

NORTH DEVON COUNCIL

REPORT TO: STRATEGY AND RESOURCES
Date: 1ST SEPTEMBER 2020
TOPIC: ANNUAL TREASURY MANAGEMENT REPORT 2019/20
REPORT BY: CHIEF FINANCIAL OFFICER

1. INTRODUCTION

1.1 The regulatory environment places responsibility 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.

2. RECOMMENDATIONS

2.1 The Committee is asked to recommend to full Council that:

- The annual treasury management report for 2019/20 be noted;
- The actual 2019/20 prudential and treasury indicators be approved.

3. REASONS FOR RECOMMENDATIONS

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 full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 25/02/2019)
- a mid year treasury update report (Council 20/11/2019)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

This Council confirms that it has complied with the requirements under the Code to give prior scrutiny to all the above treasury management reports by the Policy Development Committee before they were reported to the full Council.

4. REPORT

4.1 The Council's Capital Expenditure and Financing

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.

£000	2018/19 Actual	2019/20 Estimate	2019/20 Actual
Capital expenditure	4,298	9,011	5,454
Financed in year	(4,092)	(7,751)	(4,910)
Unfinanced capital expenditure	206	1,260	544

• Estimate from the Mid-Year Treasury Management Report

4.2 The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2019/20 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Reducing the CFR – the Council's 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 borrowing need.

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).

The Council's 2019/20 MRP Policy, (as required by MHCLG Guidance), was approved as part of the Treasury Management Strategy Report for 2019/20.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR £000	31 March 2019 Actual	31 March 2020 Estimate	31 March 2020 Actual
Opening balance	5,009	4,711	4,711
Add unfinanced capital expenditure (as above)	206	1,260	544
Less MRP	(504)	(509)	(509)
Closing balance	4,711	5,462	4,746

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

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 (2018/19) plus the estimates of any additional capital financing requirement for the current (2019/20) 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.

£000	31 March 2019 Actual	31 March 2020 Estimate	31 March 2020 Actual
Gross borrowing position	1,250	1,250	1,250
Total CFR	4,711	5,462	4,746
Over / (under) funding of CFR	(3,461)	(4,212)	(3,496)

- Estimate from the Mid-Year Treasury Management Report

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.

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.

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
Authorised limit	£22.5m
Maximum gross borrowing position during the year	£1.25m
Operational boundary	£1.25m
Average gross borrowing position	£1.25m
Financing costs as a proportion of net revenue stream	2.62%

4.3 Treasury Position as at 31st March 2020

At the beginning and the end of 2019/20 the Council's treasury position was as follows:

DEBT PORTFOLIO £000	31 March 2019 Principal	Rate/ Return	31 March 2020 Principal	Rate/ Return
Total debt	1,250	2.03%	1,250	2.04%
CFR	4,711		4,746	
Over / (under) borrowing	(3,461)		(3,496)	
Total investments	9,849	0.57%	17,121	0.71%
Net debt/(investments)	(8,599)		(15,871)	

As at 31st March 2020, the Council had received circa £3m advanced grant funding to support our cash flows during the 2020/21 financial year as a result of the covid-19 outbreak.

The maturity structure of the debt portfolio was as follows:

	31 March 2019 actual	2019/20 Estimate limits	31 March 2020 actual
Under 12 months	£0m	60%	£0.75m (60%)
12 months and within 24 months	£0.75m (60%)	60%	£0m
24 months and within 5 years	£0m	100%	£0m
5 years and within 10 years	£0.50m (40%)	100%	£0.50m (40%)
10 years and above	£0m	90%	£0m

INVESTMENT PORTFOLIO £000	31 March 2019 Actual	31 March 2020 Actual
Treasury investments		
Banks	8,560	16,250
TOTAL TREASURY INVESTMENTS	8,560	16,250

All investments were for maturities less than one year

During 2019/20, the Council made no material non-treasury investments in property with the sole view of generating an income stream.

