Audit, Governance and Standards Committee

29 April 2021

Treasury Management Annual Report 2020-2021

Report by: Assistant Director, Finance

Purpose

To inform the Committee of the Council's Treasury Management activities and performance for 2020-21.

FOR INFORMATION

Key Points

A. The Council's debt levels, and the associated revenue costs of financing that debt, continue to be prudent, whilst maintaining long-term stability of the debt portfolio.

B. The Council's investment priorities, to invest prudently and have regard to security first, portfolio liquidity second and then yield (return) were maintained, by following the Council's investment policy as set out in its Treasury Management Strategy Statement (TMSS) for 2020/21, approved by Council on 27 February 20.

Context

1. Treasury management is defined as: "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. The sums of money managed are very significant and no treasury management activity is without risk.The Council's treasury management activities are regulated by statute, official investment guidance and a professional code of practice, the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management ("the Code") (revised 2017).

3. The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM code) requires that authorities report on the performance of the treasury management function at least twice a year (mid-year and at year-end). The Authority's Treasury Management Strategy for 2020/21 was approved at Council on 27 February 2020. This report sets out the year end position.

4. Although the responsibility for treasury management decisions remains with the Council at all times, Treasury Management is a complex and technical area, therefore we employ treasury management advisors to provide specialist skills and resources.

5. Following a joint procurement exercise carried out by the Sutton and Kingston Shared Finance Service, Link Asset Services were awarded a joint contract for treasury management advice, effective from 1 April 2018.

DEBT MANAGEMENT 2020-21

6. **Prudential Indicators** - The CIPFA Prudential code requires the Council to have forward looking prudential indicators set, to both support and record local decision making with regard to capital expenditure and treasury management decisions. The full set of indicators is shown in **Annex 1** to this report, and each is described below.

7. **Capital Expenditure** - The Council's capital expenditure plans are the key driver of treasury management activity. The actual capital expenditure forms the first capital prudential indicator.

8. **Capital Financing Requirement** - The Council's Capital Financing Requirement (CFR) is the total historic outstanding capital expenditure which has not yet been financed from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and, hence, its underlying borrowing need.

9. **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

10. **Gross borrowing and the CFR** - 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 (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure.

Treasury Indicators: limits to borrowing activity

11. **The authorised limit** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. **Enclosure 1** demonstrates that during 2020/21 the Council has maintained gross borrowing within its authorised limit.

12. **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 over the boundary are acceptable subject to the authorised limit not being breached.

13. **Interest rate exposure** - to manage interest rate exposure, loans at fixed rates can be arranged up to the authorised limit (£500.0m), whilst those at variable rates are limited to 40% of this level (£200.0m). Variable rate loans at 31 March 2021 were in the sum of £46.0m.

14. **Maturity Structure of borrowing.** Maturity structure guidance requires the maturity of LOBO (Lender's Option Borrower's Option) loans to be determined by the earliest date on which the lender can require payment. LOBO instruments have a fixed initial term (typically one to ten years) and then move to an arrangement whereby the lender can decide at predetermined intervals to adjust the rate on the loan. At this stage the borrower has the option to repay the loan. However, these loans are expected to continue for much longer due to current market conditions. The table in **Enclosure 1** also shows the position if the LOBO loans ran to their final maturity date (column 4).

15. **Borrowing strategy and control of interest rate risk.** The Council's borrowing strategy as set out in the 2020/21 TMSS was to ensure that debt levels and the associated revenue costs of financing that debt, have been kept to a minimum.

16. Under the prudential regime the Council can borrow as required, as long as this falls within the agreed Prudential Limits. The Council's overall external debt at 31 March 2021 totalled £316.99m, of which £219.36m was with the Public Works Loan Board (PWLB), £61m was with individual banks, and £26.6m was an interest-free loan from the Greater London Authority. This falls within the Authorised Limit and Operational Boundary Prudential Limits**.** The average annual interest rate of the Council's long term debt at 31 March 2021 was 3.59% (£11.0m interest paid).

