interest rate	1.48%	25/07/2028
PWLB (Property purchase)	£8m	Fixed interest rate	1.88%	01/08/2034
PWLB	£1m	Fixed interest rate	1.88%	16/08/2039
PWLB	£1m	Fixed interest rate	1.74%	05/09/2069

Worthing Borough Council – new loans

Lender	Principal	Type	Interest Rate	Maturity
PWLB (property purchase)	£13m	Fixed interest rate	2.44%	25/04/2059
PWLB	£1m	Fixed interest rate	2.17%	10/06/2059
PWLB	£1m	Fixed interest rate	1.65%	26/06/2029
PWLB	£1m	Fixed interest rate	1.88%	16/08/2039
PWLB	£1m	Fixed interest rate	1.74%	05/09/2069
PWLB (property purchase)	£4m	Fixed interest rate	1.30%	12/09/2028
PWLB (property purchase)	£4m	Fixed interest rate	1.36%	12/09/2029
PWLB (property purchase)	£4m	Fixed interest rate	1.42%	12/09/2030
PWLB (property purchase)	£1.5m	Fixed interest rate	1.48%	12/09/2031
PWLB (property purchase)	£3.53m	Fixed interest rate	1.58%	20/09/2032
PWLB (property purchase)	£3.53m	Fixed interest rate	1.63%	19/09/2033

9.4 **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 which the Councils have 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 has to 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. Representations are going to be made to HM Treasury to suggest that areas of capital expenditure that the Government is keen to see move forward e.g. housing, should not be subject to such a large increase in borrowing.

Whereas the Councils have previously relied on the PWLB as the main source of funding, they now have to fundamentally 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.

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. This Authority may make use of this new source of borrowing as and when appropriate.

10 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 for either Council.

11 OTHER

11.1 **Changes in risk appetite**

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite eg for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports.

11.2 **Member Training**

The treasury advisors for the shared treasury management service, Link Asset Services, provided a training session for Members on the 13th June 2018. The session included reviews of the Councils' Balance Sheets and current debt and investment portfolios, as well an overview of developments in local government treasury management and UK economic data. The format of training for future years is being reviewed.

12. ENGAGEMENT AND COMMUNICATION

12.1 The Adur and Worthing Councils' treasury management team provides treasury services to Mid Sussex District Council through a shared services arrangement (SSA). The SSA is provided under a Service Level Agreement that was renewed from 18th October 2019, and which defines the respective roles of the client and provider authorities for a period of three years.

12.2 Information and advice is supplied throughout the year by Link Asset Services Ltd, the professional consultants for the Councils' shared treasury management service.

13. FINANCIAL IMPLICATIONS

13.1 This report has no quantifiable additional financial implications to those outlined above. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget.

Finance Officer: Sarah Gobey Date 14th November 2019

14. LEGAL IMPLICATIONS

14.1 The presentation of the Half Year Report is required by regulations issued under the Local Government Act 2003 to review the treasury management activities, the actual prudential indicators and the treasury related indicators for 2019/20.

Legal Officer…… Date….

Background Papers

Joint Treasury Management Strategy Statement and Annual Investment Strategy Report 2019/20 to 2021/22 (Adur Council 28 February 2019 and Worthing Council 26 February 2019.

Annual Joint In-House Treasury Management Operations Report 1 April 2018 – 31 March 2019 (Joint Governance Committee, 30 July 2019 and Joint Strategic Committee, 10 September 2019

Link Asset Services Ltd Half Year Report Template 2019/20

Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA)
The Prudential Code for Capital Finance in Local Authorities (CIPFA)

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SUSTAINABILITY & RISK ASSESSMENT

1. ECONOMIC

The treasury management function ensures that the Councils have sufficient liquidity to finance their day to day operations. Borrowing is arranged as required to fund the capital programmes. Available funds are invested according to the specified criteria to ensure security of the funds, liquidity and, after these considerations, to maximise the rate of return.

2. SOCIAL

2.1 Social Value

Matter considered and no issues identified.

2.2 Equality Issues

Matter considered and no issues identified.

2.3 Community Safety Issues (Section 17)

Matter considered and no issues identified.

2.4 Human Rights Issues

Matter considered and no issues identified.

3. ENVIRONMENTAL

Matter considered and no issues identified.

4. GOVERNANCE

4.1 The Councils' Treasury Management Strategy and Annual Investment Strategy places the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Council priorities contained in Platforms for our Places.

4.2 The operation of the treasury management function is as approved by the Councils' Treasury Management Strategy and Annual Investment Strategy 2019/20 - 2021/22, submitted and approved before the commencement of the 2019/20 financial year.

4.3 In the current economic climate the security of investments is paramount, the management of which includes regular monitoring of the credit ratings and other incidental information relating to credit worthiness of the Councils' investment counterparties.