**Appendix A**

# Treasury Management Update
# 30th September 2020

## 1. Introduction

1.1. Treasury Management is defined as "The management of the Authority'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".

1.2. The Council has adopted CIPFA's revised Code of Practice for Treasury Management which recommends that Members should be briefed on Treasury Management activities at least twice a year.

1.3. The Audit & Regulatory Committee has delegated responsibility for scrutinising the treasury function. The Committee's role includes approval of the annual treasury management strategy and scrutiny of operational treasury management reports. Decisions taken by the Audit & Regulatory Committee are reported to full Council.

1.4. The Treasury Management Strategy Statement (TMSS) for 2020/21 was approved by Council on 12th February 2020. This report details treasury management performance up to the 30th September 2020 and projects forward for the remainder of the financial year.

## 2. Economic Forecast – Interest Rates

2.1. The Council's treasury advisers, Link Asset Services ('Link'), provide the latest base rate and PWLB (Public Works Loan Board) forecast:

| % | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Bank Rate** | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| **5yr PWLB rate** | 1.80 | 1.80 | 1.80 | 1.80 | 1.80 | 1.80 | 1.90 | 1.90 | 1.90 | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.00 |
| **10r PWLB rate** | 2.10 | 2.10 | 2.10 | 2.10 | 2.10 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 | 2.30 | 2.20 | 2.30 | 2.30 | 2.30 |
| **25yr PWLB rate** | 2.50 | 2.50 | 2.60 | 2.60 | 2.60 | 2.60 | 2.60 | 2.70 | 2.70 | 2.70 | 2.70 | 2.80 | 2.80 | 2.80 | 2.80 |
| **50yr PWLB rate** | 2.30 | 2.30 | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 2.50 | 2.50 | 2.50 | 2.50 | 2.60 | 2.60 | 2.60 | 2.60 |

2.2. Link's interest rate forecast has the Bank of England base rate continuing at 0.10% for the short- to medium-term; and PWLB rates continuing at the current levels.

2.3. Uncertainties surround the future Bank of England base rate in the potential for negative interest rates. Link has not included these in the forecast, but their average earnings forecast shows that Councils can expect an average return of near 0%. The PWLB consultation is due to be reported on imminently and the outcome of this may impact the borrowing rates on offer.

## 3. Covid-19 impact on Treasury Management

3.1. The impact of Covid-19 on the Council's cash flows is being carefully monitored: the timing of some cash flows is changed in comparison to the usual trends with deferrals of payment plans for Council Tax and Business Rates; some grant payments having an earlier payment profile; some cash flows have been reduced, such as car parking income; and the grant schemes which the Council is delivering has the effect of unusual cash inflows followed by the outflows over a period; all of which results in a very different cash flow profile.

3.2. 'Liquidity' of cash flows being a primary concern in Treasury Management, subordinate only to 'Security', it was decided in the first quarter than no new fixed term investments would be made. As the cash flow forecast has developed during the last 6 months the Council has made investments in 95 day notice accounts which offer a good level of liquidity with slightly improved 'Yields' compared to instant access accounts.

3.3. Whilst the Council was in receipt of the £25million grant from Central Government to distribute under the Business Grants Scheme, it was necessary to increase all the Counterparty limits set in the Treasury Management Strategy Statement for 2020/21 in order to accommodate these balances in the short term as the scheme was administered and payments could be made. When cash balances had returned to more normal levels, the treasury management team reverted to the original approved Counterparty Limits. This is shown in more detail at section 5.

## 4. Investment Income

4.1. Interest earned on investment deposits up to 30th September 2020 totalled £60,130. The Council has budgeted to receive £160,000 in investment income in 2020/21. The budget was set with an expectation of higher interest rates than the current environment: 0.75% for the first three quarters of the year and a further potential rise to 1.00% at the end of the year.

4.2. During the year interest rates on accounts have fallen significantly, initially following the Bank of England base rate reductions in March to 0.10%, then compounded by the market sentiment pricing in potential negative rates. This is illustrated in the table below with the reduction in average interest rates from quarter 1 to quarter 2.

4.3. The investment portfolio is also reduced due to the continuation of internal borrowing, though this still represents a net saving in lieu of the external borrowing costs. Therefore a shortfall of £72,780 is forecast on the investment income budget.

