Annexes B & C to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Treasury Management Annual Report 2019/20

Cardiff Council

Introduction

1. Treasury management activities are 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. The Council carries out its treasury management activities in accordance with a code developed for public services and updated in 2017 by the Chartered Institute of Public Finance and Accountancy (CIPFA).

3. On 25th February 2010, Council approved policies and adopted the four clauses of the treasury management code which are replicated in **Annexe A** for information. Council received a report in February 2019 on the Council's Treasury Management Strategy for 2019/20 and a mid-year review in November 2019.

4. This report provides members with an annual report for the Council's Treasury Management activities for 2019/20. It covers:-

    - the economic background to treasury activities
    - treasury investment strategy and outturn for 2019/20
    - borrowing strategy and outturn for 2019/20
    - debt rescheduling
    - compliance with treasury limits and prudential indicators
    - treasury management issues for 2019/20

5. Council requires the scrutiny of the accounting, audit and commercial issues of its Treasury Management Strategy and practices to be undertaken by the Council's Audit Committee. A number of reports were submitted to the Committee to note and review during the year, with each committee receiving a report on the position and performance of treasury investments and borrowing. External member training was also undertaken to support the scrutiny role. A glossary of key treasury management terms is included at Annexe E.

6. In order to further support the work of the committee and also to provide assurance to the incoming S151 Officer in respect to this key function in respect of governance and compliance with CIPFA guidance, a number of review activities were undertaken during 2019/20 and reported to Audit Committee in November 2019. These were in the form of:

    - An evaluation undertaken by an external Treasury Management expert on governance and compliance with codes of practice. This was in the form of a Compliance, Evidence, Delivery and Review (CEDR) Report.
    - A periodic internal audit review of the Treasury function which primarily covered internal controls and
    - Treasury Management benchmarking information collated, albeit highlighting the risks of comparison.

7. Given the impact of Covid 19 late in 2019/20, the impact on treasury activities will be greater during 2020/21 and for future years Medium Term Financial Planning. However

in the last few weeks of March 2020 a number of actions were taken to ensure continuity and to ensure the authority was able to meet its payment obligations. These included:

- Implementation of the Treasury continuity plan to allow the function to be delivered remotely
- Additional borrowing and measures to support liquidity given significant volatility and concerns about liquidity in the financial markets at the time
- Activation of the HM Treasury Debt Management Office account in order to support the treasury team to manage the level of funds and to mitigate against counterparty risk.

Economic Background

8. Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused significant uncertainty during 2019/20. Economic growth during the year was volatile and inflation posed little concern being between 1.5% to 2.0%. Since the coronavirus outbreak however the closedown of whole sections of the economy is expected to result in a fall in GDP of at least 15% in quarter two, increases in unemployment, low inflation due to low wage growth and a significant reduction in the price of oil. UK interest rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets.

9. Bank rate remained stable at 0.75% for the majority of the year which allowed the Council a slight increase in return on investment balances. However following the COVID crises bank rate dropped to 0.25% on 11 March 2020 followed by an additional reduction to 0.10% on 19 March 2020. Further changes are not expected in the medium term. Borrowing rates continued their downward trend during the year.

10. PWLB rates are based on gilt (UK Government bonds) yields, however HM Treasury determining a specified margin to add to gilt yields. Yields were on a falling trend during 2019/20, however HM Treasury imposed two changes for PWLB rates during the year. The first in 1 October increasing the margins over gilts by 1% then partially reversing this on 11 March in respect of borrowing for the HRA. It also announced that there would be a consultation with local authorities on possibly further amending these margins.

11. The forecast is of little upward movement in PWLB rates over the next two years as it will take a prolonged period to recover momentum lost in the sharp recession resulting from the coronavirus shut down period. This is against a background of increasing national debt, which would normally result in increasing rates for borrowing.

Investments and Outturn

12. The Council's treasury investments include those arising from its own temporary cash balances as well as balances held from activities of Joint Committees such as the Cardiff Capital Region City Deal, for which it is the accountable body.

13. The management of the day-to-day cash requirements of the Council is undertaken in-house with credit advice from Link Asset Services, the Council's Treasury Management advisors. This may involve temporary borrowing pending receipt of income or the

temporary lending of surplus funds. Investment balances fluctuate daily and arise from a number of sources including differences in timing of revenue and capital cash flows, reserves, provisions and other balances held for future use.

