ADUR & WORTHING
COUNCILS

Joint Governance Committee
30 July 2020
Agenda Item 7

Joint Strategic Committee
8 September 2020
Agenda Item XX

Key Decision : No
Ward(s) Affected: All

ANNUAL TREASURY MANAGEMENT REPORT 2019-20 FOR ADUR DISTRICT COUNCIL AND WORTHING BOROUGH COUNCIL

REPORT BY THE DIRECTOR FOR DIGITAL AND RESOURCES

EXECUTIVE SUMMARY

1. PURPOSE

1.1 This report asks Members to note the Treasury Management performance for Adur and Worthing Councils for 2019/20 as required by regulations issued under the Local Government Act 2003.

1.2 Members are asked to note the breach of money market fund investment limits for 1 day on July 1st 2020 (section 13.1).

2. RECOMMENDATIONS

2.1 **Recommendation One**
The Joint Governance Committee is recommended to note the annual report, including the breach of the money market fund investment limits and to refer any comments or suggestions to the next meeting of the Joint Strategic Committee on 8th September 2020.

2.2 **Recommendation Two**
The Joint Strategic Committee is recommended to note the annual report and the breach of the money market fund investment limits.

3. CONTEXT

3.1 Treasury Management is:

> "The management of the local authority'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".

3.2 This report details the treasury management activities and portfolio positions for the 2019/20 financial year for Adur District Council and Worthing Borough Council.

3.3 This is the last of three treasury management reports that the Councils are required to consider during the financial year:

- Before the beginning of the financial year, the first report, the Treasury Management Strategy and Annual Investment Strategy, seeks approval for the Councils' approach to the management of investments and the borrowing of funds for the forthcoming year. This report details how the council will manage risk in it's treasury activities.
- This followed by a mid year review of performance against the approved strategies.
- At the year end, there is an annual report which confirms actual performance for the year.

3.4 There is a clear regulatory environment governing the Council's investment and treasury activities. The Local Government Act 2003 requires that the Council complies with the Prudential Code for Capital Finance (2017). This is a framework established to support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within this clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable. As part of the Prudential Code, indicators are established to ensure that the Council has approved limits on both capital expenditure plans and associated borrowing activity.

3.5 The presentation of this Annual Report enables the Council to meet its statutory obligations as detailed under regulations issued under the Local Government Act 2003. These regulations require that the Councils review the treasury management activities, the prudential indicators and the treasury indicators for 2019/20.

3.6 This report also ensures that the Councils meet the requirements of both the Treasury Management Code of Practice (The Code) and the Prudential Code for Capital Finance in Local Authorities (the Prudential Code), both of which are issued by The Chartered Institute of Public Finance and Accountancy (CIPFA) and recommend best practice in capital investment and treasury management activities.

3.7 The Councils' Treasury Management Strategy and Annual Investment Strategy place the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Councils' priorities set out in Platforms for our Places.

4. ISSUES FOR CONSIDERATION

4.1 For 2019/20 the minimum reporting requirements specified within the treasury management policy was that the Councils should receive the following:

The Annual Treasury Management Strategy Statement (TMSS) in advance of the financial year – this was submitted to the meeting of Adur Council on 20th February 2019 and to Worthing Council on 18th February 2019.

A mid-year treasury update report – a joint in-house operations report for both Councils was submitted to the meeting of JGC on the 26th November 2019 and JSC on 3rd December 2019.

An annual review (this report) - to be submitted by 30th September after the year end, which compares the actual activity with the planned strategy.

4.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury management activities and highlights compliance with the Councils' policies previously approved by members.

4.3 The Annual Report also confirms that the Councils have complied with the requirement under the Code to give scrutiny to all of the above treasury management reports by the Joint Governance Committee and the Joint Strategic Committee before they were reported to the full Councils.

4.4 Member training on treasury management issues was conducted on 13th June 2019 by the Councils' treasury advisors, Link Asset Services, in order to support members' scrutiny role.

5. The Councils' Capital Expenditure and Financing

5.1 The Councils undertake capital expenditure on long-term assets (land, buildings, vehicles, software and equipment). These activities may either be:

- financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Councils' borrowing need; or
- if insufficient financing is available, or a decision is taken not to apply these resources, then capital expenditure will give rise to a borrowing need.

5.2 The actual capital expenditure forms one of the required prudential indicators, because the Councils must ensure that capital expenditure is affordable, approved and monitored. The tables below show the actual capital expenditure and how this was financed. The full explanation of the expenditure and the variances between the budgets and actual expenditure can be found in the Capital Monitoring Reports, but the most significant items are detailed below. There have been some delays in delivery of the capital programme due to the Covid 19 virus.

