# AUDIT & GOVERNANCE COMMITTEE

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| **DATE** | 23/07/2020 |
| **REPORT OF** | Sharon Wroot, Director of Resources and Governance |
| **SUBJECT** | Treasury Management Outturn Report 2019-20 |
| **STATUS** | Open |

## CONTRIBUTION TO OUR AIMS

Effective treasury management provides support towards the achievement of all Council Plan aims and objectives. Treasury management is an integral part of the Council's finances providing for cash flow management and financing of capital schemes.

## EXECUTIVE SUMMARY

The report contains details of treasury management arrangements, activity and performance during 2019-20.

The Council's high-level policies for borrowing and investments are:

- The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

- The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

## RECOMMENDATIONS

That Audit and Governance Committee considers the content of the report and makes any recommendations to Cabinet as necessary in respect of treasury management activity during 2019-20.

## REASONS FOR DECISION

The Council's treasury management activity is guided by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. We therefore report after Quarter 2 and year end.

## 1. BACKGROUND AND ISSUES

1.1. CIPFA has defined treasury management as:

*The management of the organisation's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.*

1.2. The proposed Treasury Management Strategy Statement (TMSS) for 2019/20 was developed in consultation with our treasury management advisors, Link Asset Services Ltd. This statement also incorporates the Investment Strategy.

1.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

1.4 The Council has nominated Audit & Governance Committee to be responsible for ensuring effective scrutiny of treasury management arrangements.

1.5 The key issues covered in the attached appendix include: -

- Political factors (Brexit, trade tensions) added volatility to interest rate and risk environments.
- Impact of the Covid-19 crisis toward the end of the period on both access to financing and the interest rate environment.
- The decision of Public Works Loan Board to increase the margin at which it would lend to Local Authorities by 1% in October 2019 which triggered the return of alternative lenders in the market.
- In general market terms 'low for even longer' rate guidance has replaced 'Gradual and limited' rate rises for interest rates. For investments, the Authority's primary considerations remain Security of capital and liquidity.

1.6 Following consideration by Cabinet, this report will be submitted to full Council

## 2. RISKS AND OPPORTUNITIES

2.1 No Treasury activity is without risk. Specific risks include, but are not limited to, Counterparty Credit Risk (the risk of an investment not being repaid), liquidity risk (the risk that the Authority does not have its funds in the right place, at the right time and in the right amount to make it's payments as they fall due), interest rate risk (the risk that future rate movements have a revenue implication for the Authority) and reputational risk (see Section 4 below).

2.2 The attached Appendix records our approach toward mitigating these risks during 2019/20.

2.3 Treasury is an Authority-wide function and its equalities implications are the same as for the Council itself.

2.4 As large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result equality issues are an increasingly important and heavily scrutinised part of their overall business.

2.5 **General Data Protection Regulation 2018** – Relationships with external providers covered by the Treasury management Practices are governed by and operated in accordance with the act.

## 3. OTHER OPTIONS CONSIDERED

3.1 These were set out on Page 28 of the Treasury Management Strategy Statement.

## 4. REPUTATION AND COMMUNICATIONS CONSIDERATIONS

4.1 As you would expect, with large sums of public money involved, any treasury activity carries a high degree of reputational risk. Any losses have not just financial but also significant, ongoing resource implications for the Council and so Treasury retains a high degree of oversight from Senior Officers and Members.

## 5. FINANCIAL CONSIDERATIONS

5.1 As set out in the Appendices.

## 6. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

Treasury is an Authority-wide function and its climate change, environmental and sustainability implications are the same as for the Council itself.

The Authority will have regard to the environmental activities of its Counterparties (where reported) but:-

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result climate change considerations are an increasingly important and heavily-scrutinised part of their overall business.
- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority’s capacity to mitigate risk through diversification.

## 7. FINANCIAL IMPLICATIONS

7.1 As set out in the appendix.

## 8. LEGAL IMPLICATIONS

8.1 There are no direct legal implications arising from the recommendations in this report which are not covered in the body of the report. The Council has complied with its statutory obligations arising from the Local Government Act, the Local Government Finance Act and all relevant CIPFA guidance.

