

TREASURY MANAGEMENT ACTIVITY DURING 2019/20

BORROWING REQUIREMENT AND DEBT MANAGEMENT

- On the 31st March 2020, the Authority had a net borrowing need of £69M arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR) while useable reserves and working capital the underlying resources available for investments. These are the core drivers of TM Activity and the year-on-year change is summarised in table 1 below.
- The Authority's current strategy is to maintain borrowing and investments below their underlying levels in order to reduce risk and keep interest costs low which has resulted in a decrease of our internal borrowing of £15.3M.

Table 1 – Balance Sheet Summary

	31-Mar-19 Actual £M	31-Mar-20 Actual £M	31-Mar-20 Movement in year £M
General Fund CFR	334.02	339.58	5.56
Housing CFR	162.73	169.13	6.40
Total CFR	496.75	508.71	11.96
Less Other Debt Liabilities*	(71.07)	(67.83)	3.24
Loans CFR	425.68	440.88	15.20
Less External Borrowing	(246.34)	(276.87)	(30.53)
Internal (over) Borrowing	179.34	164.01	(15.33)
Less Usable Reserves	(154.28)	(174.55)	(20.27)
Less Working Capital Surplus	(92.94)	(58.01)	34.93
New Borrowing or (Investments)	(67.88)	(68.55)	(0.67)

* finance leases, PFI liabilities and Transferred debt that form part of the authority's total debt

- The forecast movement in coming years is one of the Prudential Indicators (PIs). When the strategy was last updated in February 2020, the CFR for 31 March 2020 was estimated at £535.6M, the Council's actual CFR at the end of the year was £508.7M. This decrease was due to slippage in borrowing on the capital programme, £17.5M on the General Fund and £9.4M on HRA. Actual Movement in year is shown in the following table.

Table 2 – Capital Financing Requirement Movement in year

Capital Financing Requirement	31/03/2019 Actual £M	31/03/2020 Forecast £M	31/03/2020 Actual £M	31/03/2020 Variance £M
Balance Brought forward	322.03	334.02	334.02	0.00
New Borrowing	19.41	34.75	17.26	(17.49)
MRP	(5.65)	(6.07)	(6.07)	0.00
Appropriations (to) from HRA	0.00	(2.40)	(2.40)	0.00
Movement in Other Liabilities	(2.33)	(3.24)	(3.24)	0.00
MRP Holiday	0.56	0.00	0.00	0.00
Total General Fund Debt	334.02	357.06	339.57	(17.49)
HRA	162.73	178.54	169.13	(9.41)
Total CFR	496.75	535.60	508.70	(26.90)

4. The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years. This is shown in the tables below together with activity in the year.

5. **Table 3: Borrowing and Investment Position**

	31-Mar-19 Actual £M	31-Mar-19 Average Rate %	31-Mar-20 Actual £M	31-Mar-20 Average Yield / Rate %	31-Mar-21 Estimated Balance £M
Long Term Borrowing					
Public Works Loan	197.34	3.30	257.87	2.88	527.60
LOBO Loans from Banks	9.00	4.86	9.00	4.89	9.00
	206.34	3.36	266.87	2.95	536.60
Short Term Borrowing					
Other Local Authorities	40.00	0.75	10.00	0.92	10.00
Total External Borrowing	246.34	3.03	276.87	0.92	546.60
Other Long Term Liabilities					
PFI Schemes	56.88	8.82	54.00	9.01	50.96
Deferred Debt Charges (HCC)	14.55	2.61	13.83	2.66	13.46
Total Gross External Debt	317.77	4.08	344.70	3.87	611.02
Investments:					
Managed In-House					
Government & Local Authority	(9.00)	0.79	0.00	0.00	
Cash (Instant access)	(26.06)	0.77	(31.11)	0.34	(10.00)
Cash (Notice Account)			0.00	0.00	0.00
Short Term Bonds	(1.60)	1.21	0.00	0.00	
Long Term Bonds	(6.03)	3.15	(3.01)	5.30	(3.00)
Managed Externally					
Pooled Funds (CCLA)	(27.00)	4.40	(27.00)	4.35	(27.00)
Total Investments	(69.69)	4.03	(61.13)	4.44	(40.00)
Net Debt	248.08		283.57		571.02

6. **Table 4: Movement in Borrowing during the year**

Movement in Borrowing during the year	2018/19	31-Mar-20	2019/20	Average Life
	Actual £M	Movement £M	Actual £M	
Long-term borrowing Carried Forward	217.81		206.34	
Maturities in year	(11.47)		(39.47)	
New borrowing taken in year	0.00		100.00	
Net Long Term Borrowing	206.34	60.53	266.87	17 Years
Short-term borrowing Carried Forward	33.00		40.00	
Maturities in year	(33.00)		(54.00)	
New borrowing taken in year	40.00		24.00	
Net Short Term Borrowing	40.00	(30.00)	10.00	2 Months
Total Borrowing at 31st March	246.34	30.53	276.87	

Please note that these figures do not reflect the accounting convention of moving loans maturing in the year from long term to short term so will differ from the maturity analysis.

