CABINET

DATE OF MEETING: **3 SEPTEMBER 2020**

TITLE OF REPORT: **TREASURY MANAGEMENT OUTTURN 2019/20**

Report of: **Head of Corporate Services & Section 151 Officer**

Cabinet Member: **Councillor James Radley, Deputy Leader and Finance**

1. Purpose of Report

1.1 To report the Council's Treasury Management activities during the 2019/20 financial year.

2. Officer Recommendation

2.1 To note the report and consider the Officer recommendation that further investigation be carried out by the Section 151 Officer to find alternative investment opportunities with higher returns and that options are brought back to Cabinet as part of a revised Treasury Management Strategy.

3. Background

3.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of 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).

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

- an annual treasury strategy in advance of the year
- a mid-year (minimum) treasury update report
- an annual review following the end of the year describing the activity compared to the strategy (this report)

3.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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.

3.4 This Council 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 Scrutiny Committee before they were reported to the full Council.

4. The Council's Capital Expenditure and Financing

4.1 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.

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 £'000	2019/20 Budget £'000	2019/20 Actual £'000
Capital Expenditure	2,383	3,480	9,283
Financed in year	(7,286)	(1,048)	(2,141)
Unfinanced capital expenditure	(4,903)	2,432	7,142

5. The Council's Overall Borrowing Need

5.1 The Council's underlying need to borrow to finance capital expenditure is termed the
Capital Financing Requirement (CFR).

5.2 **Gross borrowing and the CFR -** in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	2018/19 Actual £'000	2019/20 Budget £'000	2019/20 Actual £'000
Total CFR	16,263	23,783	23,405
Gross borrowing position	13,598	12,337	12,385
(Under) / over funding of CFR	(2,665)	(11,446)	(11,020)

5.3 **The authorised limit -** the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, 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.

5.4 **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 are acceptable subject to the authorised limit not being breached.

5.5 **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.

	2019/20 £'000
Authorised limit	30,000
Maximum gross borrowing position during the year	13,648
Operational boundary	25,000
Average gross borrowing position	13,410
Financing costs as a proportion of net revenue stream	2.61%

6. Treasury Position as at 31 March 2020

6.1 At the beginning and the end of 2019/20 the Council‘s treasury, (excluding borrowing by PFI and finance leases), position was as follows:

	2018/19 £'000	2019/20 £'000
Short-term Borrowing	(1,372)	(1,377)
Long-term Borrowing	(12,277)	(11,008)
Short-term Investments	12,000	11,000
Cash & Cash Equivalents	19,261	18,760

6.2 The maturity structure of the debt portfolio was as follows:

	2018/19 Actual £'000	2019/20 Actual £'000
Under 12 months	1,371	1,377
12 months and within 24 months	1,269	1,289
24 months and within 5 years	3,460	2,530
5 years and within 10 years	1,872	1,913
10 years and within 20 years	4,415	4,511
20 years and within 30 years	1,262	765