4.4 The Strategy for 2019/20

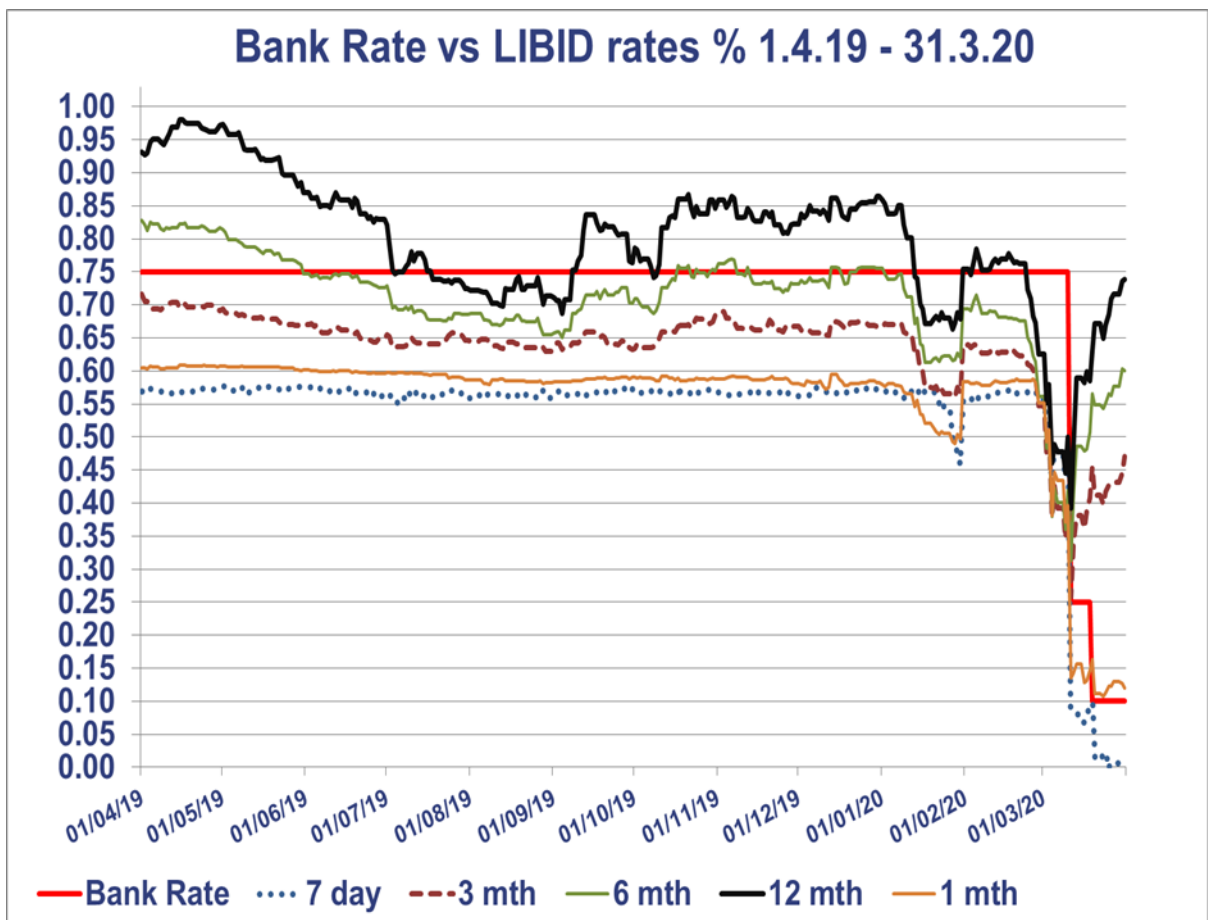
Investment strategy and control of interest rate risk - Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver 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.

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.

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.

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. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.



Two emergency cuts in Bank Rate from 0.75% occurred in March 2020, first to 0.25% and then to 0.10%, as it was clear that the coronavirus outbreak posed a huge threat to the economy of the UK. It also had the potential to impact on the Council's

cash flows and treasury strategy for 2020/21. Further information will be included in the next Mid-Year Treasury Strategy Report for 20/21.

Borrowing strategy and control of interest rate risk - 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.

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.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Section 151 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.
- 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.

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.

