Agenda Item: 4

Meeting of:	**Cabinet**
Date of Meeting:	**Monday, 21 September 2020**
Relevant Scrutiny Committee:	Corporate Performance and Resources
Report Title:	Annual Treasury Management Report 2019/20
Purpose of Report:	To present to Cabinet the annual review report on Treasury Management 2019/20.
Report Owner:	Leader and Cabinet Member for Performance & Resources
Responsible Officer:	Carys Lord, Head of Finance/Section 151 Officer
Elected Member and Officer Consultation:	Carys Lord, Head of Finance/Section 151 Officer
Policy Framework:	This is a matter for Executive decision by Cabinet and thereafter decision by Council

Executive Summary:

The Council's borrowing requirement increased by £731k in 2019/20 giving a Total Capital Financing Requirement of £199.08M at 31st March 2020. At the same date the Council held £153.91M of Gross Borrowing. The Council was therefore under borrowed by £45.17M as at 31st March 2020.

The Council's External Borrowing was well within the Authorised Limit and Operational Boundary set for 2019/20.

The Council held Loans from PWLB (£145.21M), Concessionary Loans from WG (£2.6M), Market Loans (£6M) and a Temporary Loan (£0.10M) at 31st March 2020. No new external loans were taken out in year and the Council continued to finance new Capital Expenditure (£5.871M) from internal borrowing.

The Council held investments of £98M at 31st March 2020 and the majority of this was invested with Local Authorities (£87M) with an annual return of 0.7875%. The overall return on investments in 2019/20 which includes Treasury Bills and Deposits with the Debt Management Office was £761K at a rate of 0.7498%.

Recommendations

1. That Cabinet accepts the annual report on Treasury Management 2019/20 and that the report be referred to Council for approval. Amend to ' to Full Council on 21st September 2020 for approval.
2. That the use of article 14.14.2(ii) of the Council's Constitution (Urgent Decision Procedure) be authorised in respect of recommendation 1 above

Reasons for Recommendations

1. To accept and refer the report to Council.
2. The annual report on Treasury Management 2019/20 is reviewed by Council as required by the Local Government Act 2003.

1. Background

1.1 In March 2018 the Council adopted the CIPFA Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which together with the Welsh Government (WG) revised guide on Local Government Investments (April 2010), require the Council to receive and approve as a minimum three main treasury reports each year. These are a Treasury Management and Investment Strategy to be presented before the start of each year, a mid year report and an annual outturn report to be presented at the end of each financial year.

1.2 The Coronavirus pandemic from March 2020 has had no significant impact on the treasury management function in 2019/2020.

1.3 This annual outturn Treasury Management report covers.

The economy/interest rates in 2019/20;
The strategy for 2019/20;
Compliance with treasury limits and prudential indicators;
The borrowing outturn for 2019/20, and
Investment outturn for 2019/20

The UK Economy 2019/20

1.4 The following information has been prepared by the Authority's Treasury Management advisors Link Asset Services and sets out the changing conditions under which Treasury Management operations were carried out.

1.5 The main issue in 2019 was the numerous debates in the House of Commons to agree on one way forward for the UK over the issue of Brexit.
Following the general election in December 2019, the UK was able to leave the European Union (EU) on 31 January 2020.

1.6 However, there still remains much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020.

It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline as the second and third rounds of negotiations have already had to be cancelled due to the virus.

1.7 Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% year on year.

1.8 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty and the uncertainty surrounding Brexit. However, the three monthly Gross Domestic Product (GDP) statistics in January were disappointing, being stuck at 0.0% growth and since then, the whole world has changed as a result of the coronavirus outbreak.

1.9 It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 20% in quarter two.

1.10 What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

1.11 After the Monetary Policy Committee (MPC) raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020 when at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK.

1.12 Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn.

1.13 The Government and the Bank of England were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country was locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income.

1.14 The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%.

1.15 In the Budget in March 2020, the Government also announced a large increase in spending on infrastructure which will also help the economy to recover once the lock down is ended.

1.16 Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

1.17 Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price.

1.18 Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment.

