

## **Treasury Management – Mid Year Stewardship Report 2020-21**

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: That the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the Treasury Management Mid Year Stewardship Report.

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### **1. Introduction**

- 1.1 The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2017 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2018. The Treasury Management and Investment Strategy for 2020/21 was agreed by Council in February 2020 and forms part of the published budget book.
- 1.2 The purpose of this report is to inform members of any key matters arising from the Council's Treasury and Debt Management activities during the first seven months of the 2020/21 financial year. It is intended to enable members to ensure that agreed policy is being implemented. This report, together with any comments offered by this committee, will be considered by Cabinet on 9th December.

### **2. Borrowing Strategy 2020-21 to 2022-23**

- 2.1 The overall aims of the Council's borrowing strategy are to achieve:
  - Borrowing at the lowest rates possible in the most appropriate periods;
  - The minimum borrowing costs and expenses;
  - A reduction in the average interest rate of the debt portfolio.
- 2.2. The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required, although this will be kept under review. The majority of the capital programme is funded by capital grants or use of capital receipts. Some use is made of internal borrowing from the Council's cash resources, and prudent management of the capital programme aims to ensure that there is no requirement to take on additional

external borrowing. If short-term borrowing is required to aid cashflow, this will be targeted at an average rate of 0.7%.

- 2.3 Active treasury management and the maintenance of levels of liquidity have ensured that no short term borrowing has been required for the financial year to date. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.
- 2.4 In accordance with the Medium Term Financial Strategy no long term external borrowing has been undertaken this financial year. Instead all borrowing required to fund capital expenditure has been funded by internal cash balances. This position will be kept under review, but the expectation remains that no new external borrowing will be required during the three year period.
- 2.5 At 31st October 2020 the level of long term debt remains unchanged at £507.85m as detailed in the table below.

#### Analysis of Long Term Debt

|                                 | <b>Actual<br/>31.03.20<br/>£'m</b> | <b>Interest<br/>Rate<br/>%</b> | <b>Actual<br/>31.10.20<br/>£'m</b> | <b>Interest<br/>Rate<br/>%</b> |
|---------------------------------|------------------------------------|--------------------------------|------------------------------------|--------------------------------|
| <b>Fixed Rate Debt</b>          |                                    |                                |                                    |                                |
| PWLB                            | 436.35                             | 4.99                           | 436.35                             | 4.99                           |
| Money Market                    | 71.50                              | 5.83                           | 71.50                              | 5.83                           |
| <b>Variable Debt</b>            |                                    |                                |                                    |                                |
| PWLB                            | 0.00                               |                                | 0.00                               |                                |
| Money Market                    | 0.00                               |                                | 0.00                               |                                |
| <b>Total External Borrowing</b> | <b>507.85</b>                      | <b>5.11</b>                    | <b>507.85</b>                      | <b>5.11</b>                    |

- 2.6 Every year the Council budgets for a Minimum Revenue Provision to set aside cash to then repay this external debt. At the same time, we are then borrowing that cash back, by way of internal borrowing from the Council's cash balances to finance the capital programme. At present we have "over borrowed" from cash by some £60 million, i.e. we have borrowed £60 million from the Council's cash balances, in addition to the external debt of £507.85 million, to fund the capital programme. The ability to internally borrow from the Council's cash has enabled the Council to fund its capital programme in recent years without taking out further external debt and incurring additional interest costs and other capital financing costs.
- 2.7 While cash balances remain relatively high, we can continue to internally borrow to meet our capital commitments and maintain a measured level of future capital investment. However, this may become more challenging if there continues to be growing pressure on both the Council's capital programme and revenue budget, and other calls on cash balances such as the deficit on Special Educational Needs.
- 2.8 No opportunities have arisen during this financial year to repay external debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The PWLB sets premature repayment rates and,

where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore, it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise significantly and cancel out the repayment premiums. This is unlikely to happen in the short to medium term.

- 2.9 The earliest date on which any of the Council's external debt matures is 31 March 2027, when the Council is due to repay a PWLB loan of £33.8 million, with a further £5.8 million to be repaid later in 2027. While this may still seem a long time away, officers have begun to consider plans for the repayment of these loans. Given that the Council's capital programme is "over borrowed" from its internal cash, there will need to be careful management of future capital requirements to ensure that cash resources are available so that these loans can be repaid, otherwise there might be a future need to take out new external borrowing to re-finance the debt.