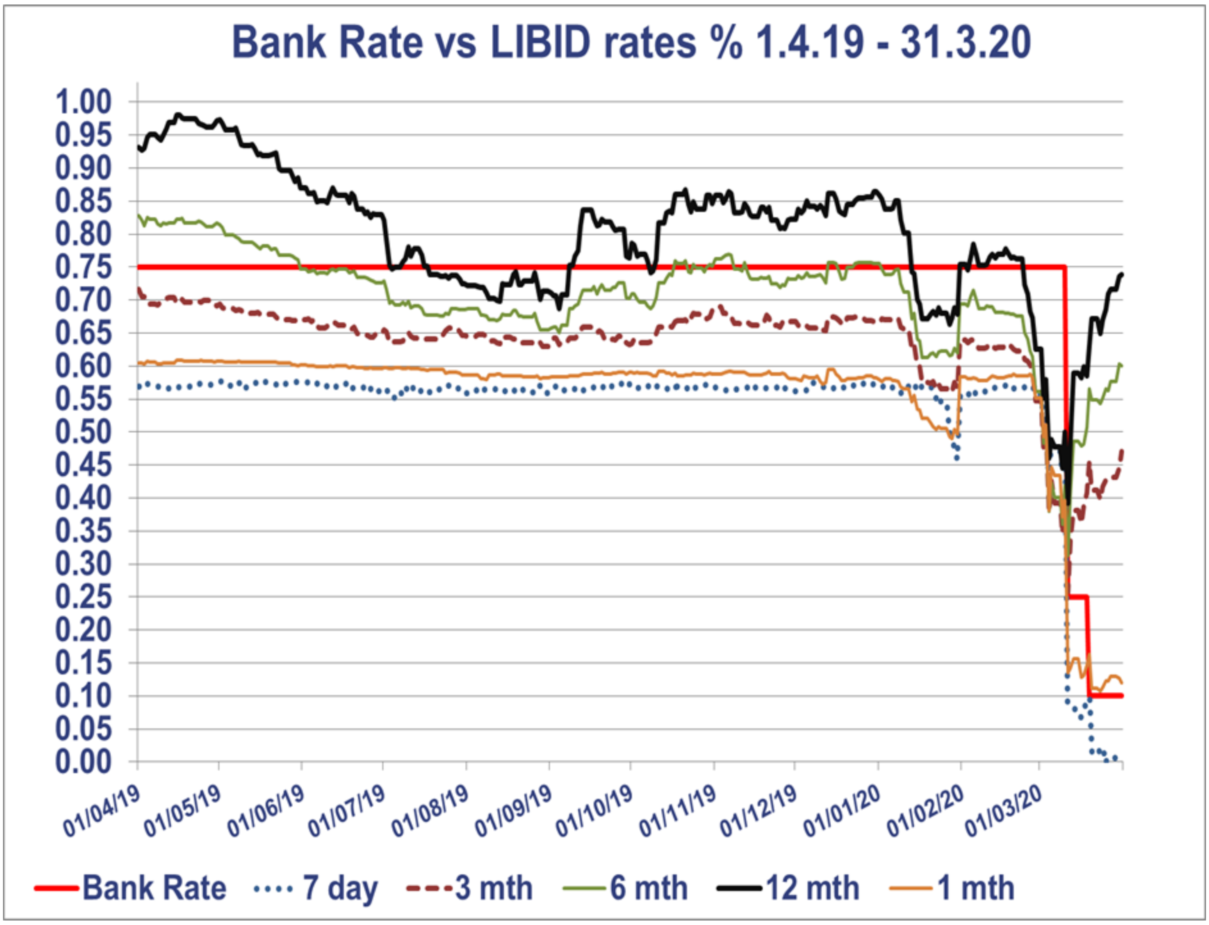
6.3 Investment portfolio:

Bank	Balance	Interest Rate (%)	Maturity (days)
Standard Chartered	2,000,000	0.72	92
Cheshire East Council	4,000,000	0.76	102
Fareham Borough Council	5,000,000	0.90	366
Mid Suffolk District Council	5,000,000	0.80	85
Bank of Scotland Call	1,000,000	0.25	116
Lloyds Bank	5,000,000	0.25	116
Bank of Scotland Call A/c	2,000,000	0.40	Instant
Santander	3,320,167	0.40	Instant
Barclays	2,320,541	0.05	Instant
	29,640,707		

7. The strategy for 2019/20

7.1 Investment strategy and control of interest rate risk

The below section has been provided by Link Asset Services; the Council's Treasury Management Advisors.



7.1.2 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.

7.1.3 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. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

7.1.4 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.

7.1.5 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 above and 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.

7.2 Borrowing strategy and control of Interest rate risk

7.2.1 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.

7.2.2 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.

7.2.3 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 authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

