Title of meeting:	Governance and Audit and Standards Committee Cabinet City Council
Date of meeting:	Governance and Audit and Standards Committee 25th September 2020 Cabinet 6th October 2020 City Council 13th October 2020
Subject:	Treasury Management Outturn Report 2019/20
Report by:	Director of Finance and Resources (Section 151 Officer)

Wards affected:	All
Key decision:	No
Full Council decision:	Yes

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1. Executive Summary

The Chartered Institute of Public Finance & Accountancy's (CIPFA) Prudential Code of Practice requires local authorities to calculate prudential indicators before the start of and after each financial year. The CIPFA Code of Practice on Treasury Management also requires the Section 151 Officer to prepare an annual report on the outturn of the previous year. This information is shown in Appendix A of the report.

2. Purpose of Report

To inform members and the wider community of the Council's treasury management activities in 2019/20 and of the Council's treasury management position as at 31st March 2020.

3. Recommendations

It is recommended that the actual prudential and treasury management indicators based on the unaudited accounts, as shown in Appendix B, be noted (an explanation of the prudential and treasury management indicators is contained in Appendix C).

4. Background

The Local Government Act 2003 requires local authorities to have regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities.

5. Reasons for Recommendations

The net cost of Treasury Management activities and the risks associated with those activities have a significant effect on the Council's overall finances.

6. Integrated impact assessment

An integrated impact assessment is not required as the recommendations do not directly impact on service or policy delivery. Any changes made arising from this report would be subject to investigation in their own right.

7. Legal implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance & Resources (Section 151 Officer) comments

All financial considerations are contained within the body of the report and the attached appendices

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Signed by Director of Finance & Revenues (Section 151 Officer)

Appendices:

Appendix A: Treasury Management Outturn Report
Appendix B: Prudential and Treasury Management Indicators
Appendix C: Explanation of Prudential and Treasury Management Indicators

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

	Title of document	Location
1	Information pertaining to the treasury management outturn	Financial Services
2		

APPENDIX A

TREASURY MANAGEMENT OUTTURN REPORT

1. GOVERNANCE

Treasury management activities were performed within the Prudential Indicators approved by the City Council.

Treasury management activities are also governed by the Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council.

2. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

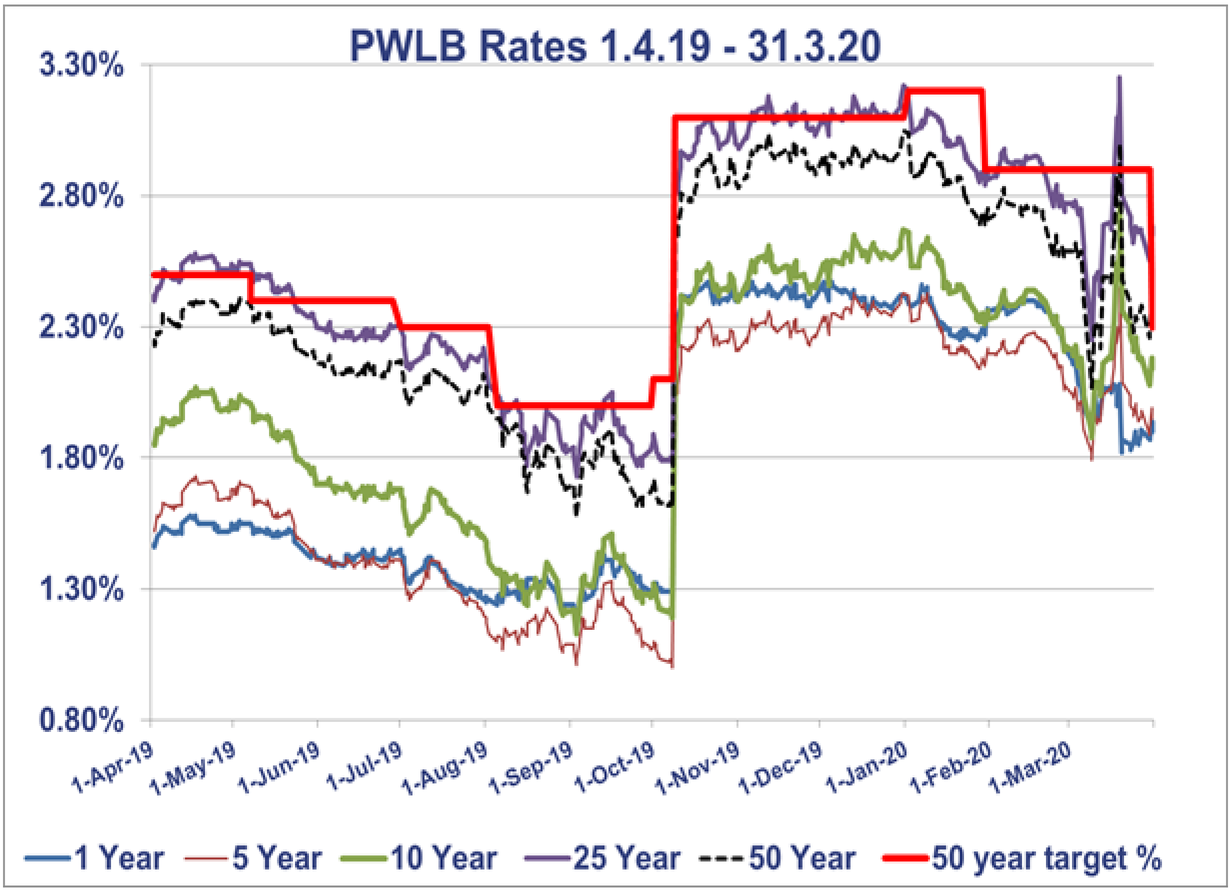
On 31 March 2020 the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £764m and gross investments of £393m giving rise to a net debt of £371m. Major components of the Council's gross investments of £393m include the Council's general and earmarked reserves of £226m, and capital grants received but yet to be applied to finance capital expenditure of £115m.

3. BORROWING ACTIVITY

Gilt yields, and consequently Public Works Loans Board (PWLB) rates, 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).

However, HM Treasury has imposed two changes in the margins over gilt yields for Public Works Loans Board (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.

The movements in PWLB rates can be seen in the graph below.



The Government also announced that there would be a consultation with local authorities on possibly further amending these margins; this ended on 30th July. It is also 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.

Following the changes on 11 March 2020 in the 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)

The Council qualifies to borrow at the certainty rates.

The Council has established a net loans requirement in its Capital Strategy for 2019/20. This is the Council's underlying need to borrow to fund the approved capital program after taking account of cash backed reserves which could be used to internally fund capital expenditure financed from borrowing for a limited period. This identified that the Council will need to borrow £46m within the next 3 years.

In July 2019 the Council purchased Lakeside North Harbour Business Park. The opportunity to acquire Lakeside North Harbour Business Park was not known about when the 2019/20 Capital Strategy was approved and consequently the Council had a much higher borrowing requirement than had been anticipated.

The Council undertook long term borrowing of £90m in 2019/20 at a weighted average interest rate of 1.83% and an average weighted term of 34 years. This is detailed below.

Date of Advance	Principal	Interest Rate	Term (years)	Repayment Method
29/5/19	£20m	2.28%	35	Annuity
7/8/19	£20m	1.57%	25	Equal Instalments of Principal
20/8/19	£17m	1.67%	49	Principal Paid at Maturity
5/9/19	£20m	1.59%	45.5	Principal Paid at Maturity
11/3/20	£13m	2.07%	50	Principal Paid at Maturity

