Havering
LONDON BOROUGH

AUDIT COMMITTEE 22 JULY 2020

Subject Heading:	**Annual Treasury Management Report 2020/21**
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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 2020/21. 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) 2020/21 was approved by Full Council on the 26th February 2020 and revisions to the strategy were approved by Audit Committee in November 2020. This report covers the delivery of the TMSS in 2020/21.

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 2020-21 as detailed in the report.

KEY HIGHLIGHTS

- Investment income for the year £1.75m slightly exceeded budget £1.7m and the interest payable outturn was £8.304m compared to budget £12.695m – a saving of £4.391m in 2020/21. .
- The Authority's weighted average return on its investments outperformed that of the treasury adviser's benchmark London Local Authority Group.
- During 2020/21 this Authority operated within the treasury limits and prudential indicators set out in the TMSS.

REPORT DETAIL

1. Background

1.1. Economic

The Bank of England (BoE) is unlikely to raise interest rates due to higher inflation, as its target overshoot is likely to be temporary.

Our central case and that of the markets is that the Bank of England (BoE) will see through the temporary rise in inflation above its target 2.0% and keep Bank Rate at 0.1% for approximately two years, in order to allow the economy to fully recover. However the risk that BoE are underestimating inflation has increased and this will be watched carefully by officers as this will influence the timing of new long term prudential borrowing.

Yields on longer duration government debt have remained steady with 10-year yields close to 0.8% after a sharp increase in February this year. The increase reflected an anticipation of higher real interest rates and inflation in the future and brought yields back to pre-pandemic levels.

1.2 Credit

As at 31 March 2021, c.68% or £75m of the Authority's treasury investments were held with other Local Authorities which have very high credit quality. However investment with any single authority did not exceed £5m. The Authority uses only the highest quality "AAA" rated low volatility money market funds (MMFs) to manage operational cash flow requirements.

2. Treasury Management Summary

2.1 The treasury management activity in year is shown in table 1 below:

Table 1: Treasury management summary as at 31st March 2021

	01.04.20 Balance £m	Movement £m	31.03.21 Balance £m	31.03.21 Ave Rate %	31.03.21 Interest £m
LONG-TERM BORROWING					
PWLB	228.234	30.000	258.234	2.97	7.673
LOBO	7.000		7.000	3.61	0.253
Short-term borrowing	38.351	(27.898)	10.453	0.31	0.033
Total borrowing	**273.585**	**2.102**	**275.687**	**2.89**	**7.959**
INVESTMENTS					
Long-term investments	13.000	(13.000)	-		
Short-term investments	142.800	(32.800)	110.000	1.39	1.752
Cash and cash equivalents	15.850	(15.850)	-		
Total investments	**171.650**	**(61.650)**	**110.000**	**1.39**	**1.752**
Net borrowing	**101.935**	**63.752**	**165.687**	**1.50**	**6.207**

3. Borrowing strategy

3.1 Table 2 sets out the change in the authority's Capital Financing Requirement (CFR) in 2020/21 – this measures how the authority's underlying borrowing need has changed in year as a result of activity on the authority's approved capital programme and how it has been financed. The authority's capital finance budget includes provision to fund the capital programme's expected borrowing requirement from new long term fixed rate debt.

Table 2: Change in CFR and its financing 2020/21

£m	**31/2/20 Act**	**31/3/21 Act**
GF CFR	156	190
HRA CFR	197	212
Total CFR	**353**	**402**
Financed by:		
Internal cash	109	137
External Debt:		
HRA	200	230
GF	35	35

3.2 The authority agreed a PWLB long-term fixed rate loan at 1.53% for 50 years discounted at the HRA certainty rate to fund the HRA capital programme in year. This was slightly ahead of need at 31/3/21 to help fund the growth in the HRA's underlying borrowing need in 2021/22.

3.3 In year, short term interest rates remained much lower than long term rates (cost of carry) by c.1.7% which the outlook over the medium term remained the same. Deferring the draw down of new long term fixed rate debt combined with capital slippage on the capital programme helped deliver £4.391m in revenue savings (of which £3.03m is General Fund and used to fund pressures elsewhere in the authority's Budget Strategy).

4. Investment strategy

4.1 2020/21 was not a good year to be holding cash when short term interest rates were approaching zero (Bank rate is 0.1%) with the added threat from the imposition of negative rates (charges) coupled with CPI inflation currently running at 2.5%. Hence the strong case for running down the authority's cash balances to help fund the capital programme.

