CRMG Scrutiny Committee	15 June 2021
Cabinet Meeting	29 June 2021
Council Meeting	17 July 2021

TREASURY MANAGEMENT ANNUAL REPORT 2020/21

Report of the Deputy Chief Executive (Section 151 Officer)

1 INTRODUCTION AND PURPOSE OF REPORT

1.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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, 27 February 2020);
- a mid-year treasury update report (Council, 21 January 2021);
- an annual report following the year describing the activity compared to the strategy (this report).

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

1.4 The Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Corporate, Resource Management and Governance Scrutiny Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 8 December 2020 in order to support Members' Scrutiny and Cabinet role.

1.5 During 2020/21, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators are found in the main body of the report. The Deputy Chief Executive (Section 151 Officer), confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

1.6 The financial year 2020/21 continued the challenging investment environment of previous years, namely low investment returns.

AGENDA ITEM

2 TREASURY MANAGEMENT POLICY STATEMENT AND PRACTICES (TMPs)

2.1 The Council's Treasury Code of Practice Statement, Treasury Management Policy Statement and the detailed Treasury Management Practices were last updated and approved by the Council Meeting on 17 September 2020.

2.2 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code. A particular focus of these revised codes was local authority investments which are not treasury type investments which consequently were reported to Members in February 2020 in a separate Capital Strategy report.

2.3 The Treasury Management Policy Statement has been updated to incorporate the necessary changes resulting from the December 2017 revisions to the Treasury Management and Prudential Codes and also for the revised MHCLG guidance for investments and MRP which were introduced in 2017.

2.4 The full TMPs have not been included in this report due to their length and complexity but are available to view on request.

3 CAPITAL EXPENDITURE AND FINANCING 2020/21

3.1 The Council undertakes capital expenditure on long-term assets. These activities may be financed by either:

- The application of specific capital or revenue resources (capital receipts, capital grants, capital reserves or revenue contributions); and
- Prudential borrowing (in year capital financing requirement).

3.2 The table below set out the original estimate and actual capital expenditure for 2020/21 and illustrates how this was financed compared to the previous financial year.

	2019/20 Actual £000	**2020/21 Budget £000**	**2020/21 Actual £000**
General Fund			
GF Capital Expenditure	78,151	155.645	94.765
Resourced by:			
Capital grants	27,997	44.838	31.155
Capital receipts	620	3.504	0.371
Capital contributions	3,372	3.526	0.824
Revenue contributions		2.323	2.962
In year Capital Financing Requirement	**46,162**	**101.454**	**59.453**
HRA			
HRA Capital Expenditure	21,572	63.170	21.308
Resourced by:			
Capital grants	144	11.440	1.521
Capital receipts	1,770	0.680	0.981
Capital contributions			0.010
Revenue contributions	11,904	12.783	12.344
In year Capital Financing Requirement	**7,754**	**38.267**	**6.452**

3.3 The decrease in General Fund prudential borrowing from £101.454m in the budget capital programme for 2020/21 to £59.453m at outturn is largely due to a number of re-phased schemes to later years; most notably £28.162m for School Capital Strategy Investment, £8.500m for the Borough Care scheme, and £8.235m for the Council's Asset Management Plan schemes.

3.4 There was also a significant decrease in the prudential borrowing in the HRA capital programme largely for the New Build schemes, reducing from £38.267m in the budget to £6.452m at outturn. The capital financing requirement has increased from £144.980m at the start of the year to £150.964m (illustrated in 4.5 below).

4 BORROWING NEED, PRUDENTIAL AND TREASURY INDICATORS

4.1 The Council's underlying need to borrow for capital expenditure is measured through the Capital Financing Requirement (CFR). This figure is a gauge of the Council's requirement to take on long term borrowing. The CFR is amortised and charged to revenue over a number of years. The in-year CFR represents 2020/21 capital expenditure (see tables above) which has not yet been paid for by revenue or covered by specific capital cash backed resources, such as specific grants.