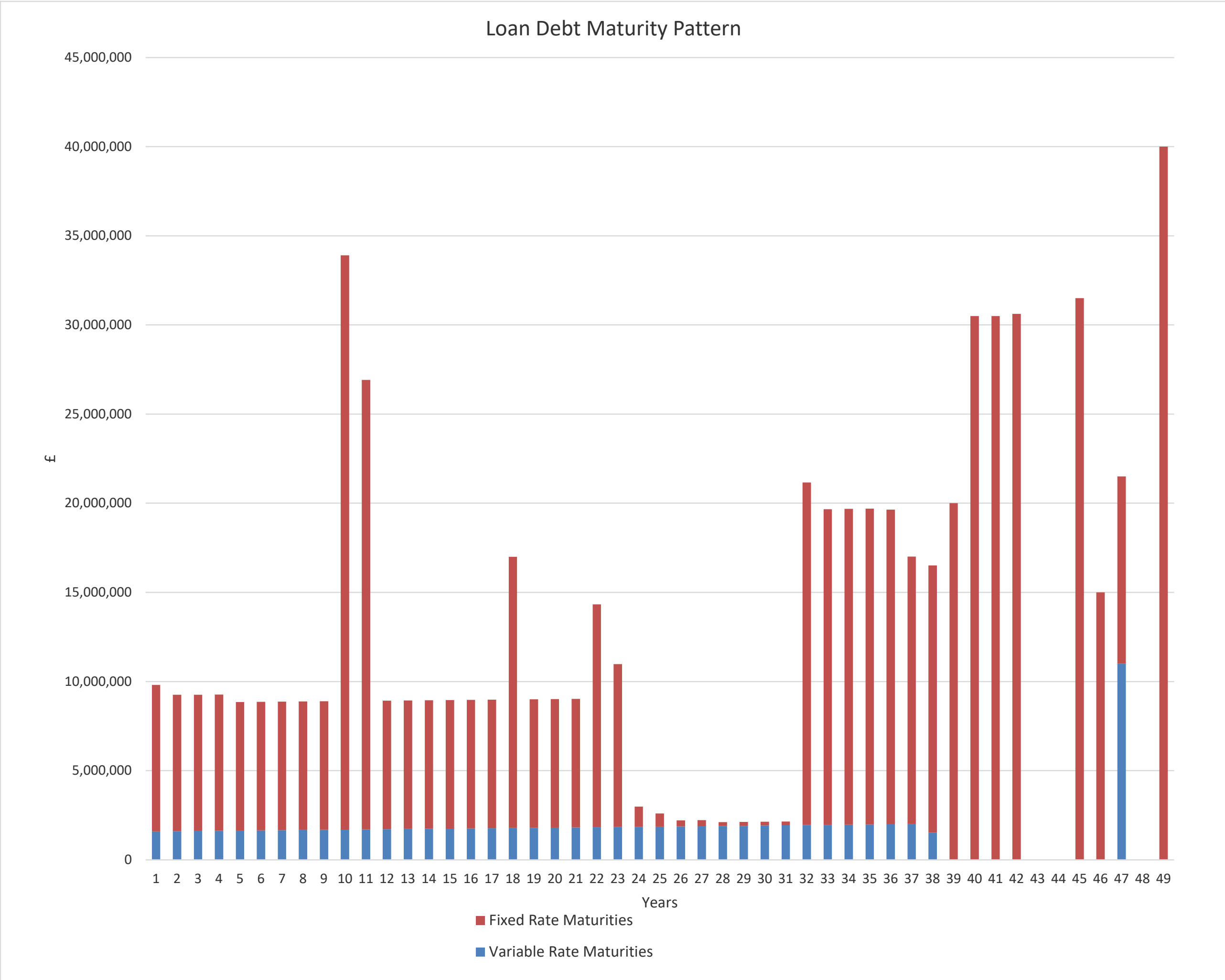
In addition, it was also necessary to undertake short term borrowing at two points in the year. £30m was borrowed in June for an average of 37 days at 0.67% in order to fund the purchase of Lakeside North Harbour Business Park. £30m was borrowed in March for an average of 50 days at 0.84% in order to fund the payment of 3 years of employer's pension contributions in advance in return for a discount. In both cases the expenditure was opportunistic and insufficient investments matured before these large single payments had to be made.

The Council borrowed £3.6m interest free from Salix repayable over 5 years to fund energy efficiency projects including the replacement of street lighting with LED lamps. Salix is a not-for-profit organisation that is funded by the Government to promote energy efficiency within the public sector.

