Stevenage BOROUGH COUNCIL

Part I
Release to Press

Meeting:	**AUDIT COMMITTEE/ EXECUTIVE / COUNCIL**	**Agenda Item:**
Portfolio Area:	Resources	
Date:	**10 September / 16 September / 14 October**	

Financial security

ANNUAL TREASURY MANAGEMENT REVIEW OF 2019/20 INCLUDING PRUDENTIAL CODE

NON-KEY DECISION

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1 PURPOSE

1.1 To review the operation of the 2019/20 Treasury Management and Investment Strategy.

1.2 To provide an update of the Covid19 on the Councils Treasury Management Strategy.

2 RECOMMENDATIONS

2.1 **Audit Committee**
That subject to any comments by the Audit Committee to the Executive, the 2019/20 Annual Treasury Management Review is recommended to Council for approval.

2.2 **Executive**
That subject to any comments made by the Executive, in addition to those made by the Audit Committee, the 2019/20 Annual Treasury Management Review is recommended to Council for approval.

2.3 **Council**
That subject to any comments from the Audit Committee and the Executive, the 2019/20 Annual Treasury Management Review be approved by Council.

3 BACKGROUND

3.1 Regulatory requirement

3.1.1 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 CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

3.1.2 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 27/02/2019)
- a mid-year treasury update report (Council 29/01/2020)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

3.1.3 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. However due to the significant impact of the Coronavirus, this report also considers the resulting impact on 2020/21 Treasury Management position.

3.1.4 Officers confirm that they have complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee and the Executive before they were reported to the Council.

3.2 The Economy and Interest rates in 2019/20 and current position

3.2.1 In 2019, the UK economy slowed due to uncertainties about Brexit causing many businesses to reduce their spending, and growth in the world economy also slowed, reducing demand for the goods and services that the UK sells abroad. GDP in the euro area grew by 0.4 per cent – 0.5 percentage points less than the Office of Budget Responsibility (OBR) expected last March, reflecting a continued slowdown in manufacturing and weaker external demand. US GDP grew by 1.0 per cent in the second half of 2019, in line with predictions. GDP growth in China and India also continued to slow during 2019.

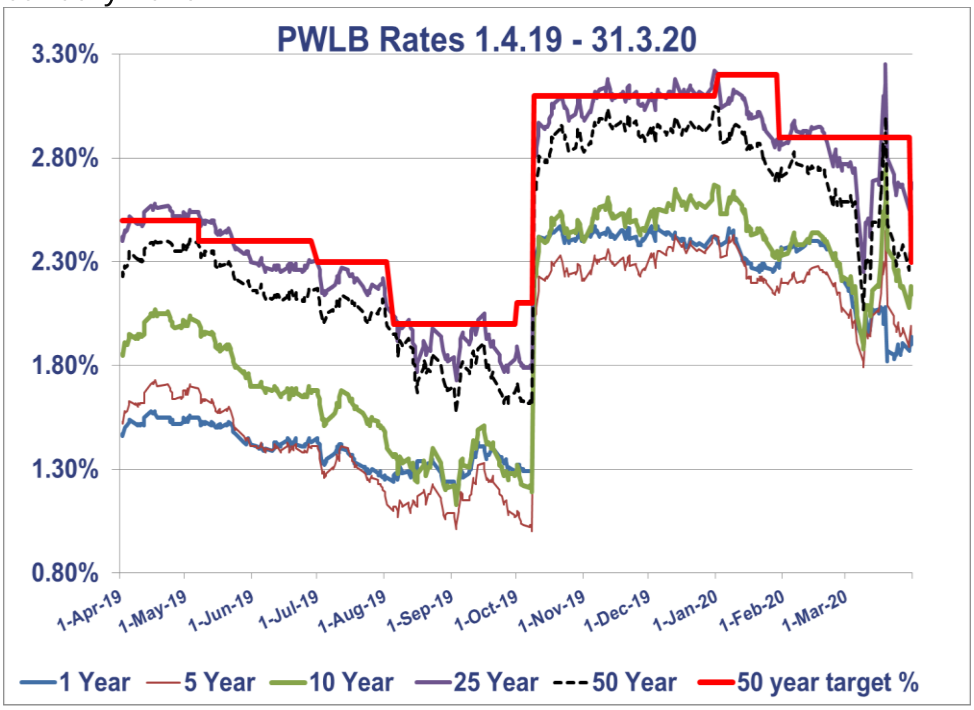
3.2.2 Inflation in advanced economies has also been lower than the OBR forecast last March. Inflation in the euro area was 1.0 per cent in the fourth quarter of 2019, 0.7 percentage points lower than expected. And in the US, inflation was 2.0 per cent in the fourth quarter of 2019, 0.2 percentage points lower than expected. UK inflation fell below the Monetary Policy Committee (MPC)'s 2% target.

