

REPORT TO: Audit and Governance Committee

MEETING DATE: 16 June 2020

BY: Depute Chief Executive – Resources and Peoples Services

SUBJECT: Annual Treasury Management Review 2019-20

1 PURPOSE

- 1.1 To update the Committee on Treasury Management Activity during 2019-20.

2 RECOMMENDATIONS

- 2.1 The Committee is asked to note the report.

3 BACKGROUND

- 3.1 The Council is required by regulations issued under the Local Government Scotland Act 2003 to produce an Annual Treasury Management Review, in accordance with the CIPFA Treasury Management Code of Practice and Prudential Code.
- 3.2 The review set out in Appendix 1 updates members on the Treasury Management activity during 2019-20, and reported relative to the indicators set out in the Treasury Management Strategy approved in February 2019. The figures contained within the report are based on the draft unaudited accounts at the time of finalising this report, and should there be any significant changes to these figures arising prior to the finalisation of the 2019-20 financial accounts, members will be kept informed.

4 POLICY IMPLICATIONS

- 4.1 There are no direct policy implications associated with this report; however the council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 INTEGRATED IMPACT ASSESSMENT

- 5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

6 RESOURCE IMPLICATIONS

- 6.1 Financial – There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.
- 6.2 Personnel - none
- 6.3 Other - none

7 BACKGROUND PAPERS

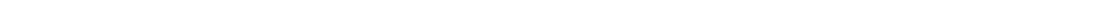
- 7.1 Treasury Management Strategy 2019-20 to 2023-24 – East Lothian Council 26 February 2019.
- 7.2 Treasury Management Mid-Year Review 2019-20 – Audit & Governance 26 November 2019.

AUTHOR'S NAME	Sarah Fortune
DESIGNATION	Chief Operating Officer - Finance
CONTACT INFO	sfortune@eastlothian.gov.uk
DATE	8 June 2020

Appendix 1



Annual Treasury Management Review 2019-20



Annual Treasury Management Review 2019-20

1. Introduction

This Council is required by regulations issued under the Local Government in Scotland 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). The review is based on figures contained within the draft unaudited accounts, and should any significant and material changes arise during the course of the audit, updated information will be made available and communicated to members.

During 2019-20 the minimum reporting requirements were that members of the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 26/02/2019)
- a mid-year (minimum) treasury update report (Audit and Governance 26/11/2019)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee with the annual strategy approved by Council.

2. The Council's Capital Expenditure and Financing

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.) with expenditure in excess of these resources giving rise to a borrowing need.

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

	2018/19 Actual £m	2019/20 Budget £m	2019/20 Actual £m
General Services			
Capital expenditure	37.519	52.074	42.260
Financed in year	(16.243)	(36.816)	(37.528)
Net borrowing need in year	21.276	15.258	4.732
HRA			
Capital expenditure	22.410	32.890	29.929
Financed in year	(10.926)	(12.922)	(15.134)
Net borrowing need in year	11.484	19.968	14.795
Total Net Borrowing need in year	32.760	35.226	19.527

3. The Council's Overall Borrowing Need

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

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and deemed 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 capital financing requirement for the current (2019-20) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure but allows the Council some flexibility to borrow in advance of its immediate capital needs if required.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2019 Actual £m	31 March 2020 Budget £m	31 March 2020 Actual £m
General Services			
CFR	264.048	260.417	258.767
External borrowing position	235.153	242.672	238.944
(Under) / over funding of CFR	(28,895)	(17.745)	(19.823)
HRA			
CFR	187.528	207.504	198.521
External borrowing position	163.531	191.031	180.784
(Under) / over funding of CFR	(23.997)	(16.473)	(17.737)
Total			
(Under) / over funding of CFR	(52.892)	(34.218)	(37.560)

