POLICY & RESOURCES COMMITTEE	Agenda Item 19 Brighton & Hove City Council

Subject:		**Treasury Management Strategy Statement 2019/20 - End of Year Review**		
Date of Meeting:		**09 July 2020**		
Report of:		**Acting Chief Finance Officer**		
Contact Officer:	**Name:**	**James Hengeveld Haley Woollard**	**Tel:**	**01273 291242 01273 291246**
	Email:	**james.hengeveld@brighton-hove.gov.uk haley.woollard@brighton-hove.gov.uk**		
Ward(s) affected:		**All**		

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2019/20 Treasury Management Strategy Statement (TMSS) and Treasury Management Practices (TMPs) were approved by Policy, Resources & Growth Committee on 14 February 2019. The TMSS sets out the role of Treasury Management, whilst the TMPs and accompanying schedules identify the practices and procedures that will be followed to achieve the aims of the TMSS and that underpin the council's Treasury Management function.

1.2 The TMSS includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash balances and was approved by full Council on 28 February 2019.

1.3 Much of the detail within treasury management is described using technical language. To aid readers, a glossary of the main terms used in this report is included at **Appendix 1**.

2. RECOMMENDATIONS:

2.1 That Policy & Resources Committee (P&R) notes the key actions taken during the second half of 2019/20 to meet the TMSS and practices (including the investment strategy) as set out in this report.

2.2 That Policy & Resources Committee notes the reported compliance with the AIS for the six month period up to the end of March 2020.

2.3 That Policy & Resources Committee notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised borrowing limit and operational boundary have not been exceeded.

3. CONTEXT/ BACKGROUND INFORMATION

Introduction

3.1 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available (i.e. liquid) when it is needed. Effective cash flow planning enables surplus monies to be invested in counterparties or instruments commensurate with the council's risk appetite, providing adequate liquidity is maintained.

3.2 The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn on may be restructured to meet council risk or cost objectives.

3.3 The contribution the treasury management function makes to the authority is therefore critical, as the balance of debt and investment operations ensure liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue spending or for larger capital projects. The treasury operations also therefore influence the interest costs of debt and the investment income arising from cash deposits which has implications for the council's budget.

3.4 Since cash balances generally result from holding earmarked and committed reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund.

3.5 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

3.6 The Chartered Institute of Public Finance & Accountancy (CIPFA) defines treasury management as:

"The management of the local authority's borrowing, investments and 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."

A key element of the Treasury Management Policy & Strategy concerns prudential indicators. These require the council to set limits on external debt and borrowing activity. These are set in the context of capital financing requirements but, more importantly, in the context of overall affordability. Anything borrowed must ultimately be repaid. All councils are required to set aside Minimum Revenue Provision (MRP) for debt but must also consider whether repayments will be affordable both now and in the longer term when resources may be predicted to reduce. Financing costs (principal and interest repayments) must also be budgeted for and any increase in repayments may therefore reduce the resources available for providing other essential services.

Economic Background

3.7 The council's treasury advisors, Link Asset Services, have provided their assessment of the UK and global economic landscapes over 2019/20 at **Appendix 2**.

3.8 The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would rise from 0.75% to 1.00% early in the financial year, and to rise again to 1.25% in March 2020.

3.9 The main issue for the UK during 2019/20 was the agreement on the way forward over Brexit. The uncertainty on the outcome resulted in volatility in UK markets and for sterling throughout the year. The general election held in December 2019 delivered a conservative majority, which enabled the UK to leave the EU on 31 January. However, there still remains some uncertainty as to whether a trade deal will be reached before the target date of 31 December 2020, particularly as the issue has been overshadowed by the coronavirus pandemic since March 2020.

3.10 The Bank of England's Monetary Policy Committee (MPC) reduced bank rates twice in March 2020 as a response to the economic threat posed by the coronavirus outbreak. The official interest rate has been at a historic low of 0.10% since 19 March 2020. The council's treasury advisors, Link Asset Services, are forecasting that there will be no movement in the official interest rate for their whole forecasting period (to March 2022). There have been some statements from MPC Members as to what options the committee will consider for further economic stimulus, including the possibility of negative interest rates.

Treasury Management Strategy

3.11 A summary of the action taken in the 6 months to March 2020 is provided in Appendix 1 to this report and further information on borrowing and investment performance is shown in the March 2020 Treasury Management statistics at **Appendix 3**. The main points are:

- The council entered into £7.5m of new borrowing in March 2020 to fund the HRA Capital Programme;
- No new General Fund borrowing was undertaken in the second half of the year;
- The highest risk indicator during the period was 0.035% which is below the maximum benchmark of 0.050%;
- The return on investments has exceeded the target benchmark rates in each of the 6 months;
- The two borrowing limits approved by full Council have not been exceeded.

