2019-2020 Annual Treasury Management Report

Appendix 1

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2019-2020 Annual Treasury Management Report

1. Introduction

1.1. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management report including a review of activities and the actual Prudential and Treasury Indicators for 2019/20.This report meets the requirements of both the Chartered Institute of Public Finance and Accounting (CIPFA) Code of Practice in Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2. The report includes:

- Capital Activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement, CFR);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Review of debt and investment activity.

1.3. During 2019/20 the Council complied with its legislative and regulatory requirements. Detailed reports have been presented to Overview and Scrutiny Committee, Cabinet and Council throughout the year as part of the Quarterly Corporate Financial Reports.

1.4. We had only one breach of counterparty limits in 2019/20 and this was reported in the Corporate Financial Update Quarter 2. Following procedure, we consulted with the portfolio holder, the Section 151 officer and then the counterparty and we were able to recall the excess. As a result were only exposed for an additional amount of £1 million for 5 working days.

1.5. Table 1 below provides a summary of the key data for 2019/20:

Table 1: Capital Expenditure, Capital Financing Requirement and Cash Resources

	2018/19 Actual £000	2019/20 Feb 19 estimate £000	2019/20 Feb 20 estimate £000	2019/20 Actual £000
Capital expenditure	4,030	12,339	7,479	4,074
Capital Financing Requirement (CFR)	18,354	20,543	18,791	18,505
External debt	12,800	12,800	12,800	12,800
Total Investments (inc. call accounts)	20,329	12,925	17,732	28,798

2. Capital Expenditure and Financing 2019/20

2.1. The Council incurs capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need;
- Un-financed capital expenditure which leads to an increase in the Council's CFR. This increases the Minimum Revenue Provision (MRP see 2.6) charged to the revenue account to ensure that resources are set aside to pay for the asset over its useful life.

2.2. Table 2 below shows the actual capital expenditure and how this was financed.

Table 2: Capital expenditure and financing.

	2018/19 Actual £000	2019/20 Feb 19 estimate £000	2019/20 Feb 20 estimate £000	2019/20 Actual £000
Capital expenditure	**4,030**	**12,339**	**7,479**	**4,074**
Resourced by:				
· Capital receipts	887	4,376	1,522	1,263
· Capital grants	1,334	3,204	2,231	626
· Revenue Reserves	877	1,942	2,570	1,316
Unfinanced capital expenditure	**932**	**2,817**	**1,156**	**869**

2.3. Explanations of the variances are included within the out-turn report to Council on 30 June 2020. A lot is delivered through partnerships with third party organisations and it has taken longer than anticipated to get the schemes under way.

2.4. The CFR represents the Council's underlying need to borrow for capital expenditure. It increases when the Council incurs capital expenditure and reduces as resources are applied to capital expenditure.

2.5. The CFR is the cumulative unfinanced capital expenditure which has not yet been 'paid for'. It can be understood in terms of an outstanding 'mortgage' balance on the Council's non-current assets.

2.6. There are statutory controls in place to ensure that the cost of capital assets is charged to revenue over the life of the assets. This is the annual MRP charge.

2.7. 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 minimum revenue charge each year through a Voluntary Revenue Provision (VRP)

2.8. The Council's 2019/20 MRP Policy (as required by MHCLG guidance) was approved as part of the Treasury Management Strategy Report for 2019/20 on 26th February 2019.

2.9. The Council's CFR for the year is shown in Table 3, and represents a key prudential indicator.

Table3: CFR Movement

CFR	2018/19 Actual £000	2019/20 Feb 19 estimate £000	2019/20 Feb 20 estimate £000	2019/20 Actual £000
Opening balance	17,995	18,478	18,354	18,354
Add unfinanced capital expenditure (as above)	932	2,817	1,156	869
Less MRP	(573)	(752)	(719)	(719)
Closing balance	18,354	20,543	18,791	18,505

3. Borrowing

3.1. A key prudential indicator is to compare the level of gross debt against the CFR. Gross debt should not exceed the CFR in the medium term in order to remain prudent and to ensure revenue activities are not being funded by borrowing. Table 4 highlights the Council's gross borrowing position against the CFR and shows that the Council has complied with this prudential indicator.

Table 4: Gross Debt v CFR

	31 March 2019 £000	31 March 2020 £000
Gross Debt	12,800	12,800
CFR	18,354	18,505
Over / (under) borrowing	(5,554)	(5,705)

3.2. During 2019-20, the council maintained an under-borrowed position of £5.7m. This means that the capital borrowing need, the 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 and minimising counterparty risk on placing investments also needed to be considered.

3.3. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However this was, and will continue to be, kept under review to avoid incurring higher borrowing costs in the future when the Council will not be able to avoid new borrowing to finance capital expenditure.