## 9. HUMAN RESOURCES IMPLICATIONS

9.1 There are no immediate HR implications arising from the recommendations contained in this report.

## 10. WARD IMPLICATIONS

10.1 All wards indirectly affected.

## 11. BACKGROUND PAPERS

11.1 CIPFA Treasury Management Code and Guidance Notes

## 12. CONTACT OFFICER(S)

Rachel Carey, Strategic Lead, Financial Planning (01472) 324633

**Sharon Wroot**

**Director of Resources and Governance**

Appendix 1

# Annual Treasury Report 2019/20

# Contents

**Key Messages:**

**All investment and borrowing transactions were in line with the Approved 2019-20 treasury Strategy.**

**The key strands of our Treasury Strategy are**
- **Reduce cost of carry by maintaining lower cash balances (this also reduces counterparty risk)**
- **Delay the majority of our long-term borrowing requirement through use of temporary borrowing from other local authorities**
- **Combine this with proportionate longer-term transactions when circumstances make it attractive to do so.**

**Outturn for borrowing costs was below budget for the period.**

**Investment income for the year exceeded budget despite historically low rates.**

# Director of Finance Overview

It remains my view that the priority for Treasury Management at North East Lincolnshire Council is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate or possible, but we will continually strive for a low risk balance framed around a keen responsibility for public money. It was pleasing to see this longstanding approach provide necessary resilience toward the end of the period covered as the Coronavirus crisis broke.

The 2019/20 Treasury environment was, for much of the period, again shaped by political developments, primarily Brexit negotiations progress, but also trade tensions and mounting concerns of an economic downturn. Domestic economic data was mixed but on occasion surprised to the upside with consumer confidence, employment levels and inflation remaining relatively firm. The combination of these factors persuaded the Bank of England to raise rates by one-quarter percent in August, but the continuing political uncertainties served to stymie any further moves.

The projection of gradual rises in interest rates that formed the Bank of England Monetary Policy Committee's guidance at the start of the period eased through the year and then evaporated entirely with the onset of the Covid-19 crisis. As the Authority's borrowing rates are directly linked to market expectations this gives rise to the potential that our borrowing rates will remain close to all time lows for some time. With the Authority's Capital Programme and re-financing commitments over the next few years, our ability to secure good value in our borrowing has significant implications for the spending plans of Authority as a whole. This ability will be affected by the outcome of the current consultation by Public Works Loan Board (PWLB) on how it offers debt to the sector. Potentially this may mean some reversal of the PWLB's 1% margin hike imposed in October 2019. At the time of writing any such reversal is by no means certain and so our central borrowing strategy remains one of undertaking regular transactions in order to lock in current rates to fulfil our long-term borrowing requirement. Timing will be managed through a portfolio of short-term debt and we will seek to add new sources of borrowing while PWLB's margin remains at 1.80%.

In summary, our Strategy of maintaining a simple, low-risk, treasury portfolio has provided a level of comfort through a period of unprecedented political and economic events – both here and abroad – whilst still delivering budget outcomes which support and benefit the wider Authority.

Sharon Wroot, Director of Finance

June 2020

**Key Messages:**

**No Treasury activity is without risk. These risks include, but are not limited to, Credit Risk, Liquidity Risk, Interest Rate Risk, Inflation Risk and Reputational Risk.**

**The Council uses in-house knowledge, advisors, treasury management software (Treasury Live) and the CIPFA Treasury Management Code to manage these risks.**

**Scrutiny of Treasury activity is undertaken by Audit Committee and reported twice-yearly to Full Council.**

# Introduction and External Context

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).

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

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.

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 Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during 2019/20 in order to support members' scrutiny role.

The Authority has borrowed and invested 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. This report covers treasury activity and the associated monitoring and control of risk.