Adur District Council Total	2018/19 Actual	2019/20 Original Budget	2019/20 Current Budget	2019/20 Actual
Capital expenditure £m	**39.566**	**29.952**	**71.972**	**60.270**
Financed in year £m	**4.919**	**9.658**	**18.486**	**16.502**
Borrowing for capital expenditure £m	**34.647**	**20.294**	**53.486**	**43.768**

The following table shows the General Fund share of the figures in the table above

Adur District Council General Fund	2018/19 Actual	2019/20 Original Budget	2019/20 Current Budget	2019/20 Actual
Capital expenditure £m	**36.573**	**21.532**	**65.891**	**56.411**
Financed in year £m	**1.926**	**3.608**	**12.567**	**12.834**
Borrowing for capital expenditure £m	**34.647**	**17.924**	**53.324**	**43.577**

The following table shows the HRA share of the figures in the table above

Adur District Council HRA	2018/19 Actual	2019/20 Original Budget	2019/20 Current Budget	2019/20 Actual
Capital expenditure £m	**2.993**	**8.420**	**6.081**	**3.859**
Financed in year £m	**2.993**	**6.050**	**5.919**	**3.668**
Borrowing for capital expenditure £m	**0.000**	**2.370**	**0.162**	**0.191**

For Adur, the difference between the original budget and the current budget is largely due to:

- the increase in the total budget of the Strategic Property Investment Fund from £75m to £125m. This £25m increase in Adur's budget was approved by Adur Council on the 25th April 2019;
- new grant funded expenditure such as the £6.75m to Southern Housing in respect of Free Wharf Housing Development in Shoreham from Housing Infrastructure Funding and £3.35m for the relocation of the Sussex Yacht Club funded by the LEP;
- re-profiling of £5.93m of capital budget from 2018/19.

The difference between the current budget and the actual spend is largely due to:

- re-profiling of £10.748m of the 2019/20 budget into 2020/21, of which £6.5m is in respect of the Strategic Property Investment Fund and £2.2m relates to the Adur Homes Capital Investment Programme;
- an underspend of £0.954m

Worthing Borough Council	2018/19 Actual	2019/20 Budget	2019/20 Current Budget	2019/20 Actual
Capital expenditure £m	**38.273**	**24.584**	**66.390**	**64.486**
Financed in year £m	**6.749**	**4.603**	**3.231**	**6.020**
Borrowing for capital expenditure £m	**31.524**	**19.981**	**63.159**	**58.466**

For Worthing, the most significant differences between the original budget and the current budget are:

- the increase in the total budget of the Strategic Property Investment Fund from £75m to £125m. This £25m increase in Worthing's budget was approved by Worthing Council on the 23rd April 2019;
- an approved £5m loan to GB Met College to support local education;
- re-profiled capital budget of £4.5m from 2018/19 into 2019/20;
- increased budgets eg £3m in respect of Decoy Farm and £1.5m for the Ultrafast Fibre Network.

The difference between the current budget and the actual spend is due to:

- re-profiling of £1.6m of the 2019/20 budget into 2020/21, partly due to delays caused by Covid 19;
- an underspend of £0.3m

6. THE COUNCILS' OVERALL BORROWING NEED

6.1 Some of the Councils' capital expenditure is funded immediately by, for example, capital grants, capital receipts from the sale of assets, or from contributions from the revenue budget (capital funded by revenue as approved by statute). Capital expenditure that is not funded by any of these means is described as "the underlying need to borrow" and is known as the Capital Financing Requirement (CFR). The Councils decide whether or not to borrow these amounts externally, or alternatively to use cash that would otherwise be invested (internal borrowing). The Councils make these decisions based on a number of factors, including the prevailing interest rates for borrowing compared to those for investing, the likelihood of a capital receipt in the near future or a forecast of additional capital grants.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Councils should ensure that their gross external borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year (2018/19), plus the estimates of any additional capital financing requirement for the current (2019/20) and next two financial years. This essentially means that the Councils are not borrowing to support revenue expenditure. This indicator allows the Councils some flexibility to borrow in advance of immediate capital needs to take advantage of, say, low interest rates.

The difference between the CFR and the gross borrowing position is termed under or over borrowing. If a Council is under borrowed, it is using some of its internal cash that could otherwise be invested. It can therefore choose to borrow externally up to the CFR so as to take advantage of favourable interest rates. If a Council is over borrowed, it needs to ensure that this position is remedied over a two year period. The Councils have complied with this prudential indicator.

The tables below highlight the Councils' gross borrowing positions against the CFRs.

This table shows the total CFR and borrowing for Adur District Council and the two following tables show the separate figures for the General Fund and the HRA.

Adur District Council Total	31 March 2019 Actual	31 March 2020 Strategy	31 March 2020 Actual
CFR General Fund £m	**123.250**	**164.777**	**167.018**
Gross borrowing position £m	**116.167**	**158.735**	**161.802**
Under/(over)funding of CFR £m	**7.083**	**6.042**	**5.216**

Adur District Council General Fund	31 March 2019 Actual	31 March 2020 Strategy	31 March 2020 Actual
CFR General Fund £m	**63.147**	**102.304**	**106.724**
Gross borrowing position £m	**57.999**	**98.197**	**103.350**
Under/(over)funding of CFR £m	**5.148**	**4.107**	**3.374**

