TREASURY MANAGEMENT ANNUAL REPORT 2020/21

Finance & Investment Advisory Committee – 7 September 2021

Report of: Deputy Chief Executive and Chief Officer - Finance & Trading

Status: For Decision

Also considered by:

- Cabinet – 16 September 2021

Key Decision: No

Executive Summary: This report provides the customary review of investment and borrowing activity during 2020/21 as required by the Council's Financial Procedure Rules. The report outlines the strategy adopted during the year, shows the position of the investment and debt portfolios at the beginning and the end of the year and gives details of how the investment fund performed in comparison with previous years and against various benchmarks.

This report supports the Key Aim of: efficient management of the Council's resources.

Portfolio Holder: Cllr. Matthew Dickins

Contact Officer: Roy Parsons, Ext. 7204

Recommendation to Finance & Investment Advisory Committee: That Cabinet be asked to approve the Treasury Management Annual Report for 2020/21.

Recommendation to Cabinet: That the Treasury Management Annual Report for 2020/21 be approved.

Reason for recommendations: As required by both the Council's Financial Procedure Rules and the CIPFA Code, an annual report of treasury management activity is to be presented to Members for approval.

Background

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 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).

2 During 2020/21 the minimum reporting requirements were that the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 25/02/2020)

- a mid year (minimum) treasury update report (Circulated to Members of Finance & Investment Advisory Committee for comment & Cabinet 10/12/2020)

- an annual review following the end of the year describing the activity compared to the strategy (this report)

3 The Council's treasury management advisers, Link Asset Services, also provided monthly reviews of our investment performance which were emailed to Members.

4 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.

5 This Council also 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 Finance & Investment Advisory Committee before they were reported to Cabinet or the full Council. Member training was last undertaken on 14 November 2018 in order to support Members' scrutiny role.

Introduction

6 This **annual treasury report** covers:

(a) The Council's capital expenditure and financing;

(b) treasury position at the beginning and end of the financial year

(c) the economy and interest rates;

(d) investment strategy and control of interest rate risk in 2020/21;

(e) borrowing requirement and debt;

(f) borrowing strategy and control of interest rate risk in 2020/21;

(g) borrowing outturn 2020/21;

(h) investment outturn for 2020/21 and performance;

(i) compliance with treasury management limits and prudential indicators; and

(j) other issues (including an update on the Municipal Bonds Agency).

The Council's capital expenditure and financing

7 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.

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

	31/3/20 Actual (£000)	**31/3/21 Actual (£000)**
Capital expenditure	11,881	11,635
Financed in year	(6,081)	(3,641)
Unfinanced capital expenditure	5,800	7,994

The unfinanced capital expenditure was funded by internal borrowing.

Treasury position at the beginning and end of the financial year

9 The Council's treasury position at the beginning and end of the financial year was as follows:

	31/3/20 Principal (£000)	Rate Return (%)	Average Life (Years)	31/3/21 Principal (£000)	Rate Return (%)	Average Life (Years)
Total debt	5,074	2.66	27.5	4,954	2.66	26.5
Capital Financing Requirement (CFR)	27,515	-	-	35,235	-	-
Over/(under) borrowing	(22,441)	-	-	(30,281)	-	-
Total investments	16,404	0.89	-	11,050	0.35	-
Net debt/ (investments)	**(11,330)**	**-**	**-**	**(6,096)**	**-**	**-**

The maturity structure of the debt portfolio was as follows:

