Appendix A

Annual Treasury Management Report 2020/21

1. Introduction

1.1. The council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management. Before the start of every year the Code requires local authorities to produce Prudential Indicators and a Treasury Management Strategy Statement detailing the policies and objectives of the council's treasury management activities for the forthcoming year. This outturn report compares actual activity to those policies and objectives.

1.2. The council borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of these risks are central to the treasury management strategy.

2. Economic Background

2.1. **Growth:** 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 damaged 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 fast programme of vaccinations promises to lead to a return to something approaching normal life during the second half of 2021. This 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.

2.2. **UK Monetary Policy**: 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 (purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields). The MPC then increased 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.

2.3. **Inflation:** Average inflation targeting 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 expected to be a temporary short lived factor.

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3. Borrowing

3.1. The council continues to choose to utilise accessing lower cost short-term loans from other local authorities, should it need to, rather than more expensive longer term debt due to the differential between short and longer-term interest rates. This policy is expected to continue in 2021/22 but should this differential decrease and short term borrowing costs increase, the council will begin securing additional fixed long term debt to fund its borrowing requirements.

3.2. In 2020/21 no new borrowing was required. The weighted average interest rate paid on council borrowing increased to 4.00% (3.96% in 2019/20) reflecting the higher cost of older long term borrowing.

3.3. It is council strategy to maintain borrowing and investments below their underlying levels by using "internal borrowing", utilising usable reserves. This maintains borrowing and investment balances to a minimum level, reducing interest cost and counterparty exposure risk.

3.4. Gilt yields and public works loan board (PWLB) rates fell sharply from the start of 2020 and then spiked up in March due to the pandemic. Once the UK vaccination programme started making rapid progress in the new year of 2021, gilt yields and PWLB rates started rising sharply as confidence in economic recovery rebounded. A consultation was 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 had purchase of assets for yield in its three year capital programme. There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years.

3.5. The premium charged by the PWLB for the early repayment of PWLB debt remained too expensive for existing loans in the council's portfolio to be repaid and rescheduled. No rescheduling activity was undertaken in 2020/21, this option will continue to be constantly considered.

3.6. Borrowing activity during the year is summarised below:

Borrowing Activity in 2019/20	**01/04/20 Balance £m**	**New Borrowing £m**	**Debt Maturing £m**	**31/03/21 Balance £m**
Short-term borrowing	0.0	0.0	0.0	0.0
Long-term borrowing	130.3	0.0	(3.5)	126.8
TOTAL BORROWING	**130.3**	**0.0**	**(3.5)**	**126.8**
Other long-term liabilities*	50.9	0.4	(2.9)	48.4
TOTAL EXTERNAL DEBT	**181.2**	**0.4**	**(6.4)**	**175.2**
**Other long term liabilities represent existing commitments under PFI arrangements included in the medium term financial strategy*				

3.7. Total borrowing decreased by £3.5m representing repayments made during the year. No new external borrowing was required during 2020/21.

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3.8. The council's underlying need to borrow is measured by the Capital Financing Requirement (CFR). As at 31/03/2021 this totalled £313.7m. The difference of £138.8m between the CFR and total external debt shown in the table above represents internal borrowing from usable reserves, working capital balances and the outstanding loan balance with Mercia waste of £34.4m.

3.9. The council's capital financing costs in 2020/21 were as follows.

Capital financing costs for 2020/21:	**Budget**	**Outturn**	**Over / (under) spend**
	£m	**£m**	**£m**
Minimum Revenue Provision (provision for repayment of loan principal)	**7.6**	**7.6**	**-**
Interest payable on all loans	**6.2**	**5.2**	**(1.0)**
TOTAL	**13.8**	**12.8**	**(1.0)**

3.10 The underspend has arisen from a slippage in the capital investment budgeted spend in 2020/21 meaning no new borrowing was required to fund this spend which delivered an underspend in expected interest payable. The saving in a reduced minimum revenue provision cost has been used to set up an ear marked reserve recovery fund.

4. Investments

4.1. The council invests significant funds, representing income received in advance of expenditure plus balances and reserves. During 2020/21 the council's investment balances averaged at £77m and ranged from £111m in January 2021 to £56m in May 2020. Much of this increased cash balance reflected the receipt of central government grant funding in advance of spend in response to Covid 19.

4.2. Security of capital remained the council's primary objective. Investment income remained low due to the continued low interest rate environment.

