Item No: 6.2	Classification: Open	Date: 14 July 2021	Meeting Name: Council Assembly
Report title:		Treasury Management Performance - 2020-21 annual report and prudential indicators	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Governance	

RECOMMENDATION

1. That Council Assembly notes the 2020-21 outturn for the council's treasury management activity and that:

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

   - the balance remaining on all external loans at 31 March 2021 was £886m, with £72m of new long-term borrowing drawn during the financial year, all long-term borrowing is to support the growth in capital investment;

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. The key issues covered in this report are:

- Prudential indicators for 2020-21
- The council's borrowing strategy and debt management position
- Investment performance and activity

KEY ISSUES FOR CONSIDERATION

Prudential Indicators - Actuals

7. 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. 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 enabled the strategic director of finance and governance to carry out his responsibilities in this area. The 2020-21 prudential indicator outturn details are included at Appendix A.

8. The council has complied with its prudential indicators throughout 2020-21.

Borrowing strategy and debt management activity and position

9. As at 31 March 2021 the outstanding debt held by the council was £886m an increase from £810m as at 31 March 2020

10. The council's debt management strategy since 2011-12 has been to pursue a policy of internal borrowing, which is the use of existing reserves and balances to fund capital expenditure 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. Borrowing in advance of need from a cash flow perspective creates a 'cost of carry' which is the difference between the short term investment income earned through holding cash balances compared against longer term external debt financing costs. Efficient use of existing council resources to fund capital expenditure through internal borrowing also reduces the counterparty risk inherent in the investment of the council's cash balances.

12. However, since 2017-18 it has become necessary to undertake new external borrowing in order to finance capital investment and to maintain target cash balances. This has necessitated the use of long term debt financing to secure

long term financial stability.

13. In November 2020 the PWLB published its response to the consultation on ‘Future Lending Terms’. From 26 November the margin on PWLB loans was reduced by 1% (reversing the increase announced in 2019), providing that the borrowing authority can confirm that it is not planning to purchase investment assets primarily for yield in the current or next two financial years. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

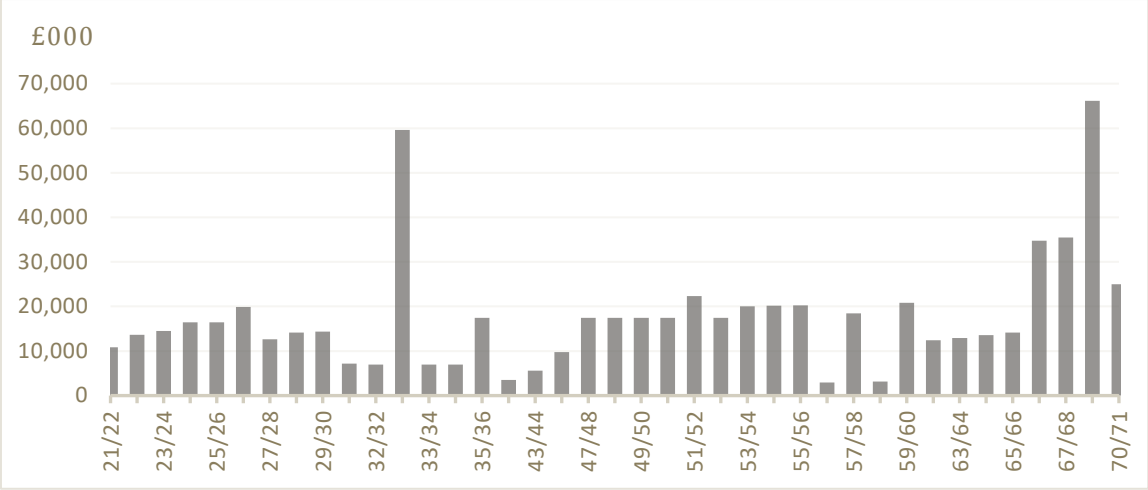
14. As part of the borrowing process the council will now be required to submit more detailed capital expenditure plans with confirmation of the purpose of capital expenditure. The PWLB can now also restrict the council from borrowing in unusual or large amounts.

15. Historical long term debt for the council has been drawn from the PWLB. However borrowing could come from a variety of different sources. The council will continue to review alternative sources of borrowing to the PWLB. Any borrowing decision is made in consideration of capital and cash flow forecasts, market conditions, interest rate expectations and with respect to associated risks. The council also utilise the advice of its external treasury advisor Arlingclose.

