NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

CABINET – THURSDAY 23 JULY 2020

Title of Report	**TREASURY MANAGEMENT STEWARDSHIP REPORT FOR 2019/20**	
Presented by	Councillor Nick Rushton Corporate Portfolio Holder	
Background Papers	Capital Strategy 2019/20 – Council 26 February 2019 Treasury Management Strategy Statement 2019/20 and Prudential Indicators 2019/20 to 2021/22 – Council 26 February 2019 Treasury Management Activity Report April 2019 to January 2020 – Audit and Governance 17 March 2020 Investment Strategy – Service and Commercial 2019/20 – Council 26 February 2019 Budget and Council Tax 2019/20 – Council 26 February 2019	**Public Report:** Yes **Key Decision:** Yes
Financial Implications	A total of £490k in investment interest was earned on balances. This is mainly split between the General Fund £273k, Housing Revenue Account £157k and S106 Fund 57k. Annual principal repayment of £1.1m was paid on two PWLB loans for the Housing Revenue Account. In addition, interest on loans of £2.7m was paid on external debt, of which £2.3m was for the Housing Revenue Account and £400k for the General Fund. The above has an impact on the financial resources available to the Council.	
	Signed off by the Section 151 Officer: Yes	
Legal Implications	There are no legal implications arising out of the contents of this report	
	Signed off by the Deputy Monitoring Officer: Yes	
Staffing and Corporate Implications	None	
	Signed off by the Acting Head of Paid Service: Yes	
Purpose of Report	To inform Cabinet of the Council's Treasury Management activity undertaken for the financial year 2019/20.	
Reason for Decision	Informing Cabinet of the Council's Treasury Management	

	activity is a statutory requirement.
Recommendations	**THAT CABINET APPROVE THIS REPORT.**

1.0 BACKGROUND

1.1 Treasury Management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the code"), which requires local authorities to produce Prudential Indicators and a Treasury Management Strategy Statement annually on the likely financing and Investment activity.

1.2 This report fulfils the council's legal obligation under the Local Government Act 2003, to have regard to both the CIPFA Code and the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance

1.3 In 2019/20, council approved its Capital Strategy (included in the Budget and Council Tax report) and Treasury Management Strategy Statement, including the Borrowing Strategy, Debt Rescheduling Strategy, Annual Investment Policy and Strategy, Interest Apportionment Policy, Prudential Indicators and Annual Minimum Revenue Position Statement in its meeting on 26 February 2019.

1.4 Investing or borrowing activities expose the council to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risks are therefore central to the council's treasury management strategy.

2.0 THE U.K. ECONOMY AND OTHER FACTORS.

2.1 An economic update and Interest rate forecast has been provided by our Treasury Advisers (Arlingclose Ltd) and summarised below. A full update can be found at Appendix A

- CPI fell to 1.7% in February 2020, below the Bank of England's target of 2%.
- The unemployment was 3.9% in the three months to January 2020, while the employment rate hit a record high of 76.5%
- GDP growth in Q4 was reported as flat by the Office for national Statistics with annual rate growth remained below-trend at 1.1%.
- The coronavirus which first appeared in China in December 2019, started spreading across the globe caused falls in financial markets not seen since the Global Financial Crisis.
- The Bank of England held policy rates steady at 0.75% through most of 2019/20, but moved in March to cut rates to 0.25%, and then swiftly thereafter reduced further to the record low of 0.1%.
- 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.

3.0 THE COUNCIL'S TREASURY POSITION.

3.1 The council's current strategy is to use internal borrowing to reduce risk and keep interest costs low. The treasury management change over the financial year is shown below.

	Balance at 01/04/2019 £m	**Net Movement £m**	**Balance at 31/03/2020 £m**

Long term borrowing - HRA	£72.80	-£1.10	£71.70
Long term borrowing – General Fund	£8.40	£0.00	£8.40
Other long-term liabilities - HBBC	£0.10	£0.00	£0.10
Total Borrowing	**£81.30**	**-£1.10**	**£80.20**
Long term investments – greater than 1 year	£3.00	£0.00	£3.00
Short term investments – less than 1 year	£39.60	£0.10	£39.70
Pooled funds and externally managed investments*	£5.80	£2.20	£8.00
Total Investments	**£48.40**	**£2.30**	**£50.70**
Net debt	**£32.90**	**-£3.40**	**£29.50**

*Represents investments held in Money Market Funds

3.2 The annual repayments on two PWLB annuity loans taken out as part of the self-financing system of Council Housing in 2011/2012, are shown in the Net Movement column.