4.3. Investments held at the start and end of the year were as follows:

Investments	**31/03/20 Balance £m**	**Investments Made £m**	**Maturities/ Withdrawals £m**	**31/03/21 Balance £m**
Instant Access Accounts	19.00	385.83	(387.28)	17.55
Notice Accounts	5.00	8.88	-	13.88

Fixed Term Deposits	14.00	45.00	(29.00)	30.00
Total	**38.00**	**439.71**	**(416.28)**	**61.43**
Increase in investments				**23.43**

4.4. Interest received during the year was as follows:

Month	Average amount invested		Average rate of interest earned		Budget	Interest earned	(Surplus) /deficit
	Actual £m	Budget £m	Actual %	Budget %	£000	£000	£000
Apr-20	78.5	40	0.50	0.50	17	30	(13)
May-20	63.2	40	0.47	0.50	17	25	(8)
Jun-20	67.0	40	0.39	0.50	17	21	(4)
Jul-20	79.4	40	0.24	0.50	17	16	1
Aug-20	75.7	40	0.20	0.50	17	13	4
Sep-20	72.2	40	0.17	0.50	16	10	6
Oct-20	71.9	40	0.15	0.50	17	9	8
Nov-20	82.2	40	0.10	0.50	16	7	9
Dec-20	84.1	40	0.09	0.50	17	6	11
Jan-21	92.0	40	0.08	0.50	17	6	11
Feb-21	85.4	40	0.09	0.50	15	6	9
Mar-21	72.3	40	0.11	0.50	17	7	10
Outturn					**200**	**156**	**44**

4.5. The interest received in the year was lower than the budget because, despite having high balances invested, the interest rates dropped in response to the Covid-19 pandemic.

4.6. The average interest rate achieved during 2020/21 was 0.22%, lower than budgeted due to the Covid-19 pandemic and the subsequent base rate reductions. This compares favourably with the generally accepted benchmark of the average 7-day London Inter-Bank Bid (LIBID) rate of (0.07%).

4.7. In addition to interest earned on balances interest has been accrued in relation to the energy from waste plant loan to Mercia waste. This totalled £2.4m, the net loan position is set aside to fund increased waste disposal costs in future years.

5. Compliance with Prudential Indicators

5.1 The Council complied with its Prudential Indicators, Treasury Management Policy Statement and Treasury Management Practices for 2020/21 as detailed in Annex 1. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

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Annex 1

Performance Indicators

1. Treasury Management Indicators

The council measures and manages its exposures to treasury management risks using the following indicators.

1.1 Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Lower Limit %	Upper Limit %	Actual Fixed Rate Borrowing 31/03/21 £m	% Fixed Rate Borrowing 31/03/21
Under 12 months	0%	10%	**2.37**	**2%**
12 months and within 24 months	0%	10%	**6.53**	**5%**
24 months and within 5 years	0%	25%	**15.21**	**12%**
5 years and within 10 years	0%	35%	**17.91**	**14%**
10 years and above	0%	80%	**84.78**	**67%**
Total			**126.80**	**100%**

Two LOBO (“Lenders Option then Borrowers Option”) bank loans of £6m each are repayable in 2054 however if the lenders seek to increase the interest rate charged, currently 4.50%, the council has the opportunity to repay the loans.

1.2 Upper Limit for Total Principal Sums Invested Over 364 Days

The purpose of this limit is to contain exposure to the possibility of financial loss that may arise as a result of the council having to seek early repayment of the sums invested.

Upper Limit for Total Principal Sums Invested Over 364 Days	2020/21 Approved £m	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m
Total	**5**	**0**	**5**	**5**

During 2020/21 no long-term investments were made for a period exceeding 364 days.

2. Prudential Indicators

2.1 Estimates of Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on council tax.

Capital expenditure has been and is expected to be financed or funded as follows:

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Capital Financing	2020/21 Estimate £000	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Capital grants	46,539	43,672	41,788	21,587	11,600
Capital receipts	9,563	696	13,410	7,041	4,020
Revenue funding	1,000	38	500	-	-
Prudential borrowing	32,914	10,604	42,172	38,006	5,559
Total	**90,016**	**55,010**	**97,870**	**66,634**	**21,179**

Generally prudential borrowing finance is provided where the return on the investment exceeds the debt financing cost.

3. Capital Financing Requirement (CFR)

Estimates of the council's cumulative maximum external borrowing requirement for 2020/21 to 2022/23 are shown in the table below:

Capital Financing Requirement	2020/21 Estimate Approved £000	**2020/21 Actual £000**	2021/22 Estimate £000	2022/23 Estimate £000
Total CFR	**380,369**	**313,663**	**346,032**	**373,021**

Total debt is expected to remain at or below the CFR during the forecast period.

4. Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit or Authorised Limit. This is a statutory limit which should not be breached.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst-case scenario without the additional headroom included within the Authorised Limit.

	2020/21 Approved Operational Boundary £m	**2020/21 Approved Authorised Limit £m**	**Actual External Debt as at 31/03/21 £m**
Borrowing	340.0	350.0	126.8
Other Long-term Liabilities	60.0	70.0	48.4
Total	**400.0**	**420.0**	**175.2**

5. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

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Ratio of Financing Costs to Net Revenue Stream	**2020/21 Approved %**	**2020/21 Actual %**
Net Revenue Stream	156,099	157,155
Financing Costs	13,573	12,786
Percentage	**8.6%**	**8.1%**

6. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the council has adopted the principles of best practice.

The council has incorporated the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* into its treasury policies, procedures and practices.