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NORTH DEVON COUNCIL

REPORT TO:	**STRATEGY AND RESOURCES**
Date:	**2ND NOVEMBER 2020**
TOPIC:	**Treasury Management Strategy Statement and Annual Investment Strategy** **MID-YEAR REVIEW REPORT 2020/21**
REPORT BY:	**CHIEF FINANCIAL OFFICER**

1. INTRODUCTION

1.1 This mid year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management (revised 2017), and covers the following:

- An economic update for the first part of the 2020/21 financial year (appendix A);
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure and prudential indicators;
- A review of the Council's investment portfolio for 2020/21;
- A review of the Council's borrowing strategy for 2020/21;
- A review of any debt rescheduling undertaken during 2020/21;
- A review of compliance with Treasury and Prudential Limits for 2020/21.

2. RECOMMENDATIONS

The Committee is asked to recommend to full Council that:

2.1 The changes to the prudential indicators be approved.

2.2 The report and the treasury activity be noted.

3. REASONS FOR RECOMMENDATIONS

3.1 This Council is required through regulations issued under the Local Government Act 2003 to produce a mid year treasury report reviewing treasury management activities and the prudential and treasury indicators for 2020/21. This report meets the requirements of the CIPFA Code of Practice on Treasury Management (revised 2017).

3.2 This Council is also required under the Code to give prior scrutiny to the treasury management reports by the Policy Development Committee before they are reported to the full Council.

4. REPORT

4.1 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2020/21 was approved by this Council on 26th February 2020.

The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes are set out below:

Prudential Indicator 2020/21	Original Estimate £000	Revised Prudential Indicator £000
Capital Financing Requirement	8,770	7,169
Operational Boundary	8,250	2,250

Section 4.3 of this report gives further information on the Capital Financial Requirement and the Operational Boundary.

4.2 The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the budget.

Capital Expenditure by Service	2020/21 Original Estimate £000	Current Position 30/09/20 £000	2020/21 Revised Estimate £000
Chief Executive & Corporate	506	52	520
Corporate & Community	5,234	672	4,613
Environmental Health & Housing	1,801	465	2,757
Operational Services	876	177	512
Place	2,026	3	655
Resources	2,179	262	1,355
Total	**12,622**	**1,631**	**10,412**

Changes to the Financing of the Capital Programme

The table below draws together the capital expenditure plans (above), and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

Capital Expenditure	2020/21 Original Estimate £000	2020/21 Revised Estimate £000
Total capital spend	**12,622**	**10,412**
Financed by:		
Capital receipts	(600)	(400)
Capital grants	(7,285)	(5,854)
Capital reserves	(1,207)	(1,195)
Total financing	**(9,092)**	**(7,449)**
Borrowing requirement	**3,530**	**2,963**

4.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table below shows the borrowing requirement (above), the reduction for the Minimum Revenue Provision (MRP) and impact on the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

	2020/21 Original Estimate £000	2020/21 Revised Estimate £000
Prudential Indicator – Capital Financing Requirement		
Borrowing requirement	3,530	2,963
Minimum Revenue Provision	(626)	(540)
Movement in CFR	2,904	2,423
Revised Total CFR	**8,770**	**7,169**
Prudential Indicator – the Operational Boundary for external debt		
Borrowing	8,000	2,000
Other long term liabilities	250	250
Total debt (year-end position)	**8,250**	**2,250**

Prudential Indicator – Capital Financing Requirement

The forecast Capital Financing Requirement has reduced by circa £1.6m. This reduction can be broken down into £1.12m for the 19/20 estimate and £0.48m for the 20/21 estimate (as shown in the CFR movement above). However, the majority of this reduction relates to the slippage in the Leisure Centre capital project. In the Strategy the projected capital spend on this scheme by March 21 was £6.37m, although the current projection is spend of £4.57m to March 21. Please note that this reduction is a timing issue only with the project spend re-profiled into future years.

Despite the reduction in CFR from the forecast, it should still be noted that the current capital programme is adding circa £2.4m to the Council's overall need to incur borrowing.

Prudential Indicator – the Operational Boundary for external debt

The forecast operational boundary has reduced by £6m. Delays to the capital programme expenditure, stronger reserve forecasts and the strategy of postponing or delaying external borrowing means that the external borrowing position is not now expected to exceed £2.25m this financial year. Section 4.5 looks at the borrowing strategy in more detail.

4.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need, which will be adhered to if this proves prudent.

	2020/21 Original Estimate £000	Current Position 30/09/20 £000	2020/21 Revised Estimate £000
Gross borrowing	5,500	500	1,500
Plus: other long term liabilities	0	0	0
Total debt	**5,500**	**500**	**1,500**
CFR (year end position)	8,770		7,169

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit that represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2020/21 Original Indicator £000	2020/21 Revised Indicator £000
Borrowing	22,000	22,000
Other long term liabilities	500	500
Total	22,500	22,500

The Leisure Provision at Seven Brethren report considered by Full Council on 13th March 2019, approved the increase in authorised borrowing limit to £22m from 2020/21.