4.2 Table 2 shows capital borrowing from internal cash resources increased by £28m. Table 1 shows that the authority's cash resources contracted by £63.7m: £27.9m was repayment of a temporary loan drawn down in the previous year, internal borrowing for capital purposes £28m, and the balance £7.8m was attributed to operational fluctuations in net revenue spend.

4.3 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. . Officers kept treasury investments in short-term instruments in 2020/21 so they could be used to fund the capital programme but the aim is to keep a liquidity buffer of between £30m-£50m in the event of any future credit crisis. Most of the authority's treasury investments were invested with other local authorities reflecting their high credit quality characteristics.

Table 3: Treasury investment activity 2020/21

Investments	Balance at 31/03/20 £m	Movement £m	Balance at 31/03/21 £m	Interest Rate as at 31.03.21 %
Bank & Building Society (fixed unsecured)	37.800	(22.800)	15.000	0.11
Bank & Building Society (Call & Notice Accounts)	15.000	5.000	20.000	0.40
Local Authorities	100.000	(25.000)	75.000	0.54
Money Market Funds	15.850	(15.850)	-	
Corporate Bonds and Loans	3.000	(3.000)	-	

Total investments	**171.650**	**(61.650)**	**110.000**	

4.4 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 of 0.46% was higher than the average for 21 London Boroughs at 0.31% as at 31.03.21.

4.5 **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 2020-21

	Benchmark Return 3 month LIBOR (Average Quarterly Rate) %	Budgeted Rate of Return %	Budgeted Interest (Full Year) £m	Weighted Actual Rate of Return %	Actual Interest to end of Quarter £m
Quarter 1	0.14	0.80	1.700	1.00	0.639
Quarter 2	0.06	0.80	1.700	0.98	0.290
Quarter 3	0.02	0.80	1.700	0.68	0.541
Quarter 4	0.08	0.80	1.700	0.46	0.282

6. Regulatory Changes

6.1 The PWLB consultation concluded their review, effective from 26th November 2020 - the main headlines were:

- PWLB rate was lowered by 100bps (or one percentage point) for all new Standard Rate and Certainty Rate loans. This takes PWLB borrowing back to a margin of 80bps (0.8%) above the equivalent Gilt rate, which is the position pre October 2019 and prior to the PWLB consultation.

- As a condition to access to PWLB, authorities were asked to submit a high level description of capital spending for 3 years.

- The S151 officer of the authority confirmed there was no intention to buy investment assets primarily for yield any time in the next 3 years

6.2 On the 1st February 2021 CIPFA released a consultation setting out their proposed changes to the current version of the Prudential Code (previously updated in 2017).

- The main focus of the proposal is to address the risk associated with the commercial property acquisition(debt for yield), following comment from the Public Accounts Committee and National Audit Office report.

- The PWLB(i.e. HM Treasury) will not lend for debt for yield(commercial/profit) schemes. The PWLB will not lend to an authority that plans to buy investment assets primarily for yield anywhere in their capital plans, regardless of whether the transaction would notionally be financed from a source other than the PWLB.

6.3 CIPFA released consultation setting the proposed changes to the current version of the Treasury Management code (previously updated in 2018). There are 3 main impacts on the Treasury Management Practices (TMP) which support the authority's Treasury Management Strategy Statement .

- TMP 10 Training and Qualification: The current requirement is to ensure that the organisation recognises the importance of all staff and board/ council members having the required skills and knowledge to be able to undertake their duties and responsibilities.
- TMP 12 Corporate Governance:The proposal of more complex treasury management functions and decision and corporate responsibilities arising from MIFID11 (Markets In Financial Instruments and Directive) and TMP 12 to be broadened.
- TMP 13 Environimental, Social and Governance Management: This is an additional TMP recommended that a framework for due diligence to cover all external investments.

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.
The report has no direct equalities implications.
The Public Sector Equality Duty (PSED) under section 149 of the Equality Act 2010 requires the Council, when exercising its functions, to have ‘due regard’ to:
(i) The need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;
(ii) The need to advance equality of opportunity between persons who share protected characteristics and those who do not, and;
(iii) Foster good relations between those who have protected characteristics and those who do not.
Note: ‘Protected characteristics’ are age, disability, gender reassignment, marriage and civil partnerships, pregnancy and maternity, race, religion or belief, sex/gender, and sexual orientation.
The Council is committed to all of the above in the provision, procurement and commissioning of its services, and the employment of its workforce. In addition, the

Council is also committed to improving the quality of life and wellbeing for all Havering residents in respect of socio-economics and health determinants.