**Key Messages:**

**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.**

**Whilst there were limited expectations of rate rises during 2019-20 the impact of Covid-19 on the economic environment during March 2020 changed the outlook entirely. As of 8 June 2020 our advisors, Link Asset Services are not forecasting a Bank Rate before March 2022.**

# Introduction and External Context

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.

There is likely to be little upward movement in 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 economies during 2020-21.

This authority does not have sufficient cash balances to be able to place deposits for more than around six months so as to earn higher rates from longer deposits. 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 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.

**Key Messages:**

**The Authority has an increasing CFR over the next four years due to the capital programme, and with reduced investments will therefore need to borrow up to £35m over the next few years. An additional £23m will be required to replace maturing loans.**

**Since the 2008 financial crisis the Authority has adopted a cautious approach whereby investments continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.**

# Local Context

**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 must 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 plus the estimates of any additional capital financing requirement for the current and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator does still allow the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20 should it desire.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

| | 31 March 2019 Principal | Rate/ Return | Average Life yrs | | 31 March 2020 Principal | Rate/ Return | Average Life yrs |
|---|---|---|---|---|---|---|---|
| Total debt | *£127.3m* | *3.51%* | *26.0* | | *£146.7m* | *3.25%* | *28.1* |
| Capital Financing Requirement (CFR) | *£159.6m* | | | | *£171.8m* | | |
| Over / (under) borrowing | *(£32.3m)* | | | | *(£25.1m)* | | |
| Total investments | *£15.4m* | *0.58%* | *0.01* | | *£32.8m* | *0.13%* | *0.01* |
| Net debt | £111.9m | | | | £114.9m | | |

The overall level of investment balances held has remained steady in recent years, as the Authority used internal borrowing to both defer more expensive long-term borrowing and reduce it's credit risk exposure, but rose toward the end of 2019-20 as the Authority sought liquidity to assist with it's response to the uncertainty created by the Covid-10 pandemic..

**Key Messages:**

**When undertaking new borrowing the Council will review both the source and tenure of loans it seeks to take.**

**The Council's current borrowing portfolio is predominantly of a long-term and fixed nature. Whilst this provides certainty of cost it can restrict flexibility to restructure debts as plans and finances change.**

**No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.**

# Borrowing Strategy

At 31/03/2020 the Authority held £147m of loans, (up £20m on 2019) as a result of funding previous years' capital programmes.

The structure of our debt portfolio as at 31.3.2020 is shown below

| Type of Loan | Amount | % of Portfolio |
|---|---|---|
| PWLB Fixed | £75.5m | 51% |
| LOBO | £21.0m | 14% |
| Market Fixed | £20.0m | 14% |
| Short-term Fixed | £30.0m | 20% |
| Variable Rate | £0.2m | 1% |
| Total | £146.7m | |

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. As a result a new loan of £20m over 30 years was arranged and drawn just after year end in April 2020.

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 :

**Key Messages:**

**Affordability and the “cost of carry” remained important influences on the Authority’s borrowing strategy. As short-term interest rates have remained, and are likely to remain at least over the forthcoming two years, lower than long-term rates, the Authority determined it was more cost effective in the short-term to use internal resources instead**

**Borrowing short-term from other local authorities provides a useful balance alternative below current fixed rates and with the ability to exit loans within a reasonable timeframe.**

**Recognising that, whilst the above represents the default strategy, there always remains a risk of higher rates in the future, the Authority completed two longer-term loans during the period, including one for 10.5 years at 0.99% the day before PWLB increased their lending margin from 0.8% to 1.8% without notice.**

# Borrowing Strategy (continued)

- where there was a significant perceived risk of a sharp FALL in long and short term rates, (e.g. due to a marked increased risk of recession or 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 sharp RISE in long and short term rates, perhaps arising from an acceleration in the start date or 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 future.

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. Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Thereafter, gilt yields fell sharply to unprecedented lows as investors sold shares in anticipation of impending recessions in western economies and moved cash into safe haven assets i.e. government bonds. However, major 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%.

However, HM Treasury imposed a change in the margin over gilt yields for PWLB rates in 2019-20 without any prior warning; on 9 October 2019, HM Treasury 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 July. The signal is 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.