14. The Council invests with institutions approved by Council as part of its Treasury Management Strategy and in accordance with investment guidelines established by the Welsh Government. As part of the Markets and Financial Instruments Directive II, the Council elected for 'professional' status. The categories, names, periods and size limits on the Council's approved investment list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers and monitored closely in conjunction with the Council's treasury advisors.

15. At 31 March 2020, investments stood at £127.6 million, with a short term investment strategy employed for most of the year. The Council's choice of investments maintained an approach of security, where the amount invested is that repayable. **Annexe B** shows with whom these investments were held.

16. A selection of performance indicators and benchmarking charts in relation to investments is included in **Annexe C.** The main areas to highlight at 31 March 2020 are as follows:-

- Counterparty exposure against the maximum allowed directly with an organisation. This shows that at 31 March 2020 no exposure limits set were breached. This was also the case during the course of the year.
- Investments held with different institutions as a percentage of the total shows that investments are diversified over a number of organisations and this was a strategy applied where possible during the course of the year.
- The geographic spread of investments as determined by the country of origin of relevant organisations. All investments are in sterling and countries are rated AA and above as per our approved criteria.

17. Using historic data adjusted for current financial market conditions, the probability of any default is low at circa 0.01% of the investments outstanding, i.e. £9,000.

18. All investments held at 31 March 2020 are deemed recoverable. Accordingly, no impairment losses are reflected in the Council's 2019/20 Statement of Accounts arising from the Council's treasury management activities.

19. The overall level of interest receivable from treasury investments totalled £1 million in 2019/20. The average returns achieved compared to industry benchmarks are shown in the table below.

	Return on Investment 2018/19		**Return on Investment 2019/20**	
	Benchmark 7day / 3month (%)	**Achieved (%)**	**Benchmark 7day / 3month (%)**	**Achieved (%)**
In-house	0.51/ 0.68	0.79	0.53/ 0.63	0.85

20. The benchmarks are the average of the 7 day London Interbank Bid Rate (LIBID) and 3 month LIBID respectively. These represent the average rate during the course of the year for investments for those periods. Performance exceeded benchmarks, due to availability of notice accounts offering higher deposit rates and undertaking longer term deposits where appropriate. The significant reduction in interest rates available for investments, had very little impact during 2019/20, but will be reflected in reduced income assumptions for 2020/21.

Borrowing and Outturn

21. Borrowing is undertaken to finance the Council's capital programme and manage any short term cash flow requirements. The main sources of borrowing are identified in the table below.

22. At 31 March 2020, the Council had £828.8 million of external borrowing. This was predominantly fixed interest rate borrowing payable on maturity.

31 March 2019			**31 March 2020**	
£m	**Rate (%)**		**£m**	**Rate (%)**
660.9		Public Works Loan Board	698.9	
51		Market (Lender Option Borrower Option)	51	
4.5		Welsh Government	16.1	
0		Local Authorities	58.3	
5.5		Other	4.5	
721.9	**4.53**	**Total External Debt**	**828.8**	**4.11**

23. Total interest payable on external debt during 2019/20 was £32.8 million of which £12.3 million was payable by the Housing Revenue Account (HRA). In total £39.0 million was set aside from General Fund and HRA revenue budgets in line with the Councils approved policy on prudent provision for debt repayment.

24. Extracts from the borrowing strategy approved by Council in February 2019 are shown below.

The Council's Borrowing Strategy for 2019/20 and the capital financing revenue budgets included in the MTFP will consider all options to meet the long-term aims of:

- *promoting revenue cost stability to aid financial planning and avoid a stop-start approach to service delivery, although it is recognised that this may have a financial impact*
- *pooling borrowing and investments to ensure the whole Council shares the risks and rewards of treasury activities*

- *ensuring borrowing plans are aligned to known capital expenditure spending plans and financial reserve levels and are also consistent with the prudent provision for the repayment of any capital expenditure paid for by borrowing*
- *achieving a balanced maturity profile*
- *having regard to the effects on current and future Council Tax and Rent Payers.*

External verses internal borrowing
Whilst interest rates for borrowing are greater than interest rates the Council receives for investments (the cost of carry), it makes financial sense to use any internal cash balances held in the short-term to pay for capital expenditure and minimise costs (Internal Borrowing), rather than undertake external borrowing. However, there is a risk that the Council may have to borrow at higher rates when it does actually need to borrow in future and so this position is kept under continuous review.

