Treasury Management activity and treasury and prudential indicators 2019-20

1. Introduction

1.1 The treasury management service is an important part of the overall financial management of the council. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions.

1.2 Strict regulations, such as statutory requirements and the CIPFA treasury management code of practice (the TM Code) govern the council's treasury activities, and the Prudential Code and MHCLG Investment Guidance non-treasury investments.

1.3 The Council holds a substantial amount of Investment property (non-treasury investment) and has a large capital programme which directly impacts on the treasury management decisions the Council may make.

2. Treasury management activity

2.1 The council has an integrated capital and investment strategy and manages its cash as a whole in accordance with its approved strategy. Therefore, overall borrowing may arise because of all the financial transactions of the council (for example, borrowing for cash flow purposes) and not just those arising from capital expenditure reflected in the Capital Financing Requirement (CFR).

Investments

2.2 The Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance requires local authorities to focus on security and liquidity rather than yield.

2.3 Both the CIPFA Code and government guidance requires local authorities to invest funds prudently, and to have regard to the security and liquidity of investments before seeking the highest rate of return, or yield. The main objective, therefore, when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitable low investment income.

2.4 Security of capital remains our main objective when placing investments. We maintained this during the year by following our investment policy, as approved in our treasury management strategy 2018-19, which defined "high credit quality" counterparties as those having a long-term credit rating of A- or higher.

2.5 Investments during the year included:

- investments in AAA rated constant net asset money market funds
- call accounts and deposits with banks and building societies systemically important to each country's banking system. We do have some investments with overseas banks, but in sterling

- other local authorities
- corporate bonds
- non-rated building societies
- covered bonds
- pooled funds without a credit rating, but only those subject to an external assessment

2.6 We divided our investments into three types

- short-term (less than one-year) internally managed cash investments
- long-term internally managed investments
- externally managed funds

2.7 Cash balances consisted of working cash balances, capital receipts, and council reserves.

2.8 The table below shows our investment portfolio, at 31 March 2020, compared to 31 March 2019. **Appendix 2** contains a detail schedule of investments outstanding at the end of the year.

Investment details	Balance at 31-03-19 £m	Weighted Avg Return for Year	Balance at 31-03-20 £m	Weighted Avg Return for Year
Internally Managed Investments				
Fixed Investments < 1 year to cover cash flow	6.00	0.96%	20.00	0.99%
Corporate bonds	0.00	1.06%	1.00	1.26%
Certificates of deposit	0.00	0.68%	18.10	1.06%
Notice Accounts	8.00	0.78%	8.00	0.90%
Call Accounts	0.00	0.37%	0.53	0.40%
Money Market Funds	13.23	0.66%	14.50	0.74%
Revolving credit facility	9.50	2.28%	5.00	1.26%
Long term investments > 1 year	48.65	1.17%	27.50	1.65%
Externally Managed Funds				
Payden & Rygel	0.00	0.64%	0.00	0.00%
Funding circle	0.51	6.22%	0.53	6.35%
CCLA	6.87	4.37%	6.51	4.41%
RLAM	0.00	0.00%	2.23	2.42%
M&G	1.39	3.20%	1.13	2.54%
Schroders	0.86	7.58%	0.57	7.31%
UBS	2.31	3.99%	2.02	4.71%
City Financials	0.00	2.68%	0.00	0.00%
Total Investments	**97.32**	**1.03%**	**107.61**	**1.56%**

2.9 Our level of investments increased during 2019-20, and we achieved a higher return than last year. Interest rates were higher for the majority of the financial year, with rates lowering in the last quarter as COVID-19 started to spread across the world.

2.10 The Councils also holds £5.460 million equity investments in Guildford Holdings Ltd and £8.183 million in North Downs Housing Ltd.

2.11 We are earning an interest return of base rate plus 5% (currently 5.10%) on the investment in North Downs Housing. This is higher than the return earned on treasury investments, but reflects the additional risks to the Council of holding the investment.

Security of investments

2.12 Counterparty credit quality was assessed and monitored with reference to credit ratings; financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices; financial statements; information on potential government support and reports in the quality financial press.

