Annual Treasury Management Review 2019/20

1 *Introduction*

1.1 The 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).

1.2 During 2019/20 the minimum reporting requirements were as follows:

- an annual treasury strategy in advance of the year (Council 20 February 2019)
- a mid year treasury update report (Governance & Audit Committee 26 November 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 is 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.

1.4 The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the annual treasury strategy by the Scrutiny Panel before it was reported to the full Council.

1.5 This report summarises:

- Capital financing activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- The overall treasury position;
- The Treasury Management Strategy for 2019/20;
- The economy and interest rates;
- Borrowing activity; and
- Investment activity.

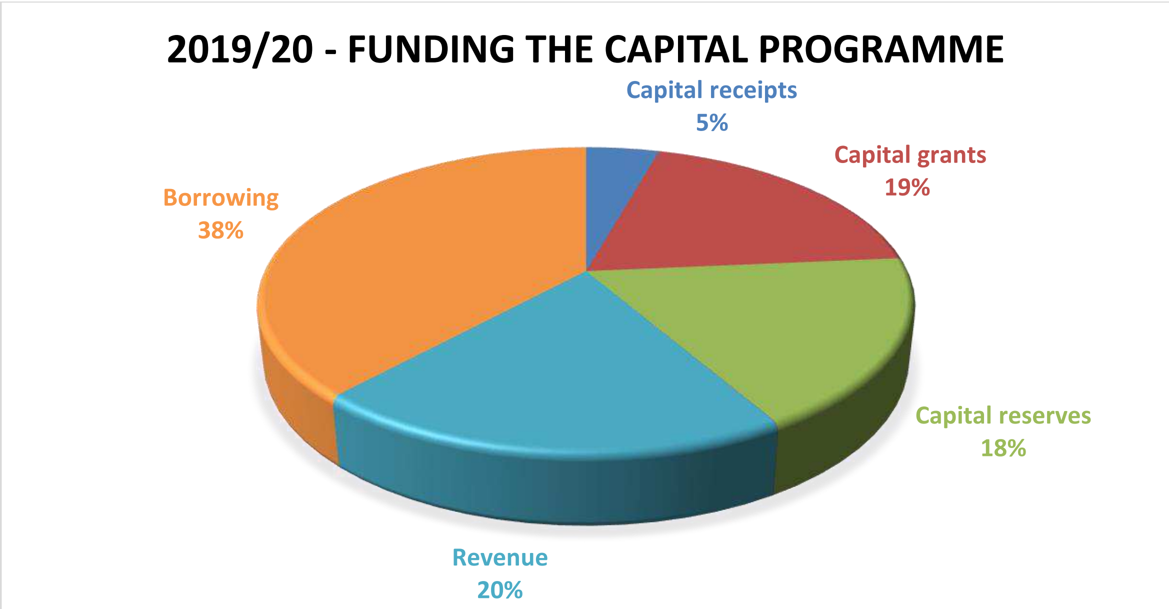
2 *Capital expenditure and financing 2019/20*

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.

2.2 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 Actual £'000
General Fund capital expenditure	14,878	30,594
HRA capital expenditure	10,226	15,648
Total capital expenditure	25,104	46,242
Resourced by:		
· Capital receipts	2,280	2,007
· Capital grants	1,840	8,892
· Capital reserves	2,544	8,369
· Finance Leases	0	11
· Revenue	9,605	9,316
New borrowing requirement	8,835	17,647



3 *The Council's overall borrowing need*

3.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2019/20 new borrowing requirement (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the Capital Programme, the Finance team organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets) or utilising temporary cash resources within the Council.

3.3 The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR. The total CFR can also be reduced by:
- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.4 The Council's 2019/20 MRP Policy (as required by MHCLG Guidance) was approved as part of the Treasury Management Strategy Report on 20 February 2019.

