

BARNSELY METROPOLITAN BOROUGH COUNCIL

This matter is not a Key Decision within the Council's definition and has not been included in the relevant Forward Plan

Report of the Executive Director, Core Services
and Service Director, Finance (S151 Officer)

ANNUAL REPORT ON TREASURY MANAGEMENT ACTIVITIES 2019/20

1. Purpose of Report

- 1.1 This report reviews the treasury management activities carried out by the Council during 2019/20, in accordance with statutory guidance.
- 1.2 In broad terms it covers the following:
- The overarching strategy for 2019/20;
 - An economic summary for the year;
 - An update on the Council's borrowing and investment activities; and
 - The Council's Prudential and Treasury Indicators.

2. Recommendations

- 2.1 It is recommended that Members:
- **Note the latest expectations for interest rates (as outlined in section 4);**
 - **Note the activities undertaken during the year to support the Council's borrowing and investment strategies (as outlined in sections 5-6), and**
 - **Note the Prudential and Treasury Indicators set out in Appendix 1.**
 - **Approve the proposed (temporary) increase in investment limits outlined in paragraph 6.3.**

3. Overarching Strategy for 2019/20

- 3.1 The Treasury Management Strategy identifies the key risks associated with the Council's borrowing and investment activities and sets out how those risks will be managed.
- 3.2 The current borrowing strategy is focused on reducing the Council's exposure to interest rate risk, whilst maintaining an appropriate under-borrowed position in order to keep its financing costs as low as possible.
- 3.3 The current investment strategy seeks to minimise credit risk and maintain sufficient liquid funds in order to meet the Council's ongoing spending commitments. As such the pursuit of higher investment returns is a secondary objective.

4. Economic Summary

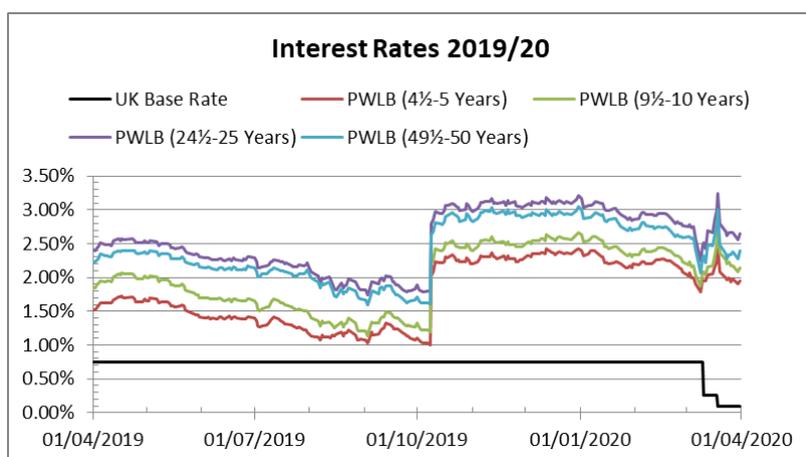
Highlights:

- A general downward trend in PWLB* borrowing rates over the first two quarters;
- A 1% increase in margin on all new PWLB loans from October;
- A temporary spike in interest rates during March in response to the Covid crisis;
- A slight upward movement expected for PWLB rates over the next year or two.

4.1 Interest rates are a key driver of the Council's treasury management activities and as such are monitored by officers on a regular basis.

4.2 As shown below there was a general downward trend in PWLB borrowing rates over the first two quarters of 2019/20; however, in early October HM Treasury announced a 1% increase in margin for new loans in an attempt to discourage local authorities from borrowing to invest in commercial property.

4.3 In mid-March there was a significant spike in interest rates in response to the Covid 19 crisis, as many investors moved away from riskier products into Government bonds, however toward the end of march they started to ease back to more normal levels.