4.2 Part of the Council's treasury activities is to manage the Council's long-term borrowing requirements. The treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and long term cash flow requirements and balance this with short term day to day cash requirements. Long-term borrowing may be sourced through borrowing from external bodies such as the Government, through the Public Works Loan Board (PWLB) or the money markets, or alternatively utilising temporary cash resources from within the Council.

4.3 The General Fund underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets financed through borrowing are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the General Fund borrowing need. There is no statutory requirement for the Council to reduce the HRA CFR.

4.4 The Council's 2020/21 MRP Policy (as required by MHCLG Guidance) was approved as part of the Treasury Management Strategy Report for 2020/21 on 27 February 2020.

4.5 The Council's CFR for the year is shown below and represents a key prudential indicator (this includes leasing schemes on the balance sheet, which increase the Council's borrowing need).

Capital Financing Requirement (CFR):	**31.03.20 Actual £000**	**31.03.21 Budget £000**	**31.03.21 Actual £000**
General Fund (GF)			
Opening balance	569,773	610.823	602,329
Add in year CFR (as above)	46,161	101.454	59,453
Transfers between GF and HRA			
Less MRP/voluntary MRP	(13,605)	(14.970)	(14,747)
Closing balance	**602,329**	**697.307**	**647,035**

Capital Financing Requirement (CFR):	31.03.20 Actual £000	31.03.21 Budget £000	31.03.21 Actual £000
Housing Revenue Account (HRA)			
Opening balance	138,512	146.047	144,980
Add in year CFR (as above)	7,754	38.267	6,452
Transfers between GF and HRA			
Less MRP/voluntary MRP	(1,286)	(692)	(468)
Closing balance	**144,980**	**183.435**	**150,964**

Note: the CFR opening balances (GF and HRA) for the 2020/21 budget differs to the actual closing balance as at 31 March 2020. This is because budget was calculated on estimates in February 2020, prior to the end of the 2019/20 financial year.

4.6 Actual borrowing activity is monitored through the prudential indicators for borrowing and the CFR and by the authorised limit and operational boundary; these are described below.

4.7 **Gross Borrowing and the CFR**: in order to ensure that actual borrowing levels are prudent over the medium term, the Council's external borrowing must only be for capital purposes. This essentially means that the Council is not borrowing to support revenue expenditure. Gross external borrowing should not therefore, except in the short term, exceeded the total of the CFR for 2020/21 plus the estimates of any additional capital financing requirement for the current year (2021/22) and next two financial years. This indicator allows 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 against the CFR. The Council has complied with this prudential indicator.

Gross Borrowing and the CFR	31.03.20 Actual £000	31.03.21 Original £000	31.03.21 Actual £000
Gross borrowing	652,700	784,757	630,425
Other long-term liabilities	13,700	13,700	13,700
Total Gross External Debt	**666,400**	**798,457**	**644,125**
CFR	747,309	880.742	797,999

Note: The actual gross external debt as at 31 March 2021 above differs from the total debt figures in the table in 5.2 below as this includes the finance lease for Stockport Exchange Central Multi-Storey Car Park under 'other long-term liabilities'.

4.8 **The authorised limit**: the authorised limit is the 'affordable borrowing limit' required by Section 3 of the Local Government Act 2003; 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.

4.9 **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 is acceptable subject to the authorised limit not being breached. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its operational boundary.

4.10 **Actual financing costs as a proportion of net revenue stream**: this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2019/20 Actual £000	**2020/21 Actual £000**
Authorised Limit	856,000	939,000
Maximum gross borrowing position during the year	642,700	674,589
Operational Boundary	836,000	919,000
Average gross borrowing position during the year	584,855	659,672
Financing costs as a proportion of net revenue stream: General Fund	9.07%	9.29%
Financing costs as a proportion of net revenue stream: HRA	10.61%	10.72%

4.11 The 2020/21 budget financing costs as a proportion of net revenue stream were:
- General Fund 8.98%
- HRA 10.79%

5 TREASURY POSITION AS AT 31 MARCH 2021

5.1 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices.