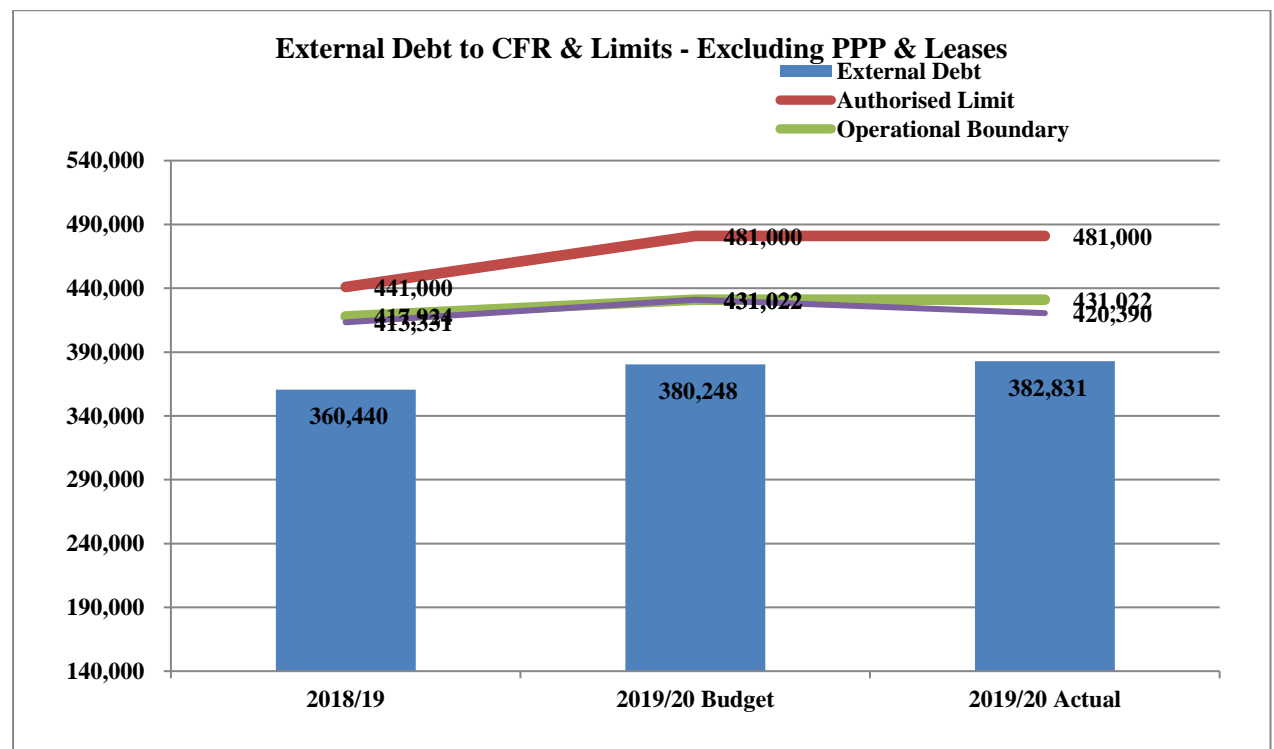
4. Treasury Position as at 31 March 2020

At the beginning and the end of 2019-20 the Council's treasury, (excluding borrowing by PPP and finance leases), position was as follows:

	31 March 2019 Principal £m	31 March 2020 Principal £m
CFR	413	420
Over / (under) borrowing	(53)	(38)
Total external debt	360	382
Total investments	(9)	(9)
Net debt	351	373

The graph below highlights the level of External Debt against approved boundary limits set out within the approved Treasury Strategy.

- **The authorised limit** - the Council has kept within its authorised external borrowing limit as shown by Table 2 in Appendix 1.
- **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.