1.19 While there is a possibility inflation turning negative in the Eurozone, this is currently not likely in the UK.

1.20 Employment had been growing healthily through the last year but it is obviously heading for a big hit in during 2020.
The good news over the last year is that wage inflation has been significantly higher than Consumer Price Index (CPI) inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while lockdown continues, retail sales will also take a big hit.

Other Economies 2019/20

1.21 In the USA growth in quarter 1 of 2019 was strong at 3.1% but fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4.

1.22 The slowdown in economic growth resulted in the Federal Government cutting rates from 2.25-2.50% by 0.25% in each of July, September and October.

1.23 Once coronavirus started to impact the US the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%.

1.24 Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months.

1.25 In addition, there will be $500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

1.26 However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%.

1.27 In the Eurozone (EZ) the annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% year on year in quarter 4 in 2019.

1.28 This downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2% prompted the European Central Bank (ECB) to take new measures to stimulate growth.

1.29 At its March 2019 meeting it announced a third round of Targeted Longer-Term Refinancing Operations (TLTROs) which provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing (QE) purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures.

1.30 Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth.

1.31 What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

1.32 Economic growth in China has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing.

1.33 The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak. This resulted in a lock down of the country and a major contraction of economic activity in February-March 2020.

1.34 While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production.

1.35 China also needs to address the level of non-performing loans in the banking and credit systems.

1.36 The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world.

1.37 These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

Treasury Management Strategy 2019/20

1.38 The Section 151 Officer continued to adopt a cautious approach with respect to Treasury Management operations. The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return. This being the case, the Authority placed the majority of funds available for investment purposes with other local authorities. These investments attract a slightly more favourable rate of return than investing with the UK government, but still give priority to the security of funds invested.

1.39 In October 2019 the Authority commenced investing in UK Treasury Bills as an alternative to investing with Local Authorities. These types of investment are also backed by the British Government and therefore are risk averse provided they are not traded in the secondary markets. All purchases of Treasury Bills were bought at the issuing auction and held to maturity.

1.40 Funds not placed with other local authorities or in Treasury Bills were placed in the 'Debt Management Account Deposit Facility' (DMADF) as these deposits are guaranteed by the British Government. However, these deposits attract a lower return than those available from placement of funds with either local authorities or commercial banks.

1.41 The Council's primary objective for the management of its debt is to ensure its long term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board at long term fixed rates of interest. In 2019/20 the Council continued to finance its capital expenditure from internal resources. The potential reduction of the Councils investments balances at times of elevated credit risk, poor investment return and the threat of the Coronavirus was still considered the most prudent option available to the Authority throughout 2019/20.

1.42 Council approved the Treasury Management Strategy for 2019/20 at its meeting on the 27th February 2019, minute no. 782.

1.43 The Section 151 Officer advises that all treasury management activity undertaken during the financial year complied with the amended approved strategy, the CIPFA Code of Practice, and the relevant legislative provisions.

2. Key Issues for Consideration

The Council's Capital Expenditure and Financing

2.1 The Council undertakes Capital Expenditure on long term assets. These activities may either be financed immediately through capital or revenue resources e.g. capital receipts, capital grants etc. Alternatively, the activities can give rise to a borrowing need which would create an increase in the Council's Capital Financing Requirement (CFR).

2.2 The table below shows the Council's capital expenditure and how it is financed.

In Year Movement in Capital Financing Requirement	2019/20	2019/20	2019/20
	General Fund	HRA	Total
	£M	£M	£M
Total Capital Expenditure	43.605	9.539	53.144
Financed in Year Inclusive of MRP	(43.787)	(8.626)	(52.413)
Appropriation of land from GF to HRA	(4.000)	4.000	0
Movement in Capital Finance Requirement/Unfinanced Capital Expenditure*	(4.182)	4.913	0.731

*This is capital expenditure that will be funded by an increase in the Council's borrowing requirement.

The Council's Overall Borrowing Need

2.3 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

Gross Borrowing and the CFR

2.4 In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its Gross External Borrowing does not (except in the short term) exceed the total of the Capital Financing Requirement in the preceding year (2018/19) plus the estimates of any additional CFR for the current year (2019/20) and the next two financial years. The Council has complied with this prudential indicator in 2019/20.