4.4. The average interest rate achieved on the Council's investments compared to industry benchmark rates shows the Council is still performing relatively well:

| Comparator | Average Rate Q1 | Average Rate Q2 |
|---|---|---|
| **HPBC Average** | **0.50%** | **0.27%** |
| HPBC long-term fixed (>364 days) | 1.10% | 1.10% |
| HPBC short-term fixed (<364 days) | 0.93% | 0.52% |
| HPBC instant access | 0.37% | 0.14% |
| ***Benchmarks*** | | |
| **LIBID 12 month rate* | *0.56%* | *0.14%* |
| **LIBID 6 month rate* | *0.40%* | *0.02%* |
| **LIBID 3 month rate* | *0.26%* | *0.00%* |
| **LIBID 7 day rate* | *0.00%* | *0.00%* |
| Base Rate at the end of the period | 0.10% | 0.10% |

**LIBID = London Inter Bank Bid Rate*

*Crescent Development*

4.5. The Council provided a loan of £250,000 to the Buxton Crescent Heritage Trust as part of the Crescent development. Interest is charged on the loan at 6% which amounts to £15,000 during 2020/21. This income is included in the investment income forecast outturn reported above.

*Icelandic Investments*

4.6. At the end of July the Council received an unexpected 16th dividend payment from the former Icelandic investment with Heritable Bank of £10,518.59. This will be treated as windfall income in the year and offsets some of the investment income shortfall against the budget.

## 5. Investment Portfolio

5.1. The Council manages its investments in-house and invests with financial institutions meeting the Council's approved lending criteria. The Council's investment portfolio at 30th September 2020 totalled £30,767,000:

| Financial Institution | Country of Domicile | Amount | Maximum recommended lending duration | Interest rate at end of period | Average Maturity |
|---|---|---|---|---|---|
| Aberdeen MMF | UK | £7,000,000 | **WHITE (12 months)** | 0.09% | Instant access |
| Handelsbanken | UK | £6,300,000 | **ORANGE (12 months)** | 0.10% | Instant access |
| Santander | UK | £5,200,000 | **RED (6 months)** | 0.60% | 95 day notice |
| Federated MMF | UK | £3,500,000 | **WHITE (12 months)** | 0.06% | Instant access |
| Lloyds Bank | UK | £3,000,000 | **RED (6 months)** *(formerly Orange)* * | 0.20% | 95 day notice |
| Barclays 'Green' | UK | £3,000,000 | **RED (6 months)** | 0.30% | 95 day notice |
| Lloyds Bank | UK | £1,150,000 | **RED (6 months)** *(formerly Orange)* * | 1.10% | 364 days |
| Standard Chartered 'Sustainable' | UK | £1,000,000 | **RED (6 months)** | 0.09% | 181 days |
| NatWest Bank | UK | £617,000 | **BLUE (12 months)** | 0.01% | Instant access |
| **TOTAL** | | **£30,767,000** | | | |

*MMF = Money Market Fund*
** Lloyds reduced to RED (6 months) on 21st October following downgrade by Moody's*

5.2. The average level of funds available for investment up to 30th September 2020 was £30.95million.

5.3. New 95 day notice accounts have been opened with Barclays and Lloyds Bank in order to obtain an improved yield compared to money market funds and instant access accounts available, but with an acceptable period of liquidity in these uncertain times; and there has been a new 6 month deposit with Standard Chartered:

- The Barclays account is linked to Barclays' Green Bond Purchasing Programme which covers 'a variety of thematic projects including energy efficiency, renewable energy, green transport, sustainable food, agriculture and forestry, waste management and greenhouse gas emission reduction'. In the 2020-21 TMSS there was reference to Ethical Investing under Environmental, Social and Governance (ESG) considerations; and the Councils would consider investment opportunities with ESG links provided that the Security, Liquidity, Yield (SLY) criteria are met. Barclays is categorised by Link as a 'Red' counterparty and therefore meets the Council's primary treasury management criterion of 'Security'; the 95 day notice period is acceptable and therefore meets the second criterion of 'Liquidity'; and the account pays the same rate as the 'normal' or 'non-green' deposit with this institution (0.30% reducing to 0.10% if notice is given), therefore meets the third criterion 'Yield'. With all these factors considered, the opportunity was taken to invest in this 'green' deposit.