3.2.3 Estimates suggest that UK output grew by 1.4 per cent in 2019, slightly above the OBR March 2019 forecast. Also, quarterly growth was more volatile than the OBR expected. Output rose by 0.6per cent in the first quarter but then fell 0.1 per cent in the second. This was in large part down to a precautionary build-up of stocks in the run-up to the UK's planned departure from the EU on 29 March 2019.

3.2.4 Investment returns remained low during 2019/20. There was an expectation for interest rates within the treasury management strategy for 2019/20 based on Bank Rate remaining at 0.75% during 2019/20. The MPC were not forecast to increase in Bank Rate until the details of the UK's exit from the EU became clearer, but there was an expectation that Bank Rate would then rise, although only to 1.0% during 2020. Actual changes to UK Base Rate were a cut to 0.25% from 0.75% at the MPC meeting on 11 March 2020, and a further cut to 0.10% on 19 March 2020 due to the impact of the Covid19 pandemic.

3.2.5 **Brexit**. The UK left the European Union on 31 January 2020. Under the Withdrawal Agreement, we are now in a transition period until the end of 2020, however the details of any trading agreements following the transition period remain unclear, giving rise to market uncertainty making forecasting of interest rates challenging. Officers have formed a Brexit working group to identify and mitigate risks after the transition period.

3.2.6 **PWLB borrowing rates** are based on, and are determined by, gilt (UK Government bonds) yields through H.M. Treasury determining a specified margin to add to gilt yields**.** PWLB were on a general downward trend until 19th October 2019, when a 1% rate rise was instituted as reflected in the chart below. Rates plateaued before resuming their downward trend from January 2020.



3.2.7 The target borrowing rate in the HRA Business Plan was 3.40% for 2020, rising to 3.70% in 2021 and 4.00% in 2022, while the average rate of the new HRA borrowing taken in March 2020 was 1.62%. The change in PWLB rates has been as follows, so despite the increases they remain lower that the Business Plan forecasts:

Table one: PWLB borrowing rates			
Rates* as at:	Apr-19	Apr-20	Aug-20
Years	Rate %	Rate %	Rate %
5	1.63	1.92	1.80
10	1.95	2.10	2.06
15	2.28	2.37	2.36
20	2.46	2.53	2.54
25	2.52	2.58	2.61

* Rates include a 0.2% reduction for the General Fund certainty, for HRA the reduction is 1.2%

3.2.8 **Covid19 Pandemic**.

3.2.8.1 As a response to the Covid19 Pandemic, UK Base Rate was cut to 0.25% from 0.75% at the MPC meeting on 11 March 2020, and was cut again to 0.10% on 19 March 2020. There is forecast to be little upward movement in PWLB rates over the next two years as it is expected to take national economies a prolonged period to recover momentum lost in the recession caused during the Covid19 lock down period. Inflation is also anticipated to be very low during this period and could possibly turn negative in some major western economies during 2020/21.

3.2.8.2 Forecast cash balances have been revised for the loss of income to the Council (see the charts in paragraphs 4.2.7.1 and 4.2.7.2) as have the forecasts of investment interest that will be earned due to both the lower investment balances and interest rates and will been reported as part of the revenue budget updates to Executive.

3.2.8.3 As can be seen in Table three in paragraph 4.2.4.1, the use of financing for the capital programme in 2019/20 was switched. This was in response to Covid19 and enabled revenue sourced financing to be redirected to support revenue pressures arising from the pandemic. In addition officers have reviewed the 2020/21 capital programme to repeat the exercise of switching financing sources where possible to reduce the pressures on revenue, maximising the use of capital receipts and other financing sources that can only be used to fund capital expenditure.

