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| Agenda Item No: | 10 | |
| Committee: | Council | |
| Date: | 30 September 2021 | |
| Report Title: | Treasury Management Annual Review 2020/21 | |

## Cover sheet:

**1 Purpose / Summary**

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2020/21.

**2 Key issues**

- In accordance with the Treasury Management Strategy approved in February 2021, Council receives an annual review of its' treasury management activities after the financial year-end.
- The Treasury Management Annual Review 2020/21 as presented to Cabinet on 15 July 2021 is attached. This report has also been presented to Audit and Risk Management Committee on 19 July 2021.
- The report highlights all the key activities carried out within the Treasury Management function during 2020/21. All activities have been conducted in accordance with the approved strategy and policies.

**3 Recommendations**

- It is recommended that members note the report.

| | |
|---|---|
| **Wards Affected** | All |
| **Portfolio Holder(s)** | Cllr Chris Boden, Leader & Portfolio Holder, Finance |
| **Report Originator(s)** | Peter Catchpole, Corporate Director and Chief Finance Officer<br>Mark Saunders, Chief Accountant |
| **Contact Officer(s)** | Peter Catchpole, Corporate Director and Chief Finance Officer<br>Mark Saunders, Chief Accountant |
| **Background Paper(s)** | Treasury Management and Annual Investment Strategy 2020/21 |

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| Agenda Item No: | 6 | |
| Committee: | Cabinet | |
| Date: | 15 July 2021 | |
| Report Title: | Treasury Management Annual Review 2020/21 | |

## Cover sheet:

### 4 Purpose / Summary

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2020/21.

### 5 Key issues

- Outstanding loans and finance lease liabilities of £8,043,210 and temporary investments of £24,000,000 as at 31 March 2021.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/21) currently attracting excessive premiums it was not financially advantageous for the Council to comply with the Gross borrowing and Capital Financing Prudential Indicator in 2020/21. This is consistent with the strategy approved by Council in February 2020.
- No new borrowing was undertaken and the authorised limit was not breached during 2020/21.
- The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- Amount received from external investments £52,144 (compared with an estimate of £55,000).
- Overall interest rate achieved from investments 0.25% (7 day LIBID uncompounded rate for 2020/21 -0.07%).

### 6 Recommendations

- It is recommended that members note the report.
- It is recommended that Council receive the Treasury Management Annual Report.

| | |
|---|---|
| **Wards Affected** | All |
| **Portfolio Holder(s)** | Cllr Chris Boden, Leader & Portfolio Holder, Finance |
| **Report Originator(s)** | Peter Catchpole, Corporate Director and Chief Finance Officer<br>Mark Saunders, Chief Accountant |
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## Report:

### 1 Introduction

1.1 The Council is required through 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 Chartered Institute of Public Finance and Accountancy (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 Council should receive the following reports:

- an annual Treasury Strategy in advance of the year (Council 20/02/2020);
- a mid-year treasury update report (Council 14/12/2020);
- 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 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 all of the above treasury management reports by the Audit and Risk Management (previously Corporate Governance) Committee before they were reported to Council.

### 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.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. Expenditure associated with the Council's Commercial and Investment Strategy is excluded from this table as it is reported separately in this report.

| | 2019/20 Actual £000 | 2020/21 Revised Estimate £000 | 2020/21 Actual £000 |
|---|---|---|---|
| **Capital expenditure** | **4,926** | **4,519** | **2,971** |
| Financed In Year | 3,621 | 3,239 | 2,418 |
| **Unfinanced capital expenditure** | **1,305** | **1,280** | **553** |
| | | | |

## 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 plus the estimates of any additional capital financing requirement for the current (2021/22) and next two financial years.