4.4 The Council's treasury advisors expect a slight upward movement in PWLB rates over the next year or two due to a prolonged period of recovery following the Covid 19 pandemic (see table below):

	Latest Interest Rate Projections (Link Asset Services)				
	Latest	Jun-20	Sep-20	Dec-20	Mar-21
UK Base Rate	0.10%	0.10%	0.10%	0.10%	0.10%
PWLB Certainty (50 Years)	2.14%	2.30%	2.30%	2.30%	2.40%

4.5 In the Spring budget, the Chancellor introduced a certainty rate for Housing Revenue Account borrowing which effectively reduced the 1% increase in October. Government are also consulting with local authorities on the future lending terms of the PWLB with a view to reducing some margins towards previous levels.

5. Borrowing Activity

Highlights:

- A closing Capital Financing Requirement (CFR) of £787 Million (up £25 Million from the original estimate);
- £100 Million of fixed-rate borrowing undertaken during the year (up £52 Million from the original estimate);
- Just 22% of the Council's borrowing requirement exposed to interest rate risk as at 31st March (well within the target of 30%);
- An additional fixed-rate borrowing requirement of £37 Million anticipated by the end of 2021/22 (subject to further review).

5.1 As outlined previously (see paragraph 3.2) the Council's borrowing strategy is to actively reduce its exposure to interest rate risk, whilst maintaining a small under-borrowed* position to keep its financing costs to a minimum.

5.2 The table below shows the Council's under-borrowed position as at 31st March and how this compares to the original estimate:

	2019/20 Estimate (£M)	2019/20 Actual (£M)	Variance (£M)
Opening CFR (exc. PFI Schemes / finance leases**)	719.107	714.211	(4.896)
Increase from in-year capital investment	50.664	76.552	25.888
Amounts set aside to repay debt	(7.749)	(4.167)	3.582
Closing CFR	762.022	786.596	24.574
External borrowing	(618.478)	(670.841)	(52.363)
Under-borrowed position	143.544	115.755	(27.789)

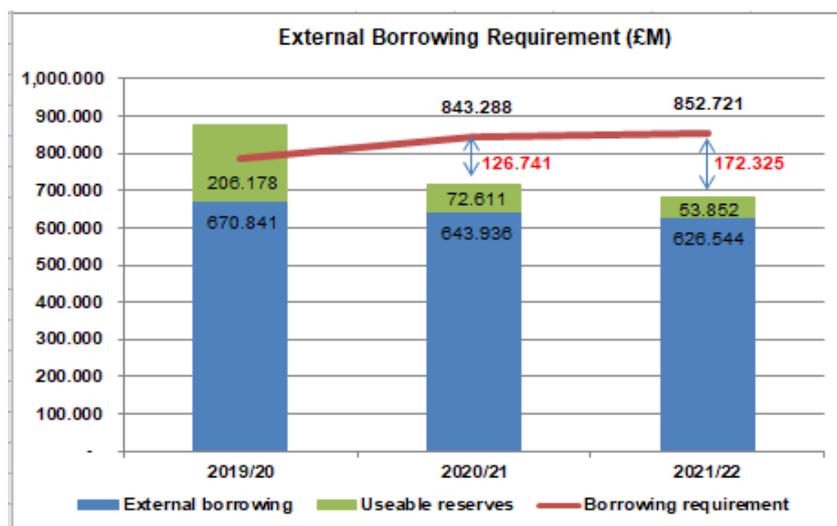
5.3 Despite an increase in capital investment funded from borrowing (due to rephrasing of plans and new schemes approved during the year), the Council's under-borrowed position was £28M lower than budgeted for, this followed £100M of new fixed-rate borrowing taken out during the year in an effort to de-risk the Council's debt portfolio during a period of increased economic uncertainty.

5.4 As a result only 22% of the Council's borrowing requirement is now exposed to interest rate risk (based on its short term and variable LOBO loans and its under-borrowed position) - well below the target of 30%.

