CABINET

17 November 2020

Title: Treasury Management 2020/21 Mid-Year Review	
Report of the Cabinet Member for Finance, Performance and Core Services	
Open Report	**For Decision**
Wards Affected: None	**Key Decision:** Yes
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Accountable Director: Philip Gregory, Finance Director (S151 Officer)	
Accountable Strategic Leadership Director: Claire Symonds, Acting Chief Executive	

Summary

Regulation changes have placed greater onus on elected Members in respect of the review and scrutiny of treasury management policy and activities. This mid-year review report provides details of the mid-year position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly on 17 February 2020 as part of the Treasury Management Strategy Statement for 2020/21.

Recommendation(s)

The Cabinet is asked to recommend the Assembly to note:

(i) The Treasury Management Strategy Statement Mid-Year Review 2020/21;

(ii) That the value of the treasury investments as at 30 September 2020 totalled £241.1m;

(iii) That the treasury investment strategy outperformed its peer group, with a return of 1.50% against an average of 0.48% for London Local Authorities and 0.34% for the total comparable population of 211 Local Authorities;

(iv) That the value of the commercial and residential loans lent by the Council as at 31 March 2020 totalled £171.0m;

(v) That the value of long term borrowing as at 30 September 2020 totalled £945.8m, of which £275.9m related to the Housing Revenue Account and £669.9m to the General Fund;

(vi) That the value of short term borrowing as at 30 September 2020 totalled £99.5m;

(vii) That interest would be capitalised on long term developments of over £10m, effective from 1 April 2019; and

(viii)	That in the first half of the 2020/21 financial year, the Council complied with all 2020/21 treasury management indicators.
Reason(s) To accord with the requirements of the Local Government Act 2003.	

1. Introduction and Background

1.1 The Council operates a balanced budget whereby cash raised during the year meets the Council's cash expenditure needs. Part of the treasury management operations is to ensure this cash flow is adequately planned, with surplus monies invested with counterparties of an appropriate level of risk, providing adequate liquidity before considering maximising investment return.

1.2 A second main function of treasury management is the funding of the Council's capital programme. These capital plans provide a guide to the Council's borrowing need, which is essentially the use of longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging loans, using cash flow surpluses, or restructuring debt to meet Council risk or cost objectives.

1.3 A third main function of treasury management is the funding and treasury advice that is required for the Council's Investment and Acquisitions Strategy (IAS).

1.4 In accordance with the Chartered Institute of Public Finance Accountancy's (CIPFA) Code of Practice for Treasury Management, there should be a review of that strategy at least half yearly. The principal requirements of the Code include:

1) Maintain a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management.
2) Maintain a Treasury Management Practices which set out the how the Council will seek to achieve those policies and objectives.
3) Receipt by full Council of a Treasury Management Strategy Statement, (TMSS) including the Annual Investment Strategy and Minimum Revenue Provision (MRP) Policy for the year ahead; a Mid-Year Review Report (this report); and an Annual Report covering activities during the previous year.
4) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5) Delegation by the Council to a specific named body, for this Council this is Cabinet, to scrutinise the treasury management strategy and policies.

1.5 This mid-year report has been prepared in compliance with CIPFA's Code of practice on Treasury Management, and covers the following:

1) Introduction and Background;
2) Economic Update and Interest Rate Forecast;
3) Council's Cash, Interest Budget and Debt Position as at 30 September 2020;
4) Investment Portfolio as at 30 September 2020;
5) Investment Strategy Performance and Benchmarking;
6) Loans and IAS Income Forecast as at 30 September 2020;

7) Accounting Policy change to interest costs; and
8) The Council's Capital Position (Prudential Indicators).

2. Economic Update and Interest Rate Forecast

2.1 The Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- Fall in GDP in the first half of 2020 was revised from -28% to -23% (subsequently revised to -21.8%).

- Peak unemployment rate revised down from 9% in Q2 to 7½% by Q4 2020.

- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022.

2.2 It also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including QE and the use of forward guidance.

2.3 The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

2.4 Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

2.5 There will be some painful longer-term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services is an area that has already seen huge growth.

2.6 One key addition to the Bank's forward guidance was a new phrase in the policy statement, namely 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". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, 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 if it takes no action to raise Bank Rate

2.7 **Interest Rate Forecast.** The Council's treasury advisor, Link Group, provided the following forecasts on 11th August 2020 (PWLB rates are certainty rates):

Link Group Interest Rate View 11.8.20										
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at subsequent meetings, although forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023.