4.5 Borrowing

The Council's capital financing requirement (CFR) for 2020/21 is £7.2m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the Public Works Loan Board (PWLB), or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

At present, the Council has projected total external borrowing of £1.5m and utilising £5.7m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring of economic conditions.

In May 2020 a PWLB loan of £0.75m matured, leaving the Council's total external borrowing at £0.5m. Whilst the borrowing projection prudently anticipates a further £1m of external borrowing might be required this financial year, however that is subject to the full capital programme being spent.

The Council's borrowing strategy remains to delay any external borrowing for as long as possible, or at least until the outcome of the PWLB consultation on the margins applied by HM Treasury is known, as there is an expectation that borrowing rates might reduce. At present we have been using internal borrowing from the Council's own cash flows, as this is a low cost financing option and reduces the net interest cost to the Council, but we will continue to monitor our cash position and amend the borrowing position as necessary.

PWLB Rates 1st April 2020 to 30th September 2020

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.70%	1.67%	1.91%	2.40%	2.13%
Date	18/09/2020	30/07/2020	31/07/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/2020	08/04/2020	08/04/2020	28/08/2020	28/08/2020
Average	1.80%	1.80%	2.04%	2.54%	2.33%

Long-term borrowing projections

The current forecast for next financial year (2021/22) shows CFR increasing by £9.9m with the bulk of the Leisure centre spend in year, giving a total CFR of £17m. This would be funded from £14.5m of external borrowing and a further £2.5m of internal borrowing.

4.6 Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

4.7 Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2020, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2020. The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

4.8 Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2020/21, which includes the Annual Investment Strategy, was approved by the Council on 26th February 2020. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach.

As shown by the interest rate forecasts in Appendix A, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2023, investment returns are expected to remain low.

Negative investment rates

While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a glut of money swilling around at the very short end of the market. This has seen a number of market operators, now including the Debt Management Account Deposit Facility (DMADF), offer nil or negative rates for very short term maturities. This is not universal, and Money Market Funds are still offering a marginally positive return, as are a number of financial institutions.

Creditworthiness.

Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during the quarter ended 30th June 2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks. The Council will continue to monitor the creditworthiness of its counterparties with our Treasury Advisors Links Asset Services.

Investment Counterparty criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function

Investment balances

The Council held £24.7m of investments as at 30 September 2020 (£16.25m at 31 March 2020) and the investment portfolio yield for the first six months of the year was 0.24% against the benchmark 7 day LIBID of -0.06%.

The Council's budgeted investment return for 2020/21 was £50,000. As at 30th September 2020 £40,689 investment interest was earned in the half-year period.

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2020/21.

Non-Treasury Management Investments

The PWLB consultation included the proposal to end any PWLB loans for 'debt for yield' projects where financial assets and property where purchased primarily for financial return. This could also mean no PWLB loans for the rest of the capital programme in that year.

We will need to review the new lending arrangements once they are finalised and released by HM Treasury and access the potential impact on the borrowing strategy, non-treasury investments and the Council's commercialisation strategy.

Bank Rate & LIBID rates 1st April 2020 to 30th September 2020

	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.07	-0.07	-0.06	-0.01	0.11
Low Date	01/04/2020	19/06/2020	21/08/2020	28/08/2020	25/08/2020	28/08/2020
Average	0.10	-0.05	-0.01	0.14	0.25	0.41
Spread	0.00	0.08	0.22	0.62	0.63	0.66

5. RESOURCE IMPLICATIONS

5.1 As detailed in the report.

6. EQUALITIES ASSESSMENT

6.1 There are not any equalities implications anticipated as a result of this report, as the purpose of this report is to present the Council's financial position only.

7. CONSTITUTIONAL CONTEXT

Article and paragraph	Referred or delegated power?
Part 4 Financial Procedure Rules (Article 13.8) Part 2, Article 4.4	Delegated

8. STATEMENT OF CONFIDENTIALITY

8.1 This report contains no confidential or exempt information under the provisions of Schedule 12A of 1972 Act.

9. BACKGROUND PAPERS

9.1 Background papers will be available for inspection and will be kept by the author of the report.

10. STATEMENT OF INTERNAL ADVICE

10.1 The author (below) confirms that advice has been taken from all appropriate Councillors and Officers.

Author: Jon Triggs, Head of Resources   Date: 19th October 2020

Reference: T:\Technical\Adam\Treasury Management\ TM Mid Year Report 2020_21.doc