ITEM NO. 12.1

Report of:	**Head of Finance**
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Portfolio Leader:	**Leader of the Council**
Key Decision:	**No**
Report Track:	**Council: 25/11/20 Audit & Gov Cttee: 30/11/20**

Council

25 November 2020

Annual Treasury Management Report 2019/20

1 Purpose of Report

1.1 To update Members on treasury management activity and performance during the 2019/20 financial year.

2 Recommendations

2.1 To note the annual treasury management report for 2019/20;

2.2 To approve the actual 2019/20 prudential and treasury indicators set out in **Appendix 1.**

3 Key Issues and Reasons for Recommendation

3.1 Treasury management activity and performance during the 2019/20 financial year.

4 Relationship to Corporate Priorities

4.1 Treasury management and investment activity link in with all of the Council's priorities and spending plans.

5 Report Detail

Background

5.1 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 2018/19. 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).

5.2 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
- a mid-year (minimum) treasury update report
- an annual review following the end of the year describing the activity compared to the strategy (this report)

5.3 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.

5.4 The submission of the above reports to the Audit and Governance Committee, to give prior scrutiny before they were reported to the full Council, ensures that this Council complies with the codes requirement. Training has been undertaken by members of the Audit and Governance Committee and further training will be arranged as required.

The Council's Capital Expenditure and Financing

5.5 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.

5.6 The actual capital expenditure forms one of the required prudential indicators. This is detailed in Appendix 1.

The Council's Overall Borrowing Need

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

5.8 **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 (2018/19) plus the estimates of any additional capital financing requirement for the current (2019/20) 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 in Appendix 1 highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

5.9 **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 in Appendix 1 demonstrates that during 2019/20 the Council has maintained gross borrowing within its authorised limit.

5.10 **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.

5.11 **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

Treasury Position as at 31 March 2020

5.12 At the beginning and the end of 2019/20 the Council's treasury, (excluding borrowing by PFI and finance leases), position was as follows:

TABLE 1	31 March 2019 Principal £'000	Rate/ Return	Average Life (yrs.)	31 March 2020 Principal £'000	Rate/ Return	Average Life (yrs.)
Total debt (PWLB)	81,605	3.89%	36.49	81,605	3.98%	35.56
CFR	93,453			92,088		
Over / (under) borrowing	(11,848)			(10,483)		
Total investments	27,000	0.66%	0.13	36,500	0.75%	0.05
Short term borrowing	0			0		
Net investments	27,000			36,500		
Net debt	54,605			45,105		

