| Public Accounts Select Committee | | | |
|---|---|---|---|
| Report Title | **Treasury Management Mid-year Review 2019/20** | | |
| Key Decision | No | | Item No: 7 |
| Ward | All | | |
| Contributors | **Head of Corporate Resources** | | |
| Class | Part 1 | | 24 September 2019 |

## 1. EXECUTIVE SUMMARY

1.1 The report presents the current economic conditions in which the Council is operating in respect of its investments and borrowing. It then sets out the Council's treasury performance (focused on security, liquidity and return in that order) and forecast capital position as at 30 September 2019. It also provides updates on the arrangements in place and an assessment of the current Treasury Management Strategy as required by the Chartered Institute of Finance and Accountancy (CIPFA) Code of Practice.

1.2 UK economic growth has fallen in the first half of 2019, influenced predominantly by Brexit uncertainty. Economies around the world are also experiencing economic stagnation, with expectations of significant downturns or possibly even recessions in some developed countries. Beyond the impact of Brexit, the outlook for the next two to three years includes a number of potential risks, including:

- The pace and scale of any future changes to the UK base rate;
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows;
- Recapitalisation of European banks and a resurgence of the Eurozone sovereign debt crisis; and
- Volatile or weakening global growth, particularly in the US, China and Japan.

1.3 In terms of performance, the capital expenditure estimate for 2019/20 has increased significantly from £142m to £197m which is in part due to the addition of new, and the variation of existing, capital schemes such as the Hyde Housing residential portfolio acquisition (£45.7m), the Fleet Vehicle Replacement Programme (£7.8m), the Achilles Street Development (£7.3m), and the Schools Minor Works Programme for 2019/19 (£3.2m). HRA capital budgets have been re-phased and so 2019/20 budgets have reduced by approximately £21m.

1.4 It is expected that the increased 2019/20 capital programme budget is to be part financed by an additional £50m of prudential borrowing. This borrowing will result in the short term breach of one of the Council's prudential indicators, the Operational Boundary (being the limit which external debt is not normally expected to exceed) as approved by Council in February 2019. However, a second prudential indicator, the Authorised Limit (being the limit beyond which borrowing is prohibited) grants additional headroom beyond the Operational Boundary for in-year unplanned movement; the additional borrowing will not cause the Council to exceed the Limit approved by Council.

1.5 No difficulties are envisaged for the current or future years in complying with the Code's requirements for prudential borrowing.

1.6 Council investments are managed within the agreed parameters and delivered an annualised average yield for the five months to 31 August of 0.98% (up from 0.70% last year). For the risk profile inherent in the portfolio, this performance exceeds modelled yield and is in line with the wider benchmark group of London Authorities.

1.7 There are no changes proposed to the Treasury Management Strategy at this time, with the next update being part of the Budget report in February 2020.

## 2 PURPOSE OF THE REPORT

2.1 This mid-year review has been prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. It covers the following:

(i) An economic update for the first part of the 2019/20 financial year;

(ii) A review of the Treasury Management Strategy Statement and Annual Investment Strategy;

(iii) The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;

(iv) A review of the Council's investment portfolio for 2019/20;

(v) A review of the Council's borrowing strategy for 2019/20;

(vi) A review of any debt rescheduling undertaken during 2019/20; and

(vii) A review of compliance with Treasury and Prudential Limits for 2019/20.

## 3 RECOMMENDATIONS

3.1 The Committee is asked to note the report, in particular the macroeconomic context, performance of investments to date, updates on capital expenditure and borrowing in line with CIPFA requirements and the prudential indicators, and compliance with the Council's Treasury Management Strategy.

## 4 STRUCTURE

4.1 The remainder of this report is structured as follows:

5. Policy Context
6. Background and Prior Year Outturn
7. Economic Update
8. Treasury Management Strategy Statement and Annual Investment Strategy Update
9. The Council's Capital Position (Prudential Indicators)
10. Investment Portfolio 2019/20
11. Borrowing
12. Debt Rescheduling
13. Other Issues
14. Financial Implications
15. Legal Implications
16. Environmental Implications
17. Human Resources Implications
18. Crime and Disorder Implications
19. Equalities Implications
20. Appendices

## 5 POLICY CONTEXT

5.1 The information set out in the body of this report is consistent with the delivery of the Council's corporate priorities identified within the Corporate Strategy 2018-2022, namely:

- **Open Lewisham** – Lewisham is a welcoming place of safety for all where we celebrate the diversity that strengthens us.
- **Tackling the housing crisis** – Everyone has a decent home that is secure and affordable.
- **Giving children and young people the best start in life** – Every child has access to an outstanding and inspiriting education and is given the support they need to keep them safe, well and able to achieve their full potential.

- **Building an inclusive local economy** – Everyone can access high quality job opportunities, with decent pay and security in our thriving and inclusive local economy.
- **Delivering and defending: health, social care and support** – Ensuring everyone receives the health, mental health, social care and support services they need.
- **Making Lewisham greener** – Everyone enjoys our green spaces and benefits from a healthy environment as we work to protect and improve our local environment.
- **Building safer communities** – Every resident feels safe and secure living here as we work together towards a borough free from the fear of crime.