25. During 2019/20 borrowing of £111 million was undertaken and £4.2 million, primarily PWLB loans was repaid. The overall effect of these transactions during the year was to reduce the average rate on the Council's borrowing to 4.11% at 31 March 2020. New loans were undertaken as follows :
.
- Short term borrowing of £58.250 million to pay for expenditure on the acquisition of the Red Dragon Centre. Borrowing is generally not taken specifically for assets, but until a long term strategy is in place for this site, borrowing was undertaken to try and match known short term cash flows, where possible in this case over a one to three year period. Refinancing will need to be considered as certainty in respect of the site and linked arena proposals are developed
- PWLB borrowing of £40 million was undertaken during the year, with the Majority at the end of March. This was to reduce the internal borrowing requirement by locking into reduced long term rates given current uncertainty in financial markets; to strengthen liquidity of the Council particularly around concerns in relation to the COVID 19 position and also to utilise the recent reduction in PWLB rates towards HRA capital expenditure.
- A loan of £10 million received from Welsh Government for the proposed Housing SME fund of the Cardiff Capital Region City Deal. The Council in this case agreed to be the recipient of the repayable loan, subject to the development of final proposals for how the fund would operate and also the Council's liability would be mitigated. Subject to the outcome of this the Council retains the option to return this loan. A further £2.810 million of repayable Town Centre regeneration funding was also received in the year from Welsh Government.

26. As part of its loan portfolio, the Council has six Lender Option Borrower Option (LOBO) loans totalling £51 million. These are where the lender can request a change in the rate of interest payable by the Council on pre-determined dates. The Council at this point has the option to repay the loan. Apart from the option to increase rates these loans are comparable to PWLB and have no other complications such as variation in interest rates or complex terms.

27. Interest rates on the LOBO's held range between 3.81% and 4.35% which are not unreasonable and are below the Council's average rate of interest payable. Details of the loans are shown in the table below.

28. None of the LOBO's had to be repaid during 2019/20. £24 million of the LOBO loans are subject to the lender having the right to change the rate of interest payable during the next financial year. The Council has the right to refuse the change, triggering early repayment and the need to re-finance. This is a manageable refinancing risk as LOBO's form a relatively low proportion of the Council's overall borrowing at 6.15%.

£m	Rate	Potential Repayment Date	Option Frequency	Full Term Maturity
6	4.28%	21/05/2020	6 months	21/11/2041
6	4.35%	21/05/2020	6 months	21/11/2041
6	4.06%	21/05/2020	6 months	23/05/2067
6	4.08%	01/09/2020	6 months	23/05/2067
22	3.81%	21/11/2020	5 years	23/11/2065
5	4.10%	16/01/2023	5 years	17/01/2078

29. In accordance with the strategy, the Council has been in a position of undertaking internal borrowing which is when it uses temporary cash balances it holds in the short term instead of undertaking external borrowing. The level of internal borrowing is nil as at 31 March 2020, and this is confirmed by a comparison of the Council's external level of debt and Capital Financing Requirement at 31 March 2020 as shown later in this report.

Debt Rescheduling

30. No debt rescheduling or early repayment of debt was undertaken during 2019/20. The main obstacle remains the level of premium (penalty) that would be chargeable on early repayment by the PWLB. The premium payable on the balance of PWLB loans at 31 March 2020, which are eligible for early repayment (£659 million), is £623 million. This premium is payable primarily because:-

- Interest rates on loans of equivalent maturities compared to those held are currently lower
- A penalty rate or lower early repayment rate was introduced by HM Treasury in November 2007, which increased the cost of premiums and reduced flexibility of Local Authorities to make savings. This has been a significant thorn in the ability of local authorities to manage debt more effectively.

31. The Council has also offered the opportunity for early repayment of LOBO loans but any required premiums payable are unviable. Whilst the cost of premiums can be spread over future years, options for restructuring that have been considered previously, but result in an adverse Net Present Value (NPV). Whilst there may have been short terms savings, these were outweighed by potentially longer term costs and not deemed cost effective.

Compliance with treasury limits and prudential indicators

32. During the financial year the Council operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy. The actual outturn is shown in the following paragraphs and compared to the original estimates contained in the 2019/20 Budget Report. Future year's figures are taken from the Budget Report for 2020/21 and will be updated in the Budget Report for 2021/22.

