TREASURY MANAGEMENT ANNUAL REPORT

1. Outline

This report reviews the results of the full financial year as well as providing quarter 4 monitoring information in line with normal quarterly management reporting. The most significant elements of treasury management activity during 2019/20 were:

- At 31st March 2020, the Council's total loan debt net of treasury investments stood at £2,998.3m, compared to the net loan debt of £3,213.3m as at 31st March 2019.

- City Council treasury investments held at 31st March 2020 were £246.6m. This was higher than originally planned due to collecting funds for a three year pension payment in April and receipt of COVID grants in advance from the Government. The Council also held investments of £104.4m as accountable body.

- The City Council did not breach any of its prudential limits set under the Local Government Act 2003 and the CIPFA Prudential Code for Capital Finance.

- Loan interest, repayment charges and associated costs totalled £265.8m gross, and £112.3m after recharges to other services. This was £2.6m above the budget of £109.7m. This was due largely to capital programme slippage offset by lower than budgeted borrowing cost recharges.

2. Background

2.1 The City Council, like all local authorities, is permitted by government to finance capital investment and day to day cash flows from borrowing, in accordance with the prudential borrowing system. The Council's net loan debt at 31st March 2020 stood at £2,998.3m (excluding accountable body investments). This report reviews how the debt and associated investments were managed during the financial year 2019/20.

2.2 The City Council has adopted CIPFA's Code of Practice for Treasury Management in the Public Services which includes the requirement to present a treasury management Annual Report.

2.3 Loans and investments are shown at nominal value unless otherwise indicated, consistent with budget and monitoring reports and the Prudential Indicators. The basis of accounting in the Financial Accounts is different in some cases where required by proper accounting practices.

3. The objective of treasury management

3.1 CIPFA defines the objective of Treasury Management as "the management of the organisation's 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". In balancing risk against return, Local Authorities should be more concerned to avoid risks than to maximise return. In particular, this requires a balance to be struck when borrowing between:

a) The security offered by long term fixed rate funding;

b) The expected cost of short term and variable rate funding, compared with long term funding

Similarly when investing surplus funds, the emphasis should be on the security of capital invested rather than maximising the rate of return.

4. Financial markets during 2019/20

4.1 The financial year to December 2019 was dominated by global economic uncertainty as the US and China continued their stand-off in trade talks; the expected slowdown in global growth led the Federal Reserve to cut interest rates three times between July and September. The turnaround in interest rate expectations prompted global financial markets to rally although bond yields remained volatile. The UK continued to grapple with leaving the European Union but a snap General Election in December allowed the new government to achieve Brexit in January 2020.

4.2 However, the spread of the COVID-19 virus profoundly affected global markets in the final quarter of 2019/20 as countries went into lockdown and governments and central banks announced measures to support businesses. Global equities suffered steep declines and bond yields fell as investors favoured their perceived safety. Oil prices plunged due to a weakened outlook for demand. In the UK, the Bank of England, in line with other central banks, reduced interest rates drastically, cutting by 65 basis points to a record low of 0.10%. Government gilt yields were extremely volatile during this period; during March 2020 alone, the UK 10 year yield fell to 0.10%, then rose to 0.82% before falling back to 0.32%. The impact can be seen in the PWLB borrowing rates available to local authorities (see chart at Annex 1).

4.3 The coronavirus has significantly weakened investment credit risks as Credit Risk Default Swaps (CDS), an indicator of credit risk, rose sharply towards the end of the year. Risks to the Council's investments remained low as it mainly invests in liquid AAA rated money market funds.

5. Treasury strategy and activities during the year

5.1 The City Council's actual net loan debt at 31st March 2020 was £2,998.3m compared to the expected net loan debt at the time of the Original Budget in March 2019 of £3,532.7m. This is due to slippage in capital expenditure and other cashflow movements across the Council. Additional long term loans taken amounted to £180m compared to the original assumption of £225m new long term borrowing.

5.2 The treasury strategy implemented in the year:

- Maintained a balanced strategy which enabled the Council to benefit from current low short term interest rates, maintaining a significant short term and variable rate loan portfolio
- Acknowledged the risk that maintaining a significant short term and variable rate loan debt may result in increasing borrowing costs in the longer term, but balanced this against the savings arising from cheaper variable rates in the short term
- Reviewed treasury management activity in the context of the Council's current financial position together with the outlook for interest rates
- Continuously reviewed the advantages and disadvantages of different sources of borrowing.

