

TREASURY MANAGEMENT ANNUAL REPORT 2019/20

Finance & Investment Advisory Committee - 8 September 2020

Report of the: Deputy Chief Executive and Chief Officer Finance & Trading

Status: For decision

Also considered by: Cabinet - 17 September 2020

Key Decision: No

Executive Summary: This report provides the customary review of investment and borrowing activity during 2019/20 as required by the Council's Financial Procedure Rules. The report outlines the strategy adopted during the year, shows the position of the investment and debt portfolios at the beginning and the end of the year and gives details of how the investment fund performed in comparison with previous years and against various benchmarks.

This report supports the Key Aim of Effective Management of Council Resources.

Portfolio Holder Cllr. Matthew Dickins

Contact Officer Roy Parsons, Principal Accountant - Ext 7204

Recommendation to Finance & Investment Advisory Committee: That Cabinet be asked to approve the Treasury Management Annual Report for 2019/20.

Recommendation to Cabinet: That the Treasury Management Annual Report for 2019/20 be approved.

Reason for recommendation: As required by both the Council's Financial Procedure Rules and the CIPFA Code, an annual report of treasury management activity is to be presented to Members for approval.

Background

- 1 The 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 Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

- 2 During 2019/20 the minimum reporting requirements were that the Council should receive the following reports:
 - an annual treasury strategy in advance of the year (Council 26/02/2019)
 - a mid year (minimum) treasury update report (Finance & Investment Advisory Committee 21/11/2019, Cabinet 05/12/2019)
 - an annual review following the end of the year describing the activity compared to the strategy (this report)
- 3 The Council's treasury management advisers, Link Asset Services, also provided monthly reviews of our investment performance which were emailed to Members.
- 4 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.
- 5 This Council also 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 Finance & Investment Advisory Committee before they were reported to Cabinet or the full Council. Member training was last undertaken on 14 November 2018 in order to support Members' scrutiny role.

Introduction

- 6 This annual treasury report covers:
 - (a) The Council's capital expenditure and financing;
 - (b) treasury position at the beginning and end of the financial year
 - (c) the economy and interest rates;
 - (d) investment strategy and control of interest rate risk in 2019/20;
 - (e) borrowing requirement and debt;
 - (f) borrowing strategy and control of interest rate risk in 2019/20;
 - (g) borrowing outturn 2019/20;
 - (h) investment outturn for 2019/20 and performance;
 - (i) compliance with treasury management limits and prudential indicators;
and
 - (j) other issues (including an update on the Municipal Bonds Agency).

The Council's capital expenditure and financing

7 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no impact on the Council's borrowing need; or
- if insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

8 The actual capital expenditure forms one of the required prudential indicators. The following table shows the actual capital expenditure and how this was financed.

	31/3/19 Actual (£000)	31/3/20 Actual (£000)
Capital expenditure	16,557	11,881
Financed in year	(8,225)	(7,785)
Unfinanced capital expenditure	8,332	4,096

The unfinanced capital expenditure was funded by internal borrowing.

Treasury position at the beginning and end of the financial year

9 The Council's treasury position at the beginning and end of the financial year was as follows:

	31/3/19 Principal (£000)	Rate Return (%)	Average Life (Years)	31/3/20 Principal (£000)	Rate Return (%)	Average Life (Years)
Total debt	5,192	2.66	28.5	5,074	2.66	27.5
Capital Financing Requirement (CFR)	21,989	-	-	25,811	-	-
Over/(under) borrowing	(16,797)	-	-	(20,737)	-	-

Total investments	21,315	0.72	-	16,404	0.89	-
Net debt/(investments)	(16,123)	-	-	(11,330)	-	-

10 The maturity structure of the debt portfolio was as follows:

	31/3/19 Actual (£000)	31/3/20 Actual (£000)
Under 12 months	-	-
12 months and over and within 20 years	-	-
20 years and over and within 30 years	5,192	5,074
30 years and over and within 50 years	-	-

11 The investment portfolio at the beginning and end of the financial year appears at Appendix A, whilst an analysis by maturity and repayment due dates appears at Appendix B.

12 All investments were for periods up to one year in duration.

The economy and interest rates

13 **UK. Brexit.** The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Theresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

14 Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5%

and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the coronavirus outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

- 15 After the Bank of England's Monetary Policy Committee (MPC) raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge 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%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income.
- 16 However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.
- 17 Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 - 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price.

