

REPORT TO: Audit and Governance Committee

MEETING DATE: 24 November 2020

BY: Depute Chief Executive (Resources & People Services)

SUBJECT: Treasury Management – Mid Year Review 2020-21

1 PURPOSE

- 1.1 To update the Committee on Treasury Management activity during the first half of 2020-21.

2 RECOMMENDATIONS

- 2.1 The Committee is asked to note the content of the report.

3 BACKGROUND

- 3.1 A main function of treasury management operations is to ensure that the cash flow is adequately planned, with cash being available when it is required. Surplus monies are invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.
- 3.2 In addition, the treasury management service ensures the accounting and funding of the Council's capital plans. The approved capital plans provide a guide to the borrowing need of the Council, setting out the longer term cash flow planning to ensure the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, any debt previously incurred may be restructured to meet wider risk or cost objectives.
- 3.3 Treasury management is defined as the management of the local authority's borrowing, 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. This mid year report is reviewed against the current Treasury Management Strategy that was approved by Council in March 2020.

- 3.4 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:
- A. An economic update for the first part of the 2020-21 financial year;
 - B. A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
 - C. The Council's capital position (prudential indicators);
 - D. A review of the Council's investment portfolio for 2020-21;
 - E. A review of the Council's borrowing strategy for 2020-21;
 - F. A review of any debt rescheduling undertaken during 2020-21.

Part A – Economic Update

- 3.5 The first half of 2020-21 has seen continued economic uncertainty across the UK, and the Monetary Policy Committee has left the bank rate unchanged at 0.1%. The MPC is to continue the programme of quantitative easing, increasing it by £150bn from January 2021.
- 3.6 The pace of economic recovery is currently forecast to be gradual and prolonged and despite some recovery in June to August still left the economy 11.7% smaller than February 2020.
- 3.7 PWLB rates were reduced in March 2020 for HRA borrowing by 1% through an 'HRA certainty rate'. Projected future PWLB rates are illustrated in the table below.

Link Group Interest Rate View 11.8.20										
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

- 3.8 HM Treasury have been undertaking a consultation with local authorities to review lending conditions may result in a reduction in the non-HRA certainty rate. The outcome of this review has not yet been announced, but it is anticipated that this will allow the Treasury to refuse any borrowing from PWLB in relation to commercial property activity where the investment is predominately to generate income (assets for yield).

Part B – Review of Treasury Management Strategy Statement and Annual Investment Strategy

- 3.9 The Treasury Management Strategy Statement (TMSS) sets out the wider Treasury and Investment Strategy, which was approved by Council on 3 March 2020 and includes a number of key treasury management indicators. This report provides an update on the Treasury Management activity undertaken by the Council relative to the approved strategy taking account of the updated economic position and budgetary changes already approved.
- 3.10 Table 3.1 below provides a summary of the current position relative to approved indicators, with more details around the position on each indicator set out in the remainder of this report.

Table 3.1

Prudential Indicators 2020-21	Approved £m	Current Estimated Prudential Indicator £m
Capital Financing Requirement	526	474
Operational Boundary	526	526
Authorised Limit	586	586

Includes long term liabilities for PPP arrangements and finance leases

Part C - The Council's Capital Position (Prudential Indicators)

- 3.11 The current projections set against the approved indicators are set out below.

Capital Expenditure and Financing of the Capital Programme

- 3.12 Table 3.2 below sets out the current projected outturns for the Council's capital investment programmes for 2020-21 relative to the approved budget as at 3 March 2020. The table sets out how the programme is financed, highlighting the supported and unsupported elements and the expected financing arrangements. The borrowing requirement increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR). This in part will be offset by any revenue charges for the repayment of debt.

