Chairs Briefing: Corporate Policy and Resources
Wednesday 07 July 2021

Subject: Treasury Management Annual Report 2020-21

Report by:	Assistant Director Finance, Business Support and Property Services (S151)
Contact Officer:	Caroline Capon Corporate Finance Team Leader caroline.capon@west-lindsey.gov.uk
Purpose / Summary:	To report on Annual Treasury Management activities and prudential indicators for 2020-21 in accordance with the Local Government Act 2003

RECOMMENDATION(S):

1. Members propose the Annual Treasury Management Report and actual Prudential Indicators 2020/21 to Full Council for approval.

IMPLICATIONS

Legal: This report complies with the requirement of the Local Government Act 2003.

Financial : FIN/51/22/A/CC

Treasury Investment activities have generated £0.185m of investment interest at an average rate of 0.896%.

Non-Treasury investments (Investment Property acquisitions) have generated a gross yield of 6.43%

Financing activities has resulted in a total of £20m of external borrowing at a cost in year of £0.391m.

Staffing : None from this report

Equality and Diversity including Human Rights : None from this report

Data Protection Implications : None from this report

Climate Related Risks and Opportunities: None from this report

Section 17 Crime and Disorder Considerations: None from this report

Health Implications: None from this report

Title and Location of any Background Papers used in the preparation of this report :
CIPFA Code of Treasury Management Practice CIPFA The Prudential Code Local Government Act 2003 Located in the Finance Department, Guildhall, Gainsborough

Risk Assessment :
The Treasury Management Strategy sets our assessment of Treasury risks.

Call in and Urgency:

Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)	**Yes**		**No**	**x**

Key Decision:

A matter which affects two or more wards, or has significant financial implications	**Yes**		**No**	**x**

1. Executive Summary

The Council are required to receive as a minimum the following reports;

- an annual treasury strategy in advance of the year (March 2020)
- a mid-year, (minimum), treasury update report (November 2020)
- an annual review following the end of the year describing the activity compared to the strategy, (this report)

In addition, this Corporate Policy and Resources Committee has received quarterly treasury management update reports.

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.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by either the Governance and Audit Committee who provide scrutiny of the Treasury Management Strategy and the Corporate Policy and Resources Committee who monitor in year performance and mid-year updates. Member training on treasury management issues was undertaken during the year in order to support members' scrutiny role.

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 as follows:

Prudential and treasury indicators	**2019/20 Actual £000**	**2020/21 Original £000**	**2020/21 Actual £000**
Capital expenditure	18,029	24,118	9,034
Capital Financing Requirement:	37,905	50,307	38,526
Of which – Investment Properties	*21,602*	30,000	*20,959*
Gross borrowing (External)	**20,000**	**38,189**	**20,000**
Finance Lease	0	0	0
Investments			
• Longer than 1 year	3,000	3,000	3,000
• Under 1 year	8,670	10,321	13,872
• **Total**	**11,670**	**13,321**	**16,872**
Net borrowing	**8,330**	**24,868**	**3,128**

Other prudential and treasury indicators are to be found in the main body of this report. The Assistant Director Property Services, Business Support and Finance (S151 Officer) also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, (the authorised limit), was not breached.

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

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness, (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

2. Capital Expenditure and Financing

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

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

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

Capital and Financing	2019/20 Actual £000's	2020/21 Original Budget £000's	2020/21 Actual £000's
Capital expenditure	**18,029**	**18,029**	**9,034**
Financed in year by:			
Capital Receipts	359	2,152	2,519
Capital grants/contributions	734	5,728	3,314
Revenue	1,801	5,538	1,576
Leases	0	0	0
S106	202	500	17
Prudential Borrowing	14,933	10,200	1,608

3. The Council's overall borrowing need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2020/21 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets 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) borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

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 02 March 2020.

In respect of Commercial Investment Properties, which are funded from borrowing, no MRP will be payable, however in 2020/21 voluntary revenue provision (VRP) was applied (£707k). The Council has retained a Valuation Volatility Reserve with a minimum balance of 5% of purchase price of the portfolio. This Reserve will be utilised to mitigate any loss on the investment upon sale of the assets if the capital receipt does not meet the debt outstanding. This is considered a prudent approach for these specific assets.

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

Capital Financing Requirement (CFR)	31 March 2020 Actual £000's	31 March 2021 Actual £000's
Opening balance	23,082	37,905
Add adjustment for the inclusion of on-balance sheet leasing arrangements and Prudential Borrowing	14,933	1,608
Less MRP/Finance Lease Repayments	(110)	(281)
Less VRP	0	(707)
Closing balance	**37,905**	**38,525**
Movement on CFR	*14,823*	*620*

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council ensures that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2020/21. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2020 Actual £000's	31 March 2021 Actual £000's
Prudential borrowing position	33,381	38,453
CFR	37,905	38,525

The Authorised Limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its authorised limit.

