


Agenda Item No:	5	
Committee:	Cabinet	
Date:	6 August 2020	
Report Title:	Treasury Management Annual Review 2019/20	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2019/20.

2 Key issues

- Outstanding loans and finance lease liabilities of £8,205,727 and temporary investments of £18,300,000 as at 31 March 2020.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/20) currently attracting excessive premiums it was not financially advantageous for the Council to comply with the Gross borrowing and Capital Financing Prudential Indicator in 2019/20. This is consistent with the strategy approved by Council in February 2019.
- No new borrowing was undertaken and the authorised limit was not breached during 2019/20.
- The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- Amount received from external investments £202,331 (compared with an estimate of £200,000).
- Overall interest rate achieved from investments 0.85% (7 day LIBID un compounded rate for 2019/20 0.53%).
- Although this report is primarily focused on reviewing activity and performance in 2019/20, the impact of COVID-19 has had a significant impact on treasury management activity so far in this current year and will continue to have for the remainder of this year. As a result of lower interest rates and lower investment activity a significant reduction in investment income in 2020/21 of around £115,000 from normal treasury activity is forecast and around £75,000 reduction in proposed Property Funds investment income as access to these funds is delayed. Further details are contained in the Budget Update report being presented to Council at their meeting today.

3 Recommendations

- It is recommended that members note the report.
- It is recommended that Council receive the Treasury Management Annual Report.

Wards Affected	All
Portfolio Holder(s)	Cllr Chris Boden, Leader & Portfolio Holder, Finance
Report Originator(s)	Peter Catchpole, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Peter Catchpole, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper(s)	Treasury Management and Annual Investment Strategy 2019/20

Report:

1 Introduction

- 1.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).
- 1.2 During 2019/20 the minimum reporting requirements were that Council should receive the following reports:
- an annual Treasury Strategy in advance of the year (Council 21/02/2019);
 - a mid-year treasury update report (Corporate Governance 5/11/2019);
 - an Annual Review following the end of the year, describing the activity compared to the strategy (this report).
- 1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.
- 1.4 The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Corporate Governance Committee before they were reported to Council.

2 The Council's Capital Expenditure and Financing

- 2.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:
- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
 - If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2018/19 Actual £000	2019/20 Revised Estimate £000	2019/20 Actual £000
Capital expenditure	2,968	5,507	4,926
Financed In Year	2,371	2,658	3,621
Unfinanced capital expenditure	597	2,849	1,305

3 The Council's Overall Borrowing Need

3.1 The Council's underlying need to borrow to finance capital expenditure is termed the capital financing requirement (CFR).

3.2 **Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20. The table below highlights the Council's gross borrowing position against the CFR (See Appendix A).

3.3

	31 March 2019 Actual £000	31 March 2020 Revised Estimate £000	31 March 2020 Actual £000
CFR opening balance	766	1,212	1,212
Capital expenditure (internal borrowing)	597	2,849	1,305
Less Minimum Revenue Provision	(151)	(243)	(243)
CFR Closing balance	1,212	3,818	2,274
Gross Debt	8,363	8,206	8,206

3.4 The CFR includes finance leases. A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle) for the lease duration (typically 7 years). The annual lease payment is made up of a capital and interest repayment.

3.5 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan.

3.6 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/20) currently attracting excessive premiums (£3.347m at the time of writing this report), if it were prematurely repaid and the fixed rate market loan of £3.3m (31/03/2020), attracting a premium charge on application to prematurely repay, it is not financially advantageous for the Council to fully comply with this prudential indicator. This has been the case since the housing stock transfer in 2007 and has been acknowledged and approved by Council since then. In addition, the Council's external auditors have also acknowledged this situation and have not raised any issues with our strategy.

