Appendix 1 - Treasury Management Outturn Report 2019/20

Introduction

The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2019/20 was approved at a full Council meeting on 25 February 2019. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The 2017 Prudential Code includes a requirement for local authorities to provide 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 CIPFA's requirement, was approved by full Council on 25 February 2019.

External Context (provided by the Council's treasury management advisor, Arlingclose)

Economic background: The UK's exit from the European Union and future trading arrangements, had remained one of major influences on the UK economy and sentiment during 2019/20. The 29th March 2019 Brexit deadline was extended to 12th April, then to 31st October and finally to 31st January 2020. Politics played a major role in financial markets over the period as the UK's tenuous progress negotiating its exit from the European Union together with its future trading arrangements drove volatility, particularly in foreign exchange markets. The outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% y/y in February, below the Bank of England's target of 2%. Labour market data remained positive. The ILO unemployment rate was 3.9% in the three months to January 2020 while the employment rate hit a record high of 76.5%. The average annual growth rate for pay excluding bonuses was 3.1% in January 2020 and the same when bonuses were included, providing some evidence that a shortage of labour had been supporting wages.

GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed and production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.

Then coronavirus swiftly changed everything. COVID-19, which had first appeared in China in December 2019, started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global Financial Crisis as part of a flight to quality into sovereign debt and other perceived 'safe' assets.

In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% from 0.75% and then swiftly thereafter brought them down further to the record low of 0.1%. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK.

The US economy grew at an annualised rate of 2.1% in Q4 2019. After escalating trade wars and a protracted standoff, the signing of Phase 1 of the trade agreement between the US and China in January was initially positive for both economies, but COVID-19 severely impacted sentiment and production in both countries. Against a slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from of 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19 related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already on (or below) the floor, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

Financial markets: Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March sterling touch its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile. The flight to quality caused gilts yields to fall substantially. The 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March. The 10-year benchmark yield fell from 1% to 0.4%, the 20-year benchmark yield from 1.47% to 0.76% over the same period. 1-month, 3-month and 12-month bid rates averaged 0.61%, 0.72% and 0.88% respectively over the period.

Since the start of the calendar 2020, the yield on 2-year US treasuries had fallen from 1.573% to 0.20% and from 1.877% to 0.61% for 10-year treasuries. German bund yields remain negative.

Credit review: In Q4 2019 Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative. The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

After remaining flat in January and February and between a range of 30-55bps, Credit Default Swap spreads rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern. Spreads declined in late March and through to mid-April but remain above their initial 2020 levels. NatWest Markets Plc (non-ringfenced) remains the highest at 128bps and National Westminster Bank Plc (ringfenced) still the lowest at 56bps. The other main UK banks are between 65bps and 123bps, with the latter being the thinly traded and volatile Santander UK CDS.

While the UK and Non-UK banks on the Arlingclose counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks was cut to 35 days in mid-March.

Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and Non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-.

Local Context

On 31st March 2019, the Authority had net borrowing of £531.7m and £92.3m of investments. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £m	31.3.20 Actual** £m
General Fund CFR	383.9	449.2
HRA CFR	249.8	274.3
Total CFR	**633.7**	**723.5**
Less: *Other debt liabilities	-31.8	-28.2
Borrowing CFR - comprised of:	**601.9**	**695.3**
- External borrowing	388.8	531.7
- Internal borrowing	213.1	163.6

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt
**subject to audit

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 31st March 2020 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.03.19 Balance £m	Movement £m	31.03.20 Balance £m	31.03.20 Rate %
Long-term borrowing	365.8	140.9	506.7	3.76
Short-term borrowing	23.0	2.0	25.0	0.98
Total borrowing	**388.8**	**142.9**	**531.7**	**3.23**
Long-term investments	0.0	0.0	0.0	0.00
Short-term investments	15.0	0.0	15.0	1.07
Cash and cash equivalents	15.6	61.7	77.3	0.07
Total investments	**30.6**	**61.7**	**92.3**	**0.22**
Net borrowing	**358.1**		**439.4**	

Borrowing Update

On 9th October 2019 the PWLB raised the cost of certainty rate borrowing by 1% to 1.8% above UK gilt yields as HM Treasury was concerned about the overall level of local authority debt, and authorities making commercial debt for yield investments using PWLB funding.

The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new HRA loans to 0.80% above equivalent gilt yields: the value of this discount is 1% below the rate at which the authority usually borrows from the PWLB.