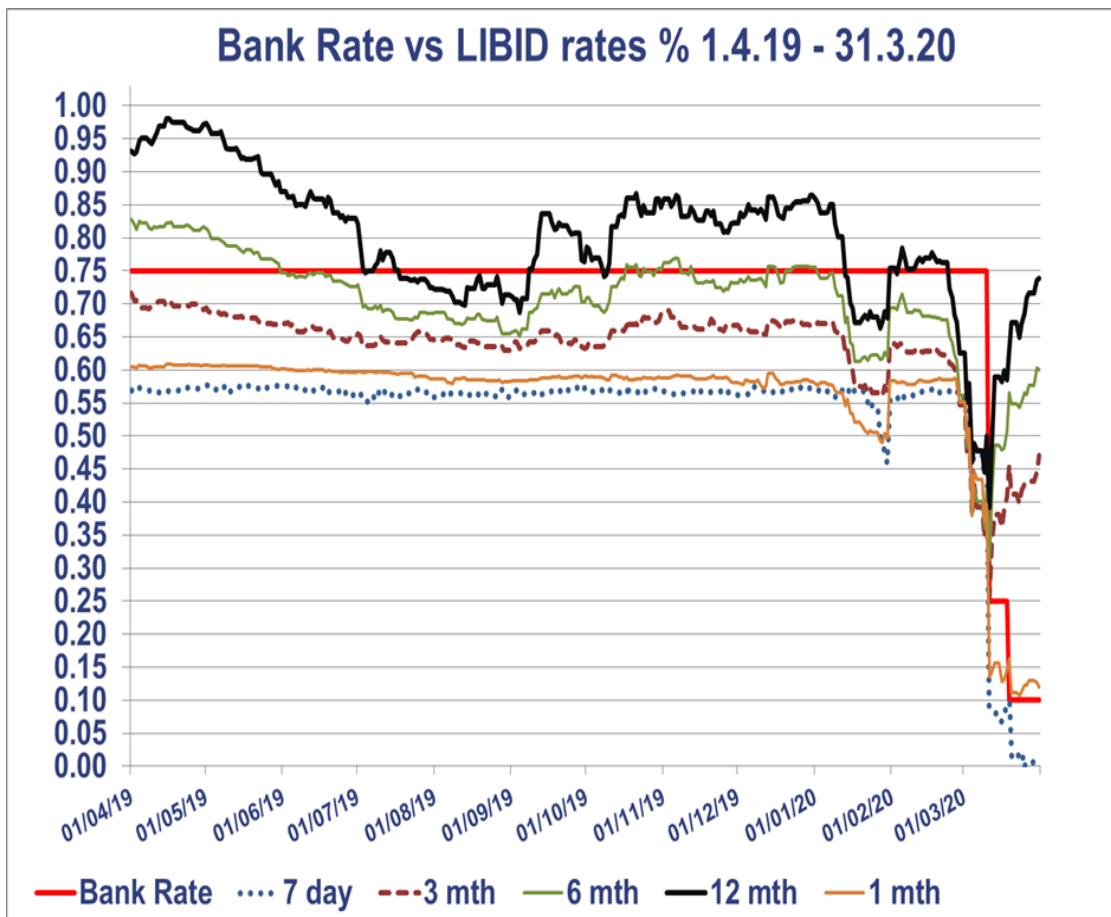
Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

- 18 Employment had been growing healthily through the last year but it is obviously heading for a big hit in March - April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.
- 19 **USA.** Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Federal Reserve (Fed) cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 - 0.25%. Near the end of March, Congress agreed a \$2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to \$6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of \$1,200 to individuals.
- 20 The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost \$367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be \$500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including \$50bn for airlines.
- 21 However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of March.
- 22 **EUROZONE.** The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of Targeted Longer-Term Refinancing Operations (TLTROs); this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a

resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures.

- 23 Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.
- 24 **CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.
- 25 **JAPAN** has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It appears to have missed much of the domestic impact from coronavirus in 2019-20 but the virus is at an early stage there.
- 26 **WORLD GROWTH.** The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

Investment strategy and control of interest rate risk in 2019/20



- 27 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.
- 28 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. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

- 29 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.
- 30 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.

The borrowing requirement and debt

- 31 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR)
- 32 In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should 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 (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31/3/19 Actual (£000)	31/3/20 Actual (£000)
CFR General Fund	21,989	25,811
Gross borrowing position	5,192	5,074
Over/(under) funding of CFR	(16,797)	(20,737)

- 33 The "authorised limit" is the "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 2019/20 the Council has maintained gross borrowing within its authorised limit.