4 TREASURY MANAGEMENT ACTIVITIES

4.1 OVERALL TREASURY POSITION AS AT 31 MARCH 2020

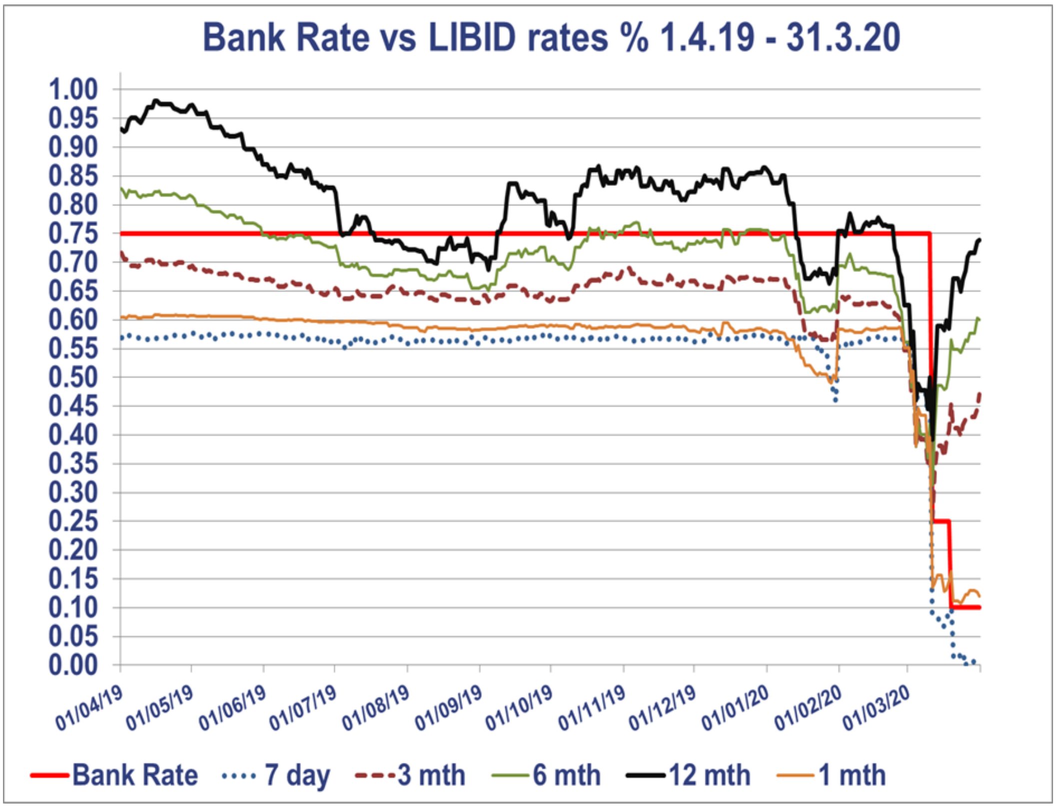
4.1.1 As at 31 March 2019 and 2020 the Council's treasury position was as follows:

Table two: Treasury Position						
	2018/19			2019/20		
	31 March 2019 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 March 2020 Principal £'000s	Rate / Return %	Average Life (Yrs)
Total Borrowing	**205,482**	**3.37**	**15.03**	**209,229**	**3.34**	**14.12**
Capital Financing Requirement	233,796			241,724		
Over/(under) borrowing	(28,314)			(32,495)		
Investments Portfolio (see section 4.2.7)	**54,135**	**0.86**		**54,072**	**0.98**	

4.1.2 Investment balances fell slightly year-on-year. The remaining balances include restricted use funds that can only be used to finance capital spend, money set aside as provisions and monies held on behalf of others including council tax and business rates provisions and advance payments (see paragraph 4.2.5.2).

4.1.3 During the year the average investment balance was £63.642 Million, earning interest of £624,724 and achieving an average interest rate of 0.98%. The comparable rate was 0.58% (average 7-day LIBID rate). This compares with an original budget assumption of £566,470 investment interest based on average investment rate of 0.7%.

4.1.4 The following chart shows UK Bank Rate and LIBID (London Interbank Bid) rates in 2019/20.



4.2 TREASURY MANAGEMENT STRATEGY 2019/20

4.2.1 The original 2019/20 Treasury Management strategy had projected Bank Rate remaining at 0.75% until the midpoint of 2019/20 when it was forecast to rise to 1.0% (and to 1.25% in the 4th quarter of 2019/20). The returns achievable on the Council's investments are currently modest based on the low Bank of England base rate and the risk appetite of the TM Strategy, which is compliant with the advice from the Council's treasury advisors, Link Asset Management.