3.12 Treasury management activity for the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Oct 2019 to 31 Mar 2020			
	Fixed deposits	Money market funds	Total	
Up to 1 week	-	£287.4m	£287.4m	78%
Between 1 week & 1 month	£5.0m	-	£5.0m	1%
Between 1 month & 3 months	£20.0m	-	£20.0m	5%
Over 3 months	£57.0m	-	£57.0m	16%
	£82.0m	**£287.4m**	**£369.4m**	**100%**

Financing Budget versus Outturn 2019/20

3.13 The following table summarises the performance achieved on investments compared to the budgeted position and approved benchmark for the whole year.

	In-house Investments		Aberdeen Short dated fund (net of fees)	
	Average Balance	Average rate	Average Balance	Average rate
Budget 2019/20	£70.0m	1.25%	£26.5m	1.34%*
Actual 2019/20	£154.3m	0.95%	£9.7m	0.92%*
Benchmark Rate**		0.63%		0.56%

* *net of fees*

*** Aberdeen Short Dated Fund Benchmark rate is set at 105% of 7 Day LIBID, whereas in-house benchmark rate was set at 7 Day LIBID +0.10% for 2019/20*

3.14 The Financing Costs budget variance in 2019/20 was £0.101m underspent. The key variance is an over-achievement of investment income (£0.136m) as a result of higher balances which offsets a loss as a result of the average rate achieved on investments being lower than budgeted for. The higher investment balances were mainly as a result of delay and re-profiling of capital expenditure and major projects (i.e. cash balances have not been drawn down as quickly as expected).

3.15 There were also underspends resulting from a lower than anticipated interest on borrowing as a result of new borrowing being undertaken at lower than budgeted interest rates (£19k), and (£60k) lower interest paid over to schools and other funds as a result of a slower than anticipated increase in official Base Rate and lower than forecast interest paid. The total underspend of £214k was offset by a pressure of £113k in Minimum Revenue Provision as a result of a change in profile of the provision compared to the original forecast.

Summary of Treasury Activity October 2019 to March 2020

3.16 The following table summarises the treasury activity in the half year to March 2020 compared to the corresponding period in the previous year:

October to March	2017/18	2018/19	2019/20
Long-term borrowing raised (General Fund)	-	(£10.0m)	(£0.0m)
Long-term borrowing raised (HRA)	(£4.0m)	(£16.0m)	(£7.5m)
Long-term borrowing repaid (General Fund)	£1.0m	£14.9m	£0.8m
Long-term borrowing repaid (HRA)	£0.5m	£16.6m	£0.4m
Short-term borrowing (raised)/repaid	(£0.5m)	(£6.0m)	(£2.0m)
Investments made	£337.7m	£337.3m	£369.4m
Investments maturing	(£322.9m)	(£352.8m)	(£367.1m)

3.17 The following table summarises how the day-to-day cash flows in the second half-year have been funded compared to the same period in the previous year:

October to March	2017/18	2018/19	2019/20
Net cash flow (shortage)/surplus	**£12.1m**	**(£20.3m)**	**(£6.9m)**
Represented by:			
Increase/(reduction) in long-term borrowing	£2.5m	(£5.5m)	(£6.3m)
Increase/(reduction) in short-term borrowing*	£0.5m	£6.0m	£2.0m

Reduction/(increase) in investments	(£14.8m)	£15.5m	£2.3m
Reduction/(increase) in bank balance	(£0.3m)	£4.3m	(£0.9m)

*South Downs National Park external investments plus temporary borrowing

Security of Investments

3.18 A summary of investments made by the in-house team and outstanding as at 31 March 2020 in the table below shows that investments continue to be held in good quality, short term instruments.

‘AAA’ rated money market funds	£36.74m	25%
‘AA’ rated institutions	£61.50m	42%
‘A’ rated institutions	£49.50m	33%
‘BBB’ rated institutions	£0.00m	0%
Total	**£147.74m**	**100%**
Period – less than one week	£34.74m	24%
Period – between one week and one month	£10.00m	7%
Period – between one month and three months	£27.00m	18%
Period – between three months and 1 year	£76.00m	51%
Total	**£147.74m**	**100%**

Risk

3.19 As part of the investment strategy for 2019/20 the council agreed a maximum risk benchmark of 0.050% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures the risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.019% and 0.035% between October 2019 and March 2020. It should be remembered however that the benchmark is an ‘average risk of default’ measure, and does not constitute an expectation of loss for any particular investment.

3.20 The treasury management service is subject to a detailed audit on a regular basis. This includes the testing of the control environment and the management of risk. A ‘reasonable’ level of assurance was provided during the most recent audit (October 2019).

