DECISION ITEM

REPORT OF	MEETING	DATE	ITEM NO
CHIEF FINANCIAL OFFICER	COUNCIL	7 DECEMBER 2020	11

MID YEAR PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT MONITORING REPORT 2020/21

PUBLIC ITEM

This item is for consideration in the public part of the meeting.

SUMMARY

This report is a mid-year Prudential Indicators and Treasury Management monitoring report which has been prepared in line with the recommendations of CIPFA's (Chartered Institute of Public Finance Accountants) Code of Practice on Treasury Management. The report has also been considered at the Audit and Standards Committee meeting of 26th November 2020.

The recommendation for Council, was published prior to the meeting of the Audit and Standards Committee. Any changes will be reported to Council by the Chairman of Audit and Standards.

RECOMMENDATIONS

The Audit and Standards Committee considered the Mid-Year Prudential Indicators and Treasury Management monitoring report at its meeting on the 26th November 2020, and recommends to Council:

1. That the Prudential Indicators and the Investment Limits as detailed in Appendix B of the report be approved; and

2. That the limit for investment funds placed in each Money Market Fund to be increased from £2m to £3m and that the overall limit in respect of Money Market Funds be removed.

SUMMARY OF PREVIOUS DECISIONS

Council approved the 2019/20 to 2023/24 Capital Strategy, which incorporated the Prudential Indicators, at its meeting on 4th March 2020.

CORPORATE PRIORITIES	
Economy – To create a vibrant and healthy economy	√
Environment – To deliver services customers expect	√
Efficiency – By spending money in the most efficient way	√
Tourism – To create a great place to live and visit	√

MID YEAR PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT MONITORING REPORT 2020/21 – POSITION AS AT 30th SEPTEMBER 2020

Report

The Code of Practice on Treasury Management requires the Council to receive a Mid-Year Treasury Review report in addition to the forward-looking Annual Capital Strategy and the backward-looking Annual Treasury Report. The Code of Practice also requires Members to scrutinise the Treasury Management function.

Background

The Mid-Year Treasury Review report has been prepared in compliance with the Code of Practice. In order to assist with the terminology and explanations that are included within this report Appendix A sets out a Glossary of Treasury Terms and a number of Treasury Management and Prudential Indicators Frequently Asked Questions. Appendix B sets out the latest Treasury Management position compared to the forecast Prudential Indicators.

1. **Economic Update**

1.1 Economic Background

1.1.1 The spread of the coronavirus pandemic dominated the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again.

1.1.2 The Bank of England maintained the Bank Base Rate at 0.1%. The potential use of negative interest rates was not ruled in or out by the Bank of England policymakers.

1.1.3 GDP growth contracted by 19.8% in the quarter to June 2020 according to the Office for National Statistics. Construction fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering.

1.1.4 The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% in August, below the Bank of England's 2% target. Labour market data showed the unemployment rate increased in July to 4.1% while wages fell by 1%. The unemployment rate is expected to increase in the coming months when the government furlough scheme ends. The Bank of England has forecast unemployment could hit a peak of between 8% and 9%.

1.2 Economic Outlook

1.2.1 The medium-term global economic outlook is weak. Coronavirus has not been suppressed and second waves have prompted more restrictive measures on a regional and national basis. The global central bank and government responses have been significant and in many cases are ongoing. Brexit is a further complication with a trade deal looking difficult as the government tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law

1.3 Interest Rate Forecast

1.3.1 The latest forecast for interest rates from the Council's Treasury Advisors, Arlingclose, is shown in Table 1 below. Bank rate is expected to remain at a low level for a very long time with a possibility of being cut to zero. Longer term yields will also remain depressed with the potential for even lower rates.

Table 1: Interest Rate Forecast from Arlingclose

Quarter Ending	Bank Rate %	Investment Rates %		Borrowing Rates %		
		3 month	5 year	5 year	20 year	50 year
Dec 2020	0.10	0.10	0.00	1.80	2.40	2.30
Mar 2021	0.10	0.10	0.00	1.80	2.40	2.30
Jun 2021	0.10	0.15	0.05	1.85	2.40	2.30
Sep 2021	0.10	0.20	0.10	1.90	2.45	2.30
Dec 2021	0.10	0.20	0.15	1.95	2.45	2.35
Mar 2022	0.10	0.20	0.15	1.95	2.45	2.35
Jun 2022	0.10	0.20	0.20	2.00	2.50	2.40
Sep 2022	0.10	0.20	0.20	2.00	2.50	2.40
Dec 2022	0.10	0.20	0.25	2.05	2.55	2.45
Mar 2023	0.10	0.20	0.25	2.05	2.55	2.45
Jun 2023	0.10	0.20	0.25	2.05	2.55	2.45
Sep 2023	0.10	0.20	0.25	2.05	2.55	2.45
Dec 2023	0.10	0.20	0.25	2.05	2.55	2.45