5.3 Opportunities to improve risk management or make savings by prematurely repaying loans are kept under review. Market conditions proved favourable for the early repayment of £30.0m of the Council's LOBO loans during the year, as set out in Annex 2. The Council was advised by its treasury advisers Arlingclose on this repurchase, which results in significant cost reductions over time.

5.4 The City Council's Treasury Strategy in recent years has sought to maintain a significant exposure to short-term and variable-rate borrowing in order to take advantage of cheaper short-term rates at around bank base rate. The variable and short term borrowing was £292.1m at 31st March 2020 (see Table 7.1). This was borrowed at an average rate of 0.97%. By borrowing short term rather than more expensive long term fixed rate loans, savings were generated, but at the risk that interest rates may subsequently rise. The short term debt portfolio size remained below the £550m indicated in the Treasury Management Strategy, as the Council's borrowing needs during the year were lower than forecast.

5.5 The majority of the Council's borrowing needs during the year were still met from short term borrowing, minimising interest costs. £180m of long term fixed rate borrowing was taken during the year from the PWLB, at interest rates from 1.57% to 2.31%. £30.0m of the new PWLB loans were taken to refinance the premature repayment of some LOBO loans (details are provided at Annex 2).

5.6 £150m of the £180m new PWLB loans were taken out before 9 October 2019 when HM Treasury, the government department responsible for the PWLB, increased the margin over gilt yields from 80bps to 180bps. Annex 1 shows that that rates since October have been substantially higher than the rates under the old policy, although they are still low when compared to historical PWLB rates.

5.7 HRA loan debt is accounted for separately in accordance with the two pool debt system, which the Council introduced following the reform of Housing Subsidy. The level of HRA loan debt has decreased from £1,064.8m, to £1,056.8m, taking account new capital investment and HRA debt repayment provision (or MRP) in the year. No long term loans were taken for the HRA during the year other than refinancing the LOBO prepayments, in order to maintain prudent exposure for the HRA to cheaper short term interest rates.

6. <u>Investment management</u>

6.1 Under the current treasury strategy, a working balance of around £40m short term investments is targeted in order to provide liquidity to meet cash flow fluctuations.

6.2 Treasury Investments are made in accordance with the creditworthiness criteria in the Treasury Management Policy and are also reported to Cabinet as part of the quarterly capital monitoring reports in line with the liquidity management objective for investments. Lending has continued to be limited to short periods less than a year to the institutions within the Treasury Management Policy's criteria. A range of information has been used to assess investment risk, in addition to credit ratings. Regular meetings are held to review outstanding investments and criteria for new investments in the light of developments in market conditions. None of the Council's treasury investments has defaulted.

6.3 Actual investments are reported quarterly to Cabinet as part of accountability for decisions made under treasury management delegations. Annex 3.1 lists all investments made during Quarter 4 of 2019/20 for the Council.

6.4 Investments outstanding at 31st March 2020 are summarised as follows.

Period Outstanding	Value Invested £m	Weighted Average Interest Rate %
Instant Access	42.63	0.47%
Fixed Overnight	81.00	0.07%
Up to 3 months	123.00	0.54%
3 to 6 months	0	0.00%
Total	**246.63**	**0.37%**

6.5 The Council also continues to manage substantial funds as Accountable Body for an increasing number of Government programmes: the Growing Places Fund, the Regional Growth Fund and the Advanced Manufacturing Supply Chain Initiative (AMSCI). These funds are managed by the Council but are not the Council's own money. The unspent balance of the funds at 31st March 2020 was £104.4m as set out in Annex 3.2. These funds are being invested in accordance with the Accountable Body agreements in very low-risk deposits with the UK Government (predominantly in the DMADF and Treasury Bills).

7. Debt profile

7.1 Long term borrowing is taken at a range of maturities to ensure that debt maturing in any year does not generally exceed 10% of total external debt, and that short-term/variable rate debt does not exceed the limit of 30% set in the City Council's prudential indicators (full maturity profile at Annex 4). This ensures that the Council is not overly exposed to the risk of high refinancing costs in any year. The following table summarises how the maturity profile of the Council's debt changed within the year.