4.2.2 The impact of the European Union (EU) Referendum decision to leave the EU and the implications of this for the UK economy were uncertain when the strategy was set, and it was anticipated that further updates of the Strategy may be required once these were known.

4.2.3 The Markets in Financial Instruments Directives (MiFID) are the EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (such as shares, bonds and units in collective investment schemes). It was introduced to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection. The Council has retained its elected professional client status under the MiFIDII legislation, having retained the minimum total investment portfolio of £10Million and continuing to pass the other quantitative and qualitative tests. This professional status has enabled the Council to maintain its existing relationships with financial institutions and ability to use financial instruments which are not available to retail clients, allowing uninterrupted advice and opportunities for investment/debt products.

4.2.4 **The Council's Capital Expenditure and Financing 2019/20.**

4.2.4.1 In 2019/20 the Council spent £43.527 Million on capital projects (General Fund and Housing Revenue Account). The capital programme was funded from a combination of existing capital resources and an increase in borrowing (General Fund £1.820 Million, HRA £7.056 Million). External loans of £4.010 Million were taken out for the HRA during 2019/20. Table three details capital expenditure and financing used in 2019/20.

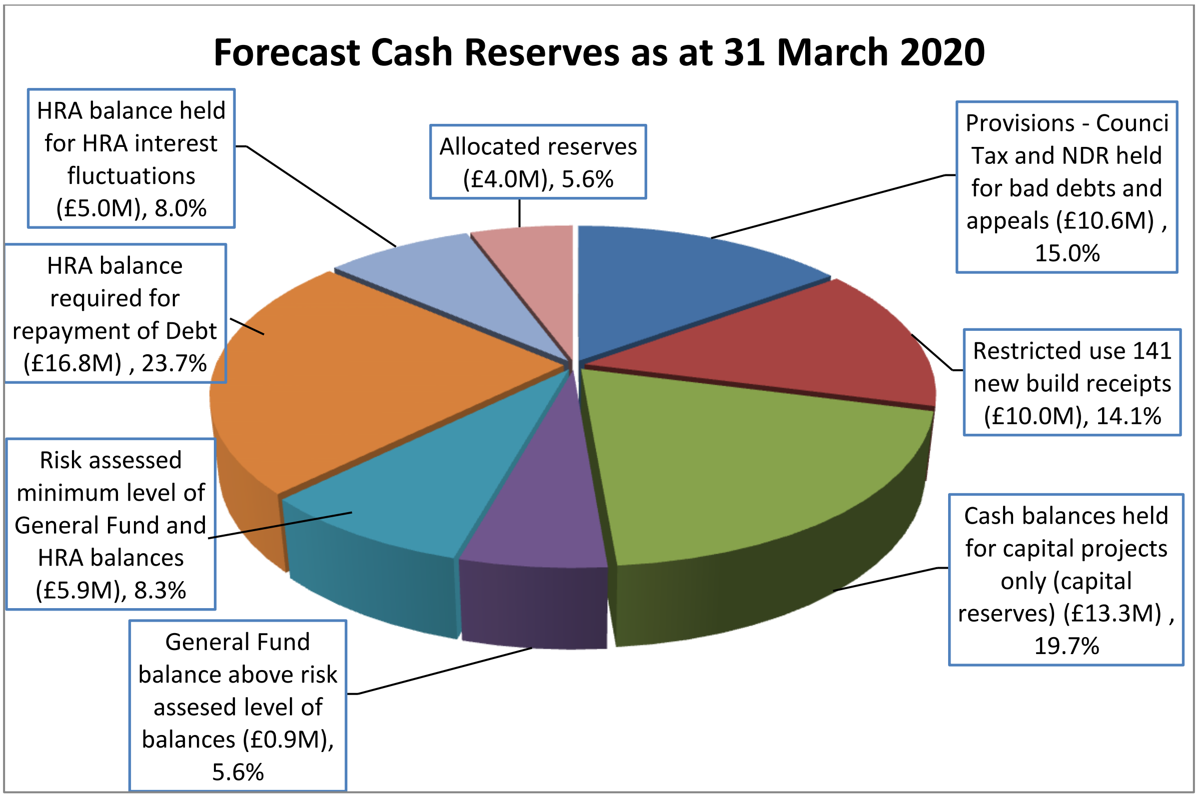
Table three : 2019/20 Capital Expenditure and Financing				
	2019/20 Original Estimate £'000	2019/20 Quarter 3 Revised Working Budget £'000	2019/20 Actual £'000	2019/20 Variance Actual to Quarter 3 Revised Working Budget £'000
Capital Expenditure:				
General Fund Capital Expenditure	32,217	17,339	13,140	(4,199)
HRA Capital Expenditure	23,528	29,941	30,387	446
Total Capital Expenditure	**55,745**	**47,280**	**43,527**	**(3,753)**
Resources Available for Capital Expenditure:				
Capital Receipts	(6,854)	(7,302)	(8,038)	(736)
Capital Grants /Contributions	(9,634)	(9,961)	(8,582)	1,378
Capital Reserves	(1,245)	(1,622)	0	1,622
Revenue contributions	(7,735)	(681)	0	681
Major Repairs Reserve	(9,876)	(18,961)	(18,030)	931
Total Resources Available	**(35,345)**	**(38,527)**	**(34,651)**	**3,877**
Capital Expenditure Requiring Borrowing	**20,400**	**8,753**	**8,876**	**124**