5.2 At the beginning and the end of 2020/21 the Council's treasury position was as follows:

Treasury Position	Financial Year 2019/20 (2 Pools)				**Financial Year 2020/21 (2 Pools)**			
	General Fund		HRA		**General Fund**		**HRA**	
	£000	%	£000	%	**£000**	**%**	**£000**	**%**
	as at 31.03.20		as at 31.03.20		**as at 31.03.21**		**as at 31.03.21**	
Fixed Rate Funding:								
PWLB	320,975	3.22%	75,494	4.76%	**305,975**	**3.31%**	**75,494**	**4.76%**
Market (LOBO)	10,942	4.26%	6,558	4.26%	**10,942**	**4.26%**	**6,558**	**4.26%**
Market (converted LOBOs)	37,517	3.89%	22,483	3.89%	**37,517**	**3.89%**	**22,483**	**3.89%**
Market (other long-term loans)	40,000	2.33%	0	0%	**40,000**	**2.33%**	**0**	**0%**
Market (other LAs +364 days)	7,500	1.00%	0	0%	**10,000**	**1.00%**	**0**	**0%**
Market (short-term)	128,000	1.00%	0	0%	**118,000**	**0.38%**	**0**	**0%**
Salix loans	3,212	0.00%	0	0%	**3,437**	**0%**	**0**	**0%**
Sub-total	548,146		104,535		**525,871**		**104,535**	
Variable Rate Funding:								
Market (short-term)	19	0.10%	0	0%	**19**	**0.10%**	**0**	**0%**
Sub-total	19		0	0%	**19**		**0**	**0%**
Total Debt	548,165	2.66%	104,535	4.54%	**525,890**	**2.57%**	**104,535**	**4.54%**
Total Investments	110,345	0.66%	0	0%	**24,275**	**0.10%**	**0**	**0%**
Net Debt	437,820		104,535		**501,615**		**104,535**	

5.3 The decrease in PWLB borrowing as at 31 March 2021 in the table above represents a £15m long-term loan repayment in April 2020. Overall the General Fund loans rate has reduced from 2.66% to 2.57% between years largely

representing the decrease in short-term borrowing costs as a result of the effect of the reduction in Bank Rate in March 2020/21.

5.4 The maturity structure of the debt portfolio was as follows:

Maturity structure of fixed rate borrowing	31.03.20 Actual	2020/21 Original (Max %)	31.03.21 Actual
Under 12 months	22.6%	45%	22.3%
12 months and within 24 months	2.4%	45%	0.12%
24 months and within 5 years	3.4%	45%	3.51%
5 years and within 10 years	1.1%	45%	3.95%
10 years and above	70.5%	100%	70.11%
	100.0%		100.0%

5.5 The maturity structure of the investment portfolio was as follows:

Investment Portfolio	31.03.20 Actual £000	2020/21 Original (Max Limit) £000	31.03.21 Actual £000
Less than 365 days	110,345	No limit	24,275
Over 365 days	0	80,000	0
Total	110,345		24,275

5.6 The exposure to fixed and variable rates was as follows:

Interest Rate Exposure	31.03.20 Actual %	2020/21 Original (Max Limit) %	31.03.21 Actual %
Fixed Rate:			
Gross borrowing (Principal)	100%	100%	100%
Variable Rate:			
Gross borrowing (Principal)	0%	40%	0%

5.7 The table above illustrates the maximum limits that have been set (in percentage terms) for the Council's total borrowing that can be at either fixed or variable interest rates; it then compares these limits to the actual borrowing at fixed and variable rates at the year end.

5.8 The percentage for fixed rate borrowing is set at 100% of the Council's loans portfolio, because at certain times in the financial year the Council does not have any temporary borrowing at variable rates, as the majority of borrowing is in the form of longer dated fixed rate loans. This point is emphasised in the Council's actual borrowing as at 31.03.21 which is entirely at fixed rates.