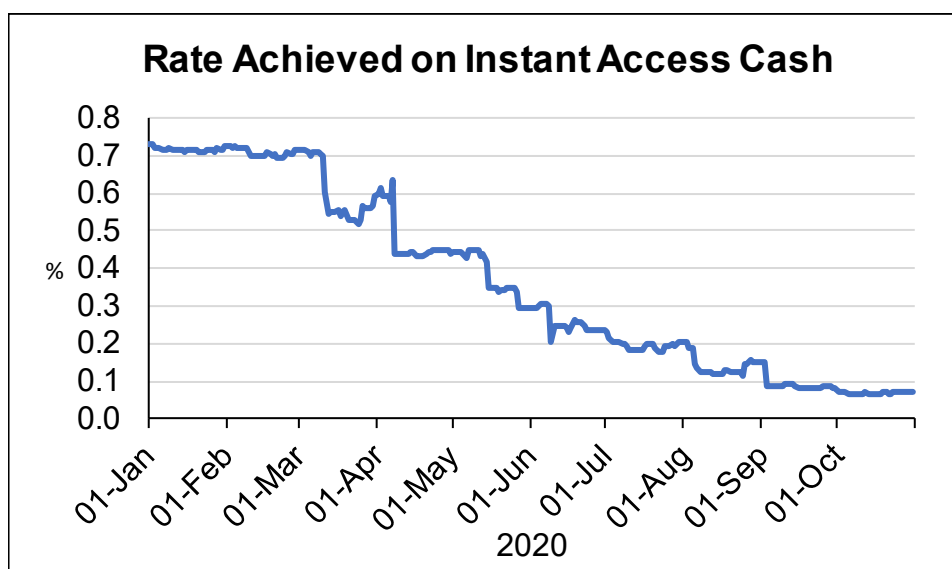
### **3. Investment Strategy 2020-21**

- 3.1 The County Council continues to adopt a very prudent approach to counterparties to whom the County Council is willing to lend. As a result, only a small number of selected UK banks and building societies, money market funds and Non-Eurozone overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. In addition, the CCLA (Churches, Charities and Local Authorities) Property Fund is being used. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list.
- 3.2 The 2020/21 Treasury Management Strategy also included provision for the use of multi-asset income funds or short dated bond funds. Use of such funds would be subject to the approval of the Cabinet Member for Resources Management.
- 3.3 The overall aim of the Council's investment strategy is to:
- Limit the risk to the loss of capital;
  - Ensure that funds are always available to meet cash flow requirements;
  - Maximise investment returns, consistent with the first two aims;
  - Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.
- 3.4 The target rate for interest on deposits with banks, building societies and money market funds is 0.75%. The target rate for the CCLA Property Fund is 4.5%.
- 3.5 The following table shows the County Council's fixed and variable rate investments as at the start of the financial year and as at 31st October 2020:

## Schedule of Investments

|                                                  |              | Actual        | Interest    | Actual        | Interest    |
|--------------------------------------------------|--------------|---------------|-------------|---------------|-------------|
|                                                  |              | 31.03.20      | Rate        | 31.10.20      | Rate        |
| Maturing in:                                     |              | £'m           | %           | £'m           | %           |
| <b>Bank, Building Society &amp; MMF Deposits</b> |              |               |             |               |             |
| <b>Fixed Rates</b>                               |              |               |             |               |             |
| Term Deposits                                    | < 365 days   | 72.50         | 1.00        | 70.00         | 0.95        |
|                                                  | 365 days & > | 20.00         | 1.40        | 13.00         | 1.60        |
| <b>Variable Rate</b>                             |              |               |             |               |             |
| Call Accounts                                    |              | 45.00         | 0.65        | 50.00         | 0.07        |
| Notice Accounts                                  |              | 45.00         | 0.90        | 80.00         | 0.47        |
| Money Market Funds (MMF's)                       |              | 23.01         | 0.48        | 1.59          | 0.06        |
| <b>Property Fund</b>                             |              | 10.00         | 4.28        | 10.00         | 3.94        |
| <b>All Investments</b>                           |              | <b>215.51</b> | <b>1.04</b> | <b>224.59</b> | <b>0.75</b> |

- 3.6 The world now looks very different compared to how it looked when the 2020/21 Treasury Management Strategy was set early in the year. The coronavirus pandemic has resulted in a lockdown of much economic activity across large parts of the world. The United Kingdom has been particularly badly hit, and as a result the Bank of England reduced its base rate firstly to 0.25% and then to 0.1% during March. When the Council set a target interest rate of 0.75% for 2020/21, it did so bearing in mind the risk of interest rates being cut as a result of a messy Brexit, but the impact of the pandemic has meant that rates have been cut further than would have been expected when the target rate was set.
- 3.7 The decision was taken in early April to keep more cash immediately available to ensure the Council could meet all cashflow requirements resulting from the coronavirus pandemic. This decision was made taking into account both additional expenditure and actual and potential loss of income. The rates available for immediately available cash (call accounts and money market funds) have reduced steadily, as shown by the following graph. The increase in immediate cash plus reduction in rates has therefore reduced the income achievable.



