

## AUDIT COMMITTEE 28 JULY 2020

### Subject Heading:

**Annual Treasury Management Report  
2019/20**

### SLT Lead:

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### Policy context:

This Authority is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the prudential and treasury indicators for 2019/20. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, ("the CIPFA TM code") and the CIPFA Prudential Code for Capital Finance in Local Authorities, ("the Prudential Code")

### Financial summary:

**The Treasury Strategy supports the  
Authority's Budget strategy.**

### The subject matter of this report deals with the following Council Objectives

Communities making Havering	[x]
Places making Havering	[x]
Places making Havering	[x]
Connections making Havering	[x]

## **SUMMARY**

The CIPFA TM Code requires that authorities report on the performance of the treasury management function to Full Council at least twice per year (mid-year and at year-end).

The Authority's Treasury Management Strategy Statement (TMSS) 2019/20 was approved by Full Council on the 13<sup>th</sup> February 2019 and revisions to the strategy were approved by Audit Committee in November 2019. This report covers the period 1<sup>st</sup> April 2019 to 31<sup>st</sup> March 2020.

The Authority borrowed and invested substantial sums of money and is potentially exposed to financial risk from loss of invested funds and the revenue impact from changing interest rates. This report covers activity on treasury managed investments and borrowings and the associated monitoring and control.

## **RECOMMENDATIONS**

- To note the content of treasury management activities and performance against targets for the financial year 2019-20 as detailed in the report.

## **KEY HIGHLIGHTS**

- Investment income for the year was £2m compared to a budget of £1.4m.
- The Authority's weighted average return on its investments outperformed that of the treasury adviser's London Local Authority Group.
- During 2019/20 this Authority operated within the treasury limits and prudential indicators set out in the TMSS.

## REPORT DETAIL

### 1. External Context

#### 1.1 Economic Background

The Bank of England (BoE) reduced its policy rate by 50 basis points on the day of the Budget, and cut rates further to 0.1% on 19 March 2020.

The UK economy went through its sharpest and deepest contraction in a generation losing 18 years of cumulative growth in the two months following the pandemic declaration in March 2020. Based on the latest ONS figures the UK economy was 24.5% smaller at the end of May than it was in February 2020.

CPI inflation rate fell to 0.5% in the month of May when it was hovering around the BoE target rate of 2% earlier this year. Government borrowing costs have sunk to record lows. On the 10 July, five year government bond yields fell to minus 0.09%, negative yields now cover all gilts with maturities up to seven years. Longer term borrowing rates have also fallen over the year. It should be noted that the Government's PWLB certainty rate on new loans are priced daily and set at 180Bp over gilt yields. Presently, the 50 year PWLB rate for fixed term borrowing is 2.43% and 25 years PWLB at 2.64%.

Despite record supply of new debt issued by the Government to support the economy in response to the pandemic there has been even higher demand mainly from the BoE's bond buying programme termed Quantitative Easing (QE) which was expanded from £100bn in June to reach £300bn. The BoE have also strongly hinted that it may introduce negative interest rates if the economic recovery falters but this is unlikely to be used in the current year.

Whilst the BoE expects a "V shaped" economic recovery the expectation is that this will not be complete until well into 2021.

Officers and the treasury adviser's central forecast is that economic recovery will be slower than the BoE forecast and that inflation will remain below the target rate of 2% and as consequence interest rates will remain low for at least late 2021.

The PWLB consultation was published earlier this year and there was a strong hint that the Government is prepared to reverse the 1% arbitrary hike in PWLB rates last October if a mechanism can be found to avoid authorities using PWLB debt to fund yield based projects. The consultation

closes at the end of July.

It is against this background that officers have adopted a “wait and see” strategy before drawing down further long term debt choosing instead to utilise the authority’s cash balances to fund the borrowing requirement where investment rates are considerably lower than long term borrowing rates. Meanwhile the alternative finance market is also developing and officers will continue to monitor opportunities there alongside PWLB rates.

## 1.2 Credit Background

As at 31 March 2020, c. 58% or £100m of the Authority’s investments were held with other Local Authorities which have very high credit quality. However investment with any single authority did not exceed £10m. The Council currently uses three AAA rated low volatility money market funds (MMFs) to manage operational cash flow requirements.