5.12.1 The table below sets out the maturity profile of the external debt held by the Council.

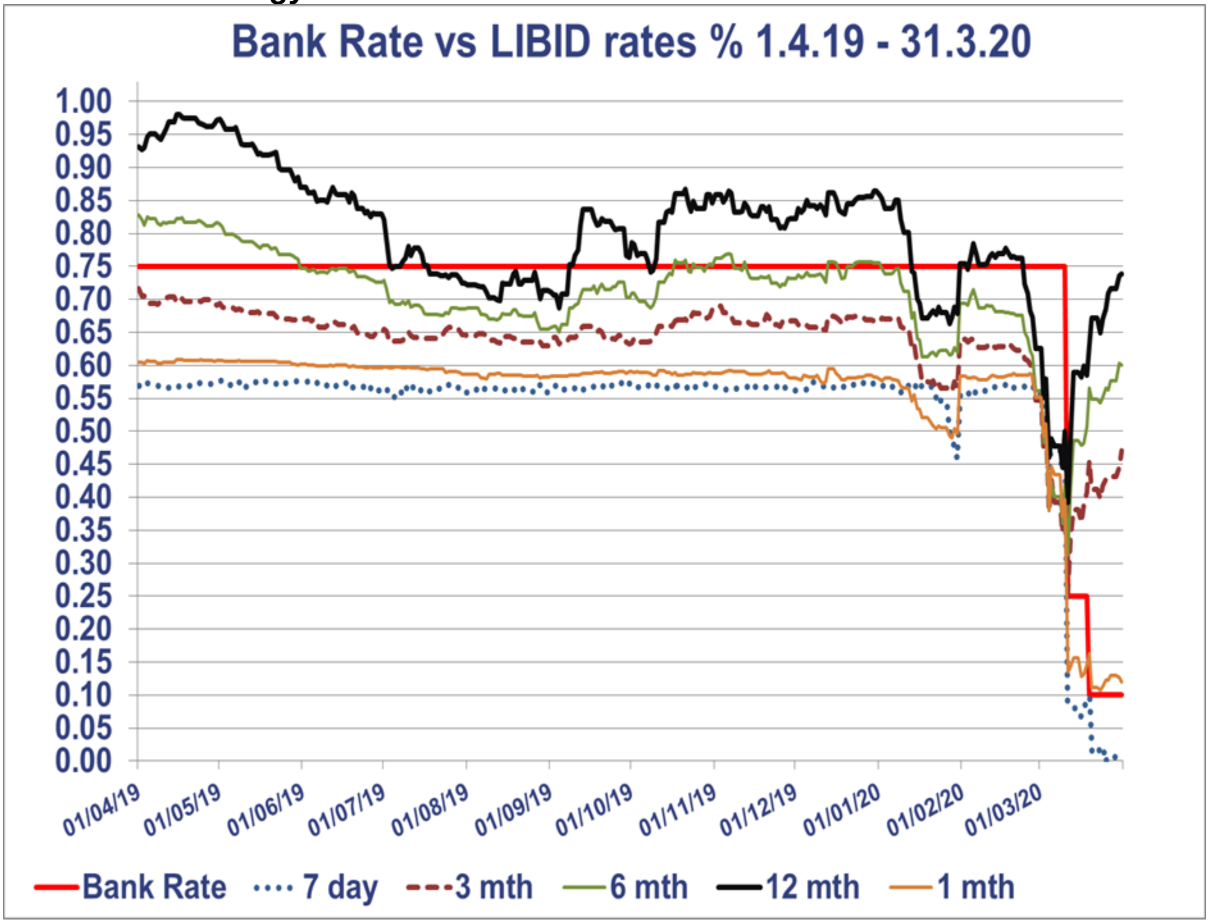
Debt Maturity Profile	**31 March 2019 Actual**	**2019/20 original limits**	**31 March 2020 Actual**
	£m	**£m**	**£m**
Under 12 months	0	0	0
12 months and within 24 months	0	0	0
24 months and within 5 years	0	0	1.4
5 years and within 10 years	4.4	4.4	3.0
10 years and within 20 years	12.60	12.60	12.60
20 years and within 30 years	0	0	
30 years and within 40 years	5.36	5.36	5.36
40 years and within 50 years	59.245	59.245	59.245
Total Debt	**81.605**	**81.605**	**81.605**

5.12.2 The following table sets out the Council's investments held at 31 March 2020:

Counterparty	**Start Date**	**End Date**	**Value (£)**	**Rate %**
Santander UK	180 Day Notice		3,500,000	1
Aberdeen GBP Liquidity Fund	Money Market Fund		6,000,000	0.46
Federated Prime Fund Class	Money Market Fund		6,000,000	0.54
Deutsche Bank	Money Market Fund		5,000,000	0.50
Invesco	Money Market Fund		6,000,000	0.54
Morgan Stanley	Money Market Fund		5,000,000	0.48
Handelsbanken	Call Account		5,000,000	0.55
			36,500,000	

5.13 All investments in the portfolio have a maturity of under 1 year.

Investment strategy and control of interest rate risk



5.14 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.

5.15 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 prior to the COVID pandemic 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.

5.16 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.

5.17 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 and control of interest rate risk

5.18 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.

5.19 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

5.20 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.