2.13 We also considered the use of secured investment products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

2.14 The minimum long-term counterparty credit rating for ‘high quality counterparties’ approved for 2019-20 was A-/A3 across all three main credit rating agencies (Fitch, S&P, and Moody’s).

2.15 The overall minimum long-term credit rating in the treasury strategy is BBB+. The strategy set different limits for different counterparty credit ratings both in maximum duration and exposure in monetary terms.

2.16 We also have the ability to invest in non-rated institutions subject to due diligence.

Liquidity of investments

2.17 In keeping with the MHCLG’s Guidance on Investments, the council maintained a sufficient level of liquidity using money market funds, call accounts, the maturity profile of fixed investments and short-term borrowing from other local authorities.

2.18 We use PSlive as our daily cash flow forecasting software to determine the maximum period for which funds may prudently be committed.

Yield of investments

2.19 The council sought to optimise returns commensurate with its objective of security and liquidity. The Bank of England base rate decreased to 0.10% in March 2020. Yields had been slowly increasing but declined rapidly when COVID-19 hit.

2.20 We invested in longer-term covered bonds, which increased the return of the portfolio and the duration. Bonds can be sold in the secondary market should we need the liquidity.

2.21 The council’s budgeted investment income for the year was £1.741 million and actual interest was £2.172 million.

Externally managed funds

2.22 We estimate to have substantial cash balances over the medium-term (our “core” cash as identified in the Councils liability benchmark), and as such we have continued investing in pooled (cash-plus, bond, equity, multi-asset and property) funds. These funds, have allowed us to diversify into asset classes other than cash without the need to own and manage the underlying investments. These funds operate on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short term. All of our pooled funds are in the respective funds distributing share class, which pay out the income generated. They have no defined maturity date, but are available for withdrawal, some with a notice period.

2.23 We regularly monitor all our external funds' performance and continued suitability in meeting our investment objectives.

Borrowing and debt management

2.24 The council's debt portfolio is detailed in the table below. Our loan portfolio increased by £23.8 million due to more short term loans at the end of the year.

Interest calc	Lender	Loan type	Principal £'000	Initial loan period (yrs)	Period remaining years	Maturity date	Rate
Long-term							
Fixed	PWLB	EIP	230	10	3.0	31/03/2021	3.60%
Variable	PWLB	Maturity	45,000	10	4.0	28/03/2022	0.96%
Fixed	PWLB	Maturity	10,000	12	6.0	28/03/2024	2.70%
Fixed	PWLB	Maturity	10,000	13	7.0	28/03/2025	2.82%
Fixed	PWLB	Maturity	10,000	14	8.0	28/03/2026	2.92%
Fixed	PWLB	Maturity	10,000	15	9.0	28/03/2027	3.01%
Fixed	PWLB	Maturity	25,000	17	11.0	28/03/2029	3.15%
Fixed	PWLB	Maturity	25,000	20	14.0	28/03/2032	3.30%
Fixed	PWLB	Maturity	25,000	25	19.0	28/03/2037	3.44%
Fixed	PWLB	Maturity	15,000	29	23.0	28/03/2041	3.49%
Fixed	PWLB	Maturity	17,435	30	24.0	28/03/2042	3.50%
Short-term							
Fixed	Broxbourne BC	Maturity	2,000	0.75	1.0	01/04/2020	0.80%
Fixed	LB Havering	Maturity	5,000	0.75	1.1	22/04/2020	0.82%
Fixed	Stockport MBC	Maturity	10,000	0.08	1.1	27/04/2020	1.00%
Fixed	LB Ealing	Maturity	2,000	1.00	1.1	19/05/2020	0.95%
Fixed	Cambridge CC	Maturity	3,000	1.00	1.1	19/05/2020	0.95%
Fixed	Rushcliffe BC	Maturity	5,000	1.00	1.1	20/05/2020	0.95%
Fixed	Cambridge & Peterborou	Maturity	8,000	0.92	1.1	20/05/2020	0.80%
Fixed	South Derbyshire	Maturity	3,000	1.00	1.2	01/06/2020	0.93%
Fixed	West Dumbartonshire	Maturity	6,000	1.00	1.4	07/09/2020	0.75%
Total			**236,665**				

2.25 Our primary objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should our long-term plans change being a secondary objective.

