Cabinet
09 July 2020

Annual Treasury Management Review 2019/20

Cabinet Member: Councillor Alex White
Responsible Officer: Deputy Chief Executive (S151), Andrew Jarrett

Reason for Report: To provide Members with a review of activities and the prudential treasury indicators on actuals for 2019/20.

Recommendations(s):

1. **That Members note the treasury activities for the year.**
2. **Approve the actual 2019/20 prudential and treasury indicators in this report.**

Relationship to the Corporate Plan: Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

Financial Implications: Good financial management and administration underpins the entire strategy.

Legal Implications: Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

Risk Assessment: The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

Equality Impact Assessment: No equality issues identified for this report.

Impact on Climate Change: No impacts identified for this report.

1. Introduction

This Council is required by 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 CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2019/20 the minimum reporting requirements were that the Full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 27/02/2019)
- a mid-year (minimum) treasury update report (Council 06/11/2019)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.
This 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 Cabinet before they were reported to the Full Council. Member training on treasury management issues was undertaken during 2019 in order to support members' scrutiny role.

2. The Council's Capital Expenditure and Financing

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.

General Fund	2018/19 Actual £000	2019/20 Actual £000
Capital expenditure	3,406	8,983
Financed in year	(901)	(1,941)
Unfinanced capital expenditure	2,505	7,042
HRA		
Capital expenditure	6,030	4,006
Financed in year	(6,030)	(4,006)
Unfinanced capital expenditure	0	0

3. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

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 (2019/20) 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. The Council has complied with this prudential indicator.

	31 March 2019 Actual £000	31 March 2020 Actual £000
CFR General Fund	9,059	15,682
CFR HRA	41,385	40,431
Total CFR	50,577	56,113
Gross borrowing position	41,029	39,916
(Under) / over funding of CFR	(9,548)	(16,197)

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. The table below demonstrates that during 2019/20 the Council has maintained gross borrowing within its authorised limit.

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.

	2019/20 £000
Authorised limit	72,000
Maximum gross borrowing position during the year	41,029
Operational boundary	63,000
Average gross borrowing position	40,473

4. Treasury Position as at 31 March 2020

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

DEBT PORTFOLIO	31 March 2019 Principal £000	31 March 2020 Principal £000
Fixed rate funding:		
-PWLB	40,718	38,937
Total debt	40,718	38,937
CFR*	50,266	55,133
(Under) / over borrowing	(9,548)	(16,197)
Total investments	22,000	20,000
Net debt	18,718	18,937

- Excludes finance leases

The maturity structure of the debt portfolio was as follows:

	31 March 2019 Actual £000	31 March 2020 Actual £000
Under 12 months	1,780	1,833
12 months and within 24 months	1,833	1,870
24 months and within 5 years	5,730	5,836
5 years and within 10 years	10,471	10,778
10 years and within 20 years	20,679	18,620
20 years and within 30 years	224	0

INVESTMENT PORTFOLIO	**Actual 31/03/19 £000**	**Actual 31/03/19 %**	**Actual 31/03/20 £000**	**Actual 31/03/20 %**
Treasury investments				
Banks	13,500	50%	10,000	40%
Local authorities	6,500	24%	9,000	36%
Other Government Organisations	2,000	7%	1,000	4%
Total managed in house*	**22,000**	**81%**	**20,000**	**80%**
Property funds (CCLA)	5,000	19%	5,000	20%
Total managed externally	**5,000**	**19%**	**5,000**	**20%**
TOTAL TREASURY INVESTMENTS	**27,000**	**100%**	**25,000**	**100%**

*See Appendix 1 for a breakdown of internally managed investments held as at 31 March.

