Treasury Management Annual Report 2019/20

Committee considering report:	Executive on 3 September 2020
Portfolio Member:	Councillor Ross Mackinnon
Date Portfolio Member agreed report:	13 August 2020
Report Author:	Gabrielle Esplin
Forward Plan Ref:	EX3947

1 Purpose of the Report

1.1 This report summarises the results of the Council's management of cash-flow, borrowing and investments in the financial year 2019/20.

2 Recommendation

2.1 That the contents of this report be noted.

3 Implications and Impact Assessment

Implication	**Commentary**
Financial:	The Council's budget for loans principal paid, and interest paid and received, forms part of the revenue Budget for Levies and Interest. The net revenue cost of borrowing and investment in 2019/20 was £10.8 million. This mainly consists of £11.7 million payments of principal and interest on long term loans to fund capital expenditure, not including principal and interest on debt embedded in the waste PFI contract and borrowing for commercial property, which form part of the Place and Resources budgets respectively. The cost of long term borrowing was offset by £379k interest earned on investments managed in house and £505k from the pre-payment of pension contributions to the Berkshire Pension Fund. Overall the cost of borrowing less income from investments was £78k below the budget for 2019/20.
Human Resource:	N/A

Legal:	Loans and investments are arranged in line with the Borrowing and Investment Strategy which was first approved by the Council on 5 March 2019, with revisions approved the Council on 9 January 2020.			
Risk Management:	The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Borrowing and Investment Strategy. Adherence to the strategy in 2019/20 is shown in this report.			
Property:	The Council's investments also include property held for the purpose of generating revenue income. The report summarises the current value of this property and the rate of return on investment achieved in 2019/20.			
Policy:	The Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA's) *Treasury Management in the Public Services: Code of Practice w*hich requires treasury management performance to be reported to the Executive, in line with the Council's Borrowing and Investment Strategy			
	Positive	**Neutral**	**Negative**	**Commentary**
Equalities Impact:				
A Are there any aspects of the proposed decision, including how it is delivered or accessed, that could impact on inequality?		x		No

B Will the proposed decision have an impact upon the lives of people with protected characteristics, including employees and service users?		x		No
Environmental Impact:		x		N/A
Health Impact:		x		N/A
ICT Impact:		x		N/A
Digital Services Impact:		x		N/A
Council Strategy Priorities:	x			The management of long term borrowing enables capital funds to be available for investment in infrastructure and other assets which help the delivery of all the Council Strategy priorities.
Core Business:	x			Treasury management activity ensures that sufficient funds are available on a day to day basis to enable the Council's business to continue. Income earned from investments also contributes to revenue funds available for the running of Council services.
Data Impact:		x		No impact on the rights of data subjects
Consultation and Engagement:	Portfolio Holder for Finance and Property, Director of Resources, Head of Property and Finance, Chief Financial Accountant, Treasury Accountant			

4 Executive Summary

4.1 Return on the Council's investments and the cost of borrowing is influenced by the UK and global economy. Throughout 2019/20 UK economic growth was slow and interest rates remained low. Interest rates fell even lower at the end of 2019/20 due to the Covid 19 pandemic, with the Bank of England (BoE) base rate being cut from 0.75% to 0.25% and then to 0.1% in March 2020.

4.2 The Council's borrowing and investments the beginning and end of 2019/20 were as follows:

	31.3.19 Balance £000	Movement in 2019/20 £000	31.3.20 Balance £000	Weighted Average Interest Rate at 31.3.20 %	Weighted Average Term at 31.3.20 (Years)
Long term loans from Public Works Loans Board (PWLB)	200,438	1,924	202,362	3.33%	31.7
Short Term Borrowing from other Local authorities	8,500	- 4,500	4,000	1.06%	0.1
Debt embedded in the PFI Contract	13,652	- 681	12,971	6.10%	12.5
Total borrowing	**222,590**	**- 3,257**	**219,333**		
Less Short-term investments	36,020	- 3,770	32,250	0.78%	0.2

4.3 Three new annuity loans totalling £7.7 million were taken from the PWLB in August 2019 to fund capital expenditure in 2019/20. These loans were for periods between 30 and 50 years at interest rates ranging from 1.58% to 1.84%. £5.8 million of existing loans was repaid in 2019/20.

