Title of meeting:	Governance and Audit and Standards Committee Cabinet City Council
Date of meeting:	Governance and Audit and Standards Committee 16th July 2021 Cabinet 27th July 2021 City Council 12th October 2021
Subject:	Treasury Management Outturn Report 2020/21
Report by:	Director of Finance and Resources (Section 151 Officer)
Wards affected:	All
Key decision:	No
Full Council decision:	Yes

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1. Executive Summary

The Chartered Institute of Public Finance & Accountancy's (CIPFA) Prudential Code of Practice requires local authorities to calculate prudential indicators before the start of and after each financial year. The CIPFA Code of Practice on Treasury Management also requires the Section 151 Officer to prepare an annual report on the outturn of the previous year. This information is shown in Appendix A of the report.

2. Purpose of Report

To inform members and the wider community of the Council's treasury management activities in 2020/21 and of the Council's treasury management position as at 31st March 2021.

3. Recommendations

It is recommended that the actual prudential and treasury management indicators based on the unaudited accounts, as shown in Appendix B, be noted (an explanation of the prudential and treasury management indicators is contained in Appendix C).

4. Background

The Local Government Act 2003 requires local authorities to have regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities.

5. Reasons for Recommendations

The net cost of Treasury Management activities and the risks associated with those activities have a significant effect on the Council's overall finances. Consequently, in accordance with good governance, the S.151 Officer is required to report to the Council on those activities.

6. Integrated impact assessment

An integrated impact assessment is not required, as the recommendations do not directly impact on service or policy delivery. Any changes made arising from this report would be subject to investigation in their own right.

7. Legal implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance & Resources (Section 151 Officer) comments

All financial considerations are contained within the body of the report and the attached appendices

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Signed by Director of Finance & Revenues (Section 151 Officer)

Appendices:

Appendix A: Treasury Management Outturn Report
Appendix B: Prudential and Treasury Management Indicators
Appendix C: Explanation of Prudential and Treasury Management Indicators

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

	Title of document	**Location**
1	Information pertaining to the treasury management outturn	Financial Services
2		

APPENDIX A

TREASURY MANAGEMENT OUTTURN REPORT

1. GOVERNANCE

Treasury management activities were performed within the Prudential Indicators approved by the City Council.

Treasury management activities are also governed by the Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council.

2. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

On 31 March 2021, the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £778m and gross investments of £403m giving rise to a net debt of £375m. Major components of the Council's gross investments of £403m include the Council's general and earmarked reserves of £281m, and capital grants received but yet to be applied to finance capital expenditure of £113m.

3. BORROWING ACTIVITY

Public Works Loans Board (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. 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.

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. 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.

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%.

HM Treasury imposed two changes to the 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, reversed for Housing Revenue Account (HRA) 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 margins were reduced by 1% for General Fund borrowing. Following this later change, PWLB rates for both the HRA and the General Fund had a margin of 0.8% over gilts. At the same time, a prohibition was introduced to deny access to borrowing from the PWLB for any local authority that had the 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. Our treasury management advisors, Link, do not forecast a rise in Bank Rate from 0.10% until 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.