2. Regulatory Updates

2.1 The 2017 Prudential Code includes a requirement for local authorities to produce a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy complying with the CIPFA's requirement, was approved by full Council on the 4th March 2020.

3. Debt Management

3.1 The Council currently holds no external debt.

3.2 The Council's underlying need to borrow is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts. For 2020/21 the Council has a £5.4m Capital Financing Requirement (CFR) based on prudential borrowing for past and current capital expenditure that has been approved as part of the Capital Programme (See Appendix B Table 2). Currently this is being funded by the Council's cash flow, i.e. internal borrowing, and it is expected that internal borrowing will continue to be used for the rest of the financial year in line with advice from the Council's Treasury Advisors.

3.3 The use of internal resources in lieu of borrowing, i.e. internal borrowing, has continued to be the most cost- effective means of funding capital expenditure. Using internal borrowing lowers the overall treasury risk by reducing both external debt and temporary investments. However, this position may not be sustainable over the longer term. Consequently, external borrowing options and the timing of such borrowing will continue to be assessed in consultation with the Council's Treasury Advisors.

4. Investments

4.1 Treasury Investment Activity

4.1.1 The Council holds significant invested funds, representing income received in advance of expenditure, monies held on behalf of the Council Tax and Business Rates Collection Fund (Lancashire County Council, the Police and Crime Commissioner for Lancashire and Lancashire Combined Fire Authority) plus balances and reserves held.

4.1.2 The Council held £26.6m of cash and investments as at 30th September 2020. The balance of cash is likely to reduce during the remainder of the financial year.

4.1.3 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk or return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

4.1.4 Given the increasing risk and low returns from short-term unsecured bank investments, the Authority has continued to invest in Local Authority loans with a maximum duration of 365 days.

4.1.5 The security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in the Investment Strategy for 2020/21 approved by Council on 4th March 2020.

4.1.6 The Council defines "high credit quality" organisations as:

- those having a credit rating of A- or higher and that are domiciled in the UK for deposits of up to one year,
- those domiciled in a foreign country those with a sovereign rating of AA+ or higher for deposits of up to one year.

These criteria are specified within table 3 (Approved Investment Counterparties and limits) of the Treasury Management Strategy as approved by the Council on 4th March 2020.

4.1.7 On the 1st April the Council received central government funding of £21.7m to support small and medium businesses during the coronavirus pandemic through grant schemes. This money was temporarily held in the Debt Management Office and Money Market Funds until it was disbursed to qualifying businesses under the scheme criteria.

4.1.8 There has been continued downward pressure on the returns of short duration investments. The returns on some Money Market Funds are zero and on the 25th September 2020 the returns on overnight investments with the Debt Management Office became negative.

4.1.9 Internally managed funds of £29.5m (average for the period to 30th September 2020) have been invested in deposit accounts, call accounts, Local Authorities, Money Market Funds and the Debt Management Office during the first half of the year. The council's cash flow has fluctuated significantly during the first half of the year, due largely to the timings of receipts and payments in respect of the Government Covid Business Support Scheme monies. To allow sufficient flexibility to manage temporarily high cash balances it is recommended that the individual limit for each Money Market Fund is increased from £2m to £3m, and that the overall limit for monies held in Money Market Funds (which currently stands at £12m) is removed. This is in line with the advice from Arlingclose. Money Market Funds are highly diversified and liquid investments and achieve a higher counterparty rating than individual banks.

4.1.10 Deposits have been made at an average rate of 0.35%, considerably above the benchmark return (based on the 7 day LIBID - The London Interbank Bid rate) of -0.50%. This has been achieved in the main by investments in other Local Authorities that were placed before the Pandemic began. The Council's original estimate for investment income for 2020/21 was £108.5k. Income from investments has been lower than the forecast amount due to downward returns on short duration investments. Consequently this income budget has been reviewed and will be reduced to £65.5k to reflect the current level of income, representing a decrease in forecast interest earnings for the current year of £43k.