Investment decisions are made by reference to the lowest published long term credit rating from the three main rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

## 2. Treasury Management Summary

The treasury management position as at 31<sup>st</sup> March 2020 and the change over the period is shown in table 1 below.

**Table 1: Treasury Management Summary as at 31<sup>st</sup> March 2020**

	01.4.19		31.03.20	31.03.20
	Balance	Movement	Balance	Weighted Average Rate
	£m	£m	£m	%
Long-term borrowing	203.234	25.000	228.234	3.20
Short-term borrowing	0.351	38.000	38.351	0.15
LOBO	7.000		7.000	3.60
<b>Total borrowing</b>	<b>210.585</b>	<b>63.000</b>	<b>273.585</b>	<b>2.78</b>
Long-term investments	38.000	(25.000)	13.000	2.02
Short-term investments	134.100	8.700	142.800	1.09
Cash and cash equivalents	14.490	1.360	15.850	0.91
<b>Total investments</b>	<b>186.590</b>	<b>(14.940)</b>	<b>171.650</b>	<b>1.14</b>
<b>Net borrowing</b>	<b>23.995</b>	<b>77.940</b>	<b>101.935</b>	<b>1.64</b>

### 3. Borrowing Strategy

3.1 The 31<sup>st</sup> March 2020 borrowing position is shown in table 2 below.

**Table 2: Borrowing Position**

	Balance at 01/04/19 £m	Raised £m	Repaid £m	Balance at 31/03/20 £m	Weighted Average Rate %
<b>Loans</b>					
PWLB	203.234	25.000	-	228.234	<b>3.20</b>
Bank (LOBO)	7.000	-	-	7.000	<b>3.60</b>
Local Authorities and Other (Short Term Borrowing)	.352	38.000		38.352	<b>0.15</b>
<b>Total Loans</b>	<b>210.586</b>	<b>63.000</b>		<b>273.586</b>	<b>2.78</b>

Investment rates remained below long term borrowing interest rates the difference being referred to the “carry rate”. The cost of carry of new borrowing has a negative impact on the budget.

### 4. Investment Activity

4.1 The Authority holds significant investments, representing grants and other income received in advance of expenditure plus balances and reserves held. The investment position during the financial year is shown in Table 3 below.

The Authority's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing, in order to reduce risk and keep interest costs low.

4.2 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve an optimal yield commensurate with these priorities.

**Table 3: Investment Activity**

	<b>01.4.19 Balance</b>	<b>Movement</b>	<b>31.03.20 Balance</b>	<b>Weighted Average Rate %</b>
<b>Investments</b>				
Banks & Building Societies (Fixed Unsecured)	34.100	3.700	37.800	0.99
Banks & Building Societies (Call & Notice Accounts Unsecured)	25.000	(10.000)	15.000	0.90
Banks & Building Societies (Fixed Secured)	1.000	(1.000)		
Local Authorities	109.000	(9.000)	100.000	1.09
Money Market Funds	14.490	1.360	15.850	0.41
Corporate Bonds and Loans	3.000	-	3.000	4.00
<b>Total</b>	<b>186.590</b>		<b>171.650</b>	

**4.3** The Authority is a member of the treasury adviser's benchmarking club which reports each quarter on its treasury investment performance in comparison with member authorities. The Authority's risk adjusted return was consistently higher than the average for 14 London Boroughs in the benchmarking club during 2019/20.

**4.4** **Appendix A** shows the breakdown of counterparties and investments for the authority.

## **5. Budgeted Income and Return**

**5.1** The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 4 below:

**Table 4: Treasury Investment Performance 2019-20**

	<b>Benchmark Return 3 month LIBOR (Average Quarterly Rate) %</b>	<b>Budgeted Rate of Return %</b>	<b>Budgeted Interest (Full Year) £m</b>	<b>Weighted Actual Rate of Return %</b>	<b>Actual Interest to end of Quarter £m</b>
<b>Quarter 1</b>	0.77	0.80	1.400	1.05	0.543
<b>Quarter 2</b>	0.75	0.80	1.400	1.08	0.525
<b>Quarter 3</b>	0.79	0.80	1.400	1.08	0.469
<b>Quarter 4</b>	0.59	0.80	1.400	1.08	0.454

## **6. New borrowing**

- 6.1** Affordability and the “cost of carry” remained important influences on the Authority’s borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.
- 6.2** Interest rate forecasts expected only gradual rises in medium and longer term borrowing rates during 2019/20, and the two subsequent financial years. Variable or short-term rates were expected to be the cheaper form of borrowing over the period.
- 6.3** The Authority executed additional PWLB 50 year borrowing of £25m at 1.48% discounted at HRA certainty rate at the end of the 2019-20.