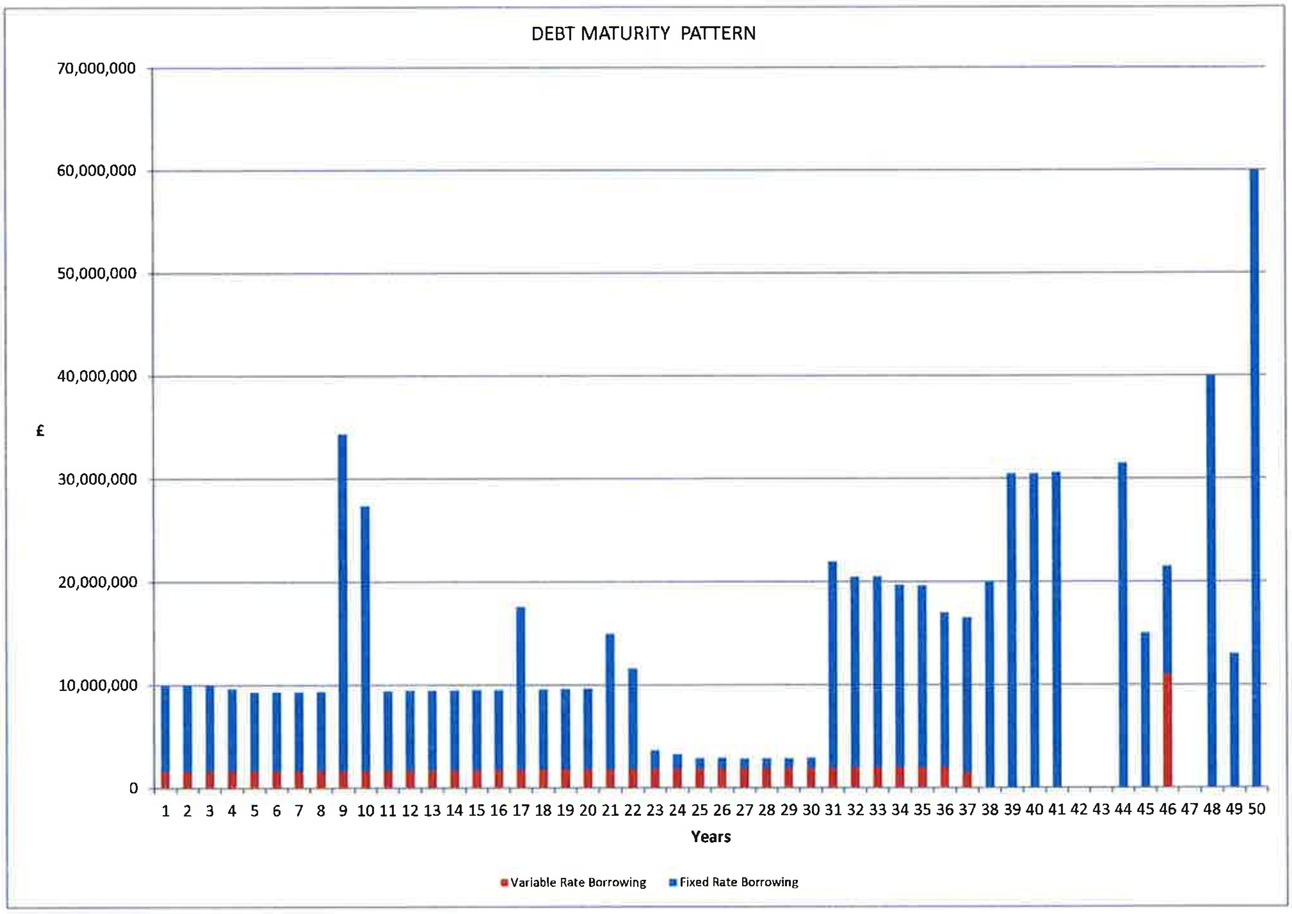
£60m was borrowed from the PWLB at the HRA certainty rate in the first quarter of 2020/21 to fund the HRA capital programme. This was because PWLB rates were very low and because the Council may not have been able to access funding from the PWLB in future because of its commercial activities. These loans were all for £20m and are repayable in 50 years at maturity. These loans have an average interest rate of 1.17%.

£30m was borrowed in March 2020 for an average of 50 days at 0.84% in order to fund the payment of 3 years of employer's pension contributions in advance in return for a discount. This expenditure was opportunistic (and not known sufficiently in advance) and insufficient investments matured before this large single payment had to be made. This borrowing was repaid in April 2020.

The Council's underlying need to borrow at 31st March 2021 was £825m, £47m in excess of its actual gross debt of £778m. This shortfall of £47m is funded by internal borrowing from the Council's reserves and will need to be borrowed externally at some point in the future.

Debt rescheduling opportunities have been limited in the current economic climate and following the various increases in the margins added to gilt yields, which has affected PWLB new borrowing rates since October 2010. No debt rescheduling was undertaken during 2020/21.