2.8 PWLB Rates

HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019/20 without any prior warning. The first on 9 October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was partially reversed for some forms of borrowing on 11 March 2020, but not for mainstream General Fund capital schemes. A consultation with local authorities on amending these margins was completed on 31 July 2020, with the Council providing a response. It is clear HM Treasury will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

The current margins over gilt yields for PWLB rates are:

- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation; however, the timing of such a change is currently an unknown, although likely to be within the current financial year.

There is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

3. Council's Cash Position as at 30 September 2020

3.1 Table 1 details the Council's mid-year treasury position. Overall, the Council's borrowing has decreased since 31 March 2020 as short-term borrowing requirements reduced and approximately £9m of long-term debt was repaid to the PWLB. The average cost of GF debt is 1.98% for a total of £669.9m of borrowing. A transfer of debt from the GF to the HRA of £24.3m to fund the street purchases is still to be actioned but will confirmed prior to year end.

Treasury investments have reduced from £347.0m as at 31 March 2020 to £241.1m as at 30 September 2020, with the average rate increasing from 1.34% to 1.50%. The average rate is as per the forecast. Commercial Loans to subsidiaries and to Reside total £171.0m at an average rate of 3.35%.

Table 1: Council's Treasury Position at 30 September 2020

	Principal Outstanding £000s	Rate of Return	Average Life (yrs)
HRA Fixed Rate Borrowing			
PWLB	265,912	3.50%	35.31
Market Loans	10,000	3.98%	57.7
Total HRA Debt	**275,912**	**3.51%**	**37.12**
General Fund Fixed Rate Borrowing			
PWLB	454,216	2.16%	25.3
Market Loans	116,166	2.75%	29.18
Short Term Borrowing	99,500	0.27%	0.25
Total General Fund Debt	**669,882**	**1.98%**	**22.25**
Short-Term Investments	(7,811)	0.06%	-
Financial Institutions	(25,000)	1.40%	0.78
Local Authorities	(208,250)	1.57%	1.06
Total Investment Income	**(241,061)**	**1.50%**	**0.93**
Commercial and Reside Loans	**(171,020)**		

3.2 Overall the Council has reduced the level of cash it holds as reinvestment rates are currently very low and as the Council already had an elevated level of cash at the start of the financial year. Borrowing has also reduced as expenditure on capital was lower than expected for the first half of the financial year and due to receipt of education funding for prior year capital spend. Treasury are also waiting for the outcome of the PWLB consultation before making any significant long-term borrowing decisions.

3.3 A loan and equity investment of £46.5m was made in 2020/21 to enable the purchase of the Muller Site in Chadwell Heath and a further payment of £6m payment was made for Welbeck.

3.4 Historically the Council has not capitalised interest costs on borrowing and these costs have been charged to the revenue accounts. The Council will adopt an accounting policy of capitalising interest for 2019/20 onwards. The impact of this on the Council is outlined in section 10.

4. Interest and IAS Position as at 30 September 2020

4.1 The funding of the IAS will require a significant amount of borrowing. Pressure on the net interest budget could be from:

- a delay in developments becoming operational, delaying interest receivable;
- an increase in borrowing requiring more interest payable than forecast; and
- a drop in treasury returns through lower returns or lower investible cash.

4.2 Table 2 below provides the latest interest receivable and payable budgets forecast and the IAS return forecast for the Council. The current net interest forecast is for a large underspend of £1.572m, predominantly due to higher than forecast income of £2.436m from treasury investments and loans. There is an overspend in interest payable of £0.864m as a result of the full year effect of treasury borrowing more towards the end of 2019/20 year.

Table 2: General Fund (GF) Interest Budget Forecast 2020/21

Interest Forecast	2020/21 Forecast		IAS Forecast	2020/21 Forecast
	£'000s			£'000s
GF Interest Payable Budget	12,867			
GF Interest Payable Forecast	13,731		**IAS Target**	**(5,725)**
Surplus / (Deficit)	**(864)**			
			Commercial Income	(2,275)
GF Interest Receivable Budget	(6,503)		Reside	(1,605)
GF Interest Receivable Forecast	(8,939)		Other Income	(311)
Surplus / (Deficit)	**2,436**		**Total IAS Income**	**(4,191)**
Net Surplus / (Deficit)	**1,572**		**Surplus / (Deficit)**	**(1,534)**
Combined Surplus / (Deficit)	**38**			

4.3 The IAS is forecasting a shortfall of £1.534m, due to a delay in a number of schemes, an increase in Reside costs and a provision for losses on income. A number of loans from the Council to Reside are included as interest receivable and as a result the interest and IAS forecast are combined to produce an overall net position, which is forecast to be a surplus to the Council of £38k against budget.