2.26 The rate on the variable rate loan is the average for the year.

2.27 We also have short-term loans outstanding at the end of the year which we took out for cash flow purposes, from other local authorities. Temporary and short-dated loans borrowed during the year from other local authorities remained affordable and attractive.

2.28 Affordability and the “cost of carry” remained important influences on our long-term borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would be invested at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained low, and are likely to remain low at least over the forthcoming two years, lower than long-term rates, the council determined it was more cost effective in the short-term to use internal resources and borrow short-term to medium-term instead.

2.29 The Councils borrowing position is monitored regularly as to whether it is more beneficial to externalise borrowing now or whether to continue internal borrowing based on predicted future borrowing costs (which are likely to be higher). Arlingclose assist us with this ‘cost of carry’ and break even analysis.

2.30 The PWLB raised the cost of the certainty borrowing rate by 1% to 1.8% above UK Gilt yields as HM Treasury were concerned about the overall level of local authority debt. PWLB borrowing remains available, but at a margin of 180bp above gilts appear expensive. Market alternatives are available and new products will be developed but the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

2.31 The Chancellor’s March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB’s future direction. Announcements included a reduction in the margin on new HRA loans to 0.80% above equivalent gilt yields. The value of this discount is 1% below the rate at which the authority usually borrows from the PWLB), available from 12th March 2020 and £1.15 billion of additional “infrastructure rate” funding at gilt yields plus 0.60% to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

2.32 The consultation titled “Future Lending Terms” represents a frank, open and inclusive invitation, allowing key stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals on allowing authorities that are not involved in “debt for yield” activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield without impeding their ability to pursue their core policy objectives of service delivery, housing, and regeneration. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

2.33 The consultation closes end of July with implementation of the new lending terms expected in the latter part of this calendar year or financial year beginning 2021-22.

3. Treasury and prudential indicators

3.1 The Local Government Act 2003 requires local authorities to have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury decisions are taken in accordance with good professional practice. To demonstrate the Council has fulfilled these objectives, the Prudential Code sets various indicators that must be set and monitored each year.

3.2 The CFO confirms that we have complied with our prudential indicators for 2019-20, which were approved in February 2019 as part of the treasury management strategy statement. The CFO also confirms that we have complied with our treasury management policy statement and treasury management practices during 2019-20.

Balance sheet and treasury position prudential indicator

3.3 The capital financing requirement (CFR) measures the council's underlying need to borrow for a capital purpose. Over the medium-term, borrowing must be only for a capital purpose, although in the short-term, we can borrow for cash flow purposes, which does not affect the CFR.

3.4 The council's CFR for 2019-20 is shown in the following table

Capital Financing Requirement	**2019-20 Approved Estimate £000**	**2019-20 Revised Estimate £000**	**2019-20 Actual £000**
HRA			
Opening balance (01 Apr 19)	197,024	197,024	197,024
Movement in year: Unfinanced cap exp	0	0	0
Closing balance (31 Mar 20)	197,024	197,024	197,024
General Fund			
Opening balance (01 Apr 19)	119,915	100,552	106,939
Movement in year: Unfinanced cap exp	49,925	43,709	18,345
Movement in year: MRP	(1,019)	(1,019)	(927)
Closing balance (31 Mar 20)	168,821	143,242	124,357
Total			
Opening balance (01 Apr 19)	316,939	297,576	303,963
Movement in year: Unfinanced cap exp	49,925	43,709	18,345
Movement in year: MRP	(1,019)	(1,019)	(927)
Closing balance (31 Mar 20)	365,845	340,266	321,381
Balances and Reserves	(154,409)	(168,628)	(133,189)
Cumulative net borrowing requirement / (investments)	**211,436**	**171,638**	**188,192**

3.5 The GF unfinanced capital expenditure mainly relates to property purchases, internal estate road and loan / equity to North Downs housing. This is lower than budgeted because of the slippage in the capital programme – we projected some slippage during the year, which is shown by the revised estimate (as in the strategy report presented to Council in February 2020).

3.6 We budgeted an underlying need to borrow of £86.7 million for 2019-20, and our actual underlying need to borrow was £18.3 million because of slippage in the capital programme and also a higher amount of capital receipts than anticipated.