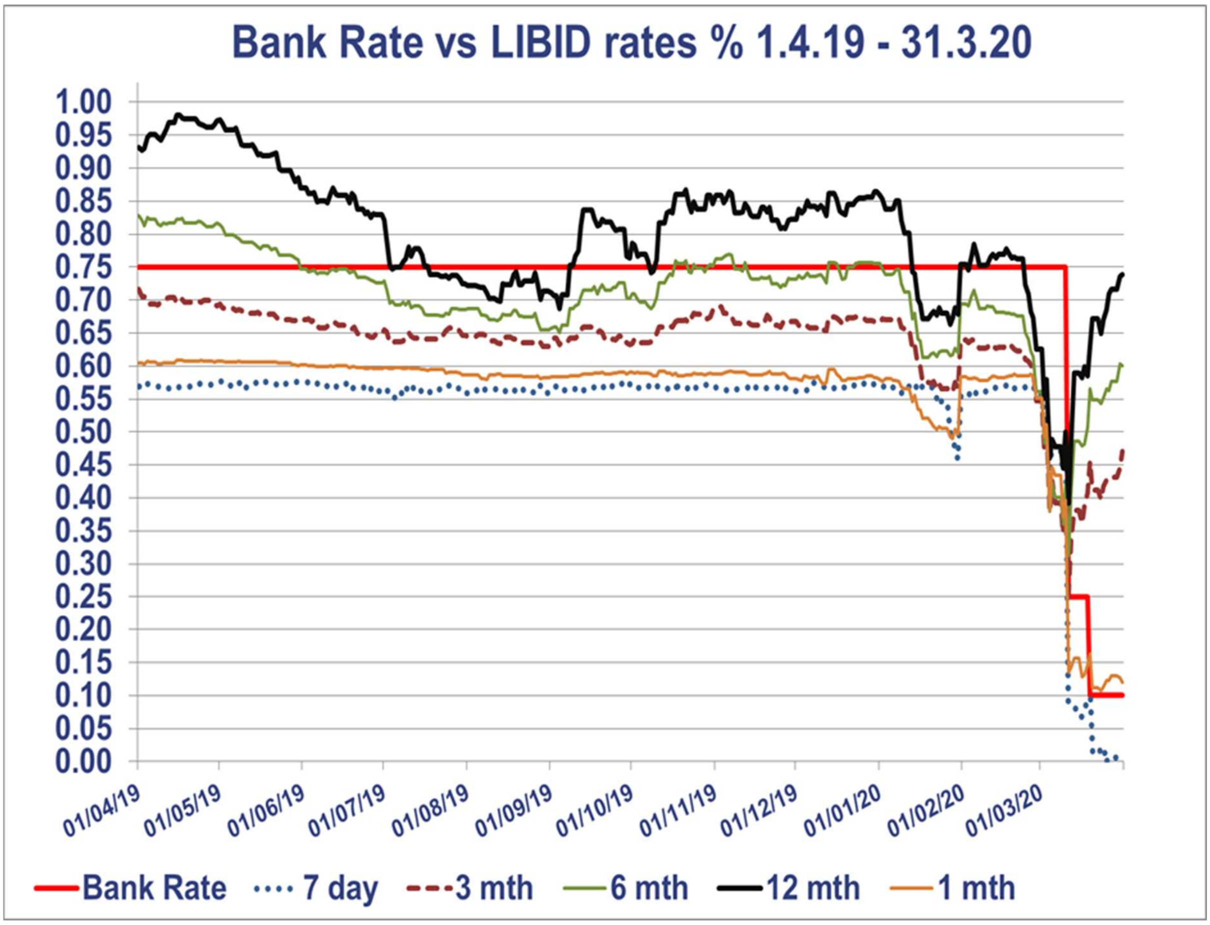
Non Treasury investments				
Subsidiaries (3 Rivers Ltd)	2,613	100%	9,061	100%
TOTAL NON TREASURY INVESTMENTS	**2,613**	**100%**	**9,061**	**100%**

On 25 March 2020, due to the economic impact of the Covid-19 pandemic, CCLA suspended all trading of shares in the property fund. This was done to protect the value of the fund and prevent disadvantage to parties buying or selling shares at unreliable market values. Trading will remain frozen until certainty in market values is re-established, however dividends will continue to be paid on existing shares.

The value shown in the above table for the Council's CCLA investment is the amount paid by the Council on share acquisition. This differs to the carrying amount in the year end accounts of £4,759k (£4,935k in 2018/19) as there is a requirement to carry the investment at fair value. It is expected that the fair value of the fund will recover over the longer term, and so this temporary drop in value is unlikely to be realised as a loss to Council funds.

5. The strategy for 2019/20

5.1 Investment strategy and control of interest rate risk



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 stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020.

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. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

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.