5.5 The chart below shows the Council's projected borrowing requirement over the next 2 years and the cash available to support this from external borrowing and useable reserves. A breakdown of this borrowing requirement has been provided in the table underneath:

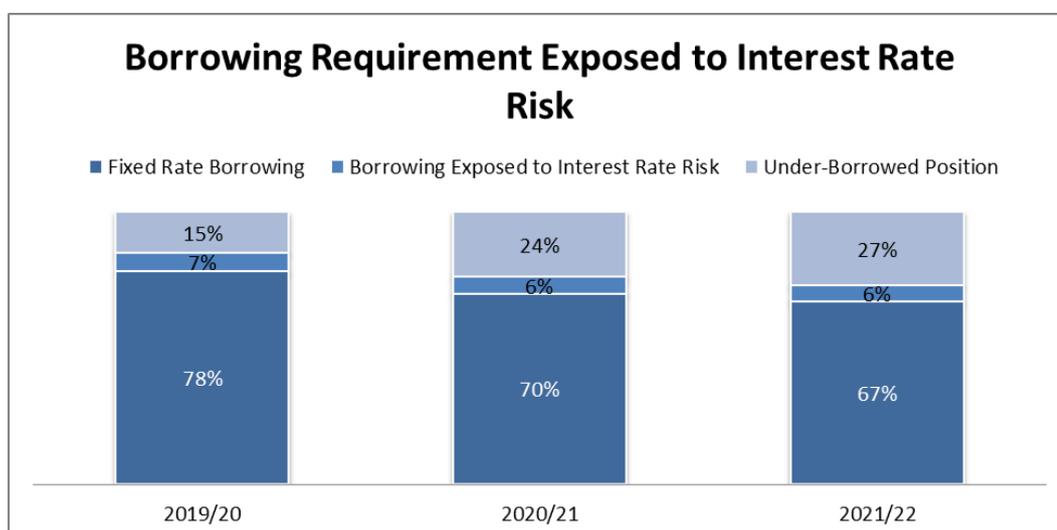
* Refers to the temporary use of internal cash resources (e.g. earmarked reserves or grants received in advance of expenditure) to support its borrowing requirement.

** Excluded on the basis that each arrangement contains its own borrowing facility therefore the Council is not required to borrow separately.



Projected external borrowing requirement 2020/21 - 2021/22	£M
Planned capital investment	74.911
Maturing loans / reduced support from useable reserves	106.142
Amounts set aside to repay debt	(8.728)
Total	172.325

5.6 As mentioned previously, the Council has committed to maintaining its exposure to interest rate risk within 30% of its borrowing requirement. To deliver against this strategy, it is anticipated that the Council will need to fix out an additional £37M by 2021/22. The remainder could be funded through temporary borrowing or internal cash resources (see chart below):



5.7 Based on these projections and previous activity, there is very little requirement for any additional fixed-rate borrowing in the next financial year to meet the target. The Council's capital programme is also being reviewed as a result of the COVID 19 spending moratorium which may reduce or delay its projected borrowing requirement. This may prompt some changes to the Council's borrowing targets which will be reported in Q1.

5.8 In light of the above, officers will continue to assess the borrowing options below as set out in the Council's borrowing strategy:

- **Deferred loans** - following the recent hike in PWLB rates, there may be an opportunity for the Council to borrow at 0.20%-0.30% below current long term PWLB rates without the additional cost of carry or credit risk. The Council has secured £40M to date and is continuing to work with its advisors in order to identify any further potential lenders.
- **Market loans** - as with deferred loans, there may be an opportunity for the Council to borrow from private lenders at rates below the PWLB.
- **Municipal Bonds Agency (MBA)** - the MBA was established in 2014 with the intention of providing an alternative source of funding to the PWLB. The MBA has recently made its first bond issue for Lancashire CC and are looking to generate interest for a further pooled bond issue over the coming weeks. Barnsley has been a leading authority in promoting the MBA and has already committed to the next bond issue subject to 'due diligence' tests.
- **Local authority loans** - the Council could look to borrow from other local authorities over 1-5 years at 1.00%-1.20% below long term PWLB rates. The Council secured a total of £20M during 2019/20 therefore the current priority is for longer-term borrowing.
- **PWLB borrowing** - PWLB rates are still reasonably low despite the recent rate hike, and therefore remains a suitable option for the Council to consider. However there is a possibility that the margin will be reduced following the latest consultation, therefore it is recommended that PWLB borrowing is minimised from the PWLB until the outcome of the consultation is known.