4.2.4.2 The Treasury Management review of 2019/20 and Prudential Indicators have been updated to reflect changes to capital budgets which have been approved throughout the year. The actual capital expenditure for 2019/20 was reported to the Executive on 8 July 2020.

4.2.5 The Council's overall need to borrow and Capital Financing Requirement

4.2.5.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt it needs to/has taken out to fund the capital programme (and includes both internal and external borrowing). The CFR is then reduced as debt repayments are made and Minimum Revenue Provisions (MRP – see also section 4.2.6) are made. A separate CFR is calculated for the General Fund and Housing Revenue Account and any transfers of assets (such as land or buildings) between the two accounts will impact on each fund's CFR. The CFR will go up on the fund "receiving" the assets and go down (by the same amount) on the fund "giving" the asset.

4.2.5.2 Cash balances enable the Council to use internal borrowing in line with its Capital Strategy and Treasury Management Strategy. This position is kept under review taking into account future cash balances and forecast borrowing rates. The apportionment of General Fund and HRA cash balances on 31 March 2020 is shown in the following chart, but Members should note that these cash balances relate in part to the restricted use right to buy "one for one" receipts (£10.0Million) and provisions (£10.6Million) for future liabilities, and that there is forecast drawing down of £3Million from reserves and balances due to the impact of Covid19 in 2020/21 in the revised September General Fund Medium Term Financial Strategy.



4.2.5.3 As at the 31 March 2020 the Council had total external borrowing of £209.229 Million. The debt repayment profile is shown in the following table:

Table four Maturity of Debt Portfolio for 2018/19 and 2019/20		
Time to maturity	**31 March 2019 Actual £'000's**	**31 March 2020 Actual £'000's**
Maturing within one year	263	263
1 year or more and less than 2 years	263	263
2 years or more and less than 5 years	526	263
5 years or more and less than 10 years	28,556	39,156
10 years or more	175,874	169,284
Total	**205,482**	**209,229**

4.2.5.4 The General Fund had external borrowing of £2.545 Million with the Public Works Loan Board (PWLB). The HRA had external borrowing of £206.684

Million all held with the PWLB, of which £11.773 Million relates to the Decent Homes programme, £7.763 Million from pre 2012 plus new loans of £4.010 Million taken out in year. The remainder of £194.911 Million relates to self- finance the payment made to central government in 2012.

4.2.5.5 In addition to the PWLB borrowing, the General Fund also has loans from the Local Enterprise Partnership (LEP) in relation to regeneration activities. The schedule as at the 31 March 2020 is set out below. Discussions are underway with the LEP regarding making these re-investible loans for further regeneration of the town, rather than needing to be repaid on the dates indicated.

