Cabinet
06 July 2021

Annual Treasury Management Review 2020/21

Cabinet Member: Councillor Andrew Moore
Responsible Officer: Deputy Chief Executive (S151), Andrew Jarrett

Reason for Report: To provide Members with a review of activities and the Prudential Treasury Indicators on actuals for 2020/21.

Recommendations(s):

1. **That Members note the treasury activities for the year.**
2. **That the actual 2020/21 Prudential and Treasury Indicators in this report be approved.**

Relationship to the Corporate Plan: Maximising our return from all associated treasury activities contributes towards the current levels of spending in accordance with our Corporate Plan.

Financial Implications: Good financial management and administration underpins the entire strategy.

Legal Implications: Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

Risk Assessment: The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

1. Introduction

1.1. This 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 that the full Council should receive the following reports:

- an Annual Treasury Strategy in advance of the year (Council 26/02/2020);
- a Mid-Year Treasury Update Report (minimum) (Council 06/01/2021);
- an Annual Review (Outturn) 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. This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by Cabinet before they were reported to the full Council. Member training on treasury management issues was undertaken during 2019 in order to support members' scrutiny role.

2. The Council's Capital Expenditure and Financing

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.

General Fund	2019/20 Actual £000	2020/21 Actual £000
Capital expenditure	8,983	6,086
Financed in year	1,941	2,130
Unfinanced capital expenditure	7,042	3,956
HRA		
Capital expenditure	4,006	2,714
Financed in year	4,006	2,637
Unfinanced capital expenditure	0	77

3. The Council's Overall Borrowing Need

3.1. The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

3.2. **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 Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year (2019/20) plus the estimates of any additional Capital Financing Requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2020/21. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this Prudential Indicator.

Under) / Over funding of CFR	31 March 2020 Actual £000	31 March 2021 Actual £000
CFR General Fund	15,682	18,295
CFR HRA	40,431	39,550
Total CFR	56,113	57,845
Gross borrowing position	39,916	39,467
(Under) / Over funding of CFR	**(16,197)**	**(18,378)**

3.3. **The Authorised Limit** – the Authorised Limit is the "affordable borrowing limit" required by Section 3 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.

3.4. **The Operational Boundary** – 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.

Borrowing Approvals	2020/21 £000
Authorised limit	**95,000**
Maximum gross borrowing position during the year	39,916
Operational boundary	**86,000**
Average gross borrowing position	39,692

4. Treasury Position as at 31 March 2021

4.1. At the beginning and the end of 2020/21 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Debt Portfolio	31 March 2020 Principal £000	31 March 2021 Principal £000
Fixed PWLB Borrowing	38,937	37,104
Total debt	**38,937**	**37,104**
CFR	55,133	55,409
(Under) / over borrowing	(16,197)	(18,305)
Total investments	20,000	17,500

Net debt	18,937	19,604

4.2. The maturity structure of the debt portfolio was as follows:

Debt Maturity Structure	31 March 2020 Actual £000	31 March 2021 Actual £000
Under 12 months	1,833	1,870
12 months and within 24 months	1,870	1,924
24 months and within 5 years	5,836	5,944
5 years and within 10 years	10,778	11,095
10 years and within 20 years	18,620	16,271
20 years and within 30 years	0	0

Investment Portfolio	Actual 31/03/20 £000	Actual 31/03/20 %	Actual 31/03/21 £000	Actual 31/03/21 %
Treasury investments				
Banks	10,000	40%	0	0%
Local authorities	9,000	36%	15,500	69%
Other Government Organisations	1,000	4%	2,000	9%
Total managed in house*	**20,000**	**80%**	**17,500**	**78%**
Property funds (CCLA)	5,000	20%	5,000	22%
Total managed externally	**5,000**	**20%**	**5,000**	**22%**
TOTAL TREASURY INVESTMENTS	**25,000**	**100%**	**22,500**	**100%**

*See Appendix 1 for a breakdown of internally managed investments held as at 31 March.

4.3. The value shown in the above table for the Council's CCLA investment is the amount paid by the Council on share acquisition. This differs to the carrying amount in the year end accounts of £4,725k (£4,759k in 2019/20) as there is a requirement to carry the investment at Fair Value. It is expected that the Fair Value of the fund will recover over the longer term, and so this temporary drop in value is unlikely to be realised as a loss to Council funds.