Table 3.2

Capital Expenditure	2020-21 Approved Budget £m	2020-21 Projected Outturn * £m
General Services	96.2	46.2
HRA	33.5	24.2
Total capital expenditure	129.7	70.4
Financed by:		
Capital receipts	31.9	17.0
Capital Grants	23.3	19.5
CFCR	3.5	3.5
Total financing	58.7	40.0
Borrowing requirement	71.0	30.4

** Projected outturn was based on the position which informed the October Council update and remains subject to change*

Impact on Prudential Indicators

- 3.13 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Table 3.3 below, sets out the CFR and the expected debt position over the period, which is termed the Operational Boundary.
- 3.14 In summary, the Council is currently projecting to be under the approved limits for both CFR and Operational Boundary. This is largely due to the re-profiling of capital expenditure due to the suspension of economic and construction activity due to COVID. Future years Treasury indicators will be revised to take cognisance of the 2020-21 projected outturn, and the Council is expected to remain well within the Authorised Limit.

Table 3.3

	2020-21 Approved Limits £m	2020-21 Projected Outturn £m
Prudential Indicator – Capital Financing Requirement		
CFR – General Services	307	264
CFR – HRA	219	210
Total CFR	526	474
Prudential Indicator – the Operational Boundary for external debt		
Borrowing	491	439
Other long term liabilities*	35	35
Total debt (year-end position)	526	474

* *PPP arrangements and finance leases*

Limits to Borrowing Activity

- 3.15 One of the main key controls over the treasury activity is to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, (except in the short term), exceed the total of CFR in the previous year plus the estimates of any additional CFR for 2020-21 and next two financial years. This allows some flexibility for limited early borrowing for future years should the need arise.
- 3.16 Table 3.4 below sets out that the Council is currently managing to operate within this limit and maintains an under-borrowed position. The table states that at the end of this year the Council expects to have external borrowings of £399m and utilise £40m of cash flow funds (under-borrowing) in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate and remains consistent with the approved Treasury Management Strategy.

Table 3.4

	2020-21 Original Estimate £m	2020-21 Revised Estimate £m
External borrowing	430	399
Other long term liabilities*	35	35
Total external debt	465	434
CFR* (year end position)	526	474
Under-borrowing	61	40

* Includes PPP arrangements and finance leases etc.

- 3.17 The Authorised Limit is a statutory requirement that represents the limit beyond which borrowing is prohibited and sets an overall control on the level of borrowing. This limit reflects the level of borrowing which while not desired, could be afforded in the short term, but is not sustainable in the longer term. The approved Authorised Limit is £586 million and as highlighted in the table above, the Council continues to operate well within approved limits, and therefore there is no change to the overall strategy required.

Part D - Investment Portfolio 2020-21

- 3.18 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return consistent with the Council's risk appetite. Wider loan interest rates remain low and in line with the current 0.10% Bank Rate. It is anticipated

that any future increases in interest Bank rates will be gradual and given this, investment returns are likely to remain low.

3.19 Investment decisions during the first 6 months of 2020-21 are in accordance with the approved strategy. Table 3.5 below sets the investment activity during this period, with a summary set out below:

- Two short-term investments were made, one investment maturing in the next six months and the other investment is in a 95 day notice account.
- Any remaining surplus cash balances are held in the Council's bank account.

Table 3.5

Date of Investment	Borrower	Amount	Interest rate	Date repaid
19/08/20	Standard Chartered Sustainable	£ 5m	0.16%	To be repaid 19/11/20
19/08/20	Lloyds 95 day notice	£ 5m	0.20%	

3.20 An external investment management company, Investec, manages East Lothian Council Common Good funds and Charitable Trust funds in two separate portfolios. The returns on these investments continue to be closely monitored during the year.

- At 30 September 2020, the East Lothian Charitable Trust portfolio was valued at £3.337m, which represents an increase of £0.343m over the 6-month period. The performance of this portfolio for the first 6 months is better than the benchmark.
- The Common Good portfolio was valued at £3.349m an increase of £0.34m over the 6 month period. The expectation is that this portfolio should grow the fund and generate the best income at the minimal risk and the increase in the first 6 months is line with this expectation given the current market conditions. The performance of this portfolio for the first 6 months is slightly better than the benchmark.

