2020/21 Mid-Year Treasury Management report to JAC

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Title:	2020/21 Mid-Year Treasury Management report
Version:	N/A
Purpose:	To review the annual activity and performance of the treasury management function.
ACPO / Strategic Lead:	PCC CFO
National Decision Model compliance:	*Yes*
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Date to be reviewed:	

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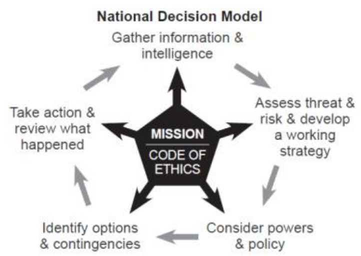

1. Background

Purpose of the Report:

1.1. The purpose of this report is to summarise the Treasury Management performance for the nine months to 31 December 2020.

1.2. The mid-year performance of the Treasury Management Service during 2020/21 is reported in line with CIPFA's Code of Practice on Treasury Management and the PCC's 202/21 Treasury Management Strategy Statement (TMSS).

1.3. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that those charged with governance and scrutiny receive regular updates on treasury management activity.

1.4. The Police and Crime Commissioner for Surrey - 2020/21 Treasury Management Strategy Statement can be found on the Police and Crime Commissioner's website as follows; https://surrey-pcc.gov.uk/wp-content/uploads/2020/07/12.pdf

Terms of Reference:

1.5. As set out in the Joint Audit Committee's terms of reference, the JAC will provide advice and recommendations to the PCC in relation to the following area of Financial Reporting;

13. Ensure that an effective system of scrutiny is in place in respect of Treasury Management, strategy, policies and practices.

2. Treasury Management – Statutory Requirements

2.1. The legal status of the Treasury Management Code in England and Wales is derived from regulations issued under the Local Government Act 2003. The Capital Finance and Accounting Regulations 2003 explicitly require English authorities (now including policing bodies) to "have regard" to the Treasury Management Code.

2.2. The Treasury Management Code and the Prudential Code are closely linked and regard to the Prudential Code is required when setting limits to the level of affordable borrowing under section 3(5) of the 2003 Act.

2.3. Treasury Management is defined in the Prudential Code 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."*

2.4. The Local Government Finance Act 1992 sets a 'balanced budget requirement' whereby the budget for the financial year is calculated and council tax charges are set to meet the expenditure after taking into account other sources of income.

2.5. The Local Government Act 2003 requires local authorities (now including policing bodies) to create and keep under review the limits of how much money they can afford to borrow. The processes that must be followed in setting these limits are described in the Prudential Code.

2.6. The 2003 England and wales Regulations place a duty to charge a 'minimum revenue provision' (MRP) to the revenue account, which is deemed to be prudent.

2.7. The Statutory Guidance on Local Authority Investments in England (MHCLG 2018) makes it clear that borrowing should never be done for the explicit purpose of making an investment return and that borrowing in advance of need purely in order to profit from the investment of the extra sums borrowed is against the principles of the statutory framework and the Prudential Code.

2.8. The MHCLG Statutory Guidance on Local Government Investments (MHCLG, 2018) stresses the prudent investment strategy order of security, liquidity and yield.

- First and foremost, ensure the security of principal sums invested, i.e. ensure we get back the full investment.
- Then ensure the liquidity needed i.e. funds are available when needed by considering the length of an investment.
- Only when the above two conditions are satisfied should the yield or return on investment be considered.

2.9. The Treasury Management Code recommends that the PCC should, as a minimum, report:

- An annual **Treasury Management Strategy Statement** (TMSS) before the start of the year
- An annual **Capital Strategy**
- An **Annual Report** on Treasury Management Activities, Performance and Non-Compliance
- A **Mid-Year Report** on Treasury Management Activities, Performance and Non-Compliance
- Treasury Management **Prudential Indicators** including borrowing limits

2.10. Adherence to the above legislation aims to ensure the PCC for Surrey have comprehensive policies and practices in place for the effective management and control of their treasury management activities, including the effective management and control of risk.

3. Treasury Management Mid-Year Report to 31 December 2020

3.1. The treasury management function is carried out by Surrey County Council (SCC) under a service level agreement. Under this agreement the following treasury management transactions were undertaken in 2019/20 and up to 31 December 2020.

3.2. There was no change in the Capital Financing Requirement and other Prudential Indicators are within approved limits.

Short Term Lending

3.3. In accordance with agreed policy, surplus cash was lent on a daily basis to SCC. The following loans were made during the period to 31 December 2020.