Adur District Council HRA	31 March 2019 Actual	31 March 2020 Strategy	31 March 2020 Actual
CFR HRA £m	**60.103**	**62.473**	**60.294**
Gross borrowing position £m	**58.168**	**60.538**	**58.452**
Under/(over)funding of CFR £m	**1.935**	**1.935**	**1.842**

As at 31 March 2020, for Adur District Council, the HRA was under borrowed by £1.842m. The General Fund was under borrowed by £5.696m based on long term debt, but it also had temporary borrowing of £2.322m. Under borrowing results from the use of internal resources to fund capital expenditure, which reduces the amount of interest payable on external borrowing. Interest rates on investments are currently very low in comparison to the rates charged on borrowed sums, so this is a cost-effective strategy reducing the overall net cost of borrowing. The difference between the budgets and the actual CFR figures is due to re-profiling of the Capital budgets as detailed in section 5.2 above.

Worthing Borough Council	31 March 2019 Actual	31 March 2020 Strategy	31 March 2020 Actual
CFR General Fund £m	**70.674**	**116.394**	**129.140**
Gross borrowing position £m	**67.250**	**113.280**	**128.071**
Under/(over)funding of CFR £m	**3.424**	**3.114**	**1.069**

Worthing Borough Council was under-borrowed based on long term debt by £3.069m at 31 March 2020, but it also held temporary borrowing of £2m.

6.2 The **authorised limit** is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, the Councils do not have the power to borrow above this level. The Councils did not breach the authorised limits during the year.

The **operational boundary** is the expected borrowing position of the Councils during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limits not being breached.

The authorised limits and operational boundaries for both Councils were increased by £25m each during the year to accommodate the increase in the Commercial Property Investment Fund. Worthing’s authorised limit and operational boundary were also increased by £5m to accommodate the approved loan to GB Met College and the College was added to the approved investments list. These amendments were approved by the Councils at meetings on 25th April 2019 (Adur) and 23rd April 2019 (Worthing) and 23rd July 2019 (Worthing - GB Met loan).

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream. The costs incurred through capital expenditure are the interest payable on money borrowed and the Minimum Revenue Provision (see section 12), which is a statutory annual revenue charge to reduce the indebtedness of a Council, based on the amount of unfunded capital expenditure.

Investment income and other income generated from the capital assets purchased or created through the capital programme are deducted from these costs. The net figure is then compared to the Councils’ net revenue stream - the income received from grants and taxation as shown in the Statement of Accounts. Consequently if only the costs of the capital programme increase, so will the proportion of financing cost to net revenue stream. If only the net revenue stream increases, then the proportion will reduce. Usually there will be a combination of both factors.

MRP (see 12.1) is not payable on the cost of properties in the year of purchase. Both Councils bought several commercial properties in 2019/20 and benefited from the rental income, but did not need to account for MRP. Therefore the financing costs are lower in 2019/20 than they will be in future years in relation to those properties.

Adur District Council	2019/20
Authorised limit	**£196.000m**
Maximum gross borrowing position during the year	**£164.383m**
Operational boundary	**£192.000m**
Commercial properties financing as a proportion of net revenue stream	**(15.10)%**
Other GF financing costs as a proportion of net revenue stream	**12.20%**
HRA Financing costs as a proportion of net revenue stream	**20.12%**

All the figures for the financing as a proportion of net revenue stream are lower than the original forecasts, in part because the approved increase in property investment in 2019/20 increased the amount of the net revenue stream, through the receipt of additional rental income. In addition:

- the forecast for Adur's commercial property financing costs as a proportion of net revenue stream was (10.41)% - the negative figure meaning that the income would exceed the financing costs. The actual figure of (15.10)% was better as explained above;

- the Other General Fund financing cost proportion is lower than the forecast of 21.15% due to re-profiling of the capital programme, the availability of loans at lower interest rates than forecast and the new income from Focus House;

- the HRA figure is lower than the forecast of 25.49% due to the re-profiling of the capital programme.

Worthing Borough Council	2019/20
Authorised limit	**£156.000m**
Maximum gross borrowing position during the year	**£128.616m**
Operational boundary	**£151.000m**
Commercial properties financing as a proportion of net revenue stream	**(10.42)%**
Other GF financing costs as a proportion of net revenue stream	**6.91%**

As with Adur, the figures for the financing as a proportion of net revenue stream are lower than the original forecasts, in part because the approved increase in property investment in 2019/20 increased the amount of the net revenue stream, through the additional rental income. In addition:

- the forecast for Worthing's commercial property financing as a proportion of net revenue stream was (4.20)% - the negative figure meaning that the income would exceed the financing costs. The actual figure of (10.42)% was better as explained above.

- the Other General Fund financing cost proportion is lower than the forecast of 10.66% due to re-profiling of the capital programme and the availability of loans at lower interest rates than forecast.

7. TREASURY POSITION AS AT 31 MARCH 2020

7.1 Adur District Council's position at the beginning and end of the year is shown below (nb PWLB refers to the Public Works Loan Board - an arm of the government).