4.4 The IAS has received significant income contributions from rental received from land assembly purchases on Thames Road and from commercial loans made for the purchase of Muller and for LEUK. Although this is short-term income received during land assembly, this income has provided additional support to the IAS and allows for the costs of borrowing to be covered for part of the development.

4.5 Only Becontree Heath was completed and operational during the first six months of the financial year, with Weighbridge due to be operational in October 2020. Progress has been made on the Film Studio development and on Welbeck Wharf and these should provide additional support to the IAS and interest budgets.

4.6 Overall the treasury and IAS strategy are forecast to provide a combined income of £13.130m against a total general fund forecast borrowing cost of £13.731m.

5. Debt Position as at 30 September 2020

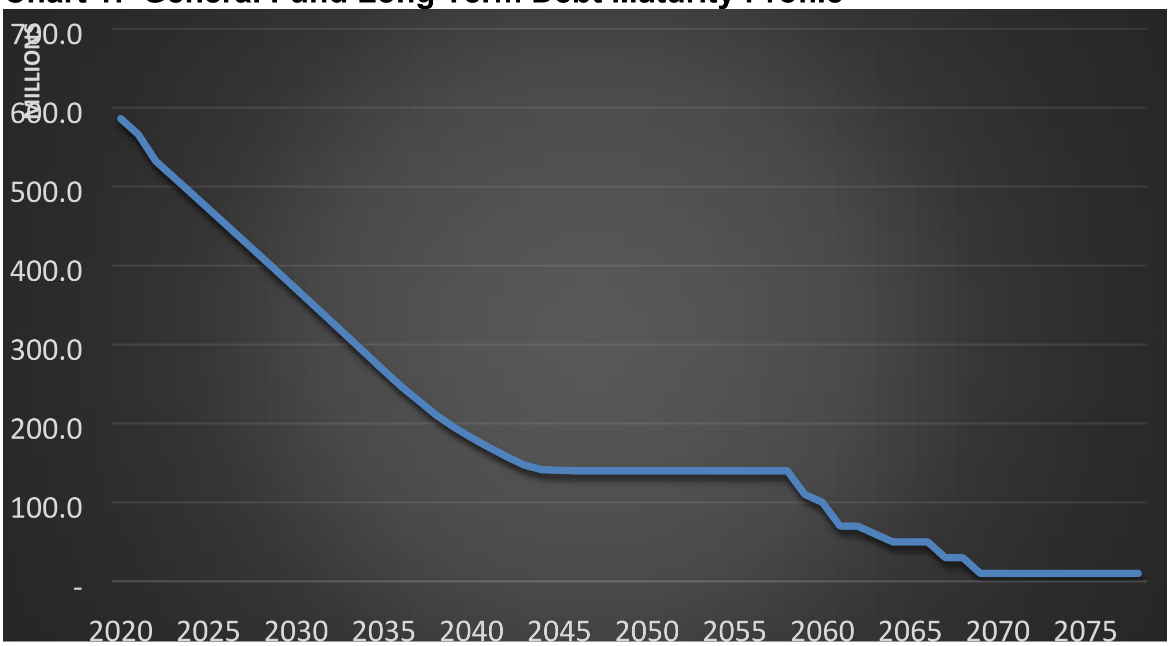
5.1 The total GF borrowing was £669.9m, with £275.9m of HRA borrowing (prior to a transfer of debt from the GF to the HRA of £24.3m to fund the street purchases). The total borrowing as at 30 September 2020 was £945.8m. Ensuring low cost of carry and debt repayment is at the forefront of any borrowing decisions.

5.2 Although the size of the Council's overall borrowing is significant, Members are asked to note that the majority of debt includes a repayment profile and that the repayment is linked to income streams that are sufficient to cover the interest costs and debt repayment.

As an example, the EIB borrowing of £89m is an annuity repayment (AP), which means that over the 30-year duration of the loan, a proportion of the loan will be repaid each year. Currently the balance owed on the EIB loan is £79.4m, with all repayment made from returns from the investment strategy, including Abbey Road and Weavers. In addition, £344.0m of the long-term PWLB borrowing is Equal Instalment Payments (EIP) or AP, which involves the repayment of a portion of the debt each year for the duration of the loan. As a result, the Council has a loan repayment profile that is similar to its forecast property debt repayment schedule.

