Item No: 6.3	Classification: Open	Date: 25 November 2020	Meeting Name: Council Assembly
Report title:		Treasury Management – Mid-year Update 2020-21	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Governance	

RECOMMENDATION

1. That council assembly note the 2020-21 mid-year treasury management update report and that:

   - all treasury management activity was undertaken in compliance with the approved treasury management strategy and within the council's prudential indicators, as Appendix A

   - the balance outstanding on all external debt as at 30 September 2020 was £809m.

   - in the six months to 30 September 2020 the average investment balance was £180m and the balance of investments at 30 September 2020 stood at £188m.

BACKGROUND INFORMATION

2. In compliance with the Local Government Act 2003, the council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice (the Code). The Code requires local authorities to determine an annual treasury management strategy and, as a minimum, formally report on their treasury activities and arrangements to Council Assembly mid-year and after the year-end.

3. The Code provides the following objective with regard to treasury management:

   "It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy."

4. The 2020-21 treasury management strategy was approved by Council Assembly in February 2020. Under financial delegation, all executive, managerial and operational decisions are the responsibility of the strategic director of finance and governance.

5. The council is exposed to financial risks from its investments, existing external debt, as well as future borrowing requirements arising from the council's capital programme. The risks include potential losses from investments and increased borrowing costs from changing interest rates. The successful identification, monitoring and control of risk remain central to the Authority's treasury management strategy.

6. This mid-year Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for the period from April to September 2020.

7. The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their economies working again. The economic situation together with the financial market conditions prevailing throughout the period continued to provide challenges for treasury management.

8. The key issues covered in this report are:
   - The council's borrowing strategy and debt management position
   - Investment performance and activity
   - Prudential indicators for 2020-21

KEY ISSUES FOR CONSIDERATION

Borrowing strategy and debt management activity and position

9. The council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

10. The council's debt management strategy is to pursue a policy of internal borrowing, which is the use of existing reserves and balances to temporarily fund capital expenditure, where possible, rather than the use of external borrowing.

11. The use of internal borrowing allows the council to minimise unnecessary external borrowing costs by only borrowing when needed for liquidity, or to benefit from advantageous borrowing rates. Efficient use of existing council resources to fund capital expenditure through internal borrowing also reduces the council's counterparty risk inherent in the investment of cash balances.

12. The council's outstanding long-term debt portfolio, used to fund historical capital expenditure, stood at £630m as at 30 September 2020. All long term outstanding debt was borrowed from the Public Works Loans Board (PWLB), part of HM Treasury, at fixed rates of interest.

13. During the first half of 2020-21, £2.5m of long debt principal matured and was repaid to the PWLB and no new PWLB loans were taken.

14. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans. By doing so, the Authority is able to reduce net borrowing costs and reduce overall treasury risk.

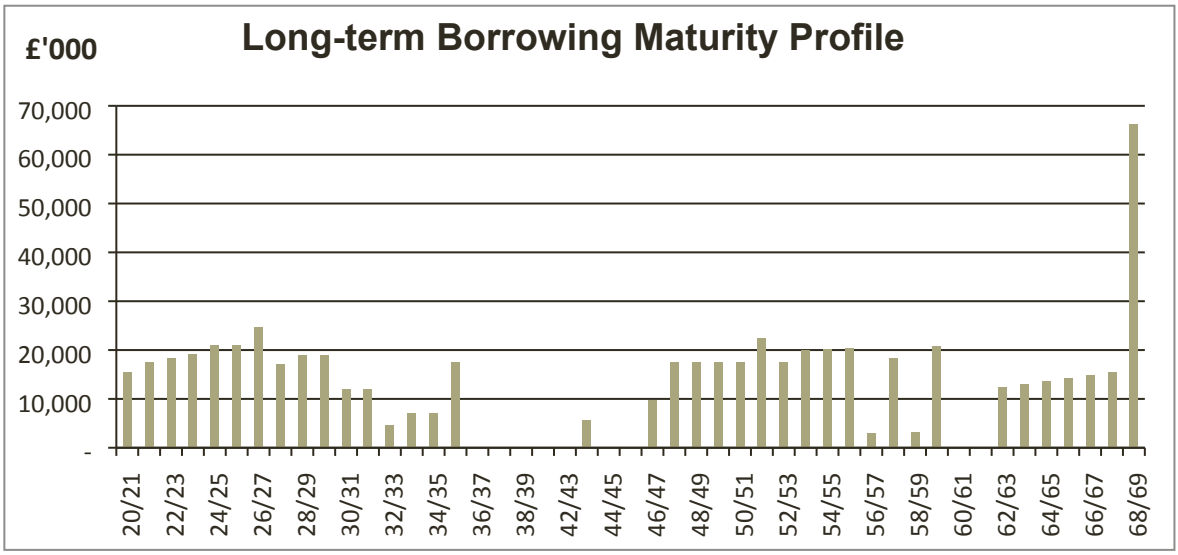
15. This policy has continued during 2020-21. The balance of short term borrowing at 30 September 2020 was £172m with a weighted average rate of interest on short term borrowing of 0.68%, significantly less than long term rates of borrowing. All short term borrowing was via other local authorities which are typically at lower rates than from other sources for short duration debt.