16. During the financial year to 31 March 2021 the council borrowed £65m from the Public Works Loans Board, as part of HM Treasury, in separate loans, with maturity terms ranging from 46 to 50 years at an average interest rate of 1.93%. The council also borrowed £7m from the Mayor of London's Energy Efficiency Fund (MEEF) with a maturity term of 18 years at interest rate 0.88%.

17. Drawing of long term borrowing has been supplemented by short term borrowing from other local authorities to reduce the overall debt interest expense for the council. This approach continued during 2020-21. The level of short term borrowing from other local authorities as at 31 March 2021 was £197m. The weighted average rate of interest for the council’s overall debt portfolio is 3.3% as at 31 March 2021. For short-term borrowing the weighted average is 0.3%, significantly less than long term rates of borrowing.

18. The maturity profile of outstanding long term debt as at 31 March 2021 is shown in the chart below:



Provision for repayment of debt

19. Each year, the general fund sets aside sums, known as the minimum revenue provision (MRP), to reduce its borrowing liabilities. In 2020-21 £10.0m (£8.9m in 2019-20) was set aside to repay debt. The HRA can also set aside sums to reduce borrowing liabilities. During 2020-21 no additional sums were set aside.

20. The overall level of internal borrowing at 31 March 2021 was £248m. The increase in internal borrowing from 31 March 2020 (£187m) reflects the increase in cash reserves during the financial year after taking account of capital spend not funded by existing resources. The council's capital spending programme is set out in more detail in the capital monitoring outturn report to Cabinet in June 2021.

21. Officers regularly monitor current and forecast interest rates to determine the appropriateness of the internal borrowing strategy, so that the reduction in current borrowing costs from use of internal balances is not offset by higher borrowing costs in the future.

22. The PWLB continues to operate a spread of approximately 1% between "premature repayment rates" and "new loan" rates so the premium charge for early repayment of PWLB debt remained expensive for the council's portfolio and therefore unattractive for debt rescheduling activity.

23. The short term debt drawn during 2020-21 will mature in 2021-22 and there will be a requirement to refinance this by drawing down further borrowing. The council will consider a number of borrowing sources, both long and short term. Decisions on the most optimal and value for money source and duration of the borrowing will be made in the context of any changes in interest rates and the longer term cash flow requirements of the council. It is expected that further borrowing will be required in 2021-22.

Investment strategy and investment activity and position

24. The council has significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Council cash that is

not immediately required for current expenditure is invested in money market instruments in accordance with the MHCLG Guidance on Local Authority Investments and the investment strategy as approved by Council Assembly for each financial year.

25. In accordance with MHCLG guidance, the council gives priority to the security and liquidity of any investments made and then to seek an investment return commensurate with these principles.

26. Council investments are managed both in-house and delegated to two external fund managers; Alliance Bernstein and Aberdeen Standard Investments. The focus for in-house investment is to meet variable near term cash liquidity requirements.

27. The external fund managers invest over a longer term across a range of investment instruments including UK government gilts, supranational bank bonds, and certificates of deposits and covered bonds issued by major banks/ building societies. 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.

28. Following the cut in Bank rate from 0.75% to 0.10% in March 2020, the council had expected to receive significantly lower income from its cash and short-dated money market investments, including money market funds in 2020-21, as rates on cash investments are close to zero percent.

29. As at 31 March 2021 total investments stood at £219m (£133m at 31 March 2020). The overall rate of return on investments during 2020-21 was 0.52% (0.73% in 2019-20).

30. To assess the external fund managers 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 financial year, the benchmark index annualised return was 0.11%. Actual fund manager returns were 0.86% indicating good performance compared to the benchmark.

31. The rate of investment return generated by the treasury management portfolio is 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.

32. The distribution of investments by maturity and credit rating as at 31 March 2021 is set out in the table below:

Maturity Profile and Credit	A	AA	AAA	Grand Total
Less than 1 year	37%	11%	24%	72%
1-2 Years	5%	6%	6%	17%
2-5 Years	3%	0%	9%	12%
Grand Total	**45%**	**17%**	**38%**	**100%**

AAA represents the highest credit quality, AA represents very high credit quality and A represents high credit quality.