17. **External Debt Position -** At the beginning and the end of 2020/21 the Council's external debt position was as follows:

Sector	**Balance on 31 March 2020**	**New Debt**	**Debt Maturing**	**Balance on 31 March 2021**
	£m	**£m**	**£m**	**£m**
PWLB – Long Term (1)	220.14	0.00	3.27	219.36
Banks – Long Term	61.00	0.00	0.00	61.00
Short Term Borrowing	0.00	10.00	0.00	10.00
Other - GLA (2)	26.63	0.00	0.00	26.63
TOTAL	**307.76**	**10.00**	**3.27**	**316.99**

1 includes £115.5m borrowed in March 2012 for HRA self-financing settlement
2 interest free - provided to facilitate Cambridge Road Estate regeneration

18. During 2020-21, 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.

19. 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 the authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

20. Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Head of Commercial Finance and Investments therefore monitored interest rates in financial markets and adopted a pragmatic strategy.

21. HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019/20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and on 25th November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.

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

22. There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not forecast to rise from 0.10% by March 2024 as the Bank of England has clearly stated that it will not raise rates until inflation is sustainably above its target of 2%; this sets a high bar for Bank Rate to start rising.

23. **LOBOs:** The Council holds £46m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which RBK has the option either to accept the new rate or to repay the loan at no additional cost. No options on these loans were exercised by the lender during 2020/21.

24. **Debt Rescheduling**: Debt restructuring involves early repayment and re-borrowing of loans. This can involve paying a premium or receiving a discount, but is intended to reduce the overall interest burden, since the

replacement loans are borrowed at lower interest rates. The premium charge for early repayment of PWLB debt has remained relatively expensive for the loans in the Council's debt portfolio and therefore unattractive for rescheduling or premature repayment of debt. No rescheduling was done during the year, as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable

CASH MANAGEMENT - 2020/21

25. **Investment Policy**, **Credit and Counterparty Risk** – 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 26 February 2020.

26. The key intention of the guidance is that councils invest prudently, and that priority is given first of all to security (protecting the investment from loss), and then liquidity (keeping the money readily available for expenditure when needed) before yield.

27. The annual investment strategy sets out the approach for choosing investment counterparties, and in order to minimise the risk to investments, the Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

    - credit watches and credit outlooks from credit rating agencies;
    - Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings;
    - sovereign ratings to select counterparties from only the most creditworthy countries.

28. The investment strategy also limits exposure to the risk of loss by setting maximum maturity and monetary exposure limits.

29. **Investment strategy and control of interest rate risk.** Investment returns remained low during 2020/21. The Bank Rate reduced from at 0.75% during 2020/21 to 0.10% due to the effects of Covid 19 and the economic uncertainty around it.

30. When the coronavirus 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. Thereafter the Council took a more cautious approach to investing. All new investments were made with Money Market Funds and Local authorities with the only exception being investments with the Debt Management Office.

31. **Investment Activity in 2020/21 -** RBK managed significant funds, representing income received in advance plus balances and reserves held. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

32. During the year investments totalling £546m were placed, the total sum of maturities was £541.57m. The amount of deposits outstanding at 31 March

2021 was £70.8m which included £12.35 for the AFC. The Council maintained an average investment balance of £64.0m and earned an average rate of return of 0.11% (£51k interest receivable). The movement in the Council's investments during 2020/21 is categorised as follows:

Sector	Balance 31 Mar 2020	Investments Made	Investments Repaid	Balance 31 Mar 2021
	£m	£m	£m	£m
Banks (fixed term)	13.50	7.11	15.00	5.00
Call Accounts	1.11	2.50	7.50	2.11
Debt Management Office	0.00	141.33	141.33	0.00
Local Authorities	0.00	30.00	0.00	30.00
Money Market Funds	20.56	364.86	369.30	16.32
Pooled Funds	5.00	0.00	0.00	5.00
Sub total	**40.17**	**545.80**	**533.13**	**58.43**
Achieving for Children (1)	11.27	9.51	8.44	12.35
TOTAL	**51.44**	**555.31**	**541.57**	**70.78**
1 As joint owners of AfC Community Interest Company, RBK, the LB Richmond and the RB of Windsor & Maidenhead provide AfC with a revolving credit facility.				

