

Annual Treasury Management Report 2019/20

as at 1/6/20 - LT



1. Introduction and Background

This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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).

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 - February 2019)
- a mid year (minimum) treasury update report (Council – January 2020)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition, the Cabinet and Scrutiny (Audit and Value for Money Council Services) Committee has received quarterly treasury management updates as part of the overall financial reporting during the course of the year.

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.

This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny of treasury management reports by the Scrutiny (Audit and Value for Money Council Services) Committee before they were reported to the full Council.

2. This Annual Treasury Report Covers

- the council's treasury position as at 31 March 2020;
- the strategy for 2019/20 – a summary;
- Borrowing and Investments outturn
- the economy and interest rates in 2019/20;
- compliance with treasury limits and prudential indicators;
- Other treasury related issues.

3. Treasury Position as at 31 March 2020

The council's debt and investment portfolio is organized by the financial management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks with all treasury management activities. Procedures and controls to achieve these objectives are well established through member reporting detailed in the introduction, and through officer activity detailed in the council's treasury management practices.

The council's treasury portfolio position (excluding borrowing from finance leases) and the average interest rates on the portfolio as at the beginning and end of the year were as follows:

2018/19	Average Rate		2019/20	Average Rate
<u>Borrowing</u>				
£6.3m		- PWLB	£6.3m	
£5.0m		- Market and other	£4.9m	
£11.3m	5.4%	Total Borrowing	£11.2m	5.4%
<u>Investments</u>				
£26.4m	0.5%	Core Deposits*	£32.7m	0.7%
(£0.7)m		Cash and Bank	£0.1m	
£25.7m		Total Investments	£32.8m	

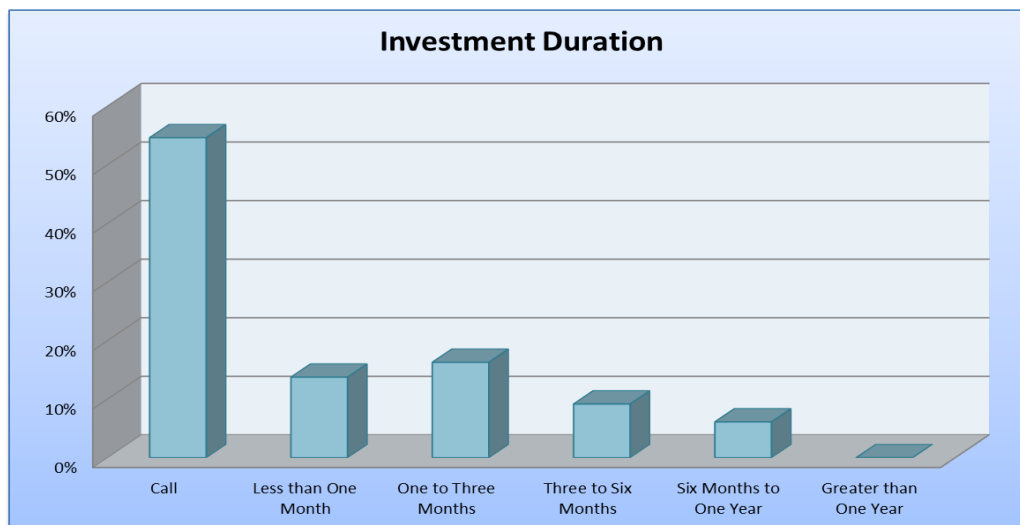
*excludes Icelandic deposits

The maturity structure of the **borrowing** was as follows:-

2018/19		2019/20
£0.6m	Under 1 Year*	£0.5m
£0m	Maturing in 1-2 Years	£0m
£0.2m	Maturing in 2-5 Years	£0.2m
£6.8m	Maturing in 5-10 Years	£6.8m
£3.7m	Maturing in 10-15 Years	£3.7m
£0m	Maturing in excess of 15 Years	£0m
£11.3m	Total	£11.2m

*This includes accrued interest as at 31st March, consistent with the financial statements.

The maturity structure of the **investments at 31st March** was as follows:-



4. The Strategy for 2019-20 - Summary

The Treasury Management Strategy Statement and Annual Investment Strategy for 2019/20 was approved by the Council on 25th February 2019.

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 and seeking to repay debt wherever possible from windfall monies, 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.

5. Borrowing Outturn for 2019/20

5.1 Capital Financing Requirement

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 debt position. The CFR results from the capital activity of the council and what resources have been used to pay for the capital spend. It represents unfinanced capital expenditure as at the year end.

The council's CFR is not allowed to rise indefinitely. Statutory controls are in place that require the authority to make an annual revenue charge, called the Minimum Revenue Provision (MRP) to reduce the CFR. This is effectively a repayment of non-housing borrowing.

