Report to Audit and Governance Committee

Date: 28th July 2021

Reference number: for cabinet member decisions only

Title: Treasury Management Annual Report 2020/21

Relevant councillor(s): John Chilver, Cabinet Member for Finance, Resources, Property and Assets

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Recommendations: The Audit and Governance Committee is asked to **note** the Treasury Management Annual Report for 2020/21.

Executive Summary

1.1 The Council is required to report to members on the previous year's treasury management activity. It has been agreed that the annual treasury management report would be reported to CMT and then the Audit and Governance Committee.

1.2 During the year, the Council proactively managed its cash position in light of the COVID pandemic, which ultimately included periodically having to manage significantly higher cash balances as a result of the COVID grants issued by the government.

1.3 In overall budget terms, the Council ended up £0.596m net better off during the year, despite an underachievement of £0.434m on treasury investment returns due in part to low rates of interest available and a need to invest surplus cash short term to help manage cashflow risk during the pandemic. Another factor, however, was the continuation of the Council's strategy to use surplus cash instead of borrowing (known as internal borrowing), which led to an underspend against budget on borrowing costs of £1.030m.

1.4 The table below is a summary of the Council's borrowing on 31st March 2021.

Maturity Structure of Borrowing

1 April 2020 £m		31 March 2021 £m
63.617	Under 12 months	6.820
6.435	12 months and within 24 months	16.910
44.765	24 months and within 5 years	21.286
64.464	5 years and within 10 years	77.365
186.167	10 years and above	194.077
365.448	**Total Borrowing**	**316.458**

1.5 The cost of external borrowing in 2020/21 was £10.297m, an underspend of £1.030m compared to the £11.327m budget. Due to the coronavirus pandemic there were some delays to the Council's capital expenditure plans resulting in a lower funding requirement.

1.6 The treasury cash (investments) position is summarised below.

Treasury Cash Position

1 April 2020 £m	%	Treasury Investments	31 March 2021 £m	%
42.17	31%	Banks & Building Societies	0.00	0%
35.51	26%	Local Authorities (invested less than 364 days)	68.85	48%
37.61	28%	Money Market Funds	29.17	20%
0.00	0%	UK Government	15.35	11%
0.00	0%	Local Authorities (invested longer than 364 days)	10.00	7%
20.00	15%	Property Fund	20.00	14%
135.29	**100%**	**Total Treasury Investments**	**143.37**	**100%**

1.7 The Council pursues a strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep external financing costs low. The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The Council will continue to internally borrow, although it will look to secure external borrowing at low rates if borrowing is required to finance items within the capital programme.

1.8 The Council continues to look for opportunities reschedule debt where this is expected to lead to an overall cost saving or a reduction in risk. The Council earned £1.315m (0.46%) interest on its investments, an underachievement of £0.434m compared to the budget of £1.749m. In light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.

Treasury Management Annual Report

1.9 In line with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management and the Council's Financial Regulations, this Council is required to provide the Audit and Governance Committee with a report on the previous year's treasury management activity.

1.10 The Code of Practice defines Treasury Management as: The management of the organisation's 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.

1.11 Treasury management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code).

1.12 The Council's treasury management strategy was approved by the Shadow Authority on 27th February 2020. The general policy is the prudent investment of its treasury balances and cost-effective borrowing to finance long term investment in the Council's assets.

1.13 At 31st March 2021 the Council held £316.458m of loans, a decrease of £48.990m compared to 31st March 2020, as part of its strategy for funding legacy Councils' capital programmes from previous years; £286.458m was from the Public Works Loans Board (PWLB[1]), £30.000m Lenders Option Borrowers Option (LOBOs[2]) from the money markets. The Council pursues a strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep external financing costs low. The Council is actively reviewing opportunities for borrowing at low rates if borrowing is required to finance items within the capital programme. The cost of external borrowing in 2020/21 was £10.297m, an underspend of £1.030m compared to the £11.327m budget. Due to the coronavirus pandemic the Council deferred its capital expenditure plans resulting in a lower funding requirement. The Council continues to look for opportunities reschedule debt where this is expected to lead to an overall cost saving or a reduction in risk. The table below is a summary of the Council's borrowing.

Maturity structure of borrowing

1 April 2020 £m		31 March 2021 £m
63.617	Under 12 months	6.820
6.435	12 months and within 24 months	16.910
44.765	24 months and within 5 years	21.286
64.464	5 years and within 10 years	77.365
186.167	10 years and above	194.077
365.448	**Total Borrowing**	**316.458**

[1] PWLB Public Works Loans Board. The PWLB is a statutory body, part of HM Treasury; its purpose is to lend money to local authorities. The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

[2]LOBOs Lender Option Borrower Option. LOBOs are long term borrowing instruments which include an option for the lender to periodically revise the interest rate. If the lender decides to revise the interest rate, the borrower then has the option to pay the revised interest rate or repay the loan.

