

TREASURY MANAGEMENT ANNUAL REPORT 2019/20

Report of the Corporate Director, Corporate and Support Services

1 INTRODUCTION AND PURPOSE OF REPORT

- 1.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).
- 1.2 During 2019/20 the minimum reporting requirements were that the full Council should receive the following reports:
- an annual treasury strategy in advance of the year (Council, 26 February 2019);
 - a mid-year treasury update report (Council, 28 November 2019);
 - an annual report following the year describing the activity compared to the strategy (this report).
- 1.3 The regulatory environment places onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.
- 1.4 The Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Corporate, Resource Management and Governance Scrutiny Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 3 December 2019 in order to support Members' Scrutiny and Cabinet role.
- 1.5 During 2019/20, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators are found in the main body of the report. The Corporate Director, Corporate and Support Services, confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.
- 1.6 The financial year 2019/20 continued the challenging investment environment of previous years, namely low investment returns.

2 **TREASURY MANAGEMENT POLICY STATEMENT AND PRACTICES (TMPs)**

- 2.1 The Council's Treasury Code of Practice Statement, Treasury Management Policy Statement and the detailed Treasury Management Practices were last updated and approved by the Council Meeting on 12 September 2019.
- 2.2 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code. A particular focus of these revised codes was local authority investments which are not treasury type investments which consequently were reported to Members in February 2019 in a separate Capital Strategy report.
- 2.3 The Treasury Management Policy Statement has been updated to incorporate the necessary changes resulting from the December 2017 revisions to the Treasury Management and Prudential Codes and also for the revised MHCLG guidance for investments and MRP which were introduced in 2017.
- 2.4 The full TMPs have not been included in this report due to their length and complexity but are available to view on request.

3 **CAPITAL EXPENDITURE AND FINANCING 2019/20**

- 3.1 The Council undertakes capital expenditure on long-term assets. These activities may be financed by either:
- The application of specific capital or revenue resources (capital receipts, capital grants, capital reserves or revenue contributions); and
 - Prudential borrowing (in year capital financing requirement).
- 3.2 The table below set out the original estimate and actual capital expenditure for 2019/20 and illustrates how this was financed compared to the previous financial year.

	2018/19 Actual £000	2019/20 Budget £000	2019/20 Actual £000
General Fund			
GF Capital Expenditure	96,620	146,096	78,151
Resourced by:			
Capital grants	45,662	41,864	27,997
Capital receipts	357	4,539	620
Capital contributions	2,261	2,994	3,372
Revenue contributions	1,524	1,583	0
In year Capital Financing Requirement	46,816	95,116	46,162
HRA			
HRA Capital Expenditure	20,142	18,659	21,572
Resourced by:			
Capital grants	1,575	0	144
Capital receipts	709	456	1,770
Capital contributions	0	0	0
Revenue contributions	11,827	12,048	11,904
In year Capital Financing Requirement	6,031	6,155	7,754

- 3.3 The decrease in General Fund prudential borrowing from £95.116m in the budget capital programme for 2019/20 to £46.161m at outturn is largely due to a number of re-phased schemes to later years; most notably £14.590m for School Capital Strategy Investment, £12.955m for the Borough Care scheme, and £5.902m for the Council's Asset Management Plan schemes.
- 3.4 The HRA capital programme largely stayed on track during 2019/20, achieving slightly more capital work than originally planned. As a result of this, more prudential borrowing has been utilised than originally budgeted for. The capital financing requirement has increased from £138.512m at the start of the year to £144.980m at outturn.

4 BORROWING NEED, PRUDENTIAL AND TREASURY INDICATORS

- 4.1 The Council's underlying need to borrow for capital expenditure is measured through the Capital Financing Requirement (CFR). This figure is a gauge of the Council's requirement to take on long term borrowing. The CFR is amortised and charged to revenue over a number of years. The in-year CFR represents 2019/20 capital expenditure (see tables above) which has not yet been paid for by revenue or covered by specific capital cash backed resources, such as specific grants.
- 4.2 Part of the Council's treasury activities is to manage the Council's long-term borrowing requirements. The treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and long term cash flow requirements and balance this with short term day to day cash requirements. Long-term borrowing may be sourced through borrowing from external bodies such as the Government, through the Public Works Loan Board (PWLb) or the money markets, or alternatively utilising temporary cash resources from within the Council.
- 4.3 The General Fund underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets financed through borrowing are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the General Fund borrowing need. There is no statutory requirement for the Council to reduce the HRA CFR.
- 4.4 The Council's 2019/20 MRP Policy (as required by MHCLG Guidance) was approved as part of the Treasury Management Strategy Report for 2019/20 on 26 February 2019.
- 4.5 The Council's CFR for the year is shown below and represents a key prudential indicator (this includes leasing schemes on the balance sheet, which increase the Council's borrowing need).

