

**REPORT OF: CHIEF EXECUTIVE**

**TO: POLICY AND RESOURCES COMMITTEE**

**DATE: 26<sup>TH</sup> NOVEMBER 2020**

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## **TREASURY MANAGEMENT – MID YEAR REPORT 2020/21**

### **PURPOSE OF REPORT**

1. The purpose of the report is to update Councillors on the treasury management activities of the Council for the period ending 30<sup>th</sup> September 2020 in accordance with the Council's Treasury Management Policy.

### **RECOMMENDATIONS**

2. It is recommended that the Policy and Resources Committee:
  - a) note the work on the Council's treasury activities for the period ending 30<sup>th</sup> September 2020 and the Mid-Year Report (**Appendix A**);
  - b) note the change in borrowing strategy for the 2020/21 year and thus recommend the revised Treasury Management Strategy Statement be approved by Council (**Appendix B**).

### **REASONS FOR RECOMMENDATION**

3. To:
  - a) comply with the Council's Treasury Management Policy and good practice in treasury management generally;
  - b) utilise surplus funds more strategically and to avoid net costs from external borrowing.

## ISSUE

### Introduction

4. In accordance with the Council's Treasury Management Policy it is a requirement that at least twice a year, a report be submitted to the Policy and Resources Committee on the Council's Treasury Management activities. Quarterly monitoring updates are provided to the Accounts & Audit Committee and at the end of the financial year a final report is presented to the Policy and Resources Committee providing details of the outturn for the year.
5. This mid-year report as attached at [Appendix A](#) has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:-
  - An economic update for the first six months of 2020/21;
  - A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
  - The Council's capital expenditure as set out in the Capital Strategy (prudential indicators);
  - A review of the Council's investment portfolio for 2020/21;
  - A review of the Council's borrowing strategy for 2020/21, including a change to the aforementioned strategy, to utilise forecast surplus cash balances ('internal borrowing') in lieu of externalising debt (prudential borrowing);
  - A review of compliance with Treasury and Prudential Limits for 2020/21.

An overview of the management of the Council's debt and investments in the year to date follows below.

### Long Term Borrowing

#### Original Borrowing Strategy

6. At the beginning of the financial year, the Council held long-term loans of £23.359m, comprised wholly of Public Works Loan Board (PWLB) debt. The 2020/21 Capital Programme approved by Council in February 2020 included PWLB borrowing for slippage from previous years. No additional borrowing has been undertaken during the first half of 2020/21.
7. The original borrowing strategy, to support the Medium Term Capital Programme, provided for the re-financing of maturing debt and also additional borrowing equal to the prior year's Minimum Revenue Provision (MRP), thus maintaining a net nil increase to the Council's overall Capital Financing Requirement (CFR).
8. New long-term borrowing was earmarked only in support of the Council's Property investment Strategy. The consultation on future lending terms via PWLB, including proposed changes that could prevent borrowing to fund commercial assets, has now closed and feedback is currently being evaluated. Whilst this Council did not respond directly, the District Council Network (DCN), of which Pendle is a member, responded to advocate no change to current legislation (amongst other responses).

#### Change to Borrowing Strategy

9. Following a review of the Council's Treasury Management Strategy for the year, and in the context of the continuing low interest rate environment, it is proposed to amend the Council's Borrowing Strategy for 2020/21 to focus more on internal rather than external borrowing as originally planned.

10. As Councillors will be aware, as part of the economic stimulus package to support businesses through the Covid-19 Pandemic, the Bank of England reduced the Bank Rate to 0.1%. This has a direct impact on the Council's investment returns and, as is reported elsewhere in this report, the average rate of return on the Council's investments is reducing leading to a shortfall in the budget for investment income. Associated with this is a tightening of the credit criteria for a number of the Council's normal Counterparties – those that we lend to – which means there are increasingly fewer Counterparties that meet the Council's accepted levels of credit quality.
11. At the same time, the Council is currently in an over-borrowed position; that is, the amount of external debt held by the Council exceeds the amount of the underlying need for debt financing as represented by the Capital Financing Requirement. This is largely a consequence of the significant amount of slippage on the Council's Capital Programme in recent years for which the Council has borrowed funds in advance (due to low interest rates) but has yet to use the borrowing.
12. In the light of this position, rather than take additional external borrowing as planned in the Treasury Management Strategy Statement agreed by the Council in March 2020, it is proposed to use internal borrowing to fund the Capital Programme for 2020/21. This will mean no new external borrowing and the repayment of debt without refinancing in the current year. This will have the benefit of:-
  - reducing the amount of surplus cash for investment, thereby reducing the Council's Counterparty risk;
  - acknowledging that investment returns are marginal in the current economic climate;
  - reduce the cost of external borrowing (the holding costs of debt)
13. This revision is considered prudent and without risk to the Council meeting its spending commitments as they fall due.
14. The revised Treasury Management Strategy Statement (TMSS) is included at [Appendix B](#).