5.9 The maximum limit for variable rate loans is set much lower as it would not be desirable for the Council to have too much of its loan portfolio at variable rates, potentially exposing it to an unacceptable levels of interest rate refinancing risk if rates should suddenly rise.

6 THE STRATEGY FOR 2020/21

6.1 The expectation for interest rates within the initial Treasury Management Strategy for 2020/21 anticipated that Bank Rate would remain at 0.75% until March 2021,

(although there were many variables at play that could significantly alter this prediction), with a bias to rates potentially being cut if Brexit ended up impacting UK economic growth.

6.2 PWLB rates would likely be subject to significant volatility, driven predominantly by developments with Brexit and ensuing investor confidence. The long-term forecast for PWLB rates was on a gently rising trend.

6.3 Target PWLB borrowing rates at which new long-term borrowing would be considered (as at Q1 2020) were; 5 year 2.40%, 10 year 2.70%, 25 year 3.30% and 50 year 3.20%.

6.4 There would be gradual rises in medium and longer term fixed borrowing rates during 2020/21. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

6.5 Investment returns were likely to remain low during 2020/21 but to be on a gently rising trend over the next few years.

6.6 In this scenario, the treasury strategy was that the Council maintain an under-borrowed position, meaning that capital borrowing need (the Capital Financing Requirement), would not be fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as a temporary measure. This strategy was prudent as investment returns were low and counterparty risk was still an issue that needed to be considered. The policy would be kept under review in light of changes in the outlook for interest rates and other market developments that may impact the central strategy; this could mean the Council may incur higher borrowing costs in the future when it may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

6.7 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Deputy Chief Executive (Section 151 Officer), therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- If it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- 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.

6.8 What actually transpired during 2020/21 is explained in the following paragraphs of the report. The global outbreak of Coronavirus forced the UK Government to take drastic steps to stem the economic impact by lowering Bank Rate significantly to

0.10% just ahead of the start of 2020/21 financial year, in March 2020, with the bank warning that the pandemic will result in a 'sharp and large' economic shock. At the same time, gilt yields also fell sharply as investors panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. The far reaching effects of the Coronavirus pandemic spanned the whole financial year and saw PWLB rates/bond yields on a volatile path as investor fears and confidence ebbed and flowed between favouring relatively more 'risky' assets, i.e. equities, or the 'safe haven' of government bonds. Bank Rate remained at 0.10% throughout the financial year with the continuous threat of negative interest rates looming.

7 THE ECONOMY AND INTEREST RATES

7.1 **UK.** 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 considerable 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 2020 did relatively little damage and by the time the third lockdown came in January 2021, businesses and individuals had become more resilient in adapting to working in new ways which resulted in less significant impact. The roll out of vaccines from December 2020 improved things and the UK and US have led the world in implementing a fast programme of vaccination which suggests 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 consequently there is expected to be plenty of repressed demand and purchasing power for services in still-depressed sectors like restaurants, travel and hotels as they reopen. It is expected that the UK economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.

7.2 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.

7.3 The Monetary Policy Committee (MPC) of the Bank of England 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 increased then QE by £100bn in June and by £150bn in November 2020 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 however 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.

7.4 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 2020 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 the 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 as such no increase is expected before 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.

7.5 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 with the Debt to GDP ratio reaching 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 also stop the Debt to GDP ratio rising further from 100%. On a less positive note, 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.

7.6 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 2021 as form filling has now proved to be a formidable barrier, however this appears to have eased somewhat, but remains an area that requires further work to ease difficulties, which are still acute in some areas.

7.7 **USA.** The US economy did not suffer quite so 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 2021 on top of the $900bn fiscal stimulus deal passed by Congress in late December 2020. 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.

7.8 **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.

8 BORROWING RATES IN 2020/21

8.1 PWLB certainty borrowing rates: the table for PWLB maturity rates below shows, for a selection of maturity periods, the range (high and low points) in rates, the average rates and individual rates at the start and the end of the financial year.