5.3 The Council's current GF long term borrowing repayment schedule is outlined in Chart 1 below:

Chart 1: General Fund Long Term Debt Maturity Profile



5.4 <u>Debt Repayment and Rescheduling</u>

For the first half of the financial year, the treasury section has repaid approximately £9m of long-term borrowing through equal instalment repayments. In addition, short-term borrowing reduced from £126.1m as at 31 March 2020 to £99.5m as at 30 September 2020.

Debt rescheduling opportunities are limited in the current economic climate and no debt rescheduling was undertaken during the first six months of the financial year.

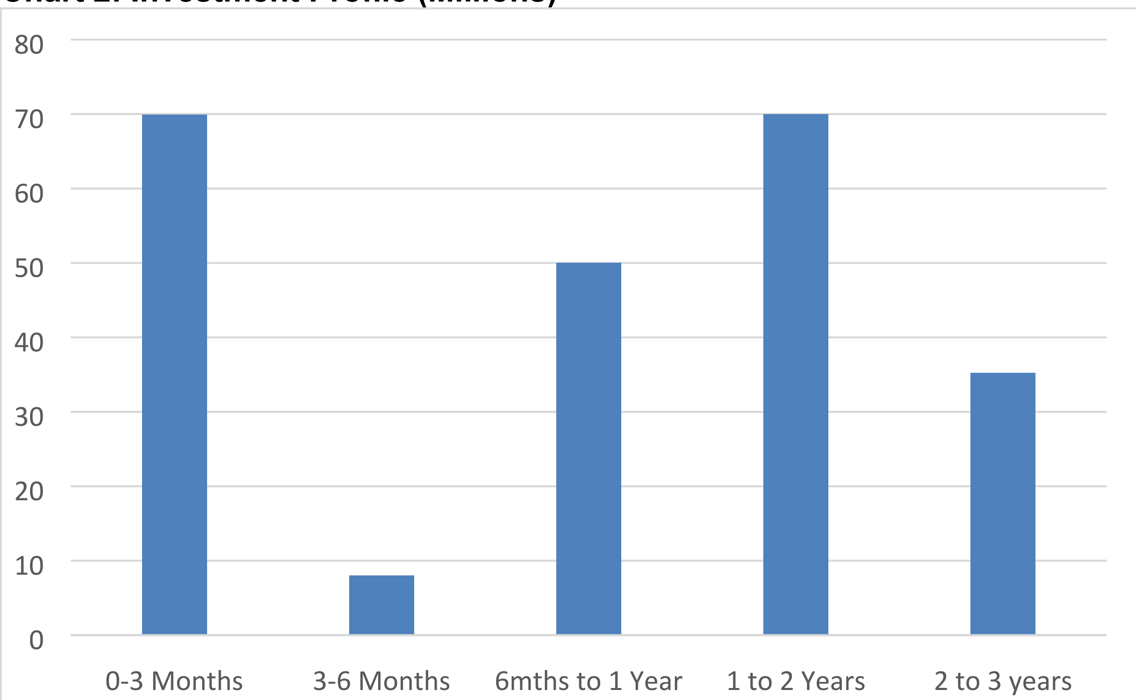
6. Treasury and Loan Portfolio at 30 September 2020

6.1 It is the Council's priority to ensure security of capital and liquidity before obtaining an appropriate level of return which is consistent with the Council's risk appetite. In the current economic climate, the Council's risk appetite remains relatively low, with the treasury section looking to take advantage of the fluctuations in rates offered by Local Authorities and Financial Institutions to lock in favourable rates without the need to take on significant additional risk.

6.2 As at 30 September 2020 the Council held £241.1m in cash, with £208.3m invested with Local Authorities and £25.0m held in deposits with banks. The Council also held a short-term position of £7.8m to cover liquidity risk but also for the purchase of Heathway Mall, Dagenham, which was completed on 1 October 2020.

6.3 The Council's investment maturity profile in Chart 2 below shows that, as at 30 September 2020, 30.0% of the Council's investments had a maturity of 3 months or less, with 54.9% having a maturity of one year or less. Spreading out the maturity of longer dated investments allows the Council to take advantage of improved rates of return while ensuring sufficient liquidity.

