Report to:	**Audit and Governance Committee**
Date:	**9 September 2020**
Title:	**Treasury Management Annual Report 2019/20**
Report of:	**Chief Finance Officer**
Cabinet member:	**Councillor Stephen Holt, Cabinet Member for Finance**
Ward(s):	**All**
Purpose of report:	To report on the activities and performance of the Treasury Management service during 2019/20
Decision type:	Budget and Policy Framework
Officer recommendation(s):	(1) To note the annual Treasury Management report for 2019/20. (2) To note the 2019/20 prudential and treasury indicators.
Reasons for recommendations:	Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code) and this has to be reported to Full Council.
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1 Introduction

1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 During 2019/20 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 06 February 2019)
- a mid year (minimum) treasury briefing (Council 05 February 2020)
- an annual report following the year describing the activity compared to the strategy (this report).

1.3 In addition Treasury Management updates are included in the quarterly performance management reports, considered by both the Cabinet and Scrutiny Committee. Recent changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members. This report will be considered by the Cabinet at the 16th September 2020 meeting.

1.4 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit & Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 22 January 2020, Court Room, Town Hall, Eastbourne. This is to support Members' scrutiny role and further training is expected to take place in 2020-21.

1.5 This report summarises:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement (CFR));
- Reporting of the required prudential and treasury indicators and changes to be approved;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Debt activity and investment activity.
- Economic and Interest Rates

2.0 The Council's Capital Expenditure and Financing 2019/20

2.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2018/19 Actual £m	2019/20 Revised Estimate £m	2019/20 Actual £m
Non-HRA capital expenditure	35.8	14.6	14.3
HRA capital expenditure	4.7	6.5	4.5
Commercial Activities/nonfinancial investments	4.0	19.0	15.0
Total capital expenditure	**44.5**	**40.01**	**33.8**
Resourced by:			
• Capital receipts	7.8	3.0	3.6
• Capital grants & external funding	3.8	3.1	2.6
• Capital Reserves	4.2	5.2	4.2
• Revenue	0.5	1.1	0.5
Use of internal balances/ borrowing	**28.2**	**27.7**	**23.4**

3.0 The Council's overall borrowing need

3.1 The Capital Financing Requirement (CFR) represents the Council's total underlying need to borrow to finance capital expenditure, i.e. capital expenditure that has not been resourced from capital receipts, capital grants and contributions or the use of reserves. Some of this borrowing is from the internal use of cash balances.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

3.3 **Reducing the CFR** – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR. The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied

capital receipts); or

- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.4 The Council's 2019/20 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2019/20 on 6 February 2019. The Council's CFR for the year is shown below, and represents a key prudential indicator. The figures include a credit sales agreement on the balance sheet, which increases the Council's borrowing need, the CFR.

CFR	31 March 2019 Actual £m	31 March 2020 Revised Estimate £m	31 March 2020 Actual £m
Opening balance	122.6	149.9	149.9
Add unfinanced capital expenditure (per table 2.0)	28.2	27.7	23.4
Less MRP	(0.9)	(0.6)	(0.5)
Closing balance	**149.9**	**177.0**	**172.8**

3.5 Minimum Revenue Provision (MRP) - A consultant was commissioned to review the Council MRP, which resulted in a revision to the MRP methodology recommendation. The current methodology for borrowing incurred before 1 April 2008 is based on using an equal instalment method and other appropriate options. The alternative now proposed was an annuity method.

3.6 Under this revised methodology, MRP will be lower in the early years and increases over time. This is considered a prudent approach as it reflects the time value of money (i.e. the impact of inflation) as well as providing a charge that is better matched to how the benefits of the asset financed by borrowing are consumed over its useful life. That is, a method that reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years. The revised MRP Policy Statement therefore reflects this change in policy introduced during 2019/20.

