Review of Treasury Management Activity 2020/21

Introduction

The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management ("the Code"), which requires authorities to produce Prudential Indicators and a Treasury Management Strategy Statement on the financing and investment activity annually. The Code also recommends that members agree a treasury management report after the end of each financial year.

Investment and borrowing decisions are taken in light of the long-term borrowing requirements, the estimated level of reserves and actual and estimated cash-flow. This is in the context of the current and forecast economic condition. Consideration is also given to risks and compliance with Prudential Indicators. Therefore, this report provides commentary on the following factors for 2020/21:

- Economic environment
- Borrowing activity
- Investment activity
- Performance against the Prudential Indicators

Economic environment during 2020/21

The coronavirus pandemic dominated 2020/21. The start of the financial year saw lockdowns which caused economic activity to grind to a halt in many countries including the UK. The Bank of England cut the interest rate from 0.75% to 0.1% in March 2020 and it remained at this level throughout the 2020/21 financial year. The UK government also provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime. The Gross Domestic Product (GDP) showed some recovery during the year, following the initial Covid-19 impact, with the figures for the financial year as follows:

	GDP quarter to quarter change %
2020 Q2	-19.5
2020 Q3	16.9
2020 Q4	1.3
2021 Q1	-1.5

In its March 2021 interest rate announcement, the Bank of England noted that while GDP would remain low in the near-term due to Covid-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year.

The UK government's response included the furlough scheme which although protected many jobs, overall unemployment still rose. Labour market data showed that in the three months to January 2021 the unemployment rate was 5.0%, in contrast to 3.9% recorded for the same period 12 months ago. The year also saw some progress on agreements relating to the UK's exit from the European Union. Inflation remained low over the 12-month period with the annual headline rate of UK Consumer Price Inflation (CPI) falling to 0.4% year on year in February, below expectations (0.8%) and still well below the Bank of England's 2% target.

A similar economic picture has occurred in various economies. The US saw growth collapsing at an annualised rate of 31.4% in quarter two before rebounding by 33.4% in quarter three and then a further 4.1% in quarter four. The US recovery has been fuelled by three major pandemic relief stimulus packages totalling over $5 trillion. The Federal Reserve cut its main interest rate to between 0% and 0.25% in March 2020 in response to the pandemic and it has remained at the same level since. In Europe the European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

The gilt yields which are a key determinant of borrowing costs for UK local authorities fluctuated with the economic conditions.

Treasury Holdings 2020/21

In summary the holdings at the beginning and end of the year were as follows:

	31/3/2021	**31/3/2020**
	£m	£m
Long term borrowing	899.6	844.6
Short term borrowing	481.8	700.8
Total borrowing	**1,381.4**	**1,545.4**
Long term investments	644.5	300.6
Short term investments	117.5	607.2
Total investments	**762.0**	**907.8**
Net Borrowing position	**619.4**	**637.6**

Borrowing Activity 2020/21

The Code requires that the council, in the medium term, only borrows for capital purposes (with the underlying need to borrow for capital purposes being measured by the Capital Financing Requirement adjusted for premiums and debt relating to other authorities). Total borrowing in the year was managed within the operational and authorised borrowing limits as approved in the Treasury Management Strategy which reflects the underlying need to borrow for capital. A comparison of gross debt to the Capital Financing Requirement is shown in the Prudential Indicators section of the report. This shows borrowing in excess of requirements at 31 March 2021 due to taking advantage of market conditions to borrow in advance of need as permitted by the code. It is anticipated that borrowing will be within limits at 31 March 2022.

In recent years the council has pursued a policy of taking short term borrowing as short-term interest rates have been lower than long-term rates. However recent years has seen significant economic uncertainty and interest rates have been at historically low levels. This has led to the re-balancing of the debt portfolio and securing debt on a longer-term basis to reduce the re-financing risk. The overall aim has been to move towards a position where the debt is split more equally between short term, medium and long term. This started in 2019/20 with some £70m of long-term borrowing taken from the Public Works Loans Board (PWLB) and the issuance of a £350m 5-year bond in March 2020. This re-balancing continued in 2020/21 with the issuance of a second bond via the Municipal Bond Agency (UKMBA).