Capital Financing Requirement (CFR):	31.03.19 Actual £000	31.03.20 Budget £000	31.03.20 Actual £000
General Fund (GF)			
Opening balance	536,999	571,944	569,773
Add in year CFR (as above)	46,816	95,116	46,161
Transfers between GF and HRA			
Less MRP/voluntary MRP	(14,042)	(13,872)	(13,605)
Closing balance	569,773	653,188	602,329
Housing Revenue Account (HRA)			
Opening balance	132,967	138,428	138,512
Add in year CFR (as above)	6,031	6,155	7,754
Transfers between GF and HRA			
Less MRP/voluntary MRP	(0,486)	(0,830)	(1,286)
Closing balance	138,512	143,753	144,980

Note: the CFR opening balances (GF and HRA) for the 2019/20 budget differs to the actual closing balance as at 31 March 2019. This is because budget was calculated on estimates in February 2019, prior to the end of the 2018/19 financial year.

- 4.6 Actual borrowing activity is monitored through the prudential indicators for borrowing and the CFR and by the authorised limit and operational boundary; these are described below.
- 4.7 **Gross Borrowing and the CFR:** in order to ensure that actual borrowing levels are prudent over the medium term, the Council's external borrowing must only be for capital purposes. This essentially means that the Council is not borrowing to support revenue expenditure. Gross borrowing should not therefore, except in the short term, have exceeded the CFR for 2019/20 plus the expected changes to the CFR over 2019/20 to 2020/21 from financing the Capital Programme. The table below highlights the Council's gross borrowing against the CFR. The Council has complied with this prudential indicator.

Gross Borrowing and the CFR	31.03.19 Actual £000	31.03.20 Original £000	31.03.20 Actual £000
Gross borrowing	579,952	668,645	652,700
Other long-term liabilities	13,700	13,700	13,700
Total Gross External Debt	593,652	682,345	666,400
CFR	708,285	796,941	747,309

Note: The actual gross external debt as at 31 March 2020 above differs from the total debt figures in the table in 5.2 below as this includes the finance lease for Stockport Exchange Central Multi-Storey Car Park under 'other long-term liabilities'.

- 4.8 **The authorised limit:** the authorised limit is the 'affordable borrowing limit' required by Section 3 of the Local Government Act 2003; the Council does not have the power to borrow above this level. The table below demonstrates that during 2019/20 the Council has maintained gross borrowing within its authorised limit.
- 4.9 **The operational boundary:** the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached. The table below demonstrates that during 2019/20 the Council has maintained gross borrowing within its operational boundary.

- 4.10 **Actual financing costs as a proportion of net revenue stream:** this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2018/19 £000	2019/20 £000
Authorised Limit	815,000	856,000
Maximum gross borrowing position during the year	616,098	642,700
Operational Boundary	795,000	836,000
Average gross borrowing position during the year	562,277	584,855
Financing costs as a proportion of net revenue stream: General Fund	6.09%	9.07%
Financing costs as a proportion of net revenue stream: HRA	10.54%	10.61%

- 4.11 The 2019/20 budget financing costs as a proportion of net revenue stream were:

- General Fund 8.45%
- HRA 10.80%

5 **TREASURY POSITION AS AT 31 MARCH 2020**

- 5.1 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices.