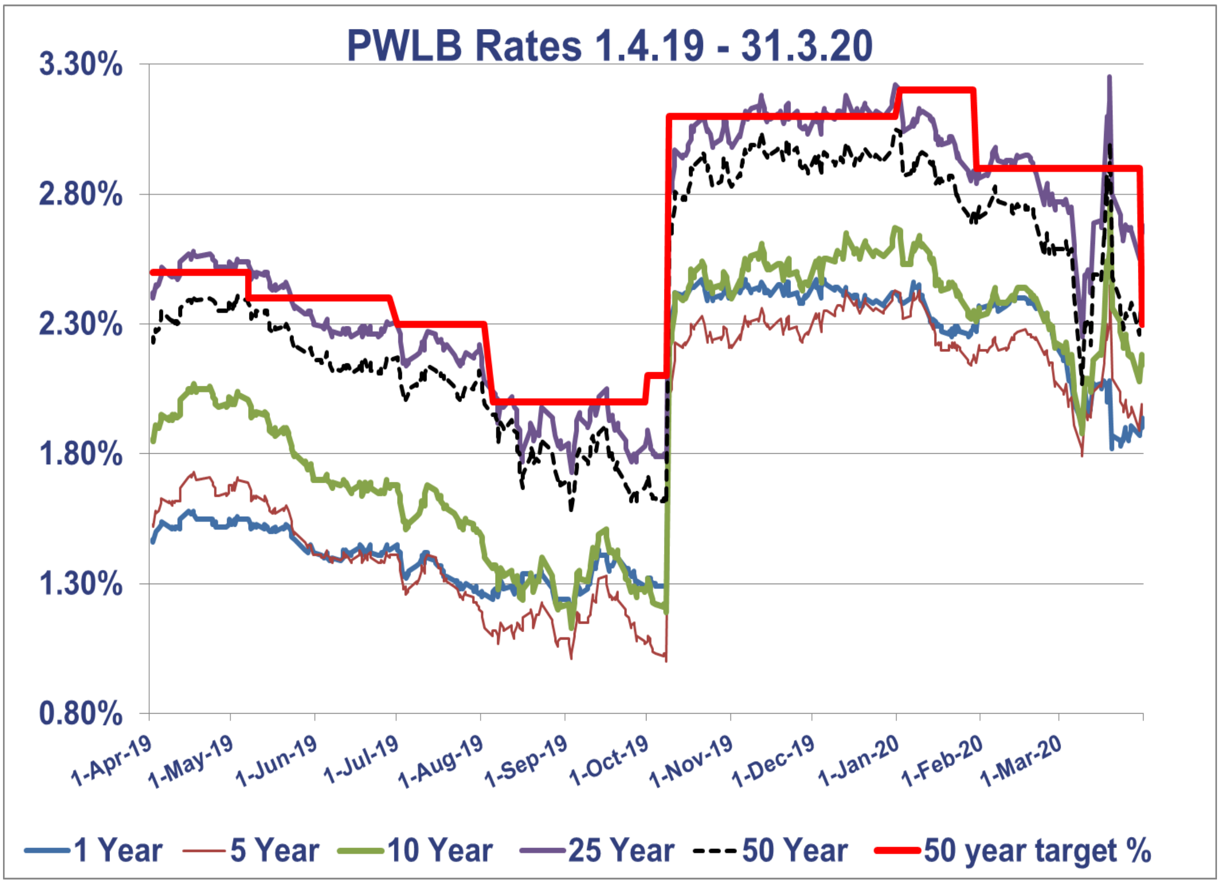
7.2.4 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- 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.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

7.2.5 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 31.1.20													
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.50	2.60	2.70	2.80	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	2.70	2.80	2.90	3.00	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.30	3.40	3.50	3.60	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.20	3.30	3.40	3.50	3.80



7.2.6 PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M. Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

7.2.7 Gilt yields 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). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.

7.2.8 However, HM Treasury has imposed **two changes in the margins over gilt yields for 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. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ends on 4 June. It is 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.

7.2.9 Following the changes on 11 March 2020 in 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)

7.2.10 There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020-21.

8. Borrowing Outturn

8.1 **Treasury Borrowing** – breakdown of borrowing at 31st March 2020:

Lender	Balance (£'000)	Type	Interest Rate	Maturity
PWLB	8,954	Fixed Rate	2.19%	23 years
Hampshire County Council	3,431	Fixed Rate	0.00%	7 years

8.2 **Borrowing** – Due to sufficient cash balances no new borrowing was undertaken during the year.

8.3 **Borrowing in advance of need** – 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.

9. Investment Outturn

9.1 **Investment Policy** – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 28/02/2019. 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.).

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

9.3 **Resources** – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources	2018/19	2019/20
Balances:	**£'000**	**£'000**
Earmark Reserves	(13,682)	(15,730)
Provisions	(334)	(302)
Usable Capital Receipts	(746)	(595)
Total	(14,762)	(16,627)

9.3 **Investments held by the Council** – at the end of the financial year the Council held the funds detailed in 6.3 which were managed internally.