The Council's underlying need to borrow at 31st March 2020 was £799m, £35m in excess of its actual gross debt of £764m. This shortfall of £35m is funded by internal borrowing from the Council's reserves and will need to be borrowed externally at some point in the future.

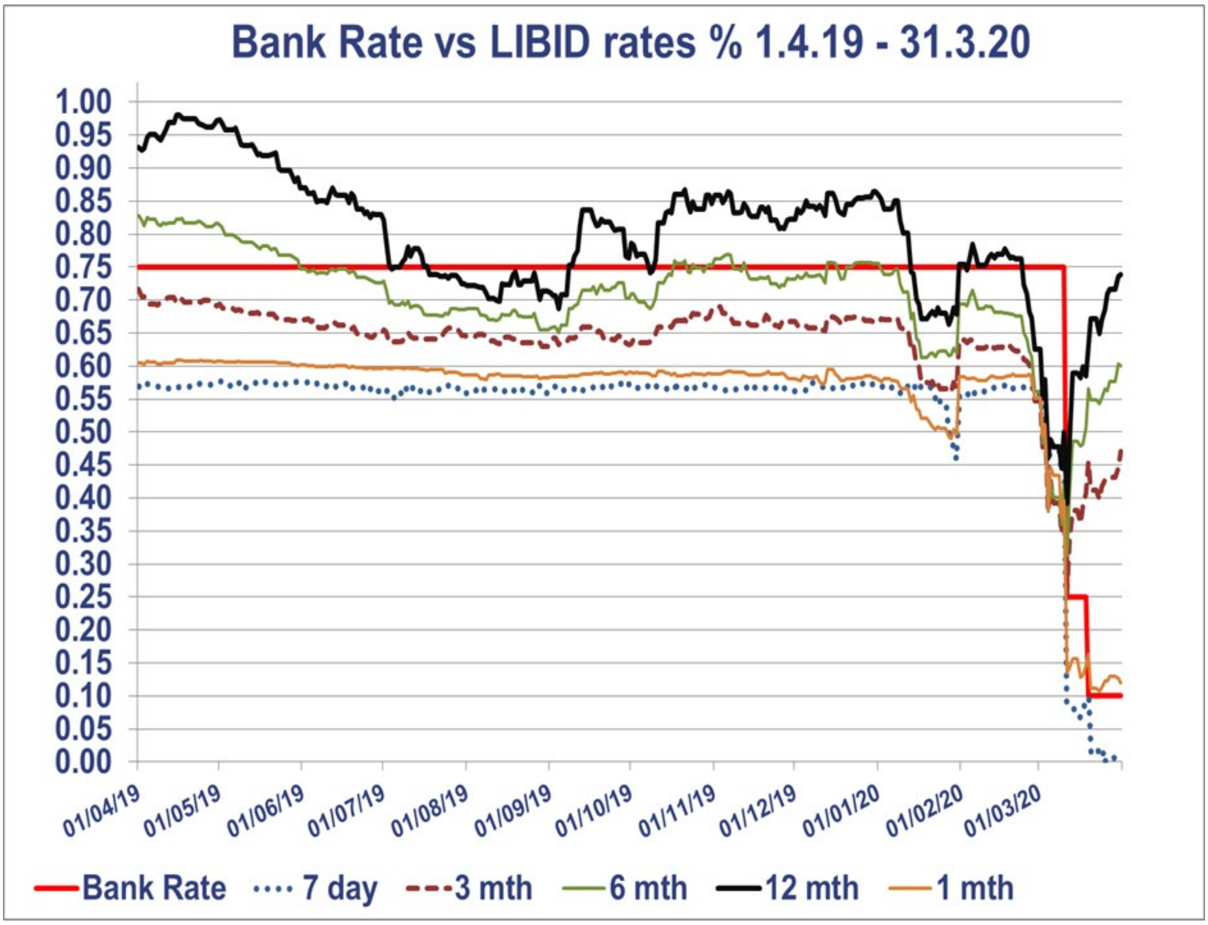
Debt rescheduling opportunities have been limited in the current economic climate and following the various increases in the margins added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling was undertaken during 2019/20.