3.4. In October 2019, HM treasury imposed a change in the margin over gilt yields for PWLB rates by adding 1%, making the PWLB Certainty rate 1.8% over gilts, and while this has been partially reversed for some forms of borrowing in the Chancellor's March 2020 Budget, this affects the affordability of the Councils capital plans and has resulted in some having their business cases reviewed and updated.

3.5. The government announced in the March budget a consultation with local authorities (LA's) on PWLB margins, the closing date of which has now been extended until 31 July 2020. It seems that the treasury intends to put a stop to LA's borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

3.6. Included in the Prudential Code are a number of other indicators for debt, the levels for which are shown in Table 5

Table 5: Summary of Debt and Debt Indicators

	2019/20 £000
Gross Debt	12,800
Authorised limit	26,815
Operational boundary	20,600
Estimate of Financing Costs : Net revenue stream (Feb 18 estimate)	8.57%
Estimate of Financing Costs : Net revenue stream (Feb 19 estimate)	8.22%
Actual of Financing Costs : Net revenue stream	6.48%

3.7. The Authorised limit; is the “affordable borrowing limit” required by section 3 of the Local Government Act 2003. This is the level of debt that while not desirable, could be afforded in the short term, but is not sustainable in the longer term. Once set the Council does not have the power to borrow above the authorised limit.

3.8. The Operational Boundary; is the limit beyond which external debt is not normally expected to exceed. This is set at a level consistent with the borrowing need (CFR) plus an allowance for unexpected expenditure.

3.9. As demonstrated in Table 5 the council has maintained gross borrowing within both its authorised limit and operational boundary for 2019/20.

3.10. The ratio of financing costs to net revenue stream identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income). This shows the percentage amount of the net revenue stream which is spent before the Council provides any services. For 2019/20 the actual was 6.48%, which came in below estimates for the year, due to no increase in borrowing and hence interest payable.

3.11. In addition to the previously mentioned indicators for debt it is also important to be aware of the maturity structure of borrowing and limits places on fixed and variable rate debt. These are shown in Table 6 below.

Table 6 Maturity Structure of Debt and Limits on Fixed and Variable rate debt.

	31 March 2019	31 March 2020	31 March 2020
	Actual	**Approved**	**Actual**
Fixed Interest Borrowings:			
Under 12 months	0.00%	Up to 25%	0.00%
12 Months to 2 Years	0.00%	Up to 25%	0.00%
2 - 5 Years	0.00%	Up to 25%	0.00%
5 to 10 years	0.00%	Up to 100%	0.00%
10 to 20 years	0.00%	Up to 100%	0.00%
20 to 30 Years	6.25%	Up to 100%	6.25%
30 to 40 Years	46.87%	Up to 100%	93.75%
40 years plus	46.88%	Up to 100%	0.00%
	100.00%		**100.00%**
Limits on Borrowing at	**£m**	**£m**	**£m**
Fixed rate	12.8	24.6	12.8
Variable rate (maturing<1 year)	0	0	0

4. Investments

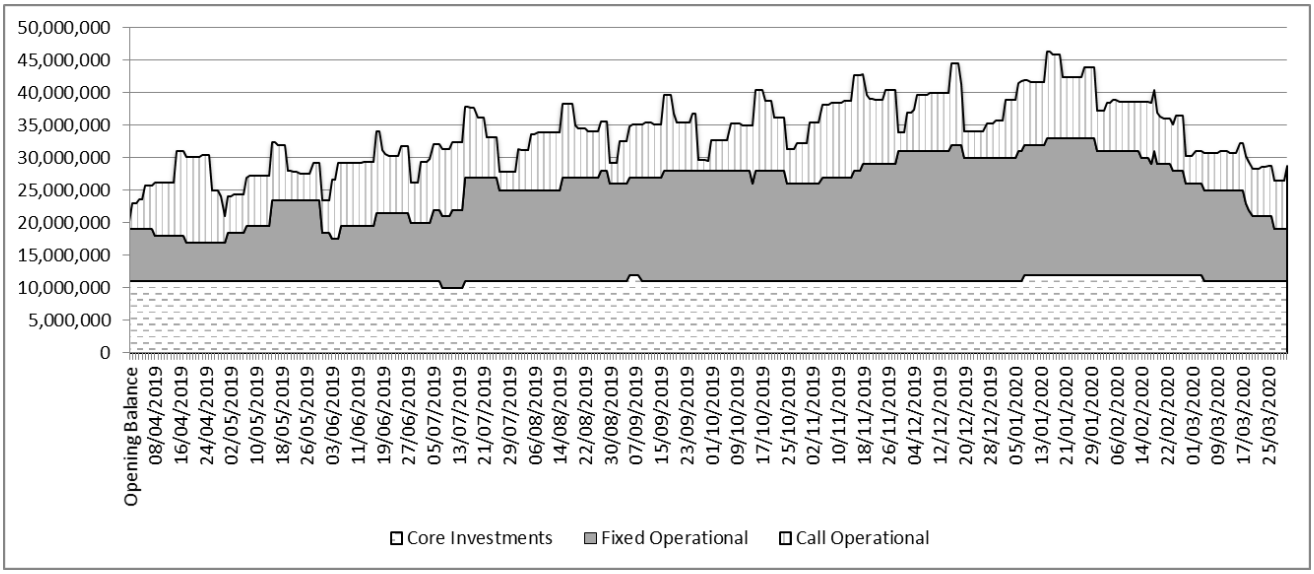
4.1. The Council’s investments are all managed in house by the Council’s finance team, with the objective to manage risk to ensure the security of investments and maintain adequate liquidity for revenue and capital activities. Procedures and controls to achieve this are well established both through member reporting and officer activity detailed in the Council’s Treasury Management Practices.