The consultation titled "Future Lending Terms" represents a frank, open and inclusive invitation, allowing key stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals on allowing authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield without impeding their ability to pursue their core policy objectives of service delivery, housing, and regeneration. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances. Haringey's capital programme does not contains projects of a predominantly 'debt for yield' nature.

The consultation was originally due to close on 4th June 2020, this was later extended to 31st July, with implementation of the new lending terms expected in the latter part of this calendar year or financial year beginning 2021/22. Haringey responded to the consultation individually, and officers were took part in a working group with London Councils which prepared a joint response on behalf of London Boroughs.

Borrowing strategy

At 31st March 2020 the Authority held £531.7m of loans, (an increase of £142.9m from 31st March 2019), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.19 Balance £m	Net Movement £m	31.03.20 Balance £m	31.03.20 Weighted Average Rate %	31.03.20 Weighted Average Maturity (years)
Public Works Loan Board	240.8	140.9	381.7	2.89	25.58
Banks (LOBO)	125.0	0.0	125.0	4.72	40.19
Banks (fixed-term)	0.0	0.0	0.0	0.00	0
Local authorities (long-term)	0.0	0.0	0.0	0.00	0
Local authorities (short-term)	23.0	2.0	25.0	0.98	0.93
Total borrowing	**388.8**	**142.9**	**531.7**	**3.23**	**27.86**

The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

As the Authority has an increasing CFR due to the capital programme and an estimated borrowing requirement, the Authority expected to carry out additional long term borrowing in 2019/20, and raised £150m of long term fixed rate loans from the PWLB in the year, with an average duration of 23 years and at an average rate of 1.72% which will provide longer-term certainty and stability to the debt portfolio. This borrowing was taken to fund the Council's growing underlying need to borrow from the capital programme, in conjunction with considerations around interest rates.

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and therefore a balanced portfolio of short- and long-term borrowing is maintained, as demonstrated in table 3 above.

LOBO loans: The Authority continues to hold £125m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

Treasury Investment Activity

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £24.3 and £101.4 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.03.19 Balance £m	Net Movement £m	31.03.20 Balance £m	31.03.20 Rate of Return %	31.03.20 Weighted Average Maturity days
Banks & building societies (unsecured)	0.0	0.0	0.0	0.00	0.0
Money Market Funds	0.0	0.0	0.0	0.00	0.0
UK Government:					
- Local Authorities	15.0	0.0	15.0	1.07	339.0
- Debt Management Office	15.6	61.7	77.3	0.07	1.0
Total investments	**30.6**	**61.7**	**92.3**	**0.23**	**55.9**

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 and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The table below shows counterparty credit quality as measured by credit ratings on the final day of each quarter during the year. The table also shows the percentage of the in-house investment portfolio exposed to bail-in risk. Bail-in is the response to the government bail-outs in the global financial crisis, when a number of banks failed and received government bail-outs in 2008. Under bail-in, unsecured deposits made with certain financial institutions would be at risk, should the institution fail, and investors would lose a portion of their invested funds. The below table shows a snapshot at a point in time, and movements in the figures do not reflect changes in policy or strategy, but are indicative of the Council's cashflows on that particular date.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
31.03.2019	3.37	AA	0%	122	0.77
31.03.2020	3.40	AA	0%	56	0.23
Similar LAs	**4.16**	**AA-**	**57%**	**108**	**-0.41%**
All LAs	**4.03**	**AA-**	**56%**	**48**	**-0.34%**

Scoring:
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

In a relatively short period since the onset of the COVID-19 pandemic, the global economic fallout was sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, businesses and individuals. Volatility measured by the VIX index was almost as high as during the global financial crisis of 2008/9 and evidenced in plummeting equity prices and the widening of corporate bond spreads, very close to rivalling those twelve years ago. Gilt yields fell but credit spreads widened markedly reflecting the sharp deterioration in economic and credit conditions associated with a sudden stagnation in economies, so corporate bonds yields (comprised of the gilt yield plus the credit spread) rose and prices therefore fell.

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government's (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Council lends money to third parties such as its subsidiaries, local businesses, local charities, local residents and its employees to support local public services and stimulate local economic growth. These are often treated as capital expenditure and included within the Council's capital programme. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, it will be ensured that any new loans made will remain proportionate to the size of the Authority. The Council also holds properties which are classified as 'investment properties' in the Council's statement of accounts. These properties are all within the local area, and the revenue stream associated with these (net of the costs of maintaining the properties) forms a modest part of the Council's annual budget, therefore contributing to the resources available to the Council to spend on local public services.