3.7 The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

3.8 The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

3.9 Neither the authorised limit or operational boundary were breached during 2019/20

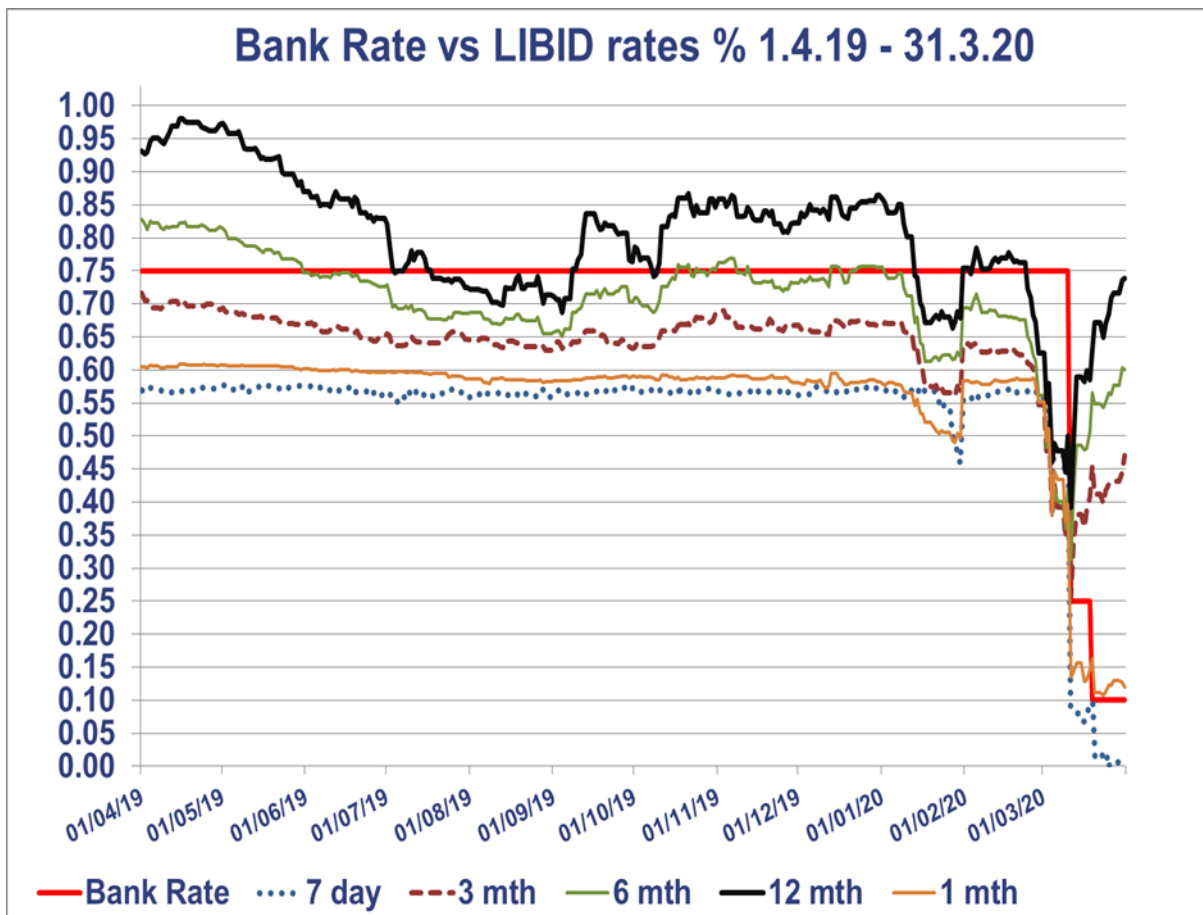
4 Overall Treasury Position as at 31 March 2020

4.1 At the beginning and end of 2019/20 the Council's treasury position was as follows.

	31 March 2020 Principal £000	Rate / Return	Average Life years	31 March 2019 Principal £000	Rate / Return	Average Life years
Fixed rate funding						
• PWLB	4,500	7.29%	10.40 yrs	4,500	7.29%	11.40 yrs
• LOBO	3,300	4.70%	33.96 yrs	3,300	4.70%	34.96 yrs
• Finance Leases	406	3.64%	2.56 yrs	563	3.61%	3.56 yrs
Total debt	8,206			8,363		
Investments	(18,300)	0.85%		(20,200)	0.73%	
Net debt /(Investments)	(10,094)			(11,837)		

4.2 All investments held at 31 March 2020 are fixed term or callable deposits due for repayment within the next twelve months.