- 34 The “operational boundary” is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.
- 35 “Actual financing costs as a proportion of net revenue stream” is an indicator identifying the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2019/20 (£000)
Authorised limit	35,831
Maximum gross borrowing position during the year	5,192
Operational boundary	30,831
Average gross borrowing position	5,133
Financing costs as a proportion of net revenue stream	0.94%

Borrowing strategy and control of interest rate risk in 2019/20

- 36 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 is known as internal borrowing. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.
- 37 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost - the difference between (higher) borrowing costs and (lower) investment returns.
- 38 The policy of avoiding new borrowing by running down spare cash balances, has served the Council well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when

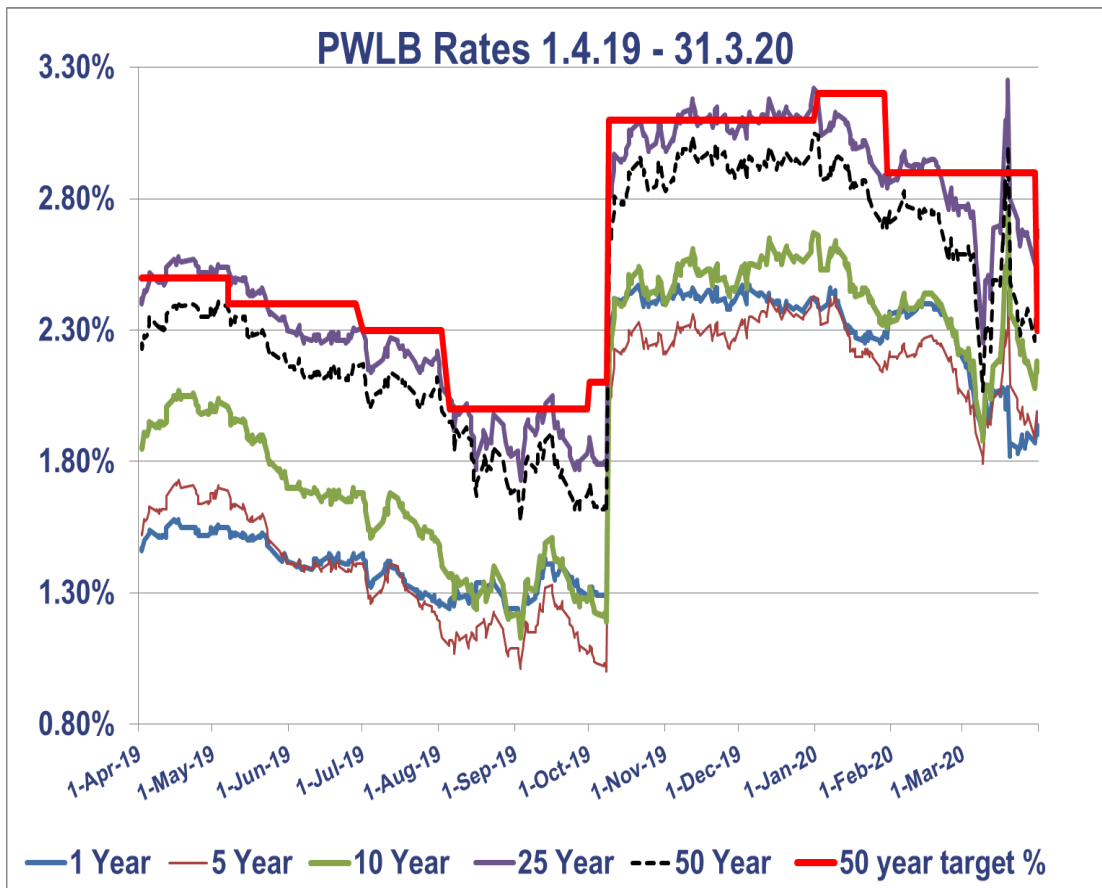
this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

PWLB certainty maturity borrowing rates

39 Interest rate forecasts anticipated only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Forecasts from our treasury management advisors, Link Asset Services, together with historical rates appear below:

Link Asset Services Interest Rate View 31.1.20													
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.50	2.60	2.70	2.80	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	2.70	2.80	2.90	3.00	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.30	3.40	3.50	3.60	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.20	3.30	3.40	3.50	3.80

Link Asset Services Interest Rate View 31.3.20								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50



- 40 PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields.
- 41 While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that

bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

- 42 Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western 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%.
- 43 However, HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019/20 without any prior warning; the first on 9 October 2019, 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. It is clear 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.
- 44 Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -
- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
 - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
 - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
 - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
 - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- 45 There is likely to be little upward movement in PWLB 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 western economies during 2020/21.

Borrowing outturn for 2019/20

- 46 No borrowing was undertaken during the year. The following is the only loan outstanding:-

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£5.25m	Fixed interest rate - Annuity	2.66%	3/11/2047

47 There were no repayments or rescheduling of debt during 2019/20.

Investment outturn for 2019/20 and performance

48 The Council's investment policy is governed by Ministry of Housing Communities and Local Government (MHCLG) guidance, which has been implemented in the annual investment strategy approved by the Council on 26 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).

