

Rother District Council

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| Report to: | Audit and Standards |
| Date: | 28 September 2020 |
| Title: | Treasury Management Update |
| Report of: | Antony Baden – Finance Manager |
| Purpose of Report: | To note the Council's treasury activities for the first financial quarter ending 30 June 2020. |
| Officer Recommendation(s): | It be RESOLVED: That the report be noted |

Introduction

1. Cabinet approved the Council's Investment Strategy for 2020/21 on the 10 February 2020 (Minute CB19/93 refers). The strategy requires regular reports to be presented to this Committee on the Council's treasury management activities. In managing these activities, the Council follows the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. This report implements best practice in accordance with the Code. Members are also reminded that investment activity is reported through the Members' Bulletin.
2. This report focuses on the financial period ending on the 30 June 2020. Treasury Management covers two main areas: -
 - i. The management of day to day cash flows by way of short-term investing and borrowing. Longer term investment opportunities may arise depending on cashflow requirements.
 - ii. Management of the Council's long-term debt portfolio, which is used to finance capital expenditure that cannot be immediately funded by internal resources (e.g. Capital Receipts).

Financial Investments review

3. The Council currently holds most of its investments in call accounts with the major financial UK institutions. It also holds investments totalling £8 million in Property Funds.
4. As at the 30 June 2020 the Council's total investments are £33.754m. There is £11,979m of borrowing and the Capital Financing requirement is £29.001m.
5. The Council's investment policy is governed by the Ministry of Housing, Communities and Local Governments' (MHCLG) investment guidance, which has been implemented in the approved annual investment strategy. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented

by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

6. The investment activity to date conforms to the approved strategy and the Council had no liquidity difficulties.
7. The total income from investments is currently forecast at £252,000. The largest returns are from the Council's property funds, which are currently delivering an average rate of return of between 2.33% and 3.69% on investments. These funds are actively managed, and it is hoped that actual income will not suffer significantly due to the current economic climate.
8. The investment portfolio as at the 30 June 2020 is shown in the table below: -

| Deposit | Type of account | Maturity Date | Amount £ | Interest Rate | Share % |
|------------------------------------|-----------------|---------------|-------------------|---------------|----------------|
| Lloyds - General (RFB) | Call | N/A | 25,751,254 | 0.00% | 76.29% |
| Lloyds - (RFB) | Fixed | 24/04/2020 | 0 | N/A | 0.00% |
| Lloyds - (RFB) | Fixed | 08/05/2020 | 0 | N/A | 0.00% |
| Bank of Scotland (RFB) | Call | N/A | 6 | 0.65% | 0.00% |
| Barclays - Call Account (NRFB) | Call | N/A | 1,066 | 0.50% | 0.00% |
| Santander - 31 Day Notice Account | 31 Days Notice | N/A | 1,655 | 0.55% | 0.00% |
| CCLA Local Authority Property Fund | Long Term | N/A | 5,000,000 | 3.69% | 14.81% |
| HERMES Property Fund | Long Term | N/A | 2,999,998 | 2.33% | 8.89% |
| Total | | | 33,753,979 | | 100.00% |
| Total managed in-house | | | 25,753,981 | | |
| Total managed externally | | | 7,999,998 | | |
| Total Treasury Investments | | | 33,753,979 | | |

9. The Council has invested £8 million in the property funds as shown in the table above. Members should note that whilst they provide a sustainable return on investment their market values have been adversely impacted by the Coronavirus pandemic. Further fluctuations should be expected, however these are long term investments and it is expected that their values will eventually rise as the overall economic situation improves. The values are shown in the table below:

| Name of Property Fund | Original Investment £ (000) | Value as at the 30 June 2020 £ (000) |
|------------------------------------|--------------------------------|--|
| CCLA Local Authority Property Fund | 5,000,000 | 4,568,164 |
| HERMES Property Fund | 2,999,998 | 2,750,923 |
| Total | 7,999,998 | 7,319,087 |

Borrowing

10. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR) and it gauges its indebtedness. The CFR results from the resources used to fund capital spend. It represents prior years'

and the 2020/21 unfinanced expenditure, which has not been funded by revenue or other resources.