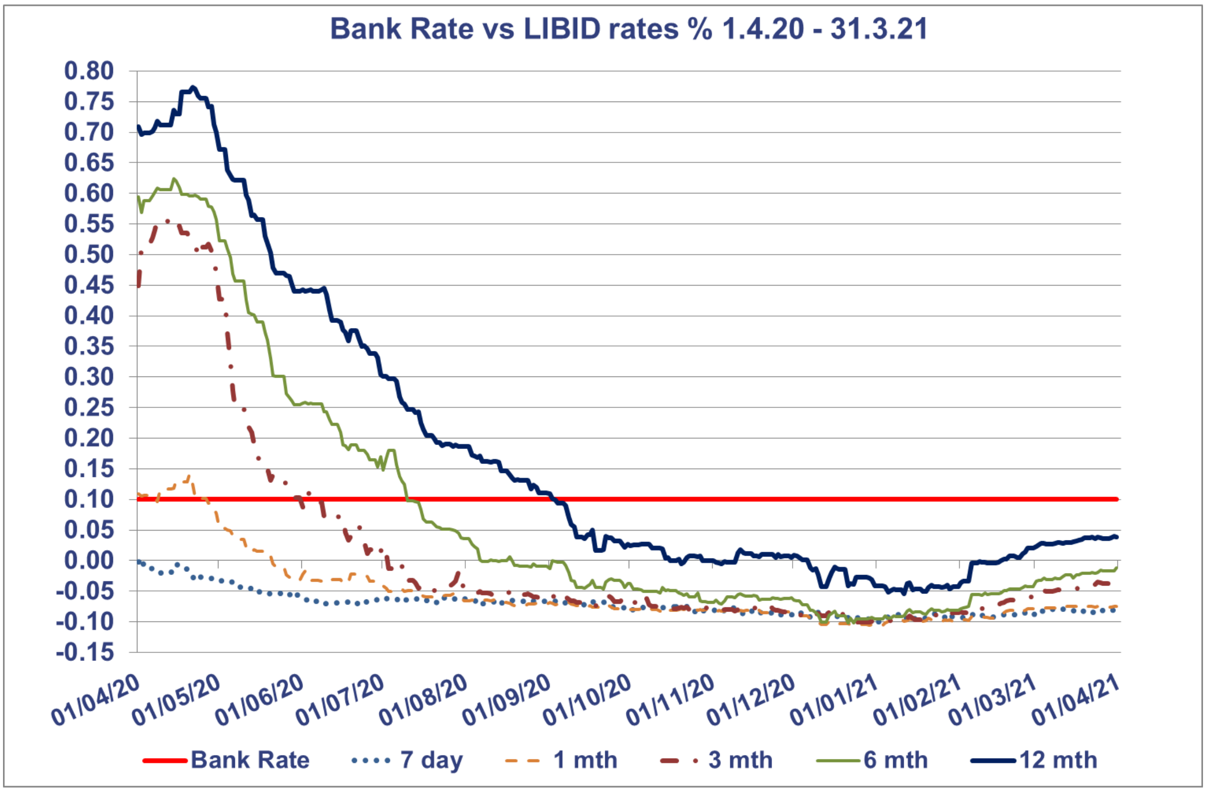
4.4. In addition, the Council has lent funds to its 100% owned subsidiary company, 3 Rivers Developments Ltd. The value of the lending at the year end stood at:

Non Treasury investments	Actual 31/03/20 £000	Actual 31/03/20 %	Actual 31/03/21 £000	Actual 31/03/21 %
Subsidiaries (3 Rivers Developments Ltd)	9,061	100%	10,163	100%
TOTAL NON TREASURY INVESTMENTS	**9,061**	**100%**	**10,163**	**100%**

5. The strategy for 2020/21
(wording supplied by Link Asset Services, our treasury management advisers)

5.1. Investment strategy and control of interest rate risk

5.1.1. As shown in the chart below, investment returns which had been low during 2019/20 and plunged during 2020/21 to near zero or even into negative territory.



5.1.2. 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.