3.3 In February 2020 Council allocated £25m in the capital programme to enable the Council to take forward projects linked to its Commercial and Investment Strategy. At the time of presenting the 2021/22 Budget to Cabinet and Full Council in February 2021, it was not anticipated that the Council would make use of any of the £25m allocated before 31 March 2021. Instead it was forecast that the money would be utitlised over a three-year period ending on 31 March 2024. However, subsequently the Investment Board was made aware of an opportunity at short notice and following a meeting in March 2021 the acquisition of an investment property in Wisbech was approved. This acquisition completed prior to 31 March 2021 and was funded from internal borrowing. This impacts on the Capital Financing Requirement as explained in the table below.

3.4 The table below highlights the Council's gross borrowing position against the CFR (See Appendix A).

| | 31 March 2020 Actual £000 | 31 March 2021 Revised Estimate £000 | 31 March 2021 Actual £000 |
|---|---|---|---|
| | | | |
| CFR opening balance | 1,212 | 2,274 | 2,274 |
| Capital expenditure – Capital Programme | 1,305 | 1,280 | 553 |
| Capital expenditure – Commerical and Investment Strategy | 0 | 0 | 3,698 |
| Less Minimum Revenue Provision | (243) | (349) | (349) |
| | | | |
| **CFR Closing balance** | **2,274** | **3,205** | **6,176** |
| of which: Capital Programme | 0 | 3,205 | 2,478 |
| Commercial and Investment Strategy | 0 | 0 | 3,698 |
| | | | |
| **Gross Debt (see table at 4.1 below)** | **8,206** | **8,043** | **8,043** |

3.5 The CFR includes finance leases. A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle) for the lease duration (typically 7 years). The annual lease payment is made up of a capital and interest repayment.

3.6 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan.

3.7 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/21) currently attracting excessive premiums (£2.716m at the time of writing this report), if it were prematurely repaid and the fixed rate market loan of £3.3m

(31/03/2021), attracting a premium charge on application to prematurely repay, it is not financially advantageous for the Council to fully comply with this prudential indicator. This has been the case since the housing stock transfer in 2007 and has been acknowledged and approved by Council since then. In addition, the Council's external auditors have also acknowledged this situation and have not raised any issues with our strategy.

3.8 The authorised limit - the authorised limit is the "affordable borrowing limit" 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.

3.9 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.

3.10 Neither the authorised limit or operational boundary were breached during 2020/21.

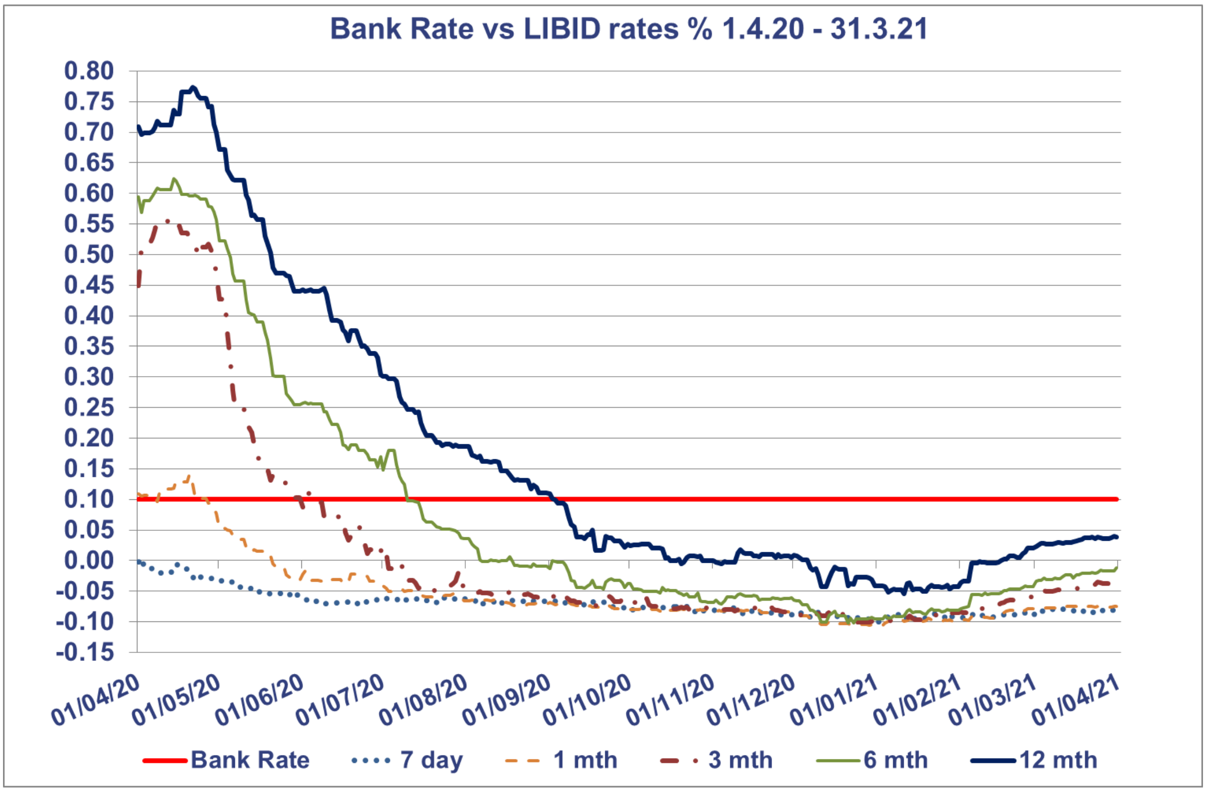
## 4 Overall Treasury Position as at 31 March 2021

