

Audit and Standards Committee – 21st September 2020

Report of the Director of Finance and Legal

Treasury Management

Purpose

1. To outline treasury activity during the financial year 2019/20 and in the current financial year up to mid-August.

Recommendations

2. It is recommended that the Audit and Standards Committee:
 - comments and notes the treasury activities outlined in this report;
 - refers all of the above to full Council for noting at its meeting on 12th October.

Background

3. The Treasury Management strategy for 2020/21 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2017. The Code recommends that members are informed of Treasury Management activities at least twice a year. This report ensures that the Council is embracing best practice in accordance with CIPFA's recommendations.
4. Treasury Management entails the management of the Council's cash flows, its borrowings and investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks.
5. The Council undertakes treasury management activity on its own behalf and as administering authority for the West Midlands Debt Administration Fund (*WMDAF*). We are responsible for administering capital funding of approximately £777m on our own account and another £107m on behalf of other West Midlands councils in respect



of the WMDAF. The treasury function is governed by the Council's Treasury Policy Statement and Treasury Management Practices.

Treasury activity in 2019/20 on the Dudley fund

6. Our treasury activities were undertaken in the context of the Treasury Strategy Statement 2019/20 approved by Audit and Standards Committee and Full Council in February 2019. The Strategy Statement stated:

“The primary factor in determining whether we undertake new long-term borrowing will be cash flow need. We will seek to minimise the time between borrowing and anticipated cash flow need, subject to the need to maintain day to day liquidity”
7. In 2019/20 our investments averaged around £22.71 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.74% (excluding the long term investment with Salford City Council, the average return was 0.51%). The majority of our investments were for less than one month or were in call accounts¹. All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2019/20. Our investment activity for 2019/20 is set out in more detail in Appendix 1.
8. The average value of long-term borrowings in 2019/20 was £618.8 million. The average rate of interest on these borrowings was 3.54% . The loans were due to mature on dates ranging from 2020 to 2061.
9. In 2019/20 we took out 8 long term market loans. The average value of these loans was £7.5m at an average rate of 1.7%, for an average duration of 33 months. The loans were taken out to replace loans that matured in the year and also some advance borrowing was taken out to fund a pre-payment of £92m to the West Midlands Pension Scheme in April 2020. This resulted in a higher than usual year end cash balance of £49.9m but assured some certainty on interest rates and reduced the risk of having to borrow large sums from the market in a short time frame when PWLB rates had been increased by the Treasury to an unattractive level compared to loans from other local authorities.
10. Due to cash flow requirements in 2019/20, it was necessary to undertake short term borrowing on 7 occasions. The average value of these loans was £5.4m at an average rate of 0.73% for average duration of 10 days.

¹ A call account is a deposit account with a financial institution without a fixed maturity date. The deposit can be "called" (withdrawn) at any time and deposits can also be made at any time. Call accounts and the specific terms associated with them differ depending upon the bank offering the account.

Treasury activity in 2019/20 on the WMDAF

11. It was necessary to undertake short term borrowing on 4 occasions for cashflow purposes, at an average value of £4.3m at 0.81% for an average duration of 143 days. We also made 1 investment in 2019/20 for the WMDAF for £4.3m at 0.52% for 85 days.

Performance comparisons 2019/20

12. Our treasury management advisors Link Asset Services have compared our treasury performance with their other clients using borrowing and investment data at financial year end. The results are summarised in the table below:

Performance Benchmarking

	Dudley	Client Average
Gross Borrowing (£M)	648.3	224.9
Investments (£M)	49.9	64.3
Net Borrowing (£M)	598.4	160.6
Gross average borrowing rate (the cost of borrowing, ignoring the return on investments)	3.46%	3.70%
Investment return rate (the return on investments, ignoring the cost of borrowing)	0.46%	0.81%
Net average borrowing rate (a combination of the above, representing the cost of borrowing net of the return on investments)	3.71%	4.86%

13. The data above is based on a snapshot of treasury portfolios at 31 March 2020 and includes long and short term borrowing and investments. Dudley's net cost of borrowing was substantially lower than the average of local authorities in the client group. This is partly because our ratio of gross to net borrowing is higher than other authorities who maintain larger levels of investments which are currently delivering very low yields.
14. It should be remembered that treasury performance measurement is not an exact science. These statistics represent the cumulative effect of decisions dating back over many years and the performance of other local authorities may have been achieved in circumstances different from our own.

Prudential indicators 2019/20

15. The 2003 Prudential Code for Capital Finance in Local Authorities sets out a framework for the consideration and approval of capital spending plans. In so doing, it requires the Council to set a number of prudential indicators, some of which concern matters of treasury management. Appendix 2 outlines those indicators for 2019/20.
16. The indicator for loans maturing between 24 months and 5 years was slightly breached in 2019-20 as a consequence of the inclusion of West Midlands County



loans which are nearing their maturity dates. The 2020-21 Treasury Strategy Statement has split the maturity indicators between Dudley and West Midlands borrowings as they are subject to different strategies.

