DECISION-MAKER:		GOVERNANCE COMMITTEE		
SUBJECT:		REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT MIDYEAR 2020/21		
DATE OF DECISION:		16 NOVEMBER 2020		
REPORT OF:		**EXECUTIVE DIRECTOR FINANCE & COMMERCIALISATION (S151 Officer)**		
CONTACT DETAILS				
AUTHOR:	**Name:**	Steve Harrison	**Tel:**	023 8083 4153
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STATEMENT OF CONFIDENTIALITY		
NOT APPLICABLE		
BRIEF SUMMARY		
The purpose of this report is to inform Governance Committee of the Treasury Management activities and performance for 2020/21 to date against the approved Prudential Indicators for External Debt and Treasury Management.		
RECOMMENDATIONS:		
It is recommended that Governance committee:		
	(i)	Notes the Treasury Management (TM) activities for 2020/21 and performance against Prudential Indicators.
	(ii)	Notes that the continued proactive approach to TM has led to reductions in borrowing costs and safeguarded investment income during the year.
	(iii)	Approve the removal of the overall limit for investments in MMF from 50% of total investment as detailed in paragraph 16.
	(iv)	Continues to delegate authority to the S151 Officer to make any future changes which benefit the authority and to report back at the next Treasury update.
REASONS FOR REPORT RECOMMENDATIONS		
1.	The Treasury Management Code requires public sector authorities to determine an annual TM Strategy and now, as a minimum, formally report on their treasury activities and arrangements to Governance Committee mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities and enable those with ultimate responsibility/governance of the TM function to scrutinise and assess its effectiveness and compliance with policies and objectives.	

<table>
<tr><td colspan="3">ALTERNATIVE OPTIONS CONSIDERED AND REJECTED</td></tr>
<tr><td>2.</td><td colspan="2">No alternative options are relevant to this report.</td></tr>
<tr><td colspan="3">DETAIL (Including consultation carried out)</td></tr>
<tr><td colspan="3">CONSULTATION</td></tr>
<tr><td>3.</td><td colspan="2">Not applicable.</td></tr>
<tr><td colspan="3">BACKGROUND</td></tr>
<tr><td>4.</td><td colspan="2">The Local Government Act 2003 introduced a system for borrowing based largely on self-regulation by local authorities themselves. The basic principle of the new system is that local authorities will be free to borrow as long as their capital spending plans are affordable, prudent and sustainable.</td></tr>
<tr><td>5.</td><td colspan="2">The Chartered Institute of Public Finance and Accountancy’s Treasury Management Code (CIPFA’s TM Code) requires that authorities report on the performance of the treasury management function at least twice a year (mid-year and at year end).</td></tr>
<tr><td>6.</td><td colspan="2">The Authority’s TM Strategy for 2020/21 was approved at Governance Committee on 10 February 2020.
The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority’s Capital Strategy, complying with CIPFA’s requirement, was approved by full Council on 26 February 2020.</td></tr>
<tr><td>7.</td><td colspan="2">Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council’s treasury management objectives. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.</td></tr>
<tr><td>8.</td><td colspan="2">This report:</td></tr>
<tr><td></td><td>a)</td><td>is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;</td></tr>
<tr><td></td><td>b)</td><td>presents details of capital financing, borrowing, debt rescheduling and investment transactions;</td></tr>
<tr><td></td><td>c)</td><td>reports on the risk implications of treasury decisions and transactions;</td></tr>
<tr><td></td><td>d)</td><td>gives details of the midyear position on treasury management transactions in 2020/21; and</td></tr>
<tr><td></td><td>e)</td><td>confirms compliance with treasury limits and Prudential Indicators.</td></tr>
<tr><td>9.</td><td colspan="2">The report and appendices highlight that:</td></tr>
<tr><td></td><td>a)</td><td>Borrowing activities have been undertaken within the borrowing limits approved by Governance Committee on 10 February 2020.</td></tr>
</table>