Gross debt and the CFR

3.7 We monitor the CFR to gross debt continuously to ensure that, over the medium term, borrowing is only for a capital purpose and does not exceed the CFR. This is a key indicator of prudence. We will report any deviations to the CFO for investigation and appropriate action. The following table shows the council is in a net internal borrowing position and gross debt does not exceed the CFR over the period.

Gross Debt and the CFR	2019-20 Actual £000
General Fund CFR	124,357
HRA CFR	197,024
Total CFR (at 31 March)	**321,381**
Gross External Borrowing	(236,665)
Net (external) / internal borrowing position	**84,716**

3.8 Actual debt levels are monitored against the operational boundary and authorised limit for external debt, detailed in paragraph 3.20 to 3.25.

3.9 We are showing as being internally borrowed up to £124 million in at the end of March 2020.

Capital expenditure prudential indicator

3.10 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on council tax or housing rent levels for the HRA.

3.11 The following table shows capital expenditure in the year, compared to the original estimate approved by the Executive in January 2019.

Projects	Original Estimate (£'000)	Actual (£'000)	Variance (£'000)
Housing Revenue Account			
HRA Capital Programme	8,973	8,887	(86)
Total Housing	**8,973**	**8,887**	**(86)**
General Fund			
Rodboro through road	450	7	0
Spectrum roof & CHP	300	164	(136)
Public Realm	1,425	19	(1,406)
Internal Estate road	6,500	8,278	1,778
A331 hotspots	2,230	121	(2,109)
Town centre approaches	1,033	7	(1,026)
Ash road bridge	4,060	1,260	(2,800)
Town centre gateway regeneration	3,481	7	(3,474)
Guildford Park CP	3,509	706	(2,803)
Midleton redevelopment	3,649	1,641	(2,008)
Strategic property	4,647	7,024	2,377
WUV	6,000	10,414	4,414
Provisional schemes	17,576	0	(17,576)
Other General Fund Projects	30,947	18,421	(12,526)
Total General Fund	**85,807**	**48,069**	**(37,295)**
Total Capital Programme	**94,780**	**56,956**	**(37,380)**

3.12 The table shows that there was a lot of slippage in the capital programme. This was mainly over a few larger schemes including:

- provisional schemes were re-profiled during the year, and include:
    - various transport schemes
    - ash road bridge
    - Guildford park car park
    - Midleton redevelopment

3.13 The following table shows the financing of capital expenditure in the year, compared with the original approved estimate.

CAPITAL EXPENDITURE - SUMMARY	**Original Estimate (£'000)**	**Actual (£'000)**
General Fund Capital Expenditure		
- Main programme	78,177	45,041
- Reserve & s106 Capital Schemes	6,805	2,386
- General Fund Housing	825	645
HRA Capital expenditure		
- Main programme	8,973	8,887
Total Capital Expenditure	**94,780**	**56,959**
CAPITAL EXPENDITURE - SUMMARY	**Original Estimate (£'000)**	**Actual (£'000)**
General Fund Capital Expenditure Financed by:		
- Borrowing/Use of Balances	(53,355)	(18,345)
- Capital Receipts	0	(18,112)
- Capital Grants/Contributions	(18,703)	(8,421)
- Capital Reserves/Revenue	(13,749)	(3,194)
HRA Capital Expenditure Financed by:		
- Capital Receipts	(4,692)	(1,491)
- Capital Reserves/Revenue	(4,281)	(7,396)
Financing - Totals	**(94,780)**	**(56,959)**

3.14 GF borrowing was less than budgeted because of slippage in the capital programme, and an increase in the opening of available capital resources which reduced the need for internal borrowing in the year.

Ratio of financing costs to the net revenue stream prudential indicator

3.15 This is an indicator of affordability and highlights the revenue impact of capital expenditure by identifying the proportion of the revenue budget required to meet the financing costs associated with capital spending. Financing costs include interest on borrowing, MRP, premium or discount on loans repaid early, investment income and depreciation where it is a real charge.