8.2 Interest rate forecasts in the initial treasury management strategy expected only gradual rises in medium and longer term fixed borrowing rates during 2020/21 and the two subsequent financial years. Short-term rates, based on Bank Rate, were expected to be the cheaper form of borrowing over the period.

8.3 As illustrated in the table below, PWLB rates were on a rising trend at the start of the financial year. This was at odds with the interest rate forecasts, provided by Link in February 2020, when the initial Treasury Management Strategy for 2020/21 was formulated. At that time the overall longer run future trend was for gilt yields, and consequently PWLB rates, to rise, albeit gently. This view was, for the majority, predicated on assumptions around an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU in December 2020. On this basis, GDP growth was also expected to be subdued in 2020 due to all the uncertainties around Brexit depressing consumer and business confidence. These assumptions where however turned on their head at the start of the financial year when the Covid-19 pandemic hit and everything that had previously been expected and assumed changed significantly.

8.4 Members will recall that the increase in PWLB borrowing rates in October 2019 of 1% implemented by HM Treasury, also meant the Council changed its initial Treasury Management strategy for 2020/21 from previous years and moved away from citing the PWLB as its first choice for raising longer term funding. As such the Council implemented various target borrowing rates for consideration of loans from other market lenders during 2020/21 below the equivalent PWLB rate.

8.5 PWLB rates are based on gilt (UK Government bonds) yields through HM 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. 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.

8.6 Gilt yields fell sharply from the start of 2020 and then spiked up during March 2020 as the effects caused by the pandemic hit western countries and in turn financial markets which 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 PWLB rates started rising sharply as confidence in economic recovery rebounded.

8.7 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%.

8.8 The increase in PWLB rates by HM Treasury in October 2019 was partially reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes. Following a consultation with local authorities during 2020, the 1% increase in lending levels to local authorities (margin over gilt yields) was reversed in November 2020. Consequently 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. As the PWLB lending terms had reverted back to the position pre-October 2019, in Q4 of the financial year, the Council returned to seeing value in borrowing from the PWLB again.

8.9 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% until Q3 2023 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.

8.10 As a result of the explanations above, during the financial year, the 50 year PWLB target (certainty) rate for new long term borrowing changed considerably. For Q1 it was based on initial estimates for PWLB rates for 2020/21 detailed in the Treasury Management Strategy report pre the onset of Covid-19 at 3.20%, this rose to 3.30% and was subsequently revised in November 2020 following the mid-year Treasury Management Review and reduction by HM Treasury PWLB lending levels to 1.30%

PWLB CERTAINTY RATES IN 2020/21					
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Date	04.01.21	11.12.20	11.12.20	11.12.20	11.12.20
High	1.94%	1.99%	2.28%	2.86%	2.71%
Date	08.04.20	08.04.20	11.11.12	11.11.20	11.11.20
Average	1.43%	1.50%	1.84%	2.33%	2.14%
Spread	1.29%	1.27%	1.28%	1.33%	1.39%

9 BORROWING PORTFOLIO OUTTURN FOR 2020/21

9.1 Borrowing is undertaken to fund net unfinanced capital expenditure and naturally maturing debt and also to maintain cashflow liquidity requirements. Throughout 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.

9.2 The Council's opening capital financing requirement (CFR) for 2020/21 was £747.309m rising to £797.999m by 31 March 2021. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table in 4.7 above shows the Council's significantly internally borrowed position (the CFR compared to total gross external debt).

9.3 Whilst the Council continued to run with internal borrowing positions during 2020/21, it was also aware of its reliance on internal cash reserves and the availability of short-term loans from other councils.

9.4 The strategy followed in 2020/21 has been to continue to borrow shorter-term cash from the market (other councils) and to draw back liquid investments to meet cashflow requirements. Years of maintaining an internal borrowing policy has given rise to the need for more significant temporary borrowing. Higher levels of temporary borrowing have also been used to boost short-term investments reserves to a higher level than is usual, aimed at negating the risk to the Council of market liquidity shortages due to the Coronavirus pandemic if they occurred.