4.2. At the beginning and end of 2019/20 the Council’s investment position was as follows:

Table 7 Investment Position

	31 March 2019 Principal £000	Rate/ Return %	31 March 2020 Principal £000	Rate/ Return %
Call Accounts	1,330	0.65%	9,798	0.71%
Cash Flow (Operational)	7,998	0.70%	8,000	0.81%
Core Cash	11,000	0.74%	11,000	0.91%
Total Investments	**20,329**	**0.71%**	**28,798**	**0.81%**

4.3. Chart 1 shows how investment balances have fluctuated over the course of the year.



4.4. Investment returns remained low during 2019/20 with the Bank of England Bank Rate falling twice in March, first to 0.25% and then to 0.10%, due to measures taken to support the country though the COVID-19 virus outbreak.

4.5. Overall the Council earned £284k on its investments against a budget of £223k as it benefited from fluctuations in market rates as a result of changing market expectations on the next move by the Monetary Policy Committee (MPC) on the Bank of England Bank Rate and a stepped maturity profile for deposits.

4.6. **Table 8 Investment Performance**

	Average Annual Return	Benchmark	Variance
Call Accounts	0.71%	0.52%	0.19%
Cash Flow (Operational)	0.81%	0.63%	0.18%
Core Cash	0.91%	0.70%	0.21%

Non-Treasury Investments

4.7. The Council owns and has previously purchased properties that are now classified as investments. These properties were purchased for economic development reasons, to provide employment opportunities in areas where the market had failed to do so and are now classified as investment properties.

An example, is the investment in 2015 to create the Mint Works, which came about due to the Council recognising that there was a lack of start-up units for businesses in the district and stepping in to meet this need.

4.8. During 2019/20 the Council purchased the remaining interest in Dowker Lane car park, to secure public parking provision in Kendal. As part of the deal the Council gained two new investment properties.

4.9. The Council continues to hold 25 investment properties with a fair value of £4.185m. All these properties are within the boundaries of SLDC. After expenses the Council earned £0.348m in income, creating a return on investment of 8.32% overall down from 8.85% in 2018/19.

5. The Economy and Interest Rates

5.1. The Bank of England Monetary Policy Committee (MPC) held the Bank rate at 0.75% until March 2020 due to Brexit uncertainty. However when it became clear that the COVID-19 virus outbreak posed a huge threat to the UK economy, the MPC delivered two emergency cuts in rates. The first to 0.25% and the second to 0.10%, along with an increase in quantitative easing.

5.2. CPI inflation has fell in 2020 to finish at 1.5% in March 2020, within the MPC's target of 2% +/- 1%. The outlook for inflation is for it to continue to fall as the world economy heads into a recession. This has already lead to a fall in oil prices and has seen wage inflation being to fall. While inflation could turn negative in the Eurozone it is currently not thought likely in the UK.

5.3. Following a very volatile year, annual growth for 2019 came in at 1.1%. 2020 started well with optimistic business surveys as the general election provided a decisive result. Since then expectations have deteriorated all over the world due to COVID 19 outbreak.

5.4. Looking forward, the COVID-19 outbreak continues to put pressure all economies, with many central banks and governments taking emergency action effectively stalling the economy though lockdowns and unprecedented amounts of central government support to business and individuals.

Recovery from this global recession, will depend on when and how quickly we move out lockdown, which business survive and how government spending is impacted. At the time of writing this report there are a number of uncertainties in the market including the prospect of negative rates in the UK, another round of austerity and a second wave of the virus.

In addition, the UK also still have Brexit on the agenda with the final deadline for leaving and getting a trade deal being December 2020.

5.5. Elsewhere the US economy grew by 2.1% in 2019, while growth in the EU fell to 0.9% in 2019.

6. Conclusions

6.1. The Council has operated in line with its Treasury and Prudential Indicators and overall investments have performance well earning the council an extra £61k in income. Uncertainty continues over the UK economy and interest rates into 2020/21.

6.2. The capital programme out-turn has led to no new borrowing being required as cash reserves have been used to fund capital. The borrowing position will continue to be kept under review.