- 5.2 At the beginning and the end of 2019/20 the Council's treasury position was as follows:

Treasury Position	Financial Year 2018/19 (2 Pools)				Financial Year 2019/20 (2 Pools)			
	General Fund		HRA		General Fund		HRA	
	£000	%	£000	%	£000	%	£000	%
	as at 31.03.19		as at 31.03.19		as at 31.03.20		as at 31.03.20	
Fixed Rate Funding:								
PWLB	277,265	3.50%	82,260	4.66%	320,975	3.22%	75,494	4.76%
Market (LOBO)	10,942	4.26%	6,558	4.26%	10,942	4.26%	6,558	4.26%
Market (converted LOBOs)	37,517	3.89%	22,483	3.89%	37,517	3.89%	22,483	3.89%
Market (other long-term loans)	40,000	2.33%	0	0%	40,000	2.33%	0	0%
Market (other LAs +364 days)	0	0	0	0%	7,500	1.00%	0	0%
Market (short-term)	100,800	0.86%	0	0%	128,000	1.00%	0	0%
Salix loans	2,107	0.00%	0	0%	3,212	0.00%	0	0%
Sub-total	468,632		111,301		548,146		104,535	
Variable Rate Funding:								
Market (short-term)	19	0.75%	0	0%	19	0.10%	0	0%
Sub-total	19		0	0%	19		0	0%
Total Debt	468,651	2.87%	111,301	4.48%	548,165	2.66%	104,535	4.54%
Total Investments	26,725	0.90%	0	0%	110,345	0.66%	0	0%
Net Debt	441,926		111,301		437,820		104,535	

- 5.3 The increase in PWLB borrowing as at 31 March 2020 in the table above represents £55m new long-term borrowing undertaken in August 2019 as detailed in paragraph 9 and repayment of an £18.056m maturing PWLB loan in year.

Overall the General Fund loans rate has reduced from 2.87% to 2.66% between years representing the increase in lower rate long-term loans.

5.4 The maturity structure of the debt portfolio was as follows:

Maturity structure of fixed rate borrowing	31.03.19 Actual	2019/20 Original (Max %)	31.03.20 Actual
Under 12 months	20.0%	50%	22.6%
12 months and within 24 months	2.6%	50%	2.4%
24 months and within 5 years	4.7%	55%	3.4%
5 years and within 10 years	1.7%	55%	1.1%
10 years and above	71.0%	100%	70.5%
	100.0%		100.0%

5.5 The maturity structure of the investment portfolio was as follows:

Investment Portfolio	31.03.19 Actual £000	2019/20 Original (Max Limit) £000	31.03.20 Actual £000
Less than 365 days	26,725	No limit	110,345
Over 365 days	0	80,000	0
Total	26,725		110,345

5.6 The exposure to fixed and variable rates was as follows:

Interest Rate Exposure	31.03.19 Actual %	2019/20 Original (Max Limit) %	31.03.20 Actual %
Fixed Rate:			
Gross borrowing (Principal)	100%	100%	100%
Variable Rate:			
Gross borrowing (Principal)	0%	40%	0%

5.7 The table above illustrates the maximum limits that have been set (in percentage terms) for the Council's total borrowing that can be at either fixed or variable interest rates; it then compares these limits to the actual borrowing at fixed and variable rates at the year end.

5.8 The percentage for fixed rate borrowing is set at 100% of the Council's loans portfolio, because at certain times in the financial year the Council does not have any temporary borrowing at variable rates, as the majority of borrowing is in the form of longer dated fixed rate loans. This point is emphasised in the Council's actual borrowing as at 31.03.20 which is entirely at fixed rates.

5.9 The maximum limit for variable rate loans is set much lower as it would not be desirable for the Council to have too much of its loan portfolio at variable rates, potentially exposing it to an unacceptable levels of interest rate refinancing risk if rates should suddenly rise.

6 **THE STRATEGY FOR 2019/20**

- 6.1 The expectation for interest rates within the initial Treasury Management Strategy for 2019/20 anticipated that Bank Rate would increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. The next increase in Bank rate (from 0.75%) to 1% was expected by mid-2019. The last interest rate rise was in August 2018. It went from 0.5% to 0.75%. In terms of historical interest rates, this is very low.
- 6.2 PWLB rates would likely be subject to significant volatility, driven predominantly by developments with Brexit and ensuing investor confidence. The long-term forecast for PWLB rates was on a gently rising trend.
- 6.3 Target PWLB borrowing rates at which new long-term borrowing would be considered (as at Q1 2019) were; 5 year 2%, 10 year 2.50%, 25 year 2.90% and 50 year 2.70%.
- 6.4 There would be gradual rises in medium and longer term fixed borrowing rates during 2019/20. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.
- 6.5 Investment returns were likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- 6.6 In this scenario, the treasury strategy was that the Council maintain an under-borrowed position, meaning that capital borrowing need (the Capital Financing Requirement), would not be fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as a temporary measure. This strategy was prudent as investment returns were low and counterparty risk was still an issue that needed to be considered. The policy would be kept under review in light of changes in the outlook for interest rates and other market developments that may impact the central strategy; this could mean the Council may incur higher borrowing costs in the future when it may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.
- 6.7 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Corporate Director, Corporate and Support Services, therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:
- If it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
 - If it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate

funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

- 6.8 What actually transpired during 2019/20 is explained in the following paragraphs of the report. In general, we saw volatile longer term PWLB rates on a falling trend throughout the financial year, until March 2020. The global outbreak of coronavirus forced the UK Government to take drastic steps to stem the economic impact by lowering Bank rate significantly. During a special meeting of the Bank's Monetary Policy Committee on 10 March 2020, the Bank of England decided to cut the interest down from 0.75% to 0.25% to counter the 'economic shock' resulting from the coronavirus outbreak. A second cut was made on 19 March to 0.1% with the bank warning that the pandemic will result in a 'sharp and large' economic shock. At the same time, gilt yields also fell sharply as investors panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds.

7 THE ECONOMY AND INTEREST RATES

- 7.1 The main subject of 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Theresa May as Prime Minister and the leader of the Conservative minority Government and the election of Boris Johnson as the new Prime Minister and leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter with a decisive victory for the Conservative Party. Following this the UK left the EU on 31 January 2020. There still, however, remains much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact this deadline; although the Government has indicated not, the second and third rounds of negotiations have already had to be cancelled due to the virus.
- 7.2 Economic growth in 2019 was very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, (+1.1% y/y). 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty following the general election in December and the course for Brexit was more certain. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the coronavirus pandemic. The closedown of whole sections of the economy that ensued resulted in a fall in GDP in April 2020 of 20.4%, with falls in quarter two 2020 expected to be more entrenched. Significant uncertainty remains to the extent of the damage that will be done to businesses by the end of the lockdown period, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.
- 7.3 After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty meant it did nothing further to alter rates until March 2020. At this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were

accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn (up from £435bn). Quantitative easing is a tool that central banks, like the Bank of England, can use to inject money directly into the economy (in June 2020 this was increased by a further £100bn).

- 7.4 The Government and the Bank were also very concerned to stop people losing their jobs during this lockdown period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs initially for three months (now extended) while the country was locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lockdown period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services.
- 7.5 At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in the coming months. Public health measures taken to slow the spread of the coronavirus have restricted people's movement and activity. Much economic activity has been suspended. The Chancellor has taken various steps to support businesses, workers and incomes during the crisis. The public finances will be significantly affected by the economic shock caused by the coronavirus outbreak. The Government's budget deficit will increase as tax revenues fall and government spending increases.
- 7.6 At this stage no one can say by how much the deficit will increase in 2020/21 nor the extent to which future deficits will be affected. The longer the crisis continues, the more the cost to Government will rise. In an illustrative scenario the Office for Budget Responsibility (OBR) analysed what might happen if there is a three-month lockdown followed by another three-month period where the lockdown is gradually lifted. In this scenario, the OBR estimates that UK GDP (economic output) would fall by around 13% in 2020. The budget deficit would reach around 15% of GDP.
- 7.7 In the Budget in March, the Government also announced a large increase in spending on infrastructure, aimed at also helping the economy to recover once the lockdown is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lockdown is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.
- 7.8 Inflation has posed little concern for the MPC during the last year, being mainly between 1.5%-2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.
- 7.9 Employment had been growing healthily through the last twelve months but the Coronavirus Pandemic will undoubtedly hit employment statistics hard over the summer months and beyond. The good news over the last year is that wage

inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

8 **BORROWING RATES IN 2019/20**

- 8.1 PWLB certainty borrowing rates: the table for PWLB maturity rates below show, for a selection of maturity periods, the range (high and low points) in rates, the average rates and individual rates at the start and the end of the financial year.
- 8.2 Interest rate forecasts in the initial treasury management strategy expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Short-term rates, based on Bank rate, were expected to be the cheaper form of borrowing over the period.
- 8.3 As illustrated in the table, PWLB rates were on a falling trend during the first half of the financial year with longer rates having almost halved to reach historic lows. This was the opposite scenario on which the interest rate forecasts, provided by Link, were predicated in February 2019, when the initial Treasury Management Strategy for 2019/20 was formulated. The 50 year PWLB target (certainty) rate for new long term borrowing fell from 2.50% to 2.00% during the first half of the financial year. However in October 2019 PWLB Certainty rates rose due to increases imposed by HM Treasury, rather than a change in market levels. This is explained further in the following paragraphs.
- 8.4 The interest rate forecast provided by Link in February 2019 when the initial Treasury Management Strategy was developed, Link were forecasting a Bank rate rise in June 2019 to 1% and March 2020 to 1.25% when in fact the rate remained at 0.75% throughout the financial year until it was cut by the Bank of England in March 2020, following the coronavirus outbreak. The reasons for the change in borrowing rates and the effect this has had on treasury strategies for 2019/20 is detailed below.
- 8.5 PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through Her Majesty's Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a 'bubble' which was driving bond prices up and yields down to historically very low levels. The context for this was heightened expectations that the US could have been heading for a recession in 2020 and a general background of downturn in world economic growth, particularly due to fears around the impact of the trade war between the US and China. Added to this, with inflation generally at low levels in most countries and expected to remain subdued, these conditions were conducive to very low bond yields.
- 8.6 While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers; this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen, over the last year, many bond yields up to 10 years in the

Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The flip side of this is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

- 8.7 PWLB Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks also started quantitative easing purchases of government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March 2020, all gilt yields from 1 to 5 years were between 0.12%-0.20% while even 25-year yields were at only 0.83%.
- 8.8 However, HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019/20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then partially reversed for some forms of borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was due to end on 4 June 2020. The government however recognised that local authorities have focused on responding to the COVID-19 crisis, therefore it has extended the deadline on the PWLB lending terms consultation to the 31 July 2020.
- 8.9 Local authorities invest billions of pounds of capital every year in their communities. The government supports this activity in part by offering low cost loans through the Public Works Loan Board (PWLB). However, in recent years a minority of councils have used this cheap finance to buy very significant amounts of commercial property for rental income, which reduces the availability of PWLB finance for core local authority activities.
- 8.10 To address this the government is consulting on revising the terms of PWLB lending to ensure that local authorities continue to invest in housing, infrastructure, and public services. It is clear that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.
- 8.11 Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows:
- PWLB Standard Rate is gilt plus 200 basis points (G+200bps)
 - PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
 - PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
 - PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
 - Local Infrastructure Rate is gilt plus 60bps (G+60bps)

- 8.7 There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus lockdown period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.
- 8.8 During the year, the 50 year PWLB target (certainty) rate for new long term borrowing fell from 2.50% to 2.00% in the first six months of the financial year, rose to 3.20% (it should be noted that this incorporated the 1% rise in PWLB rates in October 2019) and finished the year at 2.90%.

PWLB CERTAINTY RATES IN 2019/20					
	1 Year	5 Year	10 Year	25 Year	50 Year
01.04.19	1.46%	1.52%	1.84%	2.41%	2.24%
31.03.20	1.90%	1.95%	2.14%	2.65%	2.39%
High	2.47%	2.45%	2.76%	3.25%	3.05%
Date	21.10.19	19.03.20	19.03.20	19.03.20	31.12.19
Low	1.17%	1.00 %	1.13%	1.73%	1.57%
Date	03.09.19	08.10.19	03.09.19	03.09.19	03.09.19
Average	1.83%	1.77%	2.00%	2.56%	2.40%
Spread	1.30%	1.45%	1.63%	1.52%	1.48%

