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| WARWICK DISTRICT COUNCIL | **Finance and Audit Scrutiny Committee**<br>**19 August 2020** | **Agenda Item No.** |

| | |
|---|---|
| **Title** | 2019/20 Annual Treasury Management Report |
| **For further information about this report please contact** | Richard Wilson, Principal Accountant (Capital & Treasury)<br>01926 456801<br>e mail: richard.wilson@warwickdc.gov.uk |
| **Wards of the District directly affected** | None |
| **Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006** | No |
| **Date and meeting when issue was last considered and relevant minute number** | N/A |
| **Background Papers** | Treasury Management Information via External Advisers, Brokers, External Investment Agents etc. |

| | |
|---|---|
| **Contrary to the policy framework:** | No |
| **Contrary to the budgetary framework:** | No |
| **Key Decision?** | No |
| **Included within the Forward Plan? (If yes include reference number)** | 1139 |
| **Equality & Sustainability Impact Assessment Undertaken** | No – not relevant |

**Officer/Councillor Approval**

| **Officer Approval** | **Date** | **Name** |
|---|---|---|
| Chief Executive | 6/8/20 | Chris Elliott |
| Head of Service | 1/8/20 | Mike Snow |
| CMT | 6/8/20 | |
| Section 151 Officer | 1/8/20 | Mike Snow |
| Monitoring Officer | 7/8/20 | Andrew Jones |
| Finance | 22/7/20 | Richard Wilson |
| Portfolio Holder(s) | 4/8/20 | Cllr Richard Hales |

**Consultation & Community Engagement**

None

| | |
|---|---|
| **Final Decision?** | Yes |

**Suggested next steps (if not final decision please set out below)**

N/A

## 1. Summary

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). This report covers the Council's performance for the whole of 2019/20 and is attached as Appendix A.

## 2. Recommendations

2.1. That the Members of the Finance & Audit Scrutiny Committee note the contents of this report in respect of the Council's Treasury Management activities during 2019/20.

## 3. Reasons for the recommendations

3.1. The Treasury Management Strategy for 2019/20 and the Council's Treasury Management Practices, in accordance with the Code of Practice for Treasury Management, require that the Treasury Management function reports on its activities during the year by no later than 30 September in the year after that being reported on. This date remains in place despite COVID-19.

3.2. During 2019/20 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 25/3/2020[1])
- a mid-year (minimum) treasury update report (Finance & Audit Scrutiny 12/11/2019)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

3.3. In addition, this Council receives a half-yearly treasury management update reports for the second half of 2019/20 and which accompanies this report.

3.4. 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.

3.5. This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports

[1] Due to the outbreak of COVID-19 this decision was taken by the Chairman and Group Leaders in consultation with each other. The decision was taken in the absence of Council meeting due to the restrictions on public gatherings that are in place and will be ratified by Council the next time it is able to meet.

by the Finance & Audit Scrutiny Committee before they were reported to the full Council.

3.6. Member training on treasury management issues was undertaken during the year on 26 November 2019 in order to support members' scrutiny role.

3.7. Consideration of the Council's Treasury Management activities is within the remit of the Finance & Audit Scrutiny Committee on behalf of full Council; consequently, it is appropriate to report the Council's annual performance direct to this Committee.

3.8. The report follows the format used in the Treasury Management Strategy Plan presented to the Council on 25 March 2020 (see footnote) and comments, where appropriate, on the Council's actual performance against what was forecast in the Strategy Plan as well as, in certain instances, latest forecasts. The Council is also required to comment on its performance against its Annual Investment Strategy for the year.

3.9. The report consists of the following Appendices:

Appendix A - Annual Treasury Management Report 2019/20
Appendix B – Glossary of Terms

## 4. Policy Framework

4.1. **Fit for the Future (FFF)**

The Council's FFF Strategy is designed to deliver the Vision for the District of making it a Great Place to Live, Work and Visit. To that end, amongst other things, the FFF Strategy contains several Key projects. This report shows the way forward for implementing a significant part of one of the Council's Key projects.

The FFF Strategy has 3 strands – People, Services and Money and each has an external and internal element to it. The table below illustrates the impact of this proposal if any in relation to the Council's FFF Strategy.

| **FFF Strands** | | |
|---|---|---|
| **People** | **Services** | **Money** |
| **External** | | |
| **Health, Homes, Communities** | **Green, Clean, Safe** | **Infrastructure, Enterprise, Employment** |
| <u>Intended outcomes:</u><br>Improved health for all.<br>Housing needs for all met.<br>Impressive cultural and sports activities. | <u>Intended outcomes:</u><br>Becoming a net-zero carbon organisation by 2025.<br>Total carbon emissions within Warwick District | <u>Intended outcomes:</u><br>Dynamic and diverse local economy.<br>Vibrant town centres. |

| FFF Strands | | |
|---|---|---|
| **People** | **Services** | **Money** |
| Cohesive and active communities. | are as close to zero as possible by 2030.<br>Area has well looked after public spaces.<br>All communities have access to decent open space.<br>Improved air quality<br>Low levels of crime and ASB. | Improved performance/ productivity of local economy.<br>Increased employment and income levels. |
| **Impacts of Proposal** | | |
| The Treasury Management function enables the Council to meet its vision by maximising investment returns and minimising borrowing costs, while managing the risk to the Council's funds and maintaining liquidity. This protects services and benefits the Council's customers and other stakeholders. | | |
| **Internal** | | |
| **Effective Staff** | **Maintain or Improve Services** | **Firm Financial Footing over the Longer Term** |
| <u>Intended outcomes:</u><br>All staff are properly trained.<br>All staff have the appropriate tools.<br>All staff are engaged, empowered and supported.<br>The right people are in the right job with the right skills and right behaviours. | <u>Intended outcomes:</u><br>Focusing on our customers' needs.<br>Continuously improve our processes.<br>Increase the digital provision of services. | <u>Intended outcomes:</u><br>Better return/use of our assets.<br>Full Cost accounting.<br>Continued cost management.<br>Maximise income earning opportunities.<br>Seek best value for money. |
| **Impacts of Proposal** | | |
| The Treasury Management function enables the Council to meet its vision. | | |

4.2. **Supporting Strategies**

Each strand of the FFF Strategy has a number of supporting strategies. The Treasury Management function is consistent with the relevant supporting strategies. Following the Treasury Management principles of Security, Liquidity and Yield (SLY) provides the financial stability for the Council to operate effectively.