33. **Investment returns benchmarking.** The Council uses the 7 day LIBID rate to assess the performance of it's investment portfolio. The LIBID rate is based on the LIBOR rate which is a benchmark rate at which major global banks lend to one another. The LIBID rate 0.125% is taken off the LIBOR rate and due to the drop of interest rates, this had resulted in LIBID rates turning negative.

	Interest Rate	Interest Receivable
RBK	0.11%	£0.117m
Average 7 day LIBID rate	-0.0706%	-£0.056m

Timescale

34. As the report is for Members' information, there is no particular timescale for action arising out of it. However, it is good practice for the Committee to review the annual report after the end of the financial year as soon as possible, but before the end of September. It should be noted that this report may include some outturn figures that may be subject to change. However the Audit committee will be advised of any subsequent changes at the next meeting prior to the September deadline
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Resource Implications

35. As the report is for Members' information, there are no resource implications arising out of it. However, proper management of the Council's borrowing and

investment position in accordance with the approved Treasury Management Strategy contributes significantly to the financial stability of the Council's budget position.

Legal Implications

36. As the report is for Members' information, there are no legal implications arising out of it.

Risk Assessment

37. The sums of money managed are very significant and no treasury management activity is without risk. The effective identification and management of risk were central to the Council's Treasury Management Strategy for 2020/21, approved by Council on 27 February 2020.

38. The treasury and prudential indicators limit the treasury risk and activities of the Council.

39. Control of interest rate risk is covered in paragraphs 15 and 29. Credit and counterparty risk are covered in paragraph 27.

Equalities Impact Assessment

40. As the report is for Members' information, an EQIA is not needed.

Environmental Implications

41. None arising directly from this report.

Background papers – None other than those referred to in this report

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Annex 1

		2019/20 ACTUAL	2020/21 Estimate	2020/21 ACTUAL
PRUDENTIAL INDICATORS				
Capital expenditure:		**£000**	**£000**	**£000**
General Fund		24,700	58,489	*18,758
HRA		2,265	1,505	**0
TOTAL		26,965	59,994	*18,758
Proportion of financing costs to net revenue stream:		%	**%**	%
General Fund (%)		9.62	13.8	12.96
HRA (%)		16.19	14.5	14.5
Capital Financing Requirement as at 31 March:		£000	£000	£000
General Fund		157,073	153,593	*168,674
HRA		133,623	135,128	*133,623
Commercial Activities		70,664	125,000	*70,664
TOTAL		361,360	413,721	*372,961
Annual change in Capital Financing Requirement		£000	£000	£000
Brought forward 1 April		341,411	361,360	361,360
Carried forward 31 March		361,360	413,721	372,961
TOTAL		19,949	52,361	11,601

***latest outturn figures as at 20.04.21. Any outturn changes will be advised at the next Audit Committee meeting.**

**** Current HRA outturn information shows there is no borrowing requirement for 2020/21**

Enclosure 1

TREASURY MANAGEMENT INDICATORS	**2020/21**
Authorised limit	£373m
Maximum gross borrowing position during the year	£307m
Operational boundary	£363m
Average gross borrowing position	£307m
Short Term Borrowing Limit	£72m
Maximum short term borrowing position during the year	£10m

Maturity Structure of fixed rate borrowing				
Column 1	Column 2		Column 3	Column 4
Duration	**Prudential Limits**		Classifies LOBOs at earliest Repayment date	Classifies LOBOs at final Maturity date
	Lower	**Upper**		
Under 12 months	0%	50%	0%	0%
12 months - under 2 years	0%	50%	19%	1%
2 years - under 5 years	0%	50%	2%	1%
5 years - under 10 years	0%	70%	8%	16%
10 years - under 20 years	0%	70%	21%	20%
20 years - under 30 years	0%	70%	13%	19%
30 years - under 40 years	0%	70%	24%	26%
40 years - under 50 years	0%	70%	13%	17%
50 years and above	0%	70%	0%	0%

	Limit £m	**Actual £m**
Upper Limit on investments in excess of 365 days	50	0