Debt Profile (General Fund and HRA combined)	**31.03.19 £m**	**31.03.20 £m**
Fixed rate over 40 years	250.0	70.0
Fixed rate 20 to 40 years	1,261.2	1,351.2
Fixed rate 10 to 20 years	734.1	883.7
Fixed rate 5 to 10 years	419.1	301.2
Fixed rate 1 to 5 years	131.9	306.5
Fixed < 1 year (note 1)	80.0	40.2
Variable and short term	416.6	292.1
Gross Debt	3,292.9	3,244.9
Investments < 1 year	(79.6)	(246.6)
Net Debt	**3,213.3**	**2,998.3**

Note: LOBO loans shown at final maturity

7.2 The average interest rate paid on all the Council's debt in 2019/20 was 4.40%. This includes the cost of historic debt taken when fixed interest rates were higher.

7.3 The above maturity profile assumes that Lender's Option Borrower's Option (LOBO) loans are repaid at their final maturity date. A full maturity profile at 31st March 2020 compared to 31st March 2019 is given in Annex 4.

7.4 At 31st March 2020 the debt portfolio included £71.1m LOBOs, less than 3% of the total portfolio. No LOBO loans have had their options called by the lenders since the arrangements were entered into. Given the current and forecast low interest rate environment it is considered to be a low risk that this will take place in the foreseeable future.

8. Revenue cost of borrowing

8.1 The actual net cost of borrowing to corporate treasury budgets was £112.3m. This is £2.6m above the budget, due largely to capital programme slippage offset by lower than budgeted borrowing cost recharges. The Treasury Management outturn is summarised in the table below:

	Budget £m	Actual £m	Variation £m
Gross interest payable	132.2	132.3	0.1
Interest receivable	(0.3)	(0.7)	(0.4)
Revenue charge for debt repayment	152.3	148.7	(3.6)
Early payment discount - Pension	(16.8)	(16.8)	0.0
Other Costs	5.1	2.3	(2.8)
Total Treasury Management Budget	**272.5**	**265.8**	**(6.7)**
Less recharges to:			
HRA	(71.8)	(67.2)	4.6
Other Services	(91.0)	(86.3)	4.7
Net Corporate Treasury	**109.7**	**112.3**	**2.6**

9. Prudential Indicators

9.1 The City Council is required under the Local Government Act 2003 and the CIPFA Prudential Code for Capital Finance in Local Authorities to set various prudential indicators and limits covering capital finance and treasury management. The outturn position against the Council's approved prudential indicators is attached at Annex 5. The City Council did not breach any of its prudential limits set under the Local Government Act 2003 and the CIPFA Prudential Code for Capital Finance.

10. Risk management and performance

10.1 Risk management is at the centre of treasury performance and monitoring. The City Council has adopted the CIPFA Treasury Management Code's policy recommendation that "the successful identification, monitoring and control of risk are the prime criteria by which the effectiveness of its treasury management activities will be measured."

10.2 There is no single quantitative measure which summarises the management of the different types of treasury risk and their financial impact. Key reporting and review processes include:

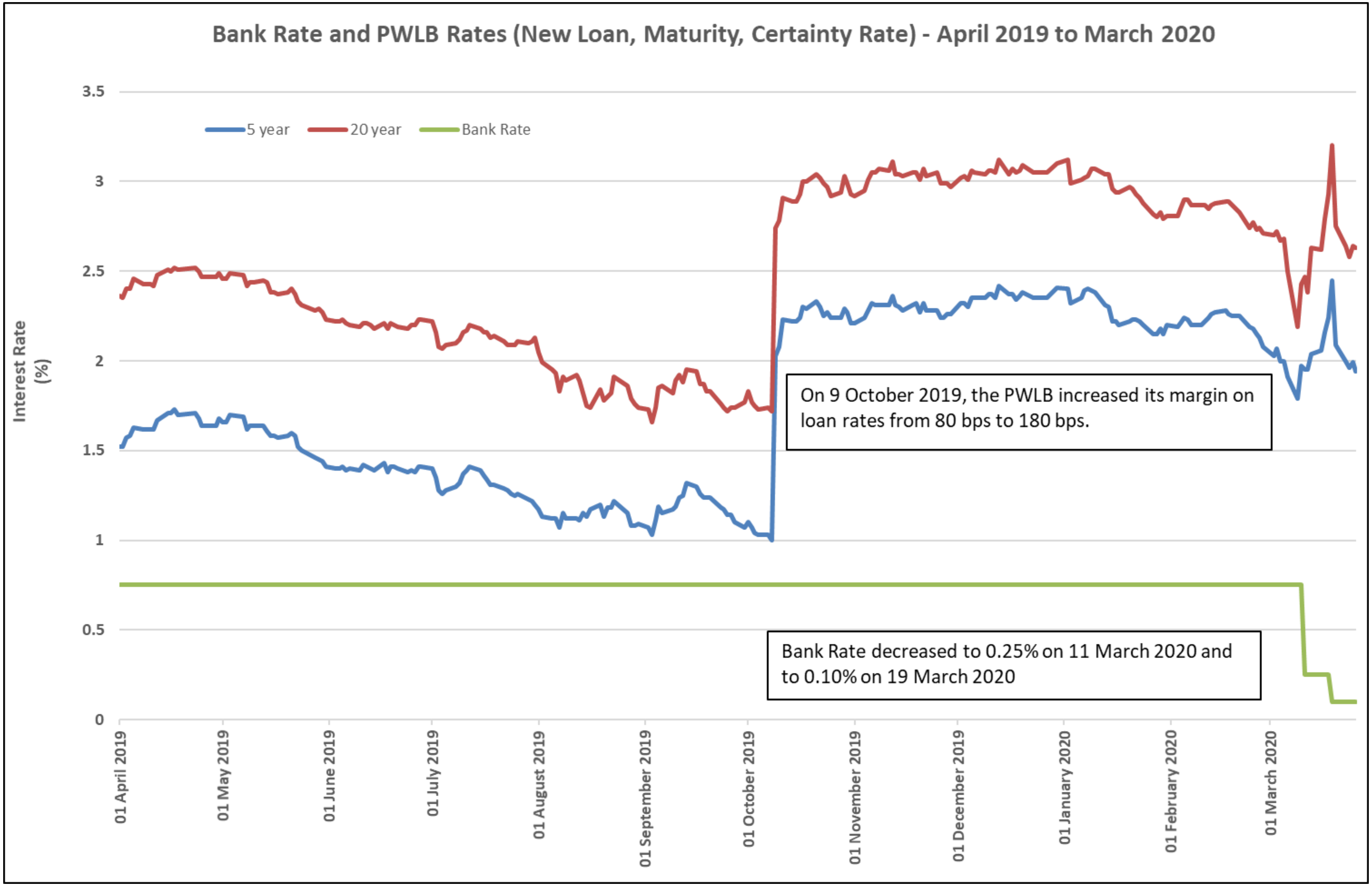
- Quarterly monitoring reports to Cabinet provide an overview of key treasury decisions and indicators.
- The adequacy of risk control arrangements are tested regularly by internal and external audit.
- The City Council's Treasury Management Policy and Strategy sets out policies, limits and strategies for managing treasury risks, which have been reviewed throughout this report.

Headline indicators include:

Has the Council complied with the CIPFA Treasury Management Code?	YES
Were the Council's lending criteria complied with during the year?	YES
Were treasury investment defaults avoided in the year?	YES
Were the Council's treasury prudential limits complied with?	YES
Were revenue costs kept within budget?	NO

11. Decisions taken under treasury management delegations

11.1 Each quarter, decisions taken by the Corporate Director of Finance and Governance and the treasury management team are reported to Cabinet as part of Capital and treasury monitoring. Long term borrowing decisions during Quarter 4 are included in Annex 2, and investment activity during Quarter 4 is reported at Annex 3 below.


Bank Rate and PWLB Rates (New Loan, Maturity, Certainty Rate) - April 2019 to March 2020
5 year
20 year
Bank Rate
Interest Rate (%)
3.5
3
2.5
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1.5
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On 9 October 2019, the PWLB increased its margin on loan rates from 80 bps to 180 bps.
Bank Rate decreased to 0.25% on 11 March 2020 and to 0.10% on 19 March 2020
01 April 2019
01 May 2019
01 June 2019
01 July 2019
01 August 2019
01 September 2019
01 October 2019
01 November 2019
01 December 2019
01 January 2020
01 February 2020
01 March 2020

Appendix 3

1st April 2019 - 31st March 2020

Annex 2

New Long Term Loans taken out during the year.

Date of loan	Loan	Counter Party	Interest Rate	Maturity Date
17 June 2019	£30m	PWLB	2.14%	17 June 2037
09 August 2019	£30m	PWLB	1.63%	09 August 2033
20 August 2019	£30m	PWLB	1.72%	20 August 2069
05 September 2019	£30m	PWLB	1.57%	05 September 2037
11 March 2020	£30m	PWLB	1.88%	09 March 2030

New Long Terms Loans to fund LOBO refinancing.