The Council's gross debt at 31st March 2020 of £764m is within the Council's authorised limit (the maximum amount of borrowing permitted by the Council) of £807m and the Council's operational boundary (the maximum amount of borrowing that is expected) of £777m. The Council aims to have a reasonably even maturity profile so that the Council does not have to replace a large amount of borrowing in any particular year when interest rates might be high. The maturity profile of the Council's borrowing (see graph below) is within the limits contained in the Council's Treasury Management Policy.



4. INVESTMENT ACTIVITY

Bank Rate and market investment rates (London Interbank Bid (LIBID)) investment rates for 2019/20 are shown below.



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 increase from 0.75% to 1.00% during 2019/20.

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.

The Council's cash investment portfolio consists of the following.

	Portfolio at 31st March 2019	Return in 2018/19	Portfolio at 31st March 2020	Return in 2019/20
Plain vanilla interest bearing deposits	£380.9m	0.39%	£375.7	0.98%
Tradable structured interest bearing deposits where the interest rate or the maturity date is determined by certain criteria	£25.2m	1.62%	£9.7m	2.05%
Externally managed corporate bonds	£8.0m	2.92%	£7.4m	-1.16%
Total	**£414.1m**	**0.47%**	**£392.8m**	**0.99%**

Returns on the Council's cash investments were adversely affected by the decision to write off the investment in Victory Energy Services Limited (VESL). £3.4m was lent to Victory Services Energy Limited (VESL) (£2.8m in 2018/19 and £0.6m 2019/20). £2.8m had been provided in 2018/19 so the charge to the General Fund in 2019/20 was £0.6m. There are no indications that any other investment will default. If it had not been necessary to provide for the default of VESL, overall returns would have been 1.12% in 2018/19 and 1.16% in 2019/20.

The shortage of liquidity in the financial markets also caused the market value of corporate bonds to fall sharply in March 2020. As a consequence of this the Council's externally managed corporate bonds made a negative return of 1.16% in 2019/20. The corporate bond portfolio has been defensively managed and has no direct exposure to the energy, travel, hospitality, or non-food retail sectors. Now that liquidity has returned to the financial markets the value of the corporate bond portfolio has recovered in the first quarter of 2020.

5. REVENUE COSTS OF TREASURY MANAGEMENT ACTIVITIES IN 2018/19

Expenditure on treasury management activities in both the General Fund and the HRA against the revised budget is shown below.

	Revised Estimate 2019/20 £000	Actual 2019/20 £000	Variance +/- £000
Interest Payable:			
PWLB	18,882	19,025	143
Other Long Term Loans	1,229	1,188	(41)
HCC Transferred Debt	379	366	(13)
Interest on Finance Lease	191	189	(2)
Interest on Service Concession Arrangements (including PFIs)	6,071	6,017	(54)
Interest Payable to External Organisations	1,443	1,514	71
Premiums and Discounts on Early Redemption of Debt	86	89	3
	28,281	**28,388**	**107**
Deduct			
Investment Income:			
Interest on Investments	(3,581)	(4,614)	(1,033)
Impairment of Investments	670	671	1
Other interest receivable	(1,358)	(1,342)	16
	(4,269)	**(5,285)**	**(1,016)**
Provision for Repayment of Debt	**4,917**	**4,763**	**(154)**
Debt Management Costs	**511**	**501**	**(10)**
	29,440	**28,367**	**(1,073)**

Net treasury management costs were £1.1m, or 3.6% below the revised budget. The principal variance was interest income which was £1.0m above the revised estimate. Higher returns and cash balances than anticipated led to more interest being earned on external lending.