4.3. **Changes to Existing Policies**

The Treasury Management function is in accordance with existing policies and national regulatory framework.

4.4. **Impact Assessments**

No impacts of new or significant policy changes proposed in respect of Equalities.

## 5. Budgetary framework

5.1. Treasury Management has a potentially significant impact on the Council's budgets through its ability to maximise its investment interest income and minimise borrowing costs.

5.2. The Council relies on interest received to fund the services it provides. The gross interest received in 2019/20, including non-Treasury Management interest, was £1,227,800. The interest paid to the HRA on its balances was £490,100, with a net of £737,600 retained by the General Fund. The table below compares this with budgeted figures:

| | Original 2019/20 Budget £'000 | Latest 2019/20 Budget £'000 | 2019/20 Actual £'000 |
|---|---|---|---|
| Gross investment interest | 1,096 | 1,091 | 1,228 |
| *less* HRA allocation | -624 | -422 | -490 |
| **Net interest to General Fund** | **472** | **670** | **738** |

5.3. The reasons for the increase against that budgeted are a combination of lower than forecast interest rates, offset by higher than expected levels of year-end reserves and balances (especially for the HRA), in part due to a slower rate of capital expenditure than assumed.

5.4. Borrowing costs to the HRA from the 2012 Self-Financing are unchanged from previous financial years and are charged directly to the HRA. The new £12 million PWLB loan taken during 2019/20 is charged to the General Fund. The full year interest costs are £220,800[2].

## 6. Risks

6.1. Continued uncertainty in the aftermath of the 2008 financial crisis, brought into sharp focus by the COVID-19 pandemic, has promoted a cautious approach, whereby investments are now dominated by low counterparty risk considerations, with relatively low returns compared to borrowing rates.

6.2. Investing the Council's funds inevitably creates risk; Treasury Management

[2] Actual cash paid for 2019/20 was £99,000 for the period 16 September 2019 to 28 February 2020 with a further £20,700 accrued to 31 March 2020.

aims to manages risk through the application of the SLY principle: Security(S) ranks uppermost followed by Liquidity (L) and finally Yield(Y).

6.3. In addition to credit ratings themselves, the Council has regard to any ratings watch notices issued by the rating agencies, as well as articles in the Financial press, market data and intelligence from benchmarking groups. It will also use Credit Default Swap (CDS) data as supplied by its treasury advisers (Link Asset Services) to determine the suitability of investing with counterparties.

6.4. Corporate Bonds and Floating Rate Notes (FRNs), if utilised, introduce counterparty credit risk into the portfolio by virtue of the fact that it is possible that the institution invested in could become bankrupt, leading to the loss of all or part of the Council's investment. This is mitigated by only investing in Corporate Bonds or FRNs with a strong Fitch credit rating, in this case 'A', and issued as Senior Unsecured debt which ranks above all other debt in the case of a bankruptcy.

6.5. Covered Bonds also reduce risk since the bond is 'backed' by high quality assets such as prime residential mortgages, ensuring that if the bond issuer defaults there are sufficient assets that can be realised in order to repay the bond in full.

6.6. While Corporate Equity Funds can help to ensure capital security in real (as opposed to nominal) terms, they consequently introduce the risk of capital loss due to market price fluctuations. This was evidenced with extreme movements worldwide in March 2020 as the extent and far-reaching consequences of COVID-19 saw investors 'take flight'. There has been some recovery from the initial 'crash' in March but the financial markets worldwide remain volatile. These type of investments must always be regarded as relatively long-term commitments to smooth out movements, both cyclical and in response to crises.

6.7. Under current (temporary) five-year accounting requirements the Council is required to take revaluation gains or losses to the Financial Instruments Revaluation Reserve, which has lessened the likely use of the Investment Rate Volatility Reserve, set up in February 2018 to mitigate against any adverse losses.

## 7. Alternative option considered

7.1. As explained in section 1 and paragraph 3.1, the Code of Practice mandates that Annual Treasury Management Performance must be reported by 30 September after that financial year has closed.

7.2. The Council has announced that it is to seek to divest from fossil fuels at the earliest opportunity; no later than the end of 2025, and ideally by the end of 2022. However, given the very significant losses incurred by the two equity funds since the COVID-19 outbreak[3] it may be very costly to divest by the earlier date as any losses would have to be charged to the General Fund revenue account in that financial year.

7.3. The Council may consider varying its investment vehicles or counterparty limits, however this would alter the potential credit and liquidity risks.

