Annual Treasury Management Review 2020/21

1 Introduction

1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2020/21. This report 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).

1.2 During 2020/21 the minimum reporting requirements were as follows:
- an annual treasury strategy in advance of the year (Council 29th January 2020)
- a mid year treasury update report (Governance & Audit Committee 19th January 2021
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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

1.4 The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the annual treasury strategy by the Scrutiny Panel before it was reported to the full Council.

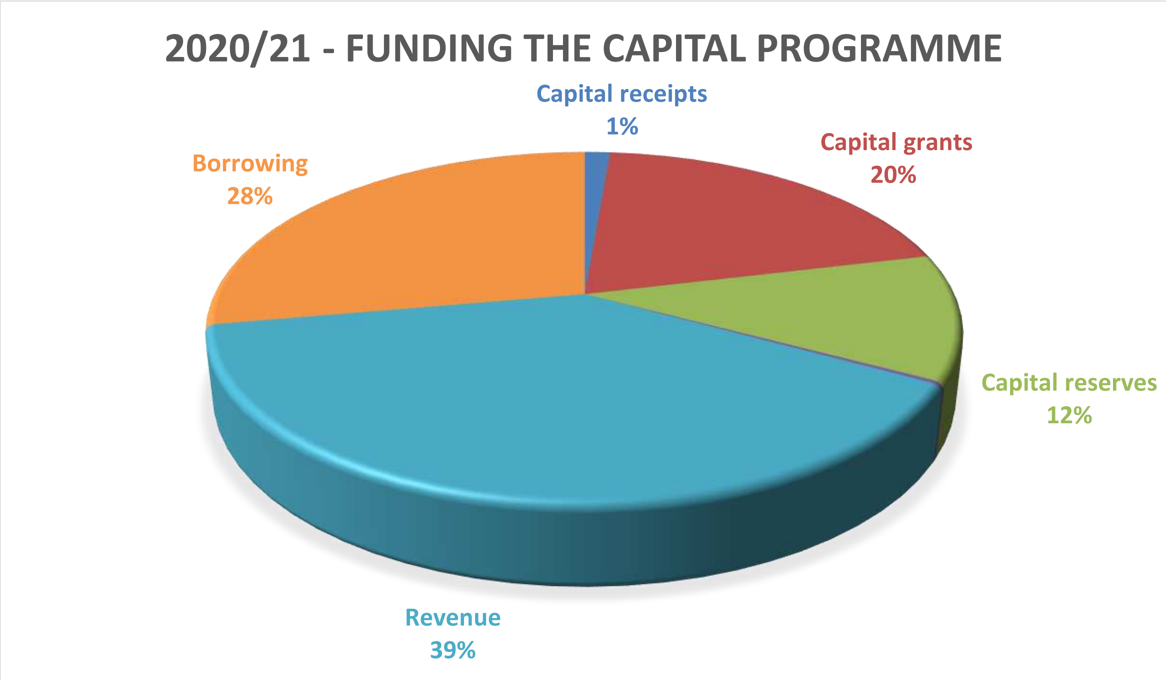
1.5 This report summarises:
- Capital financing activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- The overall treasury position;
- The Treasury Management Strategy for 2020/21;
- The economy and interest rates;
- Borrowing activity; and
- Investment activity.

2 Capital expenditure and financing 2020/21

2.1 The Council undertakes capital expenditure on long-term assets. 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 Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2019/20 Actual £'000	2020/21 Actual £'000
General Fund capital expenditure	30,594	20,457
HRA capital expenditure	15,648	20,630
Total capital expenditure	**46,242**	**41,087**
Resourced by:		
· Capital receipts	2,007	536
· Capital grants	8,892	8,182
· Capital reserves	8,369	4,780
· Finance Leases	11	105
· Revenue	9,316	16,066
New borrowing requirement	**17,647**	**11,418**



3 *The Council's overall borrowing need*

3.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2020/21 new borrowing requirement (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the Capital Programme, the Finance team organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets) or utilising temporary cash resources within the Council.

3.3 The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR. The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.4 The Council's 2020/21 MRP Policy (as required by MHCLG Guidance) was approved as part of the Treasury Management Strategy Report on 29 January 2020.