	Principal at 31.03.20 £m	Average Rate of Return	Average Life in Years	Principal at 31.03.19 £m	Average Rate of Return	Average Life in Years
Debt Portfolio						
PWLB (Public Works Loan Board)	(141.540)	2.65%	17.86	(98.227)	2.9%	20.0
Other Borrowing	(20.262)	4.62%	41.45	(17.940)	5.2%	47.0
Total Debt	**(161.802)**			**(116.167)**		
CFR	**167.018**			**123.250**		
(Over)/under borrowing	**5.216**			**7.083**		
Investments						
Bonds	0.029	n/a	n/a	0.055	n/a	n/a
Property Fund	2.728	4.05%	n/a	0.983	4.37%	n/a
Long Term	0.000	n/a	n/a	0.000	n/a	n/a
Short Term	10.665	0.85%	< 1 year	9.514	0.97%	< 1 year
TOTAL INVESTMENTS	**13.422**			**10.552**		
NET DEBT	**(148.380)**			**(105.615)**		

The maturity structure of debt table that follows demonstrates that procedures are in place to prevent the maturity of too much debt in a single period, when only high interest rates may be available for refinancing the debt, if required.

Adur District Council Maturity Structure of Debt	31 March 2020 actual	2019/20 original limits	31 March 2019 actual
under 12 months	7%	20%	6%
12 months and within 24 months	5%	25%	5%
24 months and within 5 years	13%	40%	14%
5 years and within 10 years	24%	50%	19%
10 years and within 20 years	31%	60%	27%
20 years and within 30 years	2%	60%	4%
Over 30 years	18%	45%	25%

7.2 Worthing Borough Council's position at the beginning and end of the year was as follows:-

	Principal at 31.03.20 £m	Average Rate of Return	Average Life in Years	Principal at 31.03.19 £m	Average Rate of Return	Average Life in Years
Debt Portfolio						
PWLB	(111.071)	1.94%	14.68	(61.222)	1.87%	11.31
Other Borrowing	(17.000)	1.41%	1.34	(6.028)	1.21%	0.81
TOTAL BORROWING	**(128.071)**			**(67.250)**		
CFR	**129.140**			**70.674**		
(Over)/under borrowing	**1.069**			**3.424**		
Investments						
Bonds	0.050	n/a	n/a	0.075	n/a	n/a
Property Fund	1.364	4.05%	n/a	0.491	4.37%	n/a
Long Term	-	-	-	-	-	-
Short Term	8.900	0.66%	< 1 year	9.200	0.86%	< 1 year
TOTAL INVESTMENTS	**10.314**			**9.766**		
NET DEBT	**(117.757)**			**(57.484)**		

The maturity structure of debt table that follows demonstrates that procedures are in place to prevent the maturity of too much debt in a single period, when only high interest rates may be available for refinancing the debt, if required.

Worthing Borough Council Maturity Structure of Debt	31 March 2020 actual	2019/20 original limits	31 March 2019 actual
under 12 months	9%	45%	16%
12 months and within 24 months	15%	75%	12%
24 months and within 5 years	11%	75%	24%
5 years and within 10 years	33%	75%	31%
10 years and within 20 years	21%	75%	17%
Over 20 years	11%	75%	0%

7.3 **Investments held by Adur District Council at 31 March 2020:**

Counterparty	Issue Date	Maturity Date	Principal	Current Interest Rate	Long Term Rating
Goldman Sachs Int Bank	17/04/2019	17/04/2020	£1,000,000	1.08%	A
Goldman Sachs Int Bank	25/04/2019	27/04/2020	£1,000,000	1.07%	A
Lloyds Bank	15/04/2019	15/04/2020	£1,000,000	1.25%	A+
Lloyds Bank	01/05/2019	01/05/2020	£1,000,000	1.25%	A+
Santander	27/09/2019	05/10/2020	£1,000,000	1.00%	A
Santander	02/10/2019	05/10/2020	£1,000,000	1.00%	A
Coventry BS	13/06/2019	12/06/2020	£1,000,000	1.00%	A-
Invesco MMF	01/04/2019	n/a	£2,455,000	variable	AAA
Federated MMF	01/04/2019	n/a	£1,200,000	variable	AAA
Handelsbanken	16/07/2018	n/a	£10,000	0.50%	AA-
CCLA Local Auth Property Fund	25/04/2017	n/a	£2,727,484	variable	n/a
Boom Credit Union & War Bond	06/03/2015	n/a	£29,630	n/a	n/a
TOTAL			**£13,422,114**		

Non-treasury investments

Adur District Council has approved a strategy to invest in commercial properties. Full details can be found in the Capital Strategy and Commercial Property Investment Strategy. It also holds shares in Boom Credit Union for policy purposes.

