**Meeting:** **Audit Committee** **Date:** **23rd November 2020**
**Council** **3rd December 2020**

**Wards Affected:** **All Wards in Torbay**

**Report Title:** **Treasury Management Mid-Year Review 2020/21**

**Is the decision a key decision?** No

**When does the decision need to be implemented?** Immediate

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## 1. Purpose and Introduction

1.1 This report provides Members with a review of Treasury Management activities during the first part of 2020/21. The Treasury function aims to support the provision of all Council services through management of the Council's cash flow and debt & investment operations.

1.2 The key points in the Treasury Management review are as follows:

- No new borrowing planned in 2020/21
- Bank Rate reduced to 0.1% in March 2020
- Investment rates close to zero with negative rates a risk
- Internal cash resources applied to capital funding and loan repayments
- Cash flow influenced by MHCLG and BEIS grant and funding changes

## 2. Proposed Decision

Audit Committee

**2.1 that the Audit Committee provide any comments and/or recommendations on the Treasury Management decisions made during the first part of 2020/21**

Council

**2.2 that the Treasury Management decisions made during the first part of 2020/21 as detailed in this report be noted.**

## 3. Reason for Decision

3.1 The preparation of a mid-year review on the performance of the treasury management function forms part of the minimum formal reporting arrangements required by the CIPFA Code of Practice for Treasury Management.

## Supporting Information

## 4. Position

4.1 In February 2019 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

4.2 The original Treasury Management Strategy for 2020/21 was approved by Council on 13th February 2020. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

4.3 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing. The Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 13th February 2020.

4.4 In April 2020 the Council changed its Treasury Management advisor to Arlingclose after a full tender process.

## 5. Economic Commentary

5.1 The significant economic events impacting the Treasury Management strategy during the year were:

- MPC lowered Bank Rate from 0.72% to 0.25% on 11th March 2020 followed by a further cut to 0.1% on 19th March 2020 as a result of the of the Covid-19 pandemic on the economy.
- The potential use of negative interest rates has not been ruled in or out by BoE policymakers
- Market interest rates have fallen to little more than zero with negative levels being priced in on some instruments

5.2 A full economic commentary by Arlingclose Ltd is provided at Appendix 1 to this report.

## 6 Local Context

6.1 On 31st March 2020, the Council had net borrowing of £329m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

*Table 1: Balance Sheet Summary*

| | 31.3.20 Actual £m |
|---|---|
| **Total CFR** | **413.4** |
| Less: Other debt liabilities (e.g. PFI) | (17.5) |
| **Loans CFR** | **395.9** |
| External borrowing | 395.2 |
| **Internal borrowing** | 0.7 |
| Less: Usable reserves | (48.0) |
| Less: Working capital | (18.9) |
| **Net Position** | **329.0** |

6.2 Lower official interest rates have reduced the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council pursued its strategy of keeping borrowing and investments below their underlying levels, i.e. internal borrowing, in order to reduce risk.

6.3 The treasury management position on 30th September 2020 and the change over the six months is shown in Table 2 below.

*Table 2: Treasury Management Summary*

| | 31.3.20 Balance £m | Movement £m | 30.9.20 Balance £m | 30.9.20 Rate % |
|---|---|---|---|---|
| Long-term borrowing | 395.2 | (3.4) | 391.8 | 2.99 |
| Short-term borrowing | 0 | 0 | 0 | 0 |
| **Total borrowing** | 395.2 | (3.4) | 391.8 | 2.99 |
| Long-term investments | 10.0 | 0 | 10.0 | 1.64 |
| Short-term investments | 48.5 | 17.5 | 62.0 | 0.45 |
| Cash and cash equivalents | 7.7 | (4.9) | 2.8 | 0.20 |
| **Total investments** | **66.2** | **12.6** | **78.8** | **0.59** |

## 7. Borrowing Update

7.1 On 9th October 2019 the Public Works Loan Board (PWLB) raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Officers have investigated market alternatives, however these offer limited rate advantages and require significant resource to transact (compared to PWLB). The financial strength of individual authorities will be scrutinised by investors and commercial lenders.

7.2 The Chancellor’s March 2020 Budget statement included significant changes to PWLB policy and launched a wide-ranging consultation on the PWLB’s future direction. Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields.

7.3 The consultation titled “Future Lending Terms” allows stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to allow authorities that are not involved in “debt for yield” activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

7.4 The consultation closed on 31st July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year or early next year. A response was submitted for Torbay Council by the Chief Finance Officer.