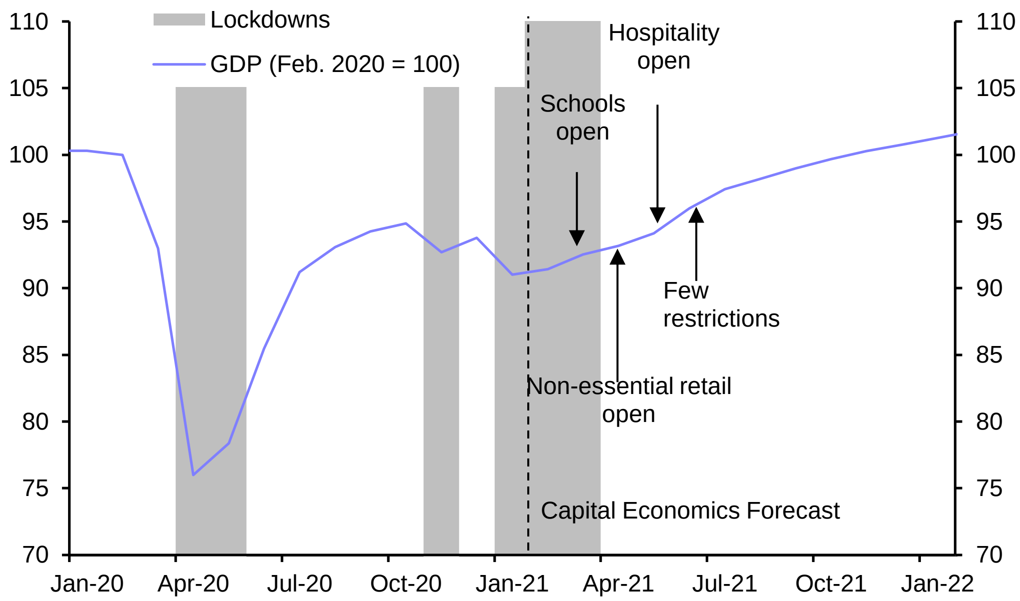
	31/3/20 Actual (£000)	31/3/21 Actual (£000)
Under 12 months	-	-
12 months and over and within 20 years	-	-
20 years and over and within 30 years	5,074	4,954
30 years and over and within 50 years	-	-

10 The investment portfolio at the beginning and end of the financial year appears at Appendix A, whilst an analysis by maturity and repayment due dates appears at Appendix B.

11 All investments were for periods up to one year in duration.

The economy and interest rates

12 **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.



Both the Government and the Bank of England took rapid action in March 2020 at the height of the crisis to provide support to financial markets to ensure their proper functioning, and to support the economy and to protect jobs.

13 The Monetary Policy Committee (MPC) cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a £200bn programme of quantitative easing (QE) i.e. purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields. The MPC increased then QE by £100bn in June and by £150bn in November to a total of £895bn. While Bank Rate remained unchanged for the rest of the year, financial markets were

concerned that the MPC could cut Bank Rate to a negative rate; this was firmly discounted at the February 2021 MPC meeting when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

14 **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.

15 **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 2020/21 and 2021/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3 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.

16 **BREXIT.** The final agreement on 24 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.

17 **USA.** The US economy did not suffer as much damage as the UK economy due to the pandemic. The Democrats won the presidential election in

November 2020 and have control of both Congress and the Senate, although power is more limited in the latter. This enabled the Democrats to pass a $1.9trn (8.8% of GDP) stimulus package in March on top of the $900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly to hit the target of giving a first jab to over half of the population within the President's first 100 days, will promote a rapid easing of restrictions and strong economic recovery during 2021. The Democrats are also planning to pass a $2trn fiscal stimulus package aimed at renewing infrastructure over the next decade. Although this package is longer-term, if passed, it would also help economic recovery in the near-term.

18 After Chair Jerome Powell spoke on the Federal Reserve's (Fed) adoption of a flexible average inflation target in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed a new inflation target - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. There is now some expectation that where the Fed has led in changing its policy towards implementing its inflation and full employment mandate, other major central banks will follow, as indeed the Bank of England has done so already. The Fed expects strong economic growth during 2021 to have only a transitory impact on inflation, which explains why the majority of Fed officials project US interest rates to remain near-zero through to the end of 2023. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping treasury yields at historically low levels. However, financial markets in 2021 have been concerned that the sheer amount of fiscal stimulus, on top of highly accommodative monetary policy, could be over-kill leading to a rapid elimination of spare capacity in the economy and generating higher inflation much quicker than the Fed expects. They have also been concerned as to how and when the Fed will eventually wind down its programme of monthly QE purchases of treasuries. These concerns have pushed treasury yields sharply up in the US in 2021 and are likely to have also exerted some upward pressure on gilt yields in the UK.

