Derby City Council

**COUNCIL CABINET**
**11 November 2020**

# ITEM XX

**Report sponsor:** Simon Riley, Strategic Director of Corporate Resources
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# Treasury Management Mid-Year Report 2020/21

## Purpose

1.1 Council is required for good practice under the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the "CIPFA TM Code") to approve treasury management mid-year and outturn reports.

1.2 This mid-year report outlines the Treasury Management activity for the period 1 April 2020 to 30 September 2020, comprising:

- Summary of the Financial Markets to date in 2020/21
- Forecast Outturn 2020/21
- Borrowing Activity
- Deposits
- Prudential Indicators.

1.3 **Summary**

The Treasury Management forecast outturn for 2020/21 is a net pressure of £0.550m as at 30 September 2020. This will be funded from the treasury management earmarked reserve.

1.4 At the end of September 2020, total debt is £447.185m and total investments are £80.747m compared to £447.967m and £76.873m as at 31st March 2020. No new borrowings have been made or are anticipated to be made in this year.

1.5 All Treasury Management activities of the Council up to 30 September 2020 have complied with Prudential Indicators.

1.6 Treasury Management advice to the Council up to 30 September 2020 has been provided by Arlingclose. Their services include economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on treasury matters as and when required.

## Recommendations

2.1 To note the forecast outturn position of £0.550m overspend. This will be met from the Treasury Management reserve.

2.2 To note the position statement on Treasury Management Activity and compliance against the Prudential Indicators for the period 1 April 2020 to 30 September 2020.

## Reasons

3.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"), it is considered good Treasury Management practice for members to note the progress and monitor performance at least twice a year. This report covers the progress of this activity.

## Supporting information

## Background

4.1 The Council's treasury management strategy for 2020/21 was approved by Full Council on 26th$^{th}$ February 2020. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

4.2 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by Full Council on 26$^{th}$ February 2020.

## The Financial Markets to date in 2020/21

5.1 The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their economies working again. After a relatively quiet few months of Brexit news it is back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal is still being considered.

5.2 The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers.

5.3 Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the ‘Eat Out to Help Out’ (EOHO) offer.

5.4 The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England’s 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme.

5.5 There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on our counterparty list and recommended duration remain under constant review

5.6 The information relating to the overall global position of the UK financial markets is provided by Arlingclose, our treasury advisors, who continue to update the Council with on-going market activity and interest rates.

**Local Context**

6.1 On 31st March 2020, the Authority had net borrowing of £282.053m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

**Table 1: Balance Sheet Summary**

| | **31.3.20 Actual £m** |
|---|---|
| General Fund CFR | 435.305 |
| HRA CFR | 214.819 |
| **Total CFR** | **650.124** |
| Less: Other debt liabilities * | (89.041) |
| **Borrowing CFR** | **561.083** |
| Less: Usable reserves | (210.659) |
| Less: Working capital | (68.371) |
| **Net borrowing** | **282.053** |

*Finance leases, PFI liabilities and transferred debt that form part of the Council’s total debt

6.2 The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing. This is because external borrowing is more expensive than the interest rate that the Council can secure on its investments. It also reduces risk and keeps net interest costs low. This policy is consistent with the Council's Treasury Management Policy.

6.3 The treasury management position at 30th September 2020 and the change during the period is show in Table 2 below.

**Table 2: Treasury Management Summary**

| | **31 March 2020 Balance £m** | **Movement £m** | **30 Sept 20120 Balance £m** | **30.9.20 Rate %** |
|---|---|---|---|---|
| Long-term borrowing<br>Short-term borrowing | 337.717<br>21.209 | (0.360)<br>(0.422) | 337.357<br>20.787 | 4.5%<br>1.4% |
| **Total borrowing** | **358.926** | (0.782) | **358.144** | **4.3%** |
| Long-term investments<br>Short-term investments<br>Cash and cash equivalents | 0.000<br>29.000<br>47.873 | 0.000<br>(21.000)<br>24.874 | 0.000<br>8.000<br>72.747 | 0.00%<br>0.20%<br>0.05% |
| **Total investments** | **76.873** | 3.874 | **80.747** | **0.06%** |
| **Net Borrowing** | **282.053** | (4.656) | **277.397** | |

6.4 Net borrowing has remained fairly consistent between March 2020 and September 2020.

**Forecast Outturn 2020/21**

7.1 The Council budgets for the net cost of its Treasury Activities (Borrowing and Investments) through its Treasury Management Budget. At 30 September this was forecasting an overspend of £0.550m. This is mainly made up of a £0.750m pressure due to amending the historic split between debt charges allocated to the General Fund and HRA. And a £0.195m saving due to the reduction in interest rates and therefore interest we pay on HRA balances.

7.2 It is proposed that the overspend will be met from the Treasury Management Reserve that was set up to help smooth volatility in the treasury management activity.

