Treasury Management Outturn Report 2019/20

Introduction

The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve a treasury management annual report after the end of each financial year.

This report fulfils the Councils legal obligation to have regard to the CIPFA Code.

The Council's treasury management strategy for 2019/20 was approved at a meeting of the Authority on 27th February 2019. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

External Context

Economic background: The UK's exit from the European Union and future trading arrangements, had remained one of major influences on the UK economy and sentiment during 2019/20. The 29th March 2019 Brexit deadline was extended to 12th April, then to 31st October and finally to 31st January 2020. Politics played a major role in financial markets over the period as the UK's tenuous progress negotiating its exit from the European Union together with its future trading arrangements drove volatility, particularly in foreign exchange markets. The outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

Then coronavirus swiftly changed everything. COVID-19, which had first appeared in China in December 2019, started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global Financial Crisis as part of a flight to quality into sovereign debt and other perceived 'safe' assets.

The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% from 0.75% and then swiftly thereafter brought them down further to the record low of 0.1%. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK.

Financial markets: Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March sterling touched its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence but financial markets remain extremely volatile. The flight to quality caused gilts yields to fall substantially. The 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March. The 10-year benchmark yield fell from 1% to 0.4%, the 20-year benchmark yield from 1.47% to 0.76% over the same period.

Credit review: In Q4 2019 Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative. The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis.

After remaining flat in January and February and between a range of 30-55bps, Credit Default Swap spreads rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern. Spreads declined in late March and through to mid-April but remain above their initial 2020 levels.

While the UK and Non-UK banks on the Arlingclose counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks was cut to 35 days in mid-March.

Local Context

On 31st March 2020, the Authority had net borrowing of £85m arising from its revenue and capital income and expenditure, an increase on 2019 of £3.4m. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors and the year-on-year change are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £000	**2019/20 Movement £000**	**31.3.20 Actual £000**
General Fund CFR	14,906	3,541	18,447
HRA CFR	130,358	(1,955)	128,403
Total	**145,264**	**1,586**	**146,850**
Less: Usable reserves	(50,776)	3,543	(47,233)

Less: Working capital	(12,699)	(1,706)	(14,405)
Net borrowing	**81,789**	**3,423**	**85,212**

Net borrowing has increased due to a rise in the CFR as new capital expenditure was lower than the financing applied including minimum revenue provision; together with a decrease in usable reserves.

The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 31st March 2020 and the year-on-year change in show in table 2 below.

Table 2: Treasury Management Summary

	31.3.19 Balance £000	**2019/20 Movement £000**	**31.3.20 Balance £000**	**31.3.20 Rate %**
Long-term borrowing Short-term borrowing	129,336 0	(1,995) 0	127,341 0	
Total borrowing	**129,336**	**(1,995)**	**127,341**	**3.64**
Long-term investments Short-term investments Cash and cash equivalents	0 27,562 19,985	0 (542) 5,960	0 28,104 14,025	
Total investments	**47,547**	**5,418**	**42,129**	**0.70**
Net borrowing	**81,789**	**3,423**	**85,212**	

Borrowing Activity

At 31st March 2020, the Authority held £127m of loans, a decrease of £2m on the previous year, as part of its strategy for funding previous years' capital programmes. The year-end borrowing position and the year-on-year change in show in table 3 below.

Table 3: Borrowing Position

	31.3.19 Balance £m	2019/20 Movement £m	31.3.20 Balance £m	31.3.20 Rate %	31.3.20 Average maturity years
Public Works Loan Board	129,336	(1,995)	127,341	3.64	27 years
Total borrowing	**131,303**	**(1,995)**	**127,341**		

The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

In furtherance of these objectives, no new external borrowing was undertaken in 2019/20, while existing loans were allowed to mature without replacement. This strategy enabled the Authority to reduce net borrowing costs and reduce overall treasury risk.

On 9th October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields.

The "cost of carry" analysis performed by the Authority's treasury management advisor Arlingclose did not indicate any value in borrowing in advance for future years' planned expenditure and therefore none was taken.

Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2019/20, the Authority's investment balance ranged between £42m and £60m million due to timing differences between income and expenditure. The year-end investment position and the year-on-year change in show in table 4 below.

Table 4: Investment Position

	31.3.19 Balance £m	2019/20 Movement £m	31.3.20 Balance £m	31.3.20 Rate %	31.3.20 Average maturity years
Banks & building societies (unsecured)	9.0	(9.0)	0	N/A	<1 year
Government (incl. local authorities)	19.0	9.0	28.0	0.84	<1 year
Money Market Funds	19.5	(5.4)	14.1	0.39	<1year
Total investments	**47.5**	**(5.4)**	**42.1**		

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

In furtherance of these objectives, the Authority continued to increase deposits into more secure asset classes during 2019/20, particularly deposits with other Local Authorities. As a result investment risk was lowered.

Other Non-Treasury Holdings and Activity

Although not classed as treasury management activities, the 2017 CIPFA Code now requires the Authority to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and regeneration purposes as well as commercial investments which are made mainly for financial reasons. The Authority holds £44m of directly owned investment property and land. This represents a decrease of £4m on the previous year due to revaluation losses. The Authority also holds a £150,000 loan to the Derbyshire Building Control Partnership that commenced in March 2018 and a £75,000 loan to Staveley Town Council that commenced in March 2020.

Performance Report

The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget, as shown in table 5 below.

Table 5: Performance

	Actual £000	Budget £000	Over/ under
Total investment income	(430)	(374)	(56)
Total debt expense	4,947	4,907	40
GRAND TOTAL	4,517	4,533	(16)

Compliance Report

The Chief Finance Officer is pleased to report that all treasury management activities undertaken during 2019/20 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	2019/20 Maximum	31.3.20 Actual	2019/20 Limit	Complied
Any single organisation	**£5m**	**£5m**	**£5m**	✓
Any group of funds under the same management	**£5m**	**£0**	**£7.5m**	✓
Enhanced Money Market Funds	**£10m**	**£9.9m**	**£12m**	✓

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	2019/20 Maximum £000	31.3.20 Actual £000	2019/20 Operational Boundary £000	2019/20 Authorised Limit £000	Complied
Borrowing	**£129,336**	**£127,341**	**£143,400**	**£158,000**	✓

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt was below the operational boundary for the whole of 2019/20.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates were:

Interest rate risk indicator	**31.3.20 Actual**	**2019/20 Limit**	**Complied**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£17,000	£150,000	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	£17,000	£100,000	✓

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	31.3.20 Actual	**Upper Limit**	**Lower Limit**	**Complied**
Under 12 months	3%	10%	0%	✓
12 months and within 24 months	1%	10%	0%	✓
24 months and within 5 years	7%	10%	0%	✓
5 years and within 10 years	11%	25%	0%	✓
10 years and within 25 years	50%	50%	20%	✓
25 years and above	28%	70%	20%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

	2019/20	**2020/21**	**2021/22**
Actual principal invested > 364 days	£0	£0	£0
Limit on principal invested > 364 days	£10m	£10m	£10m
Complied	✓	✓	✓