CYNGOR SIR *POWYS* COUNTY COUNCIL

AUDIT COMMITTEE
4th September 2020

CABINET
15th September 2020

REPORT BY:	**Cllr. Aled Davies** **Portfolio Holder for Finance**
SUBJECT:	**Treasury Management Review 2019/20**

REPORT FOR:	**Approval**

1. Introduction:

1.1 The Council's Treasury Management Policy, as per the CIPFA Code of Practice, requires an annual report on Treasury Management activity to be approved by Cabinet by 30th September each year.

1.2 Treasury Management in this context is defined as:
"The management of the authority's 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."

2. The Council's Overall Borrowing Need:

2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represent's the current year's unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP) to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or

- charging more than the statutory revenue charge (MRP) each year through a

Voluntary Revenue Provision (VRP).

2.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This can be sourced through external borrowing or utilising temporary cash resources within the Council.

3. Strategy for 2019/20:

3.1 At the start of 2019/20 the Authority had an estimated Capital Financing Requirement of £401.6m, projected to rise by £89.3m during the course of the following five years to £490.9m. The Authority's external borrowing at 1st April 2019 stood at £299.2m. In relation to the CFR figure of £401.6m, this equated to the Authority being under borrowed by £102.4m.

3.2 During 2019-20, the Council maintained an under-borrowed position. This meant that the capital borrowing need (CFR) 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 strategy was prudent as investment returns were low.

However, based on this position, a potential cost of carry remained during the year in respect of any new long-term borrowing that was not going to be immediately used to finance capital expenditure. This is because any new borrowing would cause a temporary increase in cash balances and would have incurred a revenue cost of the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances has served 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.

3.3 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% as it was not expected that the Monetary Policy Committee (MPC) would be able to deliver on an increase until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled but that it would only rise to 1.00% during 2020. This situation changed when the coronavirus outbreak hit the UK in February/March with Bank Rate decreasing to 0.25% and then 0.10% a week later. Investment returns on deposit accounts fell alongside Bank Rate to the extent that no interest was being paid on these accounts.

3.4 The Capital Programme for 2019/20 incorporated £42.3m of prudential borrowing at the start of year so there was the possibility the Authority would need to externally borrow during the year. The agreed strategy for this at the start of the year, based on interest rate forecasts and discussions with Link (the Authority's advisors), was to set a benchmark of 1.9% for 5 year borrowing, 2.3% for 10 year borrowing, 2.7%

for 25 year borrowing and 2.5% for 50 year borrowing. These rates were reviewed at various times during the year as the market changed.

Further to this, HM Treasury imposed two changes in the margins over gilt yields for PWLB rates in 2019-20 without any prior warning; the first, on 9th 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.

3.5 In light of the continuing stress on the world banking system, enhanced priority was given to the security and liquidity of investments.

The strategy for investments therefore was:

a) to ensure the security of the Authority's funds
b) to ensure the Authority had sufficient liquidity to meet its cashflow requirements
c) to achieve the optimum yield after ensuring a) and b) above.

4. Treasury Position:

4.1 The major issue for Treasury Management in 2019/20, alongside reducing cash balances, was the continuing challenging environment of previous years i.e. low investment returns and continuing counterparty risk which meant giving heightened preference to security and liquidity of investments. This resulted in the investment portfolio being in short-term investment instruments with lower rates of return but higher security and liquidity.

4.2 In order to balance the impact of the loss in investment income the Authority was mindful of the possibility of making premature repayments of debt if circumstances were conducive to this.

Net borrowing increased by £18.532M in the year. This increase arose as follows:

	£000s
Increase in PWLB debt	18,977
Increase in Market debt	10,000
Increase in Investments	(10,445)
	18,532

4.3 The table below summarises the borrowing and investment transactions during the year:

	Balance 01-04-19	**Borrowing**	**Investments**	**Repayments**	**Balance 31-03-20**
	£000's	**£000's**	**£000's**	**£000's**	**£000's**
PWLB *	229,238	20,000	N/A	(1,023)	248,215
LOBOs *	25,000	Nil	N/A	Nil	25,000
Market Loans	45,000	10,000	N/A	Nil	55,000
Temporary Borrowing	Nil	2,665	N/A	(2,665)	Nil
Total	299,238	32,665	N/A	(3,688)	328,215
Temporary Investments (other LA's/Deposit accts)	(8,960)	N/A	(313,510)	303,065	(19,405)
Long Term Investments	Nil	N/A	Nil	Nil	Nil
Net Borrowing	290,278	32,665	(313,510)	299,377	308,810