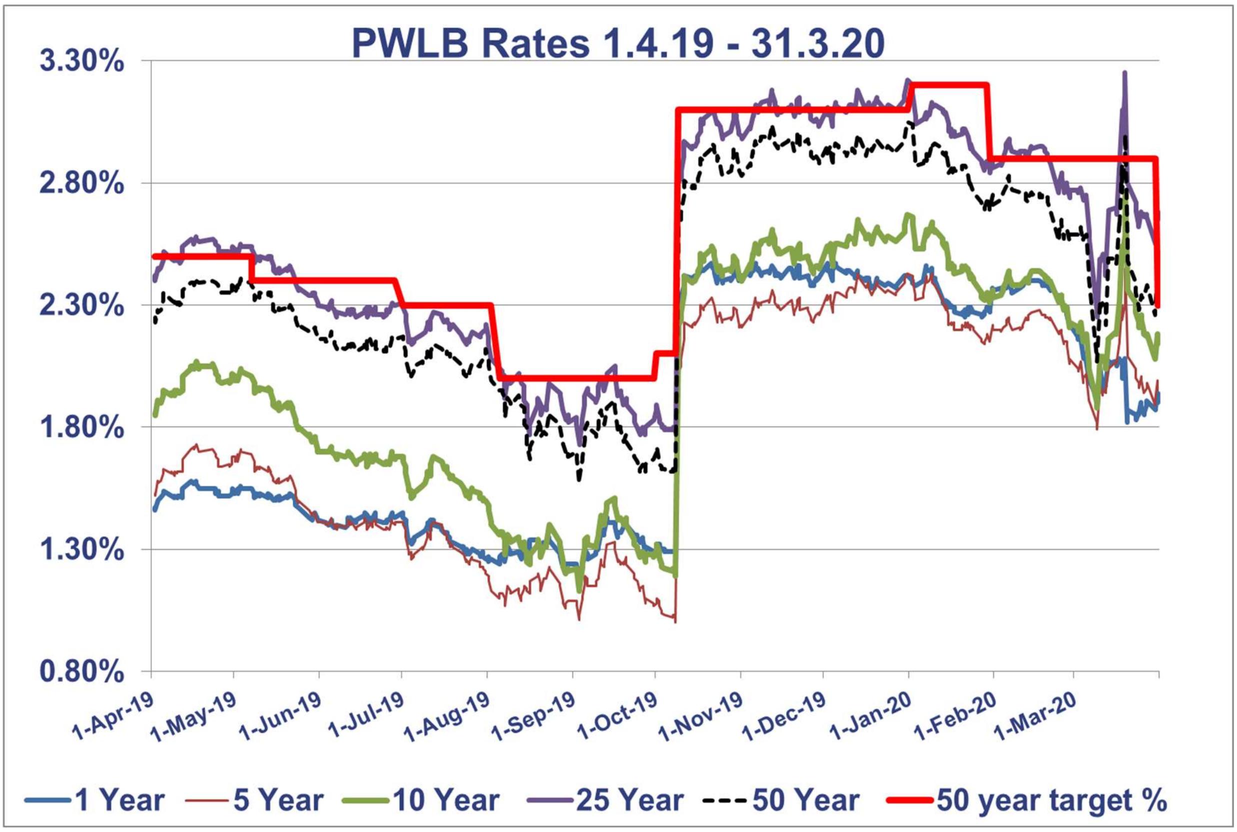
Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and 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.

5.2 Borrowing strategy and control of interest rate risk

During 2019-20, the Council maintained an under-borrowed position. This meant that the capital borrowing need (the Capital Financing Requirement) was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

The policy of avoiding new borrowing by running down spare cash balances, has served us 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.

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.



	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	1.46%	1.52%	1.84%	2.41%	2.24%
31/03/2020	1.90%	1.95%	2.14%	2.65%	2.39%
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.45%	2.76%	3.25%	3.05%
Date	21/10/2019	19/03/2020	19/03/2020	19/03/2020	31/12/2019
Average	1.83%	1.77%	2.00%	2.56%	2.40%

Link Asset Services Interest Rate View 31.3.20								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

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 was due to end on 4 June but has recently been extended to 31 July due to the Covid-19 pandemic. 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.

Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

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

Borrowing
Due to delays in a number of planned capital projects coupled with investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Borrowing in advance of need
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.

Rescheduling
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Investment Outturn

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 27/02/2019. 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 from our treasury advisers (Link Asset Services).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Investments held by the Council
- The Council maintained an average balance of £21m of internally managed funds.
- The internally managed funds earned interest of £238k giving an average rate of return of 0.90%.
- The comparable performance indicator is the 3 month LIBID rate, which was 0.6339%.
- The Council held £5m invested in Churches, Charities and Local Authorities (CCLA) property funds earning dividends of £213k (4.27%) in 2019/20.
- Interest received from 3 Rivers Ltd amounted to £251k in 2019/20.

