Agenda Item 15

Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE – 4 JUNE 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

ANNUAL TREASURY MANAGEMENT REPORT 2020/21

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 2020/21.

Policy Framework and Previous Decisions

2. Under the CIPFA Code of Practice it is necessary to report on treasury management activities undertaken in 2020/21 by the end of September 2021. This report will be referred to the Cabinet on 22 June 2021 and the committee are 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 2020/21

5. The Treasury Management Policy Statement for 2020/21 was agreed by the full Council on 19 February 2020, in relation to the sources and methods of borrowing and approved organisations for lending temporarily surplus funds.

6. The criteria for lending to Banks are 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 12 months 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. On 20th October 2020, following a ratings downgrade from Moody's, Link asset services reduced the suggested lending duration of Lloyds (Bank of Scotland) from 12 months to 6 months. As at 30 September 2020 the Council had £40m of exposure to Lloyds and £20m of this will not mature until September 2021 meaning this is now outside of the authorised lending duration.

10. The expectation for interest rates within the treasury management strategy for 2020/21 was that Bank Rate would continue at the start of the year at 0.75 % before rising to end 2022/23 at 1.25%. This forecast was invalidated by the Covid-19 pandemic which caused the Monetary Policy Committee to cut Bank Rate in March 2020, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy.

11. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with significant amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The Government also supplied significant amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

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. The MTFS 2021-25 capital programme includes a funding requirement of £143m to be funded from borrowing. However, due to the strength of the County Council's balance sheet, it is expected to be possible to use internal balances to fund this on a temporary basis instead of raising new loans.

Position at 31st March 2021

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

	31st March 2020			31st March 2021		
	Principal	Average Rate	Average Life	Principal	Average Rate	Average Life
Fixed Rate Funding						
- PWLB	£160.1m	6.77%	30 yrs	£159.6m	6.77%	30 yrs
-Market	£ 0.0m	n/a	n/a	£ 0.0m	n/a	n/a
Variable Rate Funding:						
- Market (1)	£103.5m	4.37%	1 yr	£103.5m	4.37%	1 yr
Total Debt	£263.6m	5.83%	20 yrs	£263.1m	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.

16. 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 £239m and £312m, and averaged £275m. Investments as at 31 March 2021 were £308m.

Debt Transactions

17. The Council began the financial year £25.1m over-borrowed compared with the amount required to fund the historic capital programme - the Capital Financing Requirement.

18. 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 Government's 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.

19. It is expected that the overborrowed position will reverse due to the requirement to fund the new capital programme for 2021-25. As mentioned in paragraph 14 there is

a shortfall of £143m on the funding for the programme and 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.

20. At the end of the financial year, after the repayment of debt and setting aside funding for the Minimum Revenue Provision (MRP) - (£6.2m) to ensure that loans raised to finance capital expenditure are paid off over the longer term, the Council was £31m over-borrowed.

21. 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 £263.1m and the average pool rate 5.83%.

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

Investments

23. The loan portfolio produced an average return of 0.40% in 2020/21, compared to an average base rate of 0.10% 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 -0.07%.

24. The loan portfolio has outperformed both the average base rate and the average 7-day LIBID in every one of the last 5 years. The average rate of interest earned on the portfolio in the last 5 years is 0.72%, and this compares to an average base rate and the average LIBID index which have produced returns of 0.43% and 0.29% respectively.

25. The variability of balances makes it difficult to calculate the excess interest that the over performance has achieved over the whole of the 5-year period, but it is estimated to be at least £3m.

26. Appendix A shows the weighted average rate of return for Leicestershire County Council (0.17%) against other councils in its benchmarking group (0.18%) and an average for other County Councils (0.23%) as at 31 March 2021. This shows the Council is currently performing slightly below its peers which represents a drop off in performance compared to last year; Leicestershire County Council (0.86%) against other councils in its benchmarking group (0.73%) and other County Council's (0.74%).

27. During the first quarter of 2020/21, amidst the uncertainty surrounding the COVID-19 pandemic and its impact on financial markets, the Council took the prudent decision to limit money market fund transactions and reduce lending durations to other institutions until the markets stabilised. This decision to prioritise security over yield accounts for much of the performance gap between the Council and its peers.

28. The above paragraphs exclude investments relating to private debt. The capital value of private debt investment as at 31st March 2021 was £15.2m. Since inception (January 2018) the Council has received interest payments totalling £1.1m from the private debt investment and the current performance as measured by the internal rate of return is 4.3% - which is 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 a strong 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 19 February 2020 – 'Medium Term Financial Strategy 2020-24 'Treasury Management Strategy Statement and Annual Investment Strategy 21/22' and 'Financial Plan' appendices:
http://politics.leics.gov.uk/ieListDocuments.aspx?CId=134&MId=6038&Ver=4

Circulation under local issues alert procedure

None.

Appendices

Appendix – LINK Benchmarking report

Officers to Contact

Mr C Tambini, Director of Corporate Resources,
Corporate Resources Department,
☎0116 305 6199 E-mail Chris.Tambini@leics.gov.uk

Mr D Keegan, Assistant Director (Strategic Finance and Property),
Corporate Resources Department,
☎0116 305 7668 E-mail Declan.Keegan@leics.gov.uk