CT/20/47
Corporate Infrastructure & Regulatory Services Scrutiny Committee
24 June 2020

TREASURY MANAGEMENT STEWARDSHIP ANNUAL REPORT 2019/20

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 notes the report and considers whether it wishes to make any further comments to Cabinet on the 2019/20 Treasury Management outturn position.**

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. These were not changed for 2019/20. The Treasury Management and Investment Strategy for 2019/20 was agreed by Council in February 2019 and forms part of the published budget book.

1.2. The purpose of this report is to show the outturn position, review performance and inform members of any key matters arising from the Council's Treasury and Debt Management activities during the 2019/20 financial year. The report also includes an update on the 2020/21 Strategy. This report, together with any comments offered by this committee, will be considered by Cabinet on 8th July.

2. Minimum Revenue Provision

2.1. 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.

2.2. The current policy is to charge MRP based on the period of benefit of the capital investment, i.e. straight line, over the life of the asset. However, all supported borrowing up to 1st April 2008 is charged over the life of the assets, calculated using the annuity method. The final outturn for MRP for 2019/20 was £14.432m.

3. Treasury Management Outturn Position 2019/20 - Borrowing

3.1. The overall aims of the 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.

3.2. Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. Therefore, the Medium Term Financial Strategy (MTFS) assumption was that no new long-term borrowing would be required.

3.3. In accordance with the MTFS, no long-term borrowing was undertaken during the 2019/20 financial year. Instead all borrowing required to fund capital expenditure was met from internal cash balances.

3.4. Active treasury management and the maintenance of levels of liquidity have ensured that no short-term borrowing was required during the financial year. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

3.5. No opportunities arose during the 2019/20 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The Public Works Loan Board (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. Therefore, it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums.

3.6. In October 2019, HM Treasury announced an increase in interest rates for borrowing from the Public Works Loan Board (PWLB). Some local authorities have substantially increased their use of the PWLB, as the cost of borrowing has fallen to record lows, in many cases to fund commercial property investment. HM Treasury was concerned about the level of local authority borrowing for this purpose and therefore announced that they would restore interest rates to levels available in 2018, by increasing the margin that applies to new loans from the PWLB by 100bps (one percentage point) on top of usual lending terms. This has made new borrowing less attractive, however, this has no impact on the rates applicable to the Council’s current long term debt, which were set at fixed rates when the loans were taken out.

3.7. Despite the increase in PWLB rates for new borrowing, the premature payment rates have been left unchanged. Current interest rate forecasts suggest that it is extremely unlikely that gilt yields will rise sufficiently to cancel out the premiums in the medium term.

3.8. At 31st March 2020 the level of long term debt stood unchanged at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.19 £'m	Interest Rate %	Actual 31.03.20 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

3.9. The carrying amount for long term debt figure presented in the Statement of Accounts for 2018/19, comprising PWLB, LOBO and market debt, is £511.092m, £3.3m higher than the figure stated above. This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The LOBOs (Lender Option Borrower Option) have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. The revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

4. Treasury Management Outturn Position 2019/20 - Investments

4.1. 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.

4.2. The Bank of England's Base Rate remained at 0.75% throughout the year until the country was hit by the coronavirus pandemic. In response to the pandemic the Base Rate was reduced to 0.25% on 11 March 2020, and then further to 0.10% on 19 March. These changes came too late in the year to have any significant impact on the Council's interest receipts in 2019/20 but will reduce the rates available in 2020/21.

4.3. The average interest rate earned on investments, excluding the CCLA property fund, for the year was 0.97%, against the full year budget target return of 0.75%. The CCLA property fund has yielded an average rate of 4.27% for the same period against a full year budget target of 4.5%. The combined total return from all investments was 1.11%.

4.4. The 2019/20 Treasury Management Strategy included for the first time the ability for the Council to invest in short-dated bond funds and multi-asset income funds. Short dated bond funds will invest in high quality short dated government or corporate bonds. Multi-asset income funds will invest in a wider range of investments designed to produce an income yield. In both cases, the funds concerned will invest in tradable instruments where the capital value of the investment will fluctuate. However, this provision was not utilised, as Brexit uncertainty suggested a more prudent approach, given that higher yielding investments will mean that there is an increased risk of loss of capital.