8. Other Issues

1. IFRS 9 fair value of investments
Following the consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG) on IFRS 9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This came into effect on 1 April 2018 for 2018/19. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

Risk management will need to take account of the 2018/19 Accounting Code of Practice proposals for the valuation of investments. Whilst for many authorities, this may not be a significant issue, key considerations include:

- Expected credit loss model. Whilst this should not be material for vanilla treasury investments such as bank deposits, this is likely to be problematic for some investments such as property funds, loans to third parties or loans to subsidiaries.
- The valuation of investments previously valued under the available for sale category e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar, have been changed to **Fair Value through the Profit and Loss (FVPL).**

2. Non-treasury management investments.

As shown in the table in section 4 part relating to non-treasury investments, the Authority holds a 100% interest in 3 Rivers Development Limited, a private limited company engaged in construction in the Mid Devon area. The Authority advances funds to the Company to facilitate operations with the intention that they are repaid from the proceeds of the sale of the developments.

During the year ended 31 March 2020, £6.446m was loaned to the Company and total loan value at this date was £9.061m. During the year £251k interest was paid to the Authority in respect of these loans.

These loans are subject to overarching management review on a regular basis. This is reflected in the impairments made in both periodic monitoring reports and in the year end financial statements. The year end review, carried out in compliance with IFRS 9 Financial Instruments, led to impairments totalling £790k in respect of one of the project loans and the working capital loan.

3. Counterparty limits

At the end of March 2020 approval was given by the S151 Officer and the Cabinet Member for Finance to exceed the £5m limit on deposits held with the Council's bank, NatWest, for a period of 3 months, in order to administer the Small Business Grants Fund and the Retail, Hospitality and Leisure Business Grants Fund. £22.732m was received from Government on 1st April 2020 in respect of these.

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Appendix 1: Investment Portfolio

Internally managed investments held as at 31 March:

Bank/Building Society/Local Authority/PCC	Term		Fixed Interest Rate %	31/03/19	31/03/20
	From	To		£000	£000
Santander	06/04/2018	05/04/2019	1.01%	2,000	
Barclays	01/08/2018	31/07/2019	0.94%	2,500	
Lloyds	05/04/2018	05/04/2019	0.90%	1,000	
Lloyds	28/03/2019	30/12/2019	1.05%	2,000	
Goldman Sachs	26/04/2018	26/04/2019	1.22%	2,000	
Santander	15/08/2018	15/05/2019	0.93%	1,000	
Goldman Sachs	16/01/2019	16/05/2019	0.91%	1,000	
Eastleigh Borough Council	22/01/2019	22/05/2019	0.82%	1,000	
Salford City Council	10/12/2018	10/06/2019	0.95%	2,000	
Salford City Council	01/10/2018	01/07/2019	0.90%	2,000	
Police & Crime Comm for Northumbria	31/01/2019	04/07/2019	0.95%	2,000	
Goldman Sachs	15/10/2018	15/10/2019	1.22%	2,000	
Stirling Council	11/03/2019	11/06/2019	0.93%	1,500	
Close Brothers	04/09/2019	02/09/2020	1.10%		1,000
Santander	17/09/2019	17/09/2020	0.94%		2,000
Santander	01/10/2019	01/04/2020	0.83%		1,500
Santander	07/10/2019	07/04/2020	0.83%		1,500
Rugby Borough Council	09/10/2019	07/10/2020	0.90%		1,000
Goldman Sachs	29/10/2019	29/04/2020	0.95%		1,000
Goldman Sachs	05/11/2019	05/05/2020	1.00%		1,000
Highlands Council	27/11/2019	25/11/2020	0.92%		1,000
Lloyds	30/12/2019	30/12/2020	1.10%		2,000
Merseyside PCC	02/01/2020	30/04/2020	0.85%		1,000
Nottingham City Council	02/03/2020	17/04/2020	0.80%		2,500
Central Bedfordshire Council	03/03/2020	27/05/2020	0.95%		2,000
Eastleigh Borough Council	13/03/2020	14/04/2020	1.10%		1,500
Cheltenham Borough Council	20/03/2020	20/04/2020	0.95%		1,000
Total				**22,000**	**20,000**