Appendix E

Treasury Management Outturn Report 2019/20

Introduction

In February 2019 the Authority 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 Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2019/20 was approved by Full Council in February 2019. The Authority has borrowed substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

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, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council in February 2020.

External Context

Economic commentary

The UK's exit from the European Union and future trading arrangements had remained one of major influences on the UK economy during 2019/20 as the 29th March 2019 Brexit deadline was extended to 31st January 2020. Politics played a key role in financial markets over the period as the UK's progress negotiating its exit from the European Union together with its future trading arrangements drove volatility, particularly in foreign exchange markets although the outcome of December's General Election helped to remove some uncertainty.

GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed and production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.

COVID-19 started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global Financial Crisis as part of a flight to quality into sovereign debt and other perceived 'safe' assets.

In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% from 0.75% and then swiftly thereafter brought them down further to the record low of 0.1%. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in a widespread lockdown of the UK.

In the US and China COVID-19 severely impacted sentiment and production. Against a slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19 related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already low, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

Financial markets

Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar falls. In March sterling touched its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded but remain extremely volatile. The flight to quality caused gilts yields to fall substantially. The 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March 2020.

Credit background

In Q4 2019 Fitch affirmed the UK’s AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks’ long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor’s also affirmed the UK sovereign AA rating and revised the outlook to stable from negative.

The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks’ aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

Local Context

On 31st March 2020, the Authority had total borrowing of £484.8m 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). These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £’000	2019/20 Movement £’000	31.3.20 Actual £’000
General Fund CFR	479,332	15,001	494,333
Total Borrowing	446,871	37,877	484,748
Internal Borrowing	**32,461**	**-22,876**	**9,585**

Total borrowing has increased due to a rise in the CFR as new capital expenditure was higher than the financing applied including minimum revenue provision.

The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

Additional sums were borrowed in March 2020 to ensure liquidity during the uncertainty surrounding the lockdown measures and the impacts this would have on the Money Markets. This can be seen through the higher increase in Total Borrowing over General Fund CFR in Table 1, but conversely these amounts were reinvested as can be seen in the increased Short-term investments shown in table 2, as additional cash was borrowed and subsequently invested in highly liquid money market funds.

The treasury management position as at 31st March 2020 and the year-on-year change is shown in table 2 below.

Table 2: Treasury Management Summary

	31.3.19 Balance £'000	**2019/20 Movement £'000**	**31.3.20 Balance £'000**	**31.3.20 Rate %**
Long-term borrowing	51,000	299,000	350,000	1.92%
Short-term borrowing	395,871	261,123	134,748	0.95%
Total borrowing	**446,871**	**37,877**	**484,748**	**1.66%**
Long-term investments	9,561	-342	9,219	4%
Short-term investments	10,000	22,500	32,500	0.43%
Cash and cash equivalents	5,033	-779	4,254	0.01%
Total investments	**24,594**	**21,379**	**45,973**	**1.11%**
Net borrowing	**422,277**	**16,498**	**438,775**	**1.42%**

Borrowing Strategy during the year

At 31st March 2020 the Authority held £484.7m of loans, an increase of £37.8m on the previous year, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.19 Balance £'000	**Net Movement £'000**	**31.3.20 Balance £'000**	**31.3.20 Weighted Average Rate %**
Public Works Loan Board	51,000	300,000	351,000	1.92%
Local authorities (short term)	395,871	(262,123)	133,748	0.93%
Total borrowing	**446,871**	**37,877**	**484,748**	**1.66%**

The Authority'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 Authority's long-term plans change being a secondary objective.

The Council went through an extensive restructuring of borrowing during 2019/20, switching a large proportion of debt from short term borrowing to long term. This was done in order to de-risk the borrowing portfolio, by reducing interest rate risk, without paying a financial penalty based on interest rate forecasts.

Treasury Investment Activity

The Authority generally holds minimal invested funds, representing income received in advance of expenditure plus balances and reserves held. Due to the restructuring of the Council's debt portfolio in April 2019, from short term to long term, additional balances were held during April 2019, as the Council facilitated the restructure. During this period the Council had a maximum investment position of £261m. During the rest of the year year, the Authority's investment balances ranged between £1.6 and £37.3 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.19 Balance £'000	2019/20 Movement £'000	31.3.20 Balance £'000	31.3.20 Rate %
Banks & building societies (unsecured)	4,828	(5)	4,833	0.01%
Money Market Funds	10,000	22,500	32,500	0.43%
Pooled Funds	9,561	(342)	9,219	4%
Total investments	**24,389**	**22,163**	**46,552**	**1.09%**

Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

Compliance

The Chief Financial Officer must report that treasury management activities undertaken during 2019/20 did not fully comply with the Authority's approved Treasury Management Strategy.

The limit on specified investments being a maximum of £10m with any single organisation was breached once during the year for a period of 24 days.

This was due to the restructuring of a large proportion of the Council's debt from short term to long term. This caused a large balance in the Council's current account as this money was either needed to be invested externally, or current short term debt needed to be allowed to reach maturity and repaid.

Please see table 5 below for more information.

Table 5: Investment Limits

	2019/20	31.3.20	2018/19	Complied

	Maximum	Actual	Limit	
Any single organisation, except UK Government	£229m	£4.8m	£10m	x
Money Market Funds	£10m	£10m	£10m	✓
Non Specified Investments (CCLA)	£9.6m	£9.2m	£14.5m	✓

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below. Neither the Operational Boundary, nor Authorised limit were breached during 2019/20.

Table 6: Debt Limits

	2019/20 Maximum	31.3.20 Actual	2019/20 Operational Boundary	2019/20 Authorised Limit	Complied
Borrowing	£484.4m	£484.4m	£485.2m	£506.2m	✓

Treasury Management Indicators

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

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

	31.3.20 Actual	2019/20 Target	Complied ?
Portfolio average credit score	A	A	✓

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

	31.3.20 Actual	2019/20 Target	Complied
Total sum borrowed in past 3 months without prior notice	£0m	£0m	✓

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed was:

	31.3.20 Actual	2019/20 Limit	Complied ?
Upper limit on fixed interest rate exposure	72%	100%	✓
Upper limit on variable interest rate exposure	18%	100%	✓

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

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

	31.3.20 Actual	Upper Limit	Lower Limit	Complied ?
Under 12 months	18%	100%	0%	✓
12 months and within 24 months	0%	100%	0%	✓
24 months and within 5 years	0%	100%	0%	✓
5 years and within 10 years	28%	100%	0%	✓
10 years and above	44%	100%	0%	✓

Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Authority'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:

	2017/18	2018/19	2019/20
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	£14.5m	£14.5m	£14.5m
Complied	✓	✓	✓