Note: * Public Works Loan Board / Lender's Option Borrower's Option

4.4 A summary of the economy for 2019/20 is at Appendix A.

5. Debt Rescheduling/Repayment:

5.1 No rescheduling was carried out during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

6. Performance Measurement:

6.1 Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide.
In this context, the overall average rate of interest on all debt in 2019/20 was 3.39%.

	31.03.20 £000's	Average rate for year	31.03.19 £000's	Average rate for year
Total debt	328,215	3.39%	299,238	4.02%

6.2 The Treasury Management Policy stipulates that the Average Rate on External Investments should be compared with the 3-month uncompounded LIBID rate. This is in preference to the 7-day uncompounded LIBID rate and is in line with Link's advice. It reflects a more realistic neutral investment position for core investments with a medium-term horizon and a rate which is more stable with less fluctuations

caused by market liquidity. Historically, the 3-month rate has been slightly higher than the 7-day rate and is, therefore, more challenging for the cash manager.

Average investments held during 2019/20 £000's	Average rate achieved	3 month LIBID	Average investments held during 2017/18 £000's	Average rate achieved	3 month LIBID
22,350	0.58%	0.63%	13,355	0.31%	0.67%

In 2019/20 the average rate on external investments achieved was an under performance of 0.58% compared with the 3 month uncompounded LIBID rate of 0.63%. This was expected, due to the reduced and short-term nature of the Council's cash balances available for investment.

7. Summary Statement of Accounts

7.1 The Treasury Management Policy Statement stipulates that a summary Statement of Accounts for Treasury Management be produced at the year end and reported as part of the annual review (see Appendix B).

8. Prudential/Treasury Indicators

8.1 During the year the Authority operated within the treasury limits as approved by Council.

9. Member Training

9.1 The CIPFA Code of Practice states that members charged with governance (all members as the annual strategy requires approval by Full Council) have a personal responsibility to ensure that they have the appropriate skills and training for their role. As such, the Authority provided two members' briefing sessions for treasury management in 2019/20.

10. Treasury Management Policy Statement

10.1 Any major changes to the Treasury Management Policy Statement are reported to Cabinet whilst any minor changes are circulated to members via the members' portal.

Advice

N/A

Resource Implications

N/A

Legal implications

N/A

Comment from local member(s)

N/A

Integrated Impact Assessment

N/A

Recommendation

It is recommended that the Treasury Management Review Report is approved.

Contact Officer: Ann Owen
Tel: 01597 826327
Email: ann.owen@powys.gov.uk

Head of Service: Jane Thomas

Corporate Director: Ness Young

Appendix A:

UK:

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 Teresa 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.

Economic growth in 2019 was 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.

After the Monetary Policy Committee 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 of £200bn in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England. 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. 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. 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.

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 has already caused 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.

Employment had been growing healthily through the last year but it has obviously taken a big hit as a result of the coronavirus situation and lockdown. 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 have not been able to leave their homes to do non-food shopping, retail sales have taken a big hit.

Appendix B:

Statement of Accounts
Treasury Management

		2019/20	2019/20	2018/19
		Actual	Budget	Actual
		£	**£**	**£**
Employees		174,123	165,000	175,513
Transport	*1	2,742,214	1,250,450	2,140,679
Supplies & Services	*2	249,464	200,000	201,750
Interest Paid		11,337,593	14,845,370	10,711,281
Debt Management Expenses		43,005	6,000	23,710
Gross Expenditure		**14,546,399**	**16,466,820**	**13,226,081**
Interest Received		129,141	0	51,310
Gross Income		**129,141**	**0**	**51,310**
Net Expenditure		**14,417,258**	**16,466,820**	**13,174,771**

Note 1: Transport relates to the cost of leasing/hire across the Authority and is included in the Treasury Management Statement of Accounts as leasing is classed as a Treasury Management activity.

Note 2: Supplies & Services: includes £169k dr/cr card charges, £38k bank charges