2.5 The table below highlights the Council's Gross Borrowing position against the CFR.

	31 March 2019	31 March 2020	31 March 2020
	Actual	Budget	Actual
	£M	£M	£M
CFR General Fund	124.146	124.905	119.940
CFR HRA	74.224	84.232	79.138
Total CFR	198.370	209.137	199.078
Gross Borrowing Position	(155.145)	(153.410)	(153.910)
Under/(Over) Borrowing of CFR	43.225	55.727	45.168

2.6 The Authorised Limit
The Authorised Limit is the affordable borrowing limit required by Section 3 of the Local Government Act 2003. Once it has been set, the Council does not have the power to borrow above this level.

2.7 The Operational Boundary
The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or above the boundary is acceptable subject to the Authorised Limit not being breached.

2.8 Actual Financing Costs as a Proportion of Net Revenue Stream
This indicator identifies the trend in the cost of capital, (borrowing and long term obligation costs net of investment income), against the net revenue stream.

2.9 The Council's performance against the above indicators in 2019/20 is set out in the table below.

	2019/20
Authorised Limit	£201.556M
Maximum Gross Borrowing Position in Year	£155.145M
Operational Boundary	£194.831M
Average Gross Borrowing Position	£154.962M

2.10 Interest Rate Exposure

	2018/19	2019/20
	£M	£M
Upper Limit for Fixed Interest Rate Exposure	149.045	147.810
Upper Limit for Variable Rate Exposure expressed as an absolute value	0	0

2.11 Financing Costs as a proportion of Net Revenue Stream

	Non HRA (Council Tax)	HRA (Rents)
2019/20 Budget	3.56%	23.11%
2019/20 Actual	3.27%	22.42%

Treasury Position

2.12 At the beginning and the end of 2019/20, the Council's treasury position was as follows.

Debt Portfolio	31st March 2019		31st March 2020	
	Principal	Rate of Return	Principal	Rate of Return
	£M		£M	
Fixed Rate Funding				
PWLB	146.445	4.72%	145.210	4.72%
Concessionary Loans	2.600	0%	2.600	0%
Variable Rate Funding				
Market Loans	6.000	5.32%	6.000	5.32%
Temporary Loan	0.100	0.51%	0.100	0.53%
Total Debt	**155.145**		**153.910**	
CFR	(198.370)		(199.078)	
Over/(Under) Borrowing	**(43.225)**		**(45.168)**	

Movement in Net Debt

	31st March 2019	31st March 2020
	£M	£M
Total Debt	155.145	153.910
Total Investments	(89,100)	(98.000)
Net Debt	66.045	55.910

Maturity Structure of the Debt Portfolio

2.13 The Maturity Structure of the Debt Portfolio is set out below.

	2019/20 Original Limits	2019/20 Actual*	2019/20 Actual
	%	£M	%
Less than one year	20%	1.393	0.90%
Between one and two years	20%	7.915	5.14%
Between two and five years	30%	26.650	17.31%
Between five and ten years	40%	23.149	15.04%
Between ten and twenty years	100%	55.905	36.35%
Between twenty and thirty years	100%	26.448	17.18%
Between thirty and forty years	100%	12.450	8.08%
Between forty and fifty years	100%	0	0%
Total		153.910	100%

*Principal only

Borrowing Outturn 2019/20

2.14 During 2019/20 £5,870,665 of additional internal funds was used in the financing of capital expenditure. An average rate of interest was charged to reflect the use of capital resources. The total charges for interest and principal including for prudential borrowing during the year 2019/20 were £7,833,333 and £5,139,779 respectively.

2.15 For all borrowing excluding loans that are advanced under the Local Government Borrowing Initiative an original estimate of 3.84% has been included in the estimates for 2019/20. The actual rate was 3.90%.

2.16 The Authority internally borrowed for one new loan totalling £2,457,665. This new borrowing comprised of a loan to finance Affordable Housing at a rate of 3% in line with revenue stream to be received by Welsh Government.

2.17 The Authority also raised one loan for supported borrowing in the sum of £3,413,000.

2.18 Loans borrowed from the Public Works Loan Board (PWLB) are intended to assist local authorities in meeting their longer term borrowing requirements. The Authority did not borrow any new loans from the PWLB during 2019/20, opting to fund from internal resources.

