AUDIT AND STANDARDS COMMITTEE
19 OCTOBER 2020

TITLE OF REPORT: **Treasury Management – Performance to 30 September 2020**

REPORT OF: **Darren Collins – Strategic Director, Resources & Digital**

Purpose of the Report

1. The purpose of this report is to review Treasury Management performance for the six months to 30 September 2020, covering investments and borrowing. This is consistent with approved performance management arrangements.

Background

2. The mid-year performance of the Treasury Management Service is reported in line with CIPFA's Code of Practice on Treasury Management and the Council's Treasury Policy Statement and Treasury Strategy which was approved by Council on 16 July 2020.

3. The Council operates a balanced approach, and this means broadly that cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing security and adequate liquidity initially before considering optimising investment return.

4. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations.

5. Accordingly, treasury management is defined as:

   "The management of the Council'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."

6. The primary objective of the investment strategy is to safeguard the Council's assets with a secondary objective of obtaining an optimum rate of return on investments and minimising the costs of borrowing.

Investment Performance

7. The latest projection of gross investment income for 2020/21 based on interest earned to date and expected interest to March 2020 is £0.391m, compared to an original estimate of £0.663m.

8. This gross investment interest is adjusted to account for £0.326m interest payable to third parties and interest receivable of £1.053m from various third parties. This gives a projected net interest to the General Fund 2020/21 of £1.118m compared to the budget of £1.855m. The variance to budget is mainly as a result of interest on loan notes due from Newcastle International Airport which will not be received this year due to a curtailment in operations of the airport as a result of COVID-19 as well as reduced returns on investments as a direct result of a cut in the Bank of England base rate. This is partially offset by higher levels of interest received on loans to third parties than was anticipated when the 2020/21 budget was set.

The Economy

9. The coronavirus outbreak has created huge economic damage to the UK and around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting on 6th August, although some forecasters had suggested that a cut into negative territory could happen. No increase in Bank Rate is expected prior to 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

Rate of Return

10. The average rate of return is monitored for each investment type the Council enters into and these are used to calculate an average rate of return for the year to date. The current rate of return is 0.42%, which is less than the original estimate of 0.91%.

11. The quarterly LINK Asset Services Investment Benchmarking report assesses both the rate of return and the risk of the counterparty to calculate a weighted average rate of return, which is used for comparison across Local Authorities. In the most recent report received, June 2020, the Council achieved a weighted average rate of return of 0.35% on its investments for Quarter 1 2020/21 which is in line with the risk adjusted expectations (0.32% to 0.53%) defined in the Benchmarking Report for our Group.

12. The rate of return would be expected to decrease during the year as investment balances reduce and deposits are replaced for shorter terms with lower yielding returns.

13. It is currently a difficult investment market it is now not possible to earn the level of interest rates commonly seen in previously as all investment rates up to 12 months are either negative or just above zero now that Bank Rate is at 0.10%. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current financial year 31st March 2023, investment returns are expected to remain low.

Borrowing

14. The total borrowing for the Council and HRA as at 30 September 2020 was £664.206m, which was within the operational borrowing limit of £865m. This borrowing is made up of £616.206m Public Works Loans Board (PWLB) loans and £48m market loans.

15. The Treasury Strategy estimates for the 2020/21 financial year were based on a borrowing requirement of £98.181m however, due to the uncertainty surrounding COVID-19 £30.000m of long term PWLB borrowing was taken in March 2020 which reduced the need for borrowing in the current financial year and subsequently no further borrowing has been taken in the year to date. The timing of further borrowing will depend on a combination of cash flow requirements to support the capital programme and achieving preferential borrowing rates.

16. The current forecast for interest payable on borrowing is allocated to the General Fund and the Housing Revenue Account (HRA) as shown in the following table:

	General Fund	HRA
Interest Payable	£11.915m	£13.047m
Average rate of interest	3.39%	3.83%

This represents a gross saving of £1.363m on the original estimate, of which £1.064m is a saving for the General Fund and £0.299m is for the HRA.

PWLB Government Intervention

17. PWLB lending is offered at a fixed margin above the Government's cost of borrowing, as measured by gilt yields. The Treasury raised the margin over gilts to 100bps (one percentage point) on 9th October 2019 and agreed to monitor the impact of the change and keep rates policy under review.

18. The Government undertook a consultation exercise on PWLB borrowing which closed on 31st July 2020.

19. The Treasury are proposing that they will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream. It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation; however, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

Summary of Mid-Year Performance

20. The projected net impact of investment and borrowing activity on the revenue budget in 2020/21 is an underspend of £0.576m, comprising £0.327m General Fund and £0.249m HRA.

General Fund	Estimate £m	Projected Outturn £m	Variance £m
Investments	(1.855)	(1.118)	0.737
Borrowing	12.979	11.915	(1.064)
Premia	0.462	0.462	0.000
Net Position	11.586	11.259	(0.327)

21. Investment returns are likely to remain relatively low during 2020/21 and beyond and interest rates are expected to be below long term borrowing rates therefore value for money considerations indicate that best value can be obtained by delaying new external borrowing and by using internal cash balances to finance new capital expenditure in the short term (this is referred to as internal borrowing).

22. The current approach of borrowing internally provides benefits in terms of reduced credit risk, as the Council has less cash invested than if it had gone to the markets and borrowed externally. This means that cash balances and investment returns, are historically low resulting in reduced levels of income, which at present is outweighed by the savings achieved from avoiding external borrowing. The additional element of interest rate risk will continue to be monitored.

Recommendation

The Committee is requested to note the Treasury Management Performance to 30 September 2020, prior to submission to Cabinet.