1.14In November 2020 the PWLB published its response to the consultation on 'Future Lending Terms'. From 26th November the margin on PWLB loans above gilt yields was reduced from 1.8% to 0.8% provided that the borrowing authority can confirm that it is not planning to purchase 'investment assets primarily for yield' in the current or next two financial years. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. As part of the borrowing process authorities will now be required to submit more detailed capital expenditure plans with confirmation of the purpose of capital expenditure from the Section 151 Officer. The PWLB can now also restrict local authorities from borrowing unusual or large amounts.

1.15Misuse of PWLB borrowing could result in the PWLB requesting that the authority unwinds problematic transactions, suspending access to the PWLB and repayment of loans with penalties. Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to take advantage of the reduction in the PWLB borrowing rate.

1.16The UK Municipal Bonds Agency plc (MBA) was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital market and lends the proceeds to local authorities. The Agency is expected to issue the first multiple borrower bond this autumn, the Council will monitor the progress of this bond including the underlying interest rate. Any decision to borrow from the Agency will be the subject of a separate report to Cabinet for approval.

1.17 **Treasury Position:** The Council's investment strategy sets out the approach for choosing investment counterparties. They are based on a system of credit ratings provided by the three main credit rating agencies and supplemented by additional market data (such as rating outlooks, credit default swaps and bank share prices) provided by the Council's treasury advisors.

1.18 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £185m and £295m, including the CCLA (Churches, Charities and Local Authorities) Local Authorities Property Fund investment. The balances fluctuated due to timing differences between income and expenditure, also Covid-19 government funding was received in advance of spend resulting in high cash balances that needed to be invested securely for short maturities.

Treasury Cash Position

1.19 The treasury cash (investments) position is summarised below:

1 April 2020 £m	**%**	**Treasury Investments**	**31 March 2021 £m**	**%**
42.17	31%	Banks & Building Societies	0.00	0%
35.51	26%	Local Authorities (invested less than 364 days)	68.85	48%
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0.00	0%	Local Authorities (invested longer than 364 days)	10.00	7%
20.00	15%	Property Fund	20.00	14%
135.29	**100%**	**Total Treasury Investments**	**143.37**	**100%**

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. The Council earned £1.315m (0.46%) interest on its investments, an underachievement of £0.434m compared to the budget of £1.749m. In light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks. Several of the Council's treasury counterparties have Environmental, Social and Governance (ESG) strategies integrated into their investment processes. (ESG) treasury investments are being developed but do not represent a significant proportion of the investment vehicles / Money Market Funds available. Treasury management is about ensuring the Council's has available to meet its day to day cash requirements; investments are generally short term, some overnight, secure, providing access to cash when the Council needs it, they don't include investments in fossil fuels or companies with a large carbon footprint.

1.20The Bank of England (BoE) held Bank Rate at 0.1% throughout the year, but extended its Quantitative Easing programme by £150bn to £895bn at its November 2020 meeting. The United Kingdom Government's Debt Management Office provides a Debt Management Account Deposit Facility (DMADF) deposits providing local authorities with a flexible and secure facility to supplement other investment options. Deposit rates with the DMADF fell during the year and are now largely around zero.

1.21The return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.1% in March 2020, are now at or very close to zero. In many instances, the fund management companies have temporarily lowered or waived fees to avoid negative net returns.

1.22In light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.

1.23**Externally Managed Pooled Funds** £20m of the Council's investments are held in an externally managed strategic pooled property fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.

1.24Similar to many other property funds, dealing (i.e. buying or selling units) in the CCLA Local Authorities Property Fund was suspended by the fund in March 2020. The relative infrequency of property transactions in March as the pandemic intensified meant that it was not possible for valuers to be confident that their valuations correctly reflected prevailing conditions. To avoid material risk of disadvantage to buyers, sellers and holders of units in the property fund, the management company was obliged to suspend transactions until the required level of certainty was re-established. The dealing suspension was lifted in September 2020. There has also been a change to redemption terms for the CCLA Local Authorities Property Fund; from September 2020 investors are required to give at least 90 calendar days' notice for redemptions. The Local Authorities' Property Fund achieved a performance return net of fees of 3.75% in the year to 31 March 2021.