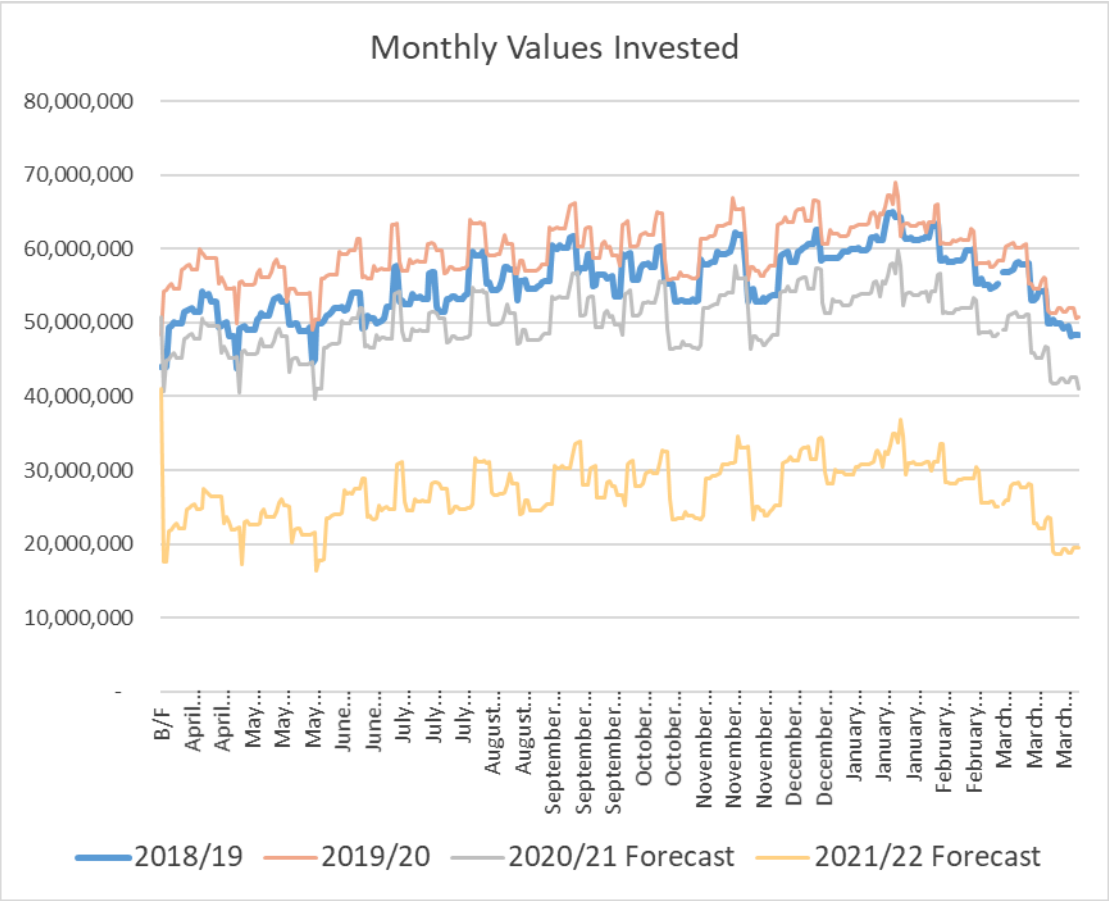
3.3 In 2019/20, the capacity for investment has increased by £2.3m. This can be affected by various factors including: increased income, contributions to/from reserves, setting aside expenditure to repay borrowing (MRP), fortuitous income, cash flow timing of receipts and payments and internal borrowing.

3.4 In 2019/20, some of the highlights that have impacted on the capacity are:

- Sales of assets – circa £3.8m
    - General Fund Vehicles £11k
    - Housing Revenue Account
        - Land £950k
        - Council Houses RTB £3.562m
        - Council Houses Non RTB £210k
- MRP £618k
- Increased income from various activities across the council including: circa £193k from investment income and £30k re-cycling income.
- There was also a delay on implementation of 2019/20 Capital Programmes; General Fund £10.7m (largely attributable from the New Leisure Centre Project) and Housing Revenue Account for £2.8m.