Treasury activity 2020/21 to August

17. Treasury activities in the current year have been undertaken in the context of the Treasury Strategy Statement 2020/21 approved by Audit and Standards Committee and Council in February of this year. In that document we anticipated that long term borrowing would be required in the next 12 months due to cash flow need.
18. Our investments up to the middle of August have averaged around £63.9 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.29% (excluding the Salford investment the average return is 0.20%). All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2020/21. Our investment activity for 2020/21 is set out in more detail in Appendix 3.
19. Temporary cash balances have been significantly higher than usual in 2020-21 due to the various Covid-19 grant payments from Central Government in early 2020-21. The Monetary Policy Committee (MPC) cut the bank rate to 0.1% in March 2020 as result of the economic downturn caused by the Covid-19 pandemic. Consequently, investment rates have dropped to record low levels. The Debt Management Office (DMO) rate has been cut to 0.01% therefore the Council has made some significant short-term investments with other local authorities to get some yield on these high cash balances but maintain low credit risk. We have also opened 2 deposit accounts with HSBC and Santander banks as cash flow forecasts indicate that balances will remain at a high level for most of this financial year.
20. The Bank base rate is not expected to change for at least the next 18 months. As at August 2020 we have seen that investment rates with other local authorities have now dropped further as demand for cash in the sector is low due to most local authorities being in the same short-term cash rich position as Dudley MBC. Therefore, average annual yield on investments is likely to reduce by the end of the financial year.
21. The average value of long-term borrowings up to late August has been £647.1million. The average rate of interest on Dudley's loans is 3.61%. The maturity dates for the loans range from the current year to 2061. So far 9 new long term market loans have been taken out in 2020-21 with an average value of £5.6m at an average rate of 1.56% for an average duration of 28 months. For cashflow purposes we took out 5 short term loans with an average value of £6m at average rate of 1% for an average duration of 310 days. These loans were arranged in advance to finance the pension



prepayment due in April 2020 before we were aware of the level of Covid-19 related grant payments that have since been received.

22. We are monitoring interest rates and cash flow closely and anticipate that no new long term borrowing will be required before the current financial year end but expect it will be required in 2021-22.
23. On the WMDAF it has not been necessary to undertake any new borrowing in 2020-21 to date. We have made 1 investment on the WMDAF to date in 2020/21 with the DMO for a value of £1.5m at a rate of 0.01% for 77 days.

Finance

24. Forecasts of performance against budget for treasury management activities are highly sensitive to movements in cash flow and interest rates.

Law

25. These matters are governed by Part IV of the Local Government and Housing Act 1989 and Section 111 of the Local Government Act 1972, which empowers the Council to do anything which is calculated to facilitate or is conducive or incidental to the discharge of its various statutory functions.

Equality Impact

26. The treasury management activities considered in this report have no direct impact on issues of equality.

Human Resources/Organisational Development

27. There are no Human Resources or Organisational Development implications associated with this report.

Commercial/Procurement

28. The over-riding purpose of the Council's Treasury Strategy is day to day cash management and not income generation. The strategy prioritises security and liquidity of cash investments over yield. Once those are met we aim to secure the maximum yield from our investments held with the small number of counterparties that meet the strict criteria laid out in our Annual Investment Strategy.

Health, Wellbeing and Safety

29. There are no Health, Wellbeing and Safety implications associated with this report.





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List of Background Papers

Treasury Policy Statement, Treasury Management Practices and Schedules to the Treasury Management Practices.

Investment Activity 2019/20

Counterparty name	Number of investments	Average value £ million	Average rate %	Average duration (days)
Debt Management Office	132	12.2	0.48	9
Babergh District Council	1	0.40	0.82	75
Calderdale MDC	1	0.26	0.85	61
Cheltenham BC	1	0.78	0.78	75
South Somerset District Council	1	0.59	0.82	69
Santander	N/A	1.27	0.40	Call Account
Bank of Scotland	N/A	2.54	0.63	Call Account
HSBC	N/A	4.13	0.41	Call Account
HSBC 31 day Notice	N/A	0.16	0.67	Deposit Account
Salford MDC*	1	0.50	11.25	Matured June 2020

* This is a fixed term deposit of £500,000.00 with Salford MDC at an interest rate of 11.25% that was made in 1985.

Prudential indicators relating to treasury management 2019/20**External Borrowing**

These indicators are intended to ensure that levels of external borrowing are affordable, prudent and sustainable. The authorised limit for external debt is a statutory limit (section 3 of the Local Government Act 2003) that should not be breached under any circumstances. The operational boundary is a lower threshold allowing for a prudent but not worst case scenario for cash flow.

	£m
Authorised limit for external borrowing	885
Operational boundary for external borrowing	819
Outturn - actual external borrowing	769

Interest rate exposures and maturity structure of borrowing and investments

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

	Indicator	Outturn
Upper limit for fixed interest rate exposure	100%	98.30%
Upper limit for variable rate exposure	10%	1.70%
Upper limit of principal maturing in any one year for sums invested for over 364 days	£10m	Nil
Maturity structure of fixed rate borrowing:-		
under 12 months	0-10%	8.68%
12 months and within 24 months	0-10%	6.29%
24 months and within 5 years	0-15%	15.88%
5 years and within 10 years	0-25%	9.09%
10 years and above	40-100%	60.06%

Appendix 3

Investment Activity 2020/21 to August

Counterparty name	Number of investments	Average value £ million	Average rate %	Average duration (days)
Debt Management Office	79	27.09	0.07	8
Babergh District Council *	1	0.57	0.82	75
Calderdale MDC *	1	0.21	0.85	61
Cheltenham BC *	1	0.96	0.78	75
South Somerset District Council *	1	0.96	0.82	69
Salford City Council *	1	2.98	0.50	92
Blackpool Borough Council	2	3.71	0.40	93
Flintshire County Borough Council	1	2.9	0.35	125
Thurrock Council	2	5.08	0.34	94
Santander	N/A	9.36	0.17	Call Account
Bank of Scotland	N/A	0.04	0.00	Call Account
HSBC	N/A	6.37	0.17	Call Account
HSBC 31 Day Notice	N/A	3.15	0.17	Deposit Account
Salford MDC*	1	0.50	11.25	Matured June 2020

* Investments carried forward from 2019-20

** This is a fixed term deposit of £500,000.00 with Salford MDC at an interest rate of 11.25% that was made in 1985