The Operational Boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

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.

	2020/21 £000's
Authorised limit	55,307
Operational boundary	21,608
Financing costs as a proportion of net revenue stream	7.41%

4. Treasury Position as at 31 March 2021

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

4.1 Borrowing

TABLE 1	**31 March 2020 Principal £000's**	**Rate/ Return**	**Average Life yrs.**	**31 March 2021 Principal £000's**	**Average Rate/ Return**	**Average Life yrs.**
Fixed rate funding:						
-PWLB	16,500	2.14%	27	16,500	2.14%	27
-Other LA	3,500	1.02%	1	3,500	1.02%	1
Total debt	**20,000**	**1.95%**	**22**	**20,000**		***22***
CFR	**37,905**		**-**	**38,525**	**-**	**-**
Over / (under) borrowing	**(17,905)**	**-**	**-**	**(18,525)**	**-**	**-**
Investments:						
	11,670	1.655%	-	16,872	0.896%	-
Total investments	**11,670**	**1.655%**	**-**	**16,872**	**0.896%**	**-**
Net debt	**8,330**	**-**	**-**	**3,128**		**-**

Under borrowing reflects Internal Borrowing from the Council's cash balances.

The maturity structure of the debt portfolio was as follows:

	31 March 2020 Actual £000's	31 March 2021 Actual £000's	%
Less than 5 years	6,000	6,000	30
5 years and within 10 years	3,000	3,000	15
10 years and within 20 years	0	0	0
20 years and within 30 years	2,500	2,500	12.5
30 years and within 40 years	0	0	0
40 years and within 50 years	8,500	8,500	42.5

£16.5m of loans have been undertaken with the Public Works Loans Board at fixed rates on a maturity basis as detailed above.

One loan for £3.5m has been undertaken with another Local Authority at a fixed rate on a maturity basis for a period of 1 year.

Borrowing in advance of need

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

The Council's capital investments and their subsequent financing costs as a % of the Net Revenue Stream is detailed below along with the impact on Council Tax (all other things being equal). The indicators reflect our Borrowing Strategy, that we will only borrow where schemes are able to provide sustained support for the costs of borrowing and reflect new income generated is in excess of the cost of borrowing.

	31 March 2020 Actual	31 March 2021 Actual
Ratio of Financing Costs to Net Revenue Stream	1.6%	7.41%
Increase/(Reduction) in Council Tax	(£7.26)	(£0.02)

4.2 Investments

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 02 March 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.).

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

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources	31 March 2020 £000's	31 March 2021 £000's
General Fund Balance	4,234	7,338
Earmarked reserves	15,787	19,209
Provisions	947	1,045
Usable capital receipts	3,462	1,168
Capital Grants Unapplied	537	2,366
Total	**24,967**	**31,126**

Investments held by the Council

- The Council maintained an average balance of £21.167m of internally managed funds.
- The internally managed funds earned an average rate of return of 0.896%.
- The comparable performance indicator is the average 7-day LIBID rate, which was -0.07%
- Total investment income was £0.185m compared to a budget of £0.144m

Types of investments	31 March 2020 Actual £000	31 March 2021 Actual £000
Deposits with banks and building societies	1,870	9,052
Money Market Funds	2,800	4,820
Other Local Authorities	4,000	0
Property funds	3,000	3,000
TOTAL TREASURY INVESTMENTS	**11,670**	**16,872**

4.3 Non Treasury Investments

YEAR OF ACQUISITION	Commercial Property Portfolio	Sector	Total Acquisition Cost £'m
2017/18	Bradford Road, Keighley	Hotel	2.490
2018/19	43 Penistone Road, Sheffield	Leisure	2.700
2018/19	Unit 7 Drake House, Sheffield	Manufacturing	3.175
2018/19	5 Sandars Road, Gainsborough	Manufacturing	6.470
2018/19	Heaton Street, Gainsborough	Retail	1.150
2019/20	Wheatley Road, Doncaster	Commercial Unit	5.681
	TOTAL PORTFOLIO		**21.666**

