AUDIT COMMITTEE – 7 JULY 2020

PART I – DELEGATED

8. TREASURY MANAGEMENT ANNUAL REPORT 2019/20 (DoF)

1 Summary

1.1 This report gives details of the 2019/20 year-end review of the Treasury Management function.

2 Details

2.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: “the management of the local authority’s 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”.

2.2 The Council’s 2019/20 Treasury Management Strategy (TMS) as approved by Council on 29 February 2019 has the primary objectives of safeguarding the repayment of the principal and interest of its investments on time, and then ensuring adequate liquidity, with the investment return being the final objective.

2.3 This report updates the Committee with the progress on whether the Council is meeting the TMS and its policies for 2019/20.

2.4 The Council has appointed treasury advisors to assist with our treasury management, Link Asset Services.

The Council’s Capital Position (Prudential Indicators)

2.5 The Council’s capital expenditure plans are one of the key drivers of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members’ overview and confirm capital expenditure plans.

2.6 The capital expenditure plans are financed in full by capital receipts, grants or capital reserves.

Capital Financing Requirement (CFR), External Debt and Operational Boundary

- **CFR** measures the Council’s underlying need to borrow for capital purposes, representing the Council’s total outstanding indebtedness.

  External Debt (borrowing) may not exceed the CFR except in the short-term.

- **The Operational Boundary** is a limit on the level of external debt set by the Council.
  This is set based on the most likely prudent (ie not worst-case scenario) estimate of total external debt, in line with statutory guidance.

  External debt may exceed the Operational Boundary, but may not exceed the Authorised Limit for external debt, which is set at a higher level and provides further headroom for unusual cash movements or refinancing.

The CFR and Operational Boundary estimates are shown below:

Prudential Indicator	2019/20 Original Estimate	2019/20 Revised Estimate (mid-year)	2019/20 Outturn
Capital Financing Requirement	£32.5m	£27.3m	£23.47m
External Debt / the Operational Boundary			
Borrowing	£15m	£8.0m	£6.7m

2.7 The borrowing balance of £6.7m represents long-term loans applied to Capital expenditure. It is net of an £8.0M loan to Thrive Homes and a £1.3M loan to Watford Community Homes for which the Council has borrowed, and temporary loans taken to support short-term liquidity needs. Gross debt is £24.0M. The increase in the CFR is due to the investment in Capital Projects during the year.

Limits to Borrowing Activity

2.8 The first key control over the treasury activity is a Performance Indicator (PI) to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and next two financial years. This allows some flexibility for limited early borrowing for future years. The borrowing in relation to the loans to Housing Associations does not count against the external borrowing limit as this has a neutral impact on net debt (the borrowing is cancelled out by the onward loan).

The Authorised Limit

2.9 This PI, which is required to be set and revised by Members, controls the overall level of borrowing and represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit For External Debt	2019/20 Original Indicator	2019/20 Revised Indicator	2019/20 Net Debt Outturn
Borrowing	£17m	£17m	£6.7m

Investment Portfolio 2019/20

2.10 In accordance with the CIPFA Prudential Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 2 of the Code, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low, in line with the Bank of England base rate.

2.11 In response to the Covid 19 public health emergency, the Bank reduced base rate to 0.10% in March 2019 in order to support the UK economy. It now appears likely that the crisis will lead to a global recession with prospects for recovery remaining highly uncertain. Given this risk environment, investment returns are likely to remain very low for some time to come.

2.12 The Council held £11.054m in accounts at Lloyds Bank as at 31 March 2020. There were no other treasury deposits.

2.13 The Lloyds bank balance at 31 March 2020 included Coronavirus business grant balances, exempted from the £10m limit on bank balances by emergency decision in March 2020.

2.14 The approved limits within the Annual Investment Strategy were not breached during 2019/20.

Security

2.15 The Council uses benchmarks as simple guides to maximum risk, and these may be breached from time to time, depending on movements in interest rates and counterparty criteria. Any breach of the benchmarks will be reported, with supporting reasons, in this report. There were no breaches to report during 2019/20.

2.16 In line with the TMS, the Council has managed to invest with those institutions who offered the best rate and the investment portfolio is above the overall benchmark during the year to date.

Liquidity

2.17 The Council set liquidity facilities/benchmarks to maintain:

Authorised bank overdraft of £nil.

Liquid short term deposits of at least £5m available with a week's notice.