The total investment income for 2019/20 was £334k compared to a budget of £200k

10. Other Issues

10.1 **Non-treasury management investments.** In March 2020 Hart District Council bought an investment property for £6.28m. This will provide a revenue return in 20/21 and in future years to support the budget shortfalls due to ceased central government funding.

10.2 **Counter Party Limits.** The council temporarily extended the counterparty limit to £10m by activating emergency treasury management measures due to receiving significant grants from central government relating to covid-19.

11. CONCLUSION

11.1 This report provides Members with information on the level of investment and interest earned during the last financial year and demonstrates the council's compliance with the Treasury Management Strategy.

Contact Details: Emma Foy
Telephone: 01252 774207
Email: Emma.Foy@hart.gov.uk

BACKGROUND PAPERS:

APPENDIX 1 - Treasury Management Strategy Statement (Feb 2019)

Prudential and Treasury Indicators

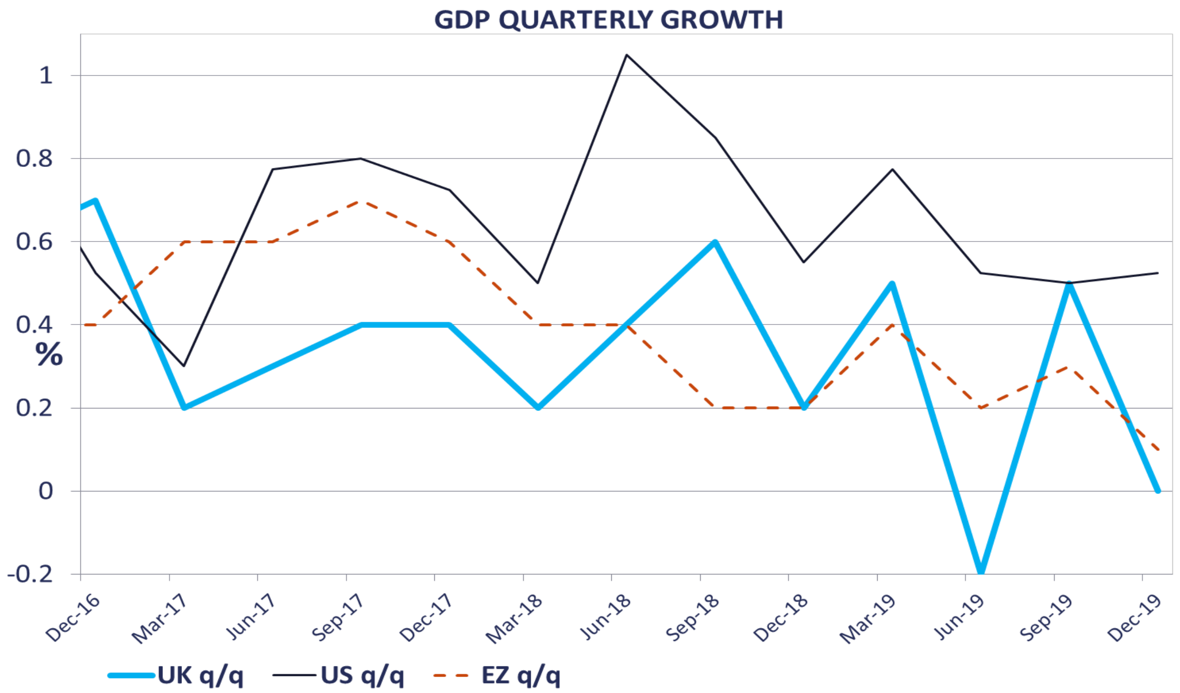
During 2019/20, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

PRUDENTIAL INDICATORS	2018/19 Actual £'000	2019/20 Original £'000	2019/20 Actual £'000
Capital Expenditure	2,383	3,480	9,283
Gross Debt	13,598	12,337	12,385
Capital Financing Requirement (CFR)			
Brought Forward 1 April	21,165	16,263	16,263
Carried Forward 31 March	16,263	23,783	23,405
Change in CFR	(4,902)	7,520	7,142
Incremental impact of capital investment decisions	£ p	£ p	£ p
Increase in council tax (band D) per annum	(3.61)	(5.08)	(3.68)