## **7. Compliance with Treasury and Prudential Limits**

- 7.1** During the year, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority Treasury Management Strategy Statement and in compliance with the authority’s Treasury Management Practices. An update on indicators and limits are reported in **Appendix B** of this report.

## IMPLICATIONS AND RISKS

### **Financial implications and risks:**

The Authority uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times. All decisions will be undertaken with regards to all available information, including, but not solely our treasury adviser.

Risk is inherent in all treasury activity. The Investment Strategy identifies the risk associated with different classes of investment instruments and sets the parameters within which treasury activities can be undertaken and controls and processes appropriate for that risk.

Treasury operations are undertaken by nominated officers as prescribed by the Treasury Management Policy Statement as approved by the Council.

### **Legal implications and risks:**

There are no apparent legal implications or risks from noting this report.

### **Human Resources implications and risks:**

There are no HR implications from this report

### **Equalities implications and risks:**

There are no Equalities implications arising from this report.





## BACKGROUND PAPERS

None

## Appendix A

**Table 1 breakdown of Deposits at 31<sup>st</sup> March 2020**

Institution Type	Start date	Maturity	Rate	Amount
<b>UK Bank</b>				
Lloyds Bank plc	08/08/19	10/08/20	1.1000%	5,000,000.00
Lloyds Bank plc	02/09/19	28/08/20	1.1000%	5,000,000.00
Lloyds Bank plc	04/09/19	02/09/20	1.1000%	2,800,000.00
Lloyds Bank plc	03/04/19	03/04/20	1.2500%	5,000,000.00
Lloyds Bank plc	15/04/19	15/04/20	1.2500%	5,000,000.00
Santander UK plc – 95 days call account	01/06/18		0.9000%	15,000,000.00
Goldman Sachs International	15/10/19	13/10/20	1.0100%	5,000,000.00
Goldman Sachs International	16/10/19	16/04/20	1.0200%	5,000,000.00
Goldman Sachs International	17/10/19	17/04/20	1.0200%	5,000,000.00
<b>Local Authorities &amp; Other Public Sectors</b>				
Newcastle upon Tyne City Council	29/02/16	26/02/21	1.8000%	5,000,000.00
London Borough of Islington	26/04/16	26/04/21	1.7500%	5,000,000.00
Northumberland County Council	16/11/16	16/11/20	1.0000%	5,000,000.00
Northumberland County Council	16/11/16	16/11/21	1.1000%	5,000,000.00
Powys County Council	22/02/18	22/02/21	1.4500%	5,000,000.00
Cambridgeshire County Council	08/05/18	09/11/20	1.5000%	5,000,000.00
Mid Suffolk District Council	06/07/18	06/07/20	1.2000%	5,000,000.00
London Borough of Enfield	14/05/19	14/04/20	0.9500%	5,000,000.00
Warrington Borough Council	18/06/19	16/06/20	0.9500%	5,000,000.00
Guildford Borough Council	22/07/19	22/04/20	0.8200%	5,000,000.00
London Borough of Croydon	04/10/19	02/10/20	0.8000%	5,000,000.00
Slough Borough Council	22/11/19	20/11/20	0.9500%	5,000,000.00
Aberdeenshire Council	31/10/19	29/10/20	0.8000%	5,000,000.00
Lancashire County Council	29/11/19	27/11/20	0.8500%	5,000,000.00
Dunbartonshire Council	23/10/19	23/07/20	0.8200%	5,000,000.00
Salford City Council	14/11/19	12/11/20	0.9500%	5,000,000.00
London Borough of Southwark	20/11/19	18/11/20	0.9500%	5,000,000.00
Folkestone & Hythe District Council	03/02/20	01/02/21	1.0000%	5,000,000.00
Plymouth City Council	24/01/20	24/09/20	0.9000%	5,000,000.00
Walsall Metropolitan Borough Council	14/02/20	12/02/21	1.0000%	5,000,000.00
<b>Money Market Fund</b>				
Insight Liquidity Sterling C3	16/01/17		0.3248%	3,000,000.00
Federated Prime Rate Sterling Liquidity 3	13/11/18		0.4250%	12,850,000.00
<b>Unrated Corporate Bonds</b>				
Rockfire Capital Ltd	15/02/18	21/04/22	3.9999%	3,000,000.00
			<b>1.0572%</b>	<b>171,650,000.00</b>

