

To: Cabinet
Date: 15 September 2021
Report of: Head of Financial Services
Title of Report: Treasury Management Annual Report 2020/21

Summary and Recommendations	
Purpose of report:	The report sets out the Council's Treasury Management activity and performance for the financial year 2020/21
Key decision:	No
Cabinet Member:	Councillor Ed Turner, Cabinet Member for Finance and Asset Management
Corporate Priority:	All
Policy Framework:	Treasury Management Strategy
Recommendation(s): That Cabinet resolves to:	
1. Note the report	

Appendices
None

Executive Summary

- The Council held investments of £79.44 million as at 31st March 2021. Net interest earned during the year, including from loans to companies and external borrowing, was £2.83 million against a target of £3.73 million, an adverse variance of £0.89 million. This relates to two factors:
 - A reduction of £0.18 million in investment interest primarily due to interest rates on general investments (excluding property funds) reducing from the anticipated 0.90% return to 0.42% by the end of March 2021; and
 - A reduction of £0.71 million in interest received from companies, primarily the Housing Company, due to reduction in loans required because of reduced development activity, partly because of the global pandemic.

The loss of interest from the Housing Company is partly offset by reduction in borrowing from the PWLB in relation to the reductions in capital spend.

2. The average rate of return on the Council's investments in 2020/21 was 0.82% compared to 1.27% in 2019/20. The Bank of England base rate remained at 0.10% for the entire 20/21 period.
3. The Council held £198.5 million of fixed rate Public Works Loan Board (PWLB) debt as at 31st March 2021. 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 5 to 50 years. A previous loan of £20 million matured on 28th March 2021 and was replaced by another loan of £20 million on that date for a period of 50 years at a fixed interest rate of 1.88%. Interest paid on the debt in 2020/21 and charged to the HRA was £6.47 million.
4. Due to the pandemic decisions were made to delay on some areas of capital spend to allow budgeting options to be kept open during the period of uncertainty and reduce the need for additional borrowing.

Background

5. The primary principle governing the Council's investment decisions is the security of the investment, with liquidity and yield being secondary considerations.
6. 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.
7. 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.
8. The Council fully complied with its Treasury Management Strategy in relation to both debt and investment management in 2020/21.
9. The prudential indicators detailed in the body of this report compare the Council's outturn position against the target set for 2020/21

Financing the Capital Programme 2020/21

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

Table 1 Capital Expenditure and Financing 2020-21			
Capital Expenditure	2020/21 Original Budget £'000	2020/21 Actual £'000	Variation £'000
Non-HRA Capital Expenditure	97,564	47,341	-50,223
HRA Capital Expenditure	47,913	21,424	-26,489
Total Capital Expenditure	145,477	68,765	-76,712
Resourced by:			
Developer Contributions	6,806	1,544	-5,262
Capital Receipts	35,401	22,480	-12,921
Capital Grants and contributions	5,987	6,316	329
Major Repairs Reserve	3,674	1,784	-1,890
Prudential Borrowing	86,861	36,092	-50,769
Revenue	6,748	549	-6,199
Total Capital Resources	145,477	68,765	-76,712

11. 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

12. 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.

13. 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).

14. Table 2 below shows the Council's CFR as at the 31st March 2021, this is a key prudential indicator, and shows that actual borrowing is below the CFR:

Table 2 Capital Financing Requirement (CFR) 2020-21 and 2021-22			
CFR	31st March 2021 Estimate £'000	31st March 2021 Actual £'000	Variation £'000
Opening Balance	246,953	253,733	6,780
Prudential Borrowing	86,861	36,092	-50,769
Minimum Revenue Provision	-291	-38	253
CFR Closing Balance	333,523	289,787	-43,736
External Borrowing	198,528	198,528	0
Internal Borrowing	134,995	91,259	-43,736

15. No new external debt was taken out during 2020/21 and as at 31st March 2021 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 2021

16. 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)

17. The Council's treasury position as at the 31st March 2021 for both debt and investments, compared with the previous year is set out in Table 3 below:

Table 3 : Borrowing and Investments 2019-20 and 2020-21				
Treasury Position	31st March 2020		31st March 2021	
	Principal £'000	Average Rate %	Principal £'000	Average Rate %
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	59,000	0.96	48,000	0.48
Call Accounts	7,500	0.90	7,500	0.90
Variable Interest Investments	10,465	0.87	8,940	0.01
Property & Investment Funds	10,000	4.56	15,000	3.54
Total Investments	80,960	1.17	79,440	1.01
Net Position	117,568		119,088	

18. Overall, the Council earned a weighted average return of 0.82% on its investment which is above the target of 0.51% above average base rate, which equated to 0.61% as at 31st March 2021.