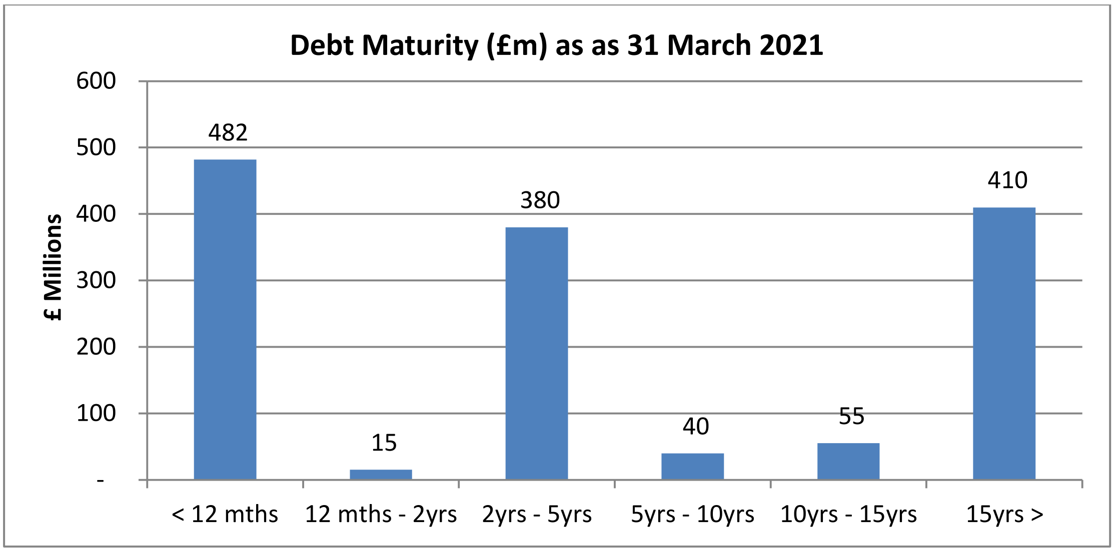
Key features of the new bond are:

- £250 million issued
- It is a 'Fixed Rate Bond'
- 40 years maturity

Despite the moves towards longer term borrowing short term debt is still significant with £482m of debt at 31 March 2021 due to mature within 12 months. It is also noteworthy that 43% of the total debt is now in the form of UKMBA bonds. The section below provides further detail on the debt held.

Analysis of Borrowing

	Debt 31/03/2020		Borrowing	Repayments	Debt 31/03/2021	
	£m		£m	£m	£m	
Fixed Rate Funding						
Public Works Loan Board	448.1	29%	0	(8.5)	439.6	32%
UKMBA Bond	0	-	250.0	0	250.0	18%
Market Borrowing	554.3	36%	290.0	(571.3)	273.0	20%
Total Fixed Rate Funding	**1,002.4**		**540.0**	**(579.8)**	**962.6**	
Variable Rate Funding						
Public Works Loan Board	125.8	8%	0	(125.8)	0	-
UKMBA Bond	350.0	23%	0	0	350.0	25%
Shared Investment Scheme	67.2	4%	545.1	(543.5)	68.8	5%
Total Variable Rate Funding	**543.0**		**545.1**	**(669.3)**	**418.8**	
Total Loan Debt	**1,545.4**		**1,085.1**	**(1,249.1)**	**1,381.4**	



Overall, the average rate of interest paid in 2020/21 on the debt administered by the council was 1.82% per annum compared with an average rate of 2.05% in 2019/20. This also compares favourably to the Public Works Loans Board average interest rate on outstanding loans which is 3.57% as at 31 March 2021 (down from 3.62% in 2020).

The council did not enter into any new other long-term liability arrangements in the year. The outstanding Private Finance Initiative liability at 31 March 2021 was £139.5m relating to schools.

Investment Activity

The council invests its reserves and other cash balances. The total value of investments held (excluding fair value adjustment), at 31 March 2021 for treasury management purposes was £762m. This is £145.8m lower than at 31 March 2020. The table below shows the investment holdings and the movements during the year:

Maturity Range	Position at 31/3/2020 £m	2020/21 Movement £m	Position at 31/3/2021 £m
Call accounts and under 1 year	589.8	(472.3)	117.5
Local Authority Deposits 3-5 years	10.0	0.0	10.0
Local authority bonds	32.8	(17.6)	15.2
UK Government and other bonds	275.2	344.1	619.3
Total	**907.8**	**(145.8)**	**762.0**

In addition to the investments made for treasury management purposes the non-treasury management investment strategy permits the investment in bonds for commercial purposes where cash-flow permits but investments outside the current treasury management credit matrix will only be incurred after agreement with the Director of Finance.