19 **EU.** Both the roll out and take up of vaccines has been disappointingly slow in the EU in 2021, at a time when many countries are experiencing a sharp rise in cases which are threatening to overwhelm hospitals in some major countries; this has led to renewed severe restrictions or lockdowns during March. This will inevitably put back economic recovery after the economy had staged a rapid rebound from the first lockdowns in Q3 of 2020 but contracted slightly in Q4 to end 2020 only 4.9% below its pre-pandemic

level. Recovery will now be delayed until Q3 of 2021 and a return to pre-pandemic levels is expected in the second half of 2022.

20 Inflation was well under 2% during 2020/21. The European Central Bank (ECB) did not cut its main rate of -0.5% further into negative territory during 2020/21. It embarked on a major expansion of its QE operations (PEPP) in March 2020 and added further to that in its December 2020 meeting when it also greatly expanded its programme of providing cheap loans to banks. The total PEPP scheme of €1,850bn is providing protection to the sovereign bond yields of weaker countries like Italy. There is, therefore, unlikely to be a euro crisis while the ECB is able to maintain this level of support.

21 **China.** After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth.

22 **Japan.** Three rounds of government fiscal support in 2020 together with Japan's relative success in containing the virus without draconian measures so far, and the roll out of vaccines gathering momentum in 2021, should help to ensure a strong recovery in 2021 and to get back to pre-virus levels by Q3.

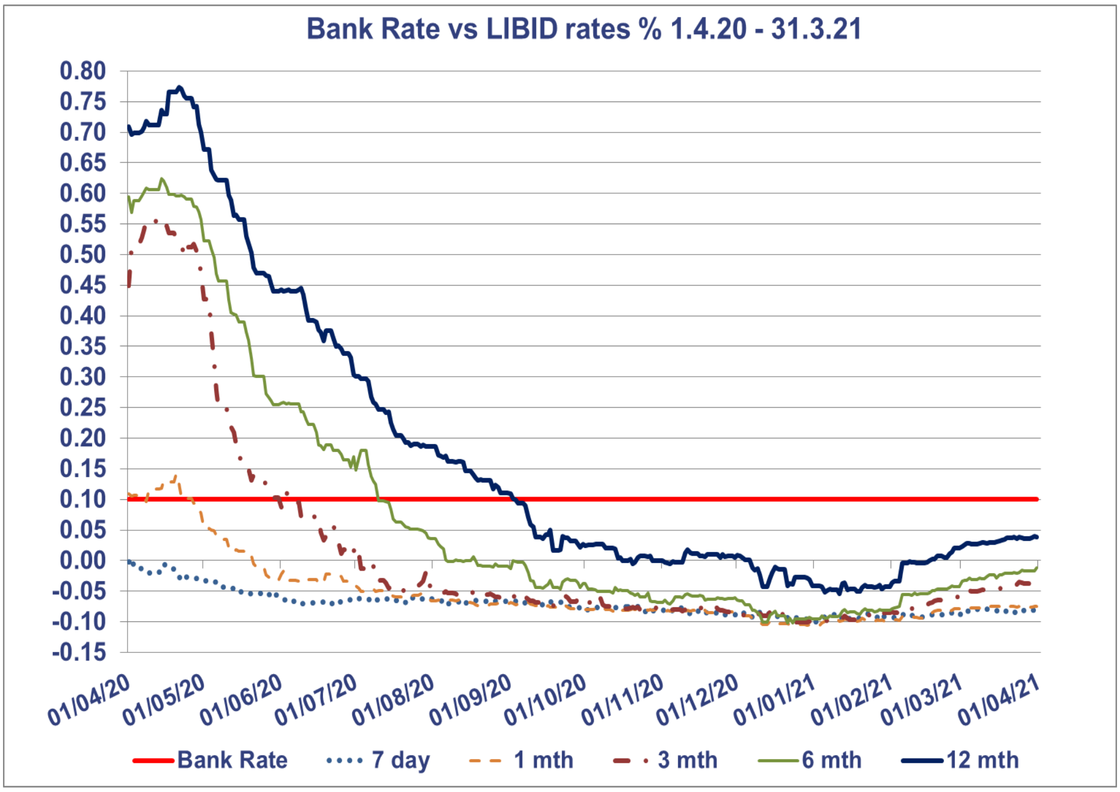
23 **World growth.** World growth was in recession in 2020. Inflation is unlikely to be a problem in most countries for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

