Civic Centre, Castle Street,
Merthyr Tydfil CF47 8AN

Main Tel: 01685 725000 www.merthyr.gov.uk

FULL COUNCIL REPORT

Date Written	22nd January 2021
Report Author	Adele Lewis
Service Area	Accountancy
Exempt/Non Exempt	Non Exempt
Committee Date	24th February 2021

To: Mayor, Ladies and Gentlemen

Treasury Management Outturn Report 2019/20

1.0 SUMMARY OF THE REPORT

1.1 The Treasury Management Outturn Report outlines the Council's performance in respect of:

- The management of the organisation's cash flows, its banking, money market and capital market transactions.
- The effective control of the risks associated with those activities.
- The pursuit of optimum performance consistent with those risks.

2.0 RECOMMENDATIONS that

2.1 The Treasury Management Outturn Report for 2019/20 be received.

2.2 The actual 2019/20 Treasury Indicators be received.

3.0 INTRODUCTION AND BACKGROUND

3.1 The Treasury Management Outturn Report for 2019/20 is attached at Appendix A, for Members' attention. This report is a requirement of the Chartered Institute for Public Finance and Accountancy's Code of Practice on Treasury Management.

3.2 The Council employs Arlingclose as its Treasury Management consultant to give specialist advice on all Treasury Management matters including borrowing and investment requirements. This advice has been followed in producing the Treasury Management Outturn Report.

4.0 FINANCIAL IMPLICATION(S)

4.1 Financial and performance information is included within the body of the report.

5.0 INTEGRATED IMPACT ASSESSMENT

	Positive Impacts	**Negative Impacts**	**Not Applicable**
1. Merthyr Tydfil Well-being Objectives	4 of 4	0 of 4	0 of 4
2. Sustainable Development Principles - How have you considered the five ways of working: • Long term • Prevention • Integration • Collaboration • Involvement	5 of 5	0 of 5	0 of 5
3. Protected Characteristics *(including Welsh Language)*	0 of 10	0 of 10	10 of 10
4. Biodiversity	0 of 1	0 of 1	1 of 1

Summary:

The main positive impacts are that the Treasury Management Policy and Annual Investment strategy supports the Council to achieve its Well-being Objectives through its Treasury Management Activities.

ELLIS COOPER
CHIEF EXECUTIVE

COUNCILLOR ANDREW BARRY
CABINET MEMBER FOR GOVERNANCE AND CORPORATE SERVICES

BACKGROUND PAPERS		
Title of Document(s)	**Document(s) Date**	**Document Location**
Prudential Indicators 2019/20	Council 4th March 2019	Accountancy/Intranet Committee Agendas and Minutes
Treasury Management Policy and Annual Investment Strategy 2019/20	Council 4th March 2019	Accountancy/Intranet Committee Agendas and Minutes
Audited Statement of Accounts for Year Ended 31st March 2020	25th November 2020	Accountancy/Intranet Committee Agendas and Minutes
Final Accounts Working Papers 2019/20	April 2020 to November 2020	Accountancy
Does the report contain any issue that may impact the Council's Constitution?		**No**

Consultation has been undertaken with the Corporate Management Team in respect of each proposal(s) and recommendation(s) set out in this report.

Appendix A

MERTHYR TYDFIL COUNTY BOROUGH COUNCIL ANNUAL TREASURY REPORT 2019/20

1.0 Introduction

1.1 In March 2010 the Authority 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.

1.2 The Authority's treasury management strategy for 2019/20 was approved at full Council on 4th March 2019.The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested sums and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

1.3 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.

1.4 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 4th March 2019.

2.0 External Context

2.1 Appendix 1 outlines an Economic Commentary for the 2019/20 financial year.

3.0 Treasury Management Summary

3.1 On 31st March 2020, the Authority had net borrowing of £97m arising from its revenue and capital income and expenditure. 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

Description	31st March 2020 £'000
General Fund CFR Less: *Other debt liabilities	104,060 (58)
Borrowing CFR	**104,002**
External borrowing	(110,251)
Internal (over) borrowing	**(6,249)**
Less: Usable reserves	**(15,788)**
Less: Working capital	**9,173**
Net (borrowing/investments)	**(12,864)**

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 as at 31st March 2020 and change during the year is shown in table 2 below.

Table2 Treasury Management Summary

Description	31st March 2019 £'000	2019/20 Movement £'000	31st March 2020 £'000	Rate/ Return %
Long term borrowing	59,751	(3,544)	56,207	6.25
Short term borrowing	44,535	9,509	54,044	1.42
Total Borrowing	**104,286**	**5,965**	**110,251**	**3.88**
Long term investments	10	0	10	0.00
Short term investments	10,078	2,776	12,854	0.75
Total Investments	**10,088**	**2,776**	**12,864**	**0.75**
Net Borrowing	**94,198**	**3,189**	**97,387**	**4.30**

4.0 Borrowing update

4.1 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. PWLB borrowing remains available but the margin of 180bp above gilt yields appears relatively very expensive. Market alternatives are available and new products will be developed; however, the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

4.2 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:

- £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

- 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.