### **Temporary (or Short Term) Borrowing**

15. Temporary borrowing relates to loans which are repayable:-
  - without notice, or
  - at less than 12 months notice, or
  - within 364 days of the date of borrowing.

During the period to date, the Council has not undertaken any short-term borrowing, but continues to have access to short-term, low cost funds should these be required.

### **Temporary (or Short Term) Investments**

16. In the wake of Covid-19, the Council received significant financial support packages from Central Government, namely:
  - £26.4m allocated and paid over to the Council to fund business grants;
  - £2.2m additional Council funding and COVID-19 hardship fund;
  - £1.3m full prepayment of 2020/21 NNDR Section 31 grant;
  - £2.5m deferral of Q1 payments for MHCLG's share of NNDR until October 20 – March 21.

17. Owing to surplus cash balances, in the year to 30<sup>th</sup> September, the Council breached its approval limit with Lloyds Bank Plc (£10m) on numerous occasions.
18. These breaches have been reported to the Accounts and Audit Committee in accordance with the approved TMSS and Treasury Management Scheme of Delegation for the Committee to discharge its functions, including scrutiny of treasury performance.
19. Whilst the TMSS has been revised to use surplus cash balances more strategically in lieu of external borrowing, the Council's Treasury Management Advisors, Link Asset Services (LAS), have been asked to review the Council's approved Counterparty List (Lending List). This will consist of a review of institutional and sector limits to help manage any temporary, surplus cash balances going forwards having due regard to security, liquidity and yield (SLY).
20. The Council's cashflow position is generally such that it has scope to undertake the short-term investment of surplus funds, i.e. as represented by balances, reserves etc. As previously stated, the Council has been adopting a more reserved approach to investing surplus funds, instead choosing to keep as much cash in instant access accounts as possible, or fixing deposits for short-term durations. The Council started the year with investments of £20.0m. The balance of investments as at 30<sup>th</sup> September 2020 was £17.0m. Table 1 summarises the investment transactions that have taken place since the beginning of the year:-

**Table 1: Analysis of Investments at 30th September 2020**

	£m	No.
Opening Balance of Investments	20.000	11
New Investments	23.000	7
Investments Realised	(26.000)	12
<b>Balance of Investments at 30<sup>th</sup> September 2020</b>	<b>17.000</b>	<b>6</b>

**Note:** The amounts and volumes shown above for 'New Investments' and 'Investments Realised' reflect cumulative values for transactions in the year to date as illustrated by way of the following example:-

- Make a new investment of £2m (counts as 1 new investment);
- Recall £0.5m from this investment (counts as the realisation of original investment of £2m and the making of 1 new investment of £1.5m);
- In summary this would be shown as 2 'new' investments with a combined value of £3.5m and 1 'realised' investment of £2m;
- The reported net position would be 1 outstanding investment with a current balance of £1.5m.

21. The 6 investments comprising the balance of £17.0m were placed with the following sectors:

	£m	%	
a. Local Authorities	6.0	35.29	(Principal Councils (1))
b. UK Banks	1.0	5.88	(Lloyds (1))
c. Government	3.0	17.65	(DMO (1))
d. Building Societies	7.0	41.18	(N'wide, Leeds, Coventry (3))
	<b>17.0</b>	<b>100.00</b>	

22. Unlike interest rates for long-term borrowing, rates for short-term investments are generally linked more closely to the prevailing Bank of England rate. At the special MPC meeting on 19<sup>th</sup> March 2020 the committee voted unanimously to cut the Bank Rate by a further 15 basis points, down to 0.10%, from the reduction to 0.25% agreed on 11<sup>th</sup> March 2020. In terms of the relative performance of the Council's investment portfolio, the average return on investments in the year to date is 0.48%, which is above the budgeted rate of return of 0.35%.