24 **Deglobalisation.** Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. In March 2021, western democracies implemented limited sanctions against a few officials in charge of government policy on the Uighurs in Xinjiang; this led to a much bigger retaliation by China and is likely to mean that the China / EU investment deal then being negotiated, will be torn up. After the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products and vice versa. This is likely to reduce world growth rates.

25 **Central banks' monetary policy.** During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This

provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.

Investment strategy and control of interest rate risk in 2020/21



	Bank Rate	7 Day	1 Mth	3 Mth	6 Mth	12 Mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
Low Date	01/04/2020	31/12/2020	29/12/2020	23/12/2020	21/12/2020	11/01/2021
Average	0.10	-0.07	-0.05	0.01	0.07	0.17
Spread	0.00	0.10	0.25	0.66	0.73	0.83

26 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.

27 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.

28 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.

The borrowing requirement and debt

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

30 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 (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) 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.

	31/3/20 Actual (£000)	**31/3/21 Actual (£000)**
CFR General Fund	27,515	35,235
Gross borrowing position	5,074	4,954
Over/(under) funding of CFR	(22,441)	(30,281)

31 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. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its authorised limit.

32 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.

33 “Actual financing costs as a proportion of net revenue stream” is an indicator identifying the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2020/21 (£000)
Authorised limit	35,520
Maximum gross borrowing position during the year	5,074
Operational boundary	30,520
Average gross borrowing position	5,014
Financing costs as a proportion of net revenue stream	0.88%

Borrowing strategy and control of interest rate risk in 2020/21

34 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 is known as internal borrowing. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

35 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.

36 The policy of avoiding new borrowing by running down spare cash balances, has served the Council 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.

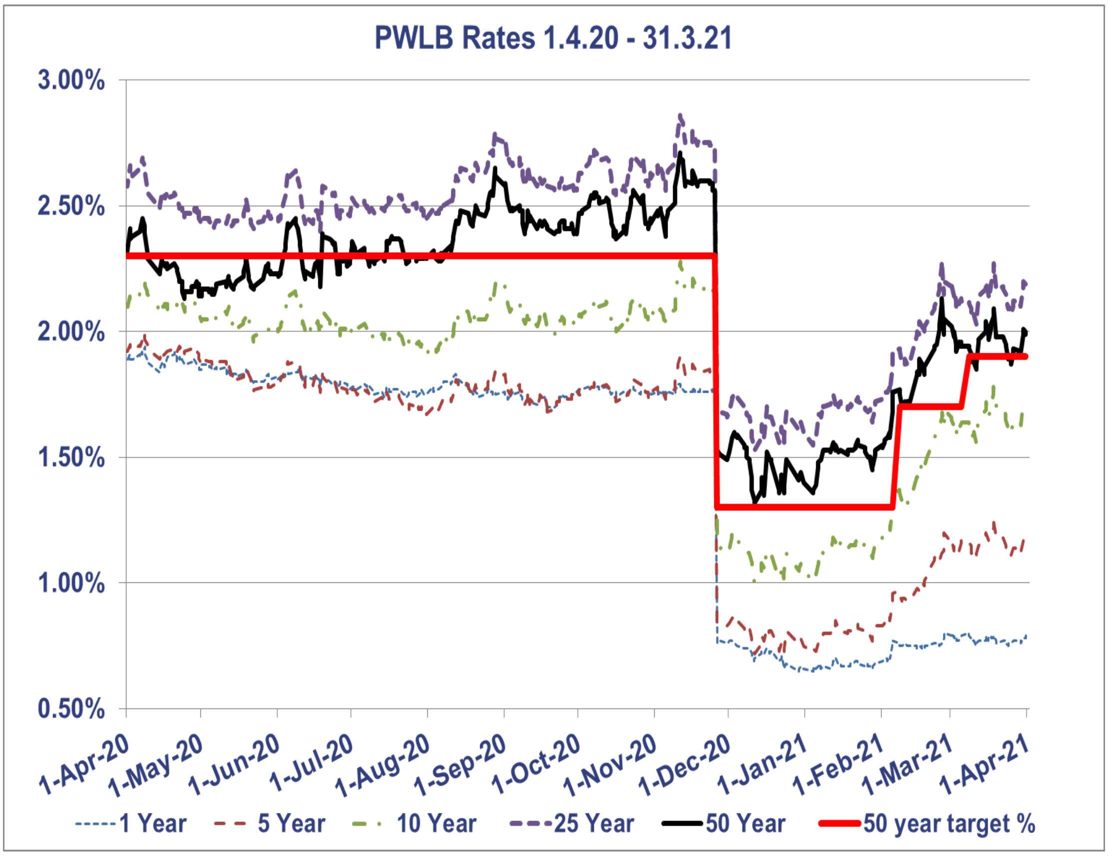
37 Interest rate forecasts anticipated only gradual rises in medium and longer term fixed borrowing rates during 2020/21 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Forecasts from our treasury management advisors, Link Asset Services, together with historical rates appear below.