5.2 The report also adheres to the Council's core values, particularly in putting service to the public first and ensuring an open, honest and fair approach in outlining the Council's treasury performance, including the steps taken to deliver the capital programme and so deliver on the priorities identified above.

## 6 BACKGROUND AND PRIOR YEAR OUTURN

**Background**

6.1 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 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.

6.2 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.

6.3 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."

6.4 The Council complies with the 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 the Public Accounts Select Committee.

**Capital Strategy**

6.5 In December 2017 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 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.

6.6 The 2019/20 Capital Strategy was approved by Council on 27 February 2019.

**2018/19 Treasury Management Outturn**

6.7 The overall treasury management portfolio as at 31 March 2019 is set out in the table below:

| Treasury Management Outturn 2018/19 | Outstanding at 31 March 2019 | Average Coupon Rate | Average Remaining Duration | Outstanding at 31 March 2018 |
|---|---|---|---|---|
| | £m | % | Years | £m |
| **Fixed Rate Borrowing** | | | | |
| Public Works Loan Board | 96.7 | 5.2 | 21.3 | 88.7 |

| Treasury Management Outturn 2018/19 | Outstanding at 31 March 2019 | Average Coupon Rate | Average Remaining Duration | Outstanding at 31 March 2018 |
|---|---|---|---|---|
| | £m | % | Years | £m |
| Market Loans | 82.5 | 4.3 | 35.0 | 92.5 |
| ***Sub-total – Fixed Rate Borrowing*** | ***179.2*** | ***4.8*** | ***28.2*** | ***181.2*** |
| **Variable Rate Borrowing** | | | | |
| Public Works Loan Board | 0.0 | 0.0 | 0.0 | 0.0 |
| Market Loans | 8.0 | 2.2 | 39.3 | 38.2 |
| ***Sub-total – Variable Rate Borrowing*** | ***38.0*** | ***2.2*** | ***39.3*** | ***38.2*** |
| **Total Debt** | **217.2** | **3.5** | **33.8** | **219.4** |
| **Investments** | | | | |
| Money Markets | 82.4 | 0.7 | N/A | 100.9 |
| Fixed Term Deposits | 260.0 | 0.9 | 163 days | 230.0 |
| Notice Deposits | 80.0 | 0.9 | N/A | 80.0 |
| **Total Investments** | **422.4** | **0.8** | **163 days** | **410.9** |

6.8 The net borrowing requirement for 2018/19 was £4.4m, this being £5.0m lower than the net borrowing requirement of £9.4m for 2017/18 as set out in the table below:

| Net Borrowing Requirement | 2018/19 | 2017/18 |
|---|---|---|
| | £m | £m |
| Capital Investment | 38.1 | 57.2 |
| Capital Grants | (9.7) | (18.5) |
| Capital Receipts | (5.2) | (18.8) |
| Revenue | (10.8) | (5.0) |
| ***Net position*** | ***12.4*** | ***14.9*** |
| MRP | (5.8) | (5.5) |
| Maturing Debt | (2.2) | 0.0 |
| **Net Borrowing Requirement** | **4.4** | **9.4** |

6.9 In previous years the Council has financed its net borrowing requirement from temporary cash balances it holds. As at 31 March 2019, this internal borrowing was estimated to be £ 41.4m, which is the difference between the Capital Financing Requirement (CFR) and the Council’s actual borrowing.

| Debt and CFR Movement | 2018/19 | 2017/18 |
|---|---|---|
| | £m | £m |
| Capital Financing Requirement * | 258.6 | 252.0 |
| External Debt** | (217.2) | (219.4) |
| ***Difference – internal borrowing*** | ***41.4*** | ***32.6*** |

* Excluding other long term liabilities

**Excluding Fair Value adjustments

## 7 ECONOMIC UPDATE

7.1 The economic update is provided by our treasury advisors Link Asset Services and is at Appendix 4.

**Interest Rate Forecasts**

7.2 The Council's treasury advisor, Link Asset Services, has provided the following interest rate forecast up to 31 March 2022:

| | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate | 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 | 1.30% | 1.50% | 1.60% | 1.70% | 1.70% | 1.80% | 1.90% | 2.00% | 2.00% | 2.10% |
| 10yr PWLB Rate | 1.60% | 1.80% | 1.90% | 2.00% | 2.00% | 2.10% | 2.20% | 2.30% | 2.30% | 2.40% |
| 25yr PWLB Rate | 2.30% | 2.40% | 2.50% | 2.60% | 2.70% | 2.70% | 2.80% | 2.90% | 3.00% | 3.00% |
| 50yr PWLB Rate | 2.20% | 2.30% | 2.40% | 2.50% | 2.60% | 2.60% | 2.70% | 2.80% | 2.90% | 2.90% |

7.3 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 last meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. 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.

