Appendix A

Treasury Management Annual Report 2019/20

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1. Background

1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority 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 financial risk are therefore central to the Authority's prudent financial management. The Treasury Management Strategy for 2019/20 was approved at Council on 21st February 2019

1.2 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.

1.3 In carrying out treasury operations the Council has regard to the advice received from it's appointed Treasury Management advisors, Arlingclose Ltd. The current contract for advice expires 31st December 2020.

1.4 Investments held for service purposes or for commercial profit are considered in the Investment Strategy Report (see **Appendix 3**).

2. External Context

2.1 **Economic background:** The UK's exit from the European Union and future trading arrangements, had remained one of major influences on the UK economy and sentiment during 2019/20. The 29th March 2019 Brexit deadline was extended to 12th April, then to 31st October and finally to 31st January 2020. Politics played a major role in financial markets over the period as the UK's tenuous progress negotiating its exit from the European Union together with its future trading arrangements drove volatility, particularly in foreign exchange markets. The outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

2.2 The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% year on year in February, below the Bank of England's target of 2%. Labour market data remained positive. The ILO 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.

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

2.4 Then coronavirus swiftly changed everything. COVID-19, which had first appeared in China in December 2019, started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global Financial Crisis as part of a flight to quality into sovereign debt and other perceived 'safe' assets.

2.5 In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

2.6 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 conjunction with these cuts, the UK government 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.

2.7 The US economy grew at an annualised rate of 2.1% in Q4 2019. After escalating trade wars and a protracted standoff, the signing of Phase 1 of the trade agreement between the US and China in January was initially positive for both economies, but COVID-19 severely impacted sentiment and production in both countries. Against a slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from of 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19 related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already on (or below) the floor, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

2.8 **Financial Markets:** 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 touch 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. The flight to quality caused gilts yields to fall substantially. 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.

2.9 **Credit Review:** In Q4 2019 Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN 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 passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

2.10 While the UK and non-UK banks on the treasury advisors counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks was cut to 35 days in mid-March.

2.11 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-.

3. Local Context

3.1 As at 31st March 2020 the Authority has borrowings of £225m and investments of £47m. This is set out in further detail at **Annex B.** Forecast changes in these sums are shown in the balance sheet analysis in **Table 1** below.

Table 1: Balance Sheet Summary and Forecast

	31/03/19 Actual £m	31/03/20 Actual £m	31/03/21 Estimate £m	31/03/22 Estimate £m	31/03/23 Estimate £m
General Fund CFR	330	371	431	458	487
Less: Other long-term liabilities *	(26)	(24)	(22)	(21)	(21)
Loans CFR	**304**	**347**	**409**	**437**	**466**
Less: External borrowing **	(158)	(201)	(130)	(78)	(77)
Internal (over) borrowing	**146**	**146**	**279**	**359**	**389**
Less: Usable reserves	(112)	(106)	(102)	(97)	(89)
Less: Working capital	(86)	(80)	(75)	(73)	(71)
Investments (or New borrowing)	**52**	**40**	**(102)**	**(189)**	**(229)**

* finance leases and PFI liabilities that form part of the Authority's debt

** shows only loans to which the Authority is committed and excludes optional refinancing

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.3 The Authority has an increasing CFR due to the capital programme and will therefore be required to borrow up to £119m over the forecast period 2020/21 to 2022/23.

3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. **Table 1** shows that the Authority expects to comply with this recommendation during 2019/20.