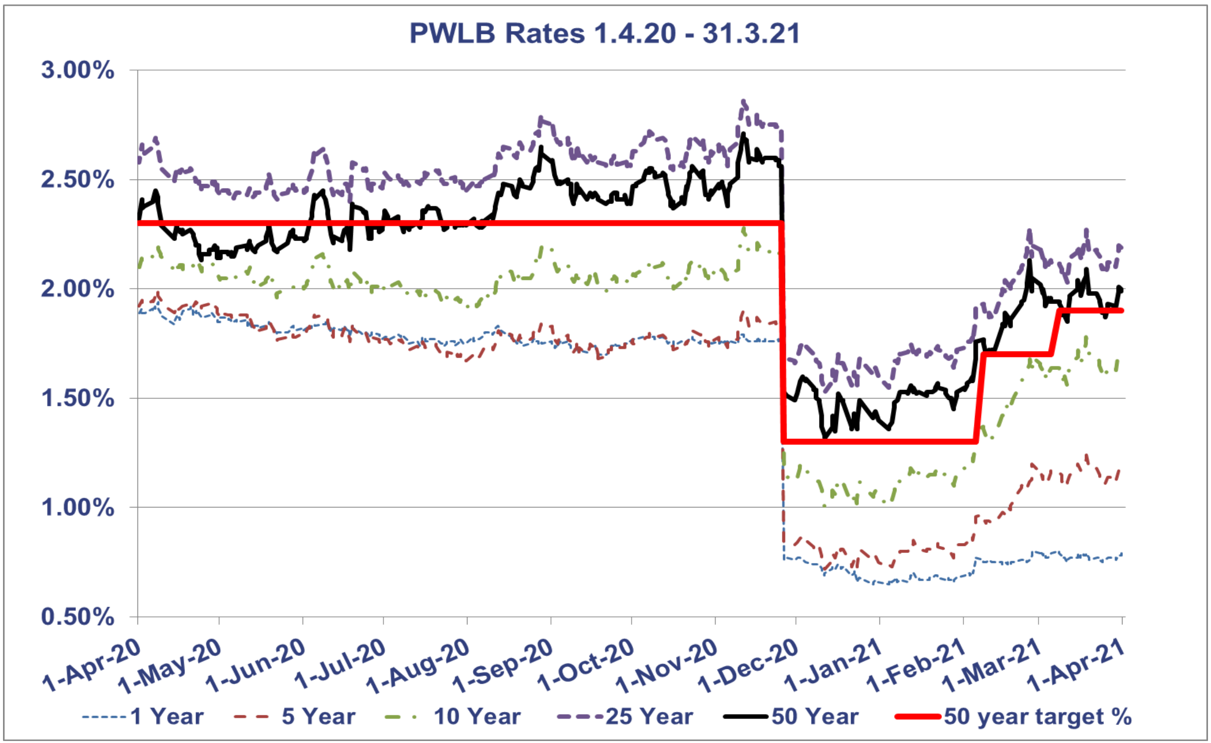
5.1.3. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing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

5.2. Borrowing strategy and control of interest rate risk

5.2.1. 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 low and minimising counterparty risk on placing investments also needed to be considered.

5.2.2. 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.

5.2.3. 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.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Date	04/01/2021	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.94%	1.99%	2.28%	2.86%	2.71%
Date	08/04/2020	08/04/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.43%	1.50%	1.81%	2.33%	2.14%
Spread	1.29%	1.27%	1.28%	1.33%	1.39%

Link Group Interest Rate View	8.3.21												
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.40	1.40	1.40	1.40
10 yr PWLB	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	1.90
25 yr PWLB	2.10	2.10	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.50	2.50	2.50	2.50
50 yr PWLB	1.90	1.90	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.30	2.30	2.30	2.30

5.2.4. HM Treasury had 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, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and on 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchased assets for yield in its three year Capital Programme. The new margins over gilt yields are as follows: -

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **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)

5.2.5. There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not forecast to rise from 0.10% by March 2024 as the Bank of England has clearly stated that it will not raise rates until inflation is sustainably above its target of 2%; this sets a high bar for Bank Rate to start rising.

6. Borrowing Outturn

6.1. Borrowing

6.1.1. Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

6.2. Borrowing in advance of need

6.2.1. The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

6.3. Borrowing

6.3.1. Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

6.4. Rescheduling

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

7. Investment Outturn

7.1. Investment Policy

7.1.1. The Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the Annual Investment Strategy approved by the Council on 26/02/2020. 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 from our treasury advisers (Link Asset Services).

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

7.2. Investments held by the Council

7.2.1. The Council maintained an average balance of £21.3m of internally managed funds. The internally managed funds earned interest of £124k giving an average rate of return of 0.25%. The comparable performance indicator is the 3 month LIBID rate, which was 0.0150%.

7.2.2. The Council held £5m invested in Churches, Charities and Local Authorities (CCLA) property funds earning dividends of £206k (4.13%) in 2020/21.

7.2.3. Interest received from 3 Rivers Ltd amounted to £496k in 2020/21.

8. Other Issues

8.1. IFRS 9 fair value of investments

8.1.1. Following the consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG) on IFRS 9, 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 came into effect on 1 April 2018 for 2018/19. 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.

