Gateshead Council

REPORT
TO AUDIT AND STANDARDS COMMITTEE
21 JUNE 2021

Title of Report: **Treasury Annual Report 2020/21**

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

Purpose of the Report

1. This report asks the Audit and Standards Committee to review the proposed Treasury Annual Report prior to consideration by Cabinet.

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.

Proposals

4. The Committee is asked to review 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

5. The Committee is asked to review the content of the Treasury Annual Report and submit any comments to Cabinet.

   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.

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APPENDIX 1

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 2020/21 (including investment and borrowing strategies);
    - Treasury Management approach to risk;
    - Outturn 2020/21 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 2020/21.

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 & 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 2020/21 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 2020/21 to 2024/25
- Council's approved Treasury Management Practice Statements

Treasury Management Annual Report 2020/21

The Strategy for 2020/21

1. The 2020/21 to 2024/25 Treasury Management Strategy was approved by Council on 24 March 2020.

2. The formulation of the 2020/21 to 2024/25 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 2020/21 to 2024/25 anticipated interest rates to remain at 0.75% before starting to gradually increase from March 2022 onwards. In the early stages of the COVID pandemic the Bank of England's' Monetary Policy Committee (MPC) reduced the base rate to 0.10% where it has remained during 2020/21. At its meeting ending on 13 May 2021 the MPC voted unanimously to maintain the Bank Rate at 0.10% and rates are expected to remain exceptionally low throughout the current financial year before slowly recovering in the second half of 2022/23.

Borrowing Strategy

7. The borrowing strategy for 2020/21 was as follows:
    - When Public Works Loan Board (PWLB) rates fall back to the following target rates borrowing should be considered, 2.90% Q1, 3.00% Q2, 3.10% Q3 and 3.20% 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 – 2.58%
      25 years – 3.12%
      50 years – 3.02%

    - 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 2021 concluded that Treasury Management control systems and procedures are satisfactory. All funds were safeguarded in 2020/21.

Outturn 2020/21 – 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 2020/21 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 22 June 2021 as part of the Capital Monitoring process. None of the approved Prudential Indicators set for 2020/21 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 2020/21 Treasury Management Strategy was that Bank Rate would stay at 0.75% during the financial year but the MPC suggested a rate cut was possible if a rise in domestic price inflation did not materialise. If the economic recovery continued a potential modest interest rate increase may occur. Due to COVID the actual position changed significantly, as the MPC reduced the Bank Rate twice in March 2020, from 0.75% to 0.25% and then to 0.10%.

- **Longer-term interest rates** – Investment returns remained low during 2020/21. At its meeting ending on 13 May 2021, the MPC voted unanimously to maintain the Bank Rate at 0.10% and rates are expected to remain exceptionally throughout the current financial year before recovering in the second half of 2022/23

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 overnight deposits and money market funds with high rated banks to maintain the security of the funds and enhance the rate of return on investments. Rates remained low for the entire financial year as a result of the COVID pandemic.

13. The most significant challenges for treasury management in 2020/21 has been generating a reasonable rate of return whilst ensuring the security of investments and the COVID pandemic. 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. COVID also presented challenges for managing the Council's cashflow due to timing uncertainties of the receipts and payment of COVID grants.

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 24 March 2020. 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. A summary of the year's activity is shown at Appendix 3. The investment interest earned in the year was £0.330m (2019/20 £0.689m) with an average interest rate of 0.30% (2019/20 0.95%). Interest earned on loans to third parties, agreed as part of the capital programme, increased total interest to £2.180m which was £0.005m more than the original budget of £2.175m. This includes £0.865m accrued interest on loan notes, in respect of Newcastle International Airport.

16. The overall return for the year of 0.30% exceeds the accepted benchmark for 2020/21, which was the 3-month London Interbank Bid Rate (LIBID) of 0.02%.