11. One of the Council's treasury activities is to address the funding requirements for the borrowing need. The Treasury service organises the Council's cash position to ensure that enough cash is available to meet capital plans and day to day cash flow requirements in the cheapest and most efficient way. To date this has been sourced via a combination of borrowing from the Government, (through the Public Works Loan Board (PWLB)) and utilising the Council's temporary cash resources.
12. The Council's CFR is not allowed to rise indefinitely. Statutory controls ensure that capital assets are broadly charged to revenue over the life of the asset. To this end the Council makes an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of borrowing.
13. The total expenditure and funding of the Capital Programme for 2019/20 is summarised in the following table:

| | 2020/21 Original Budget £ (000) | 2020/21 Revised Budget £ (000) | 2020/21 Estimated Outturn £ (000) |
|--|--|---|--|
| Capital Expenditure | 19,510 | 30,150 | 30,150 |
| Financing: | | | |
| Capital Receipts | 1,240 | 1,085 | 1,085 |
| Grants and Contributions | 4,262 | 15,100 | 15,100 |
| Borrowing | 13,287 | 12,126 | 12,126 |
| Capital Expenditure Charged to Revenue | 721 | 1,839 | 1,839 |
| Total Funding | 19,510 | 30,150 | 30,150 |

14. The capital programme includes new borrowing in 2020/21 of £12.126m and this increases the Council's CFR for the year as shown in the following table:

| | 2020/21 Original Budget £ (000) | 2020/21 Revised Budget £ (000) | 2020/21 Estimated Outturn £ (000) |
|--------------------------------------|--|---|--|
| Opening Balance | 17,117 | 17,117 | 17,117 |
| Add unfinanced capital expenditure | 13,287 | 12,126 | 12,126 |
| Less Minimum Revenue Provision (MRP) | (242) | (242) | (242) |
| Closing Balance | 30,162 | 29,001 | 29,001 |

15. At the 30 June 2020 the Council's actual borrowing position was as follows:

| Borrowing position as at the 30th June 2020 | | | | | |
|--|--------------------|----------------------|-------------|-------------|-----------------------------|
| PWLB Ref: | Amount o/s | Interest Rate | Term | Type | Full Year Repayments |
| 507499 | £440,931 | 2.59% | 50 | Annuity | £16,102 |
| 507503 | £440,905 | 2.58% | 50 | Annuity | £16,070 |
| 509130 | £1,632,498 | 2.39% | 50 | Annuity | £56,729 |
| 509131 | £1,000,000 | 2.24% | 50 | Maturity | £22,400 |
| 509165 | £8,412,690 | 2.48% | 50 | Annuity | £297,572 |
| Total Borrowing | £11,927,025 | | | | £408,873 |

16. Borrowing activity is controlled by prudential indicators for gross borrowing and the CFR. The operational boundary represents the maximum expected borrowing position of the Council during the year. The authorised limit is required by Section 3 of the Local Government Act 2003 and is the maximum amount that the Council may borrow at any point in time. It differs from the Operational Limit in that it includes additional headroom to allow for unusual/unexpected cash outflows. Once this has been set, the Council cannot borrow above this level. The table below shows the Council's borrowing limits and gross external debt level as at the 30 June 2020.

| Treasury Indicators | Actual as at 30 June 2020 £ (000) |
|---|--|
| Authorised Limit for External Debt | 57,400 |
| Operational boundary for External Debt | 52,000 |
| Gross External Debt (actual) | 11,927 |
| Remaining Authorised Limit for External Debt | 45,473 |

17. The table in paragraph 13 shows the Council's commitment to significantly increasing its capital programme in 2020/21. This will make it very likely that external borrowing will be required. Officers will keep the borrowing limits under review and report back to Members should it be necessary to increase them.
18. Financing costs as a proportion of the net revenue stream identifies how much of the Council's income is required to service the cost of its overall debt. The 2020/21 original budget figure of 3.39% is higher than last year because we expect to borrow again this year. The forecast shows a slightly higher figure of 3.89% because the Council has received a significant increase in its revenue stream as a result of additional grants received from the MHCLG in response to the Coronavirus pandemic.

| Prudential Indicators | 2020/21 Original Budget £ (000) | 2020/21 Estimate Outturn £ (000) |
|--|--|---|
| Capital Expenditure Charged to Revenue | 1,359 | 1,839 |
| Capital Financing Requirement (CFR) | 30,162 | 29,001 |
| Annual Change in CFR | 13,045 | 11,884 |
| In-Year Borrowing Requirements | 11,927 | 11,927 |
| Ratio of Financing costs to Net Revenue Stream % | 3.39% | 3.89% |

19. The Council maintains an under-borrowed position, which means the CFR is not fully funded by loan debt but instead managed by using reserves and balances. This strategy is prudent because investment returns are low, and the counterparty risk associated with placing investments is minimised. However, as mentioned in paragraph 17, it will not be possible to maintain this should the Council decide to take out significant borrowing to fund its expanded capital programme.