3.7 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the Authorised Limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term, the Council's external borrowing net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2018/19 plus the expected changes to the CFR over 2019/20 and 2020/21. This indicator allows the Council some flexibility to borrow in advance of its immediate capital need in 2019/20. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2019 Actual £m	31 March 2020 Revised Estimate £m	31 March 2020 Actual £m
Net borrowing position	123.6	151.3	162.2
CFR	149.9	177.0	172.8

3.8 **The Authorised limit** - the Authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2019/20 the Council has maintained gross borrowing within its Authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the Authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Descriptions	2019/20
Authorised limit	£202.7m
Maximum gross borrowing position	£168.0m
Operational boundary	£187.1 m
Average gross borrowing position	£143.0m
Financing costs as a proportion of net revenue stream: Non HRA HRA	 10.8% 14.1%

4.0 Treasury Position as at 31 March 2019

4.1 The Council's debt and investment position is organised by staff within Financial Services in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.

4.2 Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2019/20 the Council's treasury position was as follows:

TABLE 1	31 March 2019 Principal	Rate/ Return	31 March 2020 Principal	Rate/ Return
Fixed rate funding:				
-PWLB	£87.1m		£125.7m	
-Market	£36.5m		£36.5m	
- Serco Paisa	£0.0m		£0.0m	
Total debt	**£123.6m**	**2.74%**	**£162.2m**	**2.52%**
CFR	£149.9m		£172.8m	
Over/ (under) borrowing	(£26.3m)		(£10.6m)	
Total investments (excl. cash)	**£0m**		**£0m**	

The Council held cash balances of £3.2m in a current account on which interest of 0.65% was being earned until the March base rate change.

4.3 The maturity structure of the debt portfolio excluding Serco Paisa was as follows:

	31 March 2019 Actual £m	31 March 2020 Original limits £m	31 March 2020 Actual £m
Under 12 months	28.1	20.0	37.71
12 months and within 24 months	-	4.0	5.21
24 months and within 5 years	18.3	22.0	10.74
5 years and within 10 years	-	2.1	13.98
10 years and above	77.2	103.2	94.52

The exposure to fixed and variable rates (including Serco Paisa) was as follows:

	31 March 2019 Actual £m	31 March 2020 Original limits £m	31 March 2020 Actual £m
Principal - Debt Fixed rate	123.6	151.3	162.1
Principal – Investments Variable rate	0	N/a	0

5.0 The Strategy for 2019/20

5.1 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 stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020. Shorter term investment interest rates were fairly flat during most of the year until the two cuts in Bank Rate in March 2020 caused investment rates to fall sharply.

5.2 The Council does not have sufficient cash balances to be able to place deposits for more than a month so as to earn higher rates from longer deposits. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

5.3 Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

5.4 During 2019-20, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

5.5 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.
The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

5.6 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Chief Finance Officer, therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks. If it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of

deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

5.7 Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View 31.3.20								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

5.8 In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk. Since PWLB rates peaked during October 2018, most PWLB rates have been on a general upward trend.

6.0 Borrowing Outturn for 2019/20

6.1 Treasury Borrowing.

Borrowing – The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. New loans totalling £41m were drawn down from PWLB in 2019/20 to fund the net unfinanced capital expenditure and to replace maturing loans. Interest rates for PWLB borrowing was between 1.59% and 2.21% compared with a budget assumption of 2.8%. Various temporary loans were taken to cover cash flow requirements. All loans drawn were for fixed rate and are detailed in Appendix A.

In taking this decision, the Council carefully considered achieving best value, the risk of having to borrow at higher rates at a later date, the carrying cost of the difference between interest paid on such debt and interest received from investing funds which would be surplus until used, and that the Council could ensure the security of such funds placed on temporary investment.

Rescheduling – no debt rescheduling was carried out during the year as there was no financial benefit to the Council.
Repayment – £0m of long term PWLB debt was repaid at maturity on 19 June 2018 and £2.5m was an instalment repayment for the repayment (EIP) loans.

Various temporary loans were repaid during the year, see Appendix A.

Summary of debt transactions – the overall position of the debt activity resulted in a fall in the average interest rate by 0.2%, representing a saving to the General Fund.

7.0 Interest Rates in 2019/20

7.1 The tight monetary conditions following the financial crisis continued through 2019/20 with little material movement in the shorter term deposit rates.