Non-treasury investments

33. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which are held primarily or partly for financial return.

34. The non-treasury investments held by the council:

- The council's commercial property portfolio is valued at £381.1m at 31 March 2021 (£343.8m at 31 March 2020). Despite the pandemic rental income has held up reasonably well, generating £19.2m in 2020-21.

- The balance of loans to local institutions was £27m at 31 March 2021.

35. The pandemic continues to impact on treasury activity and performance with regard to volatility in cash balances. The council's policy of retaining accessible and liquid resources means the council does not foresee any immediate cash flow difficulties.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Governance

36. 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.

37. 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.

38. 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.

39. 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.

40. 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.

REASONS FOR URGENCY

41. The council is required to report the Treasury Management outturn for the previous financial year to Council Assembly by 30 September each year.

REASONS FOR LATENESS

42. Due to the pandemic the Government issued Regulations delaying the statutory date for the publication of local authority accounts until 31 July. The Council’s 2020-21 accounts are due to be published on 8 July 2021.

BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
Capital and Treasury Management Strategy 2020-21	160 Tooley Street PO Box 64529 London SE1P 5LX	Rob Woollatt 020 7525 0614
https://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=132&MId=6377&Ver=4		

APPENDICES

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

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Rob Woollatt, Interim Departmental Finance Manager	
Version	Final	
Version Date	7 July 2021	
Key Decision	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments sought**	**Comments included**
Director of Law and Governance	Yes	Yes
Strategic Director of Finance and Governance	Not applicable	Not applicable
Cabinet Member	Yes	Yes
Final Report Sent to Constitutional Team		7 July 2021

APPENDIX A

PRUDENTIAL INDICATORS: 2020-21 ACTUALS

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. This appendix updates 2020-21 indicators as per the un-audited statement of accounts for 2020-21.

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. The indicators themselves have no effect on those budgets.

INDICATORS ON AFFORDABILITY AND PRUDENCE

3. The indicators below are for affordability and prudence.

2019-20	2020-21	
		Ratio of Financing Cost to Net Revenue Stream A measure of the cost of borrowing and long term liabilities (e.g. PFI) net of interest income and set-asides, as a percentage of revenue.
8%	8%	HRA
4%	4%	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 (e.g. PFI). The level of gross debt should not exceed the CFR unless prudent over the short term. Actual gross debt remained below the CFR throughout 2019- 20 on account of cash balances, internal borrowing and PFI transactions.
£1,084m	£1,220m	CFR
£810m	£886m	Maximum gross debt in the year

INDICATORS ON CAPITAL FINANCE

4. The indicators below are for capital finance.

2020-21	2020-21	
Capital Expenditure - Capital expenditure includes PFI funded spend.		
£157m	£215m	HRA
£104m	£118m	General fund
£261m	**£333m**	**Total**

Capital Financing Requirement (CFR) - the CFR is the balance on past capital expenditure financed through borrowing and long term liabilities (e.g. PFI).		
£462m	£521m	HRA
£622m	£699m	General fund
£1,084m	**£1,220m**	**Total**

INDICATORS ON TREASURY MANAGEMENT

5. The indicators below are for 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 Outturn	Operational Boundary
£810m	£1,336m	£886m	Borrowing (maximum outstanding in year)
£91m	£90m	£86m	Other Long Term Liabilities
£901m	**£1,426m**	**£972m**	**Total**

			Authorised Limit
£677m	£1,637m	£886m	Borrowing (maximum outstanding in year)
£96m	£126m	£86m	Other Long Term Liabilities
£773m	**£1,763m**	**£972m**	**Total**

2019-20 Outturn	2020-21 Limit	2020-21 Outturn	
84%	100%	77%	**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 controlled framework should it be prudent.
100%	100%	100%	Fixed rate debt
0%	20%	0%	Variable rate debt

			Maturity Structure of Borrowing Limits accommodating existing positions with flexibility to vary exposure within a risk controlled framework.
22%	35%	22%	Under 1 year
8%	35%	1%	1 year and within 2 years
10%	50%	6%	2 years and within 5 years
14%	75%	8%	5 years and within 10 years
47%	100%	62%	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%	28%	Percentage longer than one year
8 months	2.5 years	11.6 months	Overall maximum average maturity