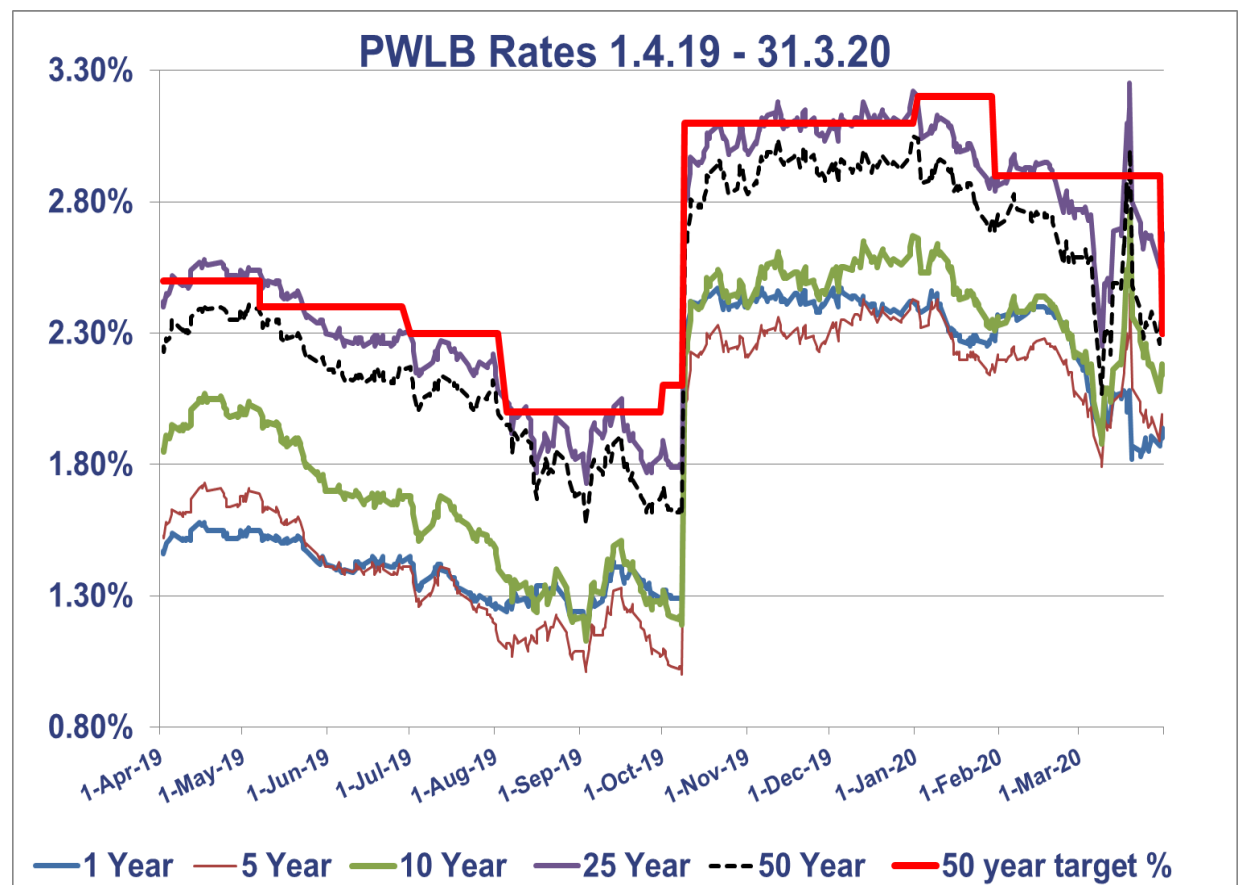
Link Asset Services Interest Rate View		31.3.20							
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30	
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40	
12 Month LIBID	0.75	0.70	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	

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.

Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -

- PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

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.



4.5 Borrowing Outturn

Due to cash flow balances and investment concerns, both counterparty risk and low investment returns, no new external borrowing was undertaken during the year.

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.

No debt rescheduling was done during the year as it was not a viable option.

4.6 Investment Outturn

Investment Policy – the Council’s investment policy is governed by HMCLG guidance, which was implemented in the annual investment strategy approved by the Council on 25th 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.).

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

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 (£000)	31 March 2019	31 March 2020
General Fund Balance	1,161	1,161
Earmarked reserves	5,230	5,336
Provisions	990	763
Usable capital receipts/grants	2,389	3,168
Total	9,770	10,428

Investments held by the Council - the Council maintained an average balance of £20.8m of internally managed funds. The internally managed funds earned £143,315 interest at an average rate of return of 0.71%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.54%. This compares with a budget assumption of £70,000 investment interest.

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 the report is to present the Council's financial position only.

7. CONSTITUTIONAL CONTEXT

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

8. STATEMENT OF CONFIDENTIALITY

8.1 This report contains no confidential 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: 10th August 2020

Reference: T:\Technical\Adam\Treasury Management\ TM Annual Report 2019 20.doc