Chart 2: Investment Profile (Millions)



6.4 Due to the economic uncertainty caused by Covid-19, treasury has sought to reduce the Council's exposure to banks and has reduced its investments in banks from £85m as at 31 March 2020 to £25m as at 30 September 2020, with any significant bank exposure limited to Lloyds Banking Group.

6.5 The Council has maintained an elevated cash position for a number of years, but it is likely that this will reduce significantly over the next two years as treasury investments mature and are invested in the Council's IAS. This will reduce the treasury investments but see a large increase in the loans and investments held by the Council, with the majority of loans and investments backed by assets.

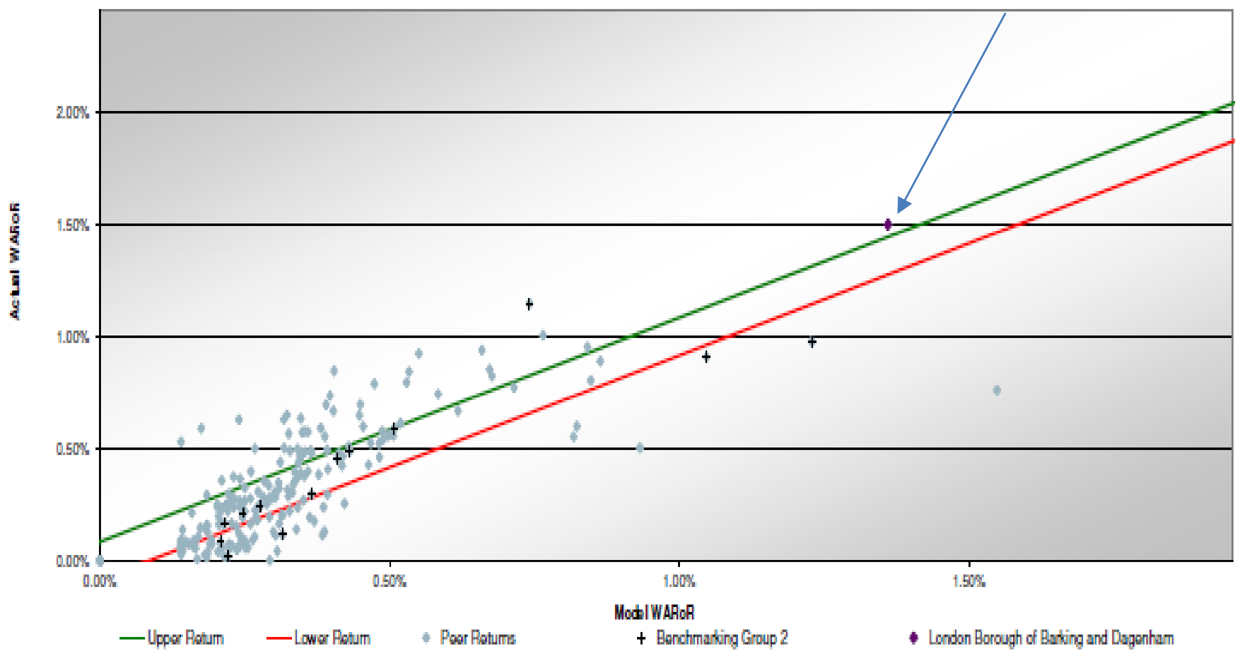
7. Treasury Investment Strategy Performance and Benchmarking

7.1 Although yields have reduced to historically low levels over the first half of the financial year, several opportunistic investments have resulted in a stable average rate of return of **1.51%** for the first six months of the year. The rate as at 30 September 2020 is **1.50%** and will likely increase for the reminder of the year.

7.2 The Council currently has a significant cash balance of £241.1m. As investment returns are very low, this cash position will be reduced over the remaining part of the year to under £200m. The reduced balance will see an increase in the average interest rate as investments maturing in 2020/21 are, on average, providing a lower return than some of the longer dated investments. The reduction in the Council's cash position will continue into 2021/22 as the Council continues to invest in its IAS.

7.3 The treasury investment strategy, which excludes property investments, loans to subsidiaries and the pension prepayment, continues to outperform its peer group, with a return of 1.50% against an average of 0.48% for London LAs and 0.34% for the total comparable population of 211 LAs. This is highlighted in chart 3 below, where the Council outperforms the other LAs and is above the upper bandings based on the duration taken. Based on a £241.1m balance, the Council earns £3.62m compared to £1.16m for London LAs and £0.82m for all LAs in the universe.