Balances as at 31.3.20 of non-treasury investments were as follows:

	31.03.20				
	Balance **£m**	**Loss Allowance** **£m**	**Balance** **£m**	**Weighted Average Rate of return** **%**	**Net Total Revenue** **£m**
Subsidiaries	16.9	-0.3	16.6	0.0	0.0
Local Businesses	4.7	-0.7	4.0	5.2	0.2
Local Charities	47.9	-43.5	4.3	3.0	0.1
Local Residents	0.1	0.0	0.1	4.0	0.0
Employees	0.1	0.0	0.1	0.0	0.0
Commercial Properties*	88.6	0.0	88.6	6.2	5.5
Total borrowing	**158.3**	**-44.6**	**113.7**		**5.9**

*for commercial properties this is the revenue generated from the properties less directly associated costs

The largest balance above relates to Alexandra Palace debts (shown under local charities). There is a large amount of historic debt that a provision was created for, however this has not been written off. The loans to local business include the opportunity investment fund, and a loan to a business who operates some of Haringey's leisure facilities.

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts for 2018/19 onwards are shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

The Authority assesses the risk of loss before entering into and whilst holding service loans by weighing up the service outcomes any such loan could provide against the creditworthiness of the recipient. This is done on a case by case basis, given the low number of such arrangements. This forms part of the Council's capital programme, further details of which are in the Council's annual medium term financial strategy.

<u>Budgeted Income and Outturn</u>

Treasury Investments generated an average rate of return of 0.70% in the year. The Council's treasury investment income for the year was £400k against a budget of £137k.

Borrowing costs for 2019/20 were £14.8m (£10.7m HRA, £4.1m General Fund) against a budget of £15.3m (£10.6m HRA, £4.7m General Fund).

Compliance

The Director of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	31.3.20 Actual £m	2019/20 Operational Boundary £m	2019/20 Authorised Limit £m	Complied?
Borrowing	531.7	702.4m	752.4m	Yes
PFI and Finance Leases	28.2	36.3m	39.9m	Yes
Total debt	**559.9**	**738.7m**	**792.3m**	Yes

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure, however Haringey's debt remained below this limit at all points in the financial year.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.03.20 Actual	2019/20 Target	Complied?
Portfolio average credit	3.40 (AA)	7.00 (A-)	Yes

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	31.03.20 Actual	2019/20 Target	Complied?
Total cash available within 3 months	£77.3m	£10.0m	Yes

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	**31.03.20 Actual**	**2019/20 Limit**	**Complied?**
Upper limit on one-year revenue impact of a 1% rise in interest rates	0.3m	£1m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	-0.3m	£1m	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Maturity structure of borrowing	Lower Limit	Upper Limit	31.03.20
under 12 months	0	50%	16.2%
12 months & within 2 years	0	40%	7.4%
2 years & within 5 years	0	40%	15.6%
5 years & within 10 years	0	40%	4.6%
10 yrs & within 20 yrs	0	40%	15.3%
20 yrs & within 30 yrs	0	40%	8.5%
30 yrs & within 40 yrs	0	50%	15.4%
40 yrs & within 50 yrs	0	50%	16.9%
50 yrs & above	0	40%	0

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Total short term borrowing: the Council has used short term borrowing (under 1 year in duration) from other local authorities extensively in recent years, as an alternative to longer term borrowing from PWLB, due to the lower interest rates, and corresponding revenue savings. Short term borrowing exposes the Council to refinancing risk: the risk that interest rates rise quickly over a short period of time, and are at significantly higher rates when loans mature and new borrowing has to be raised. With this in mind, the Authority has set a limit on the total amount of short term local authority borrowing, as a proportion of all borrowing.

Short term borrowing	**Limit**	**31.03.20 Actual**	**Complied?**
Upper limit on short term borrowing from other local authorities as a percentage of total borrowing	30%	5%	Yes

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2019/20	**2020/21**	**2021/22**
Actual principal invested beyond year end	0.0m	0.0m	0.0m
Limit on principal invested beyond year end	£10.0m	£10.0m	£10.0m
Complied?	Yes	Yes	Yes