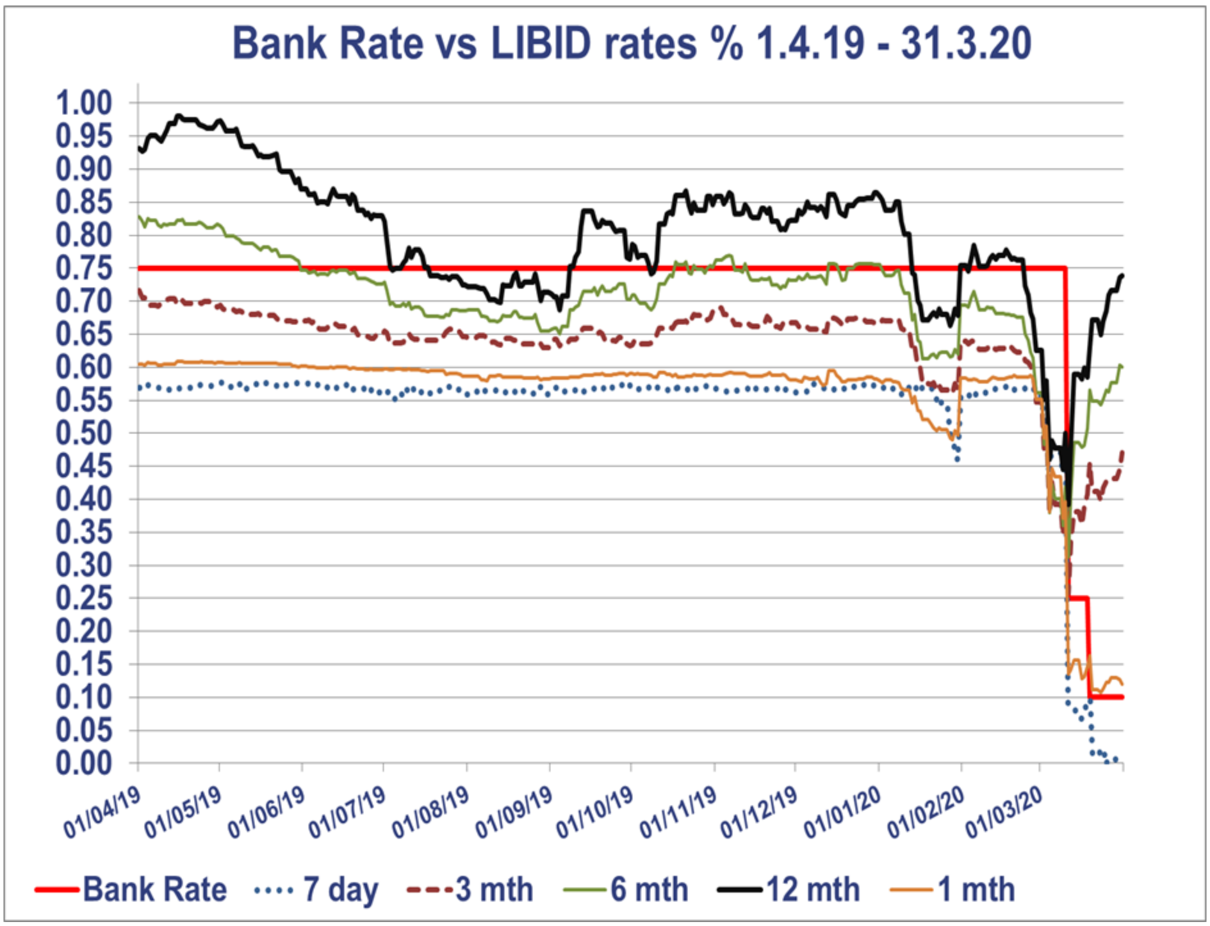
[3] Since inception the loss of value was around £878,000 at the end of March 2020, compared with £337,000 at the end of June 2020

**APPENDIX A**

## 2019/20 Annual Treasury Management Report

### 1. Investment strategy and control of interest rate risk

1.1. Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year. The table below shows rate movements during the year:




1.2. Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January 2020 departure of the UK from the EU. When the coronavirus (COVID-19) outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was, therefore, sought by placing longer term investments where cash balances were sufficient to allow this. This has placed the Council in a well-protected position against benchmarks for the first two quarters of 2020/21.

1.3. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far abler to cope with extreme stressed market and economic conditions.

1.4. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets, i.e. borrowing is deferred. External borrowing would have incurred an additional carrying cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

## 2. Borrowing strategy and control of interest rate risk

2.1. During 2019-20, the Council maintained an under-borrowed position. This meant that the capital borrowing need (the Capital Financing Requirement) 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.

2.2. A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

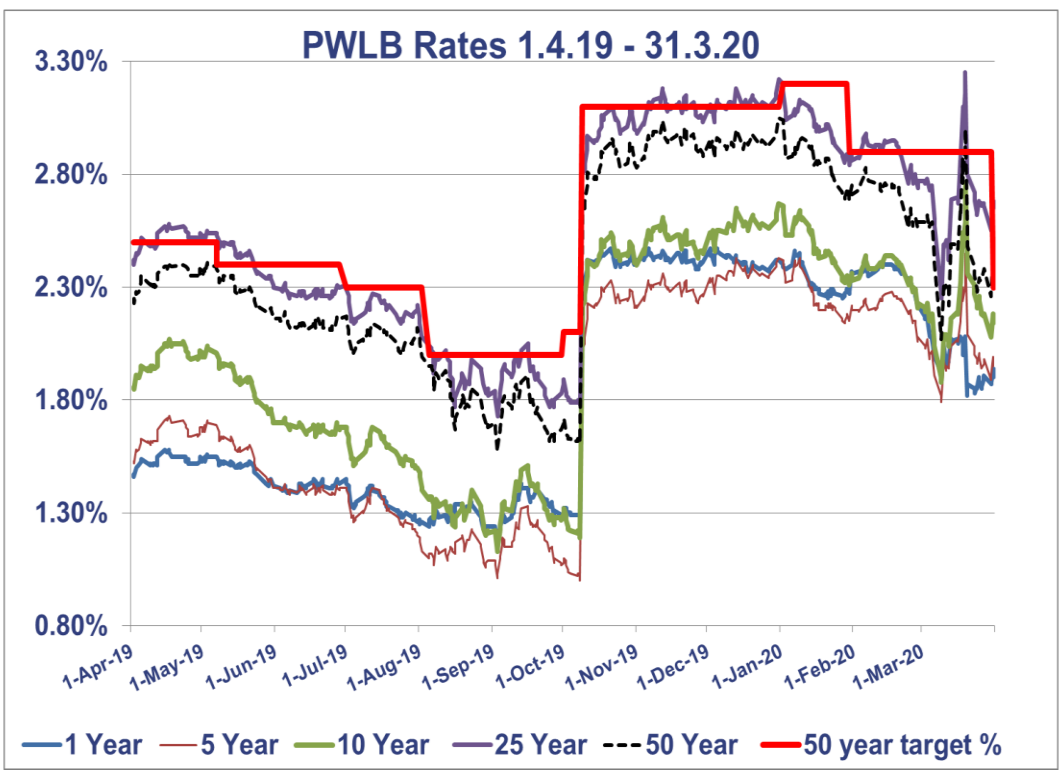
2.3. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

2.4. Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Treasury team monitored interest rates in financial markets and adopted a pragmatic strategy based on the following principle to manage interest rate risks:

- During the mid-point of 2019/20 it had been felt that there was a significant risk of a much sharper rise in long and short term rates than initially expected, due to a number of factors, including Brexit, potentially leading to an increase in world economic activity or a sudden increase in inflation risks, as well as increased Government scrutiny in the use of PWLB loans for commercial investments. Therefore, it was decided to draw down long-term General Fund borrowing that had been on hold, whilst interest rates were lower than they were projected (at September 2019) to be in the next few years.