7. The maturity analysis of the Council's debt at 31 March 2020 is further analysed below. Debt due in one year includes both short term and long term loans due in year, Lender's Option Borrower's Option (LOBO) loans are shown as uncertain as

although they are within the call option they are unlikely to be called in the current interest environment.

8. **Table 5: Maturity Structure of Borrowing**

<u>Outstanding</u> <u>31 March 2019</u>	<u>% of Total</u> <u>Debt</u> <u>Portfolio</u>	<u>Total Borrowing</u>	<u>Outstanding</u> <u>31 March 2020</u>	<u>% of Total</u> <u>Debt</u> <u>Portfolio</u>
£000	%	Source of Loan	£000	%
(197,344)	80	Public Works Loan Board	(257,875)	93
(49,000)	20	Other Financial Institutions	(19,000)	7
(246,344)	100		(276,875)	100
Analysis of Loans by Maturity				
(76,469)	31	Less than 1 Year	(45,278)	16
(19,278)	8	Between 1 and 2 years	(8,750)	3
(2,750)	1	Between 2 and 5 years	(18,000)	7
0	0	Between 5 and 10 years	(30,000)	11
0	0	Between 10 and 15 years	(37,000)	14
(10,000)	4	Between 20 and 25 years	(5,000)	2
(5,000)	2	Between 25 and 30 years	(25,000)	9
(42,000)	17	Between 30 and 35 years	(36,700)	13
(50,600)	20	Between 35 and 40 years	(47,900)	17
(31,247)	13	Between 40 and 45 years	(14,247)	5
(9,000)	4	Uncertain Date**	(9,000)	3
(246,344)	100		(276,875)	100

Borrowing Update

9. On 9th October 2019 the PWLB raised the cost of certainty rate borrowing by 1% to 1.8% above UK gilt yields as HM Treasury was concerned about the overall level of local authority debt. PWLB borrowing remains available but the margin of 180bp above gilt yields appears relatively very expensive. Market alternatives are available and new products will be developed; however, the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new HRA loans to 0.80% above equivalent gilt yields the value of this discount is 1% below the rate at which the authority usually borrows from the PWLB), available from 12th March 2020 and £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

The consultation titled "Future Lending Terms" allows key stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals on allowing authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield without impeding their ability to pursue their core policy objectives of service delivery, housing, and regeneration. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

The consultation closes on 31 July 2020 with implementation of the new lending terms expected in the latter part of this calendar year or financial year beginning 2021/22.

<u>Borrowing Strategy</u>	
10.	At 31st March 2020 the Authority held £276.87M of loans, (an increase of £30.53M since 31st March 2019), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans are summarised in Table 4 and 5 above.
11.	The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.
12.	In keeping with these objectives, new borrowing was only taken when a drop in the market presented an opportunity; short term borrowing was kept to a minimum, while existing loans were allowed to mature without replacement. We have remained under our CFR limit and had internal borrowing of £164.01M at the end of the year. This strategy enabled the Authority to reduce net borrowing costs and reduce overall treasury risk.
13.	The PWLB were the Council's preferred source of long term borrowing given the transparency and control that its facilities continue to provide but this year has illustrated, PWLB funding margins have increased quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields plus 0.80%, i.e. the PWLB HRA borrowing rate. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.
14.	However, due to the continued depressed markets and the 'cost of carry' associated with long term debt (i.e. the return from funds borrowed, whilst held and invested in the short term, would be less than the interest payments owed), the Council will defer long term borrowing and continue to use internal resources to finance the capital programme to minimise the cost of TM by keeping debt interest payments as low as possible without compromising the longer-term stability of the portfolio. This will be kept under review during 2020/21 with the need to resource an increasing capital programme and if opportunities arise as with the borrowing taken in 2019/20. Our advisors assist with this 'cost of carry' and breakeven analysis.
15.	The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long term borrowing was maintained.
<u>Lender's Option Borrower's Option Loans (LOBOs)</u>	
16.	The council continues to hold £9M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS had options during the year, none of which were exercised by the lender, but if they were it is likely that they would be replaced by a PWLB loan.
<u>Other Debt Activity</u>	
17.	Although not classed as borrowing the Council has previously raised capital finance via Private Finance Initiative (PFI). The balance at the end of the year, after allowing for repayment in year of £2.87M is £54M.
18.	In addition, the Authority holds debt in relation to debt transferred from Hampshire County Council on the 1 April 1997 when we became a unitary authority, of £13.8M. This is being repaid over 50 years at £0.4M per annum.