4.1 At the beginning and end of 2020/21, the Council's treasury position was as follows.

| | | | | | | |
|---|---|---|---|---|---|---|
| | **31 March 2021 Principal £000** | Rate / Return | Average Life years | **31 March 2020 Principal £000** | Rate / Return | Average Life years |
| Fixed rate funding | | | | | | |
| • PWLB | **4,500** | 7.29% | 9.40 yrs | **4,500** | 7.29% | 10.40 yrs |
| • Market | **3,300** | *4.70%* | 32.96 yrs | **3,300** | 4.70% | 33.96 yrs |
| • Finance Leases | **243** | 3.71% | 1.56 yrs | **406** | 3.64% | 2.56 yrs |
| Total debt | **8,043** | | | **8,206** | | |
| | | | | | | |
| Investments | **(24,000)** | 0.25% | | **(18,300)** | 0.85% | |
| | | | | | | |
| Net debt /(Investments) | **(15,957)** | | | **(10,094)** | | |
| | | | | | | |

4.2 All investments held at 31 March 2021 are fixed term or callable deposits due for repayment within the next twelve months.

## 5 The Strategy for 2020/21




### Investment Strategy

5.1 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.

5.2 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.

5.3 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.

5.4 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.

**Borrowing Strategy**

5.5 The Council was 'over borrowed' during 2020/21 the Council's gross debt exceeded its CFR, as has been the case since 2007 when the Council decided not to repay £7.8m of PWLB debt, following the Council's stock transfer.