4.3 The consultation closed on 4th June 2020 with implementation of the new lending terms expected in the latter part of this calendar year or financial year beginning 2021/22.

5.0 Borrowing Activity

5.1 At 31st March 2020, the Authority held £110m loans, an increase of £6m to the previous year. The year-end borrowing position and the year on year change is shown in table 3 below:

Table 3 Borrowing Position

Description	31st March 2019 £'000	2019/20 Movement £'000	31st March 2020 £'000	Rate/ Return %
Public Works Loan Board	48,948	(3,187)	45,761	7.08
Banks (Lender's Option Borrower's Option Loans)	12,000	0	12,000	4.50
Banks (fixed-term)	0	0	0	0.00
Local authorities (short-term)	41,000	9,500	50,500	0.99
Other	2,338	(348)	1,990	0.00
Total Borrowing	**104,286**	**5,965**	**110,251**	**3.88**

5.2 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.

5.3 With short-term interest rates remaining much lower than long-term rates, the Authority considered it to be more cost effective in the near term to use short-term loans instead. The net movement in temporary/short term loans is shown in table 3 above.

5.4 The Authority continues to hold £12m of LOBO (Lender's Options Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at 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.

6.0 Treasury Investment activity

6.1 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 £10 million and £23 million due to timing differences between income and expenditure. The investment position is shown in table 4 below

Table 4 Investment Position

Description	31st March 2019 £'000	2019/20 Movement £'000	31st March 2020 £'000	Rate/ Return %
Banks	78	2,776	2,854	0.50
Building Societies	10,000	(10,000)	0	0.00
Government (inc local authorities)	0	10,000	10,000	0.83
Other	10	0	10	0.00
Total investments	**10,088**	**2,776**	**12,864**	**0.76**

6.2 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 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.

7.0 Non-Treasury Investments

7.1 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 Authority has an investment (Gellideg Housing Co-operative) made for service purposes which is currently valued at £408,000 (as at 31st March 2020), the terms of the investment are that it is cost neutral for the Authority. A full Council report on the Gellideg Housing Co-operative project was reported on the 25th February 2015. The Council also participates in the Empty Homes and Vibrant and Viable Places Loans schemes funded by the Welsh Government.

8.0 Treasury Performance

8.1 The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget as shown in table 5 below.

Table 5 Performance

Description	2019/20 Estimate £'000	Outturn £'000
Public Works Loan Board Loans	3,693	3,475
Lender's Option Borrower's Option Loans	540	540
Short Term Borrowing	295	310
Short Term Investments	(155)	(134)
Total Borrowing	**4,373**	**4,191**

8.2 The outturn for debt interest paid in 2019/20 was £4.1m against a budgeted interest of £4.4m as explained above.

8.3 Public Works Loan Board Loans interest was lower than estimated with Short Term Borrowing interest higher, this was due to the decision taken to borrow short term at lower interest rates.

9.0 Compliance Report

9.1 The Chief Finance Officer is pleased to report 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, with the exception detailed in table 7 below.

Table 6 Debt limits

Description	2019/20 Maximum £'000	31.3.20 Actual £'000	2019/20 Operational Boundary £'000	2019/20 Authorised Limit £'000	Complied
Borrowing	110,721	110,309	116,045	127,648	✓

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 cashflow, and this is not counted as a compliance failure.

Table 7 Investment Limits

Description	2019/20 Maximum £'000	31.3.20 Actual £'000	2019/20 Limit £'000	Complied
Banks and Building Societies	6,998	0	5,000	☒
UK Local Authorities	5,000	5,000	5,000	✓
UK Government	5,000	0	As required	✓

The Authority exceeded the £5 million pound investment limit for one organisation with the Authority's own Bank Account when the Authority was unable to place money in the market, this happened on four occasions during the year. The Authority has since opened an account with the UK Government, a Debt Management Account to avoid this happening in the future.

10.0 Treasury Management Indicators

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

10.1.1 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 in interests was:

Description	31.3.20 Actual £'000	2019/20 Limit £'000	Complied
Upper limit on one year revenue impact of a 1% rise in interest rates	155	345	✓

10.1.2 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 borrowing were:

Description	31.3.20 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	60%	80%	0%	✓
12 months and within 24 months	3%	20%	0%	✓
24 months and within 5 years	7%	25%	0%	✓
5 years and within 10 years	8%	25%	0%	✓
10 years and above	21%	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.

10.1.3 Principal Sums invested for Periods longer than 364 days:

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. Long-term principal sum invested to final maturities beyond the period end were:

Description	2019/20	2020/21	2021/22
Principal Sums Invested for Periods Longer than 364 days	0	0	0
Complied	✓	✓	✓

11.0 Other

11.1 IFRS 16: CIPFA/LASAAC has proposed delaying the implementation of the new IFRS 16 Leases accounting standard for a further year to 2021/22.

Appendix 1

External Context *(Data as at 24/04/2020)*

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-.