3.5 The pattern of cash held and subsequently invested per day is shown in the chart below, illustrating the cash flow trends throughout the year. The delay in implementation of the New Leisure Centre Building for £7.3m was the main factor for the increased investment capacity in the year. This is expected to impact the Council's cash flow for 2020/21.

The chart below also shows the forecast position for 2020/21 and 2021/22. This reflects lower levels of cash available in the next two years since it is planned that internal borrowing will be used to fund Capital programmes along with the effect of the expected maturity of Housing Revenue Account's £13m PWLB loans in 2021/22.



4.0 BORROWING ACTIVITY.

4.1 The council's Borrowing Strategy 2019/20, incorporates a prudent and pragmatic approach to borrowing to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the council's Prudential Indicators.

4.2 No loans matured in 2019/20 that required replacement.

4.3 The Borrowing Strategy identified that borrowing would not be required until 2020/21 and the council has not undertaken any new long-term borrowing during the year. Annual principal repayment of £1.1m and Interest payments totalling £2.71m were made in respect of existing debt. Members should note that a significant proportion of the HRA self-financing debt was taken out on a maturity basis and therefore whilst interest is paid, the principal repayment of the loan is not made. The Council has the funds set aside within HRA reserves for the first two maturity loan redemptions in 2022 of £3m and £10m, should it decide to repay the loans rather than refinance.

4.4 The council's cash flow remained positive and did not require and temporary loans during the year.

4.5 The council had approximately £9m of internal debt at 31 March 2020. This is the cumulative value of internal cash balances used to finance new capital expenditure instead of financing through unsupported borrowing. This is currently judged to be the most cost effective means of funding the capital programme.

4.6 The estimated Minimum Revenue Provision (MRP) is intended to ensure that the capital financing debt is paid off over the longer term. The MRP charge made to General Fund revenue account for 2019/20 is £618k.

4.7 The Housing Revenue Account is not required to make MRP charges. However, the council classes the principal repayments made in respect of the two PWLB annuity loans taken out as part of the housing self-financing in 2011/12, as MRP. In 2019/20, this repayment was £1.1m (as per 4.3 above).

5.0 DEBT RESCHEDULING ACTIVITY.

5.1 The council's Debt Rescheduling Strategy 2019/20, establishes a flexible approach where the rationale for rescheduling could be one or more of the following:

- Savings in interest costs with minimal risk.
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio.
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

5.2 No opportunities for debt rescheduling were identified which conformed to the above rationale. Accordingly, the council has undertaken no debt rescheduling activity during the year.

5.3 The council's portfolio of thirteen loans - ten PWLB loans and three market loans continue to be monitored for debt rescheduling opportunities.

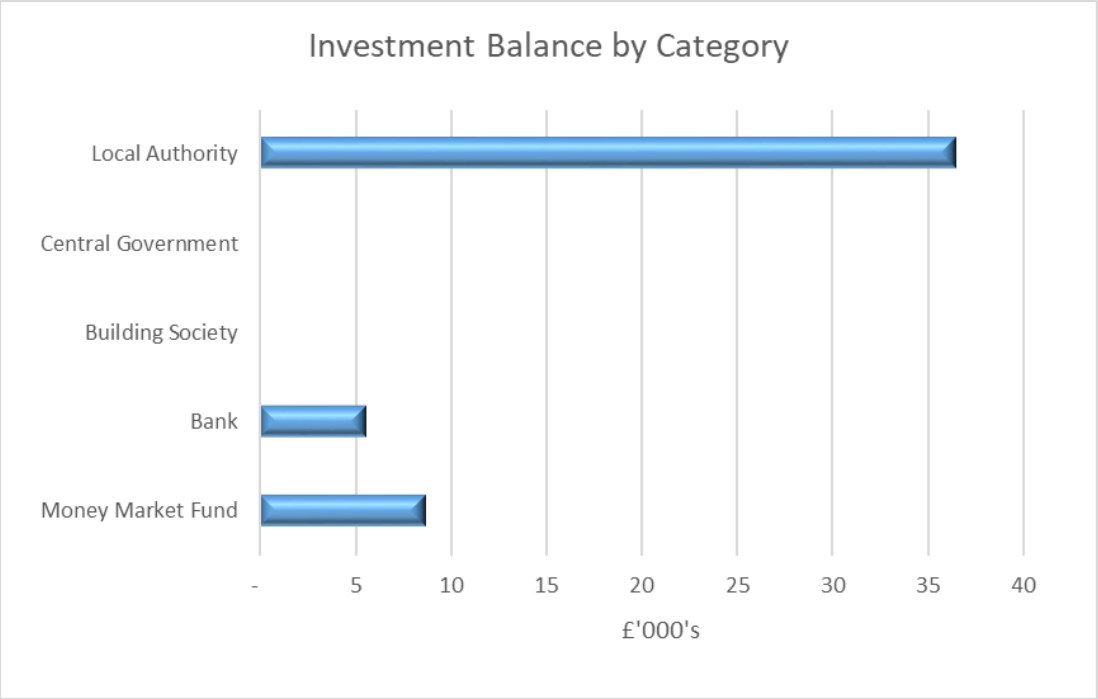
6.0 TREASURY MANAGEMENT INVESTMENT ACTIVITY.