4.4 Long term borrowing in comparison with the operational boundary and authorised limit for borrowing, set in the Council's Investment and Borrowing Strategy 2019/20 is as follows:

	2019/20 Maximum £000	31.3.20 Actual £000	2019/20 Operational Boundary £000	2019/20 Authorised Limit £000	Overall Operational Boundary Complied with?	Overall Auhtorised Limit Complied with?
Long Term Borrowing for Operational Assets	207,534	202,362	245,029	255,029		
Other long term liabilities (PFI Debt)	13,652	12,971	12,971	12,971		
Short Term borrowing	9,512	4,000	15,000	15,000		
Total	**230,698**	**219,333**	**273,000**	**283,000**	**Yes**	**Yes**

4.5 Although the overall Operational Boundary and Authorised Limit were complied with throughout the year, the sub-limit for PFI debt within the overall authorised limit was exceeded because the limit was set in error at the level of the forecast balance as at 31 March 2020, whereas it should have been set in line with the balance outstanding at 1 April 2019. The sub limit for PFI debt will be corrected in the 2020/21 strategy.

4.6 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. From time to time it is also necessary to take out short term loans to cover temporary cash-flow pressures. During the year, the Authority's investment balances ranged between £20.0 million and £53.4 million. An average of £9.9 million of this sum was held in instant access deposit accounts with UK banks rated Prime 1 by the Moody's credit agency and/or in a money market fund rated

AAA by Moody's. In addition, £30.3 million, on average, was held in fixed term deposits with Building Societies for an average term of 258 days at an average rate of 1.06% and with other local authorities for an average term of 87 days at an average rate of 0.79%. Total interest earned on these investments, net of the cost of short term borrowing was £379k or 0.94% of the average amount invested.

4.7 The Council's borrowing and Investment Strategy sets a limit £5 million to be invested at one time with any one institution. On two occasions the amount held in the Council's current account exceeded this amount by a maximum of £364k because an unexpected sum of income was paid into the account late in the day. Also on five occasions the amount held in deposit accounts or the money market fund exceeded this limit by up to £11k, because the amount deposited did not allow for interest due to be credited to the account. On all occasions the account balance was brought back within the £5 million limit within one working day. Treasury procedures have been amended to ensure that the investment limit is not exceeded in future due to the payment of interest.

4.8 The Council also prepaid £14.8 million pension contributions to the Royal Borough of Windsor and Maidenhead (RBWM) in April 2019 and earned 3.4% interest on this sum. The overall rate of return including the pre-payment of pension contributions was 1.61%.

4.9 The table below shows total amount of interest paid and received in 2019/20 in respect of long and short term borrowing and investments in comparison with the budget.

	Budget 2019/20	**Actual 2019/20 £000**	**Variance £000**
Interest on Long term borrowinng for capital spend	5,259	5,263	4
Principal Repaid of long term borrowing for capital spend	5,768	5,772	4
Provision for future repayment of long term borrowing	699	699	0
Interest paid on short term borrowing	9	10	1
Interest earned from investments	- 797	- 884	-87
Net Revenue cost of borrowing and investment	**10,938**	**10,860**	**-78**

4.10 Interest earned on investments was higher than expected because the Council gained more than expected from the pre-payment of pension contributions because the amount set aside in 2019/20 to contribute to the pension fund deficit was slightly higher than the amount required to be paid to RBWM.

4.11 In addition to its cash investments, the Council also holds investments in the form of commercial property with a value of £61.8 million at 31 March 2020. These investments generated net investment income of £1.15 million in 2019/20, which represents a net rate of return of 1.9%.

5 Supporting Information

5.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

5.2 The original Investment and Borrowing Strategy for 2019/20 was approved by the Council on 5 March 2019 and revisions to the 2019/20 Strategy were approved by the

Council on 9 January 2020. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

5.3 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

5.4 The 2017 Prudential Code also includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy for 2019/20, complying with CIPFA's requirement, was also approved by full Council on 5 March 2019.

External Context

<u>Economic Background</u>

5.5 The UK's exit from the European Union was one of the major influences on the UK economy and markets during the financial year 2019/20. However the outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

5.6 The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% in February 2019, below the Bank of England's target of 2%. Labour market data remained positive. The unemployment rate was 3.9% in the three months to January 2020 while the employment rate hit a record high of 76.5%. The average annual growth rate for pay excluding bonuses was 3.1% in January 2020 and the same when bonuses were included, providing some evidence that a shortage of labour had been supporting wages.

