Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE – 12 JUNE 2020

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

ANNUAL TREASURY MANAGEMENT REPORT 2019/20

Purpose of Report

1. The purpose of this report is to advise the Committee of the action taken and the performance achieved in respect of the treasury management activities of the Council in 2019/20.

Policy Framework and Previous Decisions

2. Under the CIPFA Code of Practice it is necessary to report on treasury management activities undertaken in 2019/20 by the end of September 2020. This report will be referred to the Cabinet on 23 June 2020 and the Committee is asked to provide comments in advance of this meeting.

Background

3. The term treasury management is defined as: -

   "The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

4. The Director of Corporate Resources is responsible for carrying out treasury management on behalf of the County Council, under guidelines agreed annually by the County Council.

Treasury Management 2019/20

5. The Treasury Management Policy Statement for 2019/20 was agreed by the full Council on 20 February 2019, in relation to the sources and methods of borrowing and approved organisations for lending temporarily surplus funds.

6. The criteria for lending to Banks is derived from the list of approved counter parties provided by the County Council's Treasury Management advisors, Link Asset Services. The list is amended to reduce the risk to the County Council by removing the lowest rated counterparties and reducing the maximum loan duration.

7. During the year all outstanding loans were repaid on time with the interest due.

8. For local authority lending the policy is unchanged with no loans permitted in excess of a 12 month duration or £10 million in value. In 2019, Moody's, one of the world's best-known credit rating agencies, re-affirmed its view that the UK local government sector has a high credit quality. The implication being that the sector continues to be a good risk for lenders. There were no new loans made to Local Authorities during the year.

9. In 2016 it was agreed that any counterparty that was downgraded whilst a loan was active, and where the unexpired period of the loan, or the amount on loan, would then breach the limit at which a new loan could be made to that counterparty, this would be included in the quarterly treasury management report to the Corporate Governance Committee. There was only one such incident during 2019/20. Following granting of loans to Goldman Sachs' their credit default swap price (a measure of risk) changed, causing the maximum length of loan to reduce from six months to 100 days, although the bank's credit rating remained unchanged. This reduction was reversed a few days later and Goldman's maximum loan length reverted to six months. The County Council had £25m of loans with the bank at the time.

10. Since August 2018 the UK base lending rates had been maintained at 0.75% until March 2020. However, due to the clear and obvious economic threat posed by the coronavirus outbreak, there were two emergency cuts in the interest rate, in March 2020, by the monetary policy committee, from 0.75% to 0.25% and then to 0.1%. It is now unlikely to rise for the next two years pending a protracted recovery of the economy from this significant setback. There is even some speculation in the press recently that the Bank of England is considering moving to negative interest rates. Due to this, investment returns remained low in 2019/20 and are likely to remain low for the foreseeable future.

11. Due to the coronavirus epidemic, investments during the last month of the financial year (March 2020) were kept to a minimum while financial markets and credit ratings stabilised.

12. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

13. On the debt portfolio, no new loans were taken. A total of £0.5m was repaid in the year which was in respect of three equal instalments of principal loans, thereby reducing the overall balance of the loan portfolio.

14. The Authority has not raised any external loans since August 2010 and external debt is around £100m lower than it was at its peak in November 2006. There are no current plans to raise any further external debt in the short to medium, however this will need to be considered as part of the next MTFS given the coronavirus epidemic. Opportunities to reduce it will be considered if they are cost effective.

15. The economic outlook for the U.K. is dire (it is likely the economy is already in recession) and further austerity measures may be forthcoming to pay for Central Government support through the COVID-19 epidemic and likely falling tax revenues. Increasing levels of unemployment and business failure, as well as being detrimental to the local economy, will also impact directly on the County Council's core funding levels through reductions in council tax and business rate income.

Position at 31st March 2020

16. The Council's external debt position at the beginning and end of the year was as follows: -

	31st March 2019			31st March 2020		
	Principal	Average Rate	Average Life	Principal	Average Rate	Average Life
Fixed Rate Funding						
- PWLB	£160.6m	6.77%	31 yrs	£160.1m	6.77%	30 yrs
-Market	£ 0.0m	n/a	n/a	£ 0.0m	n/a	n/a
Variable Rate Funding:						
- Market (1)	£103.5 m	4.37%	1 yr	£103.5m	4.37%	1 yr
Total Debt	£264.1m	5.83%	20 yrs	£263.6m	5.83%	20 yrs

(1) The lenders all have an option to increase the rates payable on these loans on certain pre-set dates, and if they exercise this option we can either repay or accept the higher rate. The average life is based on the next option date.