APPENDIX B

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

1. Capital financing requirement	Original Estimate £'000	Revised Estimate £'000	Actual £'000
General Fund	505,127	633,173	621,036
Housing Revenue Account (HRA)	180,207	175,807	177,644
Total	685,334	808,980	798,680

2. Authorised Limit	Original Limit £'000	Revised Limit £'000	Actual £'000
Long Term Borrowing	674,378	744,623	701,322
Other Long Term Liabilities	62,377	62,377	62,377
Total	736,755	807,000	763,699

3. Operational Boundary	Original Limit £'000	Revised Limit £'000	Actual £'000
Long Term Borrowing	645,043	714,623	701,322
Other Long Term Liabilities	62,377	62,377	62,377
Total	707,420	777,000	763,699

4. Ratio of financing costs to net revenue stream	Original Estimate	Revised Estimate	Actual
General Fund	12.3%	12.0%	10.8%
Housing Revenue Account (HRA)	7.6%	7.4%	6.8%

5. Maturity Structure of Fixed Rate Borrowing	Lower Limit	Upper Limit	Actual
Under 12 months	0%	10%	1%
12 months and within 24 months	0%	10%	1%
24 months and within 5 years	0%	10%	4%
5 years and within 10 years	0%	20%	11%
10 years and within 20 years	0%	30%	18%
20 years and within 30 years	0%	30%	7%
30 years and within 40 years	0%	40%	31%
Over 40 years	0%	40%	27%

6. Maturity Structure of Variable Rate Borrowing	Lower Limit	Upper Limit	Actual
Under 12 months	0%	10%	2%
12 months and within 24 months	0%	10%	2%
24 months and within 5 years	0%	10%	6%
5 years and within 10 years	0%	20%	11%
10 years and within 20 years	0%	30%	22%
20 years and within 30 years	0%	30%	24%
30 years and within 40 years	0%	30%	19%
Over 40 years	0%	30%	14%

7. Principal sums invested over 365 days	Origuinal Limit £'000	Revised Limit £'000	Actual £'000
Maturing after 31/3/2021	144,000	117,000	47,930
Maturing after 31/3/2022	117,000	50,000	18,200
Maturing after 31/3/2023	-	50,000	10,000

APPENDIX C

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

1. ACTUAL CAPITAL FINANCING REQUIREMENT

This represents the underlying requirement to borrow for capital expenditure. It takes the total value of the City Council's fixed assets and determines the amount that has yet to be repaid or provided for within the Council's accounts.

The capital financing requirement is increased each year by any new borrowing and reduced by any provision for the repayment of debt. Broadly, the higher the capital financing requirement, the higher the amount that is required to be set aside for the repayment of debt in the following year.

2. AUTHORISED LIMIT

The authorised limit for external debt is the maximum amount of debt which the authority may legally have outstanding at any time. The authorised limit includes headroom to enable the Council to take advantage of unexpected movements in interest rates and to accommodate any short-term debt or unusual cash movements that could arise during the year.

3. OPERATIONAL BOUNDARY

The Operational Boundary is based on the probable external debt during the course of the year. It is not a limit, but acts as a warning mechanism to prevent the authorised limit (above) being breached.

4. RATIO OF FINANCING COSTS TO NET REVENUE STREAM 2018/19

This ratio reflects the annual cost of financing net debt as a proportion of the total revenue financing received. It therefore represents the proportion of the City Council's expenditure that is largely fixed and committed to repaying debt. The higher the ratio, the lower the flexibility there is to shift resources to priority areas and/or reduce expenditure to meet funding shortfalls.

For the General Fund, this is the annual cost of financing debt as a proportion of total income received from General Government Grants, Non Domestic Rates and Council Tax.

The ratio of Housing Revenue Account (HRA) financing costs to net revenue stream is the annual cost of financing capital expenditure, as a proportion of total gross income received including housing rents and charges.

5. MATURITY STRUCTURE OF FIXED RATE BORROWING

The Council aims to have a reasonably even debt maturity profile so that it is not unduly exposed to refinancing risk in any particular year when interest rates may be high. The maturity structure of fixed rate borrowing matters less in future years as inflation will reduce the real value of the sums to be repaid.

6. MATURITY STRUCTURE OF VARIABLE RATE BORROWING

Variable rate borrowing could expose the Council to budgetary pressure if the interest rates increase. The maturity structure of variable rate borrowing matters less in future years as inflation will reduce the real value of the liability.

7. PRINCIPAL SUMS INVESTED FOR OVER 365 DAYS

Investing long term at fixed rates provides certainty of income and reduces the risk of interest rates falling.