5.7 UK GDP growth in Q4 2019 was reported as flat by the Office for National Statistics; service sector growth slowed; and production and construction activity contracted on the back of concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.

5.8 However COVID-19, which had first appeared in China in December 2019, started spreading across the globe causing falls in financial markets not seen since the Global Financial Crisis.

5.9 The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% from 0.75% and then swiftly thereafter brought them down further to the record low of 0.1% in response to the economic impact of the virus. The UK government also introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK.

Financial markets

5.10 Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March Sterling touched its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile. Gilt yields fell substantially, with the 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March. The 10-year benchmark yield fell from 1% to 0.4%, the 20-year benchmark yield from 1.47% to 0.76% over the same period. 1-month, 3-month and 12-month bid rates averaged 0.61%, 0.72% and 0.88% respectively over the period.

5.11 Since the start of the calendar 2020, the yield on 2-year US treasuries had fallen from 1.573% to 0.20% and from 1.877% to 0.61% for 10-year treasuries. German bund yields remain negative.

Credit review

5.12 In Q4 2019 Fitch affirmed the UK's AA sovereign rating, but assigned a negative outlook. Fitch also affirmed UK banks' long-term ratings and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative. The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven banks passed the test with an aggregate level of tier one capital at twice their level before the 2008 financial crisis.

5.13 Credit Default Swap rates give an indication of how likely the market thinks banks and other borrowers are to default. Rates remained between 0.30% and 0.55% in January and February but rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern. Spreads declined in late March and through to mid-April but remain above their initial 2020 levels. NatWest Markets Plc (non-ring-fenced) remains the highest at 1.28% and National Westminster Bank Plc (ring-fenced) still the lowest at 0.56%. The other main UK banks are between 0.65% and 1.23%, with the latter being the thinly traded and volatile Santander UK credit default swap.

5.14 Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and Non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-.

Summary of Treasury Management Position for 2019/20

5.15 On 31st March 2019, the Authority had external borrowing, net of funds invested, of £186.6m. By 31st March 2020 this had increased slightly to £187.1m. Movement in borrowing and investments is analysed in Table 1 below:

Table 1: Treasury Management Summary

	31.3.19 Balance £000	Movement in 2019/20 £000	31.3.20 Balance £000	Weighted Average Interest Rate at 31.3.20 %	Weighted Average Term at 31.3.20 (Years)
Long term loans from Public Works Loans Board (PWLB)	200,438	1,924	202,362	3.33%	31.7
Short Term Borrowing from other Local authorities	8,500	- 4,500	4,000	1.06%	0.1
Debt embedded in the PFI Contract	13,652	- 681	12,971	6.10%	12.5
Total borrowing	**222,590**	**- 3,257**	**219,333**		
Less Short-term investments	36,020	- 3,770	32,250	0.78%	0.2

Long Term Borrowing Activity

External Borrowing

5.16 With the exception of debt embedded in the waste PFI contract, all the Council's long term borrowing is with the Public Works Loans Board (PWLB), which has in recent years represented the cheapest and least risky form of borrowing available to Local Authorities. Movement in the Council's PWLB loans during 2019/20 is summarised below.

Table 2: Movement in PWLB Loans in 2019/20

	Annuity Loans to Fund Capital Expenditure £000	Maturity Loans to Fund Investment in Commercial Property £000	Maturity Loans Inherited from Berkshire County Council £000	Total PWLB Loans £000
PWLB Loans outstanding at 31/3/19	117,680	62,253	20,505	200,438
New Loans fo fund capital expenditure in 2019/20	7,696	-	-	7,696
Less Loan repayments made in 2019/20	- 5,772	-	-	- 5,772
Net Increase in PWLB Borrowing	**1,924**	**-**	**-**	**1,924**
PWLB Loans Balance at 31/3/20	**119,604**	**62,253**	**20,505**	**202,362**

5.17 Three new annuity loans totalling £7.7 million were taken in August 2019 to fund capital expenditure in 2019/20. These loans were for periods between 30 and 50 years at interest rates ranging from 1.58% to 1.84%.