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 0.30% on its investments for Quarter 4 2020/21 which is close to the risk adjusted expectations (0.33% to 0.44%) defined in the Benchmarking Report for our group.

Borrowing Performance

18. The total external borrowing at 31 March 2021 was £658.684m, which was within the operational borrowing limit of £865.000m. This is a net decrease of £36.054m from the opening figure of £694.738m.

External Borrowing at 31 March 2020	**£694.738m**
Add New Borrowing	£4.500m
Less Maturity of existing borrowing	(£40.554m)
External Borrowing at 31 March 2021	**£658.684m**

19. Investment returns/interest rates were low during 2020/21 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 2020/21 the Council had internal borrowing of £48.303m. This comprised of £6.443m General Fund under borrowing and £41.860m 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 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:

	31 March 2020 Actual £m	**31 March 2021 Actual £m**
Capital Financing Requirement for General Fund excluding PFI	359.575	361.482
Capital Financing Requirement for HRA excluding PFI	345.505	345.505
Total Capital Financing Requirement excluding PFI	705.080	706.987

21. The details of the borrowing taken during 2020/21 are as follows:

Date	**Term (years)**	**Amount £m**	**Interest Rate (%)**	**Source**
31/03/2021	365 (days)	4.500	0.00	NE LEP
		4.500		

22. At 31 March 2021 £606.184m of the total borrowing was from the PWLB and £52.500m was in the form of market loans. The average interest rate on borrowing has decreased from 3.69% in 2019/20 to 3.60% during 2020/21 which will reduce borrowing costs.

23. There was short-term borrowing of £4.5m taken during 2020/21. No long-term borrowing was taken during 2020/21.

24. The overall revenue cost of borrowing in 2020/21 was £24.081m, as a result of the application of the Treasury Management Strategy this was £2.272m 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 2020/21

27. Total interest income was £0.005m above budget, the main variances from budget were due to the reduction in interest rates and delays in dwelling sales within the Gateshead Trading Company's house building schemes.

NET INVESTMENT INTEREST MONITORING 2020/21	Base Budget	Actual March 2021	Movement	Note
	£000s	£000s	£000s	
Gross Investment Interest	-663	-329	334	Reduction in interest rates
Interest paid/(received on balances):	-2	-7	-5	
Interest due on loan balances:				
GTC	-34	-326	-292	Increase due to delay in sale of dwellings.
Others	-590	-623	-33	
Heritable Dividend	0	-30	-30	Final Dividend payment
Newcastle Airport (Loan Notes & Dividend)	-886	-865	21	
NET INVESTMENT INTEREST TOTAL	**2,175**	**2,180**	**-5**	

28. Borrowing costs were £2.272m less than budget due to a delay in taking borrowing and the decision to temporarily fund the capital programme through internal borrowing by utilising cash balances.

29. Overall Treasury Management performance against budget for 2020/21 generated net savings of £2.277m, this is summarised in the following table:

		2020/21		
		Budget £m	**Actual £m**	**Saving £m**
General Fund	Cost of Borrowing	12.979	11.501	-1.478
	Interest Income	1.855	2.186	-0.331
	Net Position	11.124	9.315	-1.809
HRA	Cost of Borrowing	13.373	12.580	-0.793
	Interest Income	0.320	-0.006	0.326
	Net Position	13.053	12.586	-0.467
Combined	Cost of Borrowing	26.353	24.081	-2.272
	Interest Income	2.175	2.180	-0.005
	Net Position	**24.178**	**21.901**	**-2.277**

Treasury Management remained challenging throughout 2020/21 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.