6. Investment Activity

Highlights:

- *A net decrease in investment balances of £63 Million during the year, as a result of the Council's capital programme and day to day expenditure;*
- *Security and liquidity remained the key priorities, with the majority of new investments placed in secure Money Market Funds and instant access accounts;*
- *A temporary increase in investment limits applied to ensure sufficient liquidity during the Covid crisis (proposed until September).*

6.1 The Council's investment strategy is to ensure that its cash balances are invested prudently and are available when needed to meet its spending commitments.

6.2 To reflect this strategy, the majority of new funds were placed in secure Money Market Funds, instant access accounts (see Appendix 2 for further details) and short terms deposits with reputable banks/ other local authorities.

6.3 In March a temporary increase in investment limits was applied to ensure sufficient liquidity during the Covid crisis (see table below). Under

Government's instruction and guidance, the Council has awarded funds in excess of £70M to local businesses and suppliers. Whilst the majority of these payments were Government funded, many were processed in advance of such funding. It was crucial therefore that the Council had sufficient cash available to cover these payments as they became due. It is proposed that this limit is extended until September subject to further review during the summer:

Institution	Minimum Long Term Rating (Fitch or Equivalent)	Previous Limit	Revised Temporary Limit
Barclays Bank PLC (The Council's own bank)	A	£10M	£50M

6.4 The key investment issues for the Council to manage in future are as follows:

1. **Money Market Fund (MMF) Reforms** - the Council's Money Market Funds converted to a new structure in early 2019, known as LVNAV funds. There are a number of requirements that must be satisfied to meet LVNAV funds but to date the Authority has met these.
2. **IFRS 9 Financial Instruments** - this new accounting standard introduced in 2018/19 changed the way that certain investments were categorised and valued, including the recognition of any potential losses on investment through its General Fund revenue account. Due to the low-risk strategy that the Council has adopted, the risk of credit loss in relation to its treasury investments is deemed immaterial, however to date changes have meant a reduction in fair value of equity investments of £0.3M (no impact on the general fund) and a loss allowance in relation to historic third-party loans of £1.4M (in the context of the Covid crisis). Officers will continue to review this position on a regular basis and ensure that sufficient consideration is given to credit risk for any new loans agreed going forwards.
3. **Local Authority Creditworthiness** - over the past two years a number of local authorities have been in the spotlight which has raised the question as to whether they are a safe investment. Whilst there are no issues foreseen from a credit perspective (there are regulations in place to avoid local authorities going bankrupt), officers recognise the reputational risk associated with such investments and will take this into consideration when deciding where to invest the Council's surplus cash.

7. Performance Measurement / Compliance with Prudential and Treasury Limits

- 7.1 The Council's capital financing budget underspent by around £1.1M in year owing to an increase in investment income (as a result of the long term borrowing undertaken over the past 12-18 months) and the use of deferred funding (saving on cost of carry of around £0.8M). This underspend is expected to reduce significantly in future years as a result of the recent increase in fixed rate borrowing.
- 7.2 The Council has operated within the prudential and treasury indicators set out in the agreed strategy and in compliance with its Treasury Management

Practices (see Appendix 1 for more details). However as referred to in paragraph 6.3, a temporary increase in investment limits was applied in March in order to effectively manage the Council's cash flows during the Covid outbreak.

8. Consultations

8.1 This report has been prepared using information supplied by Link Asset Services and approved by the Treasury Management Panel.

9. Financial Implications

9.1 The financial implications arising from the treasury management activities for the year (section 7 refers) are reported to Cabinet separately as part of the Council's revenue outturn report for 2019/20.

10. Employee Implications

10.1 None arising from this report.

11. Regulatory Framework & Risk Assessment

11.1 The Council has adopted the statutory guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Ministry of Housing, Communities and Local Government (MHCLG), which seeks to ensure that its capital expenditure and borrowing are prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

11.2 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of its Treasury Management advisers, has proactively managed the debt and investments over the year.