**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.

**Key Messages:**

**The effect of Covid-19 and the resultant tightening if short-term liquidity markets from mid-March can clearly be seen in the table. During that month Local Authorities borrowed £3.1Bn (the largest amount ever in a single month) from PWLB on minimum terms of 1 year. We managed to avoid the need to resort to such measures and although year end liquidity cost us more, we were able to mitigate the long-term impact by keeping borrowing short.**

# Borrowing Strategy (continued)

Borrowing – the following loans were taken during the year: -

| Counterparty | Start Date | Maturity Date | Amount | Rate |
|---|---|---|---|---|
| Broxbourne Borough Council | 05/04/2019 | 07/10/2019 | £2,000,000 | 1.00% |
| Hertsmere Borough Council | 05/04/2019 | 18/09/2019 | £2,000,000 | 0.98% |
| Gwent Police & Crime Commissioner | 05/04/2019 | 31/10/2019 | £2,000,000 | 0.98% |
| Royal Borough of Kensington & Chelsea | 30/04/2019 | 30/10/2019 | £4,000,000 | 0.93% |
| Gloucester City Council | 20/05/2019 | 20/04/2020 | £3,000,000 | 0.95% |
| PWLB | 08/07/2019 | 02//01/2052 | £5,000,000 | 1.98% |
| PWLB | 10/10/2019 | 10/04/2030 | £2,500,000 | 0.99% |
| Chichester District Council | 31/10/2019 | 30/04/2020 | £2,000,000 | 0.88% |
| Vale of Glamorgan Council | 31/10/2019 | 01/04/2020 | £2,000,000 | 0.77% |
| Edinburgh City Council | 30/10/2019 | 30/04/2020 | £4,000,000 | 0.85% |
| Comhairle nan Eilean Siar | 19/11/2019 | 19/05/2020 | £2,000,000 | 0.83% |
| Northern Ireland Housing Executive | 20/12/2019 | 20/03/2020 | £2,000,000 | 0.80% |
| Humber Bridge Board | 23/12/2019 | 23/03/2020 | £1,000,000 | 0.75% |
| London Borough of Merton | 22/01/2020 | 11/09/2020 | £5,000,000 | 0.90% |
| Vale of Glamorgan Council | 09/03/2020 | 05/03/2021 | £2,000,000 | 1.05% |
| Warrington Borough Council | 20/03/2020 | 30/04/2020 | £5,000,000 | 1.65% |
| Aberdeen City Council | 26/03/2020 | 30/04/2020 | £3,000,000 | 1.65% |
| Tewkesbury Borough Council | 30/03/2020 | 08/04/2020 | £2,000,000 | 1.65% |

The effect of Covid-19 and the resultant tightening of short-term liquidity markets from mid-March can clearly be seen in the table. During that month Local Authorities borrowed £3.1Bn (the largest amount ever in a single month) from PWLB on minimum terms of 1 year. We managed to avoid the need to resort to such measures and although year end liquidity cost us more, we were able to mitigate the long-term impact by keeping borrowing short.

**Key Messages:**

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

**All other things being equal we would expect to see balances fall each year by the amount of corporately funded capital expenditure less any new borrowing.**

**Legislation places the burden of rescuing failing banks disproportionately onto unsecured local authority investors through potential bail-in arrangements**

# Investment Activity

The Authority has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2019/20 investment balances ranged between £13.2m and £36.6 million. The average balance maintained was £23.7m with a weighted average maturity of 10 days. An average yield of 0.59% was achieved. This compares favourably to 1-month LIBID (0.56%) and our targeted rate of 7-day LIBID (0.53%).

Total investment income was £0.207m compared to a budget expectation of £0.050m.