5.21 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Deputy Managing Director therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

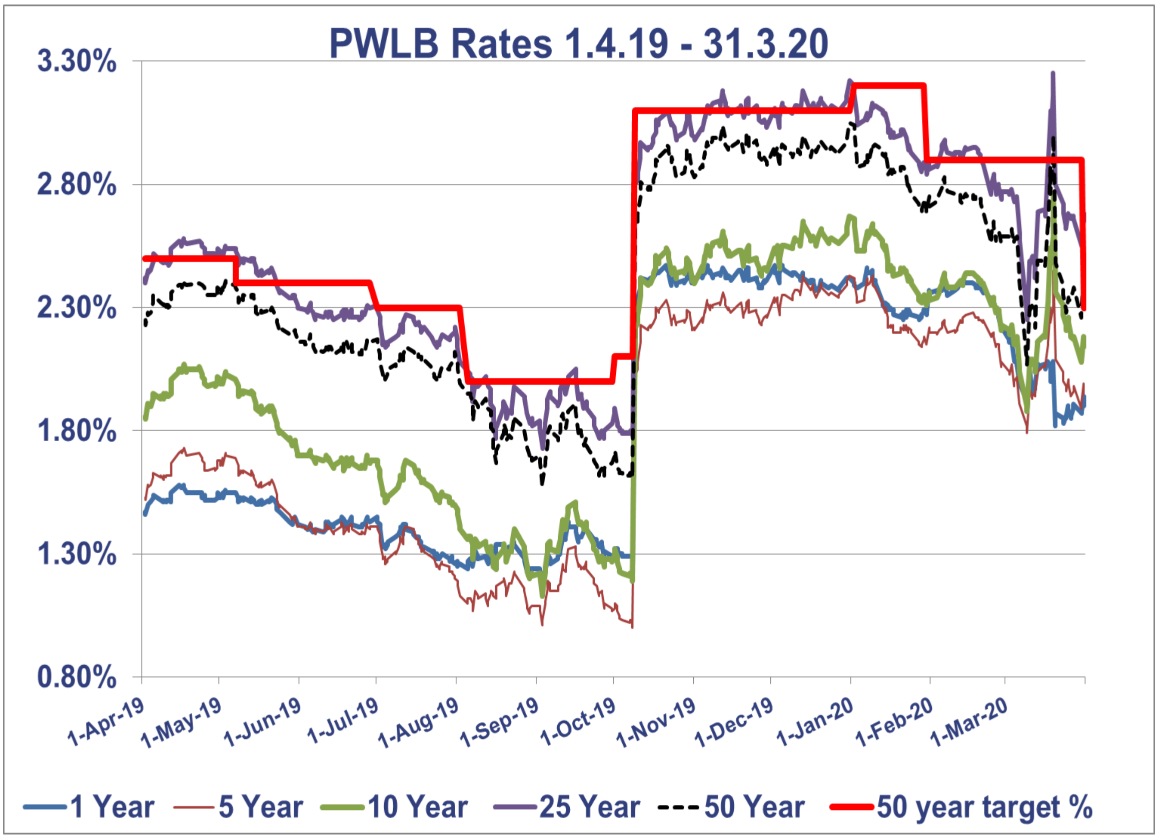
- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- 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.

5.22 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 31.1.20	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.50	2.60	2.70	2.80	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	2.70	2.80	2.90	3.00	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.30	3.40	3.50	3.60	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.20	3.30	3.40	3.50	3.80



5.23 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.

While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years.

We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

5.24 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%.

5.25 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 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.

5.26 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.

Borrowing Outturn

5.27 **Borrowing** - Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Investment Outturn

5.28 **Investment Policy** - the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy. 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).