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

50 Appendix C shows the performance of the fund during 2019/20 both in table and graphical form. The table shows the average percentage return on the fund, both monthly and for the whole year and compares them with the average 7-day and 3-month London Interbank Bid (LIBID) rates. The average return achieved by each broker is only a very basic measure of performance, because returns will depend on the number and length of each investment he/she is asked to carry out. If a particular broker is only asked to place short term investments, he/she may well not achieve the same overall rate as a broker who predominantly handles longer term investments for us.

51 The graph shows actual monthly receipts for 2017/18, 2018/19 and 2019/20 plus budgeted monthly receipts for 2019/20. The monthly interest budget has been profiled in line with the previous year's monthly weighted average principal.

52 Over the course of the year interest receipts amounted to £254,300 compared with a budget of £200,000.

53 In 2019/20 the average return on the Council's investments was roughly in line with that of our neighbouring authorities. Our overall rate of return was 0.89% compared with 0.66% for Tonbridge & Malling Borough Council and 0.96% for Gravesham Borough Council. It should be noted that investment returns are notoriously difficult to compare as they have often been compiled on a different basis (for example, whether or not interest has been compounded, whether or not cashflow generated balances have been included, whether or not externally managed funds have been included and

whether or not the figures are net of borrowings). Note that this Council has also invested in property which is not included in this report.

54 Our treasury management advisers recommend the 3-month LIBID figure as a benchmark. This reflects a more realistic neutral investment position for core investments with a medium term horizon and a rate which is more stable with less fluctuation caused by market liquidity. Historically, this rate has been slightly higher than the 7-day rate and therefore more challenging a comparator, but one which does not necessitate a significantly increased level of risk. The figures calculated by our advisers for these two benchmarks are as follows:

- 7-day LIBID uncompounded 0.5338%
- 3-month LIBID uncompounded 0.6339%

Compliance with treasury management limits and prudential indicators

55 The Council operates to approved prudential indicators for treasury management as contained in the Treasury Management Strategy Statement (TMSS). The TMSS for 2019/20 was part of the annual treasury strategy reported to Council on 26 February 2019. The approved limits exist to regulate short-term borrowing for operational cash flow fluctuations, as well as long-term borrowing for financing capital investments. Additionally, the limits aim is to mitigate against fluctuations in interest rates.

Other issues

Update on the Municipal Bonds Agency

56 During 2014/15, the Council invested £50,000 to become an equity shareholder in the Local Capital Finance Company, which was set up by the Local Government Association under the name of the Municipal Bonds Agency (MBA). This was a 'Policy Investment' and does not form part of the treasury management strategy. The purpose of the agency is to facilitate borrowing by local authorities at rates that are expected to be more competitive than those of the Public Works Loan Board (PWLB). There are 56 shareholder councils.

57 Following a lengthy set-up process, the MBA issued its inaugural bond in March 2020, a five-year floating rate note priced half-way between the PWLB variable rate and short-term local authority loans. The agency subsequently announced three pooled bond issues with maturities of 10 years, 20-25 years and 40-45 years. The final maturity of the two longer dated bonds will be set in consultation with the local authorities participating on those bond issues. Each of the issues will be offered at a rate below the PWLB certainty rate and will be issued once sufficient demand to support a benchmark issue has been reached.

Non-treasury management investments

- 58 Members will be aware that significant property purchases have been carried out in recent years which are regarded as non-treasury investments. Further details are contained within Property Investment Strategy reports that are submitted to Members separately.

Key Implications

Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement

Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This annual review report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2017.

Treasury management has two main risks :

- Fluctuations in interest rates can result in a reduction in income from investments; and
- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral in our approach to treasury management. However, this particular report has no specific risk implications as it is not proposing any new actions, but merely reporting performance over the last year.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Conclusions

The overall return on the Council's investments was above budget in 2019/20 by approximately £54,300 and the percentage return exceeded the recognised benchmarks. Whilst returns exceeded budget, inflation continues to outpace investment returns, leading to the gradual erosion of capital in real terms.

The economic situation both globally and within the Eurozone remains volatile, and this will have consequences for the UK economy. Treasury management in the past financial year was conducted against this background and with a cautious investment approach.

Appendices:

Appendix A - Investment portfolio at start and end of financial year

Appendix B - Analysis of investment portfolio by maturity and repayment due dates

Appendix C - Investment performance in 2019/20

Background Papers:

[Treasury Management Strategy for 2019/20 - Council 26 February 2019](#)

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