Treasury Management Activity 2020/21: April to August 2020

The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management ("the Code"). The Code recommends that members are informed of treasury management activities. This report provides a brief update on treasury management activity between 1 April and 31 August 2020.

Economic Context

The economic situation has been dominated by the impact on the economy of the COVID-19 pandemic. The start of the financial year saw the UK in lockdown which effectively shut down a large proportion of the UK economy, although some restrictions were eased in late May and early June. The Office of National Statistics first estimate for Gross Domestic Product in quarter 2 (April-June) 2020 is estimated to have fallen by a record 20.4%. However, within the figures there was a month on month growth of 2.4% in May and 8.7% in June. Despite the growth in May and June, the pace of any economic recovery is very uncertain especially with the potential for further COVID-19 related restrictions.

In response to the economic situation the Bank of England has maintained the Bank Rate at 0.1% while also continuing with an asset purchase programme to help stimulate the economy. Its central forecast is for Gross Domestic Product to continue to recover, supported by substantial fiscal and monetary policy actions. Unemployment is expected to rise significantly, before declining gradually, while inflation, as measured by the Consumer Prices Index, is expected to rise slowly and reach roughly the 2% target in two years' time. However, this forecast assumes that the economic impacts of the COVID-19 pandemic will reduce gradually and that there will be an immediate move to a free trade agreement with the European Union post December 2020.

Arlingclose the council treasury management advisors expects Bank Rate to remain at the current 0.10% level for the foreseeable future and that Gilt yields, which link to the rate the council can borrow from the Public Loans Work Board will remain very low in the medium term. Shorter term Gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out a negative Bank Rate or growth/inflation prospects improve.

Investment Activity

Investments at 31 August 2020 totalled £1,075m and consisted of £390m in bank and local authority deposits and £685m in corporate and government bonds. The following table shows the investment activity between 1 April and 31 August 2020.

Bank and Local Authority Deposits	**Call £m**	**Fixed £m**	**Structured £m**	**Total £m**
Balance 1 April 2020	**346.4**	**253.3**	**0.0**	**599.7**
Maturities	-338.7	-196.3	0.0	-535.0
New Investments	290.4	35.0	0.0	325.4
Balance 31 August 2020	**298.1**	**92.0**	**0.0**	**390.1**

Bonds	Local authority £m	Gilts £m	Others £m	Total £m
Balance 1 April 2020	**32.8**	**120.6**	**154.7**	**308. 1**
Maturities	-0.5	-3,771.6	-128.0	-3,900.1
New Investments	0.1	4,026.8	250.0	4,276.9
Balance 31 August 2020	**32.4**	**375.8**	**276.7**	**684.9**

The period saw some significant volatility in the price of the Gilts held. This resulted in the opportunity being taken to sell some of the holdings to enhance the overall return on the investments. This is reflected in the level of sales and new investments during the period.

The current rate of return on the investment portfolio measured by Arlingclose is 0.59% which compares favourably with the benchmark 7 day money market rate that averaged 0.13% over the same period.

Borrowing Activity

The council's capital programme includes a requirement to borrow to fund new capital investment. The table below summarises the borrowing activity which has taken place between 1 April and 31 August 2020.

Borrowing	Public Works Loan Board Fixed £m	Public Works Loan Board Variable £m	Long Term Bond £m	Other Locals £m	Police, Fire & Lancashire District Councils £m	Total £m
Balance 1 April 2020	**455.6**	**125.8**	**350.0**	**546.8**	**67.2**	**1,545.4**
New Borrowing	0.0	0.0	250.0	152.0	275.0	677.0
Maturities	0.0	-125.8	0.0	-161.4	-273.0	-560.2
Balance 31 August 2020	**455.6**	**0.0**	**600.0**	**537.4**	**69.2**	**1,662.2**
Private Finance Initiative Liability	-	-		-	-	146.6
Total Borrowing & Private Finance Initiative						**1,808.8**

Total borrowing at the end of August was £1,809m including the financing of £147m of assets through remaining Private Finance Initiative (PFI) schemes. The outstanding borrowing has increased by £117m in the period.