3.5 The Council's CFR for the year is shown below and represents a key prudential indicator. It includes on balance sheet leasing schemes that increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR	**31-Mar-19 Actual £'000**	**31-Mar-20 (1) Original £'000**	**31-Mar-20 (2) Actual £'000**
Opening balance	154,189	165,324	161,680
Add unfinanced capital expenditure	8,835	55,317	17,647
Add on-balance sheet leasing schemes	0	0	11
Write-off of finance lease creditor	(22)	217	(224)
Less MRP/VRP	1,322	1,416	1,504
Closing balance	161,680	220,641	177,610

(1) As per 2019/20 Treasury Management Strategy – February 2019

(2) As per 2019/20 statement of accounts

3.6 Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

3.7 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 borrowing position** does not, except in the short term, exceed the planned limit. The limit is the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31-Mar-19 Actual £'000	31-Mar-20 Original £'000	31-Mar-20 Actual £'000
Gross borrowing position	141,094	165,324	162,444
CFR	154,189	183,566	177,610

3.8 The **Authorised Limit** is 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.

3.9 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.

3.10 The **actual financing costs as a proportion of net revenue stream** indicator identifies the trend in the cost of capital (borrowing and other long-term obligations cost net of investment income) against the net revenue stream.

	2018/19 £'000	2019/20 £'000
Authorised limit	180,252	221,632
Maximum gross borrowing position	141,094	162,444
Operational boundary	159,613	206,849
Average gross borrowing position	141,094	142,108
Financing costs as a proportion of net revenue stream	8.15%	8.48%

4 Treasury position as at 31 March 2020

4.1 The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting (as detailed in the introduction), and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2019/20 the Council's treasury position (excluding finance leases) was as follows:

	31-Mar-19 Principal £'000	Rate/ Return %	31-Mar-20 Principal £'000	Rate/ Return %
Fixed rate funding:				
PWLB	104,594	3.80%	104,594	3.80%
LOBO	5,500	3.63%	5,500	3.63%
Market	9,000	4.28%	9,000	4.28%
Local Authorities / LEP	2,000	1.02%	23,350	1.43%
Stock Issue	20,000	8.79%	20,000	8.79%
Total debt	**141,094**	**4.46%**	**162,444**	**4.41%**
CFR	154,189		177,610	
Over/ (under) borrowing	(13,095)		(15,166)	
Investments - In house	54,212	0.78%	55,610	0.87%
Total investments	**54,212**	**0.78%**	**55,610**	**0.87%**

4.2 The maturity structure of the debt portfolio is shown below. It should be noted that for LOBO loans, the maturity date is deemed to be the next call date. They are therefore all shown as short-term debt:

	Approved Maximum %	31-Mar-19 Actual £'000	%	31-Mar-20 Actual £'000	%
Under 1 year	15.0	5,500	3.9	35,500	21.8
1 - 2 years	15.0	22,000	15.6	3,350	2.1
2 - 5 years	15.0	0	0.0	10,000	6.2
5 - 10 years	15.0	700	0.5	700	0.4
10 - 20 years	30.0	14,300	10.2	21,900	13.5
20 - 30 years	30.0	36,000	25.5	36,000	22.2
30 - 40 years	40.0	35,394	25.1	35,394	21.8
40 - 50 years	40.0	18,200	12.9	10,600	6.5
Over 50 years	10.0	9,000	6.3	9,000	5.5
		141,094	**100.0**	**162,444**	**100.0**

4.3 All of the Council's investments were for a period of less than one year, and there was not any exposure to variable rates of interest.

4.4 The outturn position for the Central Loans and Investment Account (CLIA) is shown below. This shows the outturn position as being a favourable variance of £163k.