**Compliance Report**

All treasury management activities undertaken during the financial year complied fully with the CIPFA Code of Practice and the authority's approved Treasury Management Strategy. Compliance with specific treasury limits is demonstrated in tables below.

**1.1 Interest Rate Exposures**

- 1.1.1 This indicator is set to control the Authority's exposure to interest rate risk on its debt portfolio. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of gross principal borrowed will be:

Table1: Interest rate exposure activity

	2019/20 Limit %	2019/20 Actual %	2020/21 Limit %	2021/22 Limit %
Upper limit on fixed interest rate exposure	100	96.60	100	100
Upper limit on variable interest rate exposure	30	3.40	35	35

Fixed rate borrowings are those borrowings where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

- 1.1.2 Having larger amounts of fixed interest rate borrowing gives the Authority greater stability with regards to its interest payments and reduces the risk of higher interest costs should interest rates rise. Traditionally local authorities have taken advantage of fixing interest rates long term to reduce interest rate exposure. The table excludes Salix Finance loans as these are held at zero interest hence no interest rate exposure.

**1.2 Maturity Structure of Borrowing**

- 1.2.1 This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 2: Loan maturity structure

	Upper %	Lower %	Actual %
Under 12 months	40	0	0
12 months and within 24 months	60	0	4.88
24 months and within 5 years	80	0	0
5 years and within 10 years	100	0	3.21
10 years and above	100	0	91.91

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

### 1.3 Principal Sums Invested for Periods Longer than 364 days

- 1.3.1 The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments.
- 1.3.2 The limits set in the 2019/20 treasury management strategy in comparison to the quarter one is set below. It is the authority's policy to classify investments with maturities exceeding one year as Long term investments.

Table 3: Investments for periods longer than 364 days

	2019/20 Limit £m	2019/20 Actual £m	2020/21 Limit £m
Limit on principal invested beyond year end	75	13	75

### 1.4 Liquidity Treasury Indicator

- 1.4.1 The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments overnight and within a rolling three month period without additional borrowing.

Table 4: Liquidity activity as at 31/03/2020

	<b>Target £m</b>	<b>Actual £m</b>
Total cash available by the next working day	5.000	15.850
Total cash available within 3 months	30.000	45.850

More liquidity was required to manage operational cash flow requirements.

## 1.5 Security Treasury Indicator

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

Table 5: Security Treasury Indicator

	<b>31.03.20 Actual</b>	<b>2019/20 Target</b>
Portfolio average credit rating	A+	A+

## 1.6 Gross Debt and the Capital Financing Requirement (CFR)

- 1.6.1 In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Table 6: Gross debt and the CFR at 31<sup>st</sup> March 2020

	<b>31.03.20 Actual £m</b>	<b>31.03.20 Estimate £m</b>	<b>31.03.21 Estimate £m</b>	<b>31.03.22 Estimate £m</b>
<b>Long-term External Debt</b>	<b>235.234</b>	<b>235.234</b>	<b>235.234</b>	<b>235.234</b>
General Fund	100.366	104.693	130.435	138.063
Housing HRA	197.217	212.660	254.784	284.808
Regeneration	55.844	122.537	173.897	212.414
<b>TOTAL CFR</b>	<b>353.427</b>	<b>439.890</b>	<b>559.116</b>	<b>635.285</b>
Internal Borrowing	118.193	204.656	323.882	400.051

- 1.6.2 Total debt is expected to remain below the CFR. Officers will draw down long term debt when conditions merit it. Actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt as below.

## 1.7 Operational Boundary for External Debt

- 1.7.1 The operational boundary is based on the authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. These limits may be reviewed as part of mid-year TMSS report in the event of a change in the interest rate outlook and the decision is made to fund the increase in CFR from external debt.