		2019-2020 Full year	**2020-2021 Quarters 1 - 3**
Number of Loans		257	190
Total Interest Received		£207K	£35k
Average Interest Earned	Q1	0.75%	0.31%
Average Interest Earned	Q2	0.70%	0.14%
Average Interest Earned	Q3	0.68%	0.10%
Average Interest Earned	Q4	0.63%	

The average rate of return for the year 2019-20 was 0.69% and the average rate of return for the first three quarters of the year 2020-21 was 0.18% based upon an average investment of £19.2m and is above the average London Inter-Bank BID rate (formerly Local Authority 7 day rate) for the same period of 0.05%. Appendix 1 shows the interest rate received with appendix 2 showing the actual interest received.

Appendix 3 shows that investment balances started to fall from 2016/17 due to the use of reserves to fund the budget and the reduction in capital receipts received then started to climb again in 2018/19 due to increase in interest rates, but have fallen significantly this year due to Covid.

3.4. The primary consideration governing the Surrey County Council's Strategy is to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking optimal rate of return or yield and to strike a balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the aim is to achieve a total return that is equal or higher than the prevailing rate of inflation in order to maintain the spending power of the sum invested. No sums were invested for more than one year during 2020-21 up to 31 December 2020.

3.5. The bank rate was forecast by the Council's advisors at 0.75% during 2019/20 however, in March 2020, the Bank of England decreased the Base Rate to 0.10%. SCC currently pay with higher of; the London Inter-Bank BID rate, the Bank of England Rate or the SCC rate.

3.6. Interest rates on many investments are now so low that there is a risk going forward that for some short-term deposits could exceed the interest that could be earned.

3.7. The cost to the PCC for the services of Surrey County Council for 2019/20 was £18,351 and is expected to remain at a similar level for 2020/21.

Short Term Borrowing

3.8. No short term external borrowing was undertaken during 2019/20 or to 31 December 2020, all cash balances were lent overnight allowing us the flexibility to draw on our own resources.

Long Term Borrowing

3.9. The PCC took out an external loan with PWLB on 11 March 2019 to support the Building the Future (BtF) project. This loan was for £15.635m with a loan method of Equal Instalments of Principle (EIP) running over 30 years to 11 March 2049 with an interest rate of 2.34%.

3.10. The PCC also has historical internal borrowing of £10.363m which is being repaid over periods of 5-30 years. Use of internal resources in lieu of borrowing by the PCC continues to be the most cost effective means of funding capital expenditure. This also lowers the overall treasury risk by reducing both external debt and temporary investments.

3.11. No new external borrowing was taken in the first nine months of 2020/21.

3.12. Further borrowing may be required over the next few years and is currently at the planning stage to fund the proposed capital programme and (BtF) going forward. The PCC has various options for financing borrowing, this is likely to be achieved through a mixture of internal and Public Work Lending Board (PWLB) borrowing. The PWLB remains the preferred source of borrowing given the transparency and control that its facilities continue to provide. The main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

Future Borrowing Requirements

3.13. The latest 2020/21 capital programme indicates no requirement to borrow externally to support expenditure in this financial year. This is under regular review and further borrowing in the future is highly likely.

Surrey County Council

3.14. Surrey County Council's treasury management officers monitor cash flow on behalf of the PCC and aggregate this with their own cash flow, before making appropriate investments on behalf of both organisations. Accordingly there was no requirement for the PCC of Surrey to deal with brokers or bankers during 2019/20 and up to 31 December 2020.

Value for Money

3.15. The PCC is committed to achieving value for money in treasury management. Actual returns on investment appear low, however this is partly due to the low rates available during the current economic climate and is also offset against the competitively low cost of the treasury management service provided by SCC.

4. Conclusions

4.1. The PCC has complied with relevant statutory and regulatory stipulations, which require the PCC to identify the levels of risk associated with its treasury management activities.

4.2. During the nine months to 31 December 2020 the PCC complied with legislative and regulatory requirements.

4.3. The Chief Finance Officer confirms compliance with the approved TMSS for 2020/21 and that a prudent investment approach has been followed with priority given to security and liquidity of amounts invested over actual yield achieved.

4.4. Risk management considerations:

Associated risks have been considered and adequate control measures implemented. All Treasury Management activity is carried out in accordance with the approved Treasury Management Strategy Statement, which aims to minimise risk to ensure the PCC principal sums are safeguarded. Maximising income is considered secondary to this main aim.

If the PCC does not review annual performance of treasury management activity in line with the CIPFA Treasury Management Code of Practice there is a risk that poor management of public funds could occur and go unnoticed, resulting in censure from the auditors and reputational damage as a consequence.

4.5. There are no equality or Human Right implications arising from this report

4.6. Relevant legislation and guidance has been complied with in the delivery of the Treasury Management activities.

5. Decisions Required

5.1. The Chief Finance Officer invites the Joint Audit Committee Members to review the 2020-21 Treasury Management Mid-year Report and recommend for approval by the PCC.