5 The Strategy for 2019/20



Investment Strategy

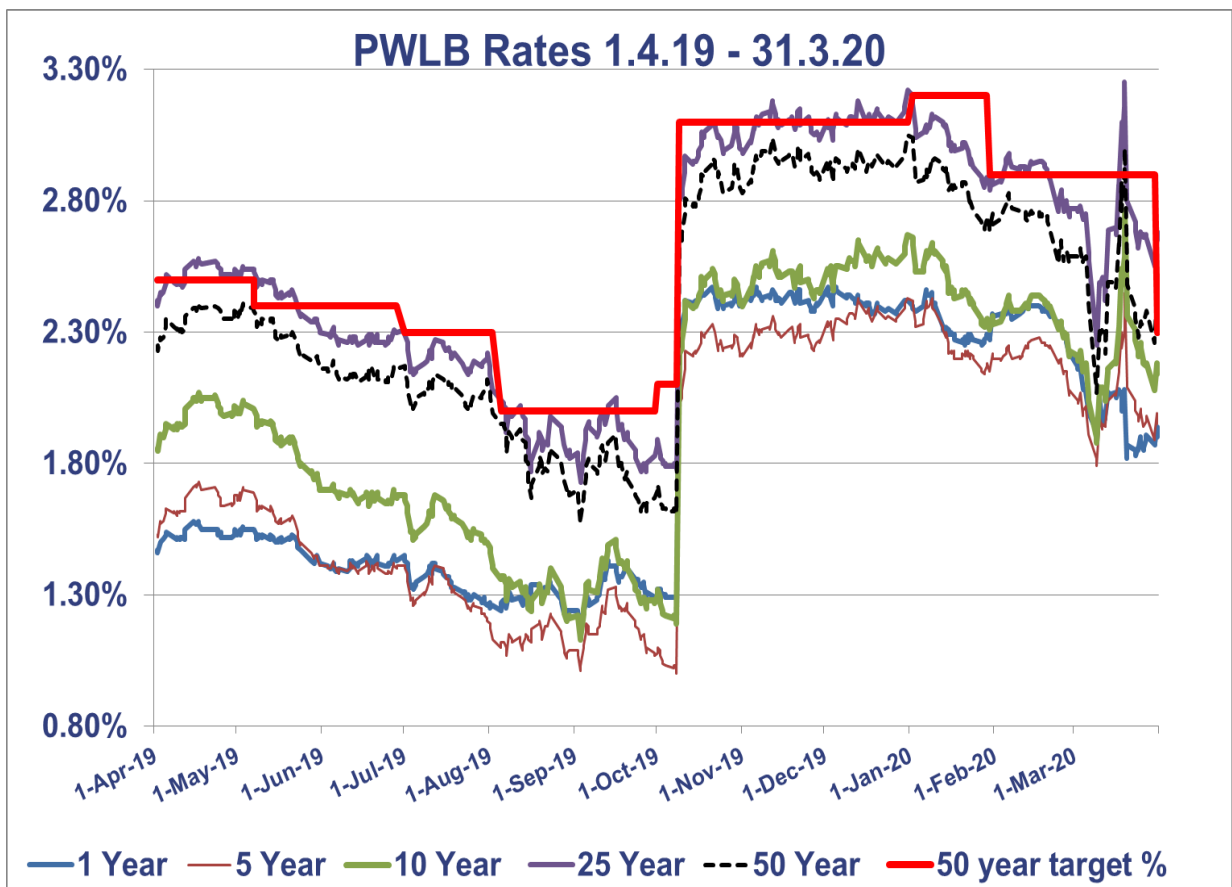
- 5.1 Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would increase, slowly, incrementally to 1.25% by February 2020 but only based on the major assumption that Parliament and the EU could agree a Brexit deal in the first quarter of 2019.
- 5.2 Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets.
- 5.3 While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.
- 5.4 Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

Borrowing Strategy

- 5.5 The Council was 'over borrowed' during 2019/20 as the Council's gross debt exceeded its CFR. This has been the case since 2007 when the Council decided not to repay £7.8m of PWLB debt, following the Council's stock transfer.
- 5.6 Therefore, as opposed to taking on additional loan debt to fund capital expenditure in 2019/20, the Council followed a strategy of using cash, supporting the Council's reserves, balances and cash flow as an interim measure. The strategy was prudent as investment returns were low and to reduce counterparty risk on placing investments
- 5.7 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.
- 5.8 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risk, if it had been felt that there was a significant risk of a much sharper rise in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

5.9 Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%



5.10 PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields.

- 5.11 Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks also started quantitative easing purchases of government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.
- 5.12 However, HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then partially reversed for some forms of borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ends on 31 July. It is clear that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.
- 5.13 There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020-21.

6 Borrowing Outturn

- 6.1 No long term or temporary borrowing was taken during 2019/20. The approach during the year was to use cash balances to finance new capital expenditure, so as to run down cash balances that were earning low investment returns and to minimise counterparty risk incurred on investments.
- 6.2 The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.
- 6.3 No rescheduling was completed during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates and the penalty position which can arise from early repayment of debt, made rescheduling unviable.

7 Investment Outturn

- 7.1 The Council's investment policy is governed by the Ministry of Housing, Communities and Local Government investment guidance, which has been implemented in the annual investment strategy approved by Council on 21 February 2019. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps and bank share price).
- 7.2 The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- 7.3 The Council maintained an average balance of £22.125m of internally managed funds. The internally managed funds earned an average rate of return of 0.85% (£202,331). The comparable performance indicator is the average 7-day LIBID rate, which was 0.53%.

8 Prudential and Treasury Indicators

- 8.1 During 2019/20 the Council complied with its legislative and regulatory requirements with the exception of gross borrowing (see paragraph 3.6 above).

Appendix A - Prudential Indicators

Prudential Indicators	2018/19 Actual £000	2019/20 Revised Estimate £000	2019/20 Actual £000
1 Capital Expenditure	2,968	5,507	4,926
2 Ratio of Financing Costs to Net Revenue Stream (external interest – investment income)	3.66%	4.99%	4.97%
3 Gross Borrowing and the Capital Financing Requirement			
Gross Debt	8,363	8,206	8,206
CFR	1,212	3,818	2,274
Treasury Management Indicators	2018/19 Actual £000	2019/20 Revised Estimate £000	2019/20 Actual £000
4 Authorised Limit for External Debt			
Borrowing	15,000	17,000	15,000
Other Long Term Liabilities	2,000	1,000	1,000
Commercial Activities	0	25,000	0
Total	17,000	43,000	16,000
5 Operational Boundary for External debt			
Borrowing	10,000	12,000	10,000
Other Long Term Liabilities	2,000	1,000	1,000
Commercial Activities	0	25,000	0
Total	12,000	38,000	11,000
6 Actual External debt (as at 31 March)			
Borrowing	7,800	7,800	7,800
Other Long Term Liabilities	563	406	406
Total	8,363	8,206	8,206