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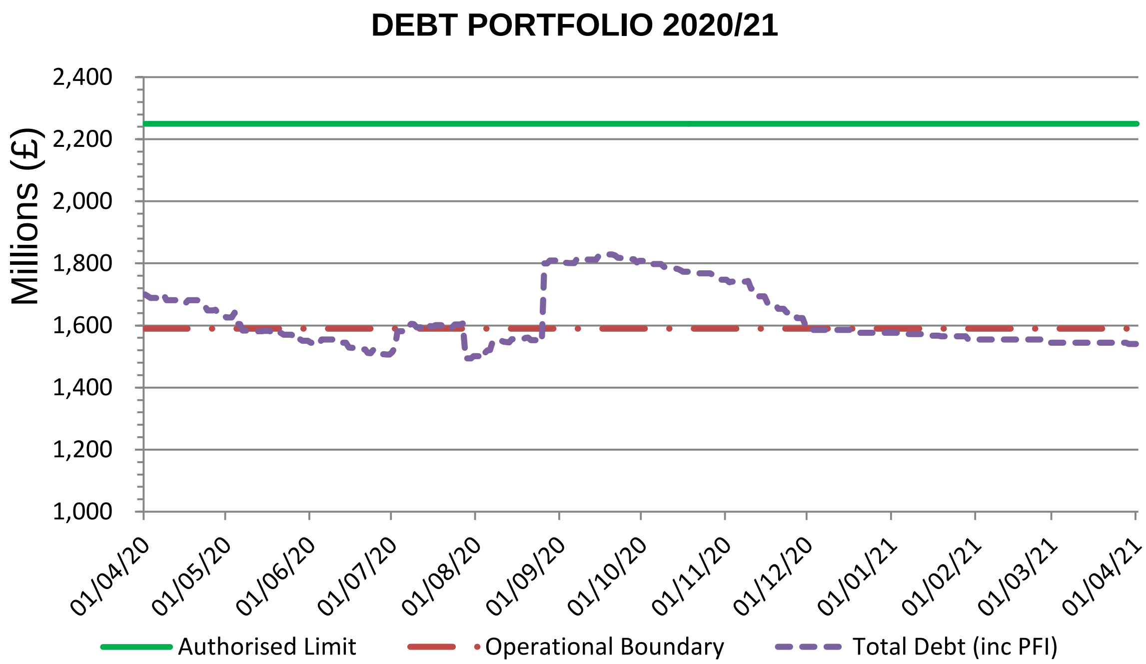
The council has in recent years principally used short term borrowing to meet its requirements. Although this continues to be an important part of the borrowing strategy there has been a move to have a higher proportion of the borrowing as long term to reduce re-financing risk while taking advantage of current low long term interest rates. As the council had successfully issued a five year bond in March, it looked into the possibility of issuing a long term bond. Therefore, in August a £250m bond was issued with a maturity period of 40 years at a fixed interest rate of 1.625%.

The borrowing is undertaken within the framework set by the authorised and operational limits. The following graph shows the level of debt for the current financial year compared with the prudential indicator operational and authorised boundaries. It is expected that the debt may exceed the operational limit on occasions, but it should not exceed the authorised Limit. The debt shown from 31 August represents the debt position if no maturing debt was replaced, rather than an estimate of the expected position.



Total debt during the year has remained below the authorised, but has exceeded the operational limits. The operational limit has temporarily been exceeded, as the opportunity was taken to take long term borrowing at low rates before existing debt matured.

The current interest rate payable on debt measured by Arlingclose is 1.59%.

Non-Treasury Investment Strategy

A non-treasury investment strategy was approved by the Full Council in February 2019. This enabled the investment in bonds for commercial purposes where cash-flow permits. In accordance with this, a number of other local authority loans were purchased from a bank and bonds in EDF (an energy company) acquired. Under accounting regulations any change in the market value of the assets will be charged or credited to the revenue account.

To mitigate the risk of adverse movements, agreements were made in the period to buy Gilts at a future date, as the impact would be a reverse of the impact on the investments. In total it is estimated that the net value of these activities at 31 August is £252m.