6. Attachments / Background Papers

6.1. Appendix 1 - **Interest Rates Received**
6.2. Appendix 2 - **Actual Interest Amounts Received**
6.3. Appendix 3 - **Average Investment Balances**
6.4. Appendix 4 - **Economic Update**
6.5. Appendix 5 - **Regulatory Update**
6.6. Appendix 6 - **PWLB certainty rates**
6.7. Background sources detailing compliance requirements:

- The PCC for Surrey's Treasury Management Strategy Statement
- CIPFA Treasury Management in Public Services Code: Guidance Notes for Local Authorities including Police and Fire Authorities (2018 Edition)
- CIPFA The Prudential Code for Capital Finance in Local Authorities: Guidance Notes for Practitioners (2018 Edition)
- MHCLG MRP Guidance and Investment Guidance
- Local Government Finance Act 1992
- Local Government Act 2003 (England and Wales)
- The Capital Finance and Accounting Regulations 2003
- International Financial Reporting Standards (IFRS) in the Code of Practice on Local Authority Accounting in the United Kingdom (2020/21 Edition)

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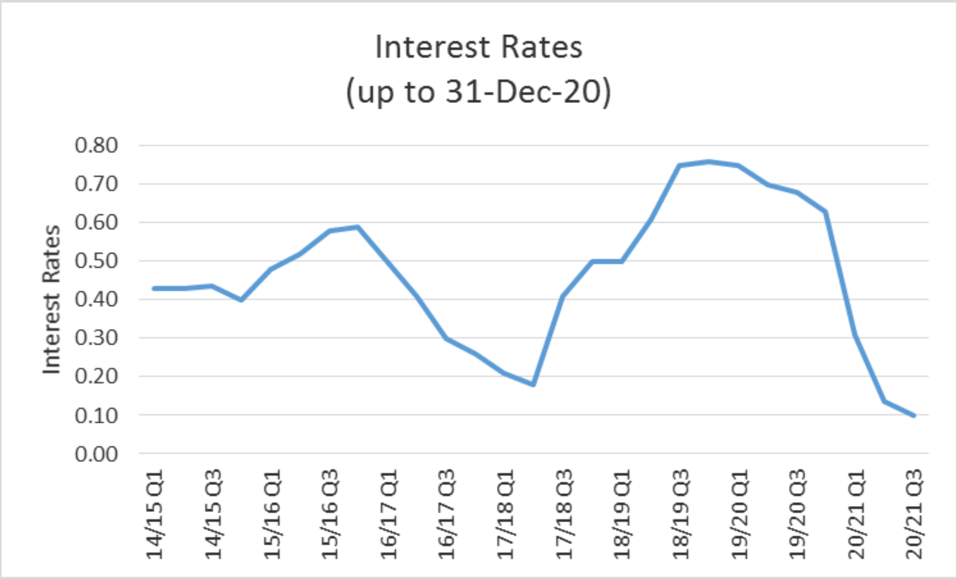
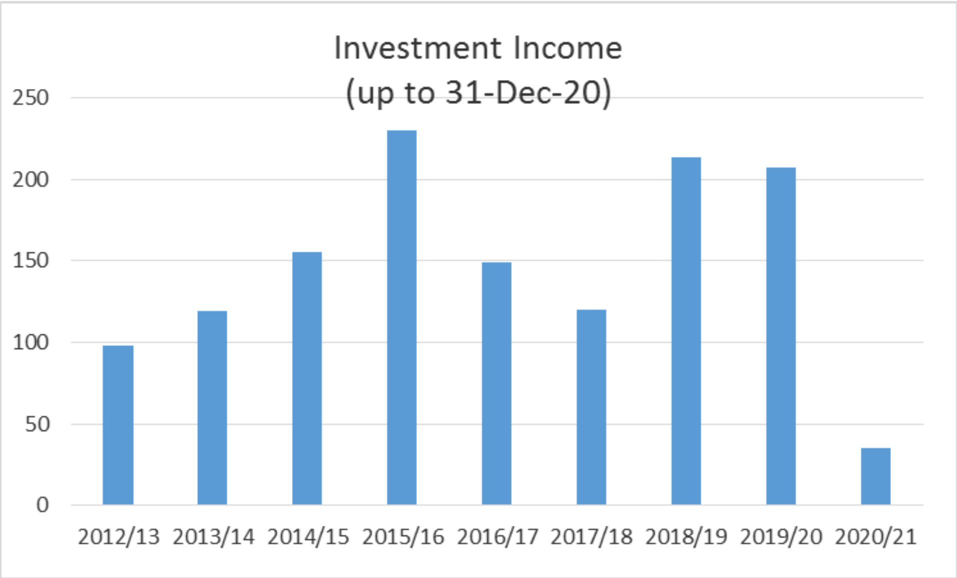
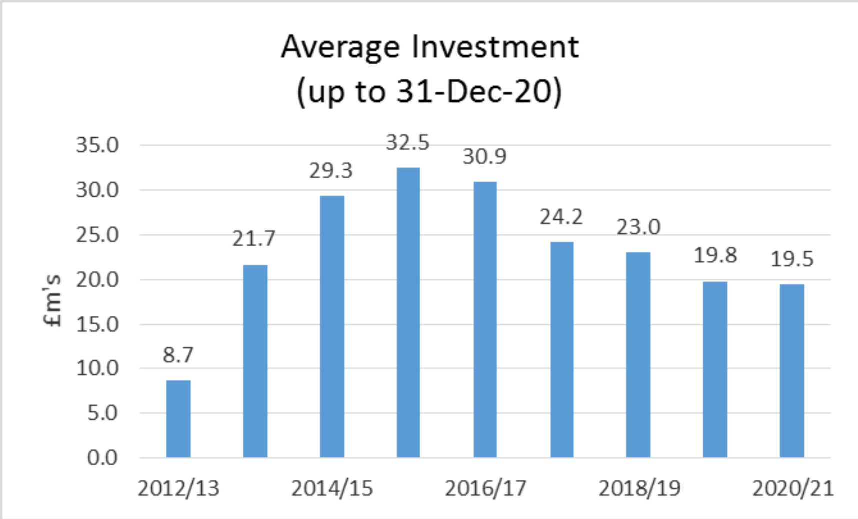
APPENDIX 1 - Interest Rates Received