4.2 Readiness for Brexit

4.2.1 The scheduled date for the UK to leave the European Union currently remains as 31st December 2020 and negotiations to secure a post-Brexit trade deal with the rest of the EU are continuing. As the scheduled Brexit date approaches the Council will ensure that it has sufficient accounts with UK-domiciled banks and

Money Market Funds to hold sufficient liquidity and that its account with the Debt Management Account Deposit Facility (DMADF) also remains available for use.

5. Compliance

5.1 The Chief Financial Officer reports that all treasury management activities undertaken during the half year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

5.2 Details of the Prudential Indicators can be found in Appendix B. As changes arise during the year some of the Prudential Indicators and Limits need to be revised.

6. Risk Assessment

6.1 Scrutiny of the revised Prudential Indicators and Limits and the subsequent recommendation of approval to the revisions by Audit and Standards Committee to Council helps to protect the Council from the risk of not having adequate liquidity or funding for the Council's capital plans.

6.2 Additionally, if this scrutiny process were absent the Council would not be compliant with the Council's approved Treasury Management Practices (as detailed in the Council Constitution) or CIPFA's Code of Practice on Treasury Management.

7. Conclusion

7.1 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first half of 2020/21. As indicated in this report, all of the Prudential Indicators have been complied with and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

IMPLICATIONS	
Finance	Financial implications are contained within the body of the report.
Legal	This report secures the continued compliance with the Council's approved Treasury Management Practices (as detailed in the Council Constitution) and CIPFA's Code of Practice on Treasury Management.
Community Safety	None
Human Rights and Equalities	None
Sustainability and Environmental Impact	None
Health & Safety and Risk Management	None

LEAD AUTHOR	CONTACT DETAILS	DATE
Paul O'Donoghue Chief Financial Officer	01253 658586	November 2020

BACKGROUND PAPERS		
Name of document	Date	Where available for inspection
Medium Term Financial Strategy Update Including General Fund, Capital Programme & Treasury 2019/20 – 2023/24	Council meeting 4th March 2020	www.fylde.gov.uk

Attached documents

1. Appendix A – Glossary of Treasury Terms and Treasury Management and Prudential Indicators Frequently Asked Questions
2. Appendix B – Prudential Indicators
3. Appendix C – Existing Investment and Debt Portfolio Summary

Appendix A

Glossary of Treasury Terms

Term	Description
Counterparty	Another party to an agreement.
Credit rating	A measure of the credit worthiness of an institution, corporation, or a country. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the counterparty being able to pay back a loan.
Liquidity	As assessment of how readily available an investment is. It is safer to invest in liquid assets because it is easier for an investor to get their money out of the investment.
Minimum Revenue Provision (MRP)	The minimum amount that the Council must charge to the revenue accounts each year in order to reflect the notional costs of financing capital expenditure.
Security	As assessment of the creditworthiness of a counterparty.
Treasury adviser	External consultancy firms that provide information to local authorities, including information regarding counterparty creditworthiness.
Prudential Borrowing	Borrowing that is not funded via the Revenue Support Grant or other grant aid system but rather from the Council's own resources, this is conditional that prudence is demonstrated.

<u>Treasury Management and Prudential Indicators Frequently Asked Questions</u>

1. What is the difference between capital expenditure and capital financing requirement?

Capital Expenditure is defined as expenditure on the acquisition, creation or enhancement of tangible fixed assets, subject to a de minimis level of £10,000. It includes expenditure on land, buildings and vehicles.

The Capital Financing Requirement (CFR) is the level of total funding that is required to fund the capital programme. The actual level of external borrowing may be lower than the CFR as a consequence of the use of internal borrowing. Internal Borrowing occurs when the Council temporarily uses its own cash resources to finance capital expenditure rather than arranging new external borrowing. This is a prudent approach when investment returns are low and counterparty risk is high.

2. What does the term 'financing' mean?

The term 'financing' does not refer to the payment of cash but the resources that will be applied to ensure that the capital payment amount is dealt with over the longer term. A number of financing options are available to Councils:-

- capital receipts (e.g. sale of land or buildings)
- contribution from revenue expenditure

- capital grant
- contribution from a third party
- borrowing
- contribution from earmarked reserves

3. Does the Council link long term loans to particular capital assets/projects?

The Council does not directly associate loans with particular capital assets/projects, as this is not best practice. The Council will, at any point in time, have a number of cash flows both positive and negative and will be managing its position in terms of its borrowings and investments in accordance with its treasury management strategy and practices. This is best practice in line with the CIPFA Prudential Code.