16. The benefits of internal/short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. This will help inform decisions on whether the council borrows additional sums at long-term fixed rates with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

17. In July 2020 the council borrowed £7m from the Mayor of London's Energy Efficiency Fund (MEEF). The MEEF gets funding from the European Regional Development Fund and other partner banks to fund developments within London councils and other public sector bodies that will result in reduction in carbon emissions. The rates are therefore more favourable than comparable PWLB rates.

18. The weighted average rate of interest for the council's debt portfolio is 3.8% at 30 September 2020 (3.6% at 31 March 2020).

19. The maturity profile of outstanding long term borrowing as at 30 September 2020 is shown in the chart below:



Investment strategy and investment activity and position

20. The council holds sizable investment balances, representing income received in advance of expenditure plus balances and reserves held. Investments as at 30 September 2020 were £188m (£133m at 31 March 2020).

21. Council resources that are not immediately required for current expenditure are invested in money market instruments in accordance with the MHCLG Guidance on Local Authority Investments and the approved investment strategy. The MHCLG guidance gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

22. Council investments are managed both in-house and delegated to two fund managers: Alliance Bernstein and Aberdeen Standard (formerly Aberdeen Asset Management). The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds (MMFs).

23. Any surplus cash resources not required in the short term to fund council activities is placed with the council's two external fund managers. The fund managers invest for a longer term in UK government gilts, supranational bank bonds, certificates of deposits issued by major banks/ building societies and other financial instruments.

24. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

25. The distribution of council investments across counterparties by rating and maturity as at 30 September 2020 is set out in the table below:

	A		**AA**		**AAA**		**Total**	
Investment Maturity	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to 1 Year	25.9	24	37.9	36	6.6	6	70.4	66
1 - 2 Years	3.8	4	5.2	5	10.3	10	19.3	19
2 - 5 Years		-	2.1	2	13.9	13	16	15
Total	**29.7**	**28**	**45.2**	**43**	**30.9**	**29**	**105.7**	**100**

26. The annualised rate of return for council treasury management assets for the first half of 2020-21 financial year was 0.7%.

27. To assess the treasury management portfolio performance, the council measures the return against a composite investment benchmark of three

month LIBID and one to three year gilt index. For the equivalent period of the financial year the benchmark index annualised return was 0.6%.

28. The priorities for treasury management investment are, in order of priority, security, liquidity, and yield. The objective therefore is to ensure that funds are available to meet council liabilities as they fall due. The rate of investment return generated by the treasury management portfolio is therefore a consequence of the council's prudent, low risk approach to treasury management investing. This is in line with the requirements of the statutory guidance for local government treasury investment issued by MHCLG.

29. The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options.

30. The investment activity during the period conformed to the approved strategy and the cash flow was successfully managed to maintain liquidity.

Prudential Indicators - Actuals

31. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance, the Treasury Management in the Public Services Code of Practice and related guidance published by CIPFA.

32. The codes require councils to set a series of indicators and limits each year. The 2020-21 indicators were agreed in February 2020, before the start of the financial year and enable the strategic director of finance and governance to carry out his responsibilities in this area. The prudential indicator estimates for 2020-21 are included at Appendix A.

33. The council has complied with its Prudential Indicators throughout 2020-21.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

34. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit, governance and standards committee.

35. Financial standing orders require the strategic director of finance and governance to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a regular basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance and governance.

36. The Local Government Act 2003 ("the 2003 Act") and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

37. Section 15(1) of the 2003 Act requires a local authority "to have regard (a) to such guidance as the Secretary of State may issue". This guidance is found in the Ministry of Housing, Communities and Local Government Guidance on Local Authority Investments updated February 2018 and there is statutory guidance on the Minimum Revenue Provision (MRP) made under section 21(1A) of the 2003 Act.