CLIA	Budget £'000	Actual £'000	Variance £'000
Total Interest Paid	6,760	6,541	(219)
Less: HRA recharge	(5,884)	(5,639)	245
Total less HRA	**876**	**902**	**26**
Total Investments	(270)	(573)	(303)
Less: Item 8 credit	30	144	114
Total less HRA	**(240)**	**(429)**	**(189)**
Total CLIA	**636**	**473**	**(163)**

4.5 The CLIA comprises the Council's borrowing costs and investment income. It is difficult to predict and can be affected by several factors. The majority of the Council's debt is on fixed rates reflecting the longer-term nature of the borrowing decisions. Investments are generally made for shorter periods, making returns more variable. This mix is generally more beneficial when interest rates are high or increasing. It is important to add that the exposure to interest rate movements is regularly monitored to minimise risks to changes in returns. The reasons that have contributed to the above variances include:

- The variance against interest income is as a result of a higher level of funds than was envisaged being available for investment, and the rates against some investments being greater than the budgeted figure. A proportion of this income was moved to the Housing Revenue Account, based on average HRA balances and investment returns.

5 The strategy for 2019/20

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 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. For the most part this forecast was correct however the impact of the Covid 19 crisis prompted the bank of England to take emergency action to reduces rates, first to 0.25% on the 11 March and then to 0.1% on 19th March 2020. Initially this rate cut had minimal impact to the rates offered by the Councils counter parties however this has subsequently changed in the new year.

5.2 The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, as capital spend increases and capital receipts are either delayed or diminished, the need to borrow increases. In the autumn of 2019, the government announces an immediate hike in PWLB borrowing due to the large amount of borrowing planned by local government. This added a 100 BPS increase the any PWLB borrowing. In March of 2020, a PWLB consultation was launch and a partial reversal of the 100bps increase for HRA investment.

5.3 Towards the end of 2019/20, the Council borrowed £20m on a short-term basis to cover the financing need. Details of the loans can be found in appendix A.

5.4 The investment policy reflected the Council's low appetite for risk, emphasising the priorities of security and liquidity over that of yield. The main features of the policy were that the Council will apply minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties, which also enables diversification and avoidance of concentration risk. Investment decisions also applies the creditworthiness service provided by Link Asset Services, which combines data from credit rating agencies with credit default swaps and sovereign ratings.

5.5 The Council would only use approved counterparties from countries with a minimum credit rating of 'AA-'. The Council will consider longer-term deals if attractive rates are available within the risk parameters set by the Council.

5.6 Investment returns remained low during 2019/20 and have subsequently dropped in March 2020 given the emergency cuts to base rate.

5.7 **Changes in strategy during the year** – the strategy adopted in the original Treasury Management Strategy for 2019/20 approved by the Council on 20 February 2019, was reviewed as part of the mid-year update report. There were no proposed changes to the strategy as a result of this review.