7.4 **Investments held by Worthing Borough Council at 31 March 2020:**

Counterparty	Issue Date	Maturity Date	Principal	Current Interest Rate	Long Term Rating
Lloyds Bank	08/05/2019	08/05/2020	£1,000,000	1.25%	A+
Lloyds Bank	19/06/2019	19/06/2020	£1,000,000	1.25%	A+
Merthyr Tydfil Council	29/01/2020	06/04/2020	£1,500,000	0.75%	n/a
Federated MMF	01/04/2019	n/a	£2,445,000	variable	AAA
Invesco MMF	01/04/2019	n/a	£1,515,000	variable	AAA
CCLA MMF	01/04/2019	n/a	£1,440,000	variable	AAA
CCLA Local Auth Property Fund	25/04/2017	n/a	£1,363,744	variable	n/a
Boom Credit Union	06/03/2015	n/a	£50,000	n/a	n/a
TOTAL			**£10,313,744**		

Non-treasury investments

Worthing Borough Council has made two loans of £5m each to Worthing Homes to support the building of homes. The Council receives £70k per annum net in interest over and above the cost to the Council of borrowing the £10m from the Public Works Loan Board. The loans are fully secured on property.

A loan of £5m was made to GB Met College in January 2020 to support local education. The Council will receive £100k in 2020/21 net in interest over and above the cost to the Council of borrowing the £5m from the Public Works Loan Board. This amount will reduce in future years because the loan is repayable by equal instalments of principal. The loan is fully secured on property.

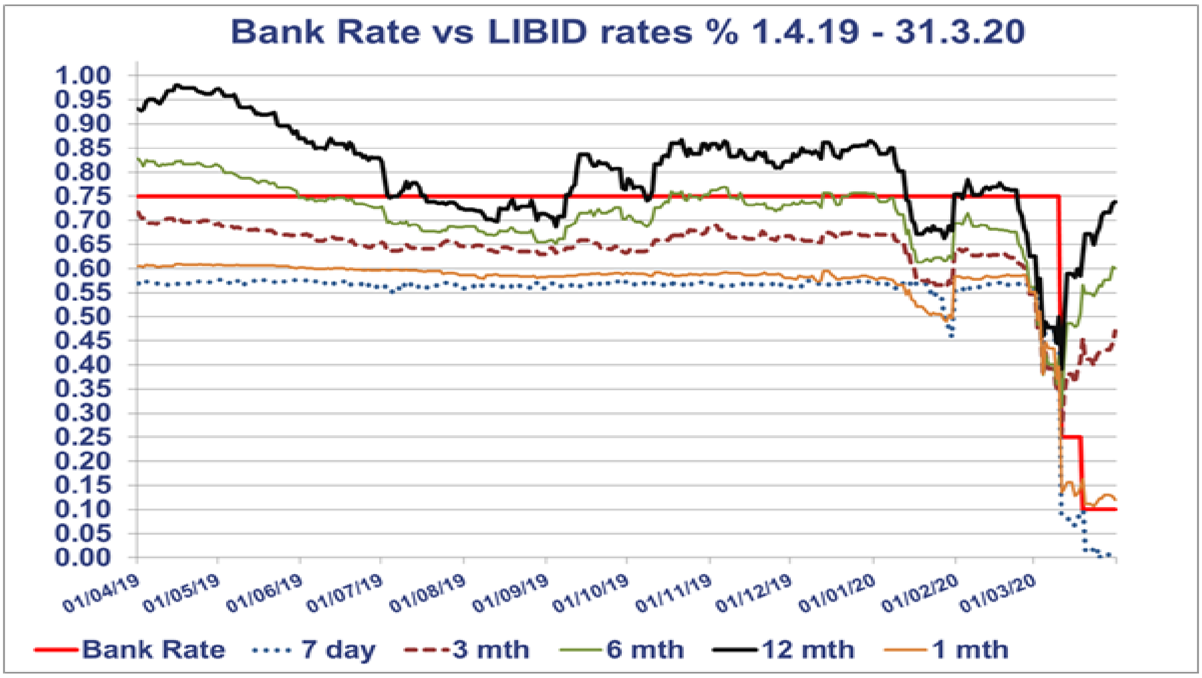
Worthing BC has approved a strategy to invest in commercial properties. Details can be found in the Capital Strategy and Commercial Property Investment Strategy. Worthing also holds shares in Boom Credit Union for policy purposes.

8. THE STRATEGY FOR 2019/20

Some of the information and tables in the following paragraphs are supplied by the Councils' treasury advisors, Link Asset Services and consist of detailed economic and market information which informed the Councils treasury management decisions throughout the year.

Investment strategy and control of interest rate risk

(LIBID - London Interbank Bid Rate - the rate bid by banks on deposits)



Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020.

Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU.

When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

9. BORROWING STRATEGY AND CONTROL OF INTEREST RATE RISK

9.1 During 2019/20, the Councils maintained an under-borrowed position. This meant that the capital borrowing requirements (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Councils' reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low in relation to the cost of borrowing and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

9.2 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Chief Financial Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