Date of loan	Loan	Counter Party	Interest Rate	Maturity Date
28 May 2019	£30.00m	PWLB	2.31%	28 May 2038

Long Term Loans prematurely repaid during the year.

Date of repayment	Loan/ (Repayment)	Counter Party	Interest Rate	Maturity Date	Premia/ (Discounts)
28 May 2019	£30.00m	Commerzbank LOBO	4.48%	24 November 2065	£18.0m

Annex 3.1

Treasury Management Investment Details
1st January 2020 to 31st March 2020

New Investments Market Fixed Term Deposits

Date Out	Date In	Borrower	Amount £	Interest Rate
21/02/2020	23/03/2020	Thurrock Council	5,000,000	0.95%
04/03/2020	23/03/2020	Thurrock Council	10,000,000	0.90%
23/03/2020	20/04/2020	Thurrock Council	15,000,000	1.00%
20/03/2020	21/04/2020	Middlesbrough Borough Council	5,000,000	1.75%
20/03/2020	21/04/2020	Forest of Dean District Counci	5,000,000	1.75%
20/03/2020	21/04/2020	Wirral Metropolitan Borough Council	5,000,000	1.75%
23/03/2020	23/04/2020	Surrey County Council	10,000,000	1.80%

In addition to the above deposits with individual institutions the Council uses money market funds and other call accounts where money may be added or withdrawn usually without notice. A summary of transactions for the quarter is as follows:

New Investments Call Accounts

	No of Transactions		Average	Average
	Investments	Withdrawals	Balance £	Rate Earned
Barclays Bank PLC FIBCA A/C	5	10	1,903,034	0.55%
Svenska Handelsbanken	11	11	15,413,636	0.55%
HSBC	0	0	1,110,539	0.30%

New Investments Money Market Funds

	No of Transactions		Average	Average
	Investments	Withdrawals	Balance £	Rate Earned
Aberdeen Standard Liquidity Fund	7	7	10,926,374	0.64%
Amundi Money Market Fund	3	5	23,564,835	0.67%
Federated Money Market Fund	5	10	4,596,703	0.72%
JPMorgan Sterling Liquidity Fund	11	25	17,810,989	0.55%
LGIM Sterling Liquidity Fund	2	4	5,280,220	0.46%

Note

This appendix reports on the exercise of investment delegations to the Corporate Director of Finance & Governance in the last quarter of the financial year.

Investment activity in previous quarters has been reported in the relevant quarterly Capital & Treasury Monitoring to Cabinet.

