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OXFORD CITY COUNCIL

To:	**Cabinet**
Date:	**9 September 2020**
Report of:	**Head of Financial Services**
Title of Report:	**Treasury Management Annual Report 2019/20**

Summary and Recommendations	
Purpose of report:	The report sets out the Council's Treasury Management activity and performance for the financial year 2019/20
Key decision:	No
Executive Board Member:	Councillor Ed Turner, Cabinet Member for Finance and Asset Management
Corporate Priority:	All
Policy Framework:	Treasury Management Strategy 2019/20
Recommendation: That Cabinet resolves to:	
1. **Note** the report	

Appendices
None

Executive Summary

1. The Council held investments of £86.97 million as at 31st March 2020. Net interest earned during the year, including from loans to companies and external borrowing, was £2.78 million against a target of £2.22 million, which primarily relates to investment balances being higher than anticipated during the year. This can be attributed to slippage in the forecast capital spend.
2. The average rate of return on the Council's investments in 2019/20 was 1.27% compared to 1.15% in 2019/20. The Council's performance target for the year was 0.51% above base rate, equating to 1.27% for April-Mar 2020. Although there was a decrease in the base rate during March 2020, this was too late to be reflected in investment returns and investment rates remained high during March due to demand in the local authority market.

3. The Council held £198.5 million of fixed rate Public Works Loan Board (PWLB) debt as at 31st March 2020. The debt was borrowed in March 2012 to fund the self-financing of the Housing Revenue Account (HRA). All of the debt relates to housing and the maturity profile ranges from 1 to 38 years. Interest paid on the debt in 2019/20 was £6.47 million.

Background

4. The primary principle governing the Council's investment decisions is the security of the investment, with liquidity and yield being secondary considerations.
5. The Council has a statutory duty to set, monitor and report on its prudential indicators in accordance with the Prudential Code, which aims to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable.
6. When considering whether to borrow, the Council's Debt Strategy requires a number of factors to be considered. These include:
    - prevailing interest rates;
    - the profile of the Council's debt portfolio;
    - the type of asset being financed; and
    - the availability of cash balances to finance capital expenditure.
7. The Council fully complied with its Treasury Management Strategy in relation to both debt and investment management in 2019/20.
8. The prudential indicators detailed in the body of this report compare the Council's outturn position against the target set for 2019/20

Financing the Capital Programme 20119/20

9. Table 1 below shows actual capital expenditure and financing compared to the original budget.

Table 1 : Capital expenditure and financing 2018-19 and 2019-20			
Capital Expenditure	**2019/20 Original Budget £'000**	**2019/20 Actual £'000**	**Variation £'000**
Non-HRA Capital Expenditure	78,035	30,121	-47,914
HRA Capital Expenditure	20,269	12,655	-7,614
Total Capital Expenditure	**98,304**	**42,776**	**-55,528**
Resourced by:			
Developer Contributions	6,675	2,027	-4,648
Capital Receipts	13,022	2,781	-10,241
Capital Grants and contributions	4,239	2,481	-1,758
Major Repairs Reserve	10,325	7,149	-3,176
Prudential Borrowing	49,978	27,748	-22,230
Revenue	14,065	590	-13,475
Total Capital Resources	**98,304**	**42,776**	**-55,528**

Much of the variation to the original budget relates to slippage in the programme, the resources for which will be moved into funding the expenditure in future financial years.

The Council's Overall Borrowing Need

10. The Council's underlying need to borrow, or Capital Financing Requirement (CFR), is the measurement and control of the Council's overall debt position. It represents all prior years' net capital expenditure which has not been financed by other means, i.e. revenue, capital receipts, grants etc.

11. The CFR can be reduced by:

- The application of additional capital resources, such as unapplied capital receipts; or
- Charging a Minimum Revenue Provision (MRP), or a Voluntary Revenue Provision (VRP).

12. Table 2 below shows the Council's CFR as at the 31st March 2020, this is a key prudential indicator, and shows that actual borrowing is below the CFR:

Table 2 Capital Financing Requirement (CFR) 2018-19 and 2019-20			
CFR	**31st March 2020 Estimate £'000**	**31st March 2020 Actual £'000**	**Variation £'000**
Opening Balance	**247,353**	**225,999**	**-21,354**
Prudential Borrowing	35,615	27,748	**-7,867**
Minimum Revenue Provision	-103	-58	**45**
CFR Closing Balance	**282,865**	**253,689**	**-29,176**
External Borrowing	**198,528**	**198,528**	**0**
Internal Borrowing	**84,337**	**55,161**	**-29,176**

