

**Title of Report:** Treasury Annual Report 2019/20

**Report of:** Darren Collins – Strategic Director, Resources & Digital

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### **Purpose of the Report**

1. Cabinet is asked to recommend to Council the attached Treasury Annual Report for 2019/20.

### **Background**

2. In line with what the Government defines as best practice and the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management, the Council must consider a Treasury Annual Report each year.
3. The attached Treasury Annual Report has been prepared taking into account the Local Government Act 2003, Ministry of Housing, Communities and Local Government 's (MHCLG) Guidance on Local Government Investments, CIPFA's Prudential Code for Capital and CIPFA's Code of Practice on Treasury Management (2017). The document is also consistent with the Council's approved Treasury Management Policy and Strategy, which require an annual report to be presented to Council prior to the end of September each year.
4. The Treasury Annual Report has been reviewed by members of the Audit and Standards Committee.

### **Proposals**

5. Cabinet is asked to recommend to Council the Treasury Annual Report attached at Appendices 2, 3 and 4 to ensure that the Council fully complies with the requirements of good financial practice in Treasury Management.

### **Recommendation**

6. Cabinet is asked to recommend to Council the Treasury Annual Report for 2019/20.

For the following reason:

To ensure that the Council fully complies with the requirements of Financial Regulations and good practice as recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in its Code of Practice on Treasury Management.

## **Policy Context**

1. The proposals in this report are consistent with Council priorities and in particular the priority of ensuring a sustainable Gateshead through ensuring the best use of its resources. The proposals are consistent with the framework for achieving the Council's new strategic approach "Making Gateshead a Place Where Everyone Thrives". The Council recognises there are huge financial pressures on not just Council resources but those of partners, local businesses and residents.

## **Background**

2. The Council fully complies with the requirements of good practice as recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in its Code of Practice on Treasury Management and its Prudential Code for Capital Finance and the Ministry of Housing, Communities and Local Government (MHCLG) Guidance on Local Authority Investments, which include the:
  - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
  - Creation and maintenance of Treasury Management Practice Statements which set out the manner in which the Council will seek to achieve those policies and objectives;
  - Receipt by the Council of an annual strategy report for the year ahead and an annual review report of the previous year;
  - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions; and
  - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to Audit and Standards Committee and receipt of a mid-year review report to Council.
3. Comprehensive details of procedures in place to ensure compliance with the Code are included within the Council's Treasury Management Practices and these procedures are followed without exception.
4. Treasury Management in this context is defined 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."
5. Taking into account the annual reporting requirements stipulated in the Code of Practice, this Annual Treasury Report covers:
  - The strategy for 2019/20 including investment and borrowing strategies);
  - Treasury Management approach to risk;
  - Outturn 2019/20 performance measurement (including market interest rates, investment and borrowing performance and compliance with treasury limits set prior to the start of the financial year as Prudential Indicators);
  - Any restructuring and repayment; and
  - Summary of Treasury Management performance for the year 2019/20.

## **Consultation**

6. Consultation on the production of the Treasury Annual Report has taken place with the Council's treasury advisors Link Asset Services. The outcome of the consultation process, along with guidance issued by CIPFA, has informed the format and content of the annual report.

## **Alternative Options**

7. There are no alternative options, as the Treasury Annual Report is required in order to comply with CIPFA's Code of Practice on Treasury Management.

## **Implications of Recommended Option**

### **8. Resources:**

- a) **Financial Implications** - The Strategic Director, Resources and Digital confirms that there are no direct financial implications associated with this report. The Annual Report sets out a financial summary of Treasury Management activity for the 2019/20 financial year end and compares this to budget.
- b) **Human Resources Implications** - There are no human resources implications arising from this report.
- c) **Property Implications** - There are no property implications arising from this report.

### **9. Risk Management Implications**

The Treasury Annual Report has been prepared to report on performance against the annual Treasury Policy and Strategy. These are prepared with the primary objective of safeguarding the Council's assets and a secondary objective of maximising returns on investments and minimising the costs of borrowing.

### **10. Equality and Diversity Implications**

There are no equality and diversity implications arising from this report.