7.4 The above forecasts have been based on an assumption that there is some agreement (not a no-deal) on Brexit. Given the current level of uncertainties, this is a significant assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

7.5 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 outlook.  The balance of risks to increases in the Bank Rate and shorter term PWLB rates are currently a little below those to the downside.

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

- Brexit – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- Bank of England monetary policy takes action too quickly, or too far, over the next three years to raise the Bank Rate, causing UK economic growth, and increases in inflation, to be weaker than currently anticipated;
- A resurgence of the Eurozone sovereign debt crisis;
- Weak growth or recession in the UK's main trading partners - the EU and US;
- Weak capitalisation of some European banks, particularly Italian banks;
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.

7.7 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, include:

- 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 the 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 the Bank Rate faster than expected.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

## 8 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

8.1 The Treasury Management Strategy Statement (TMSS) for 2019/20 was approved by Council on 27 February 2019.

8.2 No changes to the current treasury strategy are proposed at the current time.

## 9 THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

9.1 This section of the report is structured to update on:

a) The Council’s capital expenditure plans;

b) How these plans are being financed;

c) The impact of any changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and

d) Compliance with the limits in place for borrowing activity.

**Prudential Indicator for Capital Expenditure**

9.2 This table below shows the original estimates for capital expenditure in 2019/20 and the changes since the capital programme was agreed by Council in the Budget.

| Capital Expenditure | Original Feb 19 £m | Revised Sep 19 £m | Change £m | Change % |
|---|---|---|---|---|
| ***General Fund*** | | | | |
| Smarter Working Programme | 0.9 | 2.3 | 1.4 | 156% |
| Schools – Pupil Places and Other Capital Works | 12.4 | 17.0 | 4.6 | 37% |
| Highways, Footways and Bridges | 3.5 | 8.6 | 5.1 | 146% |
| Regeneration Schemes | 13.5 | 70.1 | 56.6 | 419% |
| Lewisham Homes Property Acquisition | 6.0 | 3.0 | (3.0) | (50%) |
| Town Centres and High Street Improvements | 2.1 | 1.5 | (0.6) | (29%) |
| Asset Management Programme | 2.5 | 2.0 | (0.5) | (20%) |
| Fleet Replacement Programme | 0 | 7.8 | 7.8 | - |
| Beckenham Place Park | 2.5 | 2.4 | (0.1) | (4%) |
| CCTV Modernisation Programme | 0 | 0.9 | 0.9 | - |
| Other Schemes | 3.6 | 7.6 | 4.0 | 111% |
| ***Sub total*** | **47.0** | **123.2** | ***76.2*** | ***162%*** |
| ***Housing Revenue Account*** | 95.2 | 74.0 | (21.2) | (22%) |
| **Total** | **142.2** | **197.2** | **55.0** | **39%** |

9.3 The General Fund revised capital expenditure forecast at September 2019 has increased by £76.2m, or 162%, from the position reported in the February Budget Report, with material adjustments to several forecasts throughout the programme.

- The Schools programme forecast has increased by £4.6m overall, £3.2m due to the addition of a 19/20 Schools Minor Works Programme budget.

- The Highways, Footways and Bridges budget has increased by £5.1m which takes into account funds from TFL confirmed post-budget setting in February.
- The £56.6m increased budget against regeneration schemes is principally a result of £7.3m being allocated to the Achilles Street development, and £45.7m in respect of the Hyde acquisition, a portfolio of approximately 120 residential properties acquired from Hyde Housing Association.
- £7.8m has been budgeted for the Fleet Replacement Programme, to finance the replacement of 75 vehicles in order to meet Low Emissions Zones (LEZ) changes in October 2020.
- The HRA reduction of £21.2m reflects a re-phasing of 2019/20 budgets to later years, including a £16.2m reduction in the Housing Matters Programme and a £5.7m reduction in the Decant Homes Programme.

**Financing of the Capital Programme**

9.4 The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure in 2019/20. 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. The table shows an additional £50m of prudential borrowing will be required to meet the 39% increase to the revised 2019/20 capital programme.

| Capital Expenditure Financing | Original Feb 19 £m | Revised Sep 19 £m | Change £m | % |
|---|---|---|---|---|
| Grants and contributions | 38.2 | 41.7 | 3.5 | 9% |
| Capital Receipts | 9.1 | 24.1 | 15.0 | 165% |
| General reserves / revenue | 78.5 | 65.0 | (13.5) | (17%) |
| ***Sub total*** | ***125.8*** | ***130.8*** | ***5.0*** | ***4%*** |
| **Borrowing Required** | 16.4 | 66.4 | 50.0 | 305% |
| **Total** | **142.2** | **197.2** | **55.0** | **39%** |

**Limits to Borrowing Activity**

9.5 The first key control over treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) is only undertaken for capital purposes. 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 Council's policy is not to borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within the approved CFR estimates and will be utilised if it is deemed to be prudent.