INVESTMENT ACTIVITY

19. Both the CIPFA and DCLG’s Investment Guidance requires the council to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. The Authority’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 income returns.
20. In a relatively short period since the onset of the COVID-19 pandemic, the global economic fallout was sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, businesses and individuals. Volatility measured by the VIX index was almost as high as during the global financial crisis of 2008/9 and evidenced in plummeting equity prices and the widening of corporate bond spreads, very close to rivalling those twelve years ago. Gilt yields fell but credit spreads widened markedly reflecting the sharp deterioration in economic and credit conditions associated with a sudden stagnation in economies, so corporate bonds yields (comprised of the gilt yield plus the credit spread) rose and prices therefore fell
21. The council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2019/20 the council’s investment balances have ranged between £38.7M and £152.8M. Movement in year is summarised in the table below:

22. **Table 6: Investment activity during the year**

	Balance on 01/04/2019	Investments Repaid	New Investments	Balance on 31/03/2020	(Increase)/ Decrease in Investment for Year	Average Life of Investments
	£M	£M	£M	£M	£M	Life
Multi- National Bonds (not subject to bail in)	(3)			(3)	0	2.47 years
Covered Bonds (secured)	(5)	5		0	5	
Money Market Funds and Call Account	(26)	470	(475)	(31)	(5)	1 day
Government & Local Authority Managed Externally (CCLA Pooled funds)	(9)	83	(74)	0	9	
	(27)			(27)	0	Unspecified
Total Investments	(70)	558	(549)	(61)	9	

23. Security of capital has remained the council’s main investment objective. This has been maintained by following the Authority’s counterparty policy as set out in its TM Strategy Statement for 2019/20. 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, which is supplied by our advisors. 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.

	Target	Actual
Portfolio average credit rating	A	AA-

24. Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority’s minimum long-term counterparty rating is A-) across rating agencies Fitch, S&P and Moody’s); for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

The authority also used secured investments products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

25. The table below summarises the Council’s investment portfolio at 31 March 2020 by credit rating and confirms that all investments were made in line with the Council’s approved credit rating criteria:

Table 7: Credit ratings of Investments held at 31st March 2020

Credit Rating	Long Term		Short Term	
	2019 £000	2020 £000	2019 £000	2020 £000
AAA	3,015	3,013	4,764	295
AA+			0	0
AA			9,021	10
AA-			17,001	21,840
A+			7,000	7,000
A			2,124	2,367
A-				
Shares in unlisted companies	45	20		
Unrated pooled funds	27,451	26,469	301	141
Total Investments	30,511	29,502	40,211	31,653

Credit Developments and Credit Risk Management

26. Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and Non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-. Further information is available in Appendix 1, Economic Background.

27. **Benchmarking:** Our advisors produce quarterly benchmarking which shows the breakdown of our investments and how we compare to their other clients and other English Unitary. Details can be seen in Appendix 3. It shows that on average the return on our internal investments at 0.82% is higher than the average of 0.64% and our overall return including the Local Authority Property Fund (income only) is 2.31% as opposed to the average of 1.23%. This has been achieved without impacting on our average credit rating which at AA- is in line with both other Local Authorities and Unitary Authorities.

Liquidity Management

28. In keeping with the DCLG’s Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and call accounts. There is no perceived risk that the Council will be unable to raise finance to meet its commitments. The Council also has to manage the risk that it will be exposed to replenishing a significant proportion of its borrowing at a time of unfavourable interest rates. The Council would only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

Externally Managed Funds	
29.	The Council has invested £27M in property funds which offer the potential for enhanced returns over the longer term, but will be more volatile in the shorter term. These funds are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.
30.	During 2019/20 this investment returned an average yield of 4.35% against the initial investment. Due to market conditions the value of the fund fell from £27.45M at 31 March 2019 to £26.47M a movement of £0.98M in the year, a reduction of £0.53M against the original investment. This notional “loss” at year end would only be a cost to the Authority at the point the investment is sold as the Authority is using the alternative fair value through profit and loss (FVPL) accounting and must defer the funds’ fair value losses to the Pooled Investment Fund Adjustment Account until 2023/24.
31.	Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority’s investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the long-term and the Authority’s latest cash flow forecasts, investment in these funds has been maintained.
Non – Treasury Investments	
32.	The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in MHCLG’s Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.
33.	Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment being used to fund council services, known as the Property investment fund (PIF). To date the authority has purchased 3 properties. Details of the properties purchased are shown in the table 6 below. The rate of return on these investment in 2019/20 was 6.04% gross and 2.14% net (after borrowing costs of £1.16M were incurred), which therefore represents a contribution to the revenue account of around £0.64M.
34.	All of the properties remain fully let and the tenants are meeting their financial obligations under the leases and there are currently no concerns regarding the property that has currently fallen in value below the debt outstanding on it due to the current financial environment. In November 2019, full council agreed an approach of additional investment in property, with £200M added to the capital programme, but any allocation from this sum has yet to be made.

35. Table 8: Property Investment Fund

Property	Actual	31.03.2019 Actual		31.03.2020 Actual		Outstanding Debt 31.03.2020
	Purchase Cost £M	Value in Accounts	Gain or (Loss) in Year	Value in Accounts	Gain or (Loss) in Year	£M
Property 1	6.47	6.27	0.24	6.30	0.03	5.97
Property 2	14.69	13.87	0.08	10.80	(3.07)	13.57
Property 3	8.53	8.17	0.09	8.39	0.22	7.88
	29.69	28.31	0.41	25.49	(2.82)	27.42