Table 7: Operational Boundary

<b>Operational Boundary</b>	<b>2019/20 £m</b>	<b>31.03.20 Actual</b>	<b>2020/21 £m</b>	<b>2021/22 £m</b>
Borrowing	423.000	235.234	436.000	468.000
Other long-term liabilities	10.000	0.000	10.000	10.000
<b>Total</b>	<b>433.000</b>	<b>235.234</b>	<b>446.000</b>	<b>478.000</b>

## 1.8 Authorised Limit for External Debt

- 1.8.1 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the authority can legally borrow. The authorised limit provides headroom over and above the operational boundary for unusual cash movements

Table 8: Authorised limit for external debt

<b>Authorised Limit</b>	<b>2019/20 £m</b>	<b>2020/21 £m</b>	<b>2021/22 £m</b>
Borrowing	472.000	487.000	520.000
Other long-term liabilities	10.000	10.000	10.000
<b>Total Debt</b>	<b>482.000</b>	<b>497.000</b>	<b>530.000</b>
Long Term Debt	235.234	235.234	235.234
<b>Headroom</b>	<b>246.766</b>	<b>261.766</b>	<b>294.766</b>

**A bond** is a debt instrument in which an investor lends money for a specified period of time at a fixed rate of interest. The issuing entity could be corporate, financial or government.

**A floating rate note (FRN)** is a money market instrument with a Floating/variable rate of interest, which re-fixes over a reference rate, for example 3 month LIBOR.

**Bail in** is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A **bail-in** is the opposite of a **bail-out**, which involves the rescue of a financial institution by external parties, typically governments using taxpayer's money.

**Certificates of deposit (CDs)** are a negotiable form of fixed deposit, ranked pari passu with fixed deposits. The difference is that you are not obligated to hold the CD to maturity, you can realise the cash by selling in the secondary market.

**Coupon** is the total amount of interest a security will pay. The coupon period depends on the security. A CD will often pay interest at maturity, while a bond may pay semi annually or annually and an FRN will most likely pay every 3 months.

**Covered bond** Covered bonds are conventional bonds (fixed or floating) issued by financial institutions, that are backed by a separate group of loans, usually prime residential mortgages. This lowers the creditor's exposure to default risk, enhancing the credit. This is why the issue is usually rated AAA, higher than the rating given to the issuer reduces exposure to bail-in risk.

**Credit rating** A measure of the credit worthiness of a borrower. A credit rating can be assigned to country, organisation or specific debt issue/ financial obligation. There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch or Moody's.

**MIFID** is the Markets in Financial Instruments Directive. A European Union Directive.

**Principal** is the total amount being borrowed or lent.

**Spread** is the difference between the buy and sell price of a security. It can also be the gap, usually in basis points, between the yield of a security and the benchmark security.

**Monetary Policy Committee (MPC)** is a committee of the [Bank of England](#), which meets for three and a half days, eight times a year, to decide the official [interest rate](#) in the [United Kingdom](#) (the [Bank of England Base Rate](#)).

**CPIH (Consumer Prices Index including owner occupiers' housing costs)** The new additional measure of consumer price inflation including a measure of owner occupiers' housing costs (OOH).

**Treasury bills (T-bills)** are UK government rated, short-dated form of Government debt, issued by the Debt Management Office (DMO) via a weekly tender. T-bills are normally issued for one, three or six month duration.

**Borrowing Requirements** The principal amount the Council requires to borrow to finance capital expenditure and loan redemptions.

**Capital Financing Requirement (CFR)** Capital Financing Requirement- a measure of the Council's underlying need to borrow to fund capital expenditure.

**Counterparties** Organisations or Institutions the Council lends money to e.g. Banks; Local Authorities and MMFs.

**Credit Default Swap (CDS)** A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.

**Credit Watch** A scoring system issued by credit rating agencies such as Fitch, Moody's and Standard & Poors that indicate the financial strength and other factors of a bank or similar Institution.

**Interest Rate Exposures** A measure of the proportion of money invested and what impact movements in the financial markets would have on them.

**Market Loans** Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.

**Money Market Fund (MMF)** A 'pool' of different types of investments managed by a fund manager that invests in lightly liquid short term financial instruments with high credit rating.

**Minimum Revenue Provision (MRP)** This is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.