Annex 3.2

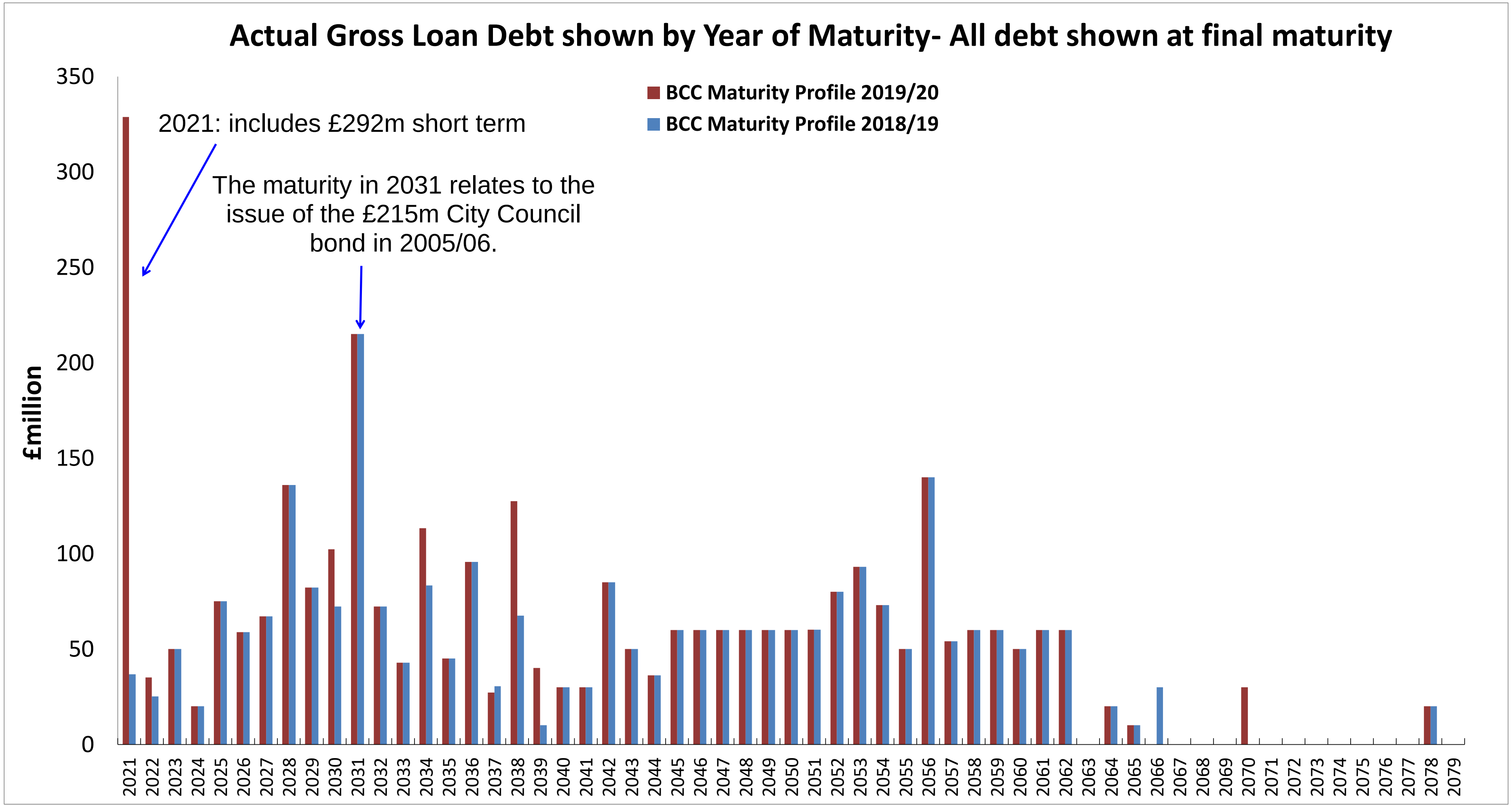
Accountable Body Investments - 31st March 2020

	Advanced Manufacturing Supply Chain Initiative	Growing Places Fund	LGF3 Fund	LOGRO Fund	National Manufacturing Competitiveness Levels	Regional Growth Fund	**Total**
	£000	£000	£000	£000	£000	£000	**£000**
BlackRock Money Market Fund				31,972	320		**32,291**
Goldman Sachs Money Market Fund	8	70	7,997	561		1,993	**10,628**
J P Morgan Money Market Fund						27	**27**
Morgan Stanley Money Market Fund	26,158	3,821				6,475	**36,454**
Total Money Market Funds	**26,166**	**3,891**	**7,997**	**32,533**	**320**	**8,495**	**79,400**
							0
Debt Management Office							**0**
Treasury Bills		9,996		9,989		4,998	**24,983**
							0
Total Accountable Body investments	**26,166**	**13,887**	**7,997**	**42,522**	**320**	**13,493**	**104,383**

Note

This appendix shows amount invested externally by The Council as Accountable Body.
These are separate from The Council's own investments.

Annex 4


Actual Gross Loan Debt shown by Year of Maturity- All debt shown at final maturity
BCC Maturity Profile 2019/20
BCC Maturity Profile 2018/19
2021: includes £292m short term
The maturity in 2031 relates to the issue of the £215m City Council bond in 2005/06.
£million
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This appendix provides monitoring against the Council's approved Prudential Indicators

DEBT AND PRUDENTIAL INDICATORS Annex 5A

	WHOLE COUNCIL	19/20 Indicators £m	19/20 Outturn £m
	Capital Finance		
1	Capital Expenditure - Capital Programme	631.5	432.3
2	Capital Expenditure - other long term liabilities	36.3	12.7
3	Capital expenditure	667.8	445.0
4	Capital Financing Requirement (CFR)	4,731.8	4,531.2
	Planned Debt		
5	Peak loan debt in year	3,590.5	3,313.9
6	+ Other long term liabilities (peak in year)	432.5	434.7
7	= Peak debt in year	4,023.0	3,748.6
8	does peak debt exceed year 3 CFR?	no	no
	Prudential limit for debt		
9	Gross loan debt	3,867.5	3,313.9
10	+ other long term liabilities	432.5	434.7
11	= Total debt	4,300.0	3,748.6

Notes

1 Forecast capital expenditure has increased since the indicator was set due to additions to the capital programme, as reported in the quarterly capital monitoring reports.