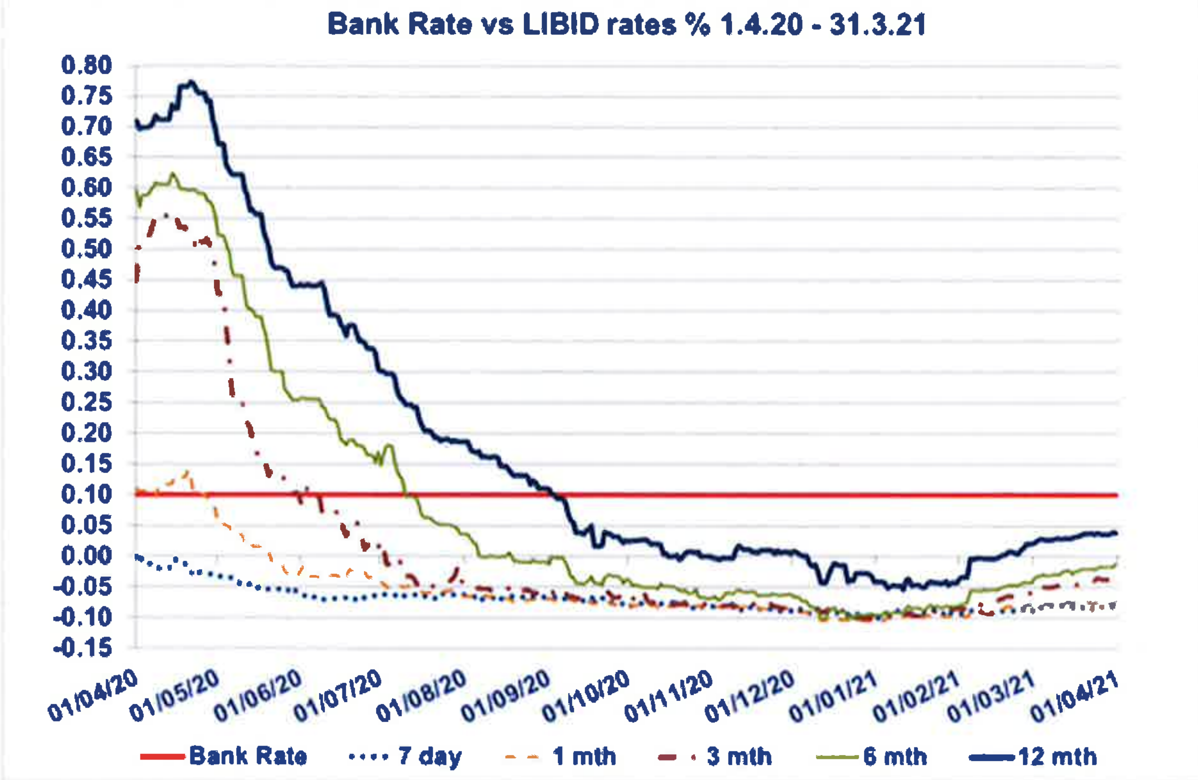
The Council's gross debt at 31st March 2021 of £778m is within the Council's authorised limit (the maximum amount of borrowing permitted by the Council) of £864m and the Council's operational boundary (the maximum amount of borrowing that is expected) of £846m. The Council aims to have a reasonably even maturity profile so that the Council does not have to replace a large amount of borrowing in any particular year when interest rates might be high. The maturity profile of the Council's borrowing (see graph below) is within the limits contained in the Council's Treasury Management Policy.



4. INVESTMENT ACTIVITY

When the coronavirus outbreak hit the UK in February/March 2020, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets.