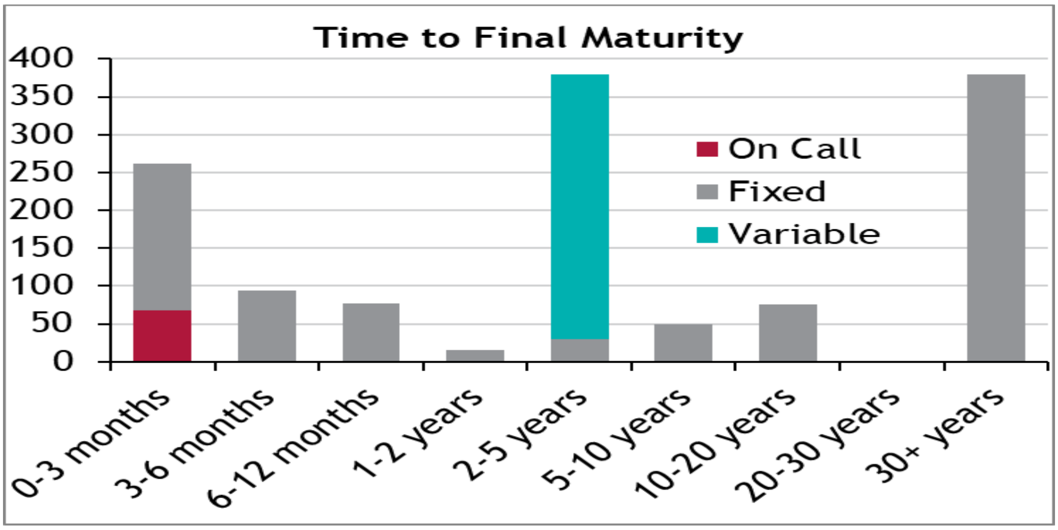
The net value of the non-treasury management investments at 31 March 2021 is £195.5m. Total investments at 31 March 2021 are therefore £957.5m.

Under this arrangement investments have been made in local authority LOBO (Lender Option Borrower Option) loans and commercial corporate bonds. As changes in the market value is charged to the accounts for these investments the council has entered into a 'short trade' which means the council agree to buy some bonds at a specific price in the future, which aims to hedge the underlying volatility in interest rates inherent in the loans. There was a net gain in valuation of £13.9m at the year-end which has been held in reserves. The value will fluctuate and as such this valuation gain is set aside in reserves with the net gain or loss only being realised when the assets are sold.

In undertaking investments consideration is given to the risks and liquidity within the portfolio which are affected by the maturity of the investment, asset type, country invested in and the credit rating. This includes those that are deemed to be non- treasury investments.

Investments by Maturity

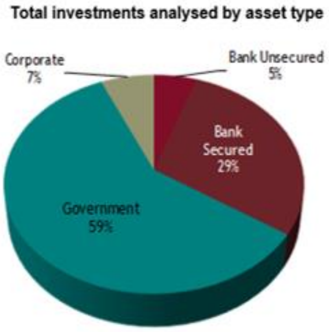
The following graph shows the maturity dates of assets along with the exposure to bail-in in the event of a bank default (i.e. the risk that the investment may be lost, or the principal repaid significantly reduced). As can be seen the exposure to bail in is relatively low and arises mainly in the short term with the use of call accounts. The very long-term investments are principally investment in the UK government via gilts. Therefore, the credit risk is considered to be low, and as the assets are saleable, they do not have to be held to maturity, thereby allowing the market and liquidity risk to be managed.

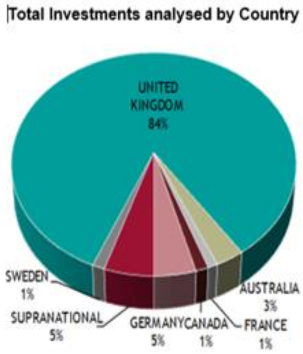


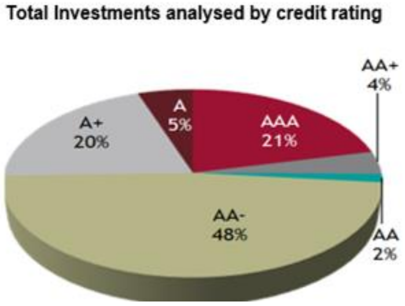
Security

Security of capital remained the council's main investment objective. This was maintained by following the council's Counterparty Policy, as set out in its Treasury Management Strategy Statement for 2020/21. This defined 'high credit quality' organisations as those having a minimum long-term credit rating of A+. In practice the average credit rating in 2020/21 was higher at AA.

Investments with banks were held in call accounts only with any longer-term deposits restricted to deposits with other local authorities.







Liquidity Management

The council maintained a minimum level of primary liquidity through the use of Call Accounts. The council also has corporate bonds which are available for sale, at current market prices, if needed as 'secondary' liquidity.

The council undertakes cash flow forecasting daily to determine the maximum period for which funds may prudently be committed.