### **11. Crime and Disorder Implications**

There are no crime and disorder implications arising from this report.

### **12. Sustainability Implications**

There are no sustainability implications arising from this report.

### **13. Human Rights Implications**

There are no human rights implications arising from this report.

### **14. Area and Ward Implications**

There are no direct area and ward implications arising from this report.

## **15. Background Information:**

The following documents have been relied on in the preparation of the report:

- Local Government Act 2003
- MHCLG Guidance on Local Government Investments (2018)
- CIPFA's Prudential Code for Capital (2017)
- CIPFA's Code of Practice on Treasury Management (2017)
- Council's approved Treasury Policy & Strategy Statements 2019/20 to 2023/24
- Council's approved Treasury Management Practice Statements

## **Treasury Management Annual Report 2019/20**

### **The Strategy for 2019/20**

1. The 2019/20 to 2023/24 Treasury Management Strategy was approved by Council on 21 March 2019.
2. The formulation of the 2019/20 to 2023/24 Treasury Management Strategy involved determining the appropriate borrowing and investment decisions with the primary objective of safeguarding the Council's assets and a secondary objective of maximising returns on investments and minimising the costs of borrowing.
3. The Treasury Management Strategy fully complies with the requirements of CIPFA's Treasury Management Code of Practice and covered the following:
  - prospects for interest rates;
  - treasury limits in force including prudential indicators;
  - the borrowing strategy;
  - the extent of debt rescheduling opportunities; and
  - the investment strategy.

### **Investment Strategy**

4. Part 1 of the Local Government Act 2003 relaxed the constraints under which local authorities can invest. These investment regulations came into force on 1 April 2004 and in conjunction with supplementary guidance are considered best practice.
5. Investments are managed in-house using counterparties listed in an approved lending list. Investments are placed over a range of periods and are dependent on the assessed security of the counterparty, the liquidity requirements of the cash flow, interest rate expectations and the interest rates actually on offer.
6. The expectation for interest rates within the Treasury Management Strategy for 2019/20 to 2023/24 anticipated growth likely to continue being weak until the conclusion of Brexit. Forecasts were based on a major assumption that Parliament and the EU agreed an orderly Brexit, either by 29 March 2019 or soon after. At their 7 February 2019 meeting, the MPC repeated that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; they quoted a Bank Rate of around 2.50% in ten years' time but declined to give a medium-term forecast. However, with so much uncertainty around Brexit, the next move could be up or down, even if there was a disorderly Brexit.

## **Borrowing Strategy**

7. The borrowing strategy for 2019/20 was as follows:

- When Public Works Loan Board (PWLB) rates fall back to the following target rates borrowing should be considered, 2.60% Q1, 2.70% Q2, 2.80% Q3 and 2.90% Q4. Preference is given to terms which ensure a balanced profile of debt maturity, this may include Local Infrastructure Rate borrowing. The average interest rates forecast across this financial year for various borrowing periods are as follows: -  
10 years – 2.45%  
25 years – 2.95%  
50 years – 2.75%
- The use of short-term borrowing (6 months to 18 months) will also be considered with the aim of minimising borrowing costs. This short-term borrowing will be replaced with longer term loans when rates are preferable.
- External borrowing rates currently far exceed the return that is available for investments, meaning savings can be achieved by borrowing internally from reserves in the short term. The current policy of internal borrowing will continue to be followed as a short-term funding option serving to minimise overall cost.
- Consideration will be given to borrowing market loans which are at least 20 basis points below the PWLB target rate.

8. Any potential opportunities for repaying debt before the maturity date to reduce borrowing costs was monitored and assessed throughout the year. However, the cost of premiums on any early repayment of debt was considered prohibitive for any debt restructuring.

## **Treasury Management Approach to Risk**

9. The primary objective is to safeguard the Council's assets. Procedures have been put in place to ensure this takes place and these are fully documented in the Council's Treasury Management Practice Statements (TMPS), which are constantly kept under review. These procedures are followed without exception. The Internal Audit report of 24th April 2020 concluded that Treasury Management control systems and procedures are satisfactory. All funds were safeguarded in 2019/20.

