

AUDIT COMMITTEE – 11 NOVEMBER 2020

PART I - DELEGATED

5. TREASURY MANAGEMENT MID-YEAR REPORT 2020/21 (DoF)

1 Summary

1.1 This report gives details of the 2020/21 mid-year review of the Treasury Management function.

2 Details

2.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: “the management of the local authority’s 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”.

2.2 The Council’s 2020/21 Treasury Management Strategy (TMS) as approved by Council on 26 February 2020 has the primary objectives of safeguarding the repayment of the principal and interest of its investments on time, and then ensuring adequate liquidity, with the investment return being the final objective.

2.3 This report updates the Committee with the progress on whether the Council is meeting the TMS and its policies for the first six months of 2020/21.

2.4 The Council has appointed treasury advisors to assist with our treasury management, Link Asset Services. The advisors have provided the following forecast:

Interest rate forecasts

Month & Year	Bank Rate %
Dec 2020	0.10
March 2021	0.10
June 2021	0.10
September 2021	0.10
December 2021	0.10
March 2022	0.10
June 2022	0.10

2.5 The Council’s Capital Position (Prudential Indicators)

2.6 The Council’s capital expenditure plans are one of the key drivers of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members’ overview and confirm capital expenditure plans.

2.7 The capital expenditure plans are financed in full by capital receipts, grants or capital reserves.

Capital Financing Requirement (CFR), External Debt and Operational Boundary

- **CFR** measures the Council’s underlying need to borrow for capital purposes, representing the Council’s total outstanding indebtedness.

External Debt (borrowing) may not exceed the CFR except in the short-term.

- **The Operational Boundary** is a limit on the level of external debt set by the Council.
This is set based on the most likely prudent (i.e. not worst-case scenario) estimate of total external debt, in line with statutory guidance.

External debt may exceed the Operational Boundary, but may not exceed the Authorised Limit for external debt, which is set at a higher level and provides further headroom for unusual cash movements or refinancing.

2.8 The CFR and Operational Boundary estimates are shown below:

Prudential Indicator	2020/21 Original Estimate	2020/21 Revised Estimate (mid-year)	2020/21 Outturn
Capital Financing Requirement	£32.8m	£28.37m	£23.47m
External Debt / the Operational Boundary			
Borrowing	£18m	£6.7m	£6.7m

2.9 The borrowing balance of £6.7m represents long-term loans applied to Capital expenditure. It is net of an £8.0m loan to Thrive Homes and a £1.3m loan to Watford Community Homes for which the Council has borrowed, and temporary loans taken to support short-term liquidity needs. Gross debt is £19.0m. The increase in the CFR is due to the investment in Capital Projects during the year.

2.10 **Limits to Borrowing Activity**

The first key control over the treasury activity is a Performance Indicator (PI) 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 borrowing in relation to the loans to Housing Associations does not count against the external borrowing limit as this has a neutral impact on net debt (the borrowing is cancelled out by the onward loan).

2.11 **The Authorised Limit**

This is required to be set and revised by Members. It controls the overall level of borrowing and represents the limit beyond which borrowing is prohibited. 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	Current Borrowing Position	2020/21 Revised Indicator
Borrowing	£20m	£6.7m	£20m

2.12 Investment Portfolio 2020/21

2.13 In accordance with the CIPFA Prudential Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 2 of the Code, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the Bank of England Bank Rate.

2.14 In response to the Covid 19 public health emergency, the Bank reduced base rate to 0.10% in March 2020 in order to support the UK economy. It now appears likely that the crisis will lead to a global recession with prospects for recovery remaining highly uncertain.

2.15 Returns on deposits with the UK Government's Debt Management Office (DMO) were nil or negative for durations under 1 month at the end of September 2020. Given this risk environment, investment returns are likely to remain low.

2.16 The nature of the Council's cash flows gives rise to very short-term cash surpluses which cannot be accommodated within the £10m counterparty limit applicable to Lloyds Bank. This exposes the Council to the achieving a negative return on deposits with the DMO. Officers will seek to minimise deposits at negative rates, but this is likely to be unavoidable at times during the second half of the year.

2.17 The Council held £13.56m of investments as at 30 September 2020 (see table below).

Institution	Principal (£)
Lloyds Bank – Current Account	8,006,453.20
UK Debt Management Office	5,350,152.00
Total	13,356,605.20

2.18 The approved limits within the Annual Investment Strategy were not breached during the first six months of 2020/21.

2.19 Security

- 2.20 The Council uses benchmarks as simple guides to maximum risk, and these may be breached from time to time, depending on movements in interest rates and counterparty criteria. Any breach of the benchmarks will be reported, with supporting reasons, in this report.
- 2.21 In line with the TMS, the Council has managed to invest with those institutions who offered the best rate and the investment portfolio is above the overall benchmark during the year to date.
- 2.22 Members are invited to note that the definition of the security of an investment is defined as receiving contractually agreed amounts at the contractually agreed date. When a negative return is applicable on an investment the amount repaid on maturity will be lower than originally invested but not less than contractually agreed. This represents the prioritisation of security and liquidity management over investment yield, in line with the principals of the Treasury Management Code.
- 2.23 **Liquidity**
- 2.24 The Council set liquidity facilities/benchmarks to maintain:
- Authorised bank overdraft of £nil.
- Liquid short term deposits of at least £5m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 10 years for an individual loan with a public body.
- 2.25 The liquidity arrangements were adequate during the year to date. The loan to Thrive is excluded in this liquidity calculation.
- 2.26 **Yield**
- 2.27 The budget for interest earned on investments for 2020/21 is £90,000; interest received and accrued up to the end of September was £10,618. It is expected that the budget will not be achieved due to the very low interest rate environment.
- 2.28 The Approved benchmark measure of yield is a return of 0.12% above the average bank rate of 0.10%.
- 2.29 The Council keeps all investments short term (other than those to the housing associations). There are no sums within the TMS invested for greater than 364 days. Given the unusual risk environment, and the need to keep ensure cash is available for prompt payment of suppliers in the pandemic environment, investments have been limited to short-term deposits with the UK Debt Management Office in order to remain within the approved bank counterparty limit.
- 2.30 The current investment counterparty criteria selection approved in the TMS is being met.
- 2.31 **Credit Ratings**
- 2.32 Credit rating information is supplied by our treasury consultants, Link Asset Services, on all counterparties that comply with the Council's criteria. Any counterparty failing to meet the criteria would be taken off the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification

of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

3 Financial Implications

3.1 As continued in the body of the report.

4 Legal Implications

4.1 There is no requirement to make any amendments to the Treasury Management Strategy at this stage.

5 Equal, Staffing, Environmental, Community Safety, Public Health, Customer Services Centre, Communications & Website, Risk Management and Health & Safety Implications

5.1 None specific.

6 Recommendation

6.1 That the Committee notes the contents of the 2020/21 mid-year review of the Treasury Management function.

Report prepared by: Alison Scott, Head of Finance

Data Quality

Data sources:

KPI monitoring information to SSOB

Link reports

Data checked by: Robert Thurlow, Finance Manager

Data rating:

1	Poor	
2	Sufficient	
3	High	x

Background Papers

None

APPENDICES / ATTACHMENTS

None