APPENDIX 2 - Actual Interest Amounts Received



APPENDIX 3 - Average Investment Balances



APPENDIX 4 - Economic Update

Economic Update

UK

The Bank of England's Monetary Policy Committee (MPC) kept the **Bank Rate unchanged at 0.10% on 5th November 2020 and again following the MPC meeting on 17th December 2020**. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December which will put back economic recovery. The Bank of England decided to do a further tranche of **quantitative easing (QE) of £150bn, to start in January**. It did this so that announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target of 2% CPI by 2023.

There was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from such a policy, at least for the next 6 -12 months.

The Bank's forward guidance in August added a new phrase in the policy statement that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". So even if inflation rises to 2% in a couple of years' time, we do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target.

The minutes did contain several references to downside risks. The MPC reiterated that the "recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside". It also said "the risk of a more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. Hopefully, restrictions will ease during the spring. Unfortunately some businesses that barely survived the first lockdown, will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to the end of 31st March will limit the degree of damage done.

Upside risks, include the various COVID19 vaccines being cleared as safe and effective for administering to the general public and mean that life could largely return to normal during 2021, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels, which would help to bring the unemployment rate down. Public borrowing is now likely to increase to around £394bn (19% of GDP) as a result of the new lockdown.

The Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn", stating that "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection".

EU Exit

The risk of the UK and the EU falling out is that the UK could override the Withdrawal Agreement with the EU starting legal proceedings and few measures being able to mitigate the disruption on 1st January 2021. This could lower GDP significantly.

United Kingdom Sovereign Rating Update

On 19 October, Moody's Investor Services downgraded the UK Sovereign Rating from Aa2 to Aa3 and the outlook on the Sovereign Rating from Negative to Stable.

This followed the slowing economic growth in the UK with adverse impacts from Brexit and the Coronavirus pandemic with rising UK debt and observations from Moody's that UK institutions and governance were weakening.

APPENDIX 5 – Regulatory Update

Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an organisation changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to the attention of the PCC and Joint Audit Committee members in treasury management update reports.

We confirm there has been no change to risk appetite during this year.

Investment guidance

The MHCLG investment guidance focused particularly on non-financial asset investments. As non-financial assets have been excluded from our TMSS, any changes in this area of investment guidance did not require any changes to our TMSS which deals solely with treasury type investments.

Minimum Revenue Provision (MRP) Guidance

The MHCLG MRP guidance focuses particularly on expenditure on purchasing non-financial asset investments. As non-financial assets have been excluded from our TMSS any changes in this area of MRP guidance did not require any changes to this report.

There are also changes to guidance on retrospective changes to MRP policy, but this does not currently affect the PCC.

APPENDIX 6 - PWLB certainty rates

Following a consultation, the government has publishing revised lending terms for the PWLB and guidance to support public bodies use of PWLB loans. These new terms apply to all loans arranged from 9am on 26 November 2020. A cut to the cost of borrowing from PWLB took the rates back to where they were a year ago in October 2019.

Under the new rules, borrowing from the PWLB will now have to provide a three year capital plan, confirming it does not intend to borrow primarily for yield at any point over the period or from any source.

The graph below illustrates the general trends in PWLB interest rates for the first six months to September 2020.