9.6 The forecast gross debt position for the end of 2019/20 has changed from that reported in the February Budget due to an expected increase in the external debt balance; this is a combination of approximately £35m of prudential borrowing required to finance the Hyde acquisition, as well as adjustments downwards to previous debt forecasts. With the adjusted CFR, the end result is a mid-year forecast under borrowed position of £36.4m, as shown in the below table.

| | 2018/19 Actual £m | 2019/20 Forecast (as per February 2019 Budget) £m | 2019/20 Forecast (at September 2019) £m |
|---|---|---|---|
| External Debt at 1 April | 219.4 | 217.2 | 217.2 |
| Change in External Debt | (2.2) | 34.3 | 70.2 |
| Other Long-Term Liabilities | 228.2 | 247.4 | 242.7 |
| **Gross Debt at 31 March** | **445.4** | **498.9** | **530.1** |
| **Capital Financing Requirement at 31 March** | **487.2** | **525.4** | **556.5** |
| **Borrowing – Over / (Under)** | **(41.8)** | **(26.5)** | **(26.4)** |

9.7 The CFR forecast for 2019/20, which is the underlying external need to incur borrowing for a capital purpose, has increased since it was reported in February's Budget. This largely reflects the increase in the underlying prudential borrowing figures. The final actuals for 2019/20, as well as forecasts for 2020/21 to 2022/23, will be presented with the 2020/21 Treasury Management Strategy in February 2020.

9.8 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 includes on balance sheet PFI schemes and finance leases as well as external borrowing, and is the expected maximum borrowing need with some headroom for unexpected movements. It is also a statutory limit determined under section 3 (1) of the Local Government Act 2003. The level for 2019/20 was originally forecast at £554.9m and agreed by Council as part of the Treasury Management Strategy in February 2019.

9.9 The table below shows the updated Operational Boundary forecast for 2019/20 as at September 2019, that is the limit which external debt is not normally expected to exceed, and how this compares to the approved 2019/20 Authorised Limit. Mid-year forecasts indicate that the approved 2019/20 Operational Boundary will be exceeded by £31.2, although the built-in provision for unknown movement means that the Authorised Limit of £554.9, approved by Council in February 2019, will not be breached and, as such, no request is made to increase the Limit.

| | 2018/19 Actual £m | 2019/20 (approved by Council in February 2019) £m | 2019/20 Forecast (at September 2019) £m |
|---|---|---|---|
| Maximum External Debt at 31 March | 217.2 | 251.5 | 287.4 |
| Other Long-Term Liabilities | 228.2 | 247.4 | 242.7 |
| **Operational Boundary for the Year** | **445.4** | **498.9** | **530.1** |
| Provision for Non Receipt of Expected Income | 56.0 | 56.0 | 56.0 |
| **Authorised Limit for Year** | **501.4** | **554.9** | **586.1** |

9.10 The Acting Chief Finance Officer reports that although no difficulties are envisaged for the current or future years in complying with either of these prudential indicators, officers will closely monitor adherence to the limits for the remainder of the year. Approval will be sought when necessary to amend the indicators to reflect the authority's developing capital programme.

## 10 INVESTMENT PORTFOLIO 2019/20

10.1 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 set out in Section 7, 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 the 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.

10.2 The Council held £395m of investments as at 31 August 2019 (£422m at 31 March 2019) and the investment portfolio annualised yield for the first five months of the year is 0.98% (compared to 0.70% this time last year).

10.3 The Council is a member of a London treasury benchmarking group (organised by Link Asset Services) along with 12 other London authorities. An extract from the latest available benchmarking report is shown in Appendix 2. This shows that the return on investments as at June 2019 is above the Council's model weighted average rate of return provided by the treasury advisors, which is adjusted for the risks inherent in the portfolio. Portfolio performance is also in line with the overall benchmarking group, as well as a wider group of 21 London boroughs.