Capital Expenditure

33. The "Prudential Code" requires the Council to estimate the capital expenditure that it plans to incur over the Medium Term. The actual capital expenditure incurred in 2019/20 and estimates of capital expenditure for the current and future years as set out in the Budget Report of February 2020 are as follows:-

Capital Expenditure								
	2019/20 Actual £m	**2019/20 Original Estimate £m**	**2020/21 Estimate Month 4 £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**
General Fund	123	99	102	137	196	169	59	27
Housing Revenue Account	42	47	53	57	88	87	56	62
Total	**165**	**146**	**155**	**194**	**284**	**256**	**115**	**89**

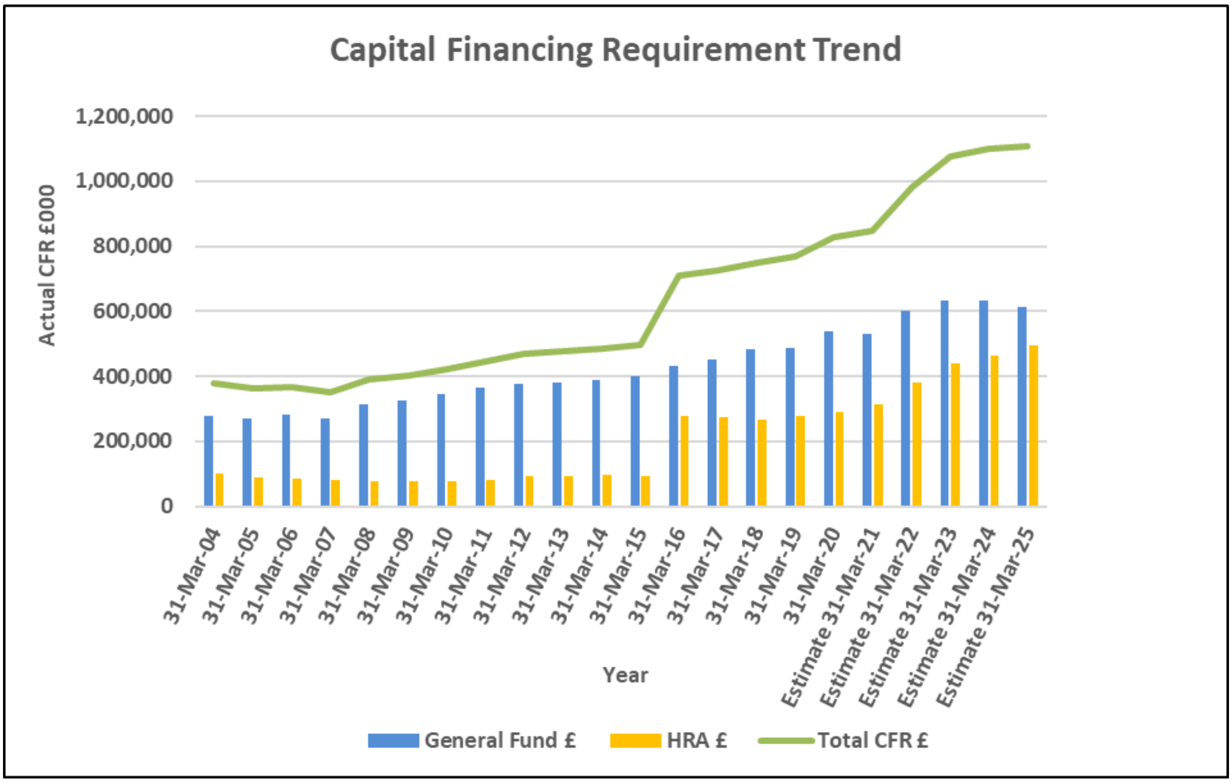
Capital Financing Requirement (CFR) – The Borrowing Requirement (Excluding Landfill Provision)

34. Where capital expenditure has been incurred without a resource to pay for it i.e. when proposed to be paid for by supported or unsupported borrowing, this will increase what is termed the Council's Capital Financing Requirement (CFR) which is the Council's underlying need to borrow. The Council is required to make a prudent provision for the repayment of historic capital expenditure from its revenue budget in line with its agreed policy. This reduces the CFR and the policy in respect to provision in relation to supported borrowing was changed in the 2020/21 budget and applied retrospectively to the 2019/20 financial year. Calculation of the CFR is summarised in the table below and results in the need to borrow money.