7.2 Bank Rate remained at 0.75% until 11 March 2020 when it was reduced to 0.25%, which was followed with a further reduction on 19 March 2020 to 0.10%. Investment rates remained very low. With many financial institutions failing to meet the Council's investment criteria, the opportunities for investment returns were limited. The investment rates at the beginning, average and end of the year are provided below.

Investment Term	Interest Rate March 2019	Average Rate	Interest rate April 2020
Overnight	0.55%	0.72%	0.10%
1 Month	0.70%	0.56%	0.11%
3 Months	0.80%	0.63%	0.26%
6 Months	0.80%	0.70%	0.31%
12 Months	0.95%	0.80%	0.39%

The PWLB rates (including the 0.2% reduction for Certainty Rate) at the beginning, average and end of the year are provided below.

Term	Interest Rate March 2019	Average Rate	Interest rate April 2020
1 Year	1.46%	1.83%	1.90%
5 Years	1.52%	1.77%	1.95%
10 Years	1.84%	2.00%	2.14%
25 Years	2.41%	2.56%	2.65%
50 Years	2.24%	2.40%	2.39%

8.0 Investment Outturn for 2019/20

8.1 **Investment Policy** – the Council's investment policy is governed by MHCLG guidance, which was been implemented in the annual investment strategy approved by the Council on 06 February 2019. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

8.3 **Resources** – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2019 (Restated) £m	31 March 2020 £m
Balances	5.55	2.03
Earmarked reserves	5.29	6.86
HRA	5.95	5.88
Major Repairs Reserve	1.06	1.15
Capital Grants & Contributions	2.60	1.95
Usable capital receipts	7.55	6.26
Total	**28.00**	**24.13**

8.4 **Investments held by the Council** - the Council maintained an average balance of £6.4m of internally managed funds. The internally managed funds earned an average rate of return of 0.6%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.53%. This excludes the Council's investment with Lloyds Bank of £1m for 5 years, (matured January 2019) at 3.03% which supported the Local Authority Mortgages Scheme (LAMS).

9.0 The Economy and Interest Rates Forecast

9.1 The Council's treasury advisor, Link, provides the following forecast as at March 2020:

Link Asset Services Interest Rate View 31.3.20								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

The Link central forecast is for the Bank Rate to increase to 1.00% in quarter 1 of 2020. The Economy and Interest Rates Forecast is attached as Appendix B.

10.0 Executive Summary and Conclusion

10.1 During 2019/20, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2018/19 Actual £m	2019/20 Revised Estimate £m	2019/20 Actual £m
Actual capital expenditure	43.6	40.1	33.8
Total Capital Financing Requirement:			
• Non-HRA	107.3	134.4	130.2
• HRA	42.6	42.6	42.6
• Total	149.9	177.0	172.8
Net borrowing	123.6		162.2
External debt	123.6		162.2
Investments (all under 1 year)	-		-

10.2 Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the Authorised limit), was not breached. The financial year 2019/20 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

11 Corporate plan and council policies

11.1 The priority themes were considered as part of the overall Capital Programme which forms part of the Treasury Management Strategy.

12 Financial appraisal

12.1 Financial appraisals were considered as part of the overall Capital Programme which forms part of the Treasury Management Strategy.

13 Legal implications

13.1 Comment from the Legal Services Team is not necessary for this routine monitoring report.

14 Risk management implications

14.1 Risks relating to the timing of borrowing and terms of borrowing are considered and advice is provided by Link. Risk management is considered for each of the schemes within the Capital Programme.

15 Equality analysis

15.1 Equality issues are considered

16 Appendices

16.1

- Appendix A – Temporary loans taken during 2019/20.
- Appendix B - The Economy and Interest Rates

17 Background papers

The Background Papers used in compiling this report were as follows:

CIPFA Treasury Management in the Public Services code of Practice (the Code)
Cross-sectorial Guidance Notes
CIPFA Prudential Code
Treasury Management Strategy and Treasury Management Practices adopted by the Council on 18 May 2010.
Link Asset Services Citywatch and interest rate forecasts