10.4 A full list of investments held as at 31 August 2019 is shown below:

| Counterparty | Duration (Days) | Principal £m | Interest Rate | Interest £k |
|---|---|---|---|---|
| National Westminster Bank PLC (RFB) | 365 | 15.000 | 1.050% | 157,500 |
| Credit Agricole Corporate and Investment Bank | 184 | 10.000 | 0.920% | 46,378 |
| Close Brothers Ltd | 182 | 5.000 | 1.100% | 27,726 |
| Close Brothers Ltd | 188 | 5.000 | 1.150% | 29,616 |
| Landesbank Hessen-Thueringen Girozentrale (Helaba) | 364 | 10.000 | 1.110% | 110,696 |
| Landesbank Hessen-Thueringen Girozentrale (Helaba) | 365 | 5.000 | 1.110% | 55,500 |
| Toronto-Dominion Bank | 365 | 5.000 | 1.030% | 51,500 |
| Sumitomo Mitsui Banking Corporation Europe Ltd | 92 | 10.000 | 0.790% | 19,912 |
| DBS Bank Ltd | 182 | 5.000 | 0.940% | 23,564 |
| DBS Bank Ltd | 92 | 5.000 | 0.790% | 9,956 |
| Sumitomo Mitsui Banking Corporation Europe Ltd | 152 | 10.000 | 0.820% | 34,373 |
| OP Corporate Bank plc | 185 | 5.000 | 0.870% | 22,167 |
| Standard Chartered Bank | 91 | 10.000 | 0.800% | 20,164 |
| Coventry Building Society | 182 | 10.000 | 0.900% | 45,123 |
| DBS Bank Ltd | 367 | 15.000 | 1.150% | 173,445 |
| Coventry Building Society | 182 | 10.000 | 0.880% | 43,879 |
| Cooperatieve Rabobank U.A. | 365 | 15.000 | 1.150% | 172,500 |
| Landesbank Hessen-Thueringen Girozentrale (Helaba) | 364 | 5.000 | 1.150% | 57,342 |
| Landesbank Hessen-Thueringen Girozentrale (Helaba) | 364 | 5.000 | 1.100% | 54,849 |
| Australia and New Zealand Banking Group Ltd. | 364 | 25.000 | 1.160% | 289,205 |
| Lloyds Bank Plc (RFB) | 345 | 5.000 | 1.250% | 59,075 |
| OP Corporate Bank plc | 273 | 10.000 | 0.960% | 72,066 |
| National Westminster Bank PLC (RFB) | 365 | 5.000 | 1.120% | 56,000 |
| OP Corporate Bank Plc | 363 | 10.000 | 1.050% | 104,425 |
| Bank of Scotland PLC (RFB) | 368 | 5.000 | 1.250% | 63,014 |
| National Westminster Bank PLC (RFB) | 365 | 10.000 | 0.880% | 88,000 |

10.5 In addition to the fixed rate investments above the Council also holds funds in same-day access money market funds, and notice accounts. A list of these investments held as at 31 August 2019 is shown below:

**Money Market Funds**

| Counterparty | Principal £m | Average Interest Rate |
|---|---|---|
| Aberdeen Standard | 30.000 | 0.730% |
| Insight | 4.916 | 0.700% |
| Federated | 30.000 | 0.740% |

**Notice Accounts**

| Counterparty | Principal £m | Interest Rate |
|---|---|---|
| Santander UK Plc (180 Day Notice) | 20.000 | 0.950% |
| Lloyds Bank Plc (175 Day Notice) | 20.000 | 1.130% |
| Bank of Scotland Plc (175 Day Notice) | 20.000 | 1.130% |
| Barclays Bank Plc (95 Day Notice) | 20.000 | 1.000% |
| Goldman Sachs International Bank (95 Day Notice) | 20.000 | 0.950% |

10.6 The Acting Chief Finance Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first five months of 2019/20.

**Investment Counterparty Criteria**

10.7 The current investment counterparty criteria approved in the TMSS is meeting the requirements of the treasury management function.

## 11 BORROWING

11.1 The Council's latest forecast capital financing requirement (CFR) for 2019/20 is £556.5m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing).

11.2 The balance of external and internal borrowing is generally driven by market conditions. As at 31 August 2019, the Council has external borrowings of £217m and has utilised approximately £24m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

11.3 It is anticipated that further borrowing, most likely external borrowing, will be undertaken during this financial year to meet the demands of the updated capital programme, and which will require ongoing monitoring to ensure adherence to prudential indicators.

## 12 DEBT RESCHEDULING

12.1 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.

## 13 OTHER ISSUES

**Brexit Planning**

13.1 In light of the ongoing uncertainty around the outcome of Brexit, and following the advice of the Council's treasury advisors and internal working groups, officers have considered the risks to the current Treasury Management strategy and any mitigating action that needs to be taken.

13.2 The general advice from advisors is not to dramatically change strategy, and to continue to apply the principles of security, liquidity and yield in all investment decisions.

13.3 The markets have already built in the expectation of a Brexit of some kind taking place at the end of October 2019, which has seen a reduction in investment rates in the three months leading up to the end of September. Combined with the wider uncertainty of what may happen post-Brexit, officers have considered it prudent to improve short-term liquidity by placing shorter duration investments and increasing balances in money market funds, at the sacrifice of yield if necessary.

13.4 The existing portfolio is not subject to any foreign currency risk, and no investments exceed one year in duration in line with the Treasury Management Strategy.

13.5 Officers will continue to monitor the market and develop formal plans in the lead up to the expected Brexit date, taking reasonable actions as necessary to minimise its impact.

## 14 FINANCIAL IMPLICATIONS

14.1 There are no additional financial implications other than those mentioned in the body of the report.

## 15 LEGAL IMPLICATIONS

15.1 Authorities are required to produce and keep under review for the forthcoming year a range of indicators based on actual figures. These are set out in the report. The CIPFA Treasury Management Code of Practice says that movement may be made between the various indicators during the year by an Authority's Chief Finance Officer as long as the indicators for the total Authorised Limit and the total Operational Boundary for external debt remain unchanged. Any such changes are to be reported to the next meeting of the Council.