## Treasury Borrowing Activity

8.1 At the 30 September 2020 the total external debt portfolio of the Council (including HRA debt and other long- term liabilities) was £447.185m. The analysis of external debt outstanding at 30 September 2019 is shown in the table 3 below:

| | £m | £m |
|---|---:|---:|
| | **As at 31 March 2020** | **As at 30 Sept 2020** |
| **External Borrowing:** | | |
| - Fixed Rate PWLB | 312.053 | 311.433 |
| - Fixed Rate Market | 20.000 | 20.000 |
| - Other Local Authorities | 25.000 | 25.000 |
| - SALIX Energy Efficiency | 1.207 | 1.044 |
| - University of Derby | 0.666 | 0.666 |
| **Total External Borrowing** | **358.926** | **358.144** |
| | | |
| **Other Long-term Liabilities:** | | |
| - Transferred Debt from other Local Authorities | 0.318 | 0.318 |
| - PFI Financing | 87.427 | 87.427 |
| - Finance Lease Liabilities | 1.296 | 1.296 |
| **Total Gross External Debt** | **447.967** | **447.185** |

**LOBO loans converted to standard fixed rate loans*

8.2 If the council needs to borrow at any point it will strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

## Treasury Investment Activity

9.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period to 30 September 2020, the Council's daily investment balance ranged between £75.884m and £141.374m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

**Table 4: Treasury Investment Summary**

| Counterparty | 31 March 2020 Balance £m | Net Movement £m | 30 Sept 2020 Balance £m |
|---|---|---|---|
| Banks & building societies (unsecured) | 0.747 | 0.000 | 0.747 |
| Local authorities | 29.000 | -21.000 | 8.000 |
| Money Market Funds | 13.126 | 6.874 | 20.000 |
| Debt Management Office | 34.000 | 18.000 | 52.000 |
| **Total investments** | **76.873** | **4.874** | **80.747** |

The S151 Officer during the year has made temporary changes to the investment criteria agreed by Council in February 2020. This was in response to spreading a higher level of investments over permitted investment categories; mitigating against negative interest rates offered by the Debt Management Office which would have resulted in negative return for the Council and finally to reflect the impact of not having the ability to invest inter-authority for the period required. Any changes are documented by the S151 Officer and continue to balance the overriding principles of Risk, Return and Liquidity

9.2 The investment activity to the 30 September 2020 together with a comparison for the previous year is summarised in table 5 below:

**Table 5: Treasury Investment Activity**

| | 2019/20 | 2020/21 to September 2020 |
|---|---|---|
| Number of fixed-term deposits made | 51 | 134 |
| Number of instant access and money market accounts used | 14 | 14 |
| Number of deposits/withdrawals from money market funds/ call accounts | 112 | 2 |
| Value of deposits/ investments held | £76.873m | £80.747m |
| Average size of deposit/ investment portfolio | £86.594m | £106.199m |
| Average size of Lloyds Balance (operational) | £9.879m | £11.728m |
| Total interest earned on deposits/ investments (including Lloyds) | £0.695m | £0.182m |
| Average Return on deposits/ investment portfolio | 0.73% | 0.17% |

9.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

9.4 Investment income in the Authority's 2020/21 was set against a very different economic backdrop. Bank Rate, which was 0.75% in January/February 2020, now stands at 0.1%. Interest earned from short-dated money market investments will be significantly lower. In fact, the Debt Management Office is currently offering a negative returns on deposits of a duration of less than two weeks.

9.5 The credit risk and return metrics for the Council investments extracted from Arlingclose's quarterly investment benchmarking is shown in table 6.

**Table 6: Investment Benchmarking**

| | **Credit Score*** | **Credit Rating** | **Bail-in Exposure** | **WAM** (days)** | **Rate of Return** |
|---|---|---|---|---|---|
| 31/03/2020 | 3.70 | AA- | 15% | 54 | 0.47% |
| 30/06/2020 | 3.60 | AA- | 11% | 20 | 0.23% |
| **Similar LAs** | 4.12 | AA- | 66% | 30 | 1.07% |
| **All LAs** | 4.10 | AA- | 59% | 18 | 0.97% |

*The lower the credit score the lower risk
** Weighted Average Maturity

9.6 The benchmarking shows that the Council's Weighted Average Maturity (WAM) for investments reduced by 34 days between 31st March 2020 and 30th June 2020. Our low WAM demonstrates that the council continues to pursue security and low risk. However, our low risk appetite can also be seen in the rate of return we have generated from our investments.