3.21 One medium and two low recommendations were made. All three recommendations have been implemented.

Compliance with the Annual Investment Strategy

3.22 During the reporting period, the information in this report provides assurance that the Annual Investment Strategy has been complied with in full.

Borrowing Strategy

3.23 The General Fund has been carrying an internal borrowing position (i.e. where the General Fund borrows cash from its own reserves) since 2008 as a response to the financial crisis. In response to a combination of an expectation of increasing interest rate forecasts, the reduction of certain reserves and historically low PWLB borrowing rates, the General Fund has entered into planned borrowing of £27.5m from the PWLB to reduce the internal borrowing position over the last three years. The most recent of this borrowing was undertaken in August 2019, where a £7.5m loan was undertaken for a period of

50 years at a historical low rate of 1.67%. Additionally, £10m of PWLB borrowing was undertaken by the General Fund in March 2019 as part of a debt restructure to replace Royal Bank of Scotland (RBS) loans.

3.24 The Housing Revenue Account (HRA) carries a fully funded borrowing position (i.e. the HRA does not borrow from its own reserves, but instead undertakes borrowing for its entire borrowing requirement). Over the last three years, the HRA has entered into a total of £24.0m of external borrowing and £4.5m of borrowing from the General Fund to support the HRA Capital Programme. Of the £24.0m, £2.5m was undertaken in August 2019 for a period of 50 years at a historical low rate of 1.67%. A second loan of £7.5m was undertaken in March 2020 for a period of 50 years at an interest rate of 1.54%, this was to support the HRA Capital Programme, and to externalise a portion of the loan from the General Fund at an attractive interest rate. Additionally, £16m of PWLB borrowing was undertaken by the HRA in March 2019 as part of a debt restructure to replace RBS loans.

3.25 The treasury management team, along with the its advisors, monitor interest rates and will seek to externalise the remainder of the HRA's borrowing from the General Fund at a time which would be optimal for both the HRA and the General Fund. The Treasury Team are also exploring alternative borrowing sources, such as forward market borrowing for future capital investment plans.

3.26 A summary of the council's debt portfolio is included in **Appendix 4**.

Treasury Advisors

3.27 The council undertook a joint procurement exercise with East Sussex County Council for a 3 year contract for Treasury Advisory Services. As a result, a new 3 year contract with Link Asset Services has been entered into from 1 April 2020, resulting in annual contract savings of approximately £4,000 per annum.

3.28 Officers recognise that responsibility for decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

Member Training

3.29 It is a requirement of CIPFA's Treasury Management code to ensure that the members responsible for decision making and scrutiny of the authority's TMSS are adequately trained to undertake their roles in this area.

3.30 Treasury Management training was last provided in October 2019. Further training will be offered to members of P&R and the Audit & Standards committee before the 2021/22 TMSS & Annual Investment Strategy is presented to P&R and Council.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 Alternative treasury management policies and practices, and investment strategies, are considered annually by Policy & Resources Committee and full Council. This report sets out action taken in the 6 months to March 2020. Treasury management actions have been carried out within the parameters of the approved AIS, TMSS, and Prudential Indicators and therefore no alternative options have been excercised. .

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted over the content of this report. No other consultation has been undertaken.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as "best and proper practice" under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year's performance. This report fulfils this requirement.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraphs 3.13 to 3.15.

Finance Officer Consulted: James Hengeveld Date: 28/6/20

Legal Implications:

7.2 The TMSS is approved and associated actions carried out under powers given to the council by Part 1 of the Local Government Act 2003, which includes the power for a local authority to invest for the purposes of the prudent management of its financial affairs (section 12).

7.3 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003/3146 require local authorities to have regard to the CIPFA Code of Practice referred to in paragraph1.3 above when carrying our their functions under Part 1 of the 2003 Act.

7.4 The council's policy and the actions outlined in the report are considered to comply with the council's obligations under the Act and with the afore-mentioned Code.

Lawyer Consulted: Victoria Simpson Date: 17/6/20

Equalities, Sustainability and other significant implications:

7.5 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. Glossary of terms
2. The Economy & Interest Rates – Link Asset Services
3. March 2020 Treasury Management Statistics
4. A summary of the action taken in the period October 2019 to March 2020

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations.

2. The Treasury Management Policy Statement, Treasury Management Practices and associated schedules 2019/20 approved by Policy, Resources & Growth Committee on 14 February 2019.

3. The Annual Investment Strategy 2019/20 approved by full Council on 28 February 2019.

4. Treasury Management Policy Statement 2019/20 (including Annual Investment Strategy 2019/20) – Mid-Year Review approved by Policy & Resources Committee on 5 December 2019.

5. Papers held within Finance, part of the Finance & Resources Directorate.

6. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2017.