2.5. Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

| Link Asset Services Interest Rate View | 31.3.20 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
| Bank Rate View | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 3 Month LIBID | 0.45 | 0.40 | 0.35 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| 6 Month LIBID | 0.60 | 0.55 | 0.50 | 0.45 | 0.40 | 0.40 | 0.40 | 0.40 |
| 12 Month LIBID | 0.75 | 0.70 | 0.65 | 0.60 | 0.55 | 0.55 | 0.55 | 0.55 |
| 5yr PWLB Rate | 1.90 | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.10 | 2.10 |
| 10yr PWLB Rate | 2.10 | 2.10 | 2.10 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 |
| 25yr PWLB Rate | 2.50 | 2.50 | 2.50 | 2.60 | 2.60 | 2.60 | 2.70 | 2.70 |
| 50yr PWLB Rate | 2.30 | 2.30 | 2.30 | 2.40 | 2.40 | 2.40 | 2.50 | 2.50 |



2.6. PWLB 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. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields.

2.7. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

2.8. Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks also started quantitative easing purchases of Government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.

2.9. However, H.M. Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019/20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then partially reversed for some forms of borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ended on 4 June. It is clear that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

2.10. Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows:

- **PWLB Standard Rate:** gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate:** gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate:** gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate:** gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate:** gilt plus 60bps (G+60bps)

2.11. There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

## 3. Borrowing Outturn

3.1. **Borrowing** – £12 million of PWLB loans were drawn to fund unfinanced General Fund capital expenditure. There is no naturally maturing debt until 2053.

3.2. **Rescheduling** - No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling economically unviable. This is likely to remain the case for several years.

3.3. **Summary of debt transactions** – The £148.157m debt portfolio had an average interest rate of 3.28% and incurred £4.865m interest in cash terms, of which £4.766m was charged to the HRA in relation to the Self-Financing borrowing incurred in 2011/12.

## 4. Investment Outturn

4.1. **Investment Policy** – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 17 April 2019 (Executive 6 February 2019). 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, (such as rating outlooks, credit default swaps, bank share prices, etc.).

4.2. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

4.3. **Resources** – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as below, showing a reduction of £6.363 million (8.3%):

| Balance Sheet Resources | 31/3/19 £'000 | 31/3/20 £'000 | Movement £'000 |
|---|---|---|---|
| Balances (GF, Collection Fund) | 2,947 | 1,174 | -1,773 |
| Balances (HRA) | 9,553 | 7,983 | -1,570 |
| Earmarked reserves / other balances | 50,507 | 47,872 | -2,635 |
| Provisions | 4,789 | 5,656 | 867 |
| Capital Receipts Reserve | 8,509 | 7,257 | -1,252 |
| **Total** | **76,305** | **69,942** | **-6,363** |

4.4. **Investments held by the Council**

- The Council maintained an average balance of £78.9m of internally managed funds.
- The internally managed funds earned an average rate of return of 0.82%.
- The comparable performance indicator is the average 7-day and up to 3-months LIBID rate, which was 0.69%.
- This compares with a budget assumption of £74.6m investment balances earning an average rate of 0.80%.
- Investment income excluding externally managed funds and non-treasury management interest was £737,600, compared to a latest budget of £669,800.

4.5. **Investments held by fund managers**

The Council uses two external fund managers to invest part of its cash balances. The performance of the managers (capital movement and dividend) against the benchmark FTSE All-share return was:

| Fund Manager | Investment held (nominal) £'000 | Return | Benchmark |
|---|---|---|---|
| Columbia Threadneedle | 3,000 | -18.0% | -21.9% |
| Royal London | 3,000 | -25.4% | -21.9% |
| **Total** | **6,000** | **-21.7%** | **-21.9%** |

4.6. The budget assumption on the average investment balances of £6.0m was a 4.25% dividend investment return and the actual return was 4.56%. However, this has been dwarfed by the unrealised capital losses of almost £1.4m – excluding dividends - for the financial year 2019/20, shown below.

| Fund Manager | Balance at 31/3/19 £'000 | Dividend 19/20 £'000 | Loss £'000 | Balance at 31/3/20 £'000 |
|---|---|---|---|---|
| Columbia Threadneedle | 3,031 | 133 | -595 | 2,569 |
| Royal London | 3,202 | 152 | -801 | 2,553 |
| **Total** | **6,233** | **285** | **-1,396** | **5,122** |

4.7. Due to the statutory override in place (see paragraph 5.2 below) this 'loss' in capital value does not have to be charged to revenue in the year but should the equity funds be disposed of any gains or losses actually realised do have to be charged to revenue in that year.

4.8. The amount of the two equity funds invested in fossil fuels at 31 March 2020 was 4.9% for Columbia Threadneedle and 8.6% for Royal London; for reference at 30 June the respective figures are 4.4% and 7.1%.

## 5. Other Issues

5.1. **IFRS 9** – The introduction of the 2019/20 Accounting Code of Practice affected the valuation of investments. The key considerations for this Council were:

- Expected credit loss (ECL) model. Whilst this should not be material for the Council's routine 'vanilla' treasury investments such as bank deposits, this is likely to be problematic for some funds that are not currently used (e.g. property funds), and also for non-treasury management investments dealt with in the Council's capital strategy e.g. longer dated service investments, loans to third parties or loans to subsidiaries (see paragraph 5.3 below). The Council's assessment of the ECL of investments was that the level of the potential impairment was immaterial.
- The valuation of investments previously valued under the 'available for sale' category - e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar - has been changed to Fair Value through the Profit and Loss (FVPL).

5.2. Following the consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG), on IFRS 9 the Government introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds, effective from 1 April 2018. The statutory override currently applies for five years from this date, subject to any further extension. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve (the Financial Instruments Revaluation 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. The net loss charged in 2019/20 was £1,105,451.