38. Section 12 of the 2003 Act grants local authorities the powers to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
None		

APPENDICES

No.	Title
Appendix A	Prudential Indicators – 2020-21 Actuals & Estimates

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Rob Woollatt, Interim Departmental Finance Manager	
Version	Final	
Dated	12 November 2020	
Key Decision?	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments Sought**	**Comment included**
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	No	N/A
Cabinet Member	Yes	No
Date final report sent to Constitutional Team		12 November 2020

APPENDIX A

PRUDENTIAL INDICATORS: 2020-21 ACTUALS AND ESTIMATES

BACKGROUND

1. Capital finance, borrowing and investment arrangements are supported by a series of prudential indicators, drawn from the Prudential Code on Capital Finance for Local Authorities and the Treasury Management in the Public Services Code of Practice plus Guidance, published by CIPFA. The Local Government Act 2003 requires that councils have regard to these codes. The indicators were approved by Council Assembly in February 2020, and the 2019-20 outturn positon was reported in July 2020. This appendix updates 2020-21 indicators.

2. The indicators are grouped into three broad areas: affordability and prudence, capital finance and treasury management. The indicators are of a technical nature and existing budgets take account of capital finance and treasury activities.

INDICATORS ON AFFORDABILITY AND PRUDENCE

2019-20 Outturn	2020-21 Estimate	
		Ratio of Financing Cost to Net Revenue Stream A measure of the cost of borrowing and long term liabilities net of interest income and set-asides, as a
8%	10%	HRA
4%	5%	General fund

		Capital Financing Requirements (CFR) and Gross Debt The CFR is the balance remaining on past capital expenditure financed through debt and long term liabilities. The level of gross debt should not exceed the CFR unless prudent over the short term. Actual gross
£1,084m	£1,255m	CFR
£810m	£902m	Maximum Gross Debt in the Year

INDICATORS ON CAPITAL FINANCE

2019-20 Outturn	2020-21 Estimate	
		Capital Expenditure
£168m	£223m	HRA
£233m	£179m	General fund
£401m	**£402m**	**Total**

		Capital Financing Requirement (CFR) The CFR is the balance on past capital expenditure financed through borrowing and long term liabilities
£462m	£522m	HRA
£622m	£733m	General fund
£1,084m	**£1,255m**	**Total**

INDICATORS ON TREASURY MANAGEMENT

Operational Boundary and Authorised Limit for External Debt:

These are limits the council determines to accommodate borrowing and long term liabilities. The lower limit is the operational boundary and takes account of existing positions and ordinary activity and the higher limit is the authorised limit, enabling additional borrowing to be taken for very short periods, in the interest of prudence, within a risk controlled framework.

2019-20 Outturn	2020-21 Limit	2020-21 Estimate	Operational Boundary
£810m	£1,336m	£952m	Borrowing (maximum outstanding in year)
£91m	£90m	£90m	Other Long Term Liabilities
£901m	**£1,426m**	**£1,136m**	**Total**

			Authorised Limit
£810m	£1,637m	£1,637m	Borrowing (maximum outstanding in year)
£91m	£126m	£126m	Other Long Term Liabilities
£901m	**£1,763m**	**£1,763m**	**Total**

2019-20 Outturn	2020-21 Limit	2020-21 Estimate	
84%	100%	84%	**Gross and Net Debt** An upper limit on net debt as a percentage of gross debt. The net debt has remained below gross on account of investments held to meet spend.
			Fixed and Variable Rate Upper Limits Limits recognising existing positions with flexibility to vary exposure within a risk
100%	100%	100%	Fixed rate debt
0%	20%	1%	Variable rate debt

			Maturity Structure of Borrowing Limits accommodating existing positions with flexibility to vary exposure within a risk
23%	35%	23%	Under 1 year
2%	35%	2%	1 year and within 2 years
10%	50%	6%	2 years and within 5 years
17%	75%	9%	5 years and within 10 years
48%	100%	60%	10 years and over

			Limits on Investments Greater than One Year Caps on the maximum exposure to longer investments, while recognising benefits from prudent exposure within a risk controlled framework.
37%	65%	40%	Percentage longer than one year
4 months	30 months	6 months	Overall maximum average maturity