No new external debt was taken out during 2019/20 and as at 31st March 2020 the Council's total external debt was £198.5 million. This is below the CFR and indicates that the Council continues to internally borrow from its cash balances which is the cheapest form of borrowing

Treasury Position at 31st March 2020

13. Whilst the Council's gauge of its underlying need to borrow is the CFR, the treasury function manages the Council's actual need to borrow by either:

- Borrowing to the CFR;
- Choosing to utilise temporary cash flow funds, instead of borrowing (known as "under borrowing"); or
- Borrowing for future increases in the CFR (borrowing in advance of need*)*

14. The Council's treasury position as at the 31st March 2020 for both debt and investments, compared with the previous year is set out in Table 3 below:

Table 3 : Borrowing and investments 2018-2019 and 2019-2020				
	31st March 2019		31st March 2020	
Treasury Position	Principal	Average Rate	Principal	Average Rate
	£'000	%	£'000	%
Borrowing				
Fixed Interest Rate Debt	198,528	3.15	198,528	3.15
Total Debt	**198,528**	**3.15**	**198,528**	**3.15**
Investments				
Fixed Interest Investments	70,000	0.97	59,000	0.96
Call Accounts	2,500	0.7	7,500	0.9
Variable Interest Investments	13,670	0.65	10,465	0.87
Property Funds	10,000	4.12	10,000	4.56
Total Investments	**80,960**	**1.17**	**86,965**	**1.27**
Net Position	**117,568**		**111,563**	

5. Overall, the Council earned a weighted average return of 1.27% on its investment which is above the target of 0.51% above average base rate, which equated to 0.70% as at 31st March 2020.

Prudential Indicators and Compliance Issues

16. Some of the prudential indicators provide an overview, others a specific limit on treasury activity. These are detailed below:

17. ***Net Borrowing and the CFR*** – In order to ensure that borrowing levels are prudent, the Council's external borrowing (net of investments) over the medium-term must only be for a capital purpose, and not exceed the CFR except in the short-term. In the short term the Council can borrow for cash flow purposes. Table 4 below highlights the Council's net borrowing position against the CFR, and shows that it is significantly below the limit, due to the level of internal borrowing that has been undertaken.

Table 4 : Net Borrowing	**CFR 2018-19 and 2019-20**	
Net Borrowing & CFR	**31st March 2019** **Actual** **£'000**	**31st March 2020** **Actual** **£'000**
Total Debt	198,528	198,528
Total Investment	80,960	86,965
Net Borrowing Position	**117,568**	**111,563**
CFR	**225,999**	**253,689**
Under Borrowing plus Investments	**108,431**	**142,126**

18. In the current climate, internal borrowing is preferable to borrowing externally as the interest rate payable on an external loan is much higher than that which can be earnt on investments. Therefore, forfeiting interest receivable on investments is more economical than paying additional interest charges for new external debt. If the net borrowing position, interest rate position and/or CFR changed significantly, the prospect of taking on additional debt would be reviewed.

19. ***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 unless it explicitly agrees to do so. Table 5 below demonstrates that during 2018/19 the Council’s gross borrowing was within its Authorised Limit. The Authorised Limit allows for some headroom above the Council’s projected CFR.

Table 5 : Authorised lending limits 2018-19 and 20219-20				
Authorised Limit compared to Actual Borrowing	**31st March 2019**		**31st March 2020**	
	Limit	**Actual**	**Limit**	**Actual**
	£'000	**£'000**	**£'000**	**£'000**
Borrowing	338,199	198,528	338,199	198,528
Other Long Term Liabilities	0	0	0	0
Total Borrowed	**338,199**	**198,528**	**338,199**	**198,528**
Amount under Limit	**139,671**		**139,671**	

20. ***The Operational Boundary Limit*** – the Operational Boundary Limit is the expected borrowing position of the Council during the year. It is possible to exceed the Operational Boundary Limit, for a short period of time, providing that the Authorised Borrowing Limit is not breached. Table 6 below shows the limits for the last two financial years. Actual borrowing remained unchanged at £198.5m hence the limits were not breached during either period.

Table 6 : Operational Boundary Limits 2018-19 and 2019-20		
	31st March 2019	**31st March 2020**
	£'000	**£'000**
Operational Borrowing Limit	**277,528**	**302,865**
Other Long Term Liabilities	**0**	**0**
Totals	**277,528**	**302,865**

21. ***Actual financing costs as a proportion of net revenue stream*** – this indicator identifies the trend in the net cost of capital against the net revenue stream and is an indicator of affordability. Table 7 below shows that for the General Fund, the ratio is negative as external loans have been repaid and investment income is positive. The HRA ratio has improved slightly after last year's reducing income stream, meaning that financing costs as a proportion have also fallen.