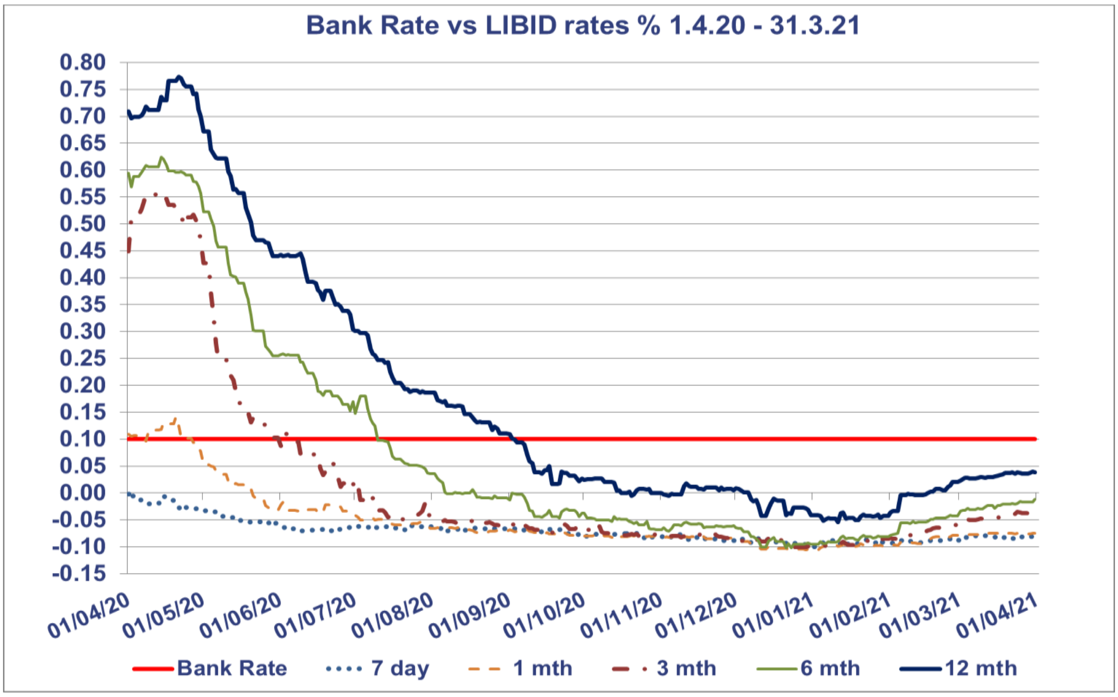
The investments are held on the balance sheet at their Fair Value *(the price expected to be received in current market conditions).* The Fair Value as at 31 March 2021 for the Commercial Property Portfolio is £20.855m, effectively reflecting a reduction for the costs of purchase.

This investment portfolio is generating a gross yield of 6.43% and £1.325m in income relevant to the financial year.

The Council mitigates any loss on investment by holding a Valuation Volatility Reserve at a minimum of 5% of the purchase price of properties. The balance on this reserve as at 31 March 2021 is £1.084m.

5.0 The strategy for 2020/21

5.1 Investment strategy and control of interest rate risk



	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

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.

This authority does not have sufficient cash balances to be able to place deposits for more than three months so as to earn higher rates from longer deposits. 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.

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

5.2 Borrowing strategy and control of interest rate risk

During 2020/21, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council’s reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

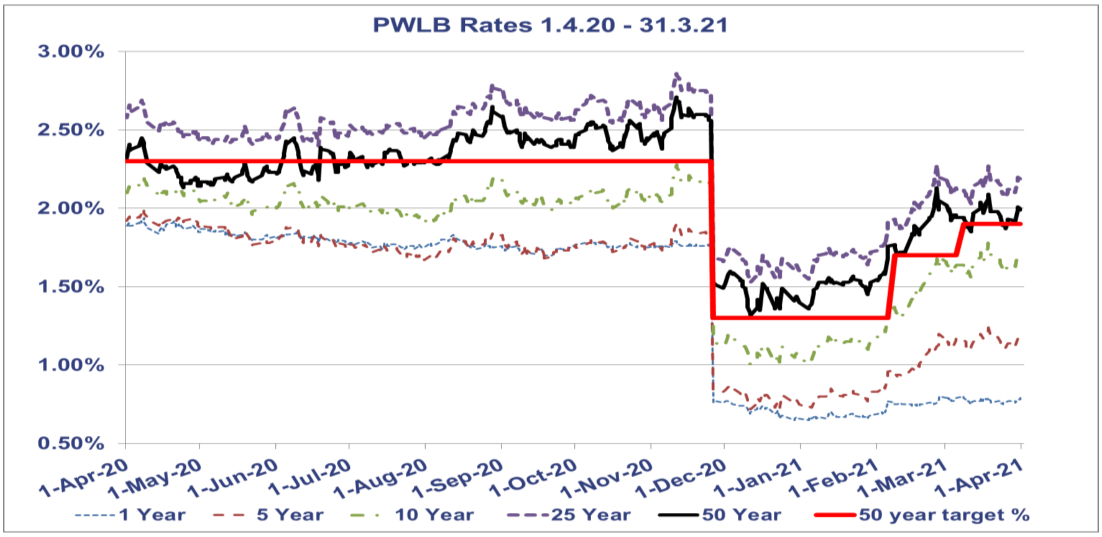
Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Assistant Director of Property Services, Business Support & Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following 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.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2020/21 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

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%
Low 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%
High 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%

PWLB rates are based on 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.

HM Treasury imposed **two changes of margins over gilt yields for PWLB rates in 2019/20** without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and **on 25th November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates;** the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which 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)

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.

5. Other Issues

5.1 Counterparty Limits

There have been no breaches of Prudential Indicators.