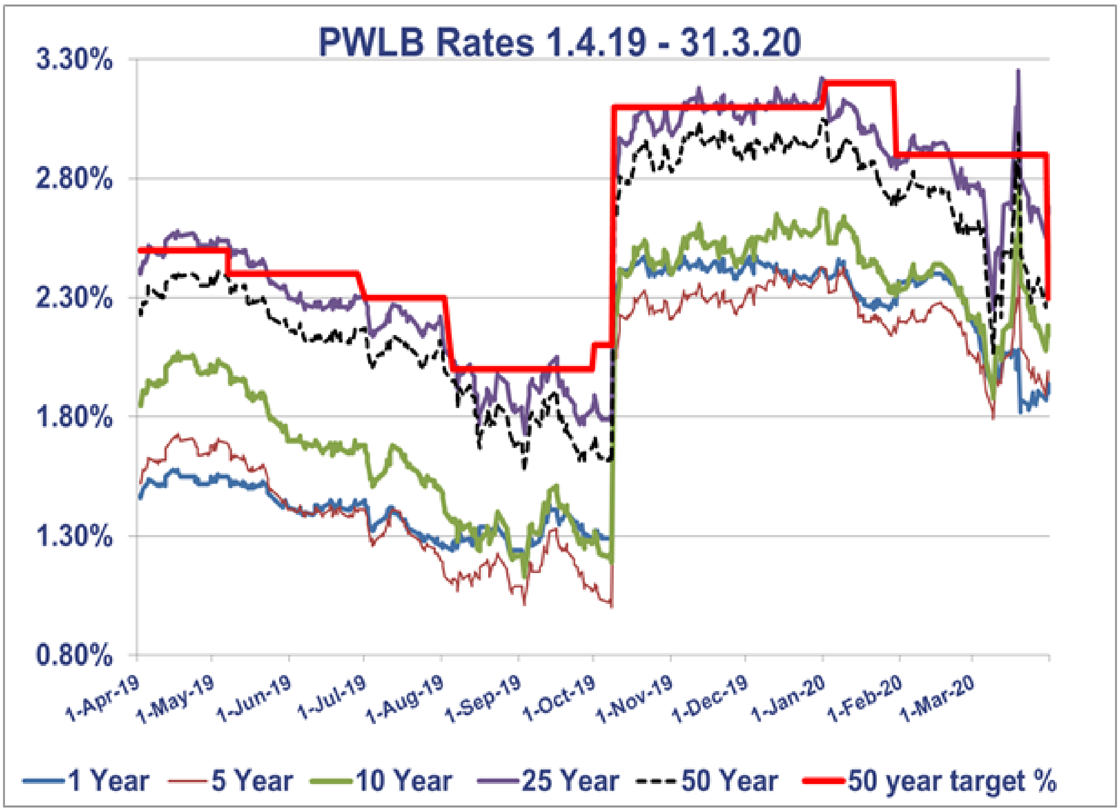
9.3 Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View 5.8.19											
	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	1.20	1.30	1.50	1.60	1.70	1.70	1.80	1.90	2.00	2.00	2.10
10yr PWLB Rate	1.50	1.60	1.80	1.90	2.00	2.00	2.10	2.20	2.30	2.30	2.40
25yr PWLB Rate	2.10	2.30	2.40	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00
50yr PWLB Rate	2.00	2.20	2.30	2.40	2.50	2.60	2.60	2.70	2.80	2.90	2.90

PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields.

While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years.

We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.



Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds.

However, major western central banks also started quantitative easing purchases of government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.

However, HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then partially reversed for some forms of borrowing on 11 March 2020 (including borrowing for the HRA), at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure.

It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ends on 4 June. It is clear that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -

- PWLB Standard Rate is gilt plus 200 basis points (G+200bps)
- PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
- PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be 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.

10. BORROWING OUTTURN

10.1 No debt was rescheduled during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

10.2 The following fixed interest rate loans were taken during the year:

Adur District Council

Lender	Principal	Purpose of Loan	Interest Rate	Maturity
PWLB	**£6m**	**Commercial Property purchase**	**1.82%**	**04/04/2037**
PWLB	**£1m**	**HRA refinancing**	**2.17%**	**10/06/2059**
PWLB	**£1m**	**Office Block Construction**	**1.65%**	**26/06/2029**
PWLB	**£8m**	**Commercial property purchase**	**1.48%**	**25/07/2028**
PWLB	**£8m**	**Commercial property purchase**	**1.88%**	**01/08/2034**

PWLB	£1m	Office Block Construction	1.88%	16/08/2039
PWLB	£1m	HRA refinancing	1.74%	05/09/2069
PWLB	£2m	Refinancing	0.99%	06/04/2030
PWLB	£21.35m	Commercial property purchase	2.50%	19/12/2035
Vale of Glamorgan	£2m	Refinancing	0.90%	27/04/2020