6.1 The main objective of the council's Investment Policy and Strategy 2019/20 is to invest its surplus funds prudently.

6.2 The council's investment priorities (S.L.Y.) are:

- **S**ecurity of the invested capital;
- sufficient **L**iquidity to permit investments; and,
- Optimum **Y**ield which is commensurate with security and liquidity.

6.3 To lower the inherent investment risk, the council has minimised the use of banks and increased the use of other Local Authorities as investment counterparties. A range of lengths of investment, from overnight investments to short and long fixed term, from 32 days to 3 years, are currently utilised to ensure that the principles of security, liquidity and yield are followed. The table below shows the range of counterparties used by the council and the values invested at 31 March 2020.



6.4 The counterparties that the council currently use all meet the criteria set out in the Treasury Management Strategy Statement 2019/20 and are monitored by the Treasury Management Advisors. A detailed list of the counterparties used and amounts currently invested can be seen in Appendix B.

Inter-Local Authority lending accounted for 68% of investments placed during the year. The Council's investments are made with reference to the Council's cash flow, the outlook for the UK Bank Rate, money market rates, the economic outlook and advice from the Council's treasury adviser.

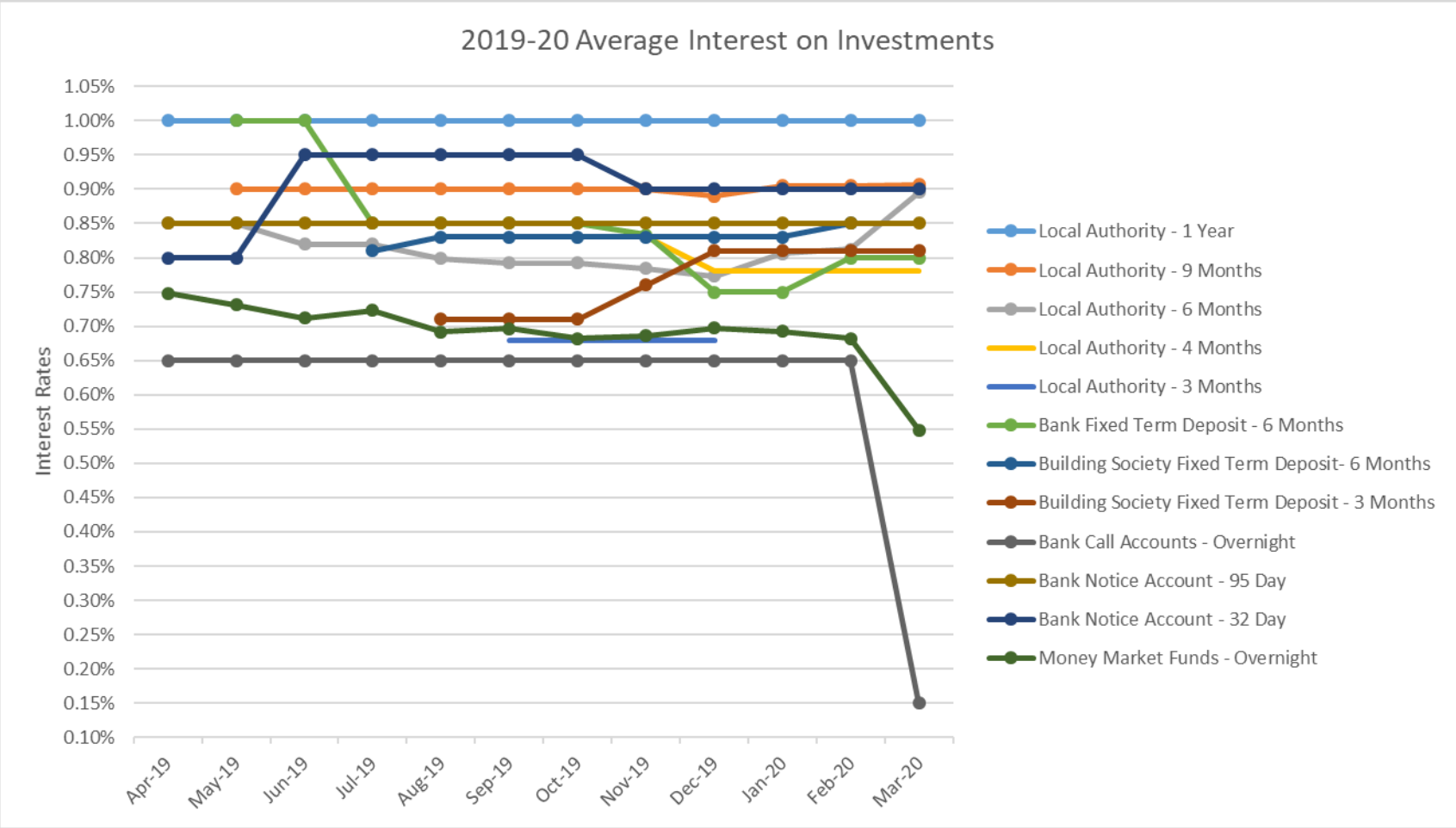
The Council exercises due diligence by assessing the organisation's financial stability. This is achieved by reviewing their credit status, most recent audited financial statements, auditor's report, budget report and current news which is financial in nature. All decisions are signed off the by Section 151 Officer or her Deputy.

6.5 The average rate of return on the council's investment balances for the year was 0.82%. For comparison purposes, the benchmark return (average 7-day London Interbank Bid Rate or LIBID rate) on 31 March 2020 was 0.58% and the average 7 day London Interbank Offered Rate (LIBOR) rate was 0.58%. This shows that we are achieving a good rate of return against benchmark.

6.6 Paragraph 6.5 above explains that the current average rate of return of 0.82% has been achieved. This was an improved rate from the budgeted interest of 0.69% and contributed to the additional interest income of £193k above the budget of £297k.

The current COVID-19 pandemic has affected the financial market followed by the Bank of England cutting interest to as low as 0.10%. This resonated on interest rates across all investment opportunities and forecasted to be the same position for at least the remainder of the year. This is expected to dramatically reduce the interest income for the coming year which is budgeted at £260k based on an average interest rate of 0.68%.

The graph below shows the average interest rate on in year investments and the movement of interest rates over the year.