8.1.2. Risk management will need to take account of the 2018/19 Accounting Code of Practice proposals for the valuation of investments. Whilst for many authorities, this may not be a significant issue, key considerations include:

- Expected credit loss model. Whilst this should not be material for vanilla treasury investments such as bank deposits, this is likely to be problematic for some investments such as property funds, loans to third parties or loans to subsidiaries.
- The valuation of investments previously valued under the available for sale category e.g. equity related to the “commercialism” agenda, property funds, equity funds and similar, have been changed to Fair Value through the Profit and Loss (FVPL).

8.2. Non-treasury management investments.

8.2.1. As shown in the Non-Treasury Investments table in Section 4, the Authority holds a 100% interest in 3 Rivers Developments Limited, a private limited company engaged in construction in the Mid Devon area. The Authority advances funds to the Company to facilitate operations with the intention that they are repaid from the proceeds of the sale of the developments.

8.2.2. During the year ended 31 March 2021, £1.742m was loaned to the Company and £0.640m of existing loans was repaid. This brings the total loan value at 31 March 2021 to £10.163m. During the year £496k interest was paid to the Authority in respect of these loans.

8.2.3. These loans are subject to overarching management review on a regular basis. This is reflected in the impairments of £790k made in both periodic monitoring reports and in the year end financial statements for 2019/20. The year-end review, carried out in compliance with IFRS 9 Financial Instruments, determined that no further impairments were required for the year ending 31 March 2021.

8.3. Counterparty limits

8.3.1. At the end of March 2020 approval was given by the S151 Officer and the Cabinet Member for Finance to exceed the £5m limit on deposits held with the Council’s bank, NatWest, for a period of 3 months, in order to administer the Small Business Grants Fund and the Retail, Hospitality and Leisure Business Grants Fund. £22.732m was received from Government on 1st April 2020 in respect of these.

8.3.2. Further approval was given at the end of June 2020 for a temporary counterparty limit of £10m on deposits held with the Council’s bank for 3 months, which was extended at the start of October for a further 3 months.

8.3.3. At the start of January 2021 a new round of business grant funds were announced, with this Council set to receive £7.307m to fund the schemes. With grant funds from November & December still ongoing, this would increase the total of grant funds being held to £12.108m, and so new temporary approval was given to move to a flexible limit of £5m plus the balance of any emergency grant funds being administered by the Council. This was incorporated into the Treasury Management Strategy Statement for 2021/22 and has become a permanent change to the counterparty limit with NatWest following approval by Council on 24 February 2021.

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Appendix 1: Investment Portfolio

Internally managed investments held as at 31 March:

Bank/Building Society/Local Authority/PCC	Term From	Term To	Fixed Interest Rate %	31/03/20 £000	31/03/21 £000
Close Brothers	04/09/2019	02/09/2020	1.10%	1,000	
Santander	17/09/2019	17/09/2020	0.94%	2,000	
Santander	01/10/2019	01/04/2020	0.83%	1,500	
Santander	07/10/2019	07/04/2020	0.83%	1,500	
Rugby Borough Council	09/10/2019	07/10/2020	0.90%	1,000	
Goldman Sachs	29/10/2019	29/04/2020	0.95%	1,000	
Goldman Sachs	05/11/2019	05/05/2020	1.00%	1,000	
Highlands Council	27/11/2019	25/11/2020	0.92%	1,000	
Lloyds	30/12/2019	30/12/2020	1.10%	2,000	
Merseyside PCC	02/01/2020	30/04/2020	0.85%	1,000	
Nottingham City Council	02/03/2020	17/04/2020	0.80%	2,500	
Central Bedfordshire Council	03/03/2020	27/05/2020	0.95%	2,000	
Eastleigh Borough Council	13/03/2020	14/04/2020	1.10%	1,500	
Cheltenham Borough Council	20/03/2020	20/04/2020	0.95%	1,000	
Blackpool Borough Council	22/09/2020	06/04/2021	0.23%		2,000
Spelthorne Borough Council	27/07/2020	26/07/2021	0.42%		1,500
Broxbourne Borough Council	02/09/2020	01/09/2021	0.40%		2,000
Salford City Council	14/09/2020	14/06/2021	0.20%		2,000
Staffordshire Moorlands DC	16/10/2020	15/10/2021	0.22%		1,000
South Somerset DC	20/10/2020	20/07/2021	0.20%		3,000
Surrey Heath Borough Council	10/12/2020	10/06/2021	0.10%		2,000
Nottinghamshire PCC	21/12/2020	21/06/2021	0.12%		2,000
Ashford Borough Council	25/02/2021	25/11/2021	0.08%		2,000
Total				**20,000**	**17,500**