7.5 **Municipal Bonds Agency (MBA)**: The MBA revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor.

7.6 If the Council intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

7.7 Since the 1% increase in PWLB rates Councils have been monitoring options for alternative borrowing sources. Torbay will also continue to review options including those taken by other Councils.

## 8. Borrowing Strategy during the period

8.1 At 30th September 2020 the Council held £391.8m of loans, (a decrease of £3.4m) as part of its strategy for funding previous years’ capital programmes. Outstanding loans on 30th September are summarised in Table 3 below.

*Table 3: Borrowing Position*

| | **31.3.20 Balance £m** | **Net Movement £m** | **30.9.20 Balance £m** | **30.9.20 Weighted Average Rate %** | **30.9.20 Weighted Average Maturity (years)** |
|---|---|---|---|---|---|
| Public Works Loan Board | 385.2 | (3.4) | 381.8 | 2.946 | 28 |
| Banks (LOBO) | 5.0 | 0 | 5.0 | 4.395 | 58 |
| Banks (fixed-term) | 5.0 | 0 | 5.0 | 4.700 | 54 |
| **Total borrowing** | **395.2** | **(3.4)** | **391.8** | **2.987** | **29** |

8.2 The Council’s chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council’s long-term plans change being a secondary objective.

8.3 In keeping with these objectives, no new borrowing was undertaken, while a £3m existing loan was allowed to mature without replacement. This strategy enabled the Council to reduce net borrowing costs and reduce overall treasury risk.

8.4 Going forward - with short-term interest rates remaining much lower than long-term rates and temporary investments earning virtually zero, it will be more cost effective in the near term to use internal resources or short-term loans instead of long term borrowing.

## 9 Treasury Investment Activity

9.1 On 30th March 2020 the Council received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £47.5m was received, which added to the Council's already significant invested funds. £38.9m of grants was disbursed by the end of September with the balance due to be repaid to central government. In addition to business grants, MHCLG have changed the profile of the council's NNDR payments and have also advanced in full a number of grants

9.2 The investment position is shown in table 4 below.

*Table 4: Treasury Investment Position*

| | 31.3.20 Balance £m | Net Movement £m | 30.9.20 Balance £m | 30.9.20 Income Return % | 30.9.20 Weighted Average Maturity days |
|---|---|---|---|---|---|
| Banks | 30.7 | (5.9) | 24.8 | 0.16 | 23 |
| Government | 0.00 | 15.0 | 15.0 | 0.01 | 12 |
| Local Authorities | 8.0 | (3.0) | 5.0 | 1.00 | 414 |
| Money Market Funds | 18.5 | 6.5 | 25.0 | 0.07 | 1 |
| Other Pooled Funds: | | | | | |
| - Short-dated bond funds | 4.0 | 0 | 4.0 | 0.77 | - |
| - Property fund | 4.7 | (0.2) | 4.5 | 4.03 | - |
| **Total Investments** | **65.9** | **12.4** | **78.3** | **0.59** | **59** |

9.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. In these uncertain economic times the Council will keep an emphasis on the security if its investments.

9.4 Continued downward pressure on short-dated cash rate brought net returns on sterling deposits and money market funds close to zero by the end of September 2020.

9.5 On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities. Since then the level for one month has fallen from 0.01% to zero.

9.6 In the light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks. The danger to this approach is the prospect of exposure to negative rates and an element will remain in fixed term deposits, likely with the government as safest counterparty.

9.7 **Externally Managed Pooled Funds**: £5m of the Council's investments are held in the CCLA Local Authorities Property Fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. The fund has generated an average income return of £109k (4.3%), which is used to support services in year. There was an unrealised capital loss of £197k (4.2%) on the fund value which will not impact the Revenue Account in the current year.

9.8 Similar to many other property funds, dealing (i.e. buying or selling units) in the Fund was suspended by the managers in March 2020. The relative infrequency of property transactions in March as the pandemic intensified meant that it was not possible for valuers to be confident that their valuations correctly reflected prevailing conditions. To avoid material risk of disadvantage to buyers, sellers and holders of units in the property fund, the management company was obliged to suspend transactions until the required level of certainty is re-established. The dealing suspension was lifted in September 2020. There has also been a change to redemption terms for the CCLA Local Authorities Property Fund; from September 2020 investors are required to give at least 90 calendar days' notice for redemptions.