3.16 Depreciation is not a real charge to the GF, but has been to the HRA since April 2012.

3.17 The ratio is based on costs net of investment income.

3.18 The net revenue stream for the GF is the total budget requirement and for the HRA is total income. Where the figure is negative, it is because there is a net investment position (more investments than debt). The total budget requirement for the GF used is the 2019-20 budget.

	2019-20 Original Estimate	2019-20 Actual
General Fund	10.61%	-1.60%
HRA	33.09%	34.18%

3.19 The figure for the GF is negative because interest received is higher than financing costs (interest payable, debt management costs and MRP). The budget assumed a large amount of external borrowing for the capital programme which was not required and was reported throughout the year as part of budget monitoring.

The authorised limit prudential indicator

3.20 The Local Government Act 2003 requires the council to set an affordable borrowing limit, irrespective of the indebted status. This is a statutory limit, which we cannot breach.

3.21 The limit is the maximum amount of external debt we can legally owe at any one time. It is expressed gross of investments and includes capital expenditure plans, the CFR and cash flow expenditure. It also provides headroom over and above for unexpected cash movements.

3.22 The limit was set at £591 million for the year and the highest level of debt was £230 million.

3.23 We measure the levels of debt on an ongoing basis during the year for compliance. The CFO confirms there were no breaches to the authorised limit in 2019-20.

The operational boundary prudential indicator

3.24 The operational boundary, based on the same estimates as the authorised limit, reflects the most likely, prudent but not worst case scenario. It does not allow for additional headroom included in the authorised limit.

3.25 The limit was set at £535 million for the year and the highest level of debt was £230 million.

Upper limit for fixed and variable interest rate exposures treasury indicator

3.26 This indicator is set to control exposure to interest rate risk. We calculate exposures on a net basis (fixed rate debt net of fixed rate investments). We take fixed rate to be if it was taken out as a fixed rate loan/investment regardless of its duration.

Net Debt / (Investments) on Principal outstanding	2019-20 Actual £000
Limits on fixed interest rates	179,680
Limits on variable interest rates	(17,495)

3.27 The above shows the peak in the year. Variable is negative because we had more variable rate investments than debt. We include our external funds as variable rate investments.

Maturity structure of fixed rate borrowing treasury indicator

3.28 The aim of this indicator is to control our exposure to refinancing risk (large concentrations of fixed rate debt needing refinancing at once). We calculate this as the amount of fixed rate borrowing maturing in each period as a percentage of fixed rate borrowing.

	Upper Limit	Lower Limit	Actual at 31 March 2020	Value of loans maturing
Under 12 months	15%	0%	1.49%	2,230,000
1-2 years	20%	0%	0.15%	230,000
3 to 5 years	25%	0%	6.67%	10,000,000
6 to 10 years	50%	0%	36.69%	55,000,000
11-15 years	100%	0%	16.68%	25,000,000
16-20 years	100%	0%	16.68%	25,000,000
21-25 years	100%	0%	21.64%	32,435,000

3.29 The above table shows the amount of debt maturing in each period and its percentage of total fixed rate loans. The targets were set to give us flexibility for drawing down new loans on a fixed or variable rate basis. If a lower upper limit for fixed rate debt were set, the council would be giving itself a greater exposure to interest rate changes by having more variable rate debt. The upper limit for under 12 months was set to cover any short-term borrowing for cash flow purposes and for allowing for the principal loan repayments falling in that period.

3.30 The limit for that maturing within 12 months is higher due to short-term borrowing levels. 45% of our fixed rate debt matures within the next 10 years, with the majority being in years 6-10. This gives the council stability in its interest payments over that time, and time to consider refinancing options. The first fixed rate loan matures in 2024.

Actual external debt treasury indicator

3.31 This indicator comes directly from our balance sheet. It is the closing balance for actual gross borrowing (short and long term) plus other deferred liabilities. It is measured in a manner consistent for comparison with the authorised limit and operational boundary.

3.32 Actual external debt (as per 3.7) stood at £237 million.

Upper limit for total principal sums invested over 1 year

3.33 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the council having to seek early repayment of the sums invested.

3.34 Our limit was set at £50 million, we ended the year with exposure of £45.6 million.

3.35 As mentioned earlier in the report, many of our long-term investments are covered bonds, which can be sold on the secondary market. There could be a price differential if they were sold, but it is unlikely to be material.