4.5. Revenue lending during 2019/20, including the use of term deposits, call accounts and property funds, earned interest of £2.496 million against a full year budget of £1.6 million. The surplus achieved over budget can mostly be attributed to the higher rates of interest earned compared to the target rate. The target rate was set on a prudent basis, reflecting the risk that the base rate could be cut if there was a no deal Brexit. However, as the rate remained unchanged until March 2020 the Council was able to achieve higher rates than the target. The interest figure quoted is the return from the Council's Treasury Management activity and is different from the figure presented in the Outturn Report and the Statement of Accounts which also includes interest generated from a number of other sources.

4.6. All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties.

4.7. The following table shows the County Council's fixed and variable rate investments as at the start and close of the financial year:

Schedule of Investments

	Maturing in:	Actual 31.03.19 £'m	Interest Rate %	Actual 31.03.20 £'m	Interest Rate %
Bank, Building Society & MMF Deposits					
Fixed Rates					
Term Deposits	< 365 days	147.50	1.01	72.50	1.00
	365 days & >	10.00	1.00	20.00	1.40
Callable Deposits					
Variable Rate					
Call Accounts		-	-	45.00	0.65
Notice Accounts		12.50	1.01	45.00	0.90
Money Market Funds (MMF's)		46.83	0.77	23.01	0.48
Property Fund		10.00	4.23	10.00	4.28
All Investments		**226.83**	**1.10**	**215.51**	**1.04**

4.8. The figure as at 31st March 2020 includes £6.9m related to the Growing Places Fund (GPF). This figure was approximately £11.7m as at 31st March 2019. Devon County Council has been the local accountable body for the GPF, which was established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. Interest achieved on the GPF funds, based on the average rate achieved by the Council's investments, accrues to the GPF and not to the County Council. Responsibility for the Growing Places Fund, together with the current balance of the fund, is due to transfer to Somerset, to be consistent with their role as host authority for the Local Enterprise Partnership.

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 the following year is revised as part of the budget setting 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 upper limit for net debt** - the Council 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 2019/20:

- Maximum borrowing during the period (Authorised Limit) £776.73m.
- Expected maximum borrowing during the year (Operational Limit) £751.73m.
- 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 during 2019/20 the Council remained within its set Borrowing Limits and complied with the interest rate exposure limits.

6. 2020/21 Update

6.1. 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 rates have been cut further than would have been expected as a result of the pandemic.

6.2. As far as borrowing is concerned, the Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required. This is still envisaged to be the case, although this will be kept under review. The PWLB policy of imposing premium penalties for the early repayment of long term debt means there is little potential to repay further debt during the current financial year.

6.3. As set out in the Treasury Management Strategy, a payment of £31.9 million was made to the Pension Fund representing advance payment of the deficit contributions due for 2020/21, 2021/22 and 2022/23. Due to the discount available for advance payment this will result in savings of £1.5 million over the three years.

6.4. Despite the pandemic, it is still currently forecast that the Council will achieve the budgeted level of investment income in 2020/21. However, this is less certain than in previous years. 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 will provide 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.
- 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. Keeping more cash immediately available will reduce the level of investment income achieved.
- 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.
- The Council would be expected to achieve investment income of between £400,000 and £450,000 from the CCLA Property Fund investment. However, yields

may be impacted by the ability of tenants to meet rent payments on the property owned by the fund.

6.5. The Bank of England has kept base rates at 0.1% since March but indicated that further support would be forthcoming when or if required. Markets are not projecting forward thoughts on interest rates, which are expected to remain at 0.1% for the foreseeable future, despite some talk of negative rates. Therefore, any new deposits are likely to be at very low rates. Given the level of risk that still remains, it is not recommended to make investments in short dated bond funds or multi asset income funds at the present time. The mid-year report will provide a further update on the forecast investment income for the year.

7. Summary

7.1. No long term or short-term borrowing was undertaken during 2019/20. It is not envisaged that any new long-term borrowing will be required over the next three year period but this will be reviewed annually.

7.2. No opportunities arose during the 2019/20 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate the benefit of repaying the debt.

7.3. Investment income of £2.496 million was achieved in 2019/20 against a full year budget of £1.6 million. This represented a return of 1.11%, including the Property Fund investment. Successful prudent management of the Council’s short-term cash reserves has delivered a surplus of £0.9 million for the 2019/20 financial year.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
Contact for Enquiries: Mark Gayler
Tel No: (01392) 383621 Room G97