5.3. **Non-treasury management investments**. These predominantly include long-term debtors, where the borrower repays interest in addition to the principal lent to them. All interest rates are above “soft loan” rates (defined as preferential terms below normal ‘market’ rates). During 2019/20 the Council made long-term loans for capital purposes of £530,000. Details of these loans and the due diligence taken is outlined in the Statement of Accounts 2019/20; none have required impairment under the IFRS 9 ECL model. The purpose of these loans is to stimulate economic development in the District rather than an overriding purpose of income generation, which is a minor consideration with these loans.

5.4. It should be noted that the Government is consulting on PWLB lending to local government and a likely outcome is that councils deemed to be borrowing ‘Debt For Yield’ (i.e. in order to make a commercial return) will be prevented from taking *any* PWLB borrowing in that financial year, even for housing purposes, and would have to repay any loans already taken (with a premium).

## 6. Capital expenditure and financing

6.1. The Council undertakes 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; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

6.2. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure of £28.384m and how this was financed.

| Capital expenditure | 2018/19 Actual £'000 | 2019/20 Budget £'000 | 2019/20 Actual £'000 |
|---|---|---|---|
| General Fund | 9,805 | 12,832 | 7,671 |
| HRA | 11,086 | 42,040 | 20,183 |
| Commercial activities / non-financial investments (long-term loans to third parties) | 5,573 | 630 | 530 |
| **Total (A)** | **26,464** | **55,502** | **28,384** |

| Financing of capital expenditure | 2018/19 Actual £'000 | 2019/20 Budget £'000 | 2019/20 Actual £'000 |
|---|---|---|---|
| Capital receipts | 1,813 | 4,031 | 3,641 |
| Capital grants and contributions | 1,322 | 10,317 | 5,537 |
| Reserves | 11,889 | 27,520 | 18,367 |
| Revenue contributions | 166 | 279 | 298 |
| **Subtotal (B)** | **15,190** | **42,147** | **27,843** |
| **Net borrowing need for the year (A – B)** | **11,274** | **13,355** | **541** |

## 7. Treasury limits and prudential indicators

7.1. The Prudential Capital Finance system, introduced in 2004, is regulated by a number of 'Prudential Indicators', a number of which are relevant for treasury management purposes and are included in the Annual Strategy Report. The table below shows the 2019/20 outturn against the budget and previous year's budget:

| Prudential Indicators (1) | 2018/19 Actual £'000 | 2019/20 Budget £'000 | 2019/20 Actual £'000 |
|---|---|---|---|
| **Authorised Limit for External Debt** | | | |
| Borrowing | 166,853 | 192,728 | 192,728 |
| Other Long term Liabilities | 2,079 | 30 | 30 |
| **Total** | **168,932** | **192,758** | **192,758** |
| **Operational Boundary for External Debt** | | | |
| Borrowing | 148,879 | 173,728 | 173,728 |
| Other Long term Liabilities | 1,079 | 30 | 30 |
| **Total** | **149,958** | **173,758** | **173,758** |
| **Actual External Debt at Year End** | | | |
| Long Term Borrowing | 136,157 | 148,157 | 148,157 |
| Long Term Liabilities | 60 | 30 | 30 |
| **Total** | **136,217** | **148,187** | **148,187** |

| Prudential Indicators (2) | 2018/19 Actual £'000 | 2019/20 Budget £'000 | 2019/20 Actual £'000 |
|---|---|---|---|
| **Actual Capital Expenditure for Year** | | | |
| General Fund | 15,378 | 13,462 | 8,201 |
| Housing Revenue Account | 11,086 | 42,040 | 20,183 |
| **Overall** | **26,464** | **55,502** | **28,384** |

| | | | |
|---|---|---|---|
| **Capital Financing Requirement** | | | |
| General Fund | 20,343 | 20,873 | 20,676 |
| Housing Revenue Account | 135,738 | 150,524 | 135,738 |
| **Total CFR** | **156,081** | **171,397** | **156,414** |
| Gross borrowing position | 136,217 | 148,187 | 148,187 |
| Under (-) / over funding of CFR | -19,864 | -23,210 | -8,227 |

| Prudential Indicators (3) | 2018/19 Actual % | 2019/20 Budget % | 2019/20 Actual % |
|---|---|---|---|
| **Financing Costs as a % of Net Revenue Stream** | | | |
| General Fund | -1.20% | -0.47% | -1.87% |
| Housing Revenue Account | 41.06% | 40.77% | 38.40% |
| **Overall** | **24.85%** | **23.37%** | **21.11%** |

7.2. Below are the indicators relating to borrowing:

**Upper limit to fixed interest rate and variable interest rate exposures**

| Exposure limits | Strategy Report | Actual |
|---|---|---|
| Upper Limit Fixed Rate | 100% | 100% |
| Upper Limit Variable Rate | 30% | 30% |

**Upper and lower limits respectively for the maturity structure of borrowing**

| Strategy 2019/20 (revised) | Fixed | | Variable | |
|---|---|---|---|---|
| **Period** | **Upper** | **Lower** | **Upper** | **Lower** |
| Under 12 months | 12% | 0% | 100% | 0% |
| 12 months and within 24 months | 20% | 0% | 100% | 0% |
| 24 months and within 5 years | 20% | 0% | 100% | 0% |
| 5 years and within 10 years | 20% | 0% | 100% | 0% |
| 10 years and above | 100% | 0% | n/a | n/a |

7.3. In both cases the indicators were complied with as the only external borrowing outstanding at the year-end was the pre-existing £136.157m

PWLB debt in respect of the HRA Self Financing Payment and new £12m General Fund PWLB debt for previous expenditure on leisure centres. This debt is all fixed rate, maturing from years 33 to 42 (2053 to 2062) and, therefore, within both indicators shown above.

7.4. The final indicator monitors the amount invested for periods longer than 365 days which in 2019/20 was set at 70% of the investment portfolio subject to a maximum of £20 million at any one time. During 2019/20 the Council entered into no investments for 365 days or over. Therefore, the indicator was complied with.

## 8. Annual investment strategy and investment performance

8.1. The Government guidance on local government investments requires the production of an Annual Investment Strategy that includes an outline of the investment vehicles that the Council would use and separates them off into Specified and Non Specified investments. The 2019/20 Annual Investment Strategy was approved in February 2019.