Forecast at the time of approval of 2020/21 Treasury Management Strategy:-

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

Forecast at year end:-

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



	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%

38 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. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and 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 seen over the last two years, many bond yields up to 10 years in the Eurozone turn negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. 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.

39 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 new year of 2021, gilt yields and 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.

40 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%.

41 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 9 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 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 purchase of 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)

42 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.

Borrowing outturn for 2020/21

43 No borrowing was undertaken during the year. The following is the only loan outstanding:-

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£5.25m	Fixed interest rate - Annuity	2.66%	3/11/2047

44 There were no repayments or rescheduling of debt during 2020/21.

Investment outturn for 2020/21 and performance

45 The Council's investment policy is governed by Ministry of Housing Communities and Local Government (MHCLG) guidance, which has been implemented in the annual investment strategy approved by the Council on 25 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).

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

47 Appendix C shows the performance of the fund during 2020/21 both in table and graphical form. The table shows the average percentage return on the fund, both monthly and for the whole year and compares them with the average 7-day and 3-month London Interbank Bid (LIBID) rates. The average return achieved by each broker is only a very basic measure of performance, because returns will depend on the number and length of each investment he/she is asked to carry out. If a particular broker is only asked to place short term investments, he/she may well not achieve the same overall rate as a broker who predominantly handles longer term investments for us.

48 The graph shows actual monthly receipts for 2018/19, 2019/20 and 2020/21 plus budgeted monthly receipts for 2020/21. The monthly interest budget

has been profiled in line with the previous year’s monthly weighted average principal.

49 Over the course of the year interest receipts amounted to £79,300 compared with a budget of £300,000. The fall in income reflects the ultra-low returns on short duration deposits (up to 12 months) available in the market at the present time. Rates declined throughout 2020/21 in response to both the March 2020 Bank Rate cut and the realisation that recovery from the economic impacts of Covid-19 is going to be with us for some time to come. Balances available for investment were significantly reduced during the year owing to the demands of the property investment strategy and the funding of the capital programme, which also restricted the planned diversification into longer-term pooled investment vehicles such as multi-asset funds. These funds have the potential for greater revenue income, but also have the potential for capital loss as well as capital growth. For these reasons, they are viewed with a minimum 5 year investment horizon which, in theory, evens out capital loss and growth.

50 In 2020/21 the average return on the Council’s investments was roughly in line with that of our neighbouring authorities. Our overall rate of return was 0.35% compared with 0.22% for Tonbridge & Malling Borough Council and 0.36% for Gravesham Borough Council. It should be noted that investment returns are notoriously difficult to compare as they have often been compiled on a different basis (for example, whether or not interest has been compounded, whether or not cashflow generated balances have been included, whether or not externally managed funds have been included and whether or not the figures are net of borrowings). Note that this Council has also invested in property which is not included in this report.