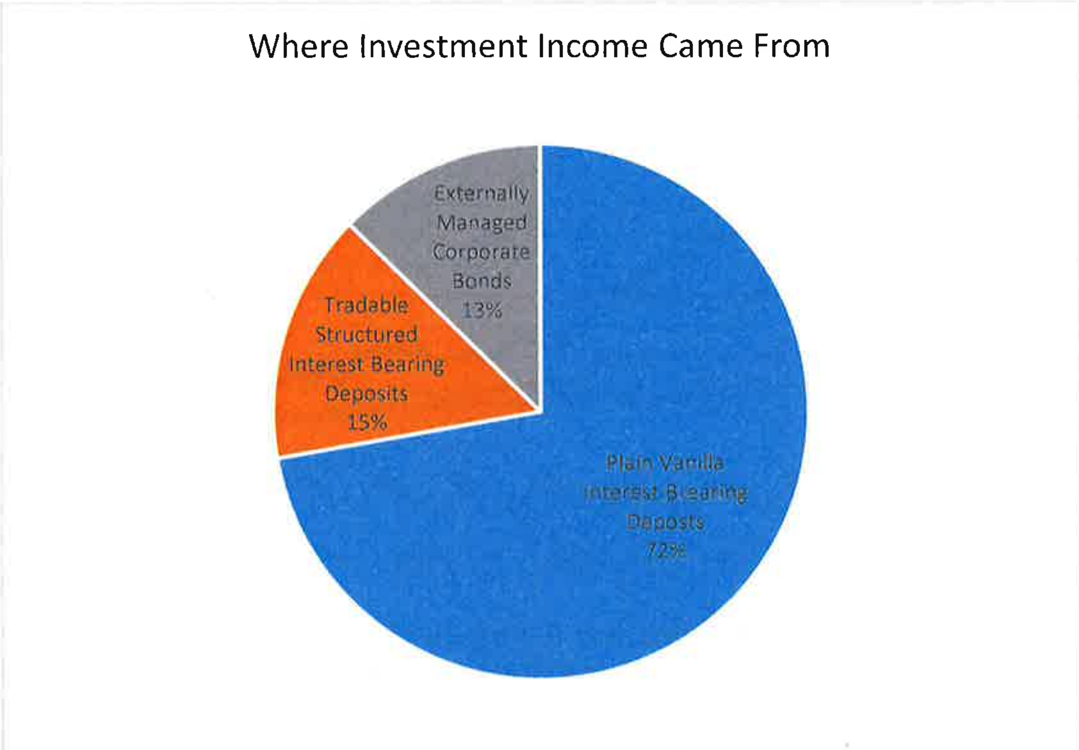
Bank Rate and market investment rates (London Interbank Bid (LIBID)) investment rates for 2020/21 are shown below.



Investment returns, which had been low during 2019/20, fell during 2020/21 to near zero or even below zero. The Council managed to avoid lending at negative rates and one feature of the year was the growth of inter local authority lending. The advent of the Covid-19 pandemic in March 2020 caused the Monetary Policy Committee of the Bank of England 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 parts 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 businesses to get through 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.

The Council's investments averaged £426.4m during 2020/21. As at 31st March 2021 the Council had, £402.7m invested. 4% of the investment portfolio was invested in tradable structured interest bearing deposits where the interest rate or the maturity date is determined by certain criteria, 2% of the portfolio was invested in externally managed corporate bonds, and the remaining 94% of the portfolio was invested in plain vanilla interest bearing deposits. These made returns of 6.06%, 7.23%, and 0.75% respectively.

The Council made an overall return of 0.99% on its cash investments in 2020/21. The chart below shows the source of the Council's cash investment income.



28% of the Council's investment income came from externally managed corporate bonds and tradable structured interest bearing deposits, despite these investments making up only 6% of the investment portfolio. However, much of these gains result from a bounce back in the market value of these investments from the low point of quarter 4 of 2019/20 when the Covid-19 pandemic struck.

The overall return on the Council's investments of 0.99% is well above the current 3-month London Inter Bank Bid (LIBID) benchmark rate of 0.02%.

5. REVENUE COSTS OF TREASURY MANAGEMENT ACTIVITIES IN 2020/21

Expenditure on treasury management activities in both the General Fund and the HRA against the revised budget is shown below.

	Revised Estimate 2020/21 £000	Actual 2020/21 £000	Variance +/- £000
Interest Payable:			
PWLB	20,043	20,043	-
Other Long Term Loans	1,207	1,192	(15)
Temporary Loans	35	17	(18)
HCC Transferred Debt	295	295	-
Interest on Finance Lease	191	191	-
Interest on Service Concession Arrangements (including PFIs)	5,669	5,669	-
Interest Payable to External Organisations	10	-	(10)
Premiums and Discounts on Early Redemption of Debt	99	53	(46)
	27,549	**27,460**	**(89)**
Deduct			
Investment Income:			
Interest on Investments	(4,206)	(4,048)	158
Other interest receivable	(1,386)	(1,374)	12
	21,957	**22,038**	**81**
Provision for Repayment of Debt	**9,624**	**9,670**	**46**
Debt Management Costs	**375**	**410**	**35**
	31,956	**32,118**	**162**

Net treasury management costs were £162,000, or 0.5% above the revised budget. There were a number of reasons for this, of which by far the largest is a shortfall in interest on investments. This shortfall occurred because a number of existing investments matured, with new replacement investments earning a little less than anticipated.