Movement	Opening Capital Financing Requirement (CFR)
+	Capital expenditure incurred in year
-	Grants, contributions, reserves and receipts used for capital expenditure
-	Prudent Minimum Revenue Provision and Voluntary Repayment
=	**Closing Capital Financing Requirement (CFR)**

35. The chart below shows the historic trend in the CFR including the Housing Revenue Account. The latter includes the £187 million payment made to HM Treasury to exit the

subsidy system in 2015/16. Future projections of the CFR are based on the timing of the Capital investment programme and resources deemed available to fund it.



36. The CFR as at 01 April 2019 was £788 million. The actual CFR as at 31 March 2020, estimates for current and future years (estimated in the February 2019 budget) are shown in the table below and exclude non cash backed provisions in relation to Landfill after care provision:-

Capital Financing Requirement (Excludes landfill provision)							
	2019/20 Actual £m	**2019/20 Original Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**
General Fund	539	492	532	601	634	634	615
Housing Revenue Account	290	309	314	381	441	464	493
Total CFR	**829**	**801**	**846**	**982**	**1,075**	**1,098**	**1,108**
External Debt	**829**						
Over / (Under) Borrowing	**0**						

37. The increase in the General Fund CFR for 2019/20 is as a result of the triggering of the affordability envelope set as part of the 2019/20 budget proposals in respect to the acquisition of the Red Dragon Centre site.

38. By comparing the CFR at 31 March 2020 (£829 million) and the level of external debt at the same point in time (£829 million), it can be seen that the Council is fully externally borrowed .i.e. it is not using internal cash balances to finance its capital expenditure as at 31 March 2020 (£45 *million at 31 March 2019).*

39. As set out in the February 2020 Budget Report, the CFR is forecast to increase over the next five years due to capital programme investment in existing assets, development of new affordable housing, and the 21st century schools programme. Forecasts will be updated in the 2021/22 Budget Report.

Actual External Debt

40. The Code requires the Council to indicate its actual external debt at 31 March 2020 for information purposes. This was £829 million as shown in the earlier paragraphs.

Affordable Borrowing Limit

41. The Council has a statutory duty under section 3 of the Local Government Act 2003 and supporting regulations to determine and keep under review how much it can afford to borrow and to enter into credit arrangements (the "Affordable Borrowing Limit"). This cannot be breached without Council approval. Council must have regard to the Prudential Code when setting this limit which is intended to ensure that total capital investment remains within sustainable limits and that the impact upon future council tax/rent levels is affordable.

42. During 2019/20 the Council remained within the authorised limit of £990 million set for that year.

Operational Boundary

43. The operational boundary is the estimated level of external borrowing set at the start of the year and is subject to the level and timing of borrowing decisions during the year. The actual level of borrowing can therefore be below or above this initial estimate, but what cannot be breached is the affordable borrowing limit mentioned above. The boundary was originally estimated to be £801 million at 31 March 2020, to match the forecast for the CFR when setting the 2019/20 budget in February 2019. The timing of borrowing decisions as well as the triggering of the affordability envelope for the acquisition of the Red Dragon Centre site during 2019/20 has resulted in the actual level of external debt as at 31 March 2020 being £829 million.

Maturity Structure of Fixed Rate Borrowing

44. The maturity structure remains within the limits below approved as part of the 2019/20 strategy below. These limits are set to avoid having large amounts of debt maturing in a short space of time, thus being exposed to significant liquidity risk and interest rate risk.

	31-Mar-19		Upper limit	31-Mar-20			
	Loans to Maturity			Loans to Maturity		Loans if LOBO's Paid Early	
	%	£m	%	%	£m	%	£m
Under 12 months	0.6	4.2	10	2.6	21.2	3.9	67.2
12 months and within 24 months	0.2	1.2	10	3.3	27.0	0.2	27.0
24 months and within 5 years	2.1	15.5	15	3.7	30.5	5.9	35.5
5 years and within 10 years	5.8	42	20	6.5	53.8	5.8	53.8
10 years and within 20 years	22.3	161	30	21.0	174.3	22.3	174.3
20 years and within 30 years	23.3	168	35	20.4	169.0	21.6	157.0
30 years and within 40 years	29.4	212.7	35	25.6	212.7	29.5	212.7
40 years and within 50 years	15.6	112.3	35	16.3	135.3	10.8	101.3
50 years and within 60 years	0.7	5	15	0.6	5.0	0	0

45. The maturity profile of the Council's borrowing as at 31 March 2020 is also shown in a chart in **Annexe D**. In the medium to long term, efforts will be made to restructure loans maturing in 2056/57 and to review LOBO maturities in order to reduce refinancing risk. Benchmarking undertaken has demonstrated that the Council's maturity profile is not inconsistent with other local authorities where information is available.