TREASURY MANAGEMENT INDICATORS	2018/19 Actual £'000	2019/20 Original £'000	2019/20 Actual £'000
Authorised Limit for External Debt			
Borrowing	30,000	30,000	30,000
Operational Boundary for External Debt			
Borrowing	25,000	25,000	25,000
Actual External Debt	13,598	12,337	12,385

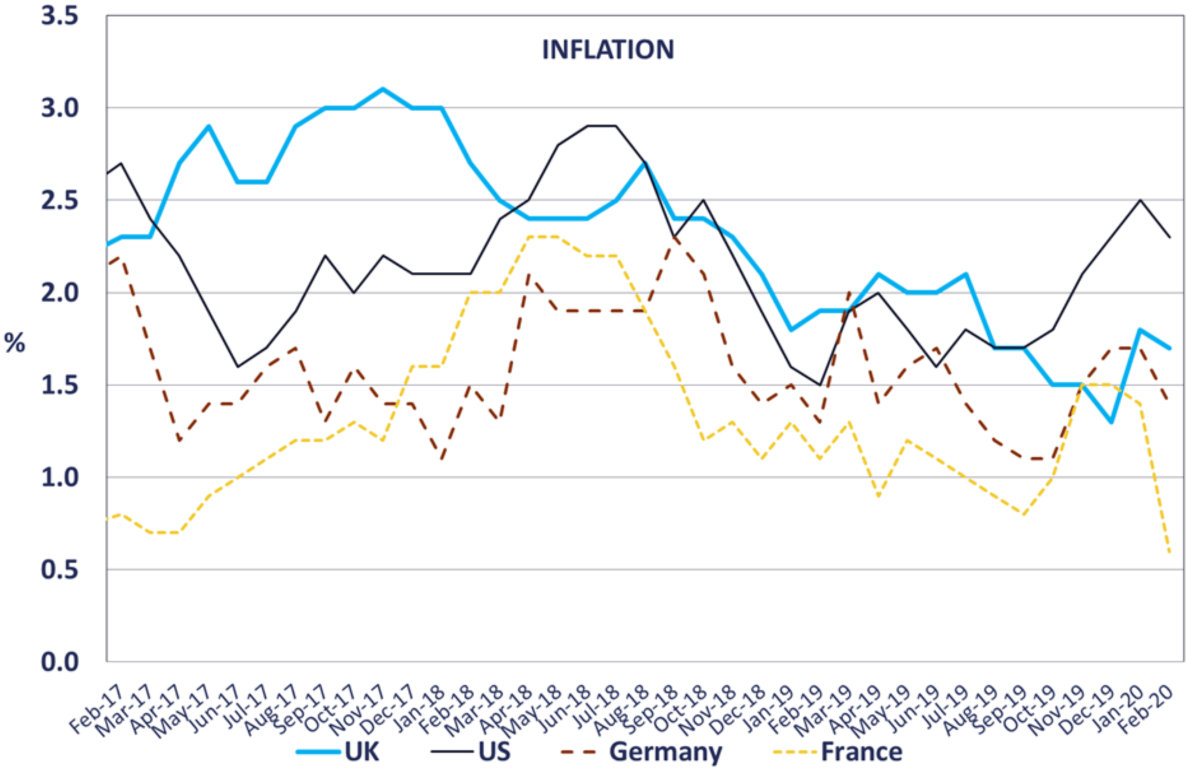
Maturity structure of borrowing during 2019/20	Lower %	Upper %
Under 12 months	0	50
12 months to 2 years	0	50
2 years to 5 years	0	50
5 years to 10 years	0	50
10 years to 20 years	0	50
20 years to 30 years	0	50
30 years to 40 years	0	50
40 years to 50 years	0	50