3.5 The Council's CFR for the year is shown below and represents a key prudential indicator. It includes on balance sheet leasing schemes that increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR	**31-Mar-20 Actual £'000**	**31-Mar-21 (1) Original £'000**	**31-Mar-21 (2) Actual £'000**
Opening balance	161,680	220,641	177,610
Add unfinanced capital expenditure	17,647	55,317	11,418
Add on-balance sheet leasing schemes	11	0	105
Write-off of finance lease creditor	(224)	217	(247)
Less MRP/VRP	1,504	1,996	1,602
Closing balance	177,610	236,887	187,284

(1) As per 2020/21 Treasury Management Strategy – January 2020

(2) As per 2020/21 statement of accounts

3.6 Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

3.7 To ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its **gross borrowing position** does not, except in the short term, exceed the planned limit. The limit is the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31-Mar-20 Actual £'000	31-Mar-21 Original £'000	31-Mar-21 Actual £'000
Gross borrowing position	162,444	220,641	169,944
CFR	177,610	236,887	187,284

3.8 The **Authorised Limit** is required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its authorised limit.

3.9 The **Operational Boundary** is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

3.10 The **actual financing costs as a proportion of net revenue stream** indicator identifies the trend in the cost of capital (borrowing and other long-term obligations cost net of investment income) against the net revenue stream.

	2019/20 £'000	2020/21 £'000
Authorised limit	221,632	262,400
Maximum gross borrowing position	162,444	169,944
Operational boundary	206,849	247,400
Average gross borrowing position	142,108	161,396
Financing costs as a proportion of net revenue stream	8.48%	12.94%

4 Treasury position as at 31 March 2021

4.1 The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting (as detailed in the introduction), and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2020/21 the Council's treasury position (excluding finance leases) was as follows:

	31-Mar-20 Principal £'000	Rate/ Return %	31-Mar-21 Principal £'000	Rate/ Return %
Fixed rate funding:				
PWLB	104,594	3.80%	132,094	3.80%
LOBO	5,500	3.63%	5,500	3.63%
Market	9,000	4.28%	9,000	4.50%
Local Authorities / LEP	23,350	1.43%	23,350	0.86%
Stock Issue	20,000	8.79%		
Total debt	**162,444**	**4.41%**	**169,944**	**3.52%**
CFR	177,610		187,284	
Over/ (under) borrowing	(15,166)		(17,340)	
Investments - In house	55,610	0.87%	51,020	0.23%

Total investments	55,160	0.87%	51,020	0.23%

4.2 The maturity structure of the debt portfolio is shown below. It should be noted that for LOBO loans, the maturity date is deemed to be the next call date. They are therefore all shown as short-term debt:

	Approved Maximum %	31-Mar-20 Actual £'000	%	31-Mar-21 Actual £'000	%
Under 1 year	15.0	35,500	21.8	8,350	4.9
1 - 2 years	15.0	3,350	2.1	15,000	8.8
2 - 5 years	15.0	10,000	6.2	700	0.4
5 - 10 years	15.0	700	0.4	3,000	1.8
10 - 20 years	40.0	21,900	13.5	22,700	13.4
20 - 30 years	40.0	36,000	22.2	38,000	22.3
30 - 40 years	40.0	35,394	21.8	36,894	21.7
40 - 50 years	10.0	10,600	6.5	36,300	21.4
Over 50 years	10.0	9,000	5.5	9,000	5.3
		162,444	**100.0**	**169,944**	**100.0**

4.3 All of the Council’s investments were for a period of less than one year, and there was not any exposure to variable rates of interest.

4.4 The outturn position for the Central Loans and Investment Account (CLIA) is shown below. This shows the outturn position as being a favourable variance of £133k.

CLIA	Budget £'000	Actual £'000	Variance £'000
Total Interest Paid	6,486	5,418	(1,068)
Less: HRA recharge	(5,240)	(4,490)	750
Total less HRA	**1,246**	**928**	**(318)**
Total Investments	(499)	(220)	279
Less: Item 8 credit	130	36	(94)
Total less HRA	**(369)**	**(184)**	**185**
Total CLIA	**877**	**744**	**(133)**

4.5 The CLIA comprises the Council’s borrowing costs and investment income. It is difficult to predict and can be affected by several factors. The majority of the Council’s debt is on fixed rates reflecting the longer-term nature of the borrowing decisions. Investments are generally made for shorter periods, making returns more variable. This mix is generally more beneficial when interest rates are high or increasing. It is important to add that the exposure to interest rate movements is regularly monitored to minimise risks to changes in returns. The reasons that have contributed to the above variances include:

- The variance against interest income is as a result of a higher level of funds than was envisaged being available for investment, and the rates against some investments being lower than the budgeted figure. A proportion of this income was moved to the Housing Revenue Account, based on average HRA balances and investment returns.