6 The economy and interest rates

6.1 The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Teresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

6.2 Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

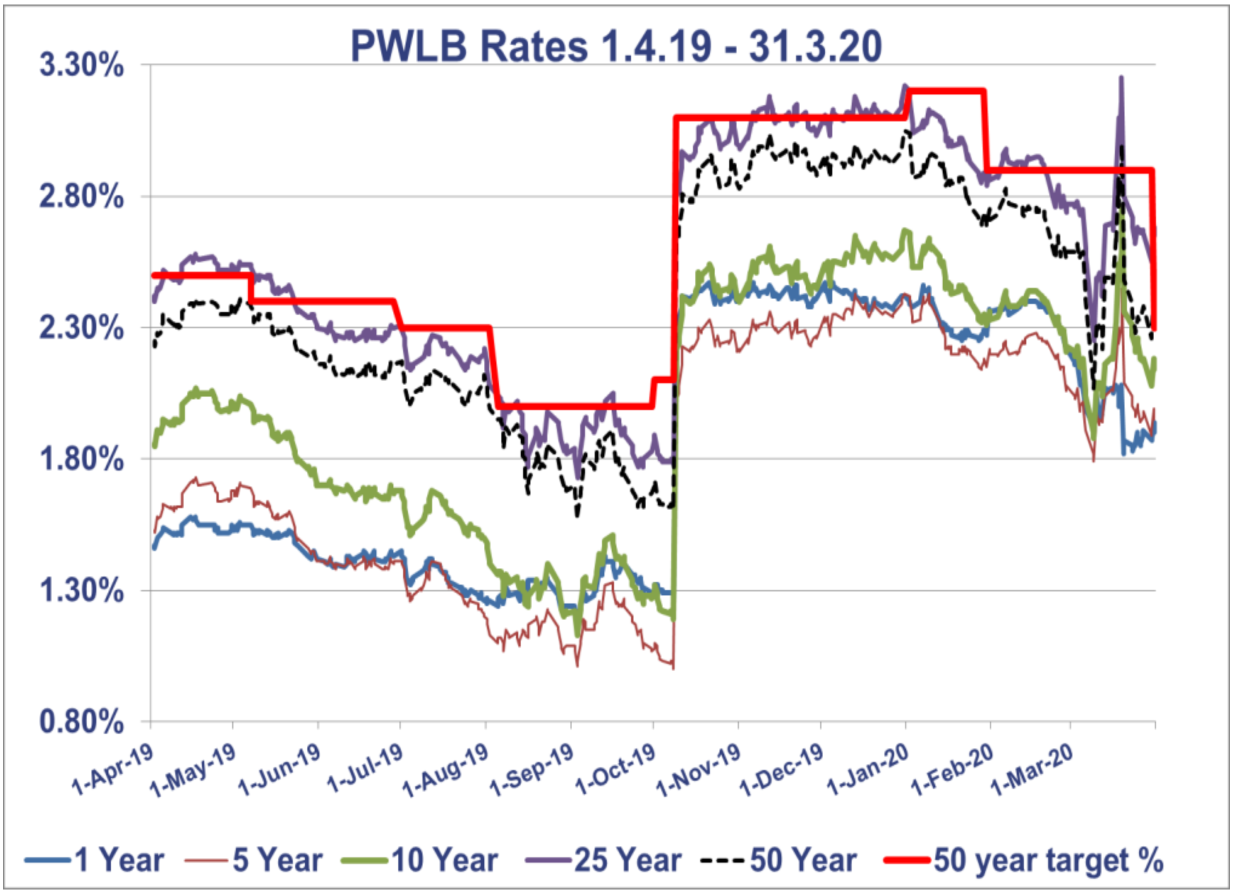
7 Borrowing

7.1 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 4 June. 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.

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

7.3

- **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)

