ITEM NO	

REPORT TO EXECUTIVE

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PORTFOLIO	Resources and Performance Management
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Annual Treasury Management Report
Review of 2020/21 Activity

PURPOSE

1. To inform members of the Council's treasury management activity during 2020/21.

RECOMMENDATION

2. That the Executive recommends that Full Council note the annual treasury management activity for the year ended 31 March 2021.

REASONS FOR RECOMMENDATION

3. To comply with the regulations issued under the Local Government Act 2003 to produce an annual treasury management report review of 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). Performance against the approved prudential and treasury indicators are shown in Appendix 1.

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

   - an annual treasury strategy in advance of the year (Full Council 26 February 2020)
   - a mid-year treasury update report (Full Council 16 December 2020)
   - an annual review following the end of the year describing the activity compared to the strategy (this report).

   The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is therefore important, 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 the Scrutiny Committee before they were reported to Full Council. Member training on treasury management issues was undertaken during the year on 10 March 2021 in order to support Members' scrutiny role.

SUMMARY OF KEY POINTS

4. **The Economy and Interest Rates (Provided by Link Asset Services)**

Coronavirus. The financial year 2020/21 will go down in history as being the year of the pandemic. The first national lockdown in late March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A short second lockdown in November did relatively little damage but by the time of the third lockdown in January 2021, businesses and individuals had become more resilient in adapting to working in new ways during a three month lockdown, so much less damage was caused than in the first one. The advent of vaccines starting in November 2020, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.

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

The Monetary Policy Committee 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 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.

Average inflation targeting. This was the major change adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that “it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably”. This sets a high bar for raising Bank Rate and no increase is expected by March 2024, and possibly for as long as five years. Inflation has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern to the MPC.

Government support. The Chancellor has implemented repeated rounds of support to businesses by way of cheap loans and other measures, and has protected jobs by paying for workers to be placed on furlough. This support has come at a huge cost in terms of the Government’s budget deficit ballooning in 2020/21 and 2021/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3rd March 2021 increased fiscal support to the economy and employment during 2021 and 2022 followed by substantial tax rises in the following three years to help to pay the cost for the pandemic. This will help further to strengthen the economic recovery from the pandemic and to return the government’s finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%. An area of concern, though, is that the government’s debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed long-term debt for floating rate debt; there is, therefore, much incentive for the Government to promote Bank Rate staying low e.g. by using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and / or by amending the Bank’s policy mandate to allow for a higher target for inflation.

BREXIT. The final agreement on 24th December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling has proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

5. <u>The Strategy for 2020/21</u>

5.1 Investment Strategy and control of interest rate risk

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 impact of the Covid-19 pandemic 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.

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. 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.

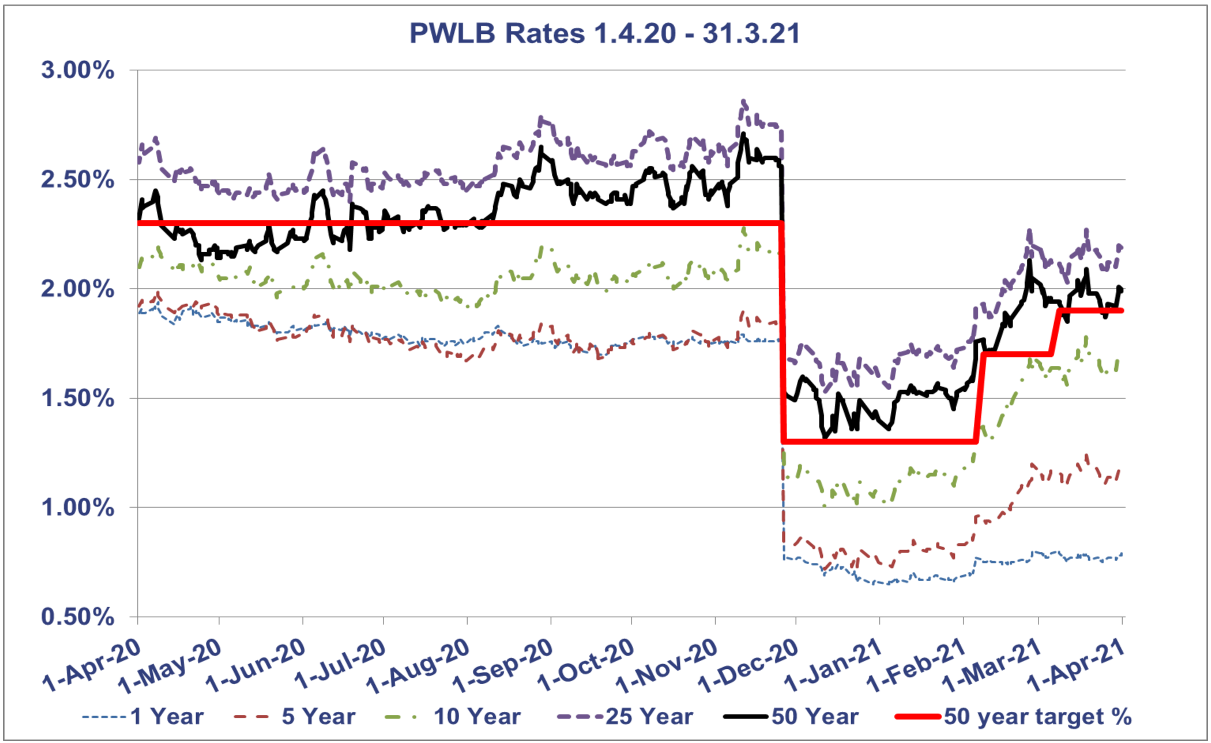
The policy of avoiding new borrowing by running down spare cash balances has previously been adopted and has served well over the last few years. However, this has been kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing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

6. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The table below shows the Council's CFR for 2020/21.