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

5.30 **Resources** – 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 March 2019	31 March 2020
	£'000	£'000
Earmarked Fund balances / reserves		
General Fund	10,835	15,977
General Fund working balance	2,916	1,000
HRA	5,225	8,445
HRA working balance	1,573	1,663
Sub Total	**20,549**	**27,085**
Capital receipts		
GF	7,371	7,408
HRA	1,006	2,047
Sub Total	**8,377**	**9,455**
Provisions	3,238	2,077
Major Repairs Reserve	2,433	4,509
Other - grants receipts in advance	664	1,036
Total core funds	**35,261**	**44,162**

5.31 Investments held by the Council

- The Council maintained an average balance of £37.6m of internally managed funds.
- The internally managed funds earned an average rate of return of 0.75%.
- The comparable performance indicator is the average 7-day LIBID rate, which was 0.53%.
- Total investment income was £283,863 compared to a budget of £174,200.

5.32 Due to the unforeseen Government grants to assist in dealing with the coronavirus outbreak, balances were held with Barclays (main bank account) temporarily in excess of £6m to ensure the council had adequate liquidity to make the grant payments out swiftly.

6 Implications

6.1 Financial

The financial implications have been referred to throughout the report.

6.2 Legal

The legal implications have been referred to throughout the report.

6.3 Human Resources

There are no human resource implications arising from this report.

6.4 Section 17 (Crime Prevention)

There are no implications arising from this report.

6.5 Human Rights Act

There are no identified implications in respect of the Human Rights Act 1998 arising from this report.

6.6 Data Protection

There are no implications arising from this report.

6.7 Risk Management

Treasury management is a high risk area due to the large amounts of money dealt with on a daily basis. However, the Council has a Treasury Policy and Strategy in place which is approved each year for the following 12 months. The Council also has advice on investment and lending from the leading company in the field and has instituted a strict control and delegation of duties regime which reduces risk to a minimum.

6.8 **Equality & Diversity**

There are no identified implications arising form this report.

6.9 **Best Value**

The strategy ensures that best value is provided to the Council.

7 Appendices to the Report

Appendix 1: Prudential and Treasury Indicators.

Appendix 2: Analysis of Investments held at 31 March 2020.

Previous Consideration

None

Background Papers

Available in Financial Services.

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Appendix 1

1. PRUDENTIAL INDICATORS	2018/19	2019/20	2019/20
	Actual	Estimate	Actual
	£'000	£'000	£'000
Capital Expenditure (HRA)	6,349	3,902	2,678
Capital Expenditure (GF)	2,907	1,465	1,113
Notional Capital expenditure – Finance Leases			
Ratio of financing costs to net revenue stream (HRA)	16.74%	16.92%	16.56%
Ratio of financing costs to net revenue stream (GF)	2.8%	2.2%	1.9%
Gross borrowing requirement (GF) - Finance Leases	1,105	674	674
Gross debt	81,605	81,605	81,605
Capital Financing Requirement as at 31 March (HRA)	82,504	82,496	82,494
Capital Financing Requirement as at 31 March (GF)	10,949	9,594	9,594
Annual change in Cap. Financing Requirement (HRA)	995	-8	-10
Annual change in Cap. Financing Requirement (GF)	-4,022	-1,355	-1,355
2. TREASURY MANAGEMENT INDICATORS			
Authorised Limit for external debt -	109,385	107,812	107,812
Operational Boundary for external debt	97,885	96,312	96,312
Actual external debt	81,605	81,605	81,605

Maturity structure of fixed rate borrowing during 2019/20	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

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Appendix 2

The following table sets out an analysis of investments held at 31 March 2020 (together with a comparator at 31 March 2019).

INVESTMENT PORTFOLIO	Actual 31.3.19	Actual 31.3.19 %	Actual 31.3.20	Actual 31.3.20 %
Money Market Funds	**£17.5m**	**65%**	**£28.m**	**77%**
Banks	**£9.5m**	**35%**	**£8.5m**	**23%**
TOTAL TREASURY INVESTMENTS	**£27.0m**	**100%**	**£36.5m**	**100%**