Worthing Borough Council

Lender	Principal	Purpose of Loan	Interest Rate	Maturity
PWLB	£13m	Commercial property purchase	2.44%	25/04/2059
PWLB	£1m	Refinancing	2.17%	10/06/2059
PWLB	£1m	Refinancing	1.65%	26/06/2029
PWLB	£1m	Refinancing	1.88%	16/08/2039
PWLB	£1m	Refinancing	1.74%	05/09/2069
PWLB	£4m	Commercial property purchase	1.30%	12/09/2028
PWLB	£4m	Commercial property purchase	1.36%	12/09/2029
PWLB	£4m	Commercial property purchase	1.42%	12/09/2030
PWLB	£1.5m	Commercial property purchase	1.48%	12/09/2031
PWLB	£3.53m	Commercial property purchase	1.58%	20/09/2032
PWLB	£3.53m	Commercial property purchase	1.63%	19/09/2033
PWLB	£2m	Refinancing	0.00%	08/04/2030
PWLB	£5.69m	Commercial property purchase	2.39%	10/12/2026
PWLB	£5.69m	Commercial property purchase	2.44%	10/12/2027
PWLB	£5m	GB Met College loan	2.60%	09/01/2040
Vale of White Horse	£3m	Refinancing	1.30%	18/11/2021
Vale of Glam	£2m	Refinancing	0.90%	27/04/2020
Stevenage	£5m	Commercial property purchase	1.50%	06/12/2021
West Yorks Combined	£5m	Refinancing	1.40%	28/02/2022

10.3 As shown above, the Councils have borrowed to fund the purchase of commercial properties. Members are reminded that in choosing to invest in Commercial Property, the Councils do not fully comply with the Prudential Code. This is allowable provided that the Councils have an Investment Strategy that explains:

- Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and
- The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or an increase in borrowing costs.

The requirement is met through the publication of a Commercial Property Investment Strategy which sets out the Councils' approach to developing and managing the commercial property portfolio including how the associated risks will be managed. Strategic Property Investment Fund 2020 and the Annual Commercial Property Investment Strategy 2020/21 Report by the Director fo

10.4 **Borrowing in advance of need**

The Councils have not borrowed more than, or in advance of their needs, purely in order to profit from the investment of the extra sums borrowed.

11. INVESTMENT OUTTURN

11.1 **Investment Policy**

The Councils' investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Councils had no liquidity difficulties.

11.2 **Resources**

The Councils' cash balances comprise revenue and capital resources and cash flow monies. The Councils' core cash resources comprised as follows:

Adur District Council

Balance Sheet Resources (£m)	31 March 2020	31 March 2019
General Fund Balances	(1,239)	156
HRA Balances	(6,362)	(5,081)
Earmarked reserves	(3,257)	(3,476)
Provisions	(600)	(802)
Usable capital receipts & grants	(5,552)	(9,012)
Total	(17,010)	(18,215)

Worthing Borough Council

Balance Sheet Resources (£m)	31 March 2020	31 March 2019
Balances	(1,359)	(83)
Earmarked reserves	(3,525)	(3,954)
Provisions	(185)	(772)
Usable capital receipts & grants	(5,432)	(7,205)
Total	(10,501)	(12,014)

11.3 Investments held by the Councils

Both Councils recorded a shortfall on investment income against budget, partly due to the use of "internal borrowing" - instead of borrowing externally to fund the capital programme, funds that could otherwise have been invested externally were used for capital expenditure. This approach was used due to the higher rates payable on borrowing compared to investing and resulted in an underspend on interest payable. The investment rates achievable in the market during the year were also lower than the original forecast.

Details of the income earned are shown below. A comparable performance indicator is the average 6 month London Interbank Bid Rate (the rate bid by banks on deposits), which was 0.70%.

Adur District Council:

Adur District Council maintained an average balance of £11.978m of internally managed funds, which earned an average rate of return of 0.94%. This excludes the

£3m investment in the Local Authorities' Property Fund, which returned an average of 4.05%, amounting to income of £115k.

The treasury investment returns included in the reported income of Adur Council for 2019/20, excluding the Local Authorities' Property Fund investment, amounted to £161k, which under-achieved the budget by £19.5k, due to the reasons explained above.

Worthing Borough Council:

Worthing Borough Council maintained an average balance of £10.432m of internally managed funds, which earned an average rate of return of 0.89%. Those figures exclude:

- the £10m loan to Worthing Homes, which earned 0.70% above the rate at which the funds were borrowed from the PWLB, amounting to £70k;

- the £5m loan to GB Met College, which earned 2.00% above the rate at which the funds were borrowed from the PWLB. As the loan only commenced in January, the net amount earned by the Council was £23k

- the investment in the Local Authorities' Property Fund, which earned an average of 4.05%, amounting to over £57k.

The Treasury investment returns included in the reported income of the Council for 2019/20 amounted to £93,322, excluding the investments specified above, just over £6k under budget, due to the reasons explained above.

12. MINIMUM REVENUE PROVISIONS (MRP) FOR REPAYMENT OF DEBT

12.1 The Councils, in accordance with legislation, make a provision from revenue to enable the repayment of borrowing that has been undertaken to fund the capital programme. This provision is known as the Minimum Revenue Provision (MRP) and is charged to the General Fund Revenue Account each year. The Councils are also permitted to make a Voluntary Revenue Provision (VRP) which is additional to the MRP and can be used to reduce the MRP in future years.

12.2 For 2019/20 an amount of £1.341m of MRP and £50k of VRP has been provided in the Adur District Council General Fund. The VRP total balance at 31 March 2020 was £50k. No voluntary amount has been set aside for the HRA.