<u>Ratio of financing costs to net revenue stream</u>

46. This indicator identifies the trend in the cost of capital financing, showing the percentage of the Council's revenue budget that is committed for this purpose. Financing costs include:

- interest payable on borrowing and receivable on treasury investments
- penalties or any benefits receivable on early repayment of debt
- prudent revenue budget provision for repayment of capital expenditure paid for by borrowing and
- re-imbursement of borrowing costs from directorates in respect of Invest to Save/Earn schemes.

47. For the General Fund, net revenue stream is the amount to be met from non-specific WG grants and Council Tax, whilst for the HRA it is the amount to be met from rent payers.

Ratio of financing costs to Net Revenue Stream							
	2019/20 Original Estimate %	**2019/20** Actual %	**2020/21** Estimate %	**2021/22** Estimate %	**2022/23** Estimate %	**2023/24** Estimate %	**2024/25** Estimate %
General Fund – **Net** Capital Financing Budget	5.59	4.77	4.61	4.64	4.56	5.16	5.01
General Fund – **Gross** Capital Financing Budget	7.50	7.06	6.94	7.06	7.29	8.09	7.88
HRA	33.14	32.97	34.66	35.44	35.98	37.86	38.38

48. Although there may be short term implications, invest to save/earn schemes are intended to be net neutral on the capital financing budget. However there are risks that the level of income, savings or capital receipts anticipated from such schemes will be delayed or will not materialise. This would have a detrimental long term consequence on the Revenue budget and requires careful monitoring when considering future levels of additional borrowing.

49. Accordingly an additional local indicator is calculated for the general fund to support decision making and is shown in the table below for the period up to 2024/25. These indicators, which will be updated in the budget proposals report for 2021/22, show capital financing costs of the Council as a percentage of its controllable budget, excluding treasury investment income:

Capital Financing Costs as percentage of Controllable Budget									
	2011/12 Actual %	**2019/20** Original Estimate %	**2019/20** Actual %	**2020/21** Estimate %	**2021/22** Estimate %	**2022/23** Estimate %	**2023/24** Estimate %	**2024/25** Estimate %	**Difference** 11/12-24/25 %
Net	13.47	13.75	11.87	11.21	11.35	11.21	12.88	12.49	(7.28)
Gross	15.17	18.38	17.27	16.02	16.41	17.05	19.35	18.82	24.06

50. An increasing percentage indicates that a greater proportion of the controllable budget is required for capital financing costs which are committed in the long term. The requirement to meet these additional costs can only come from future savings or from increases in Council Tax. An increasing ratio limits the scope for additional borrowing in future years and reduces the Council's overall flexibility when making decisions on the allocation of its revenue resources. The percentages take into account the impact on the controllable base budget of the level of savings having to be found in 2020/21 and over the medium term.

Principal Invested for over 364 days

51. An upper limit for principal invested over 364 days was set at £90 million and this was not breached during the year, primarily due to the strategy adopted of minimising the period for which investments were made during 2019/20.

Treasury Management issues for 2020/21

52. Whilst this report is primarily backward looking, in relation to Treasury Activities for 2019/20, some key issues for 2020/21 are:

- The timing of external borrowing, the Council's longer term need to borrow and alternative sources for borrowing
- The outcome of a HM Treasury review of PWLB lending policy and consultation aimed to address significant levels of borrowing undertaken by some authorities to see a financial gain
- Maximising value from temporary cash balances whilst retaining liquidity to meet unforeseen risks in a low interest rate environment,
- Understanding the impact of changes in accounting practice now proposed for 2021/22 in respect to leasing and impact on indicators
- Financial market uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020, following the departure of the UK from the EU on 31 January 2020.

53. In accordance with the Council's Treasury Management Policy, Council will receive a further update on Treasury Management issues as part of the 2020/21 Mid-Year Treasury Management report in November 2020.

Christopher Lee
Corporate Director Resources
15 October 2020

The following Annexes are attached:-
Annexe A – Treasury Management Policy and Four Clauses of Treasury Management
Annexe B – Investments at 31 March 2020
Annexe C – Investment charts at 31 March 2020
Annexe D – Maturity analysis of debt as at 31 March 2020
Annexe E – Glossary of Treasury Management terms