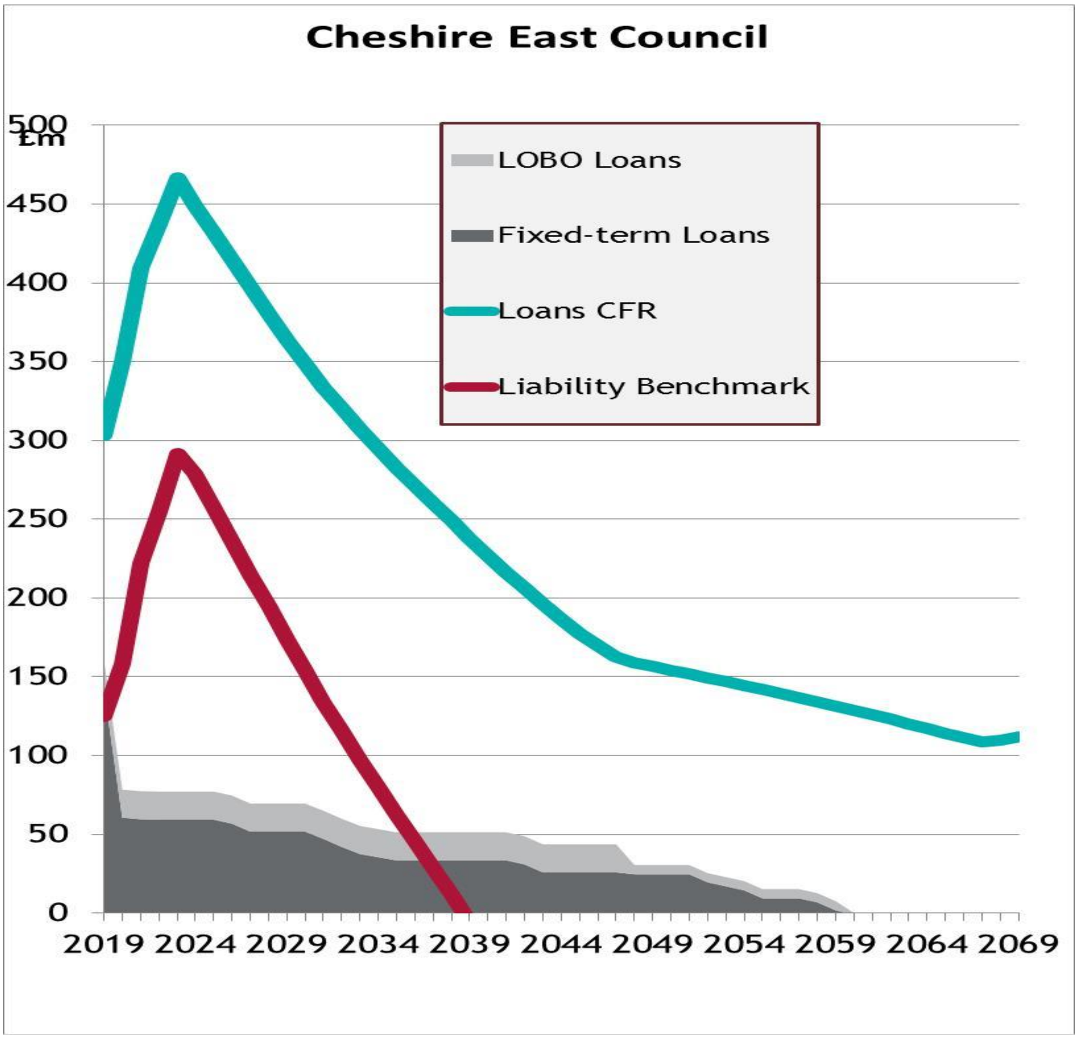
3.5 **Liability Benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £20m (increased from £10m in 2019/20) at each year-end to maintain a core strategic investment.

Table 2: Liability Benchmark

	31/03/19 Actual £m	31/03/20 Actual £m	31/03/21 Estimate £m	31/03/22 Estimate £m	31/03/23 Estimate £m
Loans CFR	304	347	409	437	466
Less: Usable reserves	(112)	(106)	(102)	(97)	(89)
Less: Working capital	(86)	(80)	(75)	(73)	(71)
Plus: Minimum investments	10	20	20	20	20
Liability Benchmark	**116**	**181**	**252**	**287**	**326**

3.6 Following on from the medium-term forecasts in table 2 above the long-term liability benchmark assumes minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in **Chart 1**.