8.2. The in-house function has invested the Council's cash funds in fixed term money market deposits, equity funds and Money Market Funds. No Corporate Bonds or Certificates of Deposit (CD's) were used during 2019/20. The table below illustrates the performance for the year of the in-house function for each category invested in (please refer to the second half year report for a breakdown by half year):

| **Vehicle** | **Return** (annualised) **£'000** | **Benchmark** (annualised) **£'000** | **Perform-ance £'000** |
|---|---|---|---|
| Money Markets | 409.9 | 344.1 | 65.9 |
| Money Market Funds | 243.8 | 206.6 | 37.2 |
| Call Accounts | 2.6 | 3.2 | -0.7 |
| **Total** | **656.4** | **553.9** | **102.4** |

**Money Market Investments:**

| Period | Investment Return (annualised) | LIBID Benchmark (annualised) | Out/(under) performance |
|---|---|---|---|
| **Up to 7 days** | | | |
| Annual performance | - | 0.55% | n/a |
| Annual interest | £0 | £0 | £0 |
| **Over 7 days & up to 3 months** | | | |
| Annual performance | 0.86% | 0.69% | 0.17% |
| Annual interest | £12,914 | £10,375 | £2,539 |
| **Over 3 months & up to 6 months** | | | |
| Annual performance | 0.91% | 0.77% | 0.15% |
| Annual interest | £140,274 | £117,843 | £22,431 |
| **Over 6 months to 365 days** | | | |
| Annual performance | 1.00% | 0.84% | 0.16% |
| Annual interest | £256,750 | £215,857 | £40,893 |
| **366 days and Over** | | | |
| Annual performance | - | - | n/a |
| Annual interest | £0 | £0 | £0 |
| **Total Interest For Year** | **£409,938** | **£344,075** | **£65,863** |

**Money Market Funds:**

8.3. Under IFRS 9 there were changes to investment categories, with most Constant Net Asset Value (CNAV) funds, other than those invested in Government bonds, being re-categorised as Low Volatility Net Asset Value (LVNAV).

8.4. The in-house function utilised AAA rated LVNAV (Deutsche, Goldman Sachs, Invesco, Standard Life and Federated) Money Market Funds and Variable Net Asset Value, VNAV, (Federated and Royal London) funds to assist in managing its short term liquidity needs. The table below illustrates the performance of these funds for the full year:

| Money Market Fund | Investment Return (annualised) | LIBID Benchmark (annualised) | Out/(under) performance |
|---|---|---|---|
| **Deutsche** | | | |
| Annual performance | 0.68% | 0.59% | 0.09% |
| Annual interest | £3,418 | £3,162 | £256 |
| **Goldman Sachs** | | | |
| Annual performance | 0.67% | 0.59% | 0.08% |
| Annual interest | £11,899 | £9,979 | £1,920 |
| **Invesco** | | | |
| Annual performance | 0.72% | 0.59% | 0.13% |
| Annual interest | £56,135 | £45,749 | £10,386 |
| **Standard Life** | | | |
| Annual performance | 0.73% | 0.59% | 0.14% |
| Annual interest | £69,672 | £56,093 | £13,579 |
| **Federated Constant Net Asset Value (CNAV)** | | | |
| Annual performance | 0.78% | 0.59% | 0.19% |
| Annual interest | £27,319 | £20,727 | £6,592 |
| **Federated Variable Net Asset Value (VNAV)** | | | |
| Annual performance | 0.76% | 0.59% | 0.17% |
| Annual interest | £46,185 | £35,507 | £10,678 |
| **Royal London Cash Plus Account (VNAV)** | | | |
| Annual performance | 0.49% | 0.59% | -0.10% |
| Annual interest | £29,222 | £35,400 | -£6,178 |
| **Total Interest For Year** | **£243,850** | **£206,617** | **£37,233** |

8.5. The 'Up to 7 days' LIBID rate is the benchmark for the LV/CNAV funds and it can be seen that they all made returns in excess of this. The VNAV fund benchmark is based on the 6 month LIBID rate (plus a margin of 0.0625%) and the returns include fees and so are not directly comparable with the benchmark.

### Call Accounts:

8.6. The Council operates two Call accounts with HSBC and Svenska Handelsbanken. In the case of the HSBC account on balances of £2m and over this offered instant access at a rate above the lower performing LV/CNAV MMF's thus forming a useful addition for investing the Council's cash flow derived money. The Svenska Handelsbanken account is a 35-day notice account that became less attractive against the rate available in the Money Markets for three-month fixed investments. The performance of these call accounts are shown in the table below:

| **Call Account** | **Investment Return** (annualised) | **LIBID Benchmark** (annualised) | **Out/(under) performance** |
|---|---|---|---|
| **HSBC Business Deposit Account** | | | |
| Rate for year | 0.48% | 0.59% | -0.11% |
| Value of interest earned in year | £2,453 | £3,109 | -£656 |
| **Svenska Handelsbanken Account** | | | |
| Rate for year | 0.57% | 0.59% | -0.02% |
| Value of interest earned in year | £120 | £124 | -£4 |
| **Total Interest For Year** | **£2,573** | **£3,233** | **-£660** |

8.7. The Annual Investment Strategy (Appendix B of the Treasury Management Strategy 2019/20) anticipated that the Council would have an average investment balance of £78.9m during the year. The actual average investment balance was £85.2m due in part to lower HRA capital expenditure than anticipated.

8.8. Paragraph 2.3 of the Annual Investment Strategy makes reference to a 70% maximum long term investments holding. Based on the average investment balance of £85.2m, a maximum of £59.6m could have been invested for more than 365 days at any one time. However, there were no investments during the year for more than 365 days, due to expectations that core investment balances would be minimal towards the end of the year. Therefore, the Council did not exceed the 70% limit on longer term investments, nor did it contravene the requirement to hold at least 40% of its portfolio in short term (365 days or less) investments.