- In addition to this the Council was recently made aware of a Sustainable Deposit with Standard Chartered, which as with the Barclays deposit, meets the Security Criterion, is an appropriate Liquidity and offers the same Yield as the 'normal' deposit with this institution. Therefore the Council invested £1m in this product. Standard Chartered operate this product under their 'Green and Sustainable Product Framework', which includes 'No poverty; zero hunger; good health and well-being; quality education; gender equality; clean water and sanitation; affordable and clean energy; decent work and economic growth; industry, innovation and infrastructure; reduced inequalities; sustainable cities and communities; responsible consumption and production; climate action; life below water; life on land; peace, justice and strong institutions; partnerships for the goals'.

- The Lloyds Bank 95 day notice account pays 0.20% with no reduction in interest rate during the notice period. This account pays the same as a 12 month fixed deposit currently, so offers much better liquidity for the same yield, with a strongly rated counterparty.

5.4. The maximum investment term, as recommended by Link, is shown by colour banding in the table below with the TMSS approved counterparty limits. Due to unexpected cash balances in the Council's accounts relating to Covid grants at the start of the year, treasury management was operated with extended counterparty limits between $1^{st}$ April and $31^{st}$ August. As cash balances returned to more normal levels, these limits reverted to the approved TMSS levels on $1^{st}$ September:

| | | **Approved TMSS 2020/21** | | **Extraordinary counterparty limit increase applied from $1^{st}$ April to $31^{st}$ August due to Covid-19 excess cash balances** |
|---|---|---|---|---|
| **Colour Banding** | **Maximum Duration of Investment** | **UK Banks** | **International Banks** | **UK Banks** |
| **PURPLE** | Up to 2 years | £7.0m | £5.2m | £14.0m |
| **ORANGE** | Up to 12 months | £6.3m | £4.2m | £12.6m |
| **RED** | Up to 6 months | £5.2m | £3.5m | £10.4m |
| **GREEN** | Up to 100 days | £4.5m | £2.8m | £9.0m |
| **BLUE (Part nationalised financial institutions)** | Up to 1 year | £7.0m | n/a | £14.0m |
| **BLUE (NatWest)** | Up to 1 year | £10.5m | n/a | £21.0m |
| **Money Market Funds** | Up to 1 year | £7.0m | n/a | £14.0m |

5.5. Group limits are also applied where counterparties are in the same group as each other:

| **Portfolio % increased by 50%** | **Approved TMSS 2020/21** | **Extraordinary counterparty limit increase applied from 1st April to 31st August due to Covid-19 excess cash balances** |
|---|---|---|
| **Category** | **Group Principal Limit** | **Group Principal Limit** |
| **BLUE** | £10.5m | £21.0m |
| **PURPLE** | £10.5m | £21.0m |
| **ORANGE** | £9.4m | £18.8m |
| **RED** | £8.0m | £16.0m |
| **GREEN** | £7.0m | £14.0m |
| **Money Market Funds** | £10.5m | £21.0m |

*UK Sovereign Rating and Counterparty Duration*

5.6. The Ratings agency Moody's downgraded the UK's credit rating on Friday 16th October to Aa3 from Aa2, the third downgrade in eight years. This does not directly affect the Council's investment strategy or activity as the TMSS states that 'when investing in institutions *outside* the UK, only banks and building societies located in countries with a minimum sovereign rating of 'AAA' will be used', i.e. a change to the UK sovereign rating has no immediate impact.

5.7. However, the ratings and outlooks of UK banks include an assessment of the willingness and capacity of a government to support banks in case of need. The lower UK sovereign debt rating has therefore reduced the uplift in some banks' ratings. Banks affected currently in use by the Council were Bank of Scotland, Lloyds Bank, Santander and NatWest. The only resulting changes to the suggested durations on Link's counterparty list were Bank of Scotland and Lloyds reducing to Red (6 months) from Orange (12 months), which also had the effect of reducing the counterparty limit to £5.2million (£8million Group) from £6.3million (£9.4million Group) previously.

5.8. The Council has an existing 12 month fixed term investment with Lloyds Bank. As this is a fixed term deposit, there is no option to terminate before the maturity date on 13th November 2020, but as this is less than six months away, there is no concern; the Council also has a 95 day notice account with Lloyds, but again this is within the new maximum duration limit; and the amounts held with this counterparty do not exceed the new (reduced) counterparty limits, so not action was required. It is also important to stress that these changes were solely because of action on the UK sovereign rating, not a reflection of deteriorating conditions at the banks themselves.