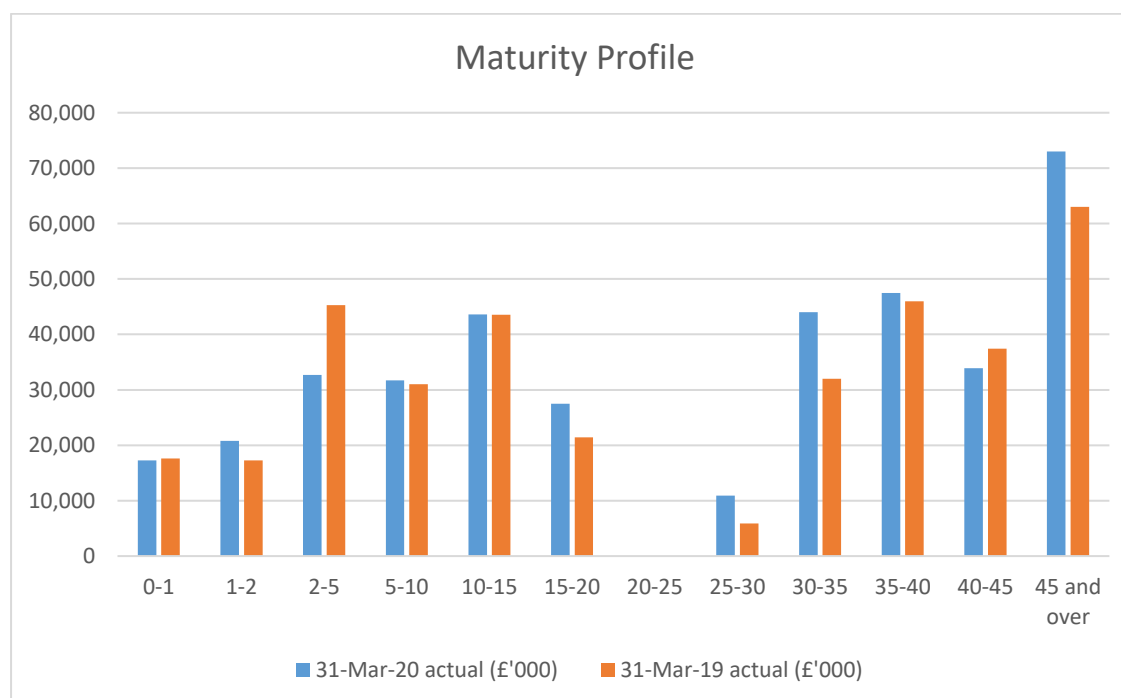
As at 31 March 2020 the average interest rate for all external debt was 3.52% (4% 2019) and the average life across all loans was 26 years (25 years 2019)

The maturity structure and profile of the debt portfolio is set out in the tables below:

	31 March 2019 Actual £m	(Paid) or New Loan* 2019-20 £m	31 March 2020 Actual £m	Net movement* 2019-20 £m
Under 12 months	17.60	(17.60)	17.27	17.27
12 months and within 24 months	17.27		20.77	3.50
24 months and within 5 years	45.30		32.68	(12.62)
5 years and within 10 years	31.00		31.69	0.69
10 years and within 15 years	43.54		43.61	0.07
15 years and within 20 years	21.43	10.00	27.50	(3.93)
20 years and within 25 years	-		-	-
25 years and within 30 years	5.90	5.00	10.90	-
30 years and within 35 years	32.00		44.00	12.00
35 years and within 40 years	46.00	10.00	47.50	(8.50)
40 years and within 45 years	37.40		33.90	(3.50)
45 years and over	63.00	15.00	73.00	(5.00)
Total	360.44	22.40	382.82	(0.02)

* More detail on this is set out in Section 6 below

** Net movement shows the change between the maturity bands for existing loans



5. The strategy for 2019-20

5.1 Investment strategy and control of interest rate risk

The Council's approved investment strategy by priority is; security, liquidity and then return. The Council adopts a prudent approach to managing risk and followed the approved 2019-20 Strategy where investments were only considered where the type of investment and exposure to risk was low or very low. Limits were set for fixed and variable interest rate exposure which were not exceeded during the year.

Investment returns remained low during 2019-20. The treasury management strategy for 2019-20 estimated that bank rate interest would stay at 0.75% as it was not expected that the MPC would increase the Bank Rate until Brexit was settled, and expectation that this would then rise but only to 1.0% during 2020. During this period, our investments were short term. Shorter term investment interest rates were fairly flat during most of the year until the two cuts in Bank Rate in March 2020 down to 0.1% caused investment rates to fall sharply.