### In-House Investment Returns:

8.9. The Annual Investment Strategy, approved in February 2019, anticipated that the in-house portfolio would achieve a 0.80% return for 2019/20. The actual rate was 0.93%, as shown below:

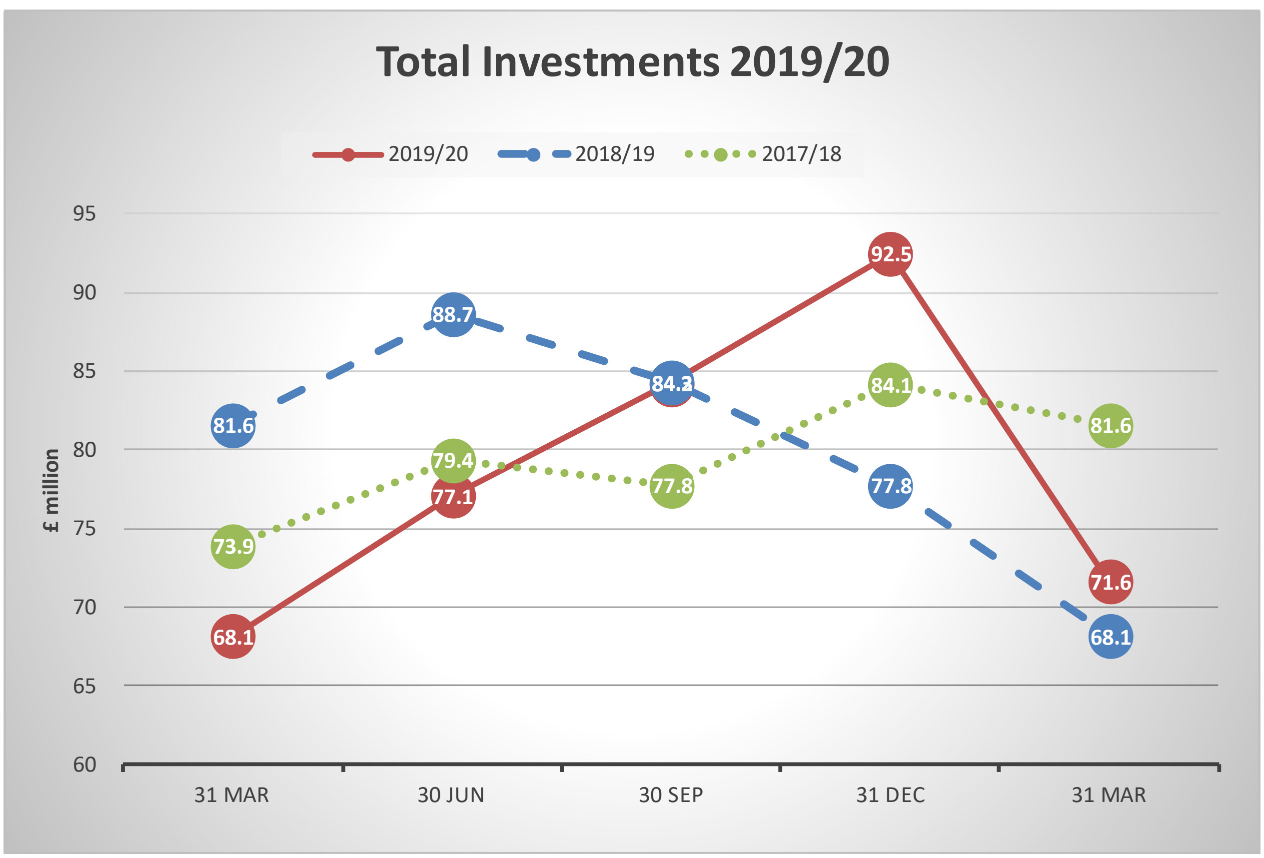
| **Year** | **Interest Received £'000** | **Interest Rate Achieved %** |
|---|---|---|
| 2018/19 Actual | 642.5 | 0.79% |
| 2019/20 Original | 472.3 | 0.80% |
| 2019/20 Latest | 669.8 | 0.90% |
| 2019/20 Actual | 737.6 | 0.93% |

8.10. An analysis of the overall investments of the Council as at 31 March 2020, split between in-house and externally managed, is shown in the table below, with the previous half-year figures shown for comparison purposes:

| Fund | Closing Balance 31 Mar 20 £'000 | Closing Balance 30 Sept 19 £'000 |
|---|---|---|
| Money Markets incl. CD's & Bonds | 36,158 | 41,900 |
| Money Market Funds | 18,425 | 29,786 |
| Business Reserve Accounts incl. Call Accounts | 11,541 | 6,551 |
| **Total In House Investments** | **66,124** | **78,237** |
| Corporate Equity Funds (nominal) | 6,000 | 6,000 |
| **Total Investments** | **72,124** | **84,237** |

8.11. The performance of the corporate equity funds was discussed in paragraphs 4.5 to 4.7 above.

8.12. The graph below shows how the total of the Council's investments varies through the year according to its cash flows, comparing 2019/20 (red solid line) with the previous two years (2018/19 blue dashes, 2017/18 green dots). It shows that during the first quarter of the financial year (April to June) the Council's investments were below previous years but continued to increase until the final quarter, when capital expenditure and other cash flows exceeded normal flows in from Council Tax and NNDR. The impact on cash from COVID-19 was not felt much during 2019/20 but will have significant effects as 2021/21 progresses beyond quarter one of 2020/21.



## 9. Equity Funds

9.1. The two equity funds commenced in April 2017, each with a £3m nominal balance. Paragraphs 4.5 to 4.7 show the returns for 2019/20. The half-year treasury management report to this meeting has more details on these funds in section 11.

| Fund | Value of Fund 31 Mar 20 £'000 |
|---|---|
| Royal London UK Equity Fund | 2,552.8 |
| Columbia Threadneedle UK Equity Income Fund | 2,568.7 |
| **Total Equity Funds** | **5,121.5** |

9.2. For comparison purposes, the total value of both funds at 31 March 2019 were £6.233m and at 30 September 2019 were £6.540m.

9.3. History has shown that these funds may present volatile returns over the short-term, as witnessed by the last few months, but in the long-term they provide returns greater than many other investment instruments. Also, equity funds are perceived to be less risky and more liquid that other similar pooled investment vehicles, such as property funds.