Chart 3: Population Returns against Model Returns (at 30 September 2020)



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
London Borough Of Barking And Dagenham	1.50%	1.36%	0.14%	1.28%	1.44%	Above

7.4 The main drivers behind this strategy is to minimise the cost of borrowing and risks and also to match the funding of the IAS, which requires more cash in 2020/21 and onwards, when a large part of the construction payments will be made. The strategy has a significantly lower credit risk of 1.31 against a London LA average of 2.27 and 2.64 for 211 LAs in the universe, which means the Council is getting a higher return while also having a much lower credit risk exposure.

8. Commercial and Reside Loans

8.1 In addition to its treasury investments, the Council has several loans to its subsidiary companies, residential property loans to Reside and a prepayment to the pension fund. These loans all have an agreed loan and a commercial interest repayment schedule agreed. As at 31 March 2020 the Council's commercial loans and loans to Reside totalled £171.0m and are summarised in table 4 below:

Table 4: Commercial and Reside Loans at 31 March 2020

Reside Company	Loan Type	Value £000s
Dagenham & Redbridge FC	Commercial Loan	98.50
BARKING RIVERSIDE LTD	Commercial Loan	5,500.00
BD ENERGY LTD	Commercial Loan	296.70
BD ENERGY LTD	Commercial Loan	2,544.70
BD Muller Developments	Commercial Loan	23,153.70
BD Muller Developments	Equity	23,349.00
BD TRADING PARTNERSHIP LEUK	Commercial Loan	23,314.50
BE-FIRST LTD	Commercial Loan	4,439.30
Gascoigne Primary School	Commercial Loan	71.40
Grafton Primary School	Commercial Loan	68.50
Southwood Primary	Commercial Loan	50.50
TPFL Regeneration Ltd	Commercial Loan	19.80
VALENCE PRIMARY SCHOOL	Commercial Loan	84.00
LBBD Pension Fund	Pension Fund Prepayment	42,100.00
Reside Abbey Roding LLP	Reside Loan	67.40
Reside Ltd	Reside Loan	288.60
Reside Regeneration LLP	Reside Loan	170.00
Reside Regeneration LLP	Reside Loan	6,439.50
Reside Regeneration Ltd	Reside Loan	65.90
Reside Weavers LLP	Reside Loan	34,473.90
Reside Weavers LLP	Reside Loan	93.30
Reside Weavers LLP	Reside Loan	2,200.70
Reside Weavers LLP	Reside Loan	1,423.00
B&D Reside Roding ltd	Reside Loan	706.80
Total		**171,019.70**

8.2 The majority of the loans outlined above are secured against an asset. Where the loan is unsecured the company is closely monitored to ensure that it remains viable.

8.3 Loans against residential properties (Reside Loans) are very long term, with the loan duration of up to 55 years (to match the asset life of the asset it is secured against). A repayment schedule, based on an annuity repayment, is in place for each loan.

8.4 Commercial loans durations vary, with some loans to schools maturing in 15 years but most of the loans have a maximum duration of 5 years. Each loan has a state aid compliant interest rate and have been agreed at Cabinet.

8.5 The Pension Fund amount is a prepayment of pension contributions totalling £40m and also includes a short-term loan. The prepayment provides the pension fund with cash, which it uses to fund investments in infrastructure but also provides a return to the Council from making the payment early. Each month a portion of the loan is repaid and the actual contribution for the month is paid by the Council to ensure that the correct contribution rate is paid to the pension fund.

9. IAS Income Forecast

9.1 The current forecast for the IAS net income is for an underperformance of £1.534m as outlined in table 5 below. The underperformance is predominantly from an increase in the target return (£4.333m in 2019/20 to £5.725m in 2020/21) and delays in new schemes becoming operational. Income from land assembly purchases has provided over half of the forecast return.

Table 5: IAS Income Forecast as at 30 September 2020

IAS 2020/21 Net Income	2019/20	2020/21
Budget	**£000s**	**£000s**
Original MTFS Savings Target	3,733	5,125
Add £600k Saving for Abbey MRP	600	600
Total Target	**4,333**	**5,725**
Total Reside Schemes	1,882	1,605
Commercial property and Loans	1,377	2,586
Total Commercial	**3,259**	**4,191**
Surplus / (Deficit)	**(1,074)**	**(1,534)**

9.2 Although the forecast for 2020/21 is an underachievement against the IAS budget, it is forecast that the outperformance in the net interest return will be sufficient to allow the overall strategy to provide a small surplus above the strategy's target return. Given the significant increase in return target for 2020/21 and the very challenging economic environment resulting from Covid-19, an overall surplus against a challenging target is a good outcome for 2020/21.