15.2 Under Section 5 of the 2003 Act, the prudential indicator for the total Authorised Limit for external debt is deemed to be increased by an amount of any unforeseen payment which becomes due to the Authority within the period to which the limit relates which would include for example additional external funding becoming available but not taken into account by the Authority when determining the Authorised Limit. Where Section 5 of the Act is relied upon to borrow above the Authorised Limit, the Code requires that this fact is reported to the next meeting of the Council.

15.3 Authority is delegated to the Acting Chief Finance Officer to make amendments to the limits on the Council's counterparty list and to undertake Treasury Management in accordance with the CIPFA Treasury Management Code of Practice and the Council's Treasury Policy Statement.

## 16 ENVIRONMENTAL IMPLICATIONS

16.1 There are no specific environmental implications relating to this report.

## 17 HUMAN RESOURCES IMPLICATIONS

17.1 There are no specific human resources implications relating to this report.

## 18 CRIME AND DISORDER IMPLICATIONS

18.1 There are no specific crime and disorder implications relating to this report.

## 19 EQUALITIES IMPLICATIONS

19.1 There are no specific equalities implications relating to this report.

For further information about this report, please contact:

David Austin, Acting Chief Finance Officer on 020 8314 9114.

**APPENDIX 1 - Extract from Credit worthiness Policy**

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

| | Minimum credit criteria / colour band | Max % of total investments/ £ limit per institution | Max. maturity period |
|---|---|---|---|
| DMADF – UK Government | N/A | 100% | 6 months |
| UK Government gilts | UK sovereign rating | £20m | 1 year |
| UK Government Treasury bills | UK sovereign rating | £60m | 6 months |
| Money Market Funds - CNAV | AAA | £30m | Liquid |
| Money Market Funds - LVNAV | AAA | £30m | Liquid |
| Money Market Funds - VNAV | AAA | £30m | Liquid |
| Local authorities | N/A | £10m | 1 year |
| Term deposits with banks and building societies | Yellow*<br>Purple<br>Blue<br>Orange<br>Red<br>Green<br>No Colour | £30m<br>£25m<br>£40m<br>£25m<br>£20m<br>£15m<br>0 | Up to 5 years<br>Up to 2 years<br>Up to 1 year<br>Up to 1 year<br>Up to 6 months<br>Up to 100 days<br>Not for use |
| CDs or corporate bonds with banks and building societies | Blue<br>Orange<br>Red<br>Green<br>No Colour | £40m<br>£25m<br>£20m<br>£15m<br>0 | Up to 1 year<br>Up to 1 year<br>Up to 6 months<br>Up to 100 days<br>Not for use |
| Call accounts and notice accounts | Yellow*<br>Purple<br>Blue<br>Orange<br>Red<br>Green<br>No Colour | £30m<br>£25m<br>£40m<br>£25m<br>£20m<br>£15m<br>0 | Liquid |
| Pooled asset funds | | £50m | At least 5 years |

**for UK Government debt, or its equivalent, Constant Net Asset Value (CNAV) money market funds and collateralised deposits where the collateral is UK Government debt.*

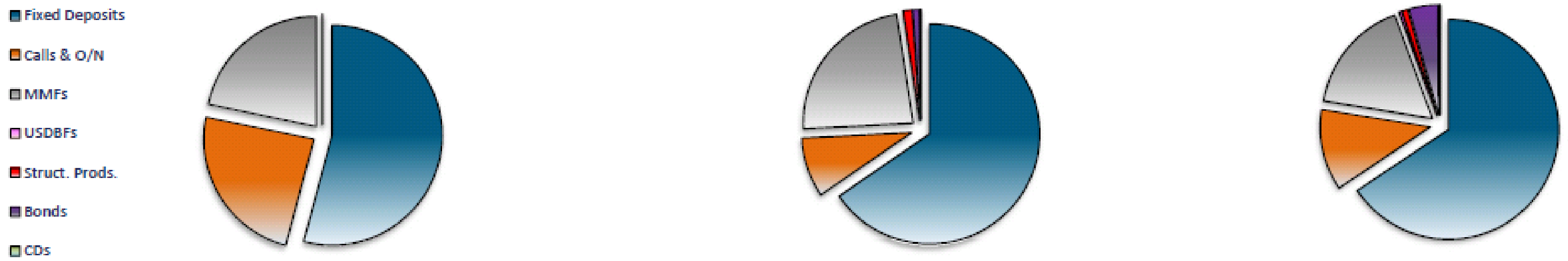
## APPENDIX 2 - Extract of the Benchmarking Data with 12 other London Authorities June 2019