9.4. The inclusion of corporate equity funds in the Council's Investment Strategy was on the basis that these funds should be held for at least five years and to 'cash-out' early may have a significant financial cost, which will need to be monitored over the next couple of years.

## 10. Performance measurement

10.1. In addition to the in-house local benchmarks referred to in this document the Council participates in the Link Group Investment Benchmarking Club. This benchmarks the investment returns and also the maturity and credit risk inherent in the portfolio. The Council is part of a local group which consists of district and county councils and this Council's performance over the past year is reflected in the tables below:

**Table A - Weighted Average Rate of Return (WARoR)**

| | WDC WARoR % | Local Group WARoR % | Link Asset Services Model WARoR % | Performance against Link Asset Services Model Band |
|---|---|---|---|---|
| June Quarter | 0.91 | 0.90 | 0.92 | Inline |
| September Quarter | 0.94 | 0.87 | 0.89 | Above |
| December Quarter | 0.86 | 0.87 | 0.87 | Inline |
| March Quarter | 0.83 | 0.67 | 0.75 | Above |
| **Average for Year** | **0.89** | **0.83** | **0.86** | |

10.2. It can be seen that the Council's average return was slightly above Link Group model portfolio rate of return and the local group, based on the risk in its portfolio. However, this has to be assessed against the slightly higher credit risk taken in this Council's portfolio, as shown below.

**Table B - Weighted Average Credit Risk**

| | WDC | Local Group |
|---|---|---|
| June Quarter | 2.46 | 2.72 |
| September Quarter | 2.85 | 2.85 |
| December Quarter | 2.66 | 2.65 |
| March Quarter | 3.15 | 2.50 |
| **Average for Year** | **2.78** | **2.68** |

10.3. This benchmark measures the average credit risk in the portfolio according to the institutions invested in and corresponds to the duration limits in Link Group's suggested credit methodology using a sliding scale of 1 to 7 where 1 indicates the least risk of default.

## 11. External treasury management advisers

11.1. Link Group continues to provide our Treasury Management Advisory service.

**APPENDIX B**

## Glossary of Treasury Management related terms

**LAS:** Link Asset Services, Treasury Solutions – the Council's treasury management advisers.

**CE:** Capital Economics - is the economics consultancy that provides Link Asset Services, Treasury solutions, with independent economic forecasts, briefings and research.

**CFR:** Capital Financing Requirement - the Council's annual underlying borrowing need to finance capital expenditure and a measure of the Council's total outstanding indebtedness.

**CIPFA:** Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

**COVID-19:** a highly infectious respiratory disease caused by a new coronavirus. The disease was discovered in China in December 2019 and then spread around the world to become a pandemic, causing an unprecedented public health crisis and major economic impacts.

**CPI:** Consumer Price Index – the official measure of inflation adopted as a common standard by countries in the EU. It is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

**ECB:** European Central Bank - the central bank for the Eurozone

**EU:** European Union

**EZ:** Eurozone -those countries in the EU which use the euro as their currency

**Fed:** The Federal Reserve System, often referred to simply as "the Fed," is the central bank of the United States. It was created by the Congress to provide the nation with a stable monetary and financial system.

**FOMC:** The Federal Open Market Committee – this is the branch of the Federal Reserve Board which determines monetary policy in the USA by setting interest rates and determining quantitative easing policy. It is composed of 12 members--the seven members of the Board of Governors and five of the 12 Reserve Bank presidents.

**GDP:** Gross Domestic Product – a measure of the growth and total size of the economy.

**G7:** The group of seven countries that form an informal bloc of industrialised democracies - United States, Canada, France, Germany, Italy, Japan, and United Kingdom - that meets annually to discuss issues such as global economic governance, international security, and energy policy.

**Gilts:** Gilts are bonds issued by the UK Government to borrow money on the financial markets. Interest paid by the Government on gilts is called a coupon and is at a rate that is fixed for the duration until maturity of the gilt, (unless a gilt is index linked to inflation); while the coupon rate is fixed, the yields will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.

**HRA:** Housing Revenue Account.

**IFRS**: International Financial Reporting Standard.

**IMF:** International Monetary Fund - the lender of last resort for national governments which get into financial difficulties.

**LIBID:** The London Interbank Bid Rate is the rate bid by banks on deposits i.e., the rate at which a bank is willing to borrow from other banks. It is the "other end" of the **LIBOR** (an offered, hence "ask" rate, the rate at which a bank will lend).

**LIBOR:** The London InterBank Offered Rate is the interest rate at which banks offer to lend funds (wholesale money) to one another in the international interbank market. It is a key benchmark rate that reflects how much it costs banks to borrow from each other but is being increasingly replaced by SONIA.

**MHCLG:** The Ministry of Housing, Communities and Local Government -the Government department that directs local authorities in England.

**MPC:** The Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

**MRP:** Minimum Revenue Provision -a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).

**PWLB:** Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

**QE:** Quantitative Easing – is an unconventional form of monetary policy where a central bank creates new money electronically to buy financial assets, such as government bonds, (but may also include corporate bonds). This process aims to stimulate economic growth through increased private sector spending in the economy and also aims to return inflation to target. These purchases increase the supply of liquidity to the economy; this policy is employed when lowering interest rates has failed to stimulate economic growth to an acceptable level and to lift inflation to target. Once QE has achieved its objectives of stimulating growth and inflation, QE will be reversed by selling the bonds the central bank had previously purchased, or by not replacing debt that it held which matures. The aim of this reversal is to ensure that inflation does not exceed its target once the economy recovers from a sustained period of depressed growth and inflation. Economic growth, and increases in inflation, may threaten to gather too much momentum if action is not taken to ‘cool’ the economy.

**RPI**: The Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – CPI. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean.  RPI is often higher than CPI for these reasons.

**SONIA:** Sterling Over Night Index Average is the effective reference for overnight indexed swaps for unsecured transactions in the Sterling market. The SONIA itself is a risk-free rate. Unlike LIBOR it is backward looking measure.

**TMSS:** The annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full Council before the start of each financial year.

**VRP:** A Voluntary Revenue Provision to repay debt, in the annual budget, which is additional to the annual MRP charge (see above definition).