4 The Capital Financing Requirement represents the underlying level of borrowing needed to finance historic capital expenditure (after deducting debt repayment charges).This includes all elements of CFR including Transferred Debt.

5-7 These figures represent the forecast peak debt (which may not occur at the year end). The Prudential Code calls these indicators the Operational Boundary.

8 It would be a cause for concern if the City Council's loan debt exceeded the CFR, but this is not the case due to positive cashflows, reserves and balances. The Prudential Code calls this Borrowing and the Capital Financing Requirement.

11 The Authorised limit for debt is the statutory debt limit. The City Council may not breach the limit it has set, so it includes allowance for uncertain cashflow movements and potential borrowing in advance for future needs.

DEBT AND PRUDENTIAL INDICATORS

Annex 5B

	HOUSING REVENUE ACCOUNT	19/20 Indicators £m	19/20 Outturn £m
	Capital Finance		
1	Capital expenditure	134.0	106.5
	HRA Debt		
2	Capital Financing Requirement (CFR)	1,051.9	1,067.8
	Affordability		
3	HRA financing costs	96.7	103.3
4	HRA revenues	273.8	274.2
5	HRA financing costs as % of revenues	35.3%	37.7%
6	HRA debt : revenues	3.8	3.9
7	Forecast Housing debt per dwelling	£17,446	£17,670

Notes

4 Financing costs include interest, and depreciation rather than Minimum Revenue Provision (MRP), in the HRA.

7 This indicator is not in the Prudential Code but is a key measure of long term sustainability. This measure is forecast to fall below 2.0 by 2026/27, which is two years later than previously forecast.

8 This indicator is not in the Prudential Code but is a key measure of affordability: the HRA debt per dwelling should not rise significantly over time.

DEBT AND PRUDENTIAL INDICATORS

Annex 5C

	GENERAL FUND	19/20 Indicators £m	19/20 Outturn £m
	Capital Finance		
1	Capital expenditure (including other long term liabilities)	533.8	338.4
2	Capital Financing Requirement (CFR)	3,680.0	3,463.4
	General Fund debt		
3	Peak loan debt in year	2,538.6	2,246.1
4	+ Other long term liabilities (peak in year)	432.5	434.7
5	= Peak General Fund debt in year	2,971.1	2,680.8
	General Fund Affordability		
6	Total General Fund financing costs	249.3	244.3
7	General Fund net revenues	851.6	851.6
8	General Fund financing costs (% of net revenues)	29.3%	2%
9	General Fund financing costs (% of gross revenues)	22.4%	22.4%

Note

4 Other long term liabilities include PFI, finance lease liabilities, and transferred debt liabilities.

6 Financing costs include interest and MRP (in the General Fund), for loan debt, transferred debt, PFI and finance leases.

8 This indicator includes the gross revenue cost of borrowing and other finance, including borrowing for the Enterprise Zone and other self-supported borrowing.

9 This is a local indicator measuring finance costs against relevant gross income including revenues from sales, fees, charges and rents, which are available to support borrowing costs.

PRUDENTIAL INDICATORS

Annex 5D

	TREASURY MANAGEMENT	**19/20 Indicators**	**19/20 Outturn**
	Interest rate exposures		**Outturn Maximum**
1	upper limit on fixed rate exposures	130%	96%
2	upper limit on variable rate exposures	30%	15%
	Maturity structure of borrowing	Limit	**Outturn**
	(lower limit and upper limit)		**Year End**
3	under 12 months	0% to 30%	10%
4	12 months to within 24 months	0% to 30%	1%
5	24 months to within 5 years	0% to 30%	4%
6	5 years to within 10 years	0% to 30%	14%
7	10 years to within 20 years	5% to 40%	25%
8	20 years to within 40 years	10% to 60%	39%
9	40 years and above	0% to 40%	7%

Investments longer than 364 days
upper limit on amounts maturing in:

		Limit	**Outturn**
10	1-2 years	400	0
11	2-3 years	100	0
12	3-5 years	100	0
13	later	0	0

<u>Note</u>

1-9 These indicators assume that LOBO loan options are exercised at the earliest possibility, and are calculated as a % of net loan debt.