5.2 Borrowing strategy and control of interest rate risk

During 2019-20 the Council continued to maintain an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) was not fully funded by external borrowing as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This was a prudent strategy as investment returns were low and minimising of counterparty risk on investments must be considered.

The policy of avoiding new borrowing where possible by close monitoring of cash balances is kept under continual review to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

The interest rate forecasts during 2019-20 predicted gradual rises in medium and longer term fixed borrowing rates and the two subsequent financial years. Interest rates did fluctuate during the year and decisions on our borrowing methods and terms were made following careful consideration of the borrowing rate projections, our current external debt maturity profile and in discussion with our Treasury advisors.

The table below shows the interest rate forecasts from our Treasury advisors. As of 31 March 2020 the bank interest rate is forecast to remain at 0.10% and PWLB rates may gradually increase over the next 2 years.

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

HM Treasury imposed a significant change in PWLB rates in 2019-20 without any prior warning; the first on 9 October 2019, an additional 1% to all PWLB rates. That increase

was then reviewed for some areas 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. The table below shows the PWLB rates at the start and end of the year, highs and lows during 2019-20 with dates and the average rate during the year.

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	1.46%	1.52%	1.84%	2.41%	2.24%
31/03/2020	1.90%	1.95%	2.14%	2.65%	2.39%
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.45%	2.76%	3.25%	3.05%
Date	21/10/2019	19/03/2020	19/03/2020	19/03/2020	31/12/2019
Average	1.83%	1.77%	2.00%	2.56%	2.40%

6. Borrowing Activity during 2019-20

Borrowing – the following loans were taken during the year:-

Lender	Principal	Type	Interest Rate	Maturity	Date
PWLB	£ 5m	Fixed interest rate	1.82%	20 years	16/08/2019
PWLB	£ 5m	Fixed interest rate	1.91%	30 years	16/08/2019
PWLB	£ 5m	Fixed interest rate	1.81%	50 years	16/08/2019
PWLB	£ 5m	Fixed interest rate	1.67%	16 years	19/03/2020
PWLB	£ 5m	Fixed interest rate	1.71%	17 years	19/03/2020
PWLB	£ 5m	Fixed interest rate	1.68%	38 years	19/03/2020
PWLB	£ 5m	Fixed interest rate	1.63%	48 years	19/03/2020
PWLB	£ 5m	Fixed interest rate	1.63%	49 years	19/03/2020
Total	£40m				

This compares with a budget assumption of borrowing at an interest rate of 3.40%.

Borrowing in advance of need

The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Rescheduling

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments

The following loans were repaid in full during the year:-

Lender	Principal	Type	Interest Rate	Maturity	Date
PWLB	£ 5m	Fixed interest rate	4.04%	9 years	24/09/2019
PWLB	£10m	Fixed interest rate	4.06%	9 years	24/09/2019
Total	£15m				

Instalments of £2.6m were also paid on 11 loans which are payable as an Annuity or EIP (equal instalments of principal) basis rather than on maturity.

7. Investment Activity for 2019-20

Investment Policy

The Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the annual investment strategy approved by the Council on 26 February 2019. This 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.).

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

Investments held by the Council

During the first 6 months of 2019-20 and in accordance with the approved strategy 4 short term investments were made and repaid. During this period and during the remaining 6 months any surplus cash balances were held in the Council's bank account, which is an interest bearing account.