5 The strategy for 2020/21

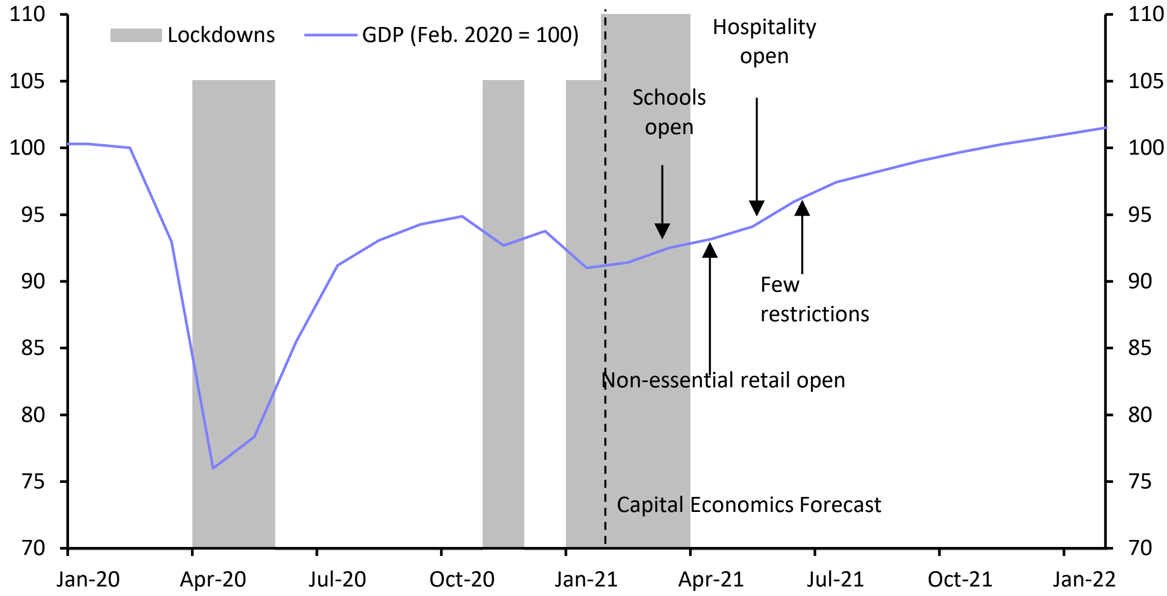
5.1 The investment policy reflected the Council's low appetite for risk, emphasising the priorities of security and liquidity over that of yield. The main features of the policy were that the Council will apply minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties, which also enables diversification and avoidance of concentration risk. Investment decisions also applies the creditworthiness service provided by Link Asset Services, which combines data from credit rating agencies with credit default swaps and sovereign ratings.

5.2 The Council would only use approved counterparties from countries with a minimum credit rating of 'AA-'. The Council will consider longer-term deals if attractive rates are available within the risk parameters set by the Council.

5.3 **Changes in strategy during the year** – the strategy adopted in the original Treasury Management Strategy for 2020/21 approved by the Council on 13th February 2020, was reviewed as part of the mid-year update report. There were no proposed changes to the strategy because of this review.

6 The economy and interest rates

6.1 **UK. Coronavirus.** The financial year 2020/21 will go down in history as being the year of the pandemic. The first national lockdown in late March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A short second lockdown in November did relatively little damage but by the time of the third lockdown in January 2021, businesses and individuals had become more resilient in adapting to working in new ways during a three-month lockdown so much less damage than was caused than in the first one. The advent of vaccines starting in November 2020, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel, and hotels as soon as they reopen. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.



6.2 **Government support.** The Chancellor has implemented repeated rounds of support to businesses by way of cheap loans and other measures and has protected jobs by paying for workers to be placed on furlough. This support has come at a huge cost in terms of the Government's budget deficit ballooning in 20/21 and 21/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3rd March 2021 increased fiscal support to the economy and employment during 2021 and 2022 followed by substantial tax rises in the following three years to help to pay the cost for the pandemic. This will help further to strengthen the economic recovery from the pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%. An area of concern, though, is that the government's debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed long-term debt for floating rate debt; there is, therefore, much incentive for the Government to promote Bank Rate staying low e.g. by using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and / or by amending the Bank's policy mandate to allow for a higher target for inflation.

6.3 **Average inflation targeting.** This was the major change adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August 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. This sets a high bar for raising Bank Rate and no increase is expected by March 2024, and possibly for as long as five years. Inflation has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short-lived factor and so not a concern to the MPC.