9 **BORROWING PORTFOLIO OUTTURN FOR 2019/20**

- 9.1 Borrowing is undertaken to fund net unfinanced capital expenditure and naturally maturing debt and also to maintain cashflow liquidity requirements. Throughout 2019/20, the Council maintained an under-borrowed position; this meant that the capital borrowing need (the Capital Financing Requirement) was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.
- 9.2 The Council's opening capital financing requirement (CFR) for 2019/20 was £708.285m rising to £747.309m by 31 March 2020. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table in 4.7 above shows the Council's significantly internally borrowed position (the CFR compared to total gross external debt).
- 9.3 Whilst the Council continued to run with internal borrowing positions during 2019/20, it was also aware of its reliance on internal cash reserves and the availability of short-term loans from other councils. As a result, the Council opted to reduce its internal borrowing position in light of the significant uncertainty surrounding Brexit and the perceived possibility of significant cash shortages that may arise in the market.
- 9.4 Temporary borrowing was supplemented with new long-term PWLB borrowing in August 2019 the Council took £55m of new PWLB borrowing at an average rate of 1.87%; this comprised of loans maturing in February 2065 and March 2069. These

have been split to mature in separate years and so not expose the Council to too much refinancing risk in any one year. The new long-term borrowing is illustrated in the table in 5.2 above.

- 9.5 Following the substantial increase to PWLB lending rates in October 2019, the Council considered alternative sources of long-term funding in the second half of the financial year, however at this stage, these appear to be few and far between. The Council did not have any funding shortfalls in the 2019/20 financial year given the £55m PWLB loans taken, its current level of investments and its ability to raise short-term loans.
- 9.6 In March and April 2020, the Council completed an equity investment in Manchester Airport, along with the other GM Councils. This is part of the airport's scheme to build a number of new car parks and will go ahead once the legal agreements have been finalised. Funding required was £5.610m.
- 9.7 The Council continued to make interest savings by also taking short-term loans from other Councils throughout 2019/20.
- 9.8 The Council did not engage in any debt-rescheduling during 2019/20 as the average 1% differential between PWLB new borrowing rates and premature repayment rates, made re-scheduling unviable.
- 9.9 The Council's overall weighted average borrowing rate for 2019/20 was 3.14% rising slightly from 3.08% for the previous financial year. This change reflects the movement from short-term to longer-term borrowing but provides the Council with increased certainty going forward.

10 **INVESTMENT RATES IN 2019/20**

- 10.1 Investment returns remained low during 2019/20 but were on a gently rising trend in the second half of the year.
- 10.2 The table below shows investment rates low, high and average levels for 2019/20.

	INVESTMENT RATES IN 2019/20					
	Bank Rate	7 Day	1 Month	3 Month	6 Month	1 Year
High	0.75%	0.58%	0.61%	0.72%	0.83%	0.98%
High Date	01.04.19	09.05.19	15.04.19	01.04.19	01.04.19	15.04.19
Low	0.10%	0.00%	0.11%	0.26%	0.31%	0.39%
Low Date	19.03.20	25.03.20	23.03.20	11.03.20	11.03.20	11.03.20
Average	0.72%	0.53%	0.56%	0.63%	0.70%	0.80%
Spread	0.65%	0.58%	0.50%	0.46%	0.52%	0.59%

11 **INVESTMENT PORTFOLIO OUTTURN FOR 2019/20**

- 11.1 The Council's cash balances comprise of revenue and capital resources and cash flow monies.

- 11.2 Investment Policy: the Council's investment policy is governed by MHCLG guidance, which was implemented in the annual investment strategy approved by the Council on 26 February 2019. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data such as rating outlooks, credit default swaps, bank share prices etc.
- 11.3 The Council followed its initial investment strategy for 2019/20, reducing investment balances during the financial year where possible in order to minimise credit risk (and in light of low market rates available). For its cash flow generated balances, the Council utilised notice accounts, Money Market Funds and a few fixed term deposits. The Council avoided making any longer term deals (over 365 days) during 2019/20 as investment rates remained at historically low levels.
- 11.4 Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was decided, but would only rise to 1.0% during 2020. Shorter term investment interest rates were fairly flat during most of the year until the two cuts in bank rate in March 2020 caused investment rates to fall sharply.
- 11.5 Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were at times significantly higher than shorter term rates during the year, value could be sought by placing longer term investments where cash balances were sufficient to allow this.
- 11.6 The Council does not generally have sufficient cash balances to be able to place deposits for more than a few months so as to earn higher rates from longer deposits. The reasons for this are twofold. The Council has generally run down investment balances in recent years when Bank rate has been at historical lows and opted to primarily use liquid investments to manage cashflow shortages. In addition, continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations.
- 11.7 However, the Council's new long-term PWLB borrowing of £55m in August 2019 was not immediately used to reduce temporary borrowing or to finance capital expenditure and so had the effect of causing a temporary increase in cash balances. As a result, some value was sought by placing investments for a longer duration where cash balances were sufficient to allow this. The Council also took a higher level of temporary borrowing towards the end of the financial year to provide a greater level of cash reserves at the end of March 2020. This strategy was used to counter any liquidity shortages that may have occurred in the market as a result of Covid-19, in addition to the usual year-end shortages and Council's generally turning away from PWLB loans to shorter-term loans due to the October 2019