5.18 After we had taken these loans, the PWLB raised the cost of certainty rate borrowing on 9th October 2019 by 1% to 1.8% above UK gilt yields, as HM Treasury was concerned about the overall level of local authority debt. PWLB borrowing remains available but the margin of 180bp above gilt yields appears relatively very expensive. Market alternatives are available and new products will be developed; however, the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

5.19 The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. The consultation contains proposals to allow authorities that are not involved in "debt for yield" activity to borrow at lower rates. There is also a proposal to stop local authorities using PWLB loans to buy commercial assets primarily for yield, without impeding their ability to pursue their core policy objectives of service delivery, housing, and regeneration. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances. The deadline for the consultation has been extended to 31 July 2020 and new lending terms are expected to take effect in the latter part of this calendar year or early in 2021.

The Capital Financing Requirement and Internal Borrowing

5.20 The CIPFA code requires the Council to report annually on its Capital Financing Requirement (CFR). This represents the total amount of capital expenditure incurred by the Council, which has not been financed by capital receipts, government grants, developers' contributions or other external sources of funding, less any loans for capital purposes which have already been repaid and provision set aside for future repayment of loans. The CFR can also be described as the Council's underlying need to borrow for capital investment. The Council has pursued a strategy of keeping external borrowing below its underlying level of need, by offsetting part of the need to borrow to fund capital investment against its useable reserves and working capital. This offset against reserves is known as internal borrowing. This approach reduces amount borrowed and invested and helps to reduce interest costs and the risks associated with borrowing and investing. The relationship between actual borrowing and the CFR is shown in Table 3 below:

Table 3: Internal Borrowing

	31.3.19 Balance £000	**Movement £000**	**31.3.20 Balance £000**
Total borrowing to Fund Capital Expenditure	200,438	1,924	202,362
Capital Financing Requirement (excluding PFI Debt)	226,468	429	226,897
Internal Borrowing to Fund Capital Expenditure	**26,030**	**- 1,495**	**24,535**

Minimum Revenue Provision (MRP)

5.21 As well as making £5.8 million repayments of maturity loans, we also set aside £277k of rents received from commercial property for future repayment of maturity loans to fund commercial property (0.4% of the outstanding balance) and £699k for future repayment of the maturity loans inherited from Berkshire County Council

(BCC) (3% of the outstanding balance). Provision for repayment of former BCC loans is funded from the revenue budget for capital financing.

5.22 The percentage set aside for commercial property is lower than that for former BCC loans because we plan to use the proceeds of future disposals of commercial property to repay part of the debt. In addition all the loans for commercial property have an outstanding term of between 47 and 49 years, whereas £16.6 million of the former BCC loans have outstanding terms of between 11 and 16 years, with the remainder due in 36 years.

5.23 The total provision for repayment of PWLB loans in 2019/20, including loan repayments made in the year, was £6.7m. This represents 3.0% of our Capital Financing Requirement at 31 March 2020 which indicates that we are currently on track to repay all our outstanding long term debt (including internal borrowing) over an average of 34 years. The total Minimum Revenue Provision for repayment of debt in 2019/20 also includes £681k repayment of PFI debt, which was included in waste contract payments. The Council's total MRP reported for 2019/20 was therefore £7.4 million.

Treasury Investment Activity in 2019/20

5.24 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. From time to time it is also necessary to take out short term loans to cover temporary cash-flow pressures. During the year, the Council's investment balances, net of temporary borrowing, ranged between £20.0 million and £53.4 million, due to timing differences between income and expenditure. The investment position and short term borrowing position at the start and end of the year is shown in table 4 below.