**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. 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.).

Investment activity during the year conformed to the Investment Strategy for 2019/20 which aimed to reduce risk by;

- Setting value and term limits for counterparties based on Credit rating, available collateral and sector.
- Utilising data tools available via Treasury Live and Link Asset Services to monitor risk.
- Ensuring a minimum level of liquidity was maintained to allow payments to be made as they fell due

**Key Messages:**

**Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A-); credit default swap prices, financial statements, and reports from quality financial news feeds.**

**Budgeted income from Investments was still over-achieved and so no pressure resulted from a cautious approach and low market yields generally.**

**The higher year end balances were a result of a combination of an active strategy to maintain liquidity during the significant uncertainty around year-end due to Covid-19 crisis and subsequent central government assistance schemes.**

# Investment Activity

| Investments | Balance on 01/04/2019 £m | Investments Made £m | Maturities/ Investments Sold £m | Balance on 31/03/2020 £m | Avg Rate/Yield (%) and Avg Life (years) |
|---|---|---|---|---|---|
| UK Government:<br>- DMADF<br>- Treasury Bills | 13.3<br>- | 374.8<br>55.3 | (361.7)<br>(55.3) | 26.4<br>- | 0.46% 7 days<br>0.69% 26 days |
| Bonds issued by Multilateral Development Banks | - | 2.5 | (2.5) | - | 0.77% 13 days |
| Direct Unsecured Investments (call accounts, deposits) with financial institutions<br>- rated A- or higher<br>- rated below A- | 3.8<br>- | 50.7<br>- | (50.9)<br>- | 2.4<br>- | 0.40% at Call |
| Tradable Investments with Financial institutions Corporates (CDs) rated A- or higher | - | 3.4 | (3.4) | - | 0.80% 40 days |
| Money Market Funds | 6.8 | 26.4 | (26.2) | 4.0 | 0.68% at Call |
| TOTAL INVESTMENTS | 19.7 | 513.1 | (500.0) | 32.8 | 0.59% 10 days |
| Increase/ (Decrease) in Investments £m | | | | 13.1 | |

Given the increasing risk and continued low returns from short-term unsecured bank investments, but having no funds available for longer-term investment, the Authority is unable to simply diversify into more secure and/or higher yielding asset classes such as repurchase agreements or covered bonds which are secured on financial assets. Eliminating Credit Risk by running down balances whilst still maintaining adequate liquidity is therefore a key strand of operational activity.

The Authority used short-term borrowing around year end to bolster available cash balances. Although this action was taken prior to year-end it was in line with recommendations issued by CIPFA in their 'Briefing to Chief Financial Officers – April 2020'.

**Key Messages:**

**Figuratively the Authority's risk profile remained fairly steady for most of the year, increasing only right at the end of Q4 reflecting the downgrade of the UK Sovereign Rating on the back of the Covid crisis.**

**As the Covid-19 crisis escalated in March 2020 and unsure of the cash flow impact to come the Authority lifted its min cash liquidity level from £10m to £20m. The majority of this extra money was placed with DMO/UK Government who still represented the 'safe haven' option regardless of Ratings Agency actions.**

# Investment Activity (contd.)

**Credit Risk**

Counterparty credit quality as measured by credit ratings is summarised below:

| Date | Value Weighted Average – Credit Risk Score | Value Weighted Average – Credit Rating |
|---|---|---|
| **31/03/2019** | 2.89 | AA |
| **30/06/2019** | 2.87 | AA |
| **30/09/2019** | 2.70 | AA |
| **31/12/2019** | 2.49 | AA+ |
| **31/03/2020** | 3.72 | AA- |

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

As the Covid-19 crisis escalated in March 2020 and unsure of the cash flow impact to come the Authority lifted its min cash liquidity level from £10m to £20m. We sought to fund our year end cash flow need via the short-term Local Authority market. As Authorities found themselves in similarly uncertain predicaments lenders in that market withdrew. This in turn led to Authorities in need of cash turning to PWLB where minimum terms are 1 year but even so £3.1Bn was borrowed nationally in March alone. The highest month on record. Fortunately, we were able to leverage our good relationships with brokers to fulfil all our requirements short-term and even though rates spiked, the short tenures meant that this was the most efficient method of meeting a substantial short-term requirement.