Table Five: LEP Loans				
Loan Received	**Site Assembly**	**Land Assembly**	**Total**	**Repayment Date**
2015/16	762,488		762,488	due to be repaid 31/03 2022
2016/17	416,306		416,306	due to be repaid 31/03 2022
2019/20		4,714,265	4,714,265	due to be repaid 31/03 2025
Total	**1,178,794**	**4,714,265**	**5,893,058**	

4.2.5.6 The Council's CFR is one of the key prudential indicators and is shown in the following table.

Table Six : Capital Financing Requirement 2018/19 and 2019/20			
CFR Calculation	**31-Mar-18 (£'000)**	**31-Mar-19 (£'000)**	**Movement in Year (£'000)**
Opening Balance	**221,877**	**233,796**	
Closing Capital Financing Requirement (General Fund)	26,976	28,053	1,077
Closing Capital Financing Requirement (Housing Revenue Account)	206,820	213,671	6,851
Closing Balance	**233,796**	**241,724**	
Increase/ (Decrease)	**11,919**	**7,928**	**7,928**

4.2.5.7 The CFR for the HRA has increased by £6.851 Million due to a borrowing requirement of £7.056 Million less asset transfers (appropriations) between the General Fund and HRA in 2019/20 with a net impact to the HRA CFR of a reduction of £205K as follows:

		GF	HRA
Symonds Green Annexe - Scarborough Ave	GF to the HRA	(444,553)	444,553
North Road	HRA to the GF	650,000	(650,000)
		205,447	(205,447)

4.2.5.8 The General Fund's CFR has increased by £1.077 Million, due to;

- the net appropriation from the HRA of +£205K
- borrowing requirement of +£1.820 Million
- less Minimum Revenue Provision (MRP) (see section 4.2.6) and loan repayments made in year totalling -£948K

4.2.5.9 Borrowing originally forecast for Investment Properties was not taken in 2019/20 (see paragraph 4.3.4).

4.2.6 **Minimum Revenue Provision (MRP)**

4.2.6.1 The Prudential Code, by which the Council has to make its borrowing decisions, requires the Council to demonstrate that borrowing is required and affordable. The MRP is a statutory requirement to ensure borrowing is affordable for the General Fund and does not apply to the HRA (the HRA affordability is determined in the HRA Business Plan). The Council is required to make annual MRP based on its policy approved by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement (regardless of whether that borrowing was internal or external) and the life of the asset for which the borrowing was required.

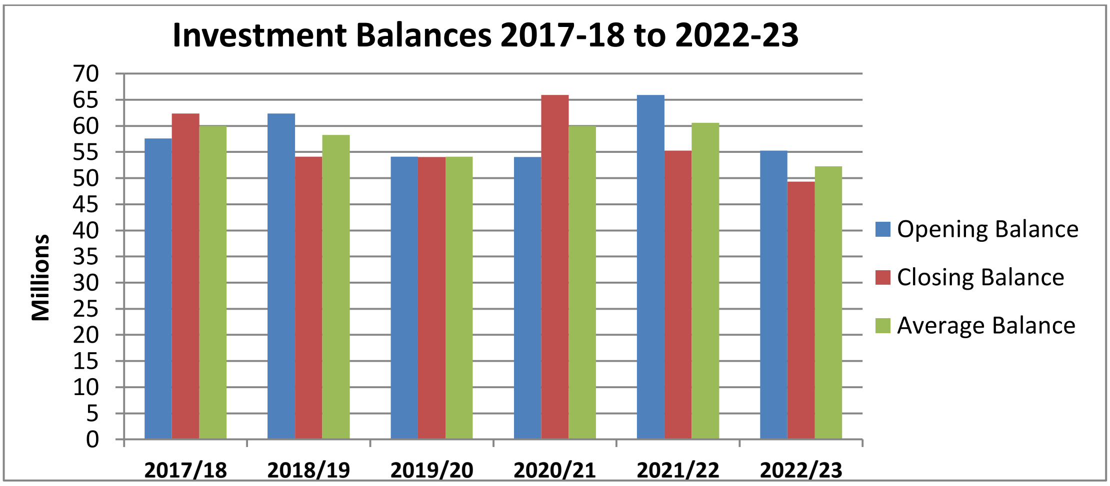
4.2.6.2 The MRP charged to the General Fund in 2019/20 was £684,906, of which

- £335,058 is effectively funded from regeneration assets
- £35,120 is funded from investment property
- £263,958 is a net cost to the General Fund
- £50,770 funded by principal loan repayments from Queensway*