## **Outturn 2019/20 – Performance Measurement**

10. It should be noted that procedures in relation to the Prudential Code were effective from 1 April 2004 and continue to apply to this report on 2019/20 performance. The performance, against limits in respect of borrowing set prior to the start of the financial year as Prudential Indicators, will be reported to Cabinet on 23 June 2020 as part of the Capital Monitoring process. None of the approved Prudential Indicators set for 2019/20 were breached in the year. For completeness the Prudential Indicators are shown at Appendix 4.

## Market Interest Rates

11. Performance must be considered in conjunction with actual rate movements over the financial year which were as follows:

- **Shorter-term interest rates** – The expectation for interest rates within the 2019/20 Treasury Management Strategy was that Bank Rate would stay at 0.75% during the financial year as it was not expected that the MPC would be able to deliver an increase in Bank Rate until Brexit was settled. By March 2020 it was clear that the coronavirus outbreak posed a 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%.
- **Longer-term interest rates** – At its meeting ending on 6 May 2020, the MPC voted unanimously to maintain Bank Rate at 0.10%. The spread of Covid-19 and the measures to contain it are having a significant impact on the United Kingdom and many countries around the world. The unprecedented situation means that the outlook for the UK and global economies is unusually uncertain.

## Investment Performance

12. There has been a continued use of a range of investment instruments in order to ensure flexibility, spread risk, maximise liquidity and obtain attractive rates. There has been an increased use of Notice Reserve accounts and money market funds with high rated banks to maintain the security of the funds and enhance the rate of return on investments.
13. The most significant challenge for treasury management in 2019/20 has been generating a reasonable rate of return whilst ensuring the security of investments. Due to the difference between the cost of borrowing and potential to generate investment interest and the reduction in suitable counterparties the Council has continued to use investment balances to temporarily fund the capital programme. This has delivered a saving on borrowing costs.
14. The Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 21 March 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.
15. summary of the year's activity is shown at Appendix 3. The investment interest earned in the year was £0.689m (2018/19 £0.693m) with an average interest rate of 0.95% (2018/19 0.80%). Interest earned on loans to third parties, agreed as part of the capital programme, increased total interest to £3.284m which was £0.864m more than the original budget of £2.420m. This includes £0.811m interest on loan notes and £0.680m dividend both in respect of Newcastle International Airport.
16. The overall return for the year of 0.95% exceeds the accepted benchmark for 2019/20, which was the 3-month London Interbank Bid Rate (LIBID) of 0.47%.

17. Furthermore, the Council is a member of Link Asset Services Investment Benchmarking Group which assesses both the rate of return and the risk of the counterparty to calculate a weighted average rate of return. This is used for comparison across other local authorities who also subscribe to this service across a number of groups. The Council achieved an average return of 0.95% on its investments for Quarter 4 2019/20 which is in line with the risk adjusted expectations (0.84% to 0.97%) defined in the Benchmarking Report for our group.

## **Borrowing Performance**

18. The total external borrowing at 31 March 2020 was £694.738m, which was within the operational borrowing limit of £865.000m. This is a net increase of £24.171m from the opening figure of £670.567m. The increase is represented by £50.000m of new borrowing offset by £25.829m repayment of borrowing.
19. Investment returns/interest rates were low during 2019/20 and were well below long term borrowing rates. Therefore, value for money considerations indicated that best value could be obtained by delaying new external borrowing by using internal cash balances to finance new capital expenditure in the short term (this is referred to as internal borrowing). At the end of the financial year 2019/20 the Council had internal borrowing of £10.115m. This comprised of £5.007m General Fund over borrowing and £15.122m HRA under borrowing. Any short-term savings gained from adopting this approach was weighed against the potential for incurring additional long-term costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be higher.
20. The Council's underlying need to borrow for capital expenditure and long-term liabilities is termed the Capital Financing Requirement (CFR). The CFR arises directly from the capital activity of the Council and the resources applied to fund the capital spend, as follows:

	<b>31 March 2019 Actual £m</b>	<b>31 March 2020 Actual £m</b>
<b>Capital Financing Requirement for General Fund excluding PFI</b>	346.741	359.348
<b>Capital Financing Requirement for HRA excluding PFI</b>	345.505	345.505
<b>Total Capital Financing Requirement excluding PFI</b>	692.246	704.853