Table 4: Investments and Short Term Borrowing

	Credit Rating (Moody's Short Term)	Balance at 31.3.19 £000	Movement in 2019/20 £000	Balance at 31.3.20 £000	Weighted Average term of 2019/20 investments (days)	Weighted Average Interest Rate of 2019/20 Investments %	Interest Received/ Paid in 2019/20 £000
Instant Access deposit accounts:							
Nat West Bank	P1	1,365	938	2,303	1	0.29%	6
Bank of Scotland	P1	3,701	299	4,000	1	0.58%	17
Santander UK Bank	P1	2	4,948	4,950	1	0.50%	8
Goldman Sachs Sterling Liquidity Money Market Fund	AAA MMF	4,952	45	4,997	1	0.66%	29
Fixed Term Investments							
Building Societies	Unrated	26,000	- 11,000	15000	258	1.06%	305
Other Local Authorities	Unrated	-	1,000	1000	87	0.79%	24
Total investments		**36,020**	**-3770**	**32,250**		**0.97%**	**389**
Short Term Borrowing for Management of Cashflow		8,500	- 4,500	4,000	18	0.84%	10
Net Investments		**27,520**	**730**	**28,250**		**0.94%**	379

5.25 In addition to investments which were managed in house, the Council also prepaid £14.8 million pension contributions to the Royal Borough of Windsor and Maidenhead in April 2019, which is the equivalent of pooling part of our investments with the Berkshire Pension Fund. By pre-paying pension contributions we earned a discount of 3.4% or £505k, which we treated as part of our interest earned on investments. Total net interest earned was therefore £884k which represents a return of 1.61% on the average value of the investment fund across the year, including pension contributions repaid.

Assessment of Security and Liquidity

5.26 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.27 These aims were achieved by keeping no more than £5 million in each of 3 instant access bank deposit accounts which are all rated Prime 1 by the Moody's credit agency (indicating very low risk of default in the short term) and up to £5m in a highly liquid AAA rated money market fund. This approach ensures that up to £20 million is available at very short notice to cover the Council's outgoings. The Nat West account pays a lower rate of interest than the other deposit accounts and the money market fund because it is linked to the Council's current account, which gives the bank less certainty over the balance available at the end of each day.

5.28 Funds which are not expected to be needed to cover outgoings in the short term are normally placed with one of the top 25 Building Societies (by asset value) or with other local authorities for fixed periods, normally between three and twelve months, in order to attract a higher rate of interest. Fixed term deposits with building societies present a higher risk of default than bank deposits.

5.29 In March 2020, the Council appointed Arlingclose to provide independent advice on our treasury management strategy and activities. Arlingclose provided the following assessment of the risk and return of our investment portfolio in comparison with the other English unitary authorities whom they advise.

Table 5: Summary or Security, Liquidity and Yield of Investments at 31 March 2020

	West Berkshire	**19 English Unitaries Average**
Internal Investments	£32.2m	£68.0m
Security		
Average Credit Score (time-weighted) *(1)*	9.32	4.22
Number of Counterparties / Funds	10	15
Liquidity		
Proportion Available within 7 days	50%	51%
Proportion Available within 100 days	69%	67%
Average Days to Maturity	92	52
Yield		
Return on Internal Investments Held at 31/3/20	0.71%	0.60%

(1) Higher score indicates higher risk

5.30 This analysis indicates that West Berkshire's investment portfolio carries higher risk than other authorities advised by Arlingclose. This is mainly because of our policy of investing with the larger building societies, most of which are not rated by the main credit rating agencies, for up to 365 days. However this is reflected by a slightly higher rate of return on our internal investments.

5.31 The Treasury Management team will review our treasury management policies over the next few months in consultation with our advisors with a view to reducing our level of risk while avoiding a significant reduction in return.

Performance against Budget

5.32 The table below shows the actual cost of principal and interest payments and provision for future repayment of long term debt, together with net interest earned on investments (including interest earned on pension contributions pre-paid), in comparison with the budget.

Table 6: 2019/20 Budget for Principal and Interest Paid and Received

	Budget 2019/20 £000	Actual 2019/20 £000	Variance £000
Long Term Borrowing			
Interest on Maturity Loans inherited from BCC	1,033	1,033	-
Provision for future repayment of maturity lonas inherited from BCC	699	699	-
Interest on annuity loans to fund capital expenditure	5,768	5,772	4
Repayment of annuity loans to fund capital expenditure	4,226	4,230	4
Total Cost of Long term borrowing	**11,726**	**11,734**	**8**
Investment income			
Deposit accounts and money market funds	- 83	- 54	29
Fixed term investments	- 351	- 335	16
Prepayment of Pensions	- 372	- 505	- 133
Total interest earned	**- 806**	**- 894**	**- 88**
Interest Paid on short term loans	9	10	1
Interest on Investments net of interest on short term loans	**- 797**	**- 884**	**- 87**
Net revenue cost of borrowing and investment	**10,938**	**10,860**	**- 78**

5.33 The revenue budget for borrowing and investment forms part of the Levies and Interest budget, but does not include levies paid to the Environment Agency and the Thames Valley Magistrate’s Court service or savings target from the Commercialisation agenda. The figures above also do not include principal and interest paid on PFI debt which forms part of the Waste Service budget in the Place Directorate or interest and provision for payment of loans for commercial property which form part of the Finance and Property budget in the Resources Directorate.