23. It is likely that we will see this rate of return reduce throughout the year, as the prevailing interest rates available for re-investment on maturing deposits are likely to be reduced. Opting to maintain higher levels of liquid funds (in lieu of anticipated reduced cash receipts as a result of the COVID-19 outbreak) will also negatively affect the amount of investment income the Council can reasonably expect to achieve. For these reasons it is likely that the 2020/21 budgeted investment income target of £100k will not be met and that these funds be used for internal borrowing to reduce debt service costs.
24. Return on the investment of surplus funds is a Key Performance Indicator (KPI) of the Council and performance will continue to be monitored monthly, and reported quarterly. The impact on the budget in 2020/21 and the medium term will be reported to members as part of the Council's established budget setting process. The underlying strategy remains one of protecting the capital invested whilst optimising, not maximising, returns on investment.
25. Total investments comprised fixed term deposits of £11.0m ranging from 23 days to 351 days in duration for amounts between £1m and £3m at interest rates of between 0.01% and 1.05%, and instant access deposit of £6.0m at a rate of 0.05%.
26. It was anticipated that a time 'lag' impacting upon the credit quality of counterparties would likely follow in Q2 or Q3 as a result of market volatility owing to Covid-19. At the time of this report, Moody's, one of the three main rating agencies has acted, downgrading the UK sovereign rating on 16<sup>th</sup> October. Whilst this has no direct operational impact on the management of the Council's cashflows, the knock-on effect has seen a change to the suggested maximum investment duration ('duration risk') for (future) sums placed with Lloyds Bank Plc. The maximum recommended duration for future fixed term deposits with Lloyds is 6 months, down from 364 days, and this is reflected in the approved Counterparty Lending List.
27. Lloyds are the Council's incumbent bankers, providing instant access to credit balances. Separately, the Council has £1m under fixed investment with Lloyds, maturing on 15<sup>th</sup> December 2020.
28. With regards to debt, the increase in the borrowing rates offered to Local Authorities from the PWLB has started to open up a range of alternative opportunities. For both investment and debt, the potential impact of COVID-19 and Brexit on markets, the Council will continue to maintain a watching brief.
29. Treasury management activities are undertaken within the Council's Treasury Management Policy and where necessary, advice is sought from Link Asset Services (LAS), the Council's Treasury Advisors. The revenue budgets associated with Treasury Management activity, namely debt charges (comprising interest and provision for principal repayment) and investment income are monitored on an ongoing basis and reported to Management Team and Policy and Resources Committee. The budgets for these items, as approved by Policy and Resources Committee in February 2020 are £1.354m and £100k respectively.
30. The Annual Treasury Management Strategy for 2020/21 was approved in consultation with Group Leaders under the Exercise of Urgent Powers Protocol in March 2020 as outlined above. This set out the framework against which the treasury management function is carried out. The annual Treasury Management Strategy for 2021/22 will be presented to Council in March 21.

## **IMPLICATIONS**

### **Policy**

31. Treasury Management activity is carried out in accordance with the Annual Treasury Management Strategy which is produced in compliance with the requirements of the Council's Treasury Management Policy.
32. Central Government consultation on PWLB future lending terms has now closed and feedback is being evaluated. Any implications for the Council will be reported in due course.

### **Financial**

33. The financial implications are as given in the report and [Appendix A](#).

### **Legal**

34. In accordance with the Local Government Act 2003, Members are required to approve the Annual Treasury Management Strategy incorporating the Annual Investment Strategy, the prudential indicators, and the authorised limit for external debt. The Strategy for the current year was approved in consultation with Group Leaders under the Exercise of Urgent Powers Protocol in March 2020.
35. The revised TMSS is attached at [Appendix B](#) for approval.

### **Risk Management**

36. Councillors will be aware of the uncertainty in the financial markets and the economy as a whole and the potential risks this may have in general. In this context, Councillors should note that treasury activities are undertaken within the Council's Treasury Management Policy and risk is managed through the application of requirements of Treasury Management Practice Notes (TMPs). Updated TMP documents will be presented to Council in 2020 to reflect operational changes and also the impact of COVID-19 and Brexit outcomes on the Council's minimum ratings criteria and availability of creditworthy counterparties.
37. The review of TMPs will include scrutiny of TMP5 "Organisation, Clarity, and Segregation of Responsibilities, and Dealing Arrangements" and TMP6 "Reporting Requirements and Management Information Arrangements" to account for remote working practices to ensure a robust control framework for the authorisation of payments remains.

### **Health and Safety:**

38. There are no health and safety implications arising from the contents of this report.

### **Sustainability:**

39. There are no sustainability issues arising from the contents of this report.

### **Community Safety:**

40. There are no community safety issues arising from the contents of this report.

### **Equality and Diversity:**

41. There are no equality and diversity issues arising from the contents of this report.

## **APPENDICES**

- [Appendix A](#) 2020/21 Mid-Year Review Report
- [Appendix B](#) Revised TMSS 2020/21

**LIST OF BACKGROUND PAPERS** - None