21. The details of the borrowing taken during 2019/20 are as follows:

Date	Term (years)	Amount £m	Interest Rate (%)	Source
06/06/2019	43	10.000	2.17	PWLB
19/12/2019	32 (days)	3.000	0.70	NIHE
26/02/2020	50	10.000	2.56	PWLB
23/03/2020	48.5	10.000	1.93	PWLB
23/03/2020	49.5	20.000	2.93	PWLB

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**53.000**

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22. At 31 March 2020 £640.038m of the total borrowing was from the PWLB and £54.700m was in the form of market loans. The average interest rate on borrowing has decreased from 3.56% in 2018/19 to 3.30% during 2019/20 which will reduce borrowing costs.
23. There was £3.000m of short-term borrowing taken during 2019/20 primarily to manage cash flow timing, the whole amount was repaid prior to year-end. All of the PWLB long term loans taken in 2019/20 were 43 years and over, which lengthens the life of the debt portfolio and provides long term security in terms of borrowing costs by securing loans at historically low rates.
24. The overall revenue cost of borrowing in 2019/20 was £24.302m. As a consequence of the level of capital expenditure and the application of the Treasury Management Strategy this was £2.378m less than the budget.

### **Debt Restructuring & Repayment**

25. Due to the reintroduction of redemption rates on the early repayment of PWLB debt it was anticipated that there would be little scope to restructure PWLB debt.
26. The rates payable on the early redemption of debt was monitored throughout the year. The cost of early repayment of PWLB loans outweighed any savings and therefore there was no early redemption of PWLB debt.

### **Summary of Treasury Management Performance for the Year 2019/20**

27. Total interest income was £0.864m more than the budget, this reflects the impact of a dividend received from Newcastle Airport and interest received from loans to our trading companies.
28. Borrowing costs were £2.378m less than budget due to a delay in taking borrowing and being taken at lower interest rates than estimated and the decision to temporarily fund the capital programme from cash balances.

29. Overall Treasury Management performance against budget for 2019/20 generated net savings of £3.242m, this is summarised in the following table:

	<b>Budget</b>	<b>2019/20 Actual</b>	<b>Saving</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Cost of Borrowing	26.680	24.302	(2.378)
Interest Income	(2.420)	(3.284)	(0.864)
<b>Net Position</b>	<b>24.260</b>	<b>21.018</b>	<b>(3.242)</b>

Treasury Management remained challenging throughout 2019/20 with one of the lowest bank interest rates in history and continuing pressure on available counterparties. The report highlights the way in which the Council has successfully managed these challenges with its day-to-day treasury management strategy and thus delivered the savings highlighted in the table whilst keeping treasury risks to a minimum throughout.

Investment Activity		
	2018/19	2019/20
Number of investments made in 2017/18 maturing in 2018/19	19	n/a
Number of investments made in 2018/19 maturing in 2018/19	28	n/a
Number of investments made in 2018/19 maturing in 2019/20	n/a	18
Number of investments made in 2019/20 maturing in 2019/20	n/a	14
Total number of investments maturing in year	47	32
Number of investments made in 2019/20 maturing in 2020/21	n/a	12
Average duration of investments (including overnight)	12 days	12 days
Average duration of investments (excluding overnight)	143 days	117 days
Non-specified investments:		
Rated non-high		
Approved limit	75%	75%
Maximum level invested	6.92%	9.14%
Not Rated		
Approved limit	0%	0%
Maximum level invested*	0.04%	0.05%
Investments greater than 364 days		
Approved limit	£15m	£15m
Maximum level Invested	£5m	£5m

\*Relates to the impaired investment with Heritable Bank.

**PRUDENTIAL INDICATORS 2019/20**

The 2019/20 Prudential Indicators were agreed by Council on 21 February 2019 (column 1). This is now compared with the 2019/20 actual outturn position as at the 31 March 2020 (column 2).

Certain Treasury Management indicators must be monitored throughout the year on a regular basis in order to avoid breaching agreed limits. The capital expenditure and capital financing requirement indicators have been revised in line with the revised budget and none of the other approved Prudential Indicators set for 2019/20 have been breached.