	b)	As we have an increasing borrowing requirement our overall treasury strategy is to minimise both external borrowing and investments and to only borrow to the level of its net borrowing requirement. The reasons for this are to reduce credit risk, take pressure off the Council's lending list and also to avoid the cost of carry existing in the current interest rate environment. Throughout the year, capital expenditure levels, market conditions and interest rate levels are monitored to minimise borrowing costs over the medium to longer term and to maintain stability.
	c)	For longer term investments the Council will continue to hold assets into more secure and/or higher yielding asset classes. Total Investment returns are estimated to be £1.2M during 2020/21 which is lower than last year end and reflects the current financial environment.
	d)	The differential between debt costs and investment earnings continued to be acute, resulting in the use of internal resources in lieu of borrowing often being the most cost effective means of financing capital expenditure. As a result the average rate for repayment of debt, (the Consolidated Loans & Investment Account Rate – CLIA), at 2.71%, is lower than that budgeted and lower than last year (2.84%), this is due to rates being lower than budgeted resulting in an decrease in variable rate debt, this was partly offset by a corresponding decrease in variable interest on investments. We do not currently have any short term debt, but it is the intention to to borrow in the short term markets during 2020/21 to take further advantage of the current interest environment.
	e)	Since 2012, the Council has pursued a strategy of internal borrowing – minimising external borrowing by running down its own investment balances and only borrowing short term to cover cash flow requirements. This has both reduced the credit risk exposure and saved the Council money in terms of net interest costs. If opportunities arise long term borrowing would be considered as demonstrated during 2020/21 when the benchmark gilt rates for PWLB loans fell to historic lows and a £90M 15 year EIP (Equal Instalment Payment) loan was taken at 1.12% to secure this advantageous rate and add some certainty to the debt portfolio.
	f)	In achieving interest rate savings, the Council is exposed to interest rate risk by taking out variable debt. This was and continues to be very financially favourable in current markets but does mean that close monitoring of the markets is required to ensure that the Council can act quickly should the situation begin to change.
	g)	Net loan debt is expected to increase during 2020/21 from £284M to £412M (£128M) as detailed in Appendix 2, paragraph 5.

		Actual debt charges for the year for borrowing (excluding HCC transferred debt and PFI schemes) is forecast at £8.4M at an average interest rate of 2.71%
	h)	The initial reaction to the COVID crisis in March meant that short term liquidity became difficult and Government sought to assist cash flow by providing up front funding as far as possible, both in terms of the grants to businesses administered by the Council on its behalf and the funding to the local authority itself (under the business rates retention scheme). As a result of this grant funding year end investment balances were and have continued to be higher than expected.
	i)	Continued downward pressure on short-dated cash brought net returns on money market funds close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out. On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities
	j)	The impact of COVID-19 will continue during the current financial year and will be reported as part of the quarterly monitoring reports and as part of the mid-year report.
10.	Appendix 1 summarises the economic outlook and events in the context of which the Council operated its treasury function during 2020/21.	
11.	Appendix 2 summarises treasury activity during the year and covers: • Borrowing Requirement and Debt Management • Investment Activity • Non – Treasury Investments	
12.	Appendix 3 summarises quarterly benchmarking produced by our advisors and shows the breakdown of our investments and how we compare to their other clients and other English Unitary. It shows that on average the return on our internal investments at 0.43% is higher than the average of 0.27% and our overall return including the Local Authority Property Fund (income only) is 1.79% as opposed to the average of 0.90%. 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.	
COMPLIANCE WITH PRUDENTIAL INDICATORS AND AMENDMENT TO 2020/21 TREASURY STRATEGY		
13.	It can be confirmed that the Council has complied with its Prudential Indicators for 2020/21, approved by Governance Committee on 10 February 2020.	

14.	In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of TM activity during 2020/21. None of the Prudential Indicators has been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. The table below summarises the Key Indicators, further details can be seen in appendix 4.
15.	***Table1: Key Prudential Indicators***

Indicator	Limit	Actual at 30/9/2020
Authorised Limit for external debt	£770M	£326M
Operational Limit for external debt	£730M	£326M
Maximum external borrowing year to date	£770M	£292M
Limit of fixed interest debt	100%	82%
Limit of variable interest debt	50%	18%
Limit for long term investments	£100M	£30M

16. As part of the 21/22 Treasury Management Strategy our advisors, Arlingclose have proposed to remove the 50% limit for total investments in MMF but recommend that each fund should be limited to 10% of total investments and to ensure that they are split over a number and not just the highest yielding funds, which we have always done.