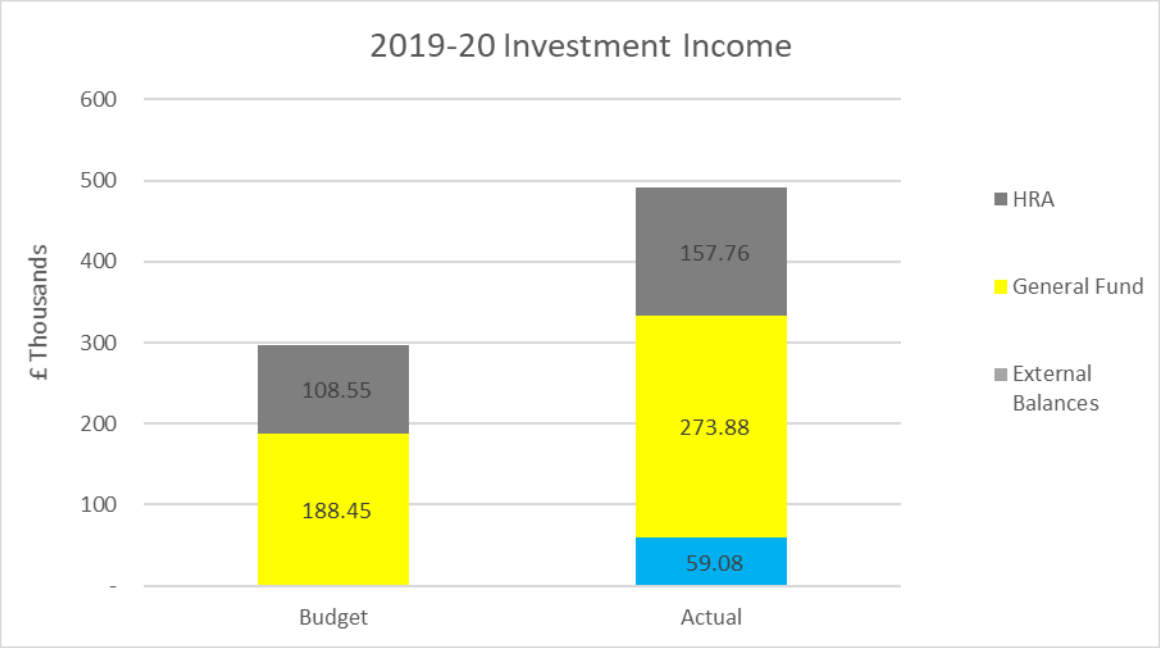


6.7 The council budgeted to achieve £297,000 of income from its investment activity in 2019/20 of which £188,450 is applied to General Fund and £108,550 to Housing Revenue Account. Investment activity for the year achieved £490,711 in interest.

6.8 Of the income achieved, an element is applied to balances held on external income. This external income largely represents balances from S106 contributions that have not yet been spent. The amount to be applied is £59,079. This is not budgeted for as S106 contributions are only achieved when specific conditions are met and are anticipated to be spent.

6.9 The remaining balance of £431,632 is apportioned between the General Fund which will receive £273,875; and Housing Revenue Account which will receive £157,756.

6.10 The budgeted and projected levels of investment income is represented in the table below.



6.11 There was one breach of investment limits in the year reported to Audit and Governance committee in December 2019. This was where the council went into an unapproved overdraft position. The council had a £1,000,000.00 deposit with Close Brothers at a rate of 1% for the period of 29 March 2019 to 30 September 2019. This trade was agreed through the broker on 28 March 2019. The funds were not credited in the Council's current bank account (as stated on the trade confirmation) on the 30 September 2019, or by 1 October 2019. The £1,000,000 deposit plus interest earned of £5,575.34 was received by the council on the 2 October 2019. This resulted in the council's bank account being overdrawn and bank charges incurred. The reason for the breach was that deal was repaid to another bank account. The overdraft charges and loss of 2 days interest has been fully reimbursed by Close Brothers Ltd.

7.0 NON-TREASURY INVESTMENT ACTIVITY

7.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

7.2 The following list represents the council's current investments in this area.

Property or Type	Value at 31 Mar 2020	Reason held
Industrial Units	£6.5m	To support the local economy and to

		generate profits to supplement council expenditure
Markets	£1.5m	Any profit supplements council expenditure
Land	£4.8m	Future economic benefit

7.3 More detailed information can be found in the “Investment Strategy – Service and Commercial” which was presented to Council on 26 February 2019.

7.4 In November 2019, Cabinet approved a new Corporate Asset Management Strategy, which set out a framework from which to manage our corporate property assets for the next five years. This strategy commits to reviewing the financial performance of our commercial assets as a priority, and an external review identified an average yield of 7.88% across our portfolio. Lower yielding assets are planned to be reviewed as part of the Council’s Journey to Self Sufficiency programme to assess whether they can managed in a different way to increase overall portfolio yield.

8.0 SUMMARY

8.1 For the financial year 2019/20, the council can confirm that it has complied with its Prudential Indicators, which were approved as part of the council’s Treasury Management Strategy Statement.

8.2 The council can confirm that during the financial year, other than the breach of prescribed limit detailed in paragraph 6.12, it has complied with its Treasury Management Practices.