6.4 **BREXIT.** The final agreement on 24th December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling has proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

7 Borrowing

7.1 During 2020/21, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

7.2 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.

7.3 The Council's approach during the year was primarily to use cash balances to finance new capital expenditure. This minimised counterparty risk incurred on investments, and maximised treasury management budget savings as investment rates were much lower than most new borrowing rates.

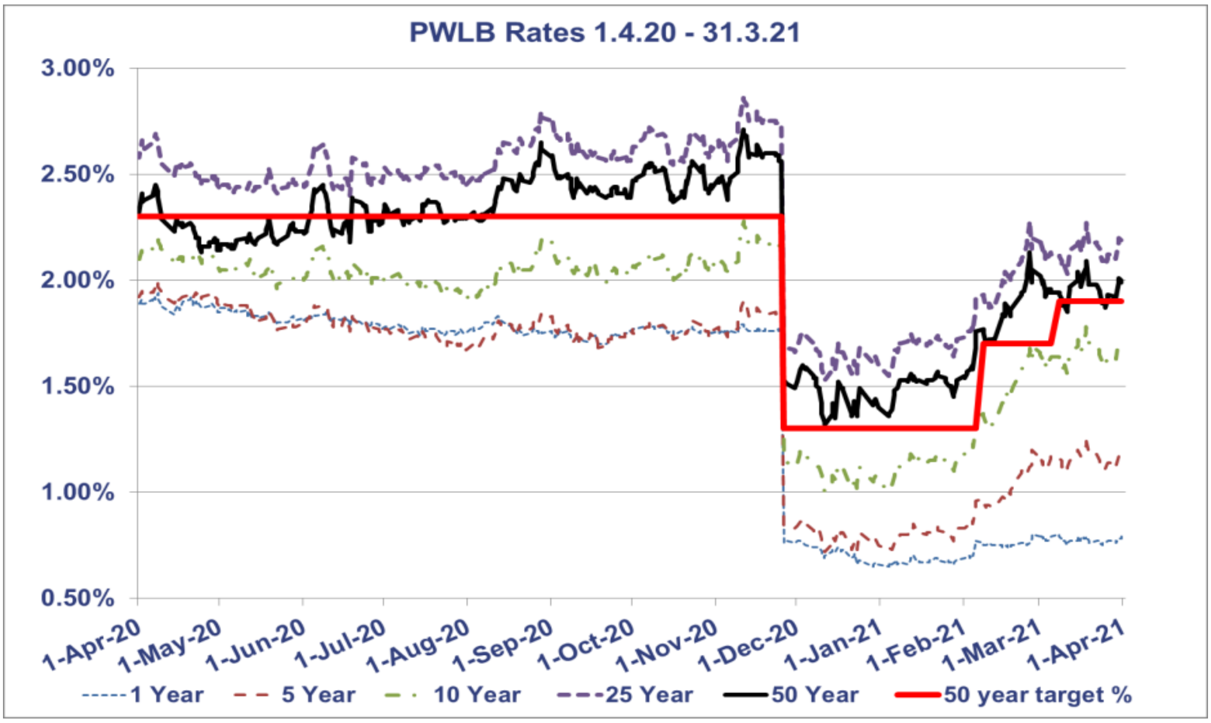
7.4 The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or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

Interest rate forecasts expected only gradual rises in medium- and longer-term fixed borrowing rates during 2020/21 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Forecasts at the time of approval of the treasury management strategy report for 2020/21 were as follows

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

PWLB Borrowing rates throughout 2020/21 were as follow



7.5 The Council's total debt outstanding at 31 March 2021 was £169.9m, which is an increase of £7.5m on last year. Due to the low rates available, this resulted in the average interest rate on the Council's debt at the end of the year reducing to 3.52%.