# London Borough Of Lewisham

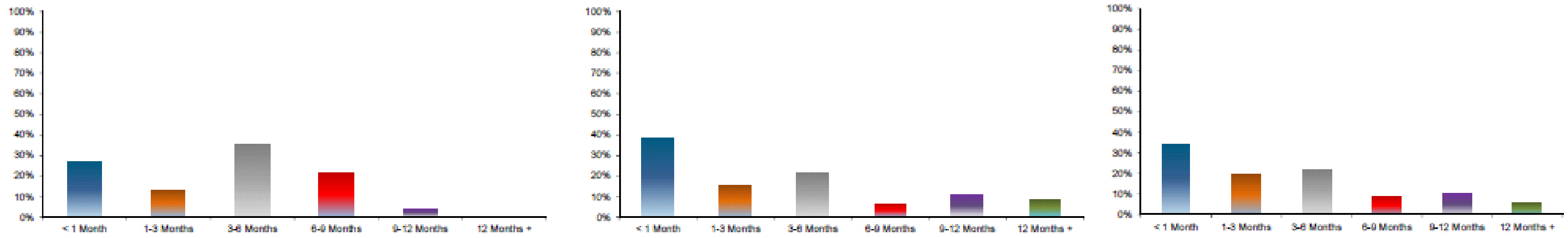
## Summary Sheet

| | London Borough Of Lewisham | Benchmarking Gorup 2 (14) | London (21) |
|---|---|---|---|
| | | Basic Portfolio Characteristics | |
| **WARoR** | 0.98% | 0.98% | 0.98% |
| **WAM** | 120 | 137 | 130 |
| **WATT** | 202 | 266 | 245 |
| **WA Credit Risk** | 3.54 | 2.63 | 2.82 |
| **Model WARoR** | 0.91% | 0.98% | 0.96% |
| **Difference** | 0.07% | 0.01% | 0.02% |
| **Model Band** | 0.86% - 0.96% | 0.92% - 1.03% | 0.91% - 1.01% |
| **Performance** | Above | Inline | Inline |

### Asset Breakdown




### Maturity Profiles



## APPENDIX 2 - Extract of the Benchmarking Data with 12 other London Authorities June 2019

### London Borough Of Lewisham

Peer Comparison

| | London Borough Of Lewisham | Benchmarking Gorup 2 (14) | | London (21) | | Population Average (224) | |
|---|---|---|---|---|---|---|---|
| **Basic Characteristics** | | | | | | | |
| **Principal** | £415,570,000 | £236,061,784 | | £239,213,968 | | £81,960,674 | |
| **WARoR** | 0.98% | 0.98% | | 0.98% | | 0.90% | |
| **WAM** | 120 | 137 | | 130 | | 85 | |
| **WATT** | 202 | 266 | | 245 | | 168 | |
| **WA Credit Risk** | 3.54 | 2.63 | | 2.82 | | 3.00 | |
| **Portfolio Breakdown** | | | | | | | |
| **Fixed Deposits** | 54.14% | 65.41% | 13 | 65.60% | 20 | 47.39% | 184 |
| **Calls & O/N** | 24.06% | 8.75% | 9 | 11.91% | 14 | 22.92% | 182 |
| **MMFs** | 21.79% | 23.44% | 13 | 16.90% | 16 | 23.59% | 160 |
| **USDBFs** | 0.00% | 0.00% | 0 | 0.41% | 1 | 1.68% | 17 |
| **Struct. Prods.** | 0.00% | 1.26% | 2 | 0.84% | 2 | 0.12% | 4 |
| **Bonds** | 0.00% | 0.98% | 2 | 4.23% | 4 | 1.58% | 15 |
| **CDs** | 0.00% | 0.16% | 1 | 0.10% | 1 | 2.72% | 32 |
| **Institution Breakdown** | | | | | | | |
| **Banks** | 73.39% | 43.58% | 13 | 42.89% | 20 | 47.25% | 207 |
| **Building Socs.** | 4.81% | 3.80% | 5 | 7.04% | 9 | 6.72% | 77 |
| **Government** | 0.00% | 28.96% | 10 | 32.49% | 17 | 20.65% | 132 |
| **MMFs** | 21.79% | 23.44% | 13 | 16.90% | 16 | 23.25% | 159 |
| **USDBFs** | 0.00% | 0.00% | 0 | 0.41% | 1 | 1.68% | 17 |
| **MLDBs** | 0.00% | 0.00% | 0 | 0.00% | 0 | 0.00% | 0 |
| **Other** | 0.00% | 0.22% | 1 | 0.27% | 2 | 0.45% | 13 |
| **Domestic/Foreign Exposure** | | | | | | | |
| **Domestic** | 40.91% | 66.21% | 13 | 71.77% | 20 | 69.57% | 215 |
| **Foreign** | 37.30% | 10.23% | 8 | 10.86% | 11 | 5.41% | 58 |
| **MMFs** | 21.79% | 23.55% | 13 | 16.96% | 16 | 23.34% | 159 |
| **USDBFs** | 0.00% | 0.00% | 0 | 0.41% | 1 | 1.69% | 17 |
| **Maturity Structure** | | | | | | | |
| **< 1 Month** | 26.61% | 38.26% | | 33.75% | | 50.93% | |
| **1-3 Months** | 13.23% | 15.12% | | 19.42% | | 13.83% | |
| **3-6 Months** | 34.89% | 21.35% | | 21.64% | | 21.00% | |
| **6-9 Months** | 21.66% | 5.91% | | 8.91% | | 5.99% | |
| **9-12 Months** | 3.61% | 10.85% | | 10.37% | | 6.03% | |
| **12 Months +** | 0.00% | 8.52% | | 5.91% | | 2.23% | |