Subsequent support programmes from Central Government and more robust income levels than expected have meant that we carried larger balances into Q1 2020-21 but again the short-term nature of these later loans will allow the position to adjust organically over the Summer even with payment levels remaining low due to subdued activity.

**Key Messages:**

**In an environment where direct unsecured bank deposits present increased risk but low return NELC has sought to avoid this imbalance by utilising UK Government based investments and diversified funds.**

**Ultimately we seek to minimise counterparty risk by limiting our cash levels whilst still maintaining adequate liquidity.**

**There were two operational breaches a TMSS limits during the period. No losses resulted and a review took place after each occurrence.**

# Investment Activity (contd.)

**Benchmarking**

- Comparisons are made to other Authorities using the Treasury Live database which looks at over £6Bn of local Authority investments. As at the outturn date this shows that other Authorities:-
    - Hold more cash than NELC. Average balance £72m (estimated) vs £33m at NELC
    - Invest for longer periods. 143 days on average vs only 3 days at NELC
    - Take more risk than us.
    - Deliver higher return than us. 0.81% vs 0.13%
- Whilst the above shows the greater return generated by term premiums the Council is of the view that, in a post Bail-in environment elimination of credit risk through lower balances is worth lower overall return. NELC also recognises that this strategy needs to ensure it does not replace credit risk with liquidity risk and so a liquid balance of £10m was maintained. As an example, this minimum balance was raised in March 2020 in order to ensure the Authority retained access to liquidity during that unprecedented period of uncertainty.

**Operational Breaches**

- There were two breaches of limits set within the TMSS during the year.
    - August 2019. Breach to enable same day settlement payment to be made when a user was unable to access online banking. No loss resulted. Subsequent discussion of how locked out user could still partake in process, offline if ever there was similar situation in the future.
    - March 2020. During an exceptionally busy period an email confirmation of an incoming loan was missed. The loan itself was received late in the day (after 4:30pm) and there was no option to invest it elsewhere at that point. Barclays balance was £2.7m overnight against a limit of £2m. Position was corrected the following morning and no loss resulted.

Key Messages:

**The Authority confirms compliance with its Prudential Indicators for 2019/20, which were set in February as part of the Authority's Treasury Management Strategy Statement.**

# Compliance with Prudential Indicators

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

**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 will be:

| | 2019/20 | 2020/21 | 2021/22 |
|---|---|---|---|
| Upper limit on fixed interest rate exposure | £260m | £280m | £280m |
| Actual* | £119m | £172m (est) | £182m (est) |
| Upper limit on variable interest rate exposure | £70m | £70m | £70m |
| Actual* | £30m | £35m (est) | £35m (est) |

*= Peak position for 2019/20

**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 fixed rate borrowing were:

| | Upper | Lower | Actual |
|---|---|---|---|
| Under 12 months | 60% | 0% | 35% |
| 12 months and within 24 months | 30% | 0% | 1% |
| 24 months and within 5 years | 50% | 0% | 2% |
| 5 years and within 10 years | 50% | 0% | 7% |
| 10 years and within 20 years | 75% | 0% | 9% |
| 20 years and within 30 years | 75% | 0% | 8% |
| Over 30 years | 90% | 0% | 38% |

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. Note: LOBO option dates are included as potential repayment dates.

Key Messages:

**For 2019-20 a minimum cash level of £10m was targeted and there were no breaches of this, or other Indicators.**

# Compliance with Prudential Indicators (contd.)

**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 total principal sum invested to final maturities beyond the period end will be:

| | 2019/20 | 2020/21 | 2021/22 |
|---|---|---|---|
| Limit on principal invested beyond year end | £21m | £21m | £21m |
| Actual | £0m | £0m | £0m |

*This indicator has been tweaked in recently issued Code of Practice/Guidance Notes. Going forward this indicator will be reported against 365 (rather than 364 days). This is not expected to make any material difference to limits or actuals.