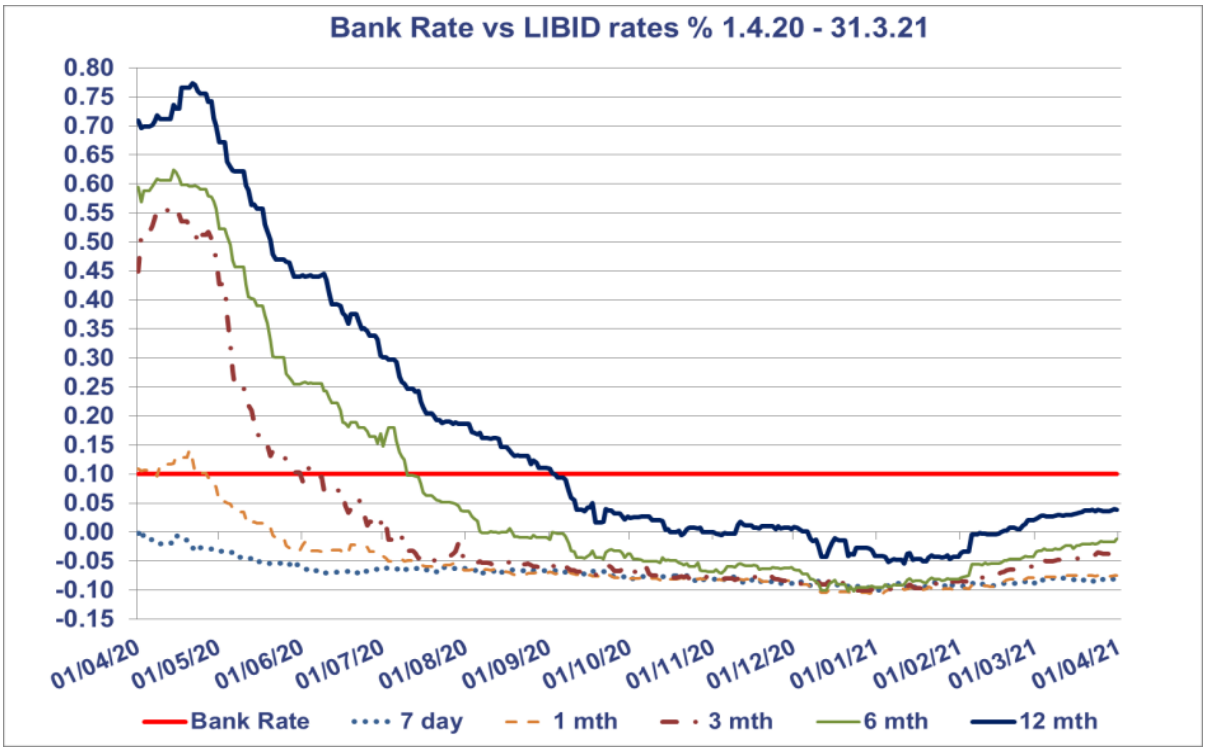
7.6 The Council's approach during the year was primarily to use cash balances to finance new capital expenditure. This minimised counterparty risk incurred on investments, and maximised treasury management budget savings as investment rates were much lower than most new borrowing rates.

8 Investments

8.1 Investment returns which had been low during 2019/20, plunged during 2020/21 to near zero or even into negative territory. Most local authority lending managed to avoid negative rates and one feature of the year was the growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2020/21 was that Bank Rate would continue at the start of the year at 0.75 % before rising to end 2022/23 at 1.25%. This forecast was invalidated by the Covid-19 pandemic bursting onto the scene in March 2020 which caused the Monetary Policy Committee to cut Bank Rate in March, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

8.2 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.

8.3 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 counterparty risk exposure, by having fewer investments placed in the financial markets.



8.4 The Council manages its investments in-house, and its cash balances comprise revenue and capital resources and cash flow monies. The Council's investment policy is governed by MHCLG investment guidance, which was implemented in the Annual Investment Strategy approved by the Council on 13 February 2020. 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.)

8.5 The investment activity during the year conformed to the approved strategy, the Council had no liquidity difficulties, and no institutions in which investments were made during 2020/21 had any difficulty in repaying investments and interest in full.

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

Balance Sheet Resources	31-Mar-20 £'000	31-Mar-21 £'000
Balances	6,206	6,519
Earmarked Reserves	32,475	41,246
Provisions	3,483	3,531
Capital Reserves	977	1,257
Total	**43,141**	**52,653**

8.7 The Council's internally managed funds earned an average rate of return of 0.23%. The comparable performance indicator is the average 3-month LIBID rate (London Interbank Bid Rate – the rate charged by one bank to another for a deposit) (uncompounded), which was 0.09%.

Financial Year	Return %	Benchmark LIBOR (6 Month Rate)
2019/20	0.87	0.70
2020/21	0.23	0.09

8.8 The Council had temporary investments totalling £51.0m outstanding as at 31 March 2021. Of this, £35.5m relates to fixed-term deposits that are due to mature during 2020/21, £10.5m is held in 'AAA' rated money market funds with the remaining £5m is held in notice accounts. All of the deposits were made in accordance with the 2020/21 Annual Investment Strategy. A full list of investments held as at 31 March 2021 is shown in **Appendix B** (confidential).