Part E – Borrowing Strategy 2020-21

3.21 In recent years, the Council has predominately used PWLB as its main source of funding partly due to the level of risk and interest rates available. A gradual increase in interest rates has already been included within the current approved capital investment plans, and therefore any increases are unlikely to impact in this financial year. Going forward however, the Council will need to consider further both the affordability of capital

investment plans and potentially seek alternative sources of borrowing in order to achieve the best rates and terms. Whilst it remains unclear as to the extent of any further increase in borrowing rates, the Council's treasury advisor, Link Asset Services is currently forecasting that all PWLB rates are likely to gradually increase over the next few years.

3.22 No new external borrowing was taken in the first 6 months of the financial year. Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR, currently £474m), it is anticipated that additional new external borrowing of £30m will be required during the second half of this financial year.

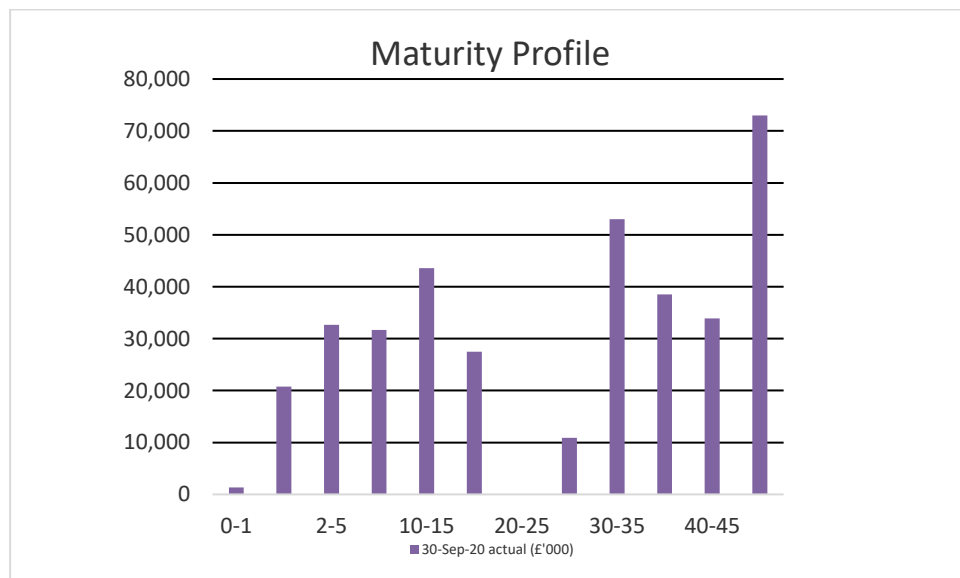
3.23 Two PWLB loans matured during the first six months and were repaid as set out in Table 3.6 below. No short term loans were taken or repaid during this time.

Table 3.6

Date repaid	Principal	Maturity	Interest rate
24/09/20	£0.662m	25 years	8.375%
24/09/20	£14m	10 years	4.200%

Current Loan Maturity Profile

3.24 The graph below sets out the current loan maturity profile for the Council, which remains consistent with the approved Strategy.



Part F – Debt Rescheduling

- 3.25 Debt rescheduling opportunities have been very limited in the current economic climate and as such, no debt rescheduling has been undertaken to date in the current financial year.

Part G - Introduction of Reporting Standard IFRS16

- 3.26 International Financial Reporting Standard 16 – Leases will come into operation from 1 April 2021. The standard brings the value of assets where the Council has the right of use including lease agreements onto the Council's balance sheet. The standard also requires these to be reflected in both capital and debt calculations. This standard has implications on treasury prudential indicators, particularly the Capital Financing Requirement as well as the Operational Boundary and Authorised Limit.
- 3.27 Work is progressing on the implementation of the new standard and an update of the likely implications will be incorporated into future reporting and in the 2021-22 Treasury Strategy.

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 has been considered and given there is no change in policy direction, there is no requirement to undertake any further impact assessment.

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 2020/21 to 2024/25 – East Lothian Council 3 March 2020

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DATE	13 November 2020