12.3 For 2019/20 an amount of £1.267m of MRP and a net £190k of VRP has been provided in the Worthing Borough Council revenue accounts. The VRP total balance at 31 March 2020 was £490k.

13. CURRENT PERIOD TREASURY MATTERS

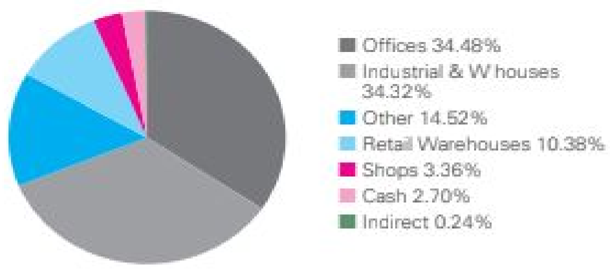
13.1 Due to the Covid-19 virus, the government made substantial payments to both Councils to distribute as Business Grants to local businesses. On April 1st 2020 Adur District Council received £17.64m and Worthing Borough Council received £26.13m. Additional funding was also received to provide relief to the local community, support the additional costs that the Councils are incurring, and to compensate for the loss of income.

The Councils have been very successful in distributing the funds to support local businesses, However it was not possible to accept the grant funding and also adhere to the counterparty investment limits whilst managing these short term funds. Consequently the Chief Executive used his urgency powers to approve changes to the investment limits for three months (April - June), which was approved by JSC on the 9th June 2020. The approval ended on the 30th June, but unfortunately the counterparty limits were still exceeded on the 1st July. All counterparty limits were met on the 2nd July and subsequently and there was no loss to either Council.

13.2 The Covid-19 virus has not affected the fixed term deposits already held by the Councils. However the rates on money market funds and new fixed term deposits are now much lower than in February and are continuing to drop. This will affect our ability to meet the 2020/21 treasury income budgets. This does also mean that new borrowing will also be at a lower rate and so overall we expect to be on target for the budgets for net treasury management costs. The Councils do not invest in stocks and shares so are not exposed to these market fluctuations.

The investments in the Local Authorities' Property Fund have reduced in value by 5.7% between February and June, however, as explained below, this will not impact on the General Fund in the short term due to the Council's statutory position. The dividend payments are still holding up well and the June dividend was 85% of the March one. The Fund is widely diversified in terms of its investment sectors and is actively managed.

Asset allocation at 31 December 19



13.3 Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, (MHCLG), on IFRS9, the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency. This applies to Adur and Worthing Councils in respect of the investments in the Local Authorities' Property Fund.

14. ENGAGEMENT AND COMMUNICATION

14.1 The Adur and Worthing Councils' treasury management team provides treasury services to Mid Sussex District Council through a shared services arrangement (SSA). The SSA is provided under a Service Level Agreement that was renewed from 18th October 2019, and which defines the respective roles of the client and provider authorities for a period of three years.

14.2 Information and advice is supplied throughout the year by Link Asset Services Ltd, the professional consultants for the Councils' shared treasury management service.

15. FINANCIAL IMPLICATIONS

This report has no quantifiable additional financial implications to those outlined above. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget.

16. LEGAL IMPLICATIONS

The presentation of the Annual Report is required by regulations issued under the Local Government Act 2003 to review the treasury management activities, the actual prudential indicators and the treasury related indicators for 2019/20.

Background Papers

Joint Treasury Management Strategy Statement and Annual Investment Strategy Report 2019/20 to 2021/22 – Joint Governance Committee 22 January 2019, Joint Strategic Committee, 31 January 2019

Joint Half-Year In-House Treasury Management Operations Report 1 April – 30 September 2019 for Adur District Council and Worthing Borough Council – Joint Governance Committee, 26 November 2019 and Joint Strategic Committee, 3 December 2019

Link Asset Services Annual Report Template 2019/20

CIPFA Code of Practice on Treasury Management and CIPFA Code for Capital Finance in Local Authorities

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SUSTAINABILITY & RISK ASSESSMENT

1. ECONOMIC

The treasury management function ensures that the Councils have sufficient liquidity to finance their day to day operations. Borrowing is arranged as required to fund the capital programmes. Available funds are invested according to the specified criteria to ensure security of the funds, liquidity and, after these considerations, to maximise the rate of return.

2. SOCIAL

2.1 Social Value

Matter considered and no issues identified.

2.2 Equality Issues

Matter considered and no issues identified.

2.3 Community Safety Issues (Section 17)

Matter considered and no issues identified.

2.4 Human Rights Issues

Matter considered and no issues identified.

3. ENVIRONMENTAL

Matter considered and no issues identified.

4. GOVERNANCE

4.1 The Councils' Treasury Management Strategy and Annual Investment Strategy place the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Councils' priorities contained in Platforms for our Places.

4.2 The operation of the treasury management function is as approved by the Councils' Treasury Management Strategy and Annual Investment Strategy 2018/19 - 2020/21, submitted and approved before the commencement of the 2018/19 financial year.

4.3 In the current economic climate the security of investments is paramount, the management of which includes regular monitoring of the credit ratings and other incidental information relating to credit-worthiness of the Councils' investment counterparties.