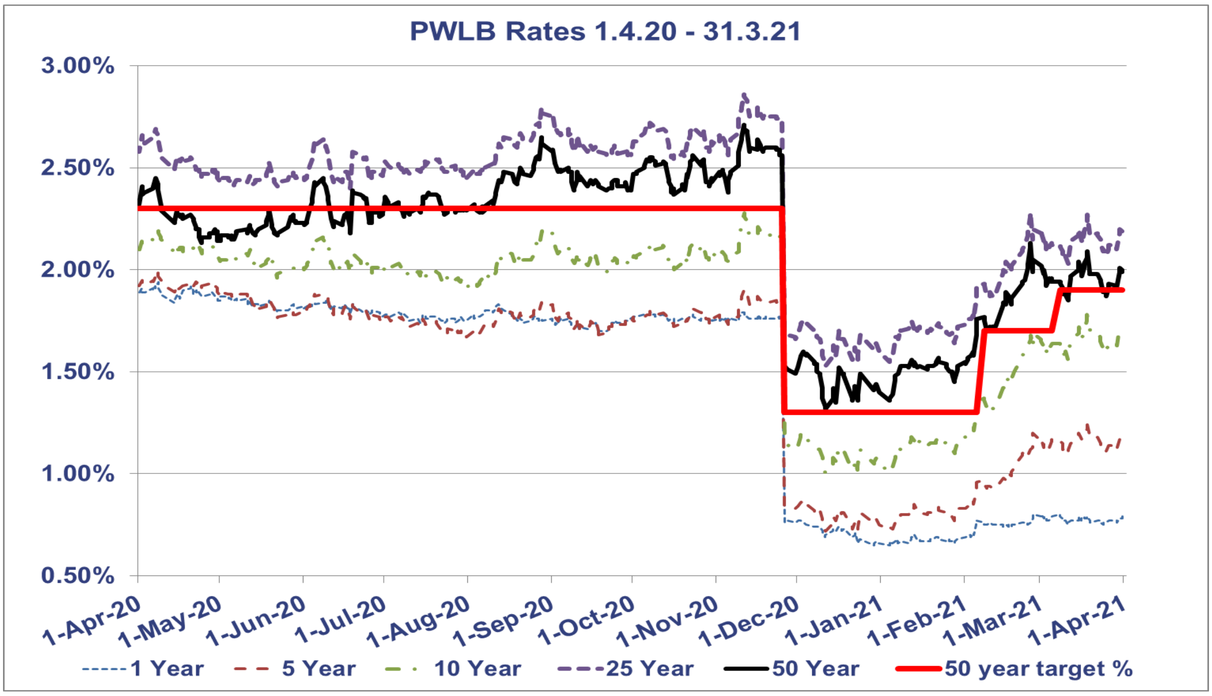
5.6 Therefore, as opposed to taking on additional loan debt to fund capital expenditure in 2020/21, the Council followed a strategy of using cash, supporting the Council's reserves, balances and cash flow as an interim measure. The strategy was prudent as investment returns were low and to reduce counterparty risk on placing investments.

5.7 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.

5.8 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based on managing interest rate risk, 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.

5.9 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. Financial estimates were based on the interest rate forecasts in the table below.

| Link Asset Services Interest Rate View | 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 | 1.25 | 1.25 | 1.25 | 1.25 |
| 3 Month LIBID | 0.70 | 0.70 | 0.80 | 0.80 | 0.90 | 1.00 | 1.00 | 1.10 | 1.20 | 1.30 | 1.30 | 1.30 | 1.30 |
| 6 Month LIBID | 0.80 | 0.80 | 0.90 | 1.00 | 1.00 | 1.10 | 1.20 | 1.30 | 1.40 | 1.50 | 1.50 | 1.50 | 1.50 |
| 12 Month LIBID | 0.90 | 0.90 | 1.00 | 1.10 | 1.20 | 1.30 | 1.40 | 1.50 | 1.60 | 1.70 | 1.70 | 1.70 | 1.70 |
| 5yr PWLB Rate | 2.30 | 2.30 | 2.40 | 2.40 | 2.50 | 2.60 | 2.70 | 2.80 | 2.90 | 2.90 | 3.00 | 3.00 | 3.10 |
| 10yr PWLB Rate | 2.50 | 2.50 | 2.60 | 2.60 | 2.70 | 2.80 | 2.90 | 3.00 | 3.10 | 3.10 | 3.20 | 3.20 | 3.30 |
| 25yr PWLB Rate | 3.00 | 3.00 | 3.10 | 3.20 | 3.30 | 3.40 | 3.50 | 3.60 | 3.70 | 3.80 | 3.80 | 3.90 | 3.90 |
| 50yr PWLB Rate | 2.90 | 2.90 | 3.00 | 3.10 | 3.20 | 3.30 | 3.40 | 3.50 | 3.60 | 3.70 | 3.70 | 3.80 | 3.80 |