Budget Monitoring Position

It was reported to Cabinet in September that there is a forecast gain in excess of the treasury management budget, including the non-treasury management investments, of £19.9m. This is primarily as a result of extra income received through the continuing volatility in the price of Gilts and other bonds, enabling sales to be made which have generated a significant surplus. However, the final outturn may be significantly different from the current forecast, due recent and expected continued market volatility.

The position is kept under regular review and discussed with the Director of Finance on a monthly basis.

Prudential Indicators

The Treasury Management Strategy included some prudential indicators which provide a framework for the operation and risk management of treasury activities. These are shown below for 2020/21 with the latest available actual position.

Authorised and Operational Limits for Debt

The 'authorised limit' is a prudent estimate of external debt, but allows sufficient headroom for unusual cash flow movements. During the year, the Director of Finance approved the re-allocation of the authorised limit between the borrowing and other long term liabilities to provide some additional flexibility to take long term borrowing. This approval is in accordance with the Prudential Code.

	Limit	Actual
	£m	£m
Borrowing	1,850	1,662
Other long term liabilities (Private Finance Initiative schemes)	400	147
TOTAL	**2,250**	**1,809**

The 'operational limit' for external debt is based on the same estimates as the authorised limit. However, although it reflects a prudent estimate of debt, there is no provision for unusual cash flow movements. In effect, it represents the estimated maximum external debt arising as a consequence of the council's current plans. As required under the Code, this limit will be carefully monitored during the year.

	Limit	Actual
	£m	£m
Borrowing	1,190	1,662
Other long term liabilities (Private Finance Initiative schemes)	400	147
TOTAL	**1,590**	**1,809**

As explained in the report, the timing of taking long term loans has resulted in the level of borrowing being above the operational limit. It is anticipated that this will continue to be the case throughout 2020/21 as some of the borrowing was taken in advance of need as permitted by the Prudential Code. It is expected that with debt maturing, the debt level will fall to or below the operational limit by 31 March 2022.

Gross Debt and the Capital Financing Requirement

Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities, recommends that the authority's total debt should be lower than its highest forecast capital financing requirement over the next three years. The county councils borrowing is in excess of the capital financing requirement. However, in making this comparison certain borrowing is included in the total borrowing, but does not count against the capital financing requirement. These include the shared investment scheme, premiums paid and the transferred debt. The current level of debt also includes an element of borrowing in advance. Therefore the Director of Finance confirms that the level of borrowing over the three years is within the capital financing requirement conditions.

Interest Rate Exposure

In order to control interest rate risk, the council measures its exposure to interest rate movements. These indicators place limits on the overall amount of risk the council is exposed to. The one year impact indicator, calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.

	Upper Limit	Actual
Upper limit on one-year revenue impact of a 1% rise in interest rates	£50m	(£17m)

Maturity Structure of Debt

Limits on the maturity structure of debt help control refinancing risk.

	Upper Limit	Actual
Under 12 months	75%	28%
12 months and within 2 years	75%	28%
2 years and within 5 years	75%	3%
5 years and within 10 years	75%	4%
10 years and above	75%	37%

Investments Over one Year

Limits on the level of long term investments help to control liquidity, although the majority of these investments are currently held in securities which are readily saleable. The limit is largely determined by the forecast of reserves and balances held at the year-end. The level of investments is managed to be in line with the estimated reserves and balances and cash flow at 31 March 2021 (deemed an operational limit which will be reviewed during the year). However, it is anticipated that the level of reserves will fall gradually during the year and there will be positive cash-flows in-year which will require a higher level of investments to be held including bonds held specifically for liquidity purposes.

	Upper limit	Actual
Total invested over 1 year	£750m	£695m
Operational or forecast limit at 31 March 2021	£450m	£695m

The indicator excludes investments undertaken as part of the trading portfolio as they are not part of the in-year liquidity requirements. With the borrowing in advance referred to earlier in the report, the level of investments held will fall, but not necessarily to the £450m by the year end.

Minimum Average Credit Rating

To control credit risk the council requires a very high credit rating from its treasury counterparties.

	Benchmark	Actual
Average counterparty credit rating	A	AA