9.9 Because the Council's externally managed fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

9.10 In 2020/21 the Council expects to receive significantly lower income from its cash and short-dated money market investments and from its externally managed funds than it did in 2019/20 and earlier years. However given the greater volumes of cash early on in the year the budget position for 2020/21 has not been severely compromised although there remains uncertainty over the 2021/22 outlook.

## 10 Non-Treasury Investments

10.1 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 the Council holds primarily for financial return. This is replicated in the Investment Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG in which the definition of investments is further broadened to also include all such assets held partially for financial return.

10.2 A full list of the Council's non-treasury investments is provided at Appendix 2 to this report

## 11 Impact of Treasury Performance on the Revenue Budget

11.1 The net revenue budget for treasury management is projected to be underspent after the suspension of new borrowing and use of internal resources.to fund capital expenditure in the near term.

*Table 5: Revenue Budget Performance*

| As at end September 2020 | Revised Budget 2020/21 | Projected Outturn 2020/21 | Variation |
|---|---|---|---|
| | **£M** | **£M** | **£M** |
| Investment Income | (0.4) | (0.4) | 0.0 |
| Interest Paid on Borrowing | 12.5 | 11.8 | (0.7) |
| **Net Position (Interest)** | **12.1** | **11.4** | **(0.7)** |
| | | | |
| Minimum Revenue Provision | 6.4 | 6.4 | 0.0 |
| **Net Position (Other)** | **6.4** | **6.4** | **0.0** |
| | | | |
| **Net Position Overall** | **18.5** | **17.8** | **(0.7)** |

## 12 Compliance

12.1 The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy Compliance with specific investment limits is demonstrated in table 8 below (para 12.4).

12.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 6: Debt Limits

| | Maximum in period | 30.9.20 Actual | 2020/21 Operational Boundary | 2020/21 Authorised Limit | Complied? |
|---|---|---|---|---|---|
| Borrowing | £395.1m | £391.8m | £570m | 690 | Yes |
| PFI and Finance Leases | £17.5m | £17.5m | £20m | £20m | Yes |
| **Total debt** | **£412.6m** | **£409.3m** | **£590m** | **£710m** | **Yes** |

12.3 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt did not exceed the operational boundary during the period.

12.4 The Head of Finance confirms that the approved limits set by him under delegated powers and in accordance with the Annual Investment Strategy were not breached during the period of this report. Detail in table 8 below

Table 7: Investment Limits

| | **Maximum in period** | **30.9.20 Actual** | **2020/21 Limit (Highest in period)** | **Complied?** Yes/No |
|---|---|---|---|---|
| Any single organisation, except the UK Government | £12M | £9M | £12M | Yes |
| Any group of organisations under the same ownership | £17M | £17M | £18M | Yes |
| Money Market Funds | £12.9 | £9m | £15M | Yes |

## 13 Treasury Management Indicators

13.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

13.2 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

| | **30.9.20 Actual** | **Upper Limit** | **Lower Limit** | **Complied?** |
|---|---|---|---|---|
| Under 12 months | 1% | 0% | 40% | Yes |
| 12 months and within 24 months | 1% | 0% | 40% | Yes |
| 24 months and within 5 years | 4% | 0% | 30% | Yes |
| 5 years and within 10 years | 7% | 0% | 40% | Yes |
| 10 years and within 20 years | 18% | 0% | 50% | Yes |
| 20 years and within 30 years | 8% | 0% | 60% | Yes |
| 30 years and within 40 years | 33% | 0% | 50% | Yes |
| 40 years and above | 29% | 0% | 50% | Yes |

13.3 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

| | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|
| Actual principal invested beyond year end | £10m | £10m | £5m |
| Limit on principal invested beyond year end | £20m | £20m | £20m |
| Complied? | Yes | Yes | Yes |

## 14 Other

14.1 **IFRS 16**: The implementation of the new IFRS 16 Leases accounting standard has been delayed until 2021/22.

## 15 Outlook for the remainder of 2020/21 (Arlingclose)

| | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.00 | 0.15 | 0.15 | 0.15 | 0.15 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| Arlingclose Central Case | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| Downside risk | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |

15.1 The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been supressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

15.2 The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

15.3 However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

15.4 This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

15.5 Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

15.6 Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

15.7 Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

15.8 Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

**Appendices**

Appendix 1: Economic commentary
Appendix 2: Non-Treasury Management Investments

**Additional Information**

Treasury Management Strategy 2020/2021