11.3 Treasury Management is subject to annual inspection from the Council's Internal Audit function, and Treasury Management risks are identified and monitored as part of the Council's overall approach to managing risk. The current assessment of Treasury Management systems is 'substantial', with no outstanding recommendations.

12. Background Papers

12.1 Various Financial Services working papers.

APPENDIX 1 - ACTUAL PRUDENTIAL AND TREASURY INDICATORS FOR 2019/20

1. Capital Expenditure

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

	2018/19 Actual (£M)	2019/20 Estimate (£M)	2019/20 Actual (£M)
General Fund	67.751	83.146	115.105
HRA	25.656	35.860	25.858
Total Capital Expenditure	93.407	119.006	140.963

2. Capital Financing Requirement (CFR)

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

	2018/19 Actual (£M)	2019/20 Estimate (£M)	2019/20 Actual (£M)
General Fund	442.477	498.431	514.804
HRA	271.734	263.591	271.734
Other Long Term Liabilities	237.332	238.949	236.751
Total CFR	951.543	1,000.971	1,023.289

3. External Debt

This indicator is obtained directly from the Council's balance sheet and is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit (External Borrowing + Other Long Term Liabilities).

	2018/19 Actual (£M)	2019/20 Estimate (£M)	2019/20 Actual (£M)
General Fund Borrowing	394.474	409.877	434.740
HRA Borrowing	265.701	208.601	236.101
Total External Borrowing	660.175	618.478	670.841
Other Long Term Liabilities	215.395	208.205	209.810
Total Debt	875.570	826.683	880.651

4. Operational Boundary for External Debt

This indicator refers to the means by which the authority manages its external debt to ensure it remains within the statutory authorised limit. It differs from the authorised limit in as far as it is based on the most likely scenario, in terms of capital spend and financing during the year.

Unlike the authorised limit breaches of the operational boundary (due to cash flow movements) are allowed during the year as long as they are not sustained over a period of time.

	2019/20 Limit (£M)	2019/20 Actual (£M)	Compliant?
Average Debt compared to Operational Boundary	1,000.971	869.863	YES

5. Authorised Limit for External Debt

The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. excluding investments) for the Council.

The Authorised Limit is the statutory limit under the Local Government Act 2003 and must not be exceeded during the year.

	2019/20 Limit (£M)	2019/20 Actual (£M)	Compliant?
Maximum Debt compared to Authorised Limit	1,030.971	900.649	YES

6. Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. Separate limits have been set for the GF and HRA debt pools.

The limits adopted by Council provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis.

General Fund (GF)	2019/20 Limit (%)	Actual 31/03/2020 (%)	Compliant?
Upper Limit on Fixed Interest Rate Exposure	100	94	YES
Upper Limit on Variable Interest Rate Exposure	15	6*	YES

* Includes temporary loans which (whilst the rate is fixed until maturity) are sensitive to movement in interest rates

HRA	2019/20 Limit (%)	Actual 31/03/2020 (%)	Compliant?
Upper Limit on Fixed Interest Rate Exposure	100	87	YES
Upper Limit on Variable Interest Rate Exposure	20	13	YES

7. Maturity Structure of Fixed Rate Borrowing

These limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

Separate limits have been set for the GF and HRA debt pools. The higher percentage of maturities within 12 months in the GF pool is representative of the strategy of short term borrowing to minimise debt interest costs. The Council's LOBOs are now shown within the 'Less than 12 months' category.