Economic information provided by Treasury Management Advisors

External Context *(based on data as at 24/04/20)*

Economic commentary

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.
The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% y/y in February, below the Bank of England's target of 2%. Labour market data remained positive. The ILO unemployment rate was 3.9% in the three months to January 2020 while the employment rate hit a record high of 76.5%. The average annual growth rate for pay excluding bonuses was 3.1% in January 2020 and the same when bonuses were included, providing some evidence that a shortage of labour had been supporting wages.

GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed and production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.
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.

In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.
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.
The US economy grew at an annualised rate of 2.1% in Q4 2019. After escalating trade wars and a protracted standoff, the signing of Phase 1 of the trade agreement between the US and China in January was initially positive for both economies, but COVID-19 severely impacted sentiment and production in both countries. Against a slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from of 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19

related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already on (or below) the floor, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

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 touch its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but 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. 1-month, 3-month and 12-month bid rates averaged 0.61%, 0.72% and 0.88% respectively over the period.

Since the start of the calendar 2020, the yield on 2-year US treasuries had fallen from 1.573% to 0.20% and from 1.877% to 0.61% for 10-year treasuries. German bund yields remain negative.

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. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

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. NatWest Markets Plc (non-ringfenced) remains the highest at 128bps and National Westminster Bank Plc (ringfenced) still the lowest at 56bps. The other main UK banks are between 65bps and 123bps, with the latter being the thinly traded and volatile Santander UK CDS.

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.

Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and Non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-.

Appendix B

Counterparty	Length	From	To	Amount	Rate
Goldman Sachs MMF	Overnight	31/03/2020	01/04/2020	2,000,000.00	0.48%
Blackrock MMF	Overnight	31/03/2020	01/04/2020	1,700,000.00	0.49%
Aberdeen Asset Management MMF	Overnight	31/03/2020	01/04/2020	1,000,000.00	0.61%
Federated Investors MMF	Overnight	31/03/2020	01/04/2020	3,000,000.00	0.57%
CCLA MMF	Overnight	31/03/2020	01/04/2020	1,000,000.00	0.59%
Lloyds Main	Overnight	31/03/2020	01/04/2020	745,274.47	0.00%
Bank of Scotland	Overnight	31/03/2020	01/04/2020	1,795,000.01	0.00%
Santander Notice Account	95 days	31/03/2020	18/06/2020	1,495,000.00	0.85%
Northumberland County Council	1096	03/04/2017	03/04/2020	3,000,000.00	0.99%
Thurrock Council	365	02/04/2019	01/04/2020	1,000,000.00	1.00%
London Borough of Brent	274	18/11/2019	18/08/2020	5,000,000.00	0.90%
North Lanarkshire Council	275	02/12/2019	02/09/2020	5,000,000.00	0.87%
Lloyds Bank Fixed Term Deposit	182	20/11/2019	20/05/2020	1,500,000.00	0.80%
Eastleigh Borough Council	122	16/12/2019	16/04/2020	3,000,000.00	0.73%
Blackburn with Darwen Council	182	10/02/2020	10/08/2020	3,000,000.00	0.85%
Blackpool Borough Council	182	29/01/2020	29/07/2020	5,000,000.00	0.90%
Islington Council	182	20/01/2020	20/07/2020	3,000,000.00	0.85%
Ards and North Down Borough Council	261	13/01/2020	30/09/2020	2,000,000.00	0.95%
Kingston-upon-Hull City Council	185	13/03/2020	14/09/2020	2,000,000.00	0.90%
Broxtowe Borough Council	182	30/01/2020	30/07/2020	2,000,000.00	0.85%
Telford & Wrekin Council	184	09/03/2020	09/09/2020	2,500,000.00	1.17%
Total				**50,735,274.48**	

Policies and other considerations, as appropriate	
Council Priorities:	Value for Money
Policy Considerations:	Treasury Management Strategy Statement
Safeguarding:	Not Applicable
Equalities/Diversity:	Not Applicable
Customer Impact:	Not Applicable
Economic and Social Impact:	Not Applicable
Environment and Climate Change:	Not Applicable
Consultation/Community Engagement:	Not Applicable
Risks:	Borrowing and investment both carry an element of risk. This risk is mitigated through the adoption of the Treasury and Investment Strategies, compliance with the CIPFA code of Treasury Management and the retention of Treasury Management Advisors (Arlingclose) to proffer expert advice
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