2.19 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this is being kept under review by the Section 151 Officer 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 refinancing maturing debt.

2.20 Market loans represent those non-PWLB loans that are repayable at least 1 year or more from the date they are advanced. The debt is a market loan, £2,000,000 of which will mature on the 8th November 2021 and £4,000,000 will mature on the 23rd February 2054.

2.21 The Concessionary Loans have been advanced to the Council by Welsh Government. Loan 1 (£2,100,000) was advanced on 1st April 2015 and is repayable on 31st March 2025. Loan 2 (£500,000) was advanced on the 28th March 2019 and is during 2020/21. Both loans are interest free.

2.22 Temporary Loans represent loans that have no fixed maturity date. Current loans have been borrowed from the Vale of Glamorgan Welsh Church Act Fund, however, this arrangement is being reviewed during 2020/21. Interest is calculated using the "Average 7 Day Rate". The interest rate payable on the Authority's outstanding temporary loans was 0.53% during 2019/20.

Borrowing in Advance of Need

2.23 The Council is under borrowed at 31st March 2020 and has not borrowed in advance of its needs during 2019/20.

Debt Rescheduling

2.24 The Council did not undertake any rescheduling activities during 2019/20 as the average differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Investment Outturn for 2019/20

2.25 All investment activity during 2019/20 conformed to the approved strategy and the Council did not encounter any liquidity difficulties in year.

Internally Managed Investments

2.26 The Authority manages investments in-house and is able to invest with those institutions which meet the minimum credit rating criteria and are included on the approved lending list as laid out in the investment strategy. The Authority currently invests short term for a range of periods from overnight to 364 days, dependent on its cash flows, its interest rate view and the interest rates/periods on offer although this will be reviewed during 2020/21

2.27 Investment movements for 2019/20 (excluding accrued interest) are summarised as follows.

Investment Portfolio	Actual 31st March 2019	Actual Return %	Actual 31st March 2020	Actual Return %
	£M		£M	
Debt Management Account Deposit Facility (DMADF)	8.100	0.145%	11.000	0.486%
Local Authorities	81.000	0.379%	87.000	0.788%
Total	89.100		98.000	

2.28 The continuing market uncertainties resulted in the majority of available funds still being invested cautiously either in Debt Management Account Deposit Facility (DMADF) or with local authorities. The Authority this year favoured deposits with local authorities as these investments attracted a slightly more favourable return without any increase in risk to the principal sums invested.

2.29 Debt Management Account Deposit Facility - The Authority continued to place a portion of all surplus funds in the DMADF which is guaranteed by the British Government. The maturity dates of these investments ranged from overnight to a maximum period of 6 months. The Authority made a return of £60,487 on these investments during 2019/20.

2.30 Local Authorities - During 2019/20 deposits were placed with local authorities. The Authority made a return on these investments of £693,591 including accrued interest.

2.31 As stated earlier on in this report the Authority commenced investing in UK Treasury Bills. The Authority bought treasury bills totalling £12.800m during 2019/20 which were held to maturity. A return of £6,541 was achieved at a rate of 0.667%.

2.32 The overall return on investments for 2019/20 was £760,619 at a rate of 0.7498%.

2.33 The Section 151 Officer will continue to keep the borrowing and investment strategies under review.

3. How do proposals evidence the Five Ways of Working and contribute to our Well-being Objectives?

3.1 The Treasury Management and Investment Strategy ensures that the financial plans of the Council are sustainable into the future and do not adversely impact on future generations.

3.2 The Treasury Management and Investment Strategy underpins the financial management of the Council and its ability to achieve its well being objectives as set out in the Corporate Plan.

4. Resources and Legal Considerations

Financial

4.1 Money is borrowed for capital purposes and interest is charged to revenue accounts.

Employment

4.2 There are no direct employment issues relating to this report.

Legal (Including Equalities)

4.3 Compliance with the Local Government Act 2003 and CIPFA's "Code of Practice for Treasury Management in the Public Services" is mandatory.

5. Background Papers

5.1 CIPFA's Code of Practice for Treasury Management in the Public Services" (2017 Edition), "The Prudential Code" (2017 Edition) and WG guidance on local authority investments.