5.9. Any future downgrades of other counterparties are likely to have minimal impact on the Council's investment activity as the majority of the current investment portfolio is instant access or 95 days in duration which fits in the lowest 'Green' creditworthiness duration limit of 100 days. All institutions used by the Council are currently 'Red' or higher.

*Other investment opportunities*

5.10. The treasury team continually monitors the investment opportunities available to the Council including instant access accounts; notice accounts; money market funds; fixed term deposits and Certificates of Deposit. These are all with rated institutions (banks, building societies, money market funds). Another option is to invest the Council's funds in the intra-local authority market. This type of investment is included in the Council's TMSS for investments for up to 12 months at the 'yellow' (up to 5 years) counterparty limit (currently £7m) as a specified investment; and up to 5 years at the >365 day limit (currently £5m) as a non-specified investment. The 'yellow' counterparty limit is in line with Link's view, as all local authorities are deemed to be AAA rated, secure and ultimately backed by government.

5.11. As interest rates on more traditional investments continue to fall, the intra-local authority market offers some good yields particularly to the longer end, but it is worth being prepared to enter this market in any case to provide a wider counterparty spread as conversations continue about the threat of negative rates.

5.12. In order to make an investment, the treasury team would contact one of the Council's brokers and make them aware of the amount of investment, duration and yield the Council would like to obtain; they then match this up with other local authority counterparts who need to borrow funds. There is no charge for this brokerage service when lending funds.

5.13. In the current climate, with Covid uncertainty and the impact on the Council's financial position and cash flows, the treasury team propose to consider investment opportunities with any local authority of less than 1 year when funds are available and these present a better yield than available elsewhere. The treasury team has discussed this with Link and they are comfortable with this approach, reiterating that all local authorities are secure and supported by government.

## 6. Capital Programme Update & Borrowing Position

*Capital Programme Update*

6.1. The table below provides current projections for capital expenditure and funding:

| | TMSS 2020/21 Estimate | Current Estimate (includes 19/20 carry forwards) |
|---|---|---|
| General Fund | £4,651,000 | £3,394,000 |
| HRA | £5,277,000 | £4,446,000 |
| **Total Capital Expenditure** | **£9,928,000** | **£7,840,000** |
| | | |
| ***Funded by:*** | | |
| Capital Receipts | £1,425,000 | £716,000 |
| External Funding | £550,000 | £562,000 |
| Reserves | £2,149,000 | £2,263,000 |
| HRA Revenue | £3,178,000 | £2,347,000 |
| **2020/21 Net Financing Requirement** | **£2,626,000** | **£1,952,000** |
| | | |
| **Capital Financing Requirement** | | |
| **Opening CFR** | **£81,260,000** | **£80,951,000** |
| *PLUS Net Financing Requirement* | £2,626,000 | £1,952,000 |
| *LESS Minimum Revenue Provision* | (£1,905,000) | (£1,899,000) |
| **Closing CFR** | **£81,981,000** | **£81,004,000** |

6.2. The Net Financing Requirement on 2020/21 spend is now estimated at £1,952,000: the variance is due to the reprofiling of elements of the capital programme, some due to delays resulting from the Covid 19 situation.

6.3. The Capital Financing Requirement (CFR) is a prudential indicator set to ensure that the Council's capital investment plans are affordable. The CFR represents the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying need to borrow to finance capital expenditure and is derived by aggregating specified items for the Council's balance sheet. The closing CFR is in line with the Capital Financing Requirement set in the Treasury Strategy Statement. On the basis of the latest forecasts, the Council's capital investment plans remain affordable.

*Borrowing Position*

6.4. In accordance with the Local Government Act 2003, it is a statutory duty of the Council to determine and keep under review how much it can afford to borrow. Therefore, the Council establishes ‘Affordable Borrowing Limits’ as part of the prudential indicators within the approved Treasury Management Strategy Statement.