Non-Treasury Investments

20. The Council invests in the economic regeneration of Rother through its Property Investment Strategy (PIS) and the expected income from these is as follows:

| 2020/21 Estimated Property Investment Income | | | |
|---|--------------------------------|-------------------------------------|-------------------------|
| Property | Rental Income £ | MRP & Interest £ | Net Income £ |
| 14 Terminus Road | 106,000 | (31,793) | 74,207 |
| 18-40 Beeching Road | 88,080 | (28,504) | 59,576 |
| 16 Beeching Road | 97,000 | (31,391) | 65,609 |
| Glovers House | 425,000 | (275,458) | 149,542 |
| Market Square, Battle | 195,000 | (110,263) | 84,737 |
| Total | 911,080 | (477,410) | 433,670 |

21. In addition to the above properties the Council has also purchased a property in Barnhorn Green, which should bring in further rental income in the future. The Council has not made any further property purchases since the last report to Audit and Standards Committee on the 29 July 2020.
22. The budget for rental income from all investment properties is £1,919,840, made up of £1,008,760 for the existing assets and £911,080 for properties purchased through the PIS. During the pandemic, lockdown tenants were not pursued for rent arrears however last month reminders were sent. Due to the continuing difficult economic circumstances, the forecast outturn for 2020/21 allows for a shortfall of £200,000. This equates to a gross return of 6.27% on the value of all properties including those purchased under the PIS. After allowing for borrowing costs the expected return on the PIS properties is 2.71%.

Economic impact of the Coronavirus

23. The Coronavirus pandemic continues to have a major impact on the global economy and is likely to do so for the foreseeable future. The UK economy is now officially in recession having contracted by over 20% quarter on quarter, as predicted by the Council's Treasury Management advisors, LINK Asset Services. The Chancellor has announced a wide range of financial packages designed to sustain and stimulate economic activity and there have been some positive signs of a recovery in recent weeks, e.g. an increase in mortgage applications but the rate of recovery could still take many months. Longer-term economic forecasts continue to be quite volatile and continued fears of a second wave add to the uncertainty.
24. The impact on the Council's treasury activities has been covered elsewhere in this report. Although the country is gradually easing out of lockdown and there is a general expectation that the economic situation will begin to improve, a second lockdown would have another profound effect.

Other Economic Updates

25. Brexit trade deal negotiations continue to be slow and unyielding as the prospect of a 'no-deal' scenario becomes increasingly likely. Neither side appear to be willing to make much in the way of concessions.
26. Interest rates continue to remain very low as indicated in the previous Treasury Management report. LINK Asset Services do not expect this position to change in the foreseeable future, therefore if Members did decide to increase borrowing activity as referenced in paragraphs 17 and 19, they would be able to secure a very favourable rate of interest. For example, the current rate for a 50-year loan is 2.3%.

Conclusion

27. The investment activity conforms to the approved strategy and the Council has no liquidity difficulties.
28. The investment environment for treasury activities remains difficult. Absolute returns are low and are likely to be so for the foreseeable future. The diversification into Property Funds increases the overall return but is less liquid and carries greater capital risk than other investments.
29. The Council's PIS focuses on regeneration and is expected to generate net returns of 2.7%. This is also riskier due to the long-term commitment of repaying borrowing and the operational risks of managing property.

| Other Implications | Applies? | Other Implications | Applies? |
|--------------------|----------|--------------------------|----------|
| Human Rights | No | Equalities and Diversity | No |
| Crime and Disorder | No | Consultation | No |
| Environmental | No | Access to Information | No |
| Sustainability | No | Exempt from publication | No |
| Risk Management | No | | |

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| Report Contact Officer: | Antony Baden |
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| Appendices: | None |
| Relevant Previous Minutes: | None |
| Background Papers: | None |
| Reference Documents: | None |