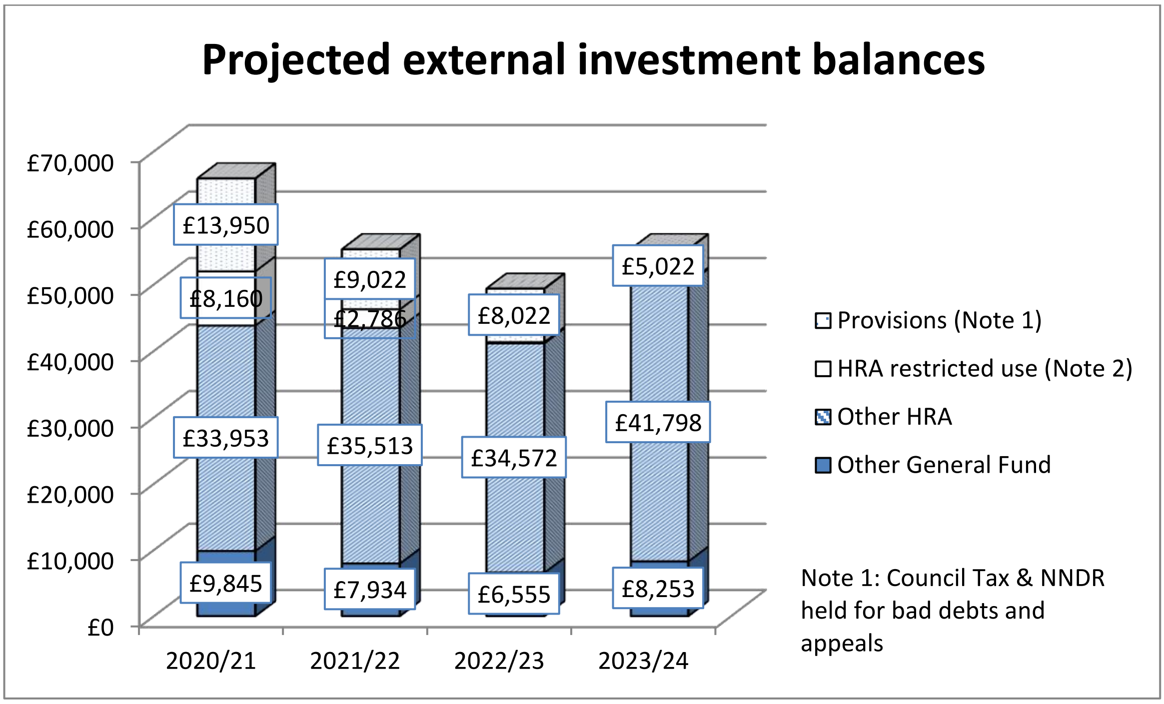
*this is included as an accounting technicality only, there is no MRP cost to SBC relating to this loan

4.2.7 **Cash Balances and Investment**

4.2.7.1 The restrictive use of a proportion of the cash balances set out in paragraph 4.2.5.2, plus the planned use of resources in line with the Council's capital and revenue strategies, mean that these resources are not available for new expenditure. The following chart shows the historic level of balances and the projected reduction following the planned use to 2022/23.



4.2.7.2 The chart below shows the breakdown of the projected external investment balances, following the drawing down and resulting reduction in the reserves and balances held on 31 March 2020 (as set out in paragraph 4.2.5.2), in accordance with the latest General Fund and HRA Medium Term Financial Strategies.



4.2.7.3 In accordance with the Treasury Management Strategy approved by Council on 27 February 2019, the Council invests it surplus cash balances. The 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 and counterparty limits dependant on level of cash balances held.

4.2.7.4 There were no breaches to this policy in 2019/20 with the investment activity during the year conforming to the approved strategy. The Council had no liquidity difficulties and no funds were placed with the Debt Management Office (DMO) during 2019/20, demonstrating that counterparty limits and availability for placing funds approved in the TM Strategy were working effectively.

4.2.8 **Other Prudential Indicators**

4.2.8.1 The treasury management indicators for 2019/20 onwards have been updated based on the updated Capital Strategy approved by Council in February 2020 and subsequently updated in the 3rd and 4th quarter capital updates reported to Executive and Council in March and July 2020.

4.2.8.2 The **net borrowing position** for the Council as at 31 March 2020 was **£155.157Million** (total external borrowings/loans of £209.229Million less total investments held of £54.072Million).