6.5. The Council’s total outstanding debt as at 30th September 2020 is £66,825,404, as detailed in the table below:

| Lender | External Borrowing | Average Interest Rate | Maturity period |
|---|---|---|---|
| **Public Works Loan Board** | £54,025,404 | 3.76% | between 2 and 43 years |
| **Market Loans** | £12,800,000 | 4.57% | between 3 and 48 years |
| **Total** | **£66,825,404** | **3.92%** | |

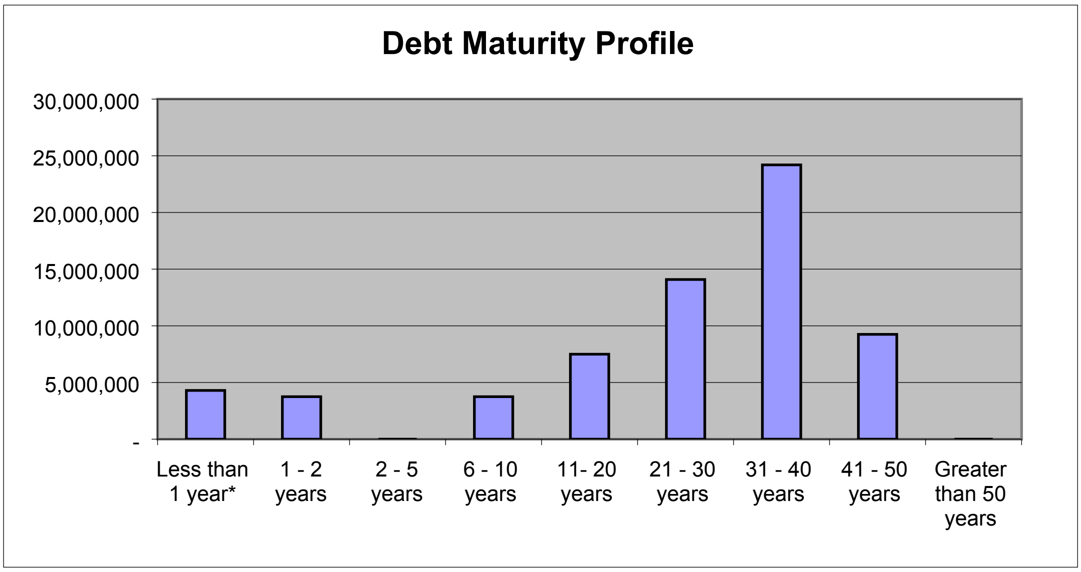
6.6. The ‘operational boundary’ (£89,098,000) and ‘authorised limit’ (£91,598,000) indicators govern the maximum level of external borrowing available to the Council to fund the capital programme. The current level of borrowing is within prudential limits.

6.7. The Council adopts a ‘one pool’ approach to borrowing whereby investments and borrowing are managed centrally with the proportional income and expenditure then split between the general fund and HRA. The Council has budgeted for interest charges and other financing costs of £1,837,940 to the general fund and £1,746,340 to the HRA in 2020/21

6.8. The budget for borrowing costs was based on the existing external debt and new external debt from the 2019/20 and 2020/21 general fund borrowing requirements. There has been no ‘new’ borrowing thus far during the current year and the Council continues to maintain a level of internal borrowing as anticipated. Therefore a small underspend of £13,140 is forecast against the borrowing costs budget, £11,530 attributable to the general fund and £1,610 to the HRA.

6.9. The treasury team will continue to monitor the appropriate time to externally borrow based on the profile of spend and opportunities to ‘internally’ borrow, considering the movement in interest rates and the cost of carry of any borrowings taken.

6.10. Attention must also be given to the maturity profile of the loans to ensure maturity dates are evenly spread so that the Council is not exposed to a substantial re-financing requirement at any one time, when interest rates are high. The graph below details the maturity profile of current loans.




*In accordance with guidance, the maturity date of LOBO's is deemed to be the next call date. Loans of £4.3m showing as 'less than 1 year' have a full maturity date of £1m 2023/24, £3.3m 2064/65.

6.11. Debt rescheduling is the reorganisation of existing debt in such a way as to amend the debt repayments, reduce the principal sum borrowed, alter the degree of volatility of debt or vary the interest payable, thus managing the risk. The treasury team, along with Link, continually monitor prospects for debt rescheduling to achieve overall financial benefit to the Council.

6.12. No rescheduling has taken place during 2020/21 to date. The Council will work with Link to identify any potential debt rescheduling options – taking account of the premium the Council would expect to pay on early redemption compared to the potential interest savings.

## 7. Prudential Indicators

7.1. The Council has operated within the treasury management and prudential indicators set in its Treasury Management Strategy Statement 2020/21 and complies with the Council's Treasury Management Practices.