The Council's 2019/20 MRP policy (as required by MHCLG guidance) was approved as part of the Treasury Management Strategy Statement for 2019/20. The CFR position is set out in the table below:-

CFR	2019/20 Actual £'000	2018/19 Actual £'000
Opening Balance	15,824	16,896
Add unfinanced capital expenditure	999	-
Less MRP	(358)	(402)
Less Voluntary Debt Repayment	(865)	(125)
Less finance lease repayments	(536)	(523)
Change in long term debtors	(17)	(22)
Closing Balance	15,047	15,824

This is higher than had originally been anticipated, due to the timing of capital receipts (£3.8m in total) that have been committed towards reducing the underlying need to borrow and delivering ongoing savings to the budget. This was reported earlier in the year and the MTFs highlights this as an ongoing risk.

Overall the CFR has reduced by £0.8m, which is combination of increased underlying borrowing (£1m) in relation to the leisure Improvements (approved as part of the original business case) and a reduction as a result of in year statutory repayments and the decision to repay £0.9m from windfall monies and capital receipts (part of the approved MTFs) in order to deliver savings to the revenue budget.

The Council's borrowing activity is constrained by affordability, and prudential indicators including the CFR, operational boundary and the authorised limit.

5.2 The Authorised Limit and Operational Boundary

The authorised limit is the “affordable borrowing limit” required by Section 3 of the Local Government Act 2003. 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 level is set at £17.5m to allow some headroom. Periods where the actual position is either above or below the boundary are acceptable subject to the authorised limit not being breached.

2018/19 £'000	Borrowing Limits and Boundaries	2019/20 £'000
19,500	Authorised Limit	19,500
17,500	Operational Boundary	17,500
12,194	Gross Borrowing at 31 st March (inc, Finance Leases)	11,545
11,340	Gross Borrowing at 31 st March (excl. Finance leases)	11,227
15,824	Capital Financing Requirement	15,047

5.3 Short-term Borrowing

It was anticipated that only very limited short-term borrowing would be required to cover temporary cash flow deficits; interest payable would therefore be minimal. This was the case and in fact no short term borrowing was necessary during the year.

5.4 Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. There has not been any restructuring undertaken during 2019/20.

5.5 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.

6. Investments Outturn 2019/20

6.1 Investment Policy

The Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council in February 2019. The policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit agencies supplemented by additional market data (such as credit outlooks, credit default swaps, bank share prices).

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

6.2 Investments as at 31st March 2020

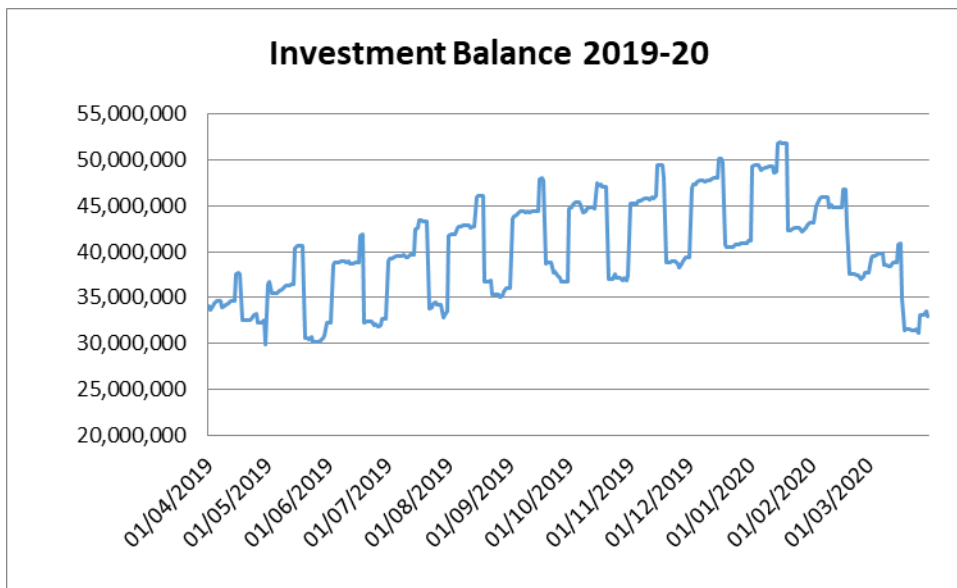
The Council's core investments as at 31st March amounted to £32.7m (excluding Icelandic deposits). These balances were, in the main, held within AAA rated Money Market Funds (£12.8m) and fixed term deposits and call accounts amounting to £15.1m have also been placed with a few UK Banks and one Building Society. With the remainder relating to UK Government Treasury Bills (£4.8m). This strategy reflects a continuation of the council's relatively low risk appetite in relation to its investments – particularly in light of the current economic uncertainties primarily in relation to the Covid-19 Pandemic.