increase in rates, which may also have resulted in increased demand for short-term cash. This policy of maintaining a higher level of investment reserves has been maintained somewhat into the 2020/21 financial year, although so far additional grants from central Government for the coronavirus outbreak have also buoyed the Council's investment balances.

11.8 The Council's average investment balances for each quarter are detailed in the table below. Whilst balances were maintained at a level to support cash flow fluctuations in the first half of 2019/20, balances rose in the later stages of the financial year as a result of the new long-term loans taken thus increasing investment balances prior to the funds being utilised to pay down some of the Council's shorter-term borrowing.

11.9 The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.

11.10 Detailed below is the result of the investment strategy undertaken by the Council.

Council Performance 2019/20		
Combined Investments	Average Balance Invested £000	Return %
Q1	19,117	0.83%
Q2	29,833	0.84%
Q3	52,561	0.88%
Q4	66,954	0.83%
Average 2019/20	42,111	0.85%

11.11 LIBID benchmark rates for differing periods up to 12 months are shown in the table below for the 2019/20 financial year.

Period	LIBID Rate 2019/20
7 Day	0.5338%
1 Month	0.5569%
3 Month	0.6339%
6 Month	0.7046%
12 Month	0.7977%

11.12 LIBID is the London interbank bid rate, i.e. what a bank will pay to lenders; 'an investment return'. It is general market practice for fund managers to be benchmarked against LIBID, however their LIBID is compounded to take account of interest that is reinvested. The Council therefore has a target for investment of cash based on LIBID as a benchmark for return/liquidity management.

11.13 During 2019/20 the Council's combined investments (long and short-term) generated a rate of return of 0.85%. This is based on no compounding of interest and can be compared against an uncompounded 7 day LIBID rate of 0.54%, (3 month rate 0.64%, six month rate 0.70% and twelve month LIBID rate of 0.80%) representing good annual performance above the benchmarks for the duration of the portfolio which is liquid in nature. The Council's return exceeds that of the twelve month LIBID rate even though its weighted average investment duration was just 50.85 days.

- 11.14 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

12 PERFORMANCE MEASUREMENT

- 12.1 One of the key requirements in the Treasury Management Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators are set in the Treasury Management Policy Statement and Annual Treasury Management Strategy.
- 12.2 This service has set the following performance indicators:
- Debt (borrowing): average rate movement year on year (illustrated in table in paragraph 5.2)
 - Investments: internal returns above the 7 day LIBID rate (paragraphs 11.10 to 11.13)

13 CONCLUSIONS AND RECOMMENDATIONS

- 13.1 The Council's treasury management function has been successful in 2019/20; investment performance has achieved an annual return of 0.85% and debt costs have been minimised at an overall rate of 2.96%
- 13.2 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.
- 13.3 The Council has had as its first priority the security of invested funds and its policy to place appropriate parameters (in terms of credit quality), to organisations with whom it invests. This has safeguarded the Council's investments during 2019/20.
- 13.4 The Council took £55m of long-term market loans during 2019/20 mitigating some of its liquidity and interest rate risk and continued to run with an internal borrowing position.
- 13.5 The Cabinet is asked to recommend that the Council Meeting:
- Approve the actual 2019/20 prudential and treasury indicators in this report;
 - Note the annual treasury management report for 2019/20; and
 - Note that changes have been made to the Council's Treasury Management Policy Statement and Practices during 2019/20 to accommodate the requirements of the revised CIPFA Codes published in December 2017.

BACKGROUND PAPERS

There are none

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian

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