9.5 Due to the increase in PWLB margins over gilt yields in October 2019 by HM Treasury, the Council refrained from undertaking new long-term PWLB borrowing in 2020/21 up until this decision was reversed in November 2020. Since November 2018, PWLB rates had fallen significantly (until 100 bps were added to all PWLB rates in October 2019). As the Link long-term forecast for Bank Rate was 2.00% and PWLB certainty rates were close to or above 2.00%, there was little near-term value in borrowing from the PWLB up until the decision was reversed/until it was clear what the new non-HRA borrowing rate would look like after HM Treasury concluded its review of the PWLB Consultation Paper responses. Accordingly the Council continued to switch to short term borrowing in the money markets until the decision was made by the Government to reconsider and reduce the margins charged over gilt yields it passes on to local authorities.

9.6 Opportunities to take long-term loans from alternative market participants were absent during 2020/21, unless the Council had considered bond issuance.

9.7 The Council's borrowing strategy continued to favour short term borrowing from other councils for the remainder of the financial year despite the reduction in PWLB rates. Even though there was now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as rates were at historic lows; greater value could be obtained in borrowing for shorter maturity periods to reduce total interest costs. Investor cash flow uncertainty and the need to maintain liquidity in unprecedented times meant there was a general glut of money circling around at the very short end of the market during 2020/21, this was exacerbated by the significant central government grants paid to local authorities during the financial year. The effect of this saw a number of market participants offer nil or negative rates for very

short term maturities, but also meant the Council could easily raise short-term loans itself from Councils struggling to find homes for their investments.

9.8 The Council continued to make interest savings by taking short-term loans from other Councils throughout 2020/21.

9.9 The Council did not engage in any debt-rescheduling during 2020/21 as the average 1% differential between PWLB new borrowing rates and premature repayment rates, made re-scheduling unviable.

9.10 The Council's overall weighted average borrowing rate for 2020/21 was 2.89% falling from 2.96% for the previous financial year. This change reflects the reduction in Bank Rate for short-term borrowing.

10 INVESTMENT RATES IN 2020/21

10.1 The table below shows investment rates low, high and average levels for 2020/21.

	INVESTMENT RATES IN 2020/21					
	Bank Rate	**7 Day**	**1 Month**	**3 Month**	**6 Month**	**1 Year**
High	0.10%	0.00%	0.14%	0.56%	0.62%	0.77%
High Date	constant	02.04.20	20.04.20	08.04.20	14.04.20	21.04.20
Low	0.10%	-0.10%	-0.11%	-0.10%	-0.10%	-0.05%
Low Date	constant	31.12.20	29.12.20	23.12.20	21.12.20	11.01.21
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%

11 INVESTMENT PORTFOLIO OUTTURN FOR 2020/21

11.1 The Council's cash balances comprise of revenue and capital resources and cash flow monies.

11.2 Investment Policy: the Council's investment policy is governed by MHCLG guidance, which was implemented in the annual investment strategy approved by the Council on 27 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.

11.3 The Council followed its initial investment strategy for 2020/21, reducing investment balances during the financial year where possible in order to minimise credit risk (and in light of low market rates available). For its cash flow generated balances, the Council utilised notice accounts, Money Market Funds and a few fixed term deposits. The Council avoided making any longer term deals (over 365 days) during 2020/21 as investment rates remained at historically low levels.

11.4 Investment returns dropped during 2020/21 to near zero and at times into negative territory. The Council's lending activity managed to avoid negative rates and one feature of 2020/21 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 quashed by the first effects of the Covid-19 pandemic in March 2020, which saw the Monetary Policy Committee of the Bank of England cut Bank Rate in March in two consecutive moves to 0.25% and then 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 large amounts of cheap credit so that banks could help cash-starved businesses survive the lockdown. The Government supplied significant grants to local authorities to pass on to local businesses, this meant that for most of 2020/21 there was considerably much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

11.5 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.