## Non-Treasury Investments

10.1 The definition of investments in the revised "CIPFA TM Code" now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return. The Council's Non-Treasury Investments are shown in table 7:

**Table 7: Non Treasury Investments as at 30 September 2020**

| Type of investment | **Investment value £m** | **Return £m** | **Rate of Return %** |
|---|---|---|---|
| Directly owned investment property* | 4.073 | 0.172 | 4.22% |
| Loans to local businesses | 2.713 | 0.053 | 5.04% |
| Loans to subsidiaries (Derby Homes)** | 2.917 | 0.150 | 5.14% |

*Investment value and return taken from the 2019/20 statement of accounts to give an indication of 2018/19 position – this will not be known until the end 2020/21.
** This is the full year position as an annual interest is charged

**Compliance Report**

11.1 All treasury management activity undertaken up to 30 September 2020 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits are demonstrated in table 8 below.

**Table 8: Investment Limits**

| | **2020/21 Maximum to date** | **30/9/20 Actual** | **2020/21 Limit** | **Complied** |
|---|---|---|---|---|
| The Councils Banking Provider – Lloyds | £15m | £13m | £15m | ✓ |
| Any single organisation, except the UK Central Government (excluding the operational bank) | £8m | £8m | £8m | ✓ |
| Any group of pooled funds under the same management | £8m | £8m | £17m | ✓ |
| Money Market Funds (MMF) | £8m | £8m | £8m | ✓ |

11.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 9 below.

**Table 9: Debt Limits**

| | 2020/21 Maximum £m | 30/09/20 Actual £m | 2020/21 Operational Boundary £m* | 2020/21 Authorised Limit £m* | Complied |
|---|---|---|---|---|---|
| Borrowing | 358.9 | 358.1 | 642.5 | 815.4 | ✓ |
| PFI & finance leases | 88.7 | 88.7 | 100.0 | 100.0 | ✓ |
| **Total debt** | **447.6** | **446.8** | **742.5** | **915.4** | ✓ |

*Breakdown of limits realigned between Borrowing and PFI & Finance Leases to reflect business need. No change to overall limits.

**Treasury Management Indicators**

12.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

12.2 Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

12.3 Local Authorities are unrated, therefore fixed term deposits with Local Authorities have to be assigned a score. The score assigned is AAA=1, this means the investments are of the highest credit quality. This is due to Local Authorities not being subject to bail-in and having an insignificant risk of insolvency linked to its covenant strength.

12.4 Table 10 shows the target for the portfolio average credit score and the actual to 30 September 2020/21:

**Table 10: Security Indicator - Portfolio average credit score**

| | Target | Actual |
|---|---|---|
| Portfolio average credit score | 3.00 | 1.04 |

12.5 The actual credit score is below the target showing the exposure to credit risk for the year to date has been lower than the target set, due to higher credit quality investment being used over lower credit quality investment. This is as a result of using fixed term deposits with Local Authorities and the DMO and high credit quality Money Market Funds (MMF's).

12.6 Interest rate exposure indicator: The other locally-set prudential indicator relates to interest rate exposure which allows the Council to manage the extent to which it is exposed to changes in interest rates. It shows the split of borrowing and investments between fixed and variable rates, and the maturity profile of long term loans. Fixed investments and borrowings are those where the rate of interest is fixed for the whole financial year or from the transaction date if later. Instruments that mature during the following financial year are classed as variable rate.

The split in respect of borrowing and investments as at 30 September 2020, and the comparative figures for the previous year, are shown in Table 11 below:

**<u>Table 11: Interest Rate Exposure</u>**

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest is shown below:

| Interest rate risk indicator | 30.9.20 Actual | 2020/21 Limit | Complied |
|---|---|---|---|
| Upper limit on one-year revenue impact of a 1% rise in interest rates | 0.000m | 0.195m | ✓ |
| Upper limit on one-year revenue impact of a 1% fall in interest rates | 0.280m | 0.550m | ✓ |

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12.7 For the purpose of the above indicator it has been assumed that investment interest rates could be negative.

12.9 Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

**<u>Table 13: Principal Sums Invested for Periods Longer than 365 days</u>**

| | **2020/21 £m** |
|---|---|
| Actual principal invested for longer than 364 days | 0.00 |
| Limit on principal invested for longer than 364 days | 20.00 |
| Complied? | ✓ |

## Economic Outlook for the remainder of 2020/21

13.1 The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been supressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

13.2 This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero.

## Public/stakeholder engagement

14.1 None arising directly from this report.

## Other options

15.1 None arising directly from this report.

## Financial and value for money issues

16.1 As described in report.

## Legal implications

17.1 None arising directly from this report.

## Climate Implications

18.1 None arising directly from this report.

## Other significant implications

18.1 None arising directly from this report.

**This report has been approved by the following people:**

| Role | Name | Date of sign-off |
|---|---|---|
| **Legal** | | |
| **Finance** | Toni Nash: Head of Finance | 22/10/2020 |
| **Service Director(s)** | Alison Parkin: Director of Financial Services | |
| **Report sponsor** | | |
| **Other(s)** | | |

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|---|
| **Background papers:** |
| **List of appendices:** |