2.18 The liquidity arrangements were adequate during the year to date. The loan to Thrive is excluded in this liquidity calculation.

Yield

2.19 The budget for interest earned on treasury investments for 2019/20 is £90k; interest received and accrued to the end of March 2020 was £89k.

2.20 The approved benchmark measure of yield is a return of 0.12% above the average bank rate. The bank rate was 0.75% until 11 March 2020, when it was reduced to 0.25%. The rate was further reduced to 0.10% on 19 March. The return for 2019/20 was equivalent to 0.72%, against a benchmark rate of 0.84% for the year.

2.21 The overall performance for the year was below the benchmark for 2019/20 because all treasury investments for 2019/20 were short-term. This reflects the prioritisation of security and liquidity over yield, as cash was available for investment only for short-periods (up to four months) during the year and the returns on the shorter term loans are generally lower than the Bank of England base rate for counterparties of a very high credit quality.

2.22 With the exception of non-treasury loans to Thrive and WCH, the Council keeps all investments short term. As such here are no sums within the TMS invested for greater than 364 days. Counterparties have been downgraded over the past few years; most investments have been limited to a 6 months period. This has resulted in lower interest rates being achieved.

2.23 The current investment counterparty criteria selection approved in the TMS is being met.

Credit Ratings

2.24 Credit rating information is supplied by our treasury consultants, Link Asset Services, on all counterparties that comply with the Council's criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

3 Policy/Budget Reference and Implications

3.1 The recommendations in this report are within the Council's agreed policy and budgets.

4 Financial Implications

4.1 This report provides formal assurance on the Council's compliance with its Treasury Management Strategy during the year

5 Legal, Equal Opportunities, Staffing, Environmental, Community Safety, Public Health, Customer Services Centre, Communications & Website, Risk Management and Health & Safety Implications

5.1 None specific.

6 Risk Implications

6.1 The Council's Treasury Management Strategy sets out the risks that it is seeking to manage. These risks are:

- **Liquidity Risk**
  That the Council may not have the cash it needs on a day to day basis to pay its bills. This risk is managed through forecasting and the retention by the Council of an adequate working capital balance. In addition, through the Public Works Loan Board and other organisations, the Council is able to access short term borrowing, usually within 24 hours.

- **Interest Rate Risk**
  That the costs and benefits expected do not materialise due to changes in interest rates. This risk is managed through the placing of different types and maturities

of investments, the forecasting and monitoring of the interest budget (with assistance from the Council's retained advisors).

- **Exchange Rate Risk**
  That losses or gains are made due to fluctuations in the prices of currency. The Council does not engage in any significant non-sterling transactions.

- **Credit and Counterparty Risk**
  That the entity holding Council funds is unable to repay them when due. This risk is managed through the maintenance of a list of authorised counterparties, with separate limits to ensure that the exposure to this risk is limited

- **Refinancing Risk**
  That the loans taken by the Council will become due for repayment and need replacing at a time when there is limited finance available or interest rates are significantly higher. The timing of loan maturities is monitored along with interest rate forecasts. Officers ensure that due dates are monitored and seek advice from the Council's advisors about when to raise any finance needed.

- **Legal and Regulatory Risk**
  That the Council operates outside its legal powers. This risk is managed through the Council's training and development of Officers involved in Treasury Management, the independent oversight of Internal and External Audit, and the advice (for example on the contents of this strategy) taken from the Council's Treasury advisors.

- **Fraud, Error and Corruption**
  The risk that losses will be caused by impropriety or incompetence is managed through the controls in the Council's financial procedures. For example, the segregation of duties between those making investment decisions and those transferring funds

- **Market Risk**
  That the price of investments held fluctuates, principally in secondary markets. The majority of the Council's investments are not traded, but where they are (e.g. Property investment portfolio) the main investments' value comes from the income they generate which is generally long term and secure.

7 Recommendation

7.1 That the Committee notes the annual 2019/20 Treasury Management report.

Report prepared by: Robert Thurlow, Finance Manager

Data Quality

Data sources: Treasury Management System; KPI Monitoring to SSOB; Link Reports

Data checked by: Robert Thurlow, Finance Manager

Data rating: Tick

1	**Poor**	
2	**Sufficient**	**x**

3	**High**	

Background Papers

Capital Strategy and Treasury Management Strategy 2019/20 (published as part of the 2019/20 budget)

APPENDICES / ATTACHMENTS

None