Yield

The rates of return on the council's short-dated money market investments reflect prevailing market conditions and the council's objective of optimising returns commensurate with the principles of security and liquidity.

Overall, the treasury management investment portfolio returned an average rate of 4.90% in 2020/21. This includes both interest receipts and realised capital gains, which can be attributed to the categories as follows:

Maturity Range	Average balance £m	Average rate
Call account and under 1 year	234.5	0.40%
Local authority deposits 3-5 years	10.0	2.95%
Local authority deposits 5 years +	-	-
Local authority bonds	27.9	3.72%
UK government and other bonds	550.9	6.92%
Total	**823.3**	**4.90%**

In addition, the non-treasury management investments had an average balance of £264.6m which made a net return of 1.62%.

Impact of the Treasury Management Strategy on the council's revenue budget

The financing charges budget covered both the treasury management and non-treasury management activities. In total there was a net underspend of £24.5m as shown in the following table.

	Budget	Year-end position	Variance
	£m	£m	£m
Minimum Revenue Provision	16.4	17.7	1.3
Interest paid	29.8	31.2	1.4
Interest received/surplus on sale	(18.6)	(51.2)	(32.6)
Total	**27.6**	**(2.3)**	**(29.9)**
Transfer to treasury management reserve		5.4	5.4
Total following transfer to reserve	**27.6**	**3.1**	**(24.5)**

The income received in the year was £32.6m higher than budgeted. Although investment balances were higher than budget the main reason for the increase was the gains on the sale of gilts. With the markets responding to economic and political events there was volatility in the price of gilts and other bonds. It is difficult to predict the movement in the markets and to assess the potential for gains. Whilst the 2020/21 budget expected a surplus on sale of assets of £5m, the actual was around £38m. However, investment levels are likely to reduce in future as existing borrowing matures and is repaid.

Interest paid was higher than budget due to the level of borrowing being higher than anticipated in the budget, predominantly due to the undertaking of the new £250m bond during the year.

Treasury Management and Prudential Indicators 2020/21

The Local Government Act 2003 and supporting regulations require the council to have regard to the Prudential Code and to set prudential indicators to ensure the council's capital investment plans are affordable, prudent and sustainable**.** A comparison of the actual position at 31 March 2021 compared to the 2020/21 indicators set in the Treasury Management Strategy is set out.

All activity in the year complied with the Prudential Indicators and Treasury Management Policy Statement for the year.

Prudential Indicators

Authorised limit for external debt The authorised limit is a prudent estimate of debt which reflects the council's capital expenditure plans and allows sufficient headroom for unusual cash movements.	**2020/21 £m**	**Actual £m**
Borrowing	1,600	1,381
Other long-term liabilities (PFI schemes)	150	140
TOTAL	**1,750**	**1,521**

Operational boundary for external debt The operational boundary is a prudent estimate of debt but has no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the council's current plans.	**2020/21 £m**	**Actual £m**
Borrowing	1,500	1,381
Other long-term liabilities (PFI schemes)	150	140
TOTAL	**1,650**	**1,521**

Capital Financing Requirement to Gross debt	**2020/21 £m**	**Actual £m**
Capital Financing Requirement	978	1,110
Estimated gross debt	1,062	1,521
Debt to Capital Financing Requirements	109%	137%

The 'Capital Financing Requirement' is the underlying need to borrow for capital purposes. This is the cumulative effect of past borrowing decisions and future plans. This is not the same as the actual borrowing on any one day, as day to day borrowing requirements incorporate the effect of cash flow movements relating to both capital and revenue expenditure and income.

Gross debt includes borrowing for premiums, long term debtors and transferred debt which are not within the Capital Financing Requirement. The adjusted gross debt is still above the Capital Financing Requirement by £324m largely due to the bond issuance in August 2020 which represents borrowing in advance for capital and is allowable within the Code. It is expected that the debt will be in line with the Capital Financing Requirement by 31 March 2022.

Treasury Management Indicators

Interest rate exposure The limit measures the council's exposure to the risk of interest rate movements. The one-year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.	**Upper Limit £m**	**Actual £m**
One-year impact of a 1% rise	50.0	(31.7)

Maturity structure of debt Limit on the maturity structure of debt helps control refinancing risk.	**Upper Limit %**	**Actual %**
Under 12 months	75	35
12 months and within 2 years	75	1
2 years and within 5 years	75	28
5 years and within 10 years	75	3
10 years and above	75	33

Minimum Average Credit Rating To control credit risk the council requires a very high credit rating from its treasury counterparties.	**Benchmark**	**Actual**
Average counterparty credit rating	A	AA