4. What does the term 'net borrowing should not exceed the total of the CFR' mean?

Net borrowing will remain below the CFR to ensure that the Council is only borrowing for a capital purpose. The Council is permitted to borrow in advance for a capital purpose over the medium term. The term 'total of the CFR' is the CFR of the current year plus increases in the CFR of the previous financial year and next two financial years. In other words, the total of the Council's existing assets, plus additions to assets resulting from forecast Capital Programme expenditure, e.g. vehicles. This gives the Council some headroom to borrow early for a capital purpose in order to secure low interest rates.

5. Is the cash that is being managed in-house revenue or capital?

The short term surplus cash that is managed during the year in house may be revenue or capital, e.g. the Council may receive a capital receipt in April but capital expenditure is incurred throughout the year which gives rise to increased cash balances in the early part of the financial year which is invested short term by the in house treasury team. The Council receives Council Tax which is classed as revenue income. Council Tax income is typically received in the months of April to January as the majority of Council Tax payers make 10 instalments. Therefore, the Council has less cash in the months of February and March and may need to borrow cash short-term in line with the cash flow forecast.

6. What does the Council invest in?

The Council is restricted in where it can invest its surplus funds. The restrictions are prescribed by statute (Local Government Act 2003 section 12(1) (b)). Councils are also required to have regard to supplementary investment guidance provided by the Communities and Local Government.

The Council's investments are typically short term, i.e. less than a year, and are made in sterling with institutions with high credit ratings. This is in accordance with the Treasury Management Strategy approved on the 4th March 2020.

7. What is the role of internal and external auditors in respect of treasury management?

The focus of external auditors work is a Council's annual accounts and the financial management systems and processes that underpin them. The external audit will enquire as to whether the Treasury Management Code has been adopted and whether its principles and recommendations have been implemented and adhered to.

Through a process of review, the role of Internal Audit is to provide an opinion of the adequacy, application and reliability of the key internal controls put in place by management to ensure that the identified risks are sufficiently mitigated. This will assist Treasury Management in meeting its desired objectives and help to ensure that the risk of fraud and/or error is minimised. Internal Audit will also look to identify other areas of potential risk which could usefully be included as well as any inefficiencies in existing processes and procedures where improvements can be made. Treasury Management is one of the core financial systems and as such is audited on a cyclical basis.

8. What are the qualifications of Council staff involved in treasury management practices?

Staff are either working towards or have achieved professional accountancy qualifications from CIPFA (Charted Institute of Public Finance Accountants), ACCA (Association of Chartered Certified Accountants) or CIMA (Chartered

Institute of Management Accountants). Staff work closely with the Council's Treasury Management Advisors and attend regular treasury training and updates (provided by the Treasury Management Advisors).

Appendix B

Prudential Indicators

1.1 Capital Expenditure

Table 1 shows the revised forecast capital expenditure as reported in the latest Capital Programme Monitoring Report 2020/21 as compared to the capital expenditure originally approved by Council.

Table 1: Forecast Capital Expenditure

Forecast Capital Expenditure	2020/21 Original Indicator £M	2020/21 Latest Estimate £M
Total	8.1	10.7

The above table shows the forecast capital expenditure for 2020/21. The increase in the latest estimate is a consequence of slippage from 2019/20 into 2020/21, the re-phasing of a number of schemes and new schemes that have been approved since the Budget Council meeting of March 2020.

1.2 Capital Financing Requirement (CFR)

Table 2 shows the CFR which is the total of all of the Council's capital assets (existing and planned) less all of the Council's capital reserves. This is the amount of capital expenditure that the Council has still to finance. The CFR is normally funded by external borrowing but currently is being funded by the Council's cash flow, i.e. internal borrowing, and it is expected that internal borrowing will continue to be used for the rest of the financial year in line with advice from the Council's Treasury Advisors. The Council has no existing borrowing therefore there is a requirement to finance £5.4m from internal cash resources as described in section 3 of the report.