**APPENDIX 3 - Extract of the Benchmarking Data with 12 other London Authorities June 2019**

## Definitions

| | | |
|---|---|---|
| **WARoR** | Weighted Average Rate of Return | This is the average annualised rate of return weighted by the principal amount in each rate. |
| **WAM** | Weighted Average Time to Maturity | This is the average time, in days, till the portfolio matures, weighted by principal amount. |
| **WATT** | Weighted Average Total Time | This is the average time, in days, that deposits are lent out for, weighted by principal amount. |
| **WA Risk** | Weighted Average Credit Risk Number | Each institution is assigned a colour corresponding to a suggested duration using Link Asset Services' Suggested Credit Methodology 1 = Yellow; 1.25 = Pink 1; 1.5 = Pink 2, 2 = Purple; 3 = Blue; 4 = Orange; 5 = Red; 6 = Green; 7 = No Colour |
| **Model WARoR** | Model Weighted Average Rate of Return | This is the WARoR that the model produces by taking into account the risks inherent in the portfolio. |
| **Difference** | Difference | This is the difference between the actual WARoR and the model WARoR; Actual WARoR minus Model WARoR. |

**APPENDIX 4 – Economic Overview from Link Asset Services**

## UK

1.1 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 31 October, with or without a deal. However, 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, (first week in September), the whole political situation in the UK over Brexit is highly fluid and could change radically by the day. The vote in the Commons on 3 September looks likely to lead to a delay in the date for Brexit to 31 January 2020, but there is also likelihood that there will be an imminent general election. In such circumstances, any interest rate forecasts are subject to material change as the situation evolves.

1.2 At present, if the UK does soon achieve an agreed deal on Brexit, including some additional clarification wording on the Irish border backstop, then it is possible that growth could recover quickly. The MPC would then need to address the issue of whether to raise the Bank Rate when there is very 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 falter and the MPC would be likely to cut the Bank Rate in order to support growth.

1.3 However, with the 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 through tax cuts and / or expenditure on infrastructure projects, to boost the economy. Infrastructure projects generally take a long time to plan, to start up, and to impact the economy; tax cuts would be much quicker in impacting the level of consumption in the economy.

1.4 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. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left the Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity over Brexit.

1.5 As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, (July 2.1%), and is likely to shift only a little upwards over the rest of 2019/20. It does not therefore pose any immediate concern to the MPC at the current time.

1.6 In the political arena, 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.

**USA**

1.7 President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1% (annualised rate) to 2.0% in quarter 2. Quarter 3 is expected to fall further. The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019 it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. Financial markets are, however, expecting another cut in September.

1.8 Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

**Eurozone**

1.9 Growth has been slowing from +1.9% during 2018 to +0.4% q/q (+1.2% y/y) in quarter 1 and then to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 5.2% y/y in June with car production especially being hit. Germany would be particularly vulnerable to a no deal Brexit, depressing exports further, and if President Trump imposes tariffs on EU produced cars. The ECB meeting in July expressed concern as to the weak outlook for growth and how low inflation was despite all the monetary stimulus the bank still has in place. The ECB is therefore expected to take action to cut its main rate of -0.4% further, but only marginally, and to look at the potential for more quantitative easing and/or other instruments of monetary policy to provide further stimulus to economic growth. On the political front, Spain and Italy are in the throes of trying to form coalition governments while the very recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

**Bond Yields**

1.10 The souring of investor confidence has largely contributed to the sharp fall in bond yields on government debt in mid-2019 in the major western economies, as investors have switched out of risky assets - equities, fearing an impending recession, and buying into bonds, so pushing their prices up and correspondingly, pushing yields down. Investors have little confidence that the US China trade war will have a satisfactory outcome in the near future and both sides look as if they are digging in to entrenched positions. However, most domestic US economic indicators are not currently pointing to a recession in the US, only to a slowing of growth.

1.11 Provided the major world economies do avoid recession, then it is likely that there will be some reversal of this flow from equities into bonds and, therefore, that bond yields will recover to a limited extent from recent truly exceptional lows. However, the near-term reality is that we have seen 10 year bond yields fall below 2 year yields in the US; this has historically been a prime indicator of impending recession in the US, though this correlation has been much weaker in the UK. All German bond yields between 2 and 30 years are actually negative while many other EZ countries have bond yields which are also negative, at least in some maturity years.

**Asia**

1.12 Chinese economic growth has been weakening over successive years; despite repeated rounds of central bank stimulus, medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. The trade war with the US does not appear to have had a significant effect on GDP growth as yet as some of the impact of tariffs has been offset by falls in the exchange rate and by transhipping exports through other countries, rather than directly to the US.

1.13 Japan has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

END