Maturity Period - GF	2019/20 Limit (%)	Actual 31/03/2020 (%)	Compliant?
Less than 12 months	0-50	6	YES
12 months to 2 years	0-25	4	
2 years to 5 years	0-25	10	
5 years to 10 years	0-25	6	
10 years to 20 years	0-75	5	
20 years to 30 years	0-75	9	
30 years to 40 years	0-75	21	
40 years to 50 years	0-75	39	

Maturity Period - HRA	2019/20 Limit (%)	Actual 31/03/2020 (%)	Compliant?
Less than 12 months	0-25	1	YES
12 months to 2 years	0-25	1	
2 years to 5 years	0-25	8	
5 years to 10 years	0-25	5	
10 years to 20 years	0-75	4	
20 years to 30 years	0-75	15	
30 years to 40 years	0-75	54	
40 years to 50 years	0-75	12	

8. Ratio of Financing Costs to 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.

	2018/19 Actual (%)	2019/20 Estimate (%)	2019/20 Actual (%)
General Fund	23	23*	24
HRA	35	45	44

* Restated in order to meet the requirements of the prudential code.

9. Maximum Principal Sums Invested

This indicator sets an upper limit for the level of investment that may be fixed for a period greater than 365 days. This limit is set to contain exposure to credit and liquidity risk.

	2019/20 Limit (£M)	2019/20 Actual (£M)	Compliant?
Sums Invested > 365 days	20	0	YES

APPENDIX 2 - MOVEMENT ON EXTERNAL BORROWING / INVESTMENTS

Movement on External Borrowing

As shown below there was a net increase of £11M on the Council's borrowing portfolio during the year, comprising £124M of new borrowing and £114M of principal repaid.

New borrowing included:

- £40M of new borrowing from the PWLB in response to the interest rate volatility that occurred during quarter 4;
- £40M of deferred funding from PBB which was secured in order to cover the Council's maturing PWLB loans, and
- £20M of new borrowing from other local authorities to provide certainty over the medium term whilst taking advantage of sub-PWLB rates.

	Balance on 01/04/2019 (£M)	New Borrowing (£M)	Principal Repaid (£M)	Balance on 31/03/2020 (£M)	Net Movement (£M)
PWLB borrowing	573.713	40.000	(88.333)	525.380	(48.333)
Other long term loans	55.000	40.000	-	95.000	40.000
Temporary loans	2.004	23.830	(24.830)	1.004	(1.000)
Longer term local authority loans	29.457	20.000	-	49.457	20.000
Total external borrowing	660.174	123.830	(113.164)	670.841	10.667

Movement on Investments

As shown below, there was a net decrease of £63M on the Council's investment portfolio during the year, comprising £730M of new investments and £793M of principal redeemed.

This included a net reduction in short term deposits of £100M as officers sought to cover the Council's capital programme and day to day expenditure. In addition, officers made a significant shift towards more liquid investments in March in order to manage the Council's cash flows during the Covid outbreak:

	Balance on 01/04/2019 (£M)	New Investments (£M)	Principal Redeemed (£M)	Balance on 31/03/2020 (£M)	Net Movement (£M)
Short term deposits	156.500	173.000	(272.500)	57.000	(99.500)
Money Market Funds / instant access accounts	38.080	557.000	(520.080)	75.000	36.920
Total investments	194.580	730.000	(792.580)	132.000	(62.580)

Further details regarding the Council's borrowing and investment portfolios are available on request.

APPENDIX 3 - LOAN PORTFOLIO AS AT 31/03/2020

Summary as at 31/03/2020:

	Balance (£M)	Average Rate (%)
PWLB borrowing	525.380	3.39
Other long term loans	95.000	3.83
Temporary loans	1.004	1.00
Longer term local authority loans	49.457	1.24
Total external borrowing	670.841	3.52

New long term borrowing in year:

Date	Category	Service	Balance (£M)	Term (Y)	Rate (%)
11/03/2020	PWLB	GF	10.000	31.0	2.21
23/03/2020			10.000	10.0	2.59
23/03/2020		HRA	20.000	40.0	1.98
20/11/2019	Other long term loans		20.000	28.5	2.65
03/03/2020			20.000	27.5	2.50
05/11/2019	Longer term local authority loans	GF	5.000	2.0	1.45
15/11/2019			5.000	3.0	1.60
12/12/2019			5.000	2.0	1.40
17/12/2019			2.500	4.0	2.00
13/01/2020			2.500	4.0	2.00
Total			100.000	23.9 (avg)	2.23 (avg)