Health and Wellbeing implications and risks:

The Council is committed to improving the quality of life and wellbeing for all Havering employees and residents in respect of socio-economics and health determinants. Whilst there are no direct implications to the Council's workforce and residents health and wellbeing as a result of this report.

BACKGROUND PAPERS

None

Appendix A

Table 1 breakdown of treasury deposits at 31st March 2021

Institution Type	Start date	Maturity	Rate	Amount
UK Bank				
Goldman Sachs International	15/10/21	15/07/21	0.1000%	5,000,000.00
Goldman Sachs International	26/01/21	26/07/21	0.1100%	5,000,000.00
Goldman Sachs International	01/02/21	02/08/21	0.1200%	5,000,000.00
Santander UK plc	01/06/18		0.4000%	20,000,000.00
Local Authorities & Other Public Sectors				
Dudley Metropolitan Borough Council	17/04/20	16/04/21	1.6000%	5,000,000.00
Mid Suffolk District Council	06/07/20	05/07/21	0.8500%	5,000,000.00
Swale Borough Council	25/08/20	24/08/21	0.2700%	5,000,000.00
Blackpool Council	29/10/20	28/10/21	0.3300%	5,000,000.00
Plymouth City Council	24/09/20	23/09/21	0.3200%	5,000,000.00
London Borough of Waltham Forest	23/09/20	22/09/21	0.3300%	5,000,000.00
Woking Borough Council	17/11/20	16/11/21	0.3500%	5,000,000.00
Wrexham County Borough Council	02/12/20	01/12/21	0.2500%	5,000,000.00
Denbighshire County Council	30/11/20	29/11/21	0.2500%	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	16/11/21	1.1000%	5,000,000.00
Slough Borough Council	18/12/20	17/12/21	0.2500%	5,000,000.00
London Borough of Haringey	10/12/20	09/12/21	0.2000%	5,000,000.00
West Dunbartonshire Council	29/12/20	29/06/21	0.1200%	5,000,000.00
Wokingham Borough Council	05/01/21	04/01/22	0.2000%	5,000,000.00
				110,000,000.00

Appendix 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

	2020/21 Limit %	2020/21 Actual %	2021/22 Limit %	2022/23 Limit %
Upper limit on fixed interest rate exposure	100	97.36	100	100
Upper limit on variable interest rate exposure	30	2.64	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	0.42
24 months and within 5 years	70	0	1.52
5 years and within 10 years	80	0	32.26
10 years and above	100	0	65.80

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 2020/21 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

	2020/21 Limit £m	2020/21 Actual £m	2021/22 Limit £m
Limit on principal invested beyond year end	75	-	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 31/03/2021

	Target £m	Actual £m
Total cash available by the next working day	5.000	-

Total cash available within 3 months	30.000	35.000

More liquidity was required to manage operational cash flow requirements.

1.5 Security Treasury Indicator

1.5.1 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

	31.03.21 Actual	**2020/21 Target**
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 31st March 2021

	31.03.21 Actual £m	**31.03.21 Estimate £m**	**31.03.22 Estimate £m**	**31.03.23 Estimate £m**
Long-term External Debt	**265.234**	**265.234**	**265.234**	**265.234**
General Fund	125.307	152.225	163.405	169.187
Housing HRA	212.752	249.521	320.561	391.107
Regeneration	63.444	181.158	214.454	229.156
TOTAL CFR	**401.503**	**582.904**	**698.420**	**789.450**
Internal Borrowing	136.269	317.670	433.186	524.216

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

Operational Boundary	**2020/21 £m**	**31.03.21 Actual**	**2021/22 £m**	**2022/23 £m**
Borrowing	465.000	265.234	558.000	631.000
Other long-term liabilities	10.000	0.000	10.000	10.000
Total	**475.000**	**265.234**	**568.000**	**641.000**

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

Authorised Limit	**2020/21 £m**	**2021/22 £m**	**2022/23 £m**
Borrowing	698.000	837.000	946.000
Other long-term liabilities	10.000	10.000	10.000
Total Debt	**708.000**	**847.000**	**956.000**
Long Term Debt	265.234	265.234	265.234
Headroom available (amount)	**442.766**	**581.766**	**690.766**

Glossary of Terms **Appendix C**

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.