Chart 1: Liability Benchmark Chart



4. Borrowing Strategy

4.1 The Authority currently holds loans of £201m, an increase of £43m since 31st March 2020. PWLB debt has been reducing by £6m per year whilst cash flow shortfalls caused by internal borrowing is being funded through cheaper short term borrowing.

4.2 At the moment this is being be met by temporary borrowing from other Local Authorities which is considerably cheaper than other sources of borrowing. Generally this was on a one to three month basis but with some extending into 2020/21 and 2021/22 as liquidity within the markets is expected to become scarce. The cost (including fees) in 2019/20 was around 0.97%. A full list of temporary borrowings as at 31st March 2020 is shown below in Table 3.

Table 3 – Current Temporary Borrowing

Lender	Start	Maturity	Rate %	£m
Tameside	05/03/19	05/05/20	1.15	5.0
Derbyshire	15/03/19	24/04/20	1.20	10.0
Lincolnshire	15/03/19	15/04/20	1.15	5.0
Wokingham	11/09/19	10/09/21	0.90	5.0
PCC Dyfed - Powys	20/01/20	22/04/20	0.49	2.0
Northern Ireland Housing Executive	13/01/20	15/04/20	0.77	10.0
Cheshire West & Chester	20/01/20	20/04/20	0.80	5.0
Essex	23/01/20	23/04/20	0.76	5.0
Kingston Upon Hull	14/02/20	01/04/20	0.70	10.0
Hart	03/02/20	15/05/20	0.76	4.0
Calderdale	05/02/20	22/04/20	0.70	1.0
PCC Staffordshire	06/03/20	06/05/20	0.80	3.0
Erewash	13/03/20	15/06/20	1.05	1.0
Lancashire	12/03/20	14/04/20	1.15	20.0
West Lindsey	16/03/20	23/04/20	0.62	1.0
Lancashire	19/03/20	19/05/20	0.85	10.0
Trafford	20/03/20	21/09/20	1.50	2.0
Warwickshire	19/03/20	21/09/20	1.60	10.0
Cherwell	20/03/20	09/04/20	1.50	3.0
North Yorkshire	27/03/20	28/09/20	1.45	5.0
TOTAL				**117.0**

4.3 **LOBO's:** The Authority holds £17m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBO's had options during 2019/20 but no changes were proposed.

5. Investment Strategy

5.1 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. Due to the overriding need for short term borrowing, other than £20m invested strategically in managed funds, the investments are generally short term for liquidity purposes. On occasions higher balances than expected have been held due to the timing of receipt of grants, particularly COVID-19 related grants in March 2020.

5.2 The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest 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.

5.3 The maximum amount that can be invested with any one organisation is set in the Treasury Management Strategy Report. The maximum amount and duration of investments with any institution depends on the organisations credit rating, the type of investment and for banks and building societies, the security of the investment. Generally credit rated banks and building societies have been set at a maximum value of £6m for unsecured investments and £12m for secured investments. Any limits apply to the banking group that each bank belongs to. Limits for each Money Market fund have been set at a maximum value of £12m per fund with a limit of 50% of total investments per fund. There is also a maximum that can be invested in all Money Market Funds at any one time of £50m. Due to their smaller size, unrated Building Societies have a limit of £1m each.

5.4 As reported in the last monitoring report, in October the Council has exceeded its limit for unsecured investments with Santander UK Bank with £8.5m invested in notice accounts which is in excess of the limit by £2.5m. This position was rectified in November and arose as there are separate accounts in use with different terms. This situation should not arise again.

5.5 A further breach occurred in March as large overnight balances were held with the Councils bank, Barclays. This arose due to the late receipt of high value grants and maintaining liquidity whist COVID-19 lockdown processes were being implemented.

5.6 Treasury Management income for 2019/20 is £673,000 which is higher than the budgeted £440,000. Offsetting this are increased borrowing costs (£126,000 higher than budget).