11.6 Overall, 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 higher borrowing and investment rates. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

11.7 At times, however, during the financial year the Council has maintained a higher level of investments for cashflow purposes for the following reasons:

- As a risk measure to counteract any shortages in the market as a result of the Covid-19 pandemic in what has been a very turbulent year;

- As a result of significant Government grants for Covid-19 which the Council has necessarily held for a period before paying out to businesses, i.e. before the necessary mechanisms for pass porting the funds to businesses had been put in place;

- As higher PWLB borrowing rates were still in place for much of the financial year (until they were reduced in November 2020), therefore the Council would maintain higher levels of cash as external long-term loans were more expensive and the Council did not what to put itself at risk (interest rate risk) of being forced to take new PWLB loans if it could not, on occasion, raise short-term loans.

11.8 The Council does not generally have sufficient cash balances to be able to place deposits for more than a few months so as to earn higher rates from longer deposits. The reasons for this are twofold. The Council has generally run down investment balances in recent years when Bank Rate has been at historical lows and opted to primarily use liquid investments to manage cashflow shortages. In addition, continued uncertainty in the aftermath of the 2008 financial crisis has

promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations.

11.9 The Link economic and interest rate forecast was for no change in Bank Rate through 2020 and little material movement in bond yields through the year. With a neutral outlook, this would provide little bias to either extending investment maturities or keeping them short. This meant that cash flow requirements were the pre-eminent role in determining Council's money market activity through 2020.

11.10 The Council's average investment balances for each quarter are detailed in the table below. Whilst balances were maintained at a level to support cash flow fluctuations to the end of 2020, balances fell towards the end of the final quarter of the financial year. This followed the reduction in PWLB rates in Nov 2020 which reduced the Council's need to protect itself against interest rate risk by carrying less liquid investments in reserve.

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

11.12 Detailed below is the result of the investment strategy undertaken by the Council.

Council Performance 2020/21			
Combined Investments	**Average Balance Invested £000**	**Return %**	**Average Duration (days)**
Q1	85,547	0.57%	44.5
Q2	66,748	0.36%	32.4
Q3	75,277	0.17%	52.7
Q4	50,416	0.14%	41.4
Average 2020/21	69,558	0.33%	43.3

11.13 LIBID benchmark rates for differing periods up to 12 months are shown in the table below for the 2020/21 financial year.

Period	**LIBID Rate 2020/21**
7 Day	-0.07%
1 Month	-0.05%
3 Month	0.02%
6 Month	0.07%
12 Month	0.17%

11.14 LIBID is the London interbank bid rate, i.e. what a bank will pay to lenders; 'an investment return'. It is general market practice for fund managers to be benchmarked against LIBID, however their LIBID is compounded to take account of interest that is reinvested. The Council therefore has a target for investment of cash based on LIBID as a benchmark for return/liquidity management.

11.15 During 2020/21 the Council's combined investments (long and short-term) generated a rate of return of 0.33%. This is based on no compounding of interest and can be compared against an uncompounded 7 day LIBID rate of -0.07%, (1 month rate of -0.05%, 3 month rate 0.02%, six month rate 0.07% and twelve month LIBID rate of 0.17%) representing good annual performance above the benchmarks for the duration of the portfolio which is liquid in nature. The Council's return

exceeds that of the twelve month LIBID rate even though its weighted average investment duration was just 43.3 days. The reducing return in the table in 11.3 above also illustrates how market rates fell to lower levels towards the end of the financial year, particularly Money Market Funds.

11.16 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

11.17 Credit Ratings. Whilst UK economic activity has suffered a financial blow during the last fifteen months, despite unpreceded external support from both Government and the Bank of England, UK banks have remained in a stable position. In fact, observing the active role that major UK banks have played during the pandemic, it would be fair to say that they have provided meaningful support to the overall economic and financial stability of the country. Moreover, the role of UK banks and the key credit challenges they face, also need to be understood in the context of the pandemic leading to UK GDP being some 7.3% below what it was pre-pandemic. Indeed, the decline of UK economic output in 2020 was the worst annual performance in more than three centuries.