APPENDIX B

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

1. Capital financing requirement	Original Estimate £'000	Revised Estimate £'000	Actual £'000
General Fund	678,951	645,232	627,485
Housing Revenue Account (HRA)	189,155	200,286	197,651
Total	868,106	845,518	825,136

2. Authorised Limit	Original Limit £'000	Revised Limit £'000	Actual £'000
Long Term Borrowing	825,730	806,363	721,303
Other Long Term Liabilities	57,151	57,151	57,159
Total	882,881	863,514	778,462

3. Operational Boundary	Original Limit £'000	Revised Limit £'000	Actual £'000
Long Term Borrowing	810,955	788,367	721,303
Other Long Term Liabilities	57,151	57,151	57,159
Total	868,106	845,518	778,462

4. Ratio of financing costs to net revenue stream	Original Estimate	Revised Estimate	Actual
General Fund	16.3%	12.2%	13.7%
Housing Revenue Account (HRA)	7.9%	6.6%	6.2%

5. Maturity Structure of Fixed Rate Borrowing	Lower Limit	Upper Limit	Actual
Under 12 months	0%	10%	1%
12 months and within 24 months	0%	10%	1%
24 months and within 5 years	0%	10%	4%
5 years and within 10 years	0%	20%	13%
10 years and within 20 years	0%	30%	13%
20 years and within 30 years	0%	40%	5%
30 years and within 40 years	0%	40%	32%
Over 40 years	0%	50%	31%

6. Maturity Structure of Variable Rate Borrowing	Lower Limit	Upper Limit	Actual
Under 12 months	0%	10%	2%
12 months and within 24 months	0%	10%	2%
24 months and within 5 years	0%	10%	6%
5 years and within 10 years	0%	20%	11%
10 years and within 20 years	0%	30%	23%
20 years and within 30 years	0%	40%	25%
30 years and within 40 years	0%	40%	17%
Over 40 years	0%	40%	14%

7. Principal sums invested over 365 days	Origuinal Limit £'000	Revised Limit £'000	Actual £'000
Maturing after 31/3/2022	117,000	200,000	45,000
Maturing after 31/3/2023	50,000	134,000	25,000
Maturing after 31/3/2024	-	103,000	-

APPENDIX C

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

1. ACTUAL CAPITAL FINANCING REQUIREMENT

This represents the underlying requirement to borrow for capital expenditure. It takes the total value of the City Council's fixed assets and determines the amount that has yet to be repaid or provided for within the Council's accounts.

The capital financing requirement is increased each year by any new borrowing and reduced by any provision for the repayment of debt. Broadly, the higher the capital financing requirement, the higher the amount that is required to be set aside for the repayment of debt in the following year.

2. AUTHORISED LIMIT

The authorised limit for external debt is the maximum amount of debt which the authority may legally have outstanding at any time. The authorised limit includes headroom to enable the Council to take advantage of unexpected movements in interest rates and to accommodate any short-term debt or unusual cash movements that could arise during the year.

3. OPERATIONAL BOUNDARY

The Operational Boundary is based on the probable external debt during the course of the year. It is not a limit, but acts as a warning mechanism to prevent the authorised limit (above) being breached.

4. RATIO OF FINANCING COSTS TO NET REVENUE STREAM 2020/21

This ratio reflects the annual cost of financing net debt as a proportion of the total revenue financing received. It therefore represents the proportion of the City Council's expenditure that is largely fixed and committed to repaying debt. The higher the ratio, the lower the flexibility there is to shift resources to priority areas and/or reduce expenditure to meet funding shortfalls.

For the General Fund, this is the annual cost of financing debt as a proportion of total income received from General Government Grants, Non Domestic Rates and Council Tax.

The ratio of Housing Revenue Account (HRA) financing costs to net revenue stream is the annual cost of financing capital expenditure, as a proportion of total gross income received including housing rents and charges.

5. MATURITY STRUCTURE OF FIXED RATE BORROWING

The Council aims to have a reasonably even debt maturity profile so that it is not unduly exposed to refinancing risk in any particular year when interest rates may be high. The maturity structure of fixed rate borrowing matters less in future years as inflation will reduce the real value of the sums to be repaid.

6. MATURITY STRUCTURE OF VARIABLE RATE BORROWING

Variable rate borrowing could expose the Council to budgetary pressure if the interest rates increase. The maturity structure of variable rate borrowing matters less in future years as inflation will reduce the real value of the liability.

7. PRINCIPAL SUMS INVESTED FOR OVER 365 DAYS

Investing long term at fixed rates provides certainty of income and reduces the risk of interest rates falling.