- 3.8 However, despite the pandemic, it is still currently forecast that the Council will achieve the budgeted level of investment income in 2020/21. Revenue lending up to 31st October, including the use of term deposits, call accounts, money market funds and the CCLA property fund, has earned interest of £1,090,000 against a full year budget of £1,542,000. It is forecast that the investment income for the full financial year will exceed budget by around £150,000.
- 3.9 The following factors contribute to that position:
- Term deposits carried forward into 2020/21 that were made at the rates prevailing before the pandemic hit the economy have provided some mitigation against the rate cuts.
  - Local authorities that were seeking to bolster their cash balances in March were offering significantly higher rates, and we were able to agree forward deals totalling £20 million at rates above 1% over varying time periods. Subsequently the rates on offer from other local authorities have dropped significantly.
  - Front-loading of Government grants related to the pandemic has meant that to date the Council's cash balances have not been significantly impacted, but the anticipated level of additional expenditure is forecast to be higher than the grants provided.
- 3.10 The income forecast in paragraph 3.8 includes the investment in the CCLA Property Fund. The Council would be expected to achieve investment income of between £400,000 and £450,000 per year from the fund. Income over the first half of the financial year was down to around £193,000. This reflects collection of 93% of rents originally due on 25 March, 88% for the difficult quarter to 24 June and 75% received for the 29 September quarter-day, a figure that is likely to increase. This is a reasonably positive result under the current circumstances, but uncertainty remains.

#### **4. Minimum Revenue Provision**

- 4.1 Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.
- 4.2 The current policy, following a review in 2018/19 is to charge MRP in equal instalments over the life of the asset benefiting from the capital spend, based on the annuity method. The budgeted MRP for 2020/21 is £12.704m.

#### **5. Prudential Indicators**

- 5.1 Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in

order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

5.2 The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

5.3. Three Prudential Indicators control the overall level of borrowing. They are:

- The Authorised Limit - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for 2021/22 is revised as part of the 2021/22 budget process.
- The Operational Boundary – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- The Underlying Borrowing Requirement to Gross Debt - the Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

5.4 During the Budget process, the following Borrowing Limits were set for 2020/21:

- Maximum borrowing during the period (Authorised Limit) - £780.972m
- Expected maximum borrowing during the year (Operational Boundary) - £755.972m
- Maximum amount of fixed interest exposure (as a percentage of total) - 100%
- Maximum amount of variable interest exposure (as a percentage of total) - 30%

5.5 Members are asked to note that for 2020/21 to date, the Council has remained within its set Borrowing Limits and has complied with the interest rate exposure limits.

## **6. Prospects for 2021/22**

6.1 The coronavirus outbreak has done significant economic damage to the UK and economies around the world. The Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%. Given the combination of a potential “no deal” Brexit, the expected growth in unemployment when the Government’s furlough scheme concludes, and the introduction of a second national lockdown resulting from a second wave of COVID infections, it is likely to be some time before the economy recovers

sufficiently for interest rates to increase. Some forecasters have suggested that a cut into negative territory could happen.

- 6.2 There is also likely to be significant pressure on the Council's finances going forward. Significant expenditure has been committed to support the response to the pandemic, while the Council also faces a growing deficit on the provision for Special Educational Needs (SEND). While at the end of October 2020 the cash balances remain relatively high, this has been partly due to the front-loading of Government grants related to the pandemic, and as this continues to be spent, and the SEND deficit grows, it is likely that the cash balances will reduce significantly before the financial year end.
- 6.3 The Government's funding settlement for the next financial year is not yet known, but with significant savings likely to be required there may be a need to draw on reserves which may further reduce the cash in 2021/22.
- 6.4 Therefore, in planning the Treasury Management Strategy for 2021/22, it is likely that we will have to budget for lower cash balances and lower rates than in the current year. The target rate for lending to banks and building societies is likely to be reduced from 0.75% down to between 0.3% and 0.35%. This target rate will only be possible because of some continuing two year deals already in place at higher rates. The level of budgeted income for 2021/22 is therefore likely to be around half what is budgeted in 2020/21. These assumptions will be reviewed before the 2021/22 Strategy is presented in January.

## **7. Summary**

- 7.1. No long term borrowing has been undertaken to date in 2020/21. The expectation is that no new borrowing will be required during the remainder of the 2020/21 financial Year.
- 7.2 No short term borrowing has been undertaken to date in 2020/21.
- 7.3 The investment income achieved as at the end of October stands at around £1.09 million compared to the budget target for the year of £1.542 million.
- 7.4 Looking ahead, falling interest rates will reduce the level of interest income that can be achieved on the Council's cash balances in future years. A potential reduction in available cash will mean that the Council will need to manage its capital programme carefully to ensure it remains affordable within the policy of not taking out further external debt.

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Electoral Divisions: All

Local Government Act 1972:

List of Background Papers: Nil

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