11.18 Looking at the major UK banks, and noting that most of them are UK focused operationally, it is perhaps surprising that we have seen no major negative credit-rating actions by the three main credit rating agencies, excluding the fact that ratings of the UK banks were place on Negative Outlook in March 2020, reflecting the economic disruption driven by the Coronavirus pandemic.

11.19 More than a year on and not much has changed from the ratings agencies' perspective as we have seen very little movement in credit ratings. The same could be said if we observe key market indicators, such as equity prices and CDS yields. This is not to say that UK financial institutions were left unscathed from recent months of hardship. Whilst rating changes were kept to a minimum, agencies were active in providing regular updates assessing banks' resilience during the pandemic.

11.20 Looking at the most recent ones, the general theme is quite encouraging and the outlook for UK banks is expected to remain steady, highlighting their strong position. As the same time, it is important to emphasise that credit risk is still present and susceptible to on-going market volatility which will be a feature for the Treasury Team to continue to manage in 2021.

12 **PERFORMANCE MEASUREMENT**

12.1 One of the key requirements in the Treasury Management Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators are set in the Treasury Management Policy Statement and Annual Treasury Management Strategy.

12.2 This service has set the following performance indicators:

- Debt (borrowing): average rate movement year on year (illustrated in table in paragraph 5.2)

- Investments: internal returns above the 7 day LIBID rate (paragraphs 11.11 to 11.14)

13 CONCLUSIONS AND RECOMMENDATIONS

13.1 The Council's treasury management function has been successful in 2020/21; investment performance has achieved an annual return of 0.33% and debt costs have been minimised at an overall rate of 2.89%

13.2 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

13.3 The Council has had as its first priority the security of invested funds and its policy to place appropriate parameters (in terms of credit quality), to organisations with whom it invests. This has safeguarded the Council's investments during 2020/21.

13.4 2020 was an unprecedented year due to the outbreak of the Coronavirus pandemic and its far reaching effects on all aspects of life, with the UK economy shrinking by 9.9% as Coronavirus restrictions hit output. The contraction in 2020 was more than twice as much as the previous largest annual fall on record.

13.5 Going forward, the pandemic will continue to weigh on the global economy in 2021 and it is likely it will take time for it to get back to where it was in February 2020, even with the roll out of vaccines. The pace at which the recovery will be achieved will be helped by the vaccine, but there will be disparity in the rate of inoculation around the world, with the UK to the fore in this area. Against that background there appears to be little prospect of a swift reversal of the fiscal/monetary stimulus pumped into economies to sustain them through the pandemic. Central banks will face the tightrope of the timing of such decisions, knowing that acting too early would dent the recovery. Government debt levels will remain high for some time to come, with the US about to increase levels under the new Biden administration. The recent sales in global bonds has seen a pick-up in yields and investors have had a period of concern about rising inflation and the impact on policy, but central banks have come out to reiterate that current policies will be kept in place until their targets for growth, employment and inflation have been met, and achievement of those is some way off.

13.6 Analysts do not expect Covid-19 to have a long-lasting impact on the economy, as the recovery should be swift and broad enough to avert such problems. The bank of England, however, may not be able to change policy rates until as far down the line as 2025, because sustained CPI of higher than 2% is not likely before 2023, or possibly 2024. The economy will gradually reopen over the coming months, with all adults having received their first vaccination by July. Thereafter a consumer spending spree is expected, particularly in hospitality and recreation. Recovery could be stronger if savings built up over the pandemic start to be used. There may also be a speedier return of investment than seen post financial crash. However Eurozone weakness and Brexit challenges could hold back exports, though the strength of domestic demand should underpin recovery.

13.7 The Cabinet is asked to recommend that the Council Meeting:

- Approve the actual 2020/21 prudential and treasury indicators in this report;
- Note the annual treasury management report for 2020/21.

BACKGROUND PAPERS

There are none

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian

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