<b><i>Capital Expenditure</i></b>		
	2019/20 £000 Reported Indicator	2019/20 £000 Actual
Non-HRA	94,817	59,458
HRA	24,104	20,070
<b>Total</b>	<b>118,921</b>	<b>79,528</b>
To reflect the reported capital monitoring agreed by Council during the year		

<b><i>Ratio of Financing Costs to Net Revenue Stream</i></b>		
	2019/20 Reported Indicator	2019/20 Actual
Non-HRA	16.50%	11.08%
HRA	47.30%	40.51%

<b><i>Capital Financing Requirement</i></b>		
	2019/20 £000 Reported Indicator	2019/20 £000 Actual
Non-HRA	414,628	359,348
HRA	345,505	345,505

There were no breaches to the Prudential Indicators set for 2019/20,

<b><i>Authorised Limit for External Debt</i></b>	
	2019/20 £000 Reported Indicator
Borrowing	890,000
Other Long Term Liabilities	0
<b>Total</b>	<b>890,000</b>
Maximum YTD 31/03/20 £694.738m	

<b><i>Operational Boundary for External Debt</i></b>	
	2019/20 £000 Reported Indicator
Borrowing	865,000
Other Long Term Liabilities	0
<b>Total</b>	<b>865,000</b>
Maximum YTD 31/03/20 £694.738m	

The Council's actual external debt at 31 March 2020 was £694.738m. It should be noted that actual external debt is not directly comparable to the Authorised Limit and Operational Boundary, since the actual external debt reflects the position at one point in time.

### ***Estimated Incremental Impact on Council Tax and Housing Rents***

This indicator is set at the time the Council's budget is set. Therefore, there is no requirement for this Indicator to be monitored on a quarterly or annual basis.

### ***Adherence to CIPFA code on Treasury Management***

The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

<b>Upper / Lower Limits for Maturity Structure of Fixed Rate Borrowing</b>				
	<b>2019/20 £000 Reported Indicator</b>		<b>2019/20 £000 Actual Position</b>	
	<b>Upper Limit</b>	<b>Lower Limit</b>	<b>Actual Percentage</b>	<b>Maximum YTD</b>
Under 12 months	25%	0%	5.84%	5.87%
12 months to 24 months	25%	0%	3.47%	7.54%
24 months to 5 years	25%	0%	4.34%	7.49%
5 years to 10 years	25%	0%	9.70%	10.31%
10 years to 20 years	30%	0%	9.32%	11.74%
20 years to 30 years	30%	0%	1.12%	1.19%
30 years to 40 years	50%	0%	27.19%	28.81%
40 years to 50 years	50%	0%	36.14%	36.14%
50 years and above	30%	0%	0.00%	0.00%
All within agreed limits.				

<b>Upper / Lower Limits for Maturity Structure of Variable Rate Borrowing</b>				
	<b>2019/20 £000 Reported Indicator</b>		<b>2019/20 £000 Actual Position</b>	
	<b>Upper Limit</b>	<b>Lower Limit</b>	<b>Actual Percentage</b>	<b>Maximum YTD</b>
Under 12 months	30%	0%	2.88%	3.05%
12 months to 24 months	15%	0%	0.00%	0.00%
24 months to 5 years	15%	0%	0.00%	0.00%
5 years to 10 years	15%	0%	0.00%	0.00%
10 years to 20 years	15%	0%	0.00%	0.00%
20 years to 30 years	15%	0%	0.00%	0.00%
30 years to 40 years	15%	0%	0.00%	0.00%
40 years to 50 years	15%	0%	0.00%	0.00%
50 years and above	15%	0%	0.00%	0.00%
All within agreed limits.				

On 8 March 2007, Council agreed to the placing of investments for periods of longer than 364 days in order to maximise investment income before forecasted cuts in interest rates. An upper limit was set and agreed as a new Prudential Indicator.

***Upper Limit on amounts invested beyond 364 days***

	2019/20 £000 Reported Indicator	2019/20 £000 Actual Position	2019/20 £000 Maximum YTD
	<b>15,000</b>	<b>5,000</b>	<b>5,000</b>
Investments			