Due to the current low interest environment banks are no longer paying interest for call accounts and as detailed in paragraph 9 (i) above the DMADF are now pay negative rates on investments up to 3 weeks, and although MMF yields are low at 0.01% – 0.06% they are currently the best option.

There is a limited inter LA market for short term deposits as the market is currently cash rich and we are likely to be in a borrowing position in December so cannot lend out for too long, rates are between 0.01% and 0.03% without the ability to access the cash during term of investment.

It is recommended that the current strategy is updated to incorporate this change for investments held for cash flow purposes, as there are occasions when we have been above this limit and would have previously used the DMADF.

This is not seen as an increase in risk as the amount in individual funds has not increased and in fact due to our reduced investments balances in MMF are lower than they were this time last year, £25.4M as opposed to £66.4M, with a maximum investment £7M compared to £10M last year.

RESOURCE IMPLICATIONS

<u>Capital/Revenue</u>

17. This report is a requirement of the TM Strategy, which was approved at Council on 10 February 2020.

18.	The interest cost of financing the Authority's long term and short term loan debt is charged corporately to the Income and Expenditure account. The interest cost of financing the Authority's loan debt is estimated at £8.4M for 2020/21. This is lower than budgeted mainly due to variable interest rates being lower than those estimated, and slippage of capital spend to later years.
19.	In addition, interest earned on temporary balances invested externally is credited to the Income and Expenditure account. The current forecast for 2020/21 is £1.2M which is lower than budgeted due the current interest environment and lower than expected returns on the CCLA property investment fund.
20.	The expenses of managing the Authority's loan debt consist of brokerage and internal administration charges. These are pooled and borne by the HRA and General Fund proportionately to the related loan debt. Debt management expenses are currently in line with budget and expected to be £0.16M in 2020/21 but will be dependent on actual borrowing taken in year.
Property/Other	
21.	None.
LEGAL IMPLICATIONS	
Statutory power to undertake proposals in the report:	
22.	Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System. From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1)(a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.
Other Legal Implications:	
23.	None.
RISK MANAGEMENT IMPLICATIONS	
24.	Not Applicable
POLICY FRAMEWORK IMPLICATIONS	
25.	This report has been prepared in accordance with the CIPFA Code of Practice on TM.

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<tr><td colspan="2">KEY DECISION?</td><td colspan="2">~~Yes~~/No</td></tr>
<tr><td colspan="2">WARDS/COMMUNITIES AFFECTED:</td><td colspan="2">NONE</td></tr>
<tr><td colspan="4" align="center"><u>SUPPORTING DOCUMENTATION</u></td></tr>
<tr><td colspan="4">Appendices</td></tr>
<tr><td>1.</td><td colspan="3">2020/21 Economic Background</td></tr>
<tr><td>2.</td><td colspan="3">Treasury Activity during 2020/21</td></tr>
<tr><td>3.</td><td colspan="3">Southampton Benchmarking 30th September 2020</td></tr>
<tr><td>4.</td><td colspan="3">Compliance with Prudential Indicators</td></tr>
<tr><td>5.</td><td colspan="3">Glossary of Treasury Terms</td></tr>
<tr><td colspan="4">Documents In Members’ Rooms</td></tr>
<tr><td>1.</td><td colspan="3">None.</td></tr>
<tr><td colspan="4">Equality Impact Assessment</td></tr>
<tr><td colspan="3">Do the implications/subject of the report require an Equality and Safety Impact Assessments (ESIA) to be carried out.</td><td>~~Yes~~/No</td></tr>
<tr><td colspan="4">Privacy Impact Assessment</td></tr>
<tr><td colspan="3">Do the implications/subject of the report require a Privacy Impact Assessment (PIA) to be carried out.</td><td>~~Yes~~/No</td></tr>
<tr><td colspan="4">Other Background Documents
Equality Impact Assessment and Other Background documents available for inspection at:</td></tr>
<tr><td colspan="2">Title of Background Paper(s)</td><td colspan="2">Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)</td></tr>
<tr><td>1.</td><td colspan="2">The Medium Term Financial Strategy, Budget & Capital Programme 2020/21 to 2022/23 – reported to Council 26 February 2020</td><td></td></tr>
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