£m	31 March 2020 Actual	31 March 2021 Budget	31 March 2021 Actual
CFR General Fund	37.7	43.8	41.7

7. **Borrowing Rates in 2020/21**



PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields.

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

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.

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%.

8. **<u>Borrowing Outturn for 2020/21</u>**

Borrowing – Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Rescheduling – No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments – The following PWLB loans were repaid during the year, as scheduled:

Date	Lender	Principal	Balance at Repayment	Type	Interest Rate	Duration
30/9/20	PWLB	£1.0m	£1.0m	Maturity	5.15%	17 years
31/3/21	PWLB	£1.0m	£1.0m	Maturity	5.00%	20.5 years

9. **<u>Investment Rates in 2020/21</u>**

The Council operates a deposit account with it's bank, HSBC, which pays an interest rate of 0.15% below Bank Rate. As Bank Rate is currently below this, HSBC have applied a rate of 0.01% to the account since August 2020. There was an average daily total of £19.4m being invested within the HSBC "sweep" deposit account in 2020/21. This was higher than the usual level of deposit due to the large amount of government funding being made available for distribution to businesses during the pandemic.

10. **<u>Investment Outturn for 2020/21</u>**

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by Full Council on 26 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. This guidance is enhanced by advice from Link Asset Services.

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

Investments held by the Council - the Council maintained a daily average balance of £28.5m of internally managed funds during 2020/21.These investments earned an average rate of return of 0.15%.

There were a total of 5 market investments made during the financial year, totalling £12m. The table below shows the amount deposited, and the rate of return against the market benchmark.

Counterparties	Date of Investment	Investment Made £m	Return	Benchmark
Santander (95 Day Notice)	05/08/2020	4.0	0.48%	0.015%
HSBC (31 Day Notice)	12/08/2020	2.0	0.12%	0.052%

Close Brothers Ltd (6 month fixed)	11/09/2020	2.0	0.45%	0.073%
Goldman Sachs (6 month fixed)	12/03/2021	2.0	0.28%	0.073%
Moray Council (6 month fixed)	19/03/2021	2.0	0.18%	0.073%

All investments were for one year or under.

The table below shows the maximum amount invested with any of the counterparties at any one time during the period April 2020 to the end of March 2021 against the maximum limits approved in the 2020/21 Treasury Management Strategy.

Counterparties	Maximum Limits £m	Highest level of Investment 2020/21 (£m)
HSBC	50.0	40.3
Bank of Scotland	4.0	4.0
Goldman Sachs	4.0	2.0
Santander UK plc	4.0	4.0
Close Brother Ltd	2.0	2.0
Suffolk County Council	2.0	2.0
Moray Council	2.0	2.0

11. **Interest payable on External Borrowing / Interest Receivable on Investments**

The total PWLB interest payable on external borrowing for 2020/21 was £1,156,188 compared to the annual budget of £1,144,466.

The total interest receivable on temporary investments in 2020/21 amounted to £40,107 compared to the annual budget of £119,995. The shortfall in interest received was due to the cut in Bank Rate at the start of the year and sustained low interest rates throughout the year.

12. **Property Fund Investments, & dividends received**

The Council continues to invest £2m in property funds with CCLA and Hermes. Dividends receivable amounted to £74,397 compared to a budget of £60,000.

The aim of the Property Fund investments is to provide high levels of income and long-term capital appreciation. During the pandemic, the UK economy and commercial property market have proved to be more resilient than many initial forecasts. The UK economy outlook and business confidence have been improving following positive outcomes from the vaccination programme and a gradual lifting of lockdown restrictions. Whilst the long-term social, economic, and political risks associated with the current pandemic are still unknown, there are signs that the impact to occupier and investor confidence in certain property market segments is starting to ease.

Valuations were reported on the basis of material value uncertainty (issued without expected confidence in their accuracy) at the end of March 2020, and trading was temporarily suspended in both property funds. This was removed in September 2020 and trading was resumed.

FINANCIAL IMPLICATIONS AND BUDGET PROVISION

13. None arising as a direct result of this report.

POLICY IMPLICATIONS

14. All transactions are in accordance with the Council's approved Treasury Policy Statement

DETAILS OF CONSULTATION

15. None

BACKGROUND PAPERS

16. Treasury Management Strategy Report & Prudential Indicators Report for 2020/21.

FURTHER INFORMATION PLEASE CONTACT:	**Howard Hamilton-Smith,** **Head of Finance & Property**