1.25 In 2020/21 Buckinghamshire Council received significantly lower income from its cash and short-dated money market investments and from its externally managed funds than the legacy Councils did in 2019/20 and earlier years. Income paid depended on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact.

1.26 As reported to the Audit and Governance Committee earlier this year, in the exceptional circumstances due to the covid pandemic, the Council invested more in Money Market Funds than the approved Strategy due to the need to keep funds liquid, the near zero rates obtainable with the DMADF and the shortage of counterparties available in the inter-local authority market. The 2021/22 treasury management removed the upper limit on all Money Market Fund investments, although the Council ensures that its liquid investments are diversified over a variety of providers to ensure access to cash at all times.

1.27 **Prudential Indicators:** Each year, the Council agrees Prudential Indicators under the Local Government Act 2003 which are affordable, prudent and sustainable. The indicators were agreed by the Shadow Authority at its meeting on 27 February 2020.

1.28 **Borrowing Indicators:** The Capital Financing Requirement measures the Council's underlying need to borrow for capital purposes. This is essentially the Council's outstanding debt, necessary to finance the Council's capital expenditure. The actual debt is dependent on the type and maturity of the borrowing undertaken as well as seeking the optimal cashflow situation.

1.29 Comparing gross debt with the capital financing requirement is an indicator of the Council's prudence in managing its capital expenditure and is designed to ensure that, over the medium term, external borrowing is only for capital purposes. The Council should ensure that gross debt does not exceed the total of the 'capital financing requirement'. The values are measured at the end of the financial year.

1.30 The authorised limit for external debt is required to separately identify external borrowing (gross of investments) and other long-term liabilities such as covenant repayments and finance lease obligations. The limit provides a maximum figure that the Council could borrow at any given point during each financial year.

1.31 The Operational Boundary for External Debt is a key management tool for in-year monitoring and is lower than the Authorised Limit as it is based on an estimate of the most likely level of external borrowing at any point in the year. In comparison, the authorised limit is the maximum allowable level of borrowing.

Comparison of gross debt with the capital financing requirement

Indicator	Approved £m	Actual £m
Gross Debt	509.23	316.46
Capital Financing Requirement	722.82	467.53

Authorised Limit (for total external debt)

Indicator	Approved £m	Actual £m
Authorised limit (for borrowing) *	630.00	316.46
Authorised limit (for other long-term liabilities) *	10.00	0.00
Total Authorised limit (for external debt) *	**640.00**	**316.46**

* These limits can only be breached with the approval of the full Council to raise them

Operational boundary (for borrowing)

Indicator	Approved £m	Actual £m
Operational boundary (for borrowing) *	530.00	316.46
Operational boundary (for other long-term liabilities) *	7.50	0.00
Total Authorised limit (for external debt) *	**537.50**	**316.46**

1.32 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 is acceptable subject to the authorised limit not being breached. The operational boundary allowed for £100m borrowing approval delegated to Cabinet should viable and robust businesses come forward, this was not utilised in 2020/21.

1.33 **Treasury Management Indicators:** The Council measures and manages its exposures to treasury management risks using the following indicators.

1.34 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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.

Credit Risk Indicator

	Indicator as at 31 March 2021	Target
Portfolio average credit rating	AA-	A

1.35 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one-month period, without additional borrowing. In light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.

Liquidity Risk Indicator

	Actual	Target
Total cash available within one month	£29.17m	£10m

1.36 **Interest rate exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest Rate Risk Indicator

	Indicator at 31 March 2021	Target
Upper limit on one-year revenue impact of a 1% rise in interest rates	£774,000	£250,000

1.37 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. A 1% increase interest would increase the Council's net interest income by £774k.

1.38 **Maturity structure of borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator

	31 March 2021	Upper Limit	Lower Limit
Under 12 months	2%	25%	0%
12 months and within 24 months	5%	20%	0%
24 months and within 5 years	7%	20%	0%
5 years and within 10 years	24%	25%	0%
10 years and above	62%	70%	25%

1.39Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

1.40**Principal sums invested for periods longer than a year:** 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 will be:

Principal Sums Invested for Periods Longer than a Year

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	£10m	£10m	£10m
Limit on principal invested beyond year end	£25m	£25m	£25m

The £10m invested with a maturity date in the financial year 2022/23 complied with the limit of £25m.

Legal and financial implications

1.41The publication of an annual strategy, a mid-year treasury report and an annual treasury management report conforms to best practice as required by the Code of Practice CIPFA Treasury Management in the Public Services.

Corporate implications

1.42 There are none.