Table 7 : Financing cost 2018-19 and 2019-20		
	2018/19 £'000	**2019/20 £'000**
Revenue Stream		
General Fund	26,755	27,762
Housing Revenue Account	44,739	45,458
Comparison to Actual Revenue Position		
Financing Costs as a proportion of Net Revenue Stream - General Fund	-5.79%	-6.98%
Financing Costs as a proportion of Net Revenue Stream - HRA	16.93%	16.35%

Investment Income

22. Markets are remaining weak as interest rate rise increases look less likely due to the Covid19 pandemic and economic pressures, no rate rise now predicted by Link Asset Services (the Council's treasury advisors) for the foreseeable future.

23. The Council manages its investments in-house and invests with institutions listed in the Council's approved counterparty list. The Council invests for a range of periods from overnight to 364 days, dependant on cash flow requirements, its view on interest rates and duration limits set out in the Council's Investment Strategy.

24. During 2019/20, the Council maintained an average investment balance of £113 million and received an average return of 1.27%. The upper limit of non-specified investments allowed in the strategy is 25% of the average investment balance for the preceding calendar year. The average balance for 2019 was £114 million giving a limit on non-specified investments of £28.5 million. Only the property funds fell into the non-specified investment category; their original investment value was £10 million which is within the non-specified limit at 8.84% of the average investment balance.

25. The property funds are classified as Non-specified Investments within the approved Investment Strategy. The current rate of return on the investments is circa 4.56% per annum. The capital value of the Communities, Churches and Local Authorities (CCLA) Fund has increased by 29.57% between April 2013 and March 2020. Normal valuation of the property funds has been suspended due to the pandemic, however, whilst indicative figures show that the values of both funds have fallen during March and over the 2020/21 financial year; the indicative valuations are still higher than the value of the

funds at the time of investment. It is important to understand that fluctuations in value are to be expected with property fund investments over the short term and that they are a long term investment; as such, any gains and losses in fund value should be considered over the long term.

The overall value of the Lothbury property fund investment has increased by 17.64% since inception in August 2014. This valuation was at 31/3/20 and that valuation did reflect some element of the Covid19 uncertainty at that point.

26. Actual investment income for 2019/20 was £2.75 million; £0.53m higher than the budget estimate of £2.22 million. The difference is primarily due to Investment balances being higher than anticipated during the year this can be attributed to slippage in the forecast capital spend.

27. Fluctuations in the Council's balances have been managed through a mix of instant access and notice accounts, money market funds and short term deposits (up to 364 days). This approach is in line with the Investment Strategy approved by the Council.

Interest Rates since 31st March 2020

28. The Council takes advice from Link Asset Services on the appropriate durations to place investments with counterparties. These durations and also the availability of individual counterparties are subject to change dependant on market conditions and the credit ratings of the individual institutions. This means that the investment portfolio has to be actively managed to ensure both the availability of enough suitable counterparties and that the Council achieves the best interest rates possible within the agreed security and liquidity parameters.

29. The Bank of England base rate was reduced to 0.10% in March 2020 and due to uncertainty caused by the Covid19 pandemic will remain so for the foreseeable future. The Council continues to use money market funds, call accounts and instant access accounts for liquidity purposes, whilst seeking to maximise its returns by arranging longer term deposits where possible. In order to achieve this position, it is vital to maintain a robust cash-flow model which is continuously reviewed and updated. However, given the volatile nature of the Council's cash-flow requirements, it is not always possible to "lock away" funds for as long as may be desirable and so a strategic approach to investments is fundamental in order to achieve the most practicable yet favourable outcome. The council holds £10m investment in property funds and the overall value of the funds has fallen due to the Covid19 pandemic and continues to be monitored. Dividends from the funds are still being paid and although the overall value has fallen since the Covid outbreak the investment is seen as long term and prices will fluctuate over time. Values are still currently well above the initial amount invested.

Financial implications

30. These are set out within the body of the report.

Legal Issues

31. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of 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).Level of risk

32. Risk going forward is around uncertainty caused by the Covid19 pandemic. Interest rates are anticipated to remain low. Property markets are also uncertain. Risk assessment and management is a key part of Treasury Management activity, especially in the selection of counterparties when investment is being considered. The Council uses external advisors and counterparty credit ratings issued by the rating agencies to assist in this process.

Equalities impact

33. The Council follows an ethical investment policy, investment interest helps provide council services, which has a beneficial equalities impact.

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Background Papers: None

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