Date of Lending	Borrower	Amount	Interest rate	Date repaid
07/06/19	Nottingham City Council	£ 5m	0.75%	23/09/19
20/06/19	Central Bedfordshire Council	£ 5m	0.75%	20/09/19
28/08/19	Goldman Sachs	£ 5m	0.82%	28/11/19
28/08/19	Lloyds 95 day notice	£ 5m	1.10%	17/03/20
	Total	£20m		

The Council also has the following loans to third parties which fall under the scope of the Council's approved Investment Strategy

	Loan balance at 31 March 2019 £m	Loan balance at 31 March 2020 £m
East Lothian Housing Association	9.198	8.959
East Lothian Investments	0	0.228

Under accounting standard IFRS9 effective from 1 April 2018, an expected credit loss for all loans to third parties must be obtained and recognised in the Council's Income and Expenditure account within Surplus/Deficit on Provision of Services. This was £72k for 2018-19 and reduced to £36k for 2019-20.

Investments held by fund managers

The Council uses Investec as external fund managers to invest cash balances on behalf of the 4 Common Good Funds and the ELC Charitable Trusts. The performance of the managers against the benchmark return was:

	Investments held 31 March 2019 £m	Investments held 31 March 2020 £m	Return	Benchmark
Charitable Trusts	3.393	2.294	-9.07%	-9.06%
Common Good Funds	3.459	3.012	-9.76%	-9.06%
Total	6.852	5.306	-£1.546m	

The principal reason for the reduction in value is the significant negative impact of Covid-19 on the financial markets. The return was in line with the benchmark for Charitable Funds. Common Good Funds underperformed compared to the benchmark due to falls in property investments but this is expected to be relatively short term.

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2018/19	2019/20	2019/20
	Actual £m	Budget £m	Actual £m
Capital Expenditure			
General Services	37.519	52.074	42.260
HRA	22.410	32.890	29.929
TOTAL	59.928	84.964	72.189
Ratio of financing costs to net revenue stream			
General Services	6.94%	8.29%	6.55%
HRA	29.84%	33.78%	32.23%
Gross borrowing requirement - General Services			
brought forward 1 April	212.918	220.644	225.804
carried forward 31 March	225.804	223.519	221.870
in year borrowing requirement	12.886	2.875	(3.934)
Gross borrowing requirement - HRA			
brought forward 1 April	178.877	191.264	187.528
carried forward 31 March	187.528	207.504	198.521
in year borrowing requirement	8.651	16.240	10.993
CFR			
General Services	225.804	223.519	221.870
HRA	187.528	207.504	198.521
TOTAL	413.332	431.023	420.391
Annual Change in Capital Financing Requirement			
General Services	12.886	4.985	(3.934)
HRA	8.651	13.039	10.993
TOTAL	21.537	18.024	7.059
Annual Impact of Capital Investment Decisions			
General Services – Debt per Band D Equivalent	£4,700	£4,609	£4,522
HRA – Debt per dwelling	£21,456	£23,487	£22,457

	2018/19	2019/20	2019/20
2. TREASURY MANAGEMENT INDICATORS	Actual	Budget	Actual
	£m	£m	£m
Authorised Limit for External Debt -			
Borrowing	441	481	481
Other long term liabilities	39	37	37
Total	480	518	518
Operational Boundary for External Debt -			
Borrowing	413.332	431.022	420.391
Other long term liabilities	38.244	36.899	36.897
Total	451.576	467.921	457.288
Actual External Debt			
Borrowing	360.440	396.805	382.831
Other long term liabilities	38.244	36.899	36.897
Total	398.684	433.704	419.728
3. LOANS FUND			
General Services			
Opening balance	213	221	226
Add advances	21	15	5
Less repayments	(8)	(12)	(9)
Closing balance	226	224	222
HRA			
Opening balance	179	191	187
Add advances	11	20	15
Less repayments	(3)	(4)	(4)
Closing balance	187	207	198
Total			
Opening balance	392	412	413
Add advances	33	35	19
Less repayments	(11)	(16)	(12)
Closing balance	413	431	420

ABBREVIATIONS USED IN THIS REPORT

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.

GDP: gross domestic product – a measure of the growth and total size of the economy.

HRA: housing revenue account.

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).

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.

PPP: Private Public Partnership – capital expenditure financed by the private sector i.e. not by direct borrowing by 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.

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.

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.