9.3 Although the overall treasury and investment strategy is forecast to provide a small surplus to the Council, there are still pressures from the impact of Covid-19 that may mean that a surplus is not possible in 2020/21. The current forecast does include a provision for losses both from residential rental income and commercial income. Reside are providing regular updates on rental income and forecast are being adjusted accordingly. Be First and the Council's Commercial team are liaising with the various commercial tenants to ensure that any income pressures are identified and addressed.

9.4 If there is a deficit in overall treasury and IAS income then a reserve has been established from the prior year's outperformance which will allow this underperformance to be covered.

9.5 Work continues between the Council, Be First and Reside to improve the time it takes to deliver residential and commercial schemes and to ensure that operational schemes are management efficiently and effectively. Be First continues to seek other regeneration and investment options and there is the potential for these to improve the return during 2020/21.

10. Accounting Policy Change to Interest Costs

10.1 The Council uses a mix of short-term and long term borrowing to fund the capital costs for the various IAS schemes. To fund this borrowing the Council has allocated an interest budget for the IAS borrowing. The interest budget includes both interests received, and interest expensed.

10.2 The Council, from 1 April 2019, will capitalise interest costs against qualifying assets. A qualifying asset is an asset that takes in excess of two years to get ready for intended use and is where the forecast expenditure is in excess of £10m. Qualifying assets are therefore the majority of the IAS schemes.

10.3 Capitalisation of interest will start from when the asset has been agreed at Gateway 2, which is the point at which the development is initially agreed and will be on all qualifying expenditure. Where land has been purchased as part of land assembly the capitalisation of interest will be from the later date of the either the completion date of the purchase or the date of this accounting policy.

10.4 Interest will be capitalised on a quarterly basis and will be based on the weighted average of the borrowing costs that are outstanding during the period. Cessation of capitalisation will occur when substantially all the activities necessary to prepare the qualifying asset for its intended use are complete.

10.5 Capitalising borrowing costs moves from charging the interest costs each year to the Income and Expenditure (I&E) to adding the borrowing costs to the cost to build an asset. The costs are then spread over the asset life. Therefore, any capitalised borrowing costs will have a neutral impact on the I&E, the capitalisation of the borrowing costs would increase the asset value on the balance sheet and therefore increase the Council’s CFR. It would be expensed to revenue through the Authority’s MRP policy.

10.6 An estimate of the amounts to be capitalised has been completed for the period 2019/20 to 2023/24 and is summarised below:

Year	**Capitalised Interest**
	£000s
2019/20	1,500
2020/21	3,000
2021/22	5,000
2022/23	1,500
2023/24	1,000
	12,000

10.7 As part of the Treasury outturn report, an outturn figure for the amount of interest that was capitalised for the year, will be provided to Members.

11. The Council's Capital Position (Prudential Indicators)

11.1 <u>Prudential Indicator for Capital Expenditure</u>

Table 6 shows the changes to the original capital expenditure budgets. Table 6 also highlights the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure.

The borrowing need increases the underlying indebtedness of the Council by way of the CFR, although this will be reduced by MRP. This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Table 6: Revised Estimate to Capital Programme as at 30 September 2020

Capital Expenditure	2019/20 actual £000s	2020/21 Initial Budget £000s	2020/21 September Forecast £000s
General Fund			
Adults Care & Support	1,989	2,241	1,790
Community Solutions	23	-	187
Core	1,108	3,492	4,316
Culture, Heritage & Recreation	1,276	10,015	8,820
Education, Youth & Childcare	37,417	42,958	17,993
Enforcement	804	2,908	1,116
My Place	5,207	3,625	4,284
Public Realm	6,104	3,179	3,391
CIL/S106/TFL/other	2,227	4,322	2,775
Transformation	4,248	6,495	2,777
Financed by:			
Capital Grants	(42,060)	(41,954)	(27,361)
CIL/S106	(675)	(4,322)	(2,775)
Revenue Contributions	-	(340)	-
Capital Receipts	(3,625)	(6,495)	(2,777)
Total Net Borrowing Requirement	**14,043**	**26,124**	**14,536**
Housing Revenue Account (HRA)			
HRA	41,136	48,958	30,894
Financed by:			
HRA Contributions	(29,165)	(32,236)	(32,236)
RTB Receipts		(750)	(750)
Total Net Borrowing Requirement	**11,971**	**15,972**	**(2,092)**
IAS			
Residential	90,515	227,743	179,030
Commercial	28,638	25,305	12,711
Financed by:			
Grants	(9,818)	(21,395)	(26,684)
RTB Receipts		(5,887)	(5,887)
Capital Receipts			
Total Net Borrowing Requirement	**109,335**	**225,766**	**159,170**
Net financing need for the year	**135,349**	**267,862**	**171,615**