UK, US and EZ GDP growth



Inflation UK, US, Germany and France

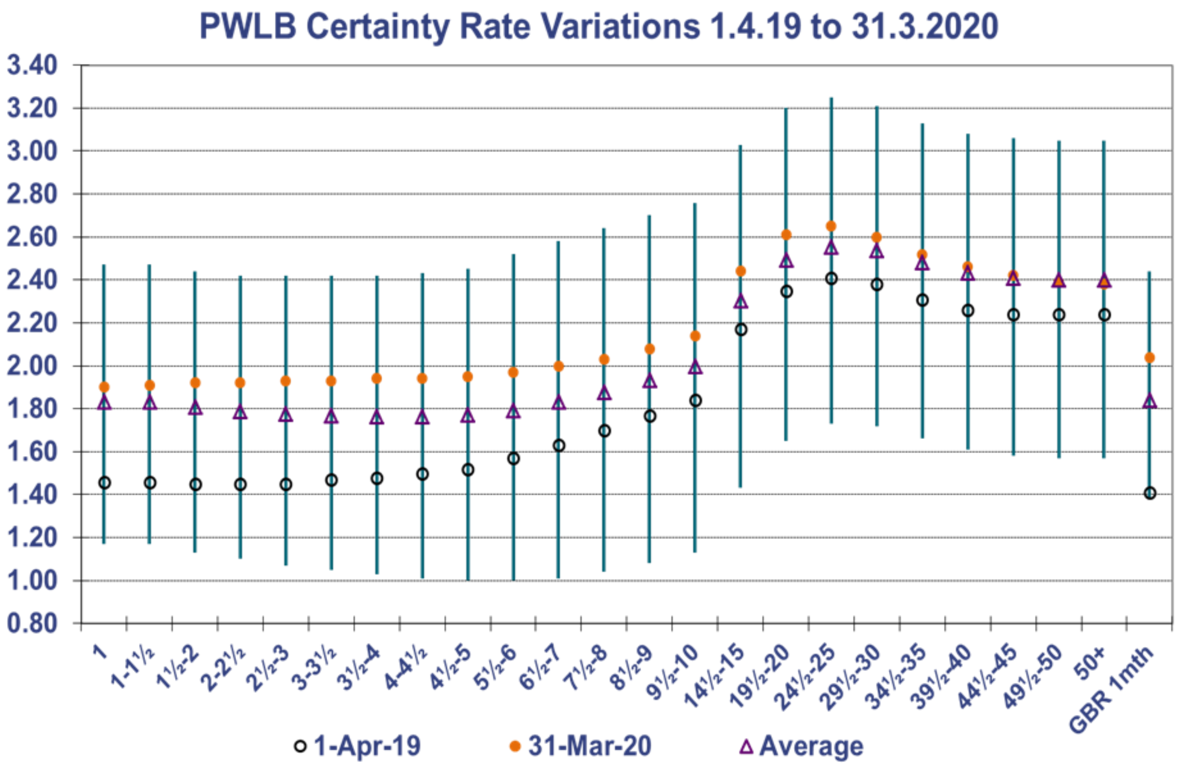
APPENDIX 1



INFLATION
%
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
Feb-17 Mar-17 Apr-17 May-17 Jun-17 Jul-17 Aug-17 Sep-17 Oct-17 Nov-17 Dec-17 Jan-18 Feb-18 Mar-18 Apr-18 May-18 Jun-18 Jul-18 Aug-18 Sep-18 Oct-18 Nov-18 Dec-18 Jan-19 Feb-19 Mar-19 Apr-19 May-19 Jun-19 Jul-19 Aug-19 Sep-19 Oct-19 Nov-19 Dec-19 Jan-20 Feb-20
UK
US
Germany
France

Borrowing and investment rates

a) PWLB borrowing rates



	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	1.46%	1.52%	1.84%	2.41%	2.24%
31/03/2020	1.90%	1.95%	2.14%	2.65%	2.39%
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.45%	2.76%	3.25%	3.05%
Date	21/10/2019	19/03/2020	19/03/2020	19/03/2020	31/12/2019
Average	1.83%	1.77%	2.00%	2.56%	2.40%

Money Market and investment rates 2019/20.

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	0.66%	0.72%	1.04%	1.61%	1.44%
31/03/2020	0.10%	0.15%	0.34%	0.85%	0.59%
Low	0.02%	-0.01%	0.08%	0.45%	0.27%
Date	20/03/2020	09/03/2020	09/03/2020	09/03/2020	09/03/2020
High	0.78%	0.93%	1.27%	1.78%	1.61%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	17/04/2019
Average	0.55%	0.49%	0.72%	1.28%	1.12%