**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. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

| | Target | Actual |
|---|---|---|
| Portfolio average credit rating | A | AA- |

**Liquidity**: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

| | Target | Actual (Low) |
|---|---|---|
| Total cash available within 1 month | £10m | £13m |

**Key Messages:**

**Borrowing remains comfortably below control levels as a result of continued internal borrowing support for the Capital Programme.**

**Borrowing levels were projected to be £157m at the end of 2019/20 when the TMSS was set in Feb 2019. The actual position as at 31.3.2020 was £147m. The difference was held in cash at the period end and was expected to be utilised to fund Capital Spend during the early months of 2020/21 although the Covid-19 crisis may force some delay in planned spend.**

# Compliance with Prudential Indicators (contd.)

### Other Prudential Indicators

The following prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

**Operational Boundary for External Debt:** The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst-case scenario for external debt.

| Operational Boundary | 2019/20 £m | 2020/21 £m | 2021/22 £m | 2022/23 £m |
|---|---|---|---|---|
| Borrowing | £190m | £215m | £225m | £225m |
| Other long-term liabilities | £30m | £25m | £25m | £25m |
| Total Debt | £220m | £240m | £250m | £250m |

**Authorised Limit for External Debt**: The authorised limit is "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 2018/19 the Council has maintained gross borrowing within its authorised limit.

| Authorised Limit | 2019/20 £m | 2020/21 £m | 2021/22 £m | 2022/23 £m |
|---|---|---|---|---|
| Borrowing Limit | £230m | £250m | £250m | £250m |
| Other long-term liabilities | £30m | £30m | £30m | £30m |
| Total Debt Limit | £260m | £280m | £280m | £280m |
| Actual/projected Peak Debt levels | £147m | £182m (est) | £192m (est) | £189m (est) |

**Adoption of the CIPFA Treasury Management Code:** The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition in February 2018.

**Key Messages:**

**The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.**

**The Authority confirms compliance with its Capital Finance Prudential Indicators for 2019/20, which were set in February as part of the Authority's Treasury Management Strategy Statement.**

**Changes to the 2020/21 and later programmes may occur as these are rolled forward in the coming months.**

# Compliance with Capital Finance Prudential Indicators

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

**Estimates of Capital Expenditure**

The Authority's planned capital expenditure and financing as at 31 March 2020 may be summarised as follows.

| Capital Expenditure and Financing | 2019/20 Approved £m | 2019/20 Actual £m | 2020/21 Estimate £m | 2021/22 Estimate £m | 2022/23 Estimate £m |
|---|---|---|---|---|---|
| Total Expenditure | 42.7 | 35.9 | 74.8 | 34.9 | 19.5 |
| Capital Receipts | 1.0 | 3.0 | 0.3 | 0.3 | 0.0 |
| Government Grants | 23.2 | 20.1 | 33.0 | 15.0 | 14.4 |
| Ring-fenced External Funding | .1.3 | 0.1 | 0.8 | 0.0 | 0.0 |
| Borrowing | 17.2 | 12.7 | 40.7 | 19.6 | 5.1 |
| Total Financing | 42.7 | 35.9 | 74.8 | 34.9 | 19.5 |

**Key Messages:**

**The percentage of the Council's income required to service it's debt came in below projections due primarily to a one-off accounting adjustment in addition to slippage in the capital programme and the effect of using short-term borrowing which came at lower interest rates.**

# Compliance with  Capital Finance Prudential Indicators (contd.)

**Ratio of Financing Costs to Net Revenue Stream**
This is a voluntary indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

| Ratio of Financing Costs to Net Revenue Stream | 2019/20 Original Estimate % | 2019/20 Actual % | 2020/21 Estimate % | 2021/22 Estimate % | 2022/23 Estimate % |
|---|---|---|---|---|---|
| General Fund | 7.5 | 3.7* | 7.2 | 8.5 | 8.7 |

Previously provided for Voluntary Revenue Provision which was not utilised was applied to reduce Minimum Revenue Provision during 2019/20 only. Without this one-off adjustment the percentage of Net Revenue required to cover Financing Costs in 2019/20 would have been 6.3%.