51 Our treasury management advisers recommend the 3-month LIBID figure as a benchmark. This reflects a more realistic neutral investment position for core investments with a medium term horizon and a rate which is more stable with less fluctuation caused by market liquidity. Historically, this rate has been slightly higher than the 7-day rate and therefore more challenging a comparator, but one which does not necessitate a significantly increased level of risk. The figures calculated by our advisers for these two benchmarks are as follows:

- 7-day LIBID uncompounded -0.0706%
- 3-month LIBID uncompounded 0.0150%

Compliance with treasury management limits and prudential indicators

52 The Council operates to approved prudential indicators for treasury management as contained in the Treasury Management Strategy Statement (TMSS). The TMSS for 2020/21 was part of the annual treasury strategy reported to Council on 25 February 2020. The approved limits exist to regulate short-term borrowing for operational cash flow fluctuations, as well

as long-term borrowing for financing capital investments. Additionally, the limits aim is to mitigate against fluctuations in interest rates.

Other issues

Update on the Municipal Bonds Agency

53 During 2014/15, the Council invested £50,000 to become an equity shareholder in the Local Capital Finance Company, which was set up by the Local Government Association under the name of the Municipal Bonds Agency (MBA). This was a ‘Policy Investment’ and does not form part of the treasury management strategy. The purpose of the agency is to facilitate borrowing by local authorities at rates that are expected to be more competitive than those of the Public Works Loan Board (PWLB). There are 56 shareholder councils.

54 The MBA has revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor. A planned third bond issuance by Warrington Borough Council was withdrawn in early December after the reduction in PWLB borrowing rates.

55 The Company also engaged with a number of local authorities amongst its shareholders and others with respect to their debt finance requirements and supported authorities in their due diligence process. The Company is now working to assemble a number of councils with borrowing demand, with a view to returning to the market with a pooled bond in 2021.

56 The MBA is an option for any future borrowing requirement, but the Council will first need to ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

CIPFA consultations

57 In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee’s recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. These are principle-based consultations and will be followed by more specific proposals later in the year.

58 In the Prudential Code the key area being addressed is the statement that “local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed”. Other proposed changes include the sustainability of capital expenditure in

accordance with an authority's corporate objectives, i.e. recognising climate diversity and innovation, commercial investment being proportionate to budgets, expanding the capital strategy section on commercial activities, replacing the "gross debt and the CFR" with the liability benchmark as a graphical prudential indicator.

59 Proposed changes to the Treasury Management Code include requiring job specifications and "knowledge and skills" schedules for treasury management roles to be included in the Treasury Management Practices (TMP) document and formally reviewed, a specific treasury management committee and a new TMP 13 on Environmental, Social and Governance Risk Management.

Non-treasury management investments

60 Members will be aware that significant property purchases have been carried out in recent years which are regarded as non-treasury investments. Further details are contained within Property Investment Strategy reports that are submitted to Members separately.

Key Implications

Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement

Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This annual review report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2017.

Treasury management has two main risks :

- Fluctuations in interest rates can result in a reduction in income from investments; and

- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral in our approach to treasury management. However, this particular report has no specific risk implications as it is not proposing any new actions, but merely reporting performance over the last year.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Conclusions

The overall return on the Council's investments was below budget in 2020/21 by more than £220,000 but the percentage return exceeded the recognised benchmarks. Inflation continues to outpace investment returns, leading to the gradual erosion of capital in real terms.

The economic situation both globally and within the Eurozone remains volatile, and this will have consequences for the UK economy. Treasury management in the past financial year was conducted against this background and with a cautious investment approach.

Appendices

Appendix A – Investment portfolio at start and end of financial year

Appendix B – Analysis of investment portfolio by maturity and repayment due dates

Appendix C - Investment performance in 2020/21

Background Papers

Treasury Management Strategy for 2020/21 - Council 25 February 2020

Adrian Rowbotham
Deputy Chief Executive and Chief Officer Finance & Trading