5.10 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. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields

5.11 Gilt yields fell sharply from the start of 2020 and then spiked up during a financial markets melt down in March caused by the pandemic hitting western countries; this was rapidly countered by central banks flooding the markets with liquidity. While US treasury yields do exert influence on UK gilt yields so that the two often move in tandem, they have diverged during the first three quarters of 2020/21 but then converged in the final quarter. Expectations of economic recovery started earlier in the US than the UK but once the UK vaccination programme started making rapid progress in the early months of 2021, gilt yields and PWLB rates started rising sharply as confidence in economic recovery rebounded. Financial markets also expected Bank Rate to rise quicker than in the forecast tables in this report.

5.12 At the close of the day on 31 March 2021, all gilt yields from 1 to 5 years were between 0.19 – 0.58% while the 10-year and 25-year yields were at 1.11% and 1.59%.

5.13 HM Treasury imposed **two changes of margins over gilt yields for PWLB rates in 2019/20** without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and **on 25th 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 included the purchase of assets for yield in its three year capital programme.

5.14 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 No long term or temporary borrowing was taken during 2020/21. The approach during the year was to use cash balances to finance new capital expenditure, so as to run down cash balances that were earning low investment returns and to minimise counterparty risk incurred on investments.

6.2 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 No rescheduling was completed during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates and the penalty position which can arise from early repayment of debt, made rescheduling unviable.

## 7 Investment Outturn

7.1 The Council's investment policy is governed by the Ministry of Housing, Communities and Local Government investment guidance, which has been implemented in the annual investment strategy approved by Council on 20 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 and bank share price).

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

7.3 The Council maintained an average balance of £21.858m of internally managed funds. The internally managed funds earned an average rate of return of 0.25% (£52,144). The comparable performance indicator is the average 7-day LIBID rate, which was -0.07%.

## 8 Prudential and Treasury Indicators

8.1 During 2020/21 the Council complied with its legislative and regulatory requirements with the exception of gross borrowing (see paragraph 3.7 above).

## Appendix A - Prudential Indicators

| | Prudential Indicators | 2019/20 Actual £000 | 2020/21 Revised Estimate £000 | **2020/21 Actual £000** |
|---|---|---|---|---|
| 1 | **Capital Expenditure (including Commercial and Investment Strategy)** | 4,926 | 4,519 | **6,670** |
| 2 | **Ratio of Financing Costs to Net Revenue Stream (external interest – investment income)** | 4.97% | 7.01% | **7.03%** |
| 3 | **Gross Borrowing and the Capital Financing Requirement** | | | |
| | Gross Debt | 8,206 | 8,043 | **8,043** |
| | CFR | 2,274 | 3,205 | **7,107** |

| | Treasury Management Indicators | 2019/20 Actual £000 | 2020/21 Revised Estimate £000 | **2020/21 Actual £000** |
|---|---|---|---|---|
| 4 | **Authorised Limit for External Debt** | | | |
| | Borrowing | 15,000 | 17,000 | **17,000** |
| | Other Long-Term Liabilities | 1,000 | 1,000 | **1,000** |
| | Commercial Activities | 0 | 25,000 | **25,000** |
| | Total | 16,000 | 43,000 | **43,000** |
| 5 | **Operational Boundary for External debt** | | | |
| | Borrowing | 10,000 | 12,000 | **12,000** |
| | Other Long-Term Liabilities | 1,000 | 1,000 | **1,000** |
| | Commercial Activities | 0 | 25,000 | **25,000** |
| | Total | 12,000 | 38,000 | **38,000** |
| 6 | **Actual External debt (as at 31 March)** | | | |
| | Borrowing | 7,800 | 7,800 | **7,800** |
| | Other Long-Term Liabilities | 406 | 243 | **243** |
| | Total | 8,363 | 8,043 | **8,043** |