Appendix 3

Investment Activity

	2019/20	2020/21
Number of investments made in 2018/19 maturing in 2019/20	18	n/a
Number of investments made in 2019/20 maturing in 2019/20	14	n/a
Number of investments made in 2019/20 maturing in 2020/21	n/a	12
Number of investments made in 2020/21 maturing in 2020/21	n/a	14
Total number of investments maturing in year	32	26
Number of investments made in 2020/21 maturing in 2021/22	n/a	14
Average duration of investments (including overnight)	12 days	6 days
Average duration of investments (excluding overnight)	117 days	87 days
Non-specified investments:		
Rated non-high		
Approved limit	75%	25%
Maximum level invested	9.14%	4.83%
Not Rated		
Approved limit	0%	0%
Maximum level invested*	0.05%	0.03%
Investments greater than 364 days		
Approved limit	£15m	£15m
Maximum level Invested	£5m	£5m

*Relates to the impaired investment with Heritable Bank.

Appendix 4

PRUDENTIAL INDICATORS 2020/21

The 2019/20 Prudential Indicators were agreed by Council on 27 February 2020 (column 1). This is now compared with the 2020/21 actual outturn position as at the 31 March 2021 (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 2020/21 have been breached.

Capital Expenditure		
	2020/21 £000 Reported Indicator	2020/21 £000 Actual
Non-HRA	87,254	50,086
HRA	23,221	20,732
Total	**110,475**	**70,818**
To reflect the reported capital monitoring agreed by Council during the year		

Ratio of Financing Costs to Net Revenue Stream		
	2020/21 Reported Indicator	2020/21 Actual
Non-HRA	17.40%	14.69%
HRA	44.25%	39.92%

Capital Financing Requirement		
	2020/21 £000 Reported Indicator	2020/21 £000 Actual
Non-HRA	435,607	361,482
HRA	345,505	345,505

There were no breaches to the Prudential Indicators set for 2020/21.

Authorised Limit for External Debt	
	2020/21 £000 Reported Indicator
Borrowing	880,000
Other Long Term Liabilities	0
Total	**880,000**
Maximum YTD 31/03/21 £694.738m	

Operational Boundary for External Debt	
	2020/21 £000 Reported Indicator
Borrowing	865,000
Other Long Term Liabilities	0
Total	**865,000**
Maximum YTD 31/03/21 £694.738m	

The Council's actual external debt at 31 March 2021 was £658.684m. 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.

Upper / Lower Limits for Maturity Structure of Fixed Rate Borrowing				
	2020/21 £000 Reported Indicator		**2020/21 £000 Actual Position**	
	Upper Limit	**Lower Limit**	**Actual Percentage**	**Maximum YTD**
Under 12 months	30%	0%	3.43%	5.84%
12 months to 24 months	25%	0%	0.17%	3.60%
24 months to 5 years	25%	0%	7.56%	7.61%
5 years to 10 years	30%	0%	11.06%	11.14%
10 years to 20 years	30%	0%	7.37%	9.75%
20 years to 30 years	25%	0%	1.18%	1.19%
30 years to 40 years	50%	0%	32.18%	32.41%
40 years to 50 years	50%	0%	34.61%	36.36%
50 years and above	25%	0%	0.00%	0.00%
All within agreed limits.				

Upper / Lower Limits for Maturity Structure of Variable Rate Borrowing				
	2020/21 £000 Reported Indicator		**2020/21 £000 Actual Position**	
	Upper Limit	**Lower Limit**	**Actual Percentage**	**Maximum YTD**
Under 12 months	25%	0%	2.43%	2.95%
12 months to 24 months	20%	0%	0.00%	0.00%
24 months to 5 years	20%	0%	0.00%	0.00%
5 years to 10 years	20%	0%	0.00%	0.00%
10 years to 20 years	20%	0%	0.00%	0.00%
20 years to 30 years	20%	0%	0.00%	0.00%
30 years to 40 years	20%	0%	0.00%	0.00%
40 years to 50 years	20%	0%	0.00%	0.00%
50 years and above	20%	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			
	2020/21 £000 Reported Indicator	2020/21 £000 Actual Position	2020/21 £000 Maximum YTD
Investments	**15,000**	**5,000**	**5,000**