Table 2: Capital Financing Requirement (CFR)

	2020/21 Original Indicator £M	2020/21 Latest Estimate £M
Total CFR	5.5	5.4

The latest estimate of the CFR is in line with the original approved indicator.

1.3 Gross Debt and Capital Finance Requirement

The Council needs to ensure that its total capital borrowing does not, except in the short term, exceed the total of the CFR. Table 3 below shows that the Council will be able to comply with this requirement.

There are no difficulties anticipated in keeping the long term capital borrowing below the CFR.

Table 3: Gross Debt and Capital Finance Requirement

As at 31/03/2020	2020/21 Original Indicator £M	2020/21 Latest Estimate £M

Estimated Long Term Borrowing	0	0
Capital Financing Requirement	5.5	5.4

The Council is forecast to be able to fund the capital borrowing requirement with internal borrowing and does not expect to require new external borrowing during 2020/21, in line with advice from Treasury Advisors.

1.4 Authorised Limit and Operational Boundary for External Debt

Affordable Borrowing Limit: The Council is legally obliged to set an affordable borrowing limit (also termed 'Authorised Limit' for external debt) each year. In line with statutory guidance, a lower 'Operational Boundary' is also required to be set as a warning level should debt approach the limit. This is detailed in table 4.

The Operational Boundary is based on the maximum external debt during the course of the year. It is not a limit and therefore may be exceeded on occasion.

The Authorised Limit for external debt represents the limit beyond which borrowing is prohibited, and is set and revised by Council. It reflects the level of borrowing which, in extreme circumstances, could be afforded in the short term. This is a statutory limit which should not be breached.

There were no breaches to the Authorised Limit and the Operational Boundary to 30th September 2020.

Table 4: Authorised Limit and Operational Boundary for External Debt

	2020/21 Original Indicator £M	2020/21 Latest Estimate £M
Authorised Limit – total external debt	8.0	6.0
Operational boundary	2.0	0

Note

1. The Authorised Limit and Operational Boundary have reduced as a consequence of there being no requirement to borrow in the short-term for day to day cash flow. The Council is able to fund the capital borrowing requirement with internal borrowing and does not expect to require new external borrowing during 2020/21.

2. The Authorised Limit includes £6.0m for 'contingency' which is an amount that has been estimated to provide scope to undertake short-term borrowing in the event of a service delivery failure or emergency, e.g. a failure to collect council tax income.

1.5 Forecast Treasury Position

Table 5 shows the expected balances for investments and debt at 31st March 2020.

Table 5: Forecast Treasury Position

	2020/21 Estimate £M	2020/21 Revised £M
Debt (Long-Term External Borrowing)	0	0
Investments	12.1	18.1

The Council has not undertaken any new external long-term borrowing as it is funding capital expenditure with internal borrowing (see Section 3 of the report).

The forecast investments position has been updated to reflect the latest changes to the movements in reserves, provisions and capital expenditure. The increase in the level of investments at the 31st March from £12.1m to £18.1m is a consequence of the forecast timing of daily cash flows.

1.6 Proportion of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the financing costs (Minimum Revenue Provision (MRP) plus interest payable less interest receivable) as a percentage of the net revenue stream as shown in Table 6.

Table 6: Ratio of Financing Costs to Net Revenue Stream

	2020/21 Estimate £M	2020/21 Revised £M
Financing costs (£m)	0.705	0.678
Proportion of net revenue stream	6.0%	5.8%

The latest estimate is lower than the original estimate due to a reduction in the forecast Minimum Revenue Provision (MRP) for 2020/21 as a result of the re-phasing of fleet purchases, the full effect of which is partially offset by the reduction in interest receivable from investments.

1.7 Investments over 365 days

This limit is set to ensure adequate liquidity and is the maximum amount of funds the Council will invest longer term.

Table 7: Investments over 365 days

	2020/21 Estimate £M	2020/21 Revised £M
Limit for investments over 365 days	5.0	0

Appendix C

Existing Investment & Debt Portfolio Position at 30.09.20

	30.09.209 Actual Portfolio £m	**30.09.20 Average Rate %**
External Borrowing:		
Public Works Loan Board	0	-
Total External Borrowing	**0**	
Treasury investments:		
Short Term		
Banks - unsecured	(4.6)	0
Local Authorities	(14.0)	0.46
Money Market Funds	(8.0)	0.04
Total Treasury Investments	**(26.6)**	
Net Borrowing / (Lending)	**(26.6)**	