4.2.8.3 The **operational boundary** and **authorised limit** refers to the borrowing limits within which the treasury team operate. A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. **There were no breaches of either limit in 2019/20.**

4.2.8.4 The **ratio of financing costs** to net revenue stream is equal to General Fund interest costs divided by the General Fund net revenue income from Council tax, Revenue Support Grant and retained business rates. The 2019/20 indicator is **8.22%.**

4.2.8.5 The full list of treasury prudential indicators is shown in Appendix A and has been updated for the 2019/20 outturn position and the revised 2020/21 capital programme.

4.3 OTHER ISSUES

4.3.1 International Financial Reporting Standard 9 (IFRS9) covers the recognition, measurement and impairment of financial instruments such as loans and investments. Following consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG) on IFRS9, the Government introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This was effective from 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency. **These changes have no impact** on the valuation of investments held by Stevenage Borough Council, and the statutory override has not been needed.

4.3.2 No updates have been made to the MRP Policy, since the review of asset lives on property as per the 2019/20 Mid-Year Treasury Management review (Council 29 January 2020). The policy remains unchanged in that Option 3 Life expectancy is used in calculation of the MRP charge. The maximum life used is capped at 50 years as permissible under the prudential code.

4.3.3 **Operational and Authorised Borrowing Limits**

4.3.3.1 General Fund limits will be reviewed if necessary in the Mid-Year 2020/21 Treasury Management Strategy, due to go to Executive and Audit Committee in November 2020 and Council in December 2020.

4.3.3.2 HRA limits will be reviewed as part of the refresh of the HRA Business Plan currently being undertaken.

4.3.4 **Property Funds and Commercial Strategy**

Separate to Treasury Management cash investments, the Council has a strategy to invest in Property Funds and Commercial Property. To date one Commercial Property has been acquired, Essex House in 2017/18 at a purchase cost of £1.756 Million. A number of other properties have been considered, however despite the appointment of specialist to help identify suitable properties none have met the approved investment criteria to warrant their purchase. The difficulty in identifying further suitable properties, combined with adverse market conditions, has led to no further properties being acquired. There has also been a consultation into the lending arrangements for PWLB funding. The deadline for the consultation was extended to 31 July 2020, and the date for the outcome of the consultation has yet to be confirmed.

5 IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for 2019/20. Any consequential financial impacts identified in the Capital strategy and Revenue budget monitoring reports have been incorporated into this report.

5.1.2 During the financial year Officers operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

5.2 Legal Implications

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy are intended to ensure that the Council complies with relevant legislation and best practice.

5.2.2 The potential changes to PWLB borrowing arrangements as per paragraph 4.3.4 refer to the use of PWLB for 'Investment for Yield' schemes, where Council's may be prohibited from the use of this borrowing source for commercial investment property purchases. This could have an impact on the plans currently in the Council's Capital Strategy.

5.3 Equalities and Diversity Implications

5.3.1 The purpose of this report is to review the implementation of the Treasury management policy in 2019/20. Before investments are placed with counter parties the Council has the discretion not to invest with counter parties where there are concerns over sovereign nations' human rights issues.

5.3.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity;

sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

5.4 Risk Implications

5.4.1 The current policy of minimising external borrowing only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. Should these conditions change the Council may need to take borrowing at higher rates which would increase revenue costs.

5.4.2 There remains uncertainty on the impact of exiting the EU on UK economy and borrowing rates. Officers monitor interest rate forecasts to inform the timing of borrowing decisions.

5.4.3 The Council's Treasury Management Strategy is based on limits for counterparties to reduce risk of investing with only a small number of institutions.

5.4.4 The thresholds and time limits set for investments in the Strategy are based on the relative ratings of investment vehicles and counter parties. These are designed to take into account the relative risk of investments and also to preclude certain grades of investments and counterparties to prevent loss of income to the Council.

5.5 Policy Implications

5.5.1 This report confirms treasury decisions have been made in accordance with the existing policy.

5.6 Climate Change Implications

5.6.1 The council's investment portfolio is sterling investments and not directly in companies. However the TM team will review the use of Money Market funds in 2020/21 to ensure, where possible, money market funds that invest in environmentally sustainable companies are used. In this way the TM team will align with the Councils ambition to attempt to be carbon neutral by 2030.

BACKGROUND PAPERS

- BD1 Mid-year Treasury update (Council 29 January 2020)
- BD2 Treasury Management Strategy including Prudential Code Indicators 2019/20 (Council 27 February 2019)

APPENDICES

- Appendix A Prudential Indicators
- Appendix B Investment and Borrowing Portfolio