Prudential Indicators and Compliance Issues

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

20. **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 2019-20 and 2020-21		
Net Borrowing & CFR	31st March 2020 Actual £'000	31st March 2021 Actual £'000
Total Debt	198,528	198,528
Total Investment	80,960	79,440
Net Borrowing Position	117,568	119,088
CFR	253,733	289,787
Under Borrowing plus Investments	136,165	170,699

21. 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 earned 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.

22. **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 2020/21 the Council’s gross borrowing was within its Authorised Limit. The Authorised Limit allows for some headroom above the Council’s projected CFR.

Authorised Limit compared to Actual Borrowing	31st March 2020		31st March 2021	
	Limit £'000	Actual £'000	Limit £'000	Actual £'000
Borrowing	338,199	198,528	532,111	198,528
Other Long Term Liabilities	0	0	0	0
Total Borrowed	338,199	198,528	532,111	198,528
Amount under Limit	139,671		333,583	

23. **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.

Operational Boundaries	31st March 2020 £'000	31st March 2021 £'000
Operational Borrowing Limit	302,865	353,523
Other Long Term Liabilities	0	0
Totals	302,865	353,523

24. **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.

Actual Finance Costs	2019/20 £'000	2020/21 £'000
Revenue Stream		
General Fund	27,762	29,412
Housing Revenue Account	45,458	45,581
Comparison to Actual Revenue Position		
Financing Costs as a proportion of Net Revenue Stream - General Fund	-10.44%	-7.02%
Financing Costs as a proportion of Net Revenue Stream - HRA	16.35%	16.30%

Note that the General Fund Revenue Stream above has been adjusted to remove the additional £23.6 million section 31 grants paid in advance of in 2020/21 by the government.

Investment Income

25. 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) until September 2023
26. 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.
27. During 2020/21, the Council maintained an average investment balance of £104 million and received an average return of 0.82%. 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 2020/21 was £113 million giving a limit on non-specified investments of £28.5 million. Property funds and a new Multi Asset Fund fell into the non-specified investment category; their original investment value was £15 million which is within the non-specified limit at 13.2% of the average investment balance.
28. The property funds and the Multi asset Fund are classified as Non-specified Investments within the approved Investment Strategy. The current rate of return on the investments is circa 4.4% per annum. The capital value of the Communities, Churches and Local Authorities (CCLA) Fund has increased by 25.04% between April 2013 and March 2021. The overall value of the Lothbury property fund investment has increased by 15.33% since inception in August 2014. 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.

29. Actual investment income for 2020/21 was £1.04 million; £0.18m Lower than the budget estimate of £1.22 million. The difference is primarily due to Investment balances and Interest rates being lower than anticipated during the year which can be attributed to higher retention of cash balances and reductions in investment interest rates
30. 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 2021

31. 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.
32. The Bank of England base rate was reduced to 0.10% in March 2020 and due to uncertainty caused by the Covid19 pandemic and is currently predicted to remain so until September 2023. 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 £5m in Multi asset funds. The overall capital value of the funds had fallen due to the Covid19 pandemic but now have seen a recovery in these values and levels are now around pre pandemic levels. . Dividends from the funds were still paid although they reduced slightly during the year and have now fully recovered to previous return levels.

Environmental Social and Governance

33. The Council adopted an ethical investment policy in 2015/16. No changes were made to the policy in setting the 2020/21 Treasury Management Strategy which is set out below:

The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's mission and values. This would include, inter alia, avoiding direct investment in institutions with material links to:

- a. Human rights abuse (e.g. child labour, political oppression)
 - b. Environmentally harmful activities (e.g. pollutants, destruction of habitat, fossil fuels)
 - c. Socially harmful activities (e.g. tobacco, gambling)
34. The Council had £7.5 million in green deposit notice accounts offered by Barclays Bank who are working in association with Sustainalytics, a leading global provider of environmental, social and corporate governance research and ratings, to achieve a

positive environmental impact. Their green framework covers the following environmental areas:

- Energy efficiency projects and renewable energy
- Sustainable food agriculture and forestry
- Waste management
- Greenhouse gas emission reduction
- Sustainable water

35. The intention is to have a separate Environmental Social and Governance policy within the 2022/23 Treasury Strategy. Environmental, social, and governance (ESG) criteria are a set of standards for a company’s operations that socially conscious investors use to inform potential investments. Members will be updated on progress on this in a future report, considering whether and how it can sharpen the ethical aspects of the Council’s investment decision-making.

Financial implications

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

Legal Issues

37. 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 2020/21. 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

38. The key risk going forward is around uncertainty still caused by the Covid19 pandemic. Interest rates are anticipated to remain low. 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

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

Report author	Bill Lewis
Job title	Financial Accounting Manager
Service area or department	Financial Services
Telephone	01865 252739
e-mail	blewis@oxford.gov.uk

Background Papers: None

This page is intentionally left blank