5.34 The cost of principal and interest payments for long term borrowing was largely in line with the budget. The target for interest on investments was overachieved by £88k. Interest earned on pre-payment of pensions was higher than expected, because the amount set aside in 2019/20 to contribute to the pension fund deficit was slightly higher than the final amount required to be paid to the pension fund. This was offset by a fall in interest rates on deposit accounts and fixed term investments towards the end of the year.

<u>Outlook for 2020/21</u>

5.35 As explained above, interest rates decreased sharply in the latter part of 2019/20 and remain very low. It is therefore expected that interest on investments will be significantly lower in 2020/21 than in 2019/20. In addition we did not pre-pay pension contributions in 2020/21 because the pension fund advised that this might lead to a risk of higher contributions being payable in future years if returns on pension fund investments in 2020/21 are poor, as seems likely in the current economic climate. This will have a significant impact on interest earned in 2020/21. We currently forecast that net interest will be approximately £420k below target in 2020/21.

5.36 However it is now expected that the amount of new long term borrowing required to fund capital expenditure in 2019/20 and 2020/21 will be lower than was allowed for in the revenue budget for capital financing for 2020/21. It is therefore currently expected that a saving in the cost of long term borrowing will offset the reduction in investment income and that the overall revenue budget for borrowing and investment in 2020/21 will be in balance. Forecast income from investments and the cost of borrowing will be closely monitored and an updated forecast will be reported to the Executive at the end of Quarter 2 2020/21.

Non-Treasury Investments

5.37 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government's (MHCLG), in which the definition of investments is further broadened to also include all such assets held partially for financial return.

5.38 The Authority also held £61.8 million of such investments in the form of commercial property acquired since 2018 for the purposes of generating income. No new properties were acquired in 2019/20. A full list of the Authority's non-treasury investments is shown in appendix A. The current value of these properties will be included in the 2019/20 financial statements.

5.39 These investments generated £1.15 million of investment income in 2019/20, after taking account of direct costs and future liabilities for maintenance and repayment of debt. This represented a rate of return of 1.9%.

Compliance with Key Performance Indicators

5.40 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Compliance with Operational Boundary and Authorised Limit

	2019/20 Maximum £000	31.3.20 Actual £000	2019/20 Operational Boundary £000	2019/20 Authorised Limit £000	Overall Operational Boundary Complied with?	Overall Auhtorised Limit Complied with?
Long Term Borrowing for Operational Assets	207,534	202,362	245,029	255,029		
Other long term liabilities (PFI Debt)	13,652	12,971	12,971	12,971		
Short Term borrowing	9,512	4,000	15,000	15,000		
Total	**230,698**	**219,333**	**273,000**	**283,000**	**Yes**	**Yes**

5.41 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt was below the operational boundary throughout the year. However the sub-limit for PFI debt within the overall operational boundary and authorised limit was exceeded because the limit was set in error at the level of the forecast balance as at 31 March 2020, whereas it should have been set in line with the balance outstanding at 1 April 2019. (PFI debt is repaid as part of monthly waste contract payment at a rate of approximately £57k per month).

Table 8: Compliance with Counterparty Limits

	2019/20 Maximum £000	2019/20 Limit £000	No of Occasions on which Limit Exceeded
UK Local Authorities (including Police and Fire Authorities and similar public bodies)	-	5,000	None
UK Building Societies			
Ranked 1 to 11	5,000	5,000	None
Ranked 12 to 21	4,000	4,000	None
Ranked 22 to 25	-	3,000	None
UK Banks & Other Financial Institutions rated at least Prime 1 by Moody's	5,364	5,000	5
UK Banks & Other Financial Institutions rated at least Prime 2 by Moody's	-	4,000	None
UK Banks & Other Financial Institutions rated at least Prime 3 by Moody's	-	3,000	None
UK based Money Market Funds (AAA rated by Moody's)	5,003	5,000	2
Registered Charities, Public Sector Bodies and Council owned companies/joint ventures	-	5,000	None