The Council's Investments as at 31st March 2020 were as follows:

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date
Call Accounts and Money Market Funds				
RBS SIBA	122,959	0.01%		
Barclays	73	0.01%		
Santander Notice Account	3,500,000	1.20%		95 day notice
Bank of Scotland Notice Account	500,000	0.45%		95 day notice
Lloyds Notice Account	1,000,000	0.45%		95 day notice
MMF Federated	4,000,000	0.43%		Call
MMF Insight	4,000,000	0.32%		Call
MMF Aberdeen	4,000,000	0.42%		Call
MMF Blackrock	750,000	0.29%		Call
Bank of Scotland	500,000	1.15%	08/05/2019	08/05/2020
Lloyds	2,500,000	0.85%	15/10/2019	15/04/2020

UK Treasury Bill	830,000	0.74%	18/11/2019	18/05/2020
UK Treasury Bill	2,000,000	0.74%	25/11/2019	26/05/2020
UK Treasury Bill	2,000,000	0.74%	16/12/2019	15/06/2020
National Westminster Bank CD	2,000,000	0.84%	15/10/2019	15/04/2020
National Westminster Bank CD	1,000,000	0.92%	16/09/2019	15/09/2020
National Westminster Bank CD	2,000,000	0.89%	19/02/2020	18/02/2021
Nationwide Building Society CD	2,000,000	0.78%	08/01/2020	08/07/2020

The chart below illustrates the movement in the level of investments held by the Council throughout the year, with the peak being £51.9m in January and the average being £40.1m.



6.3 Investment Rates

The following table illustrates the rate of return generated by the Council's Investments for 2019/20, which compares favourably with the benchmark returns:

	Average Rate Year to 31/03/20
ESBC	0.80%
3 Month LIBID Rate	0.64%
6 Month LIBID Rate	0.70%
Base Rate	0.72%
Budget	0.90%

**LIBID = London Inter Bank Deposit Rate

The ESBC average return for the year exceeds the base rate as well as other benchmarks.

7. The Economy and Interest Rates

UK. Brexit. The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Theresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the **coronavirus outbreak**. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in **quantitative easing (QE)**, essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time

of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but it is obviously heading for a big hit in March – April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

USA. Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a \$2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to \$6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of \$1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost \$367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be \$500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including \$50bn for airlines.

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of March.

Eurozone. The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

China. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

Japan has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It appears to have missed much of the domestic impact from coronavirus in 2019-20 but the virus is at an early stage there.

World Growth. The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

8. Compliance with Treasury Limits

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators *is shown in Appendix 1.*

9. Other Treasury Matters

a) Icelandic Bank Defaults

This authority currently has the following investments outstanding in Icelandic banks:

Borrower - Icelandic Exposure	Principal (£)	Interest Rate	Start Date	Maturity Date
KSF	266,600	5.41%		08/10/2008

The administrators for Kaupthing, Singer and Friedlander Ltd made three dividend payments during the financial year, with total dividend payments to date of 86.67%. The administration process has now been extended to October 2021.

Appendix 1: Prudential Indicators

PRUDENTIAL INDICATOR	2018/19	2019/20	2019/20
	£'000	£'000	£'000
	Actual outturn	Original Estimate	Actual outturn
Capital Expenditure (a)	541	2,895	2,104
Ratio of financing costs to net revenue stream	12.50%	10.23%	11.10%
Capital Financing Requirement as at 31 March (excluding finance leases) (b)	14,970	12,599	14,730
Capital Financing Requirement as at 31 March (including finance leases) (b)	15,824	12,963	15,047
External Debt (including leasing)	12,194	11,661	11,545

- (a) This reflects the timing of capital spend/commitments in the capital programme.
- (b) The outturn is higher than the original estimate (but closer to the mid-year estimate) due to the timing of the capital receipts committed towards the repayment of debt.

PRUDENTIAL INDICATOR	2018/19	2019/20	2019/20
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000
	Actual Outturn	Original	Actual Outturn
Authorised Limit for external debt -			
Borrowing	16,500	16,500	16,500
other long term liabilities*	3,000	3,000	3,000
TOTAL	19,500	19,500	19,500
Operational Boundary for external debt -			
Borrowing	15,500	15,500	15,500
other long term liabilities*	2,000	2,000	2,000
TOTAL	17,500	17,500	17,500
Upper limit for total principal sums invested for over 1 year	5,000	5,000	5,000

*This provides an allowance for on-balance sheet finance leases, as set out in previous reports.