11.2 Prudential Indicator – CFR

Table 7 shows that the Council's revised CFR will not exceed the Operational boundary. The S151 reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

The Authorised Limit represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Overall table 6 and 7 show the forecast capital spend is lower than originally forecast, predominantly due to delays caused by Covid-19. Expenditure is still significant in the IAS but there are delays in completing some of the schemes. Right to Buy grant is backloaded as it is only utilised when the scheme is complete, and this will reduce the overall borrowing requirement in subsequent years.

Both the operational boundary and the authorised limit are not forecast to be exceeded in 2020/21 and the borrowing forecast may reduce as a result of capital receipts from the sale of the film studio land.

Table 7: Revised Capital Financing Requirement as at 30 September 2020

Capital Expenditure	2019/20 Actual £000s	2020/21 Estimate £000s	2020/21 September Forecast £000s
Capital Financing Requirement			
Opening CFR - General Fund	464,028	555,384	555,384
Net financing need for the year	123,378	251,890	173,706
Movements between HRA and GF	(24,291)		
Investment Debt Repayment (MRP)			
Other MRP & Financing	(7,731)	(10,202)	(7,881)
Total General Fund CFR	555,384	797,072	721,209
CFR - Housing	278,472	314,734	314,734
Net financing need for the year	11,971	15,972	(2,092)
Movements between HRA and GF	24,291	-	-
Total HRA CFR	314,734	330,706	312,642
Total CFR	870,118	1,127,778	1,033,852
Movement in CFR	127,618	257,660	163,734
Operational Boundary	**1,052,000**	**1,250,000**	**1,250,000**
Authorised Limit	**1,152,000**	**1,350,000**	**1,350,000**

11.3 <u>Treasury Indicators: Limits to Borrowing Activity</u>

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs / improve performance. The indicators are:

i. Upper limits on variable interest rate exposure: identifies a maximum limit for variable interest rates based upon the debt position net of investments;

ii. Upper limits on fixed interest rate exposure: is similar to the previous indicator and covers a maximum limit on fixed interest rates; and

iii. Maturity structure of borrowing: gross limits to reduce the Council's exposure to large fixed rate sums requiring refinancing.

The S151 reports that there were no breaches in any of the limits outlined below:

Interest rate exposures	**2020/21**	**2020/21**	**2020/21**
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	70%	70%	70%
Limits on fixed interest rates:			
• ***Debt only***	100%	100%	100%
• ***Investments only***	90%	90%	90%
Limits on variable interest rates			
• ***Debt only***	70%	70%	70%
• ***Investments only***	80%	80%	80%

Maturity structure of fixed interest rate borrowing 2020/21		
	Lower	**Upper**
Under 12 months	0%	40%
12 months to 2 years	0%	60%
2 years to 5 years	0%	70%
5 years to 10 years	0%	70%
10 years and above	0%	100%

Maturity structure of variable interest rate borrowing 2020/21		
	Lower	**Upper**
Under 12 months	0%	40%
12 months to 2 years	0%	40%
2 years to 5 years	0%	70%
5 years to 10 years	0%	70%
10 years and above	0%	80%

12. Consultation

12.1 The Finance Director, in his role as statutory chief finance officer, has been informed of the approach, data and commentary in this report.

13. Financial Implications

Implications completed by: Katherine Heffernan, Head of Services Finance

13.1 This report sets out the mid-year position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long-term borrowing positions.

14. Legal Implications

Implications completed by: Dr. Paul Feild, Senior Governance Lawyer

14.1 The Local Government Act 2003 (the "Act") requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

14.2 The Council also has to 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.

14.3 The Assembly agreed the Treasury Management Strategy Statement for 2020/21 on 17 February 2020. This report is a mid-year review of the strategy's application and there are no further legal implications to highlight.

15. Options Appraisal

15.1 There is no legal requirement to prepare a TMSS Mid-Year Review; however, it is good governance to do so and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

16. Other Implications

16.1 Risk Management - The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income during the first 6 months of the year.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- Appendix 1: Investments as at 30 September 2020