- The average daily investment balance including managed funds during 2019/20 is £31.7m

- The average annualized interest rate received on in-house investments during 2019/20 is 0.74%

- The average annualized interest rate received on the externally managed funds during 2019/20 is 4.23%

5.7 The Authority's total average interest rate on all investments in 2019/20 is 2.12%. The returns continue to exceed our benchmark, the London Inter-bank Bid Rate for 7 days at 0.66% (average 2019/20), and our own performance target of 1.25% (Base Rate for most of 2019/20 + 0.50%).

Table 4 – Interest Rate Comparison

Comparator	Average Rate 2019/2020
Cheshire East	2.12%
LIBID 7 Day Rate	0.68%
LIBID 3 Month Rate	0.72%
Base Rate	0.75%
Target Rate	1.25%

5.8 As the Authority holds a large amount of reserves and working capital, the level of strategic investments was increased from £10m to £20m in order to benefit from higher income returns whilst spreading risk across different asset classes.

5.9 The additional £10m was invested between October 2019 and February 2020 across 4 different funds which are all designed to give an annual income return between 4% and 5% but which have different underlying levels of volatility. By spreading investments across different types of fund, the intention is to dampen any large fluctuations in the underlying value of the investments. These are shown below in Table 5.

Table 5 –Strategic Investments

Fund Manager	Asset Class	£m
CCLA	Property	7.5
Kames	Multi Asset	5.0
Fidelity	Equity - Global	4.0
Schroders	Equity - UK	2.5
M & G	Bonds	1.0
TOTAL		20.0

5.10 The value of these investments does vary. The effects of COVID-19 on financial markets and values of underlying assets has been considerable. Fund values at 31st March 2020 were significantly lower than the amounts invested. The Balance Sheet shows the value of these investments at £18.1m. However, since then the values of some of these funds have improved whilst they all continue to deliver high levels of income return.