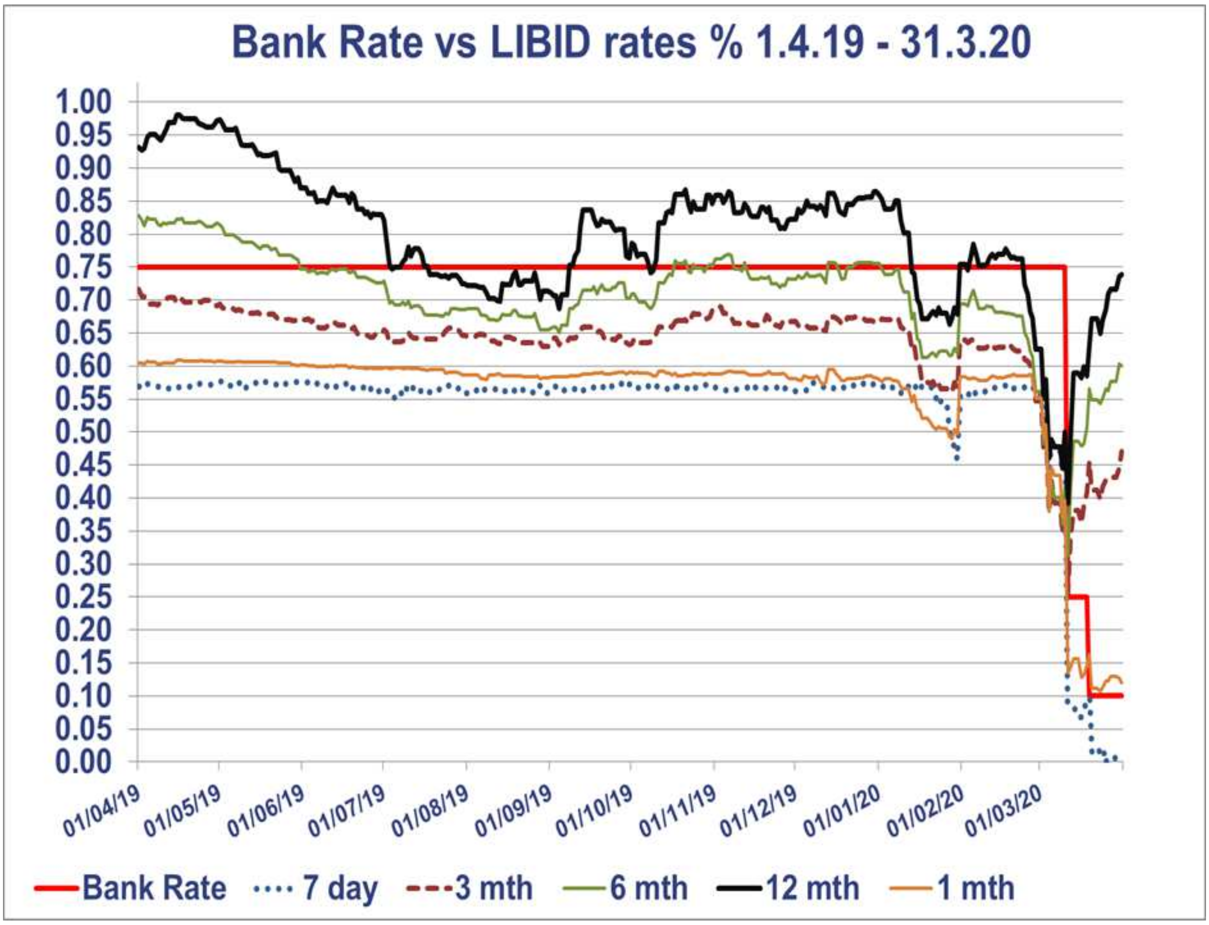


7.4 The Council's total debt outstanding at 31 March 2020 was £162.4m, which is an increase of £21.3m on last year. Due to the low rates available, this resulted in the average interest rate on the Council's debt at the end of the year reducing to 4.41%.

7.5 The Council's approach during the year was primarily to use cash balances to finance new capital expenditure. This minimised counterparty risk incurred on investments, and maximised treasury management budget savings as investment rates were much lower than most new borrowing rates.

8 Investments

8.1 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 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. Shorter term investment interest rates were fairly flat during most of the year until the two cuts in Bank Rate in March 2020 caused investment rates to fall sharply.



8.2 The Council manages its investments in-house, and its cash balances comprise revenue and capital resources and cash flow monies. The Council's investment policy is governed by MHCLG investment guidance, which was implemented in the Annual Investment Strategy approved by the Council on 20 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, bank share prices etc.)

8.3 The investment activity during the year conformed to the approved strategy, the Council had no liquidity difficulties, and no institutions in which investments were made during 2019/20 had any difficulty in repaying investments and interest in full.

8.4 The Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources	31-Mar-19 £'000	31-Mar-20 £'000
Balances	12,498	6,206
Earmarked Reserves	23,080	32,475
Provisions	4,526	3,483
Capital Reserves	4,044	977
Total	**44,148**	**43,141**

8.5 The Council's internally managed funds earned an average rate of return of 0.87%. The comparable performance indicator is the average 6-month LIBID rate (London Interbank Bid Rate – the rate charged by one bank to another for a deposit) (uncompounded), which was 0.70%.

Financial Year	Return %	Benchmark LIBOR (6 Month Rate)
2018/19	0.78	0.72
2019/20	0.87	0.70

8.6 The Council had temporary investments totalling £55.6m outstanding as at 31 March 2020. Of this, £18.1m relates to fixed-term deposits that are due to mature during 2020/21, £30m is held in 'AAA' rated money market funds with the remaining £7.5m is held in notice accounts. All of the deposits were made in accordance with the 2019/20 Annual Investment Strategy. A full list of investments held as at 31 March 2020 is shown in **Appendix A** (confidential).