5.42 On two occasions the amount held in the Council's current account exceeded the £5 million limit by a maximum of £364k, because an unexpected sum of income was paid into the account late in the day. Also on five occasions the amount held in deposit accounts or the money market fund exceeded their limits by up to £11k, because the amount deposited on the day did not allow for interest due to be credited to the account. On all occasions the account balance was brought back within the £5 million limit within one working day. Treasury procedures have been amended to ensure that the investment limit is not exceeded in future due to the payment of interest. Every effort will also be made to ensure that the Treasury team are aware in advance of any income due to be received and the amount planned to be invested in each account each day will be kept slightly below the maximum limit to allow for unexpected income.

Maturity Structure of Borrowing

5.43 This indicator is set to control the Authority's exposure to refinancing risk. Compliance with the upper and lower limits set on the maturity structure of borrowing in the revised 2019/20 Borrowing and Investment Strategy was as follows:

	31.3.20 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	5%	50%	0%	Yes
12 months and within 24 months	3%	50%	0%	Yes
24 months and within 5 years	8%	50%	0%	Yes
5 years and within 10 years	17%	50%	0%	Yes
10 years and above	68%	50%	0%	No

5.44 In the original Borrowing and Investment Strategy for 2019/20 there was a limit for borrowing over 15 years of 90% of total borrowing. This limit was changed in error in the revised strategy to 50% over 10 years. The original limit for borrowing over 15 years was complied with. This limit will be corrected in the 2020/21 strategy.

6 Other options considered

6.1 Not applicable as this report is to note only.

7 Conclusion

7.1 A net rate of return of 0.94% was achieved on investments managed in house, in comparison with the BoE base rate which remained at 0.75% for most of 2019/20

7.2 As a result of the sharp drop in interest rates in March 2019, we currently forecast that net interest will be approximately £420k below target in 2020/21. However it is expected that the amount of new long term borrowing required to fund capital expenditure in 2019/20 and 2020/21 will be lower than was allowed for in the revenue budget for capital financing for 2020/21. A saving in the cost of long term borrowing is therefore expected to offset the reduction in investment income and the overall revenue budget for borrowing and investment in 2020/21 is expected to be in balance.

7.3 The overall rate of return achieved by West Berkshire Council was higher than the average rate earned on internally managed investments by the other English Unitary Authorities supported by Arlingclose, whom West Berkshire appointed as treasury advisors for the first time in March 2020. This was partly achieved by investing with unrated building societies for up to 365 days, which also makes the risk of investment default as measured by Arlingclose higher than average. The Treasury Management team will therefore review our investment policies over the next few months in consultation with Arlingclose, with a view to reducing our level of risk while avoiding a significant reduction in return.

8 Appendices

8.1 Appendix A – List of non-treasury investments

Subject to Call-In:

Yes: ☐ No: ☒

The item is due to be referred to Council for final approval	☐
Delays in implementation could have serious financial implications for the Council	☐
Delays in implementation could compromise the Council's position	☐
Considered or reviewed by Overview and Scrutiny Management Committee or associated Task Groups within preceding six months	☐
Item is Urgent Key Decision	☐
Report is to note only	☒

Wards affected: None specifically

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Change History

Version	Date	Description	Change ID
1			
2			

Appendix A

Investment Property Held at 31 March 2020

Name and Address of Property	Prroperty Type	Value at 31/3/20 £000
Lloyds Bank 104 Terminus Road, Eastbourne	Retail	2,800
Aldi/Iceland, Cleveland Gate Retail Park, Gisborough	Retail Warehouse	6,380
303 High Street and 2 Waterside South, Lincoln	Retail	6,014
Dudley Port Petrol Filling Station, Tipton	Petrol Filling Station	3,731
3&4 The Sector, Newbury Business Park	Office	18,801
79 Bath Road, Chippenham	Retail Warehouse	9,648
Ruddington Fields Business Park, Mere Way, Nottingham	Office	6,931
Sainsburys, High Street, Northallerton	Retail	7,460
Total Value		**61,765**