Chart 2 – Current Investments by Counterparty Type

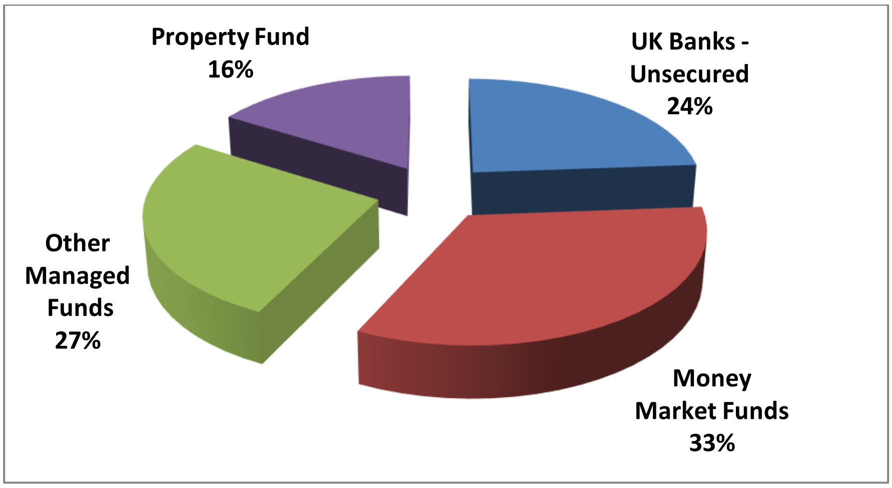


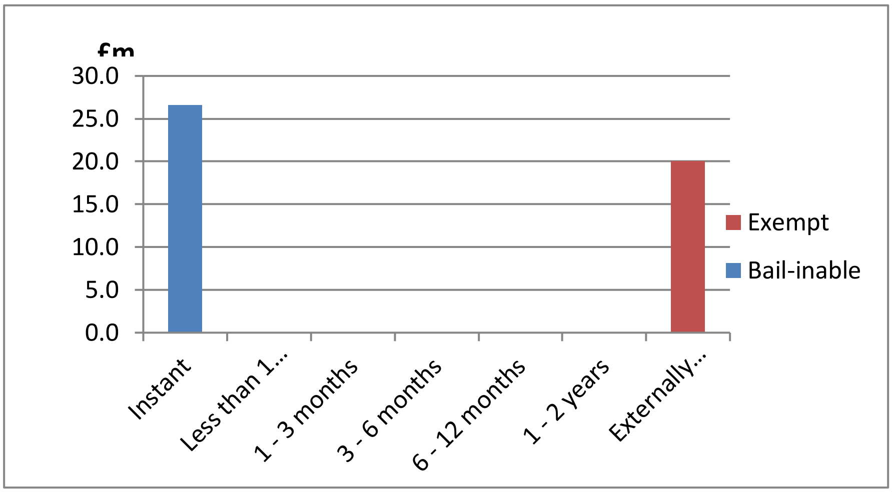
Table 6 – Types of Investments and Interest Rates at 31st March 2020

Instant Access Accounts	Average Rate %	£m
Money Market Funds	0.43	15.5
Barclays Call Account	0.30	11.1

Externally Managed Funds	£m
Property Fund	7.5
Other Managed Funds	12.5

Summary of Current Investments	£m
TOTAL	**46.6**

Chart 3 – Maturity Profile of Investments



Note: Bail-inable means that in the event of default the counterparty may be required to use part of the investments as their own capital in which case the Council would not get back as much as they invested. This would apply with most bank and Building Society investments.

6. Treasury Management Indicators

6.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

6.2 **Interest Rate Exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The upper limit on the one-year revenue impact of a 1% rise in interest rates is:

Interest Rate Risk Indicator	Limit
Upper limit on one-year revenue impact of a 1% **rise** in interest rates	£410,000
Actual impact in 2019/20 of increase in interest rates	£0

6.3 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The remained a net borrower in 2019/20 so any fall in rates would lead to savings rather than incurring additional cost. The limit and the actual impact were therefore £0.

6.4 **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. Lower limits have been set at 0%. The upper limits on the maturity structure of borrowing which were set in February 2020 and the actual maturity profiles as at 31st March 2020 are:

Refinancing rate risk indicator	Upper Limit	Actual
Under 12 months	70%	66%
12 months and within 24 months	35%	3%
24 months and within 5 years	35%	0%
5 years and within 10 years	75%	1%
10 years and within 20 years	100%	12%
20 years and above	100%	18%

6.5 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. The upper limit for loans maturing in under 12 months is relatively high as short term funding is currently considerably cheaper than alternatives. The increased margin applied to PWLB rates and the reduction in Base rates in March 2020 has increased the differences between long term certainty of interest costs and short term borrowing costs. This allows the Council to take full advantage the maximum that could be taken as short term borrowing was increased to 70% when setting the Treasury Management Strategy in February 2021.

6.6 **Principal Sums Invested for Periods Longer than 364 days:** 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. The limits on the total principal sum invested to final maturities beyond the period end will be:

Price Risk Indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£25m	£15m	£10m
Actual amounts committed beyond year end	£0m	£0m	£0m

Annex A: Existing Investment & Debt Portfolio Position

	31/03/20 Actual Portfolio £m	31/03/20 Average Rate for the year %
External Borrowing :		
PWLB*– Fixed Rate	65	4.26%
Local Authorities	117	0.90%
LOBO Loans *	17	4.63%
Other	2	-
Total External Borrowing	**201**	**2.79%**
Other Long Term Liabilities:		
PFI	22	-
Finance Leases	2	-
Total Gross External Debt	**225**	-
Investments:		
Managed in-house		
Short-term investments:		
Instant Access	27	0.37%
Managed externally		
Property Fund	8	4.62%
Other Managed Funds	12	3.66%
Total Investments	**47**	**2.12%**
Net Debt	**178**	-

* The Authority inherited the majority of the external loans from Cheshire County Council in April 2009. The opening balance sheet position as at 1st April 2009 included PWLB loans totaling £120m and LOBO loans of £17m.