17. The position in respect of investments varies throughout the year as it depends on large inflows and outflows of cash. Over the course of the year the loan portfolio (which includes cash managed on behalf of schools with devolved banking arrangements) varied between £227m and £284m, and averaged £257m. Investments as at 31 March 2020 were £227m.

Debt Transactions

18. The Council began the financial year £17.6m over-borrowed compared with the amount required to fund the historic capital programme - the Capital Financing Requirement.

19. Although the term over borrowed suggests an unusual situation it is simply caused by the County Council setting aside money each year so that when loans become due they can be repaid. Historically this situation did not arise because new borrowing was undertaken each year. For the last ten years there has been no requirement to borrow to fund the capital programme (which leads to debt financing costs that fall on the revenue budget), and also the Governments change a number of years ago to award grants to fund the capital programme rather than the previous approach of supported borrowing. Ideally the situation would be remedied by repaying loans early. However, given the large penalties that would be incurred from early repayment the position is unlikely to change unless long-term interest rates rise significantly.

20. It is expected that the overborrowed position will reverse due to the requirement to fund the new capital programme for 2020-24, a total of £222m is included – due to the level of cash balances held it is expected that the additional funding requirement will be funded internally without raising any new external debt. This will save over £60m in interest payments.

21. At the end of the financial year, after the repayment of debt and setting aside funding for the Minimum Revenue Provision (MRP) - (£10m) to ensure that loans raised to finance capital expenditure are paid off over the longer term, the Council was £25m over-borrowed.

22. The lack of opportunity to reduce the debt portfolio because of historic stagnant interest rates makes the punitive redemption costs prohibitive. The debt portfolio stands at £263.6m and the average pool rate 5.83%.

23. Only £0.5m of repayments were made during the year meaning that the average pool rate was stagnant.

Investments

24. The loan portfolio produced an average return of 1% in 2019/20, compared to an average base rate of 0.70% and the average 7-day LIBID (London Interbank Bid Rate) index (representative of what could be achieved if only short-term loans within the money market were made) of 0.54%.

25. The loan portfolio has outperformed both the average base rate and the average 7-day LIBID in every one of the last 25 years, which is when the figures started to be produced. The level of the out performance is flattered somewhat by the significant over performance achieved both during and in the immediate aftermath of the credit crunch. The average rate of interest earned on the portfolio in the last 25 years is 3.73%, and this compares to an average base rate and the average LIBID index which have both produced a return of 3.1%.

26. The variability of balances makes it difficult to calculate the excess interest that the over performance has achieved over the whole of the 20+ year period for which performance records are available, but it is estimated to be at least £29m. Almost half of this added value came in the five financial years from 2008 to 2013, which can be categorised as the start of the banking crisis and a period in which a number of loans placed during the financial crisis were earning interest at rates that (relative to base rates) were extraordinary.

27. The Appendix attached to this report shows the weighted average rate of return for Leicestershire County Council (0.86%) against other councils in its benchmarking group (0.73%) and other County Council's (0.74%) during 2019/20. This shows that the Council has outperformed its peers in its benchmarking group and other counties.

28. The above paragraphs exclude investments relating to private debt. The total value of private debt investment as at 31 March 2020 was £19.2m and is performing in line with expectations.

Summary

29. Treasury Management is an integral part of the Council's overall finances and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium / long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in significant savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.

30. The loan portfolio has produced an exceptional level of over performance in the period in which performance figures have been calculated. Adding significant value in a period of extremely low interest rates is very difficult. Ironically a period in which there begins to be differentiation in expectations for both the pace and extent of future base rate rises will make the cash sums that can be gained larger, whilst also giving a higher level of risk that the decisions taken might retrospectively prove to be sub-optimal. Given that interest rates are unlikely to rise for the next two years, low levels of returns are likely to continue and the cost of getting investment decisions wrong is unlikely to be significant.

Equality and Human Rights Implications

31. None.

Background Papers

Report to County Council on 20 February 2019 – 'Medium Term Financial Strategy 2019/20 – 2022/23' - 'Treasury Management Strategy Statement and Annual Investment Strategy 2019/20' and 'Financial Plan' appendices:
http://politics.leics.gov.uk/ieListDocuments.aspx?CId=134&MId=5125&Ver=4

Circulation under local issues alert procedure

None.

Appendices

Appendix – LINK Benchmarking report

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