Blaby District Council

Cabinet Executive

Date of Meeting	5 July 2021
Title of Report	**Treasury Management Outturn 2020/21**
	This is not a Key Decision and is on the Forward Plan
Lead Member	**Cllr. Maggie Wright – Finance, People & Performance (Deputy Leader)**
Report Author	Strategic Finance Manager
Corporate Priority	Medium Term Financial Strategy (MTFS)

1. What is this report about?

1.1 The report reviews the Council's treasury management activities undertaken during the 2020/21 financial year, and gives details of the prudential and treasury indicators for the same period.

2. Recommendation(s) to Cabinet Executive and Council

2.1 That the treasury management activities for 2020/21 are approved.

2.2 That the prudential and treasury indicators for 2020/21 are approved.

3. Reason for Decisions Recommended

3.1 The regulatory framework governing treasury management activities includes a requirement that the Council should produce an annual review of treasury activities undertaken in the preceding financial year. It must also report the performance against the approved prudential indicators for the year.

3.2 This report fulfils the requirement above and incorporates the needs of the Prudential Code to ensure adequate monitoring of capital expenditure plans and the Council's prudential indicators. The treasury strategy and prudential indicators for 2020/21 were contained in the report approved by Council on 20th February 2020.

4. Matters to consider

4.1 Background

The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the Chartered Institute of Public Finance Accountants' (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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 (Cabinet Executive 17th February 2020, Council 20th February 2020)
- a mid-year treasury update report (Cabinet Executive 9th November 2020, Council 17th November 2020)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulations place responsibility 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.

The Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Cabinet Executive and/or Scrutiny Commission before they were reported to the full Council. Member training on treasury management issues is undertaken as and when required or requested, with the last session having taken place at a joint Cabinet/SLT meeting on 12th October 2018. It is proposed to arrange for refresher training during 2021/22.

4.2 Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets which may either be:

- Financed immediately through the application of capital or revenue resources (e.g. capital receipts, grants, revenue contributions), which has no resultant impact on the Council's borrowing need; or
- Financed through borrowing if insufficient resources are available, or a decision is taken not to apply resources.

The actual capital expenditure forms one of the main prudential indicators. The table below summarises the capital expenditure and financing for the year. A more detailed analysis is provided at Appendix A.

	2019/20 Actual £	**2020/21 Budget £**	**2020/21 Actual £**
Capital Expenditure	6,662,833	6,536,188	2,854,964
Financed in year	(1,751,115)	(3,449,516)	(1,350,928)
Unfinanced Capital Expenditure	**4,911,718**	**3,086,672**	**1,504,036**

4.3 The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is known as the Capital Financing Requirement (CFR).

It is important to ensure that borrowing is prudent over the medium term and that it is only undertaken for capital purposes. Therefore, the Council needs to make sure that, except in the short term, its gross external borrowing does not exceed the total of the CFR in the preceding year (2020/21) plus the estimates of any additional CFR for the current year (2021/22) and next two financial years. Effectively this means that the Council is not borrowing to support revenue expenditure.

The Council undertook no new borrowing during 2020/21. Although there was a borrowing need to fund the capital programme, there are still sufficient reserves and balances available to enable the Council to effectively borrow internally. Since borrowing rates have been considerably higher than investment rates during 2020/21 this has led to net revenue savings.

The table below highlights the gross borrowing position against the CFR.

	31st March 2020 Actual £	**31st March 2021 Budget £**	**31st March 2021 Actual £**
CFR	14,184,794	16,249,247	14,666,611
Gross Borrowing	9,007,721	10,804,686	8,804,685
(Under)/Over Funding of CFR	**(5,177,073)**	**(5,444,561)**	**(5,861,926)**

The Authorised Limit – this is the affordable borrowing limit required by Section 3 of the Local Government Act 2003. Once it has been set, the Council doesn't have the power to borrow above this level. The table below demonstrates that the Council has maintained gross borrowing within the authorised limit during 2020/21.

The Operational Boundary – this is the expected borrowing position for the year. Periods where the actual position is either above or below 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 (i.e. borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2020/21
Authorised limit	£15,200,000
Maximum gross borrowing position during the year	£9,007,721
Operational boundary	£13,680,000
Average gross borrowing position	£8,930,832
Financing costs as a proportion of net revenue stream	8.82%

4.4 Treasury Position as at 31st March 2021

The following table shows the Council's overall treasury position at 31st March 2021 compared with the position 12 months earlier. This excludes other long term liabilities such as finance lease arrangements.

	Principal at 31st March 2020	**Rate/ Return**	**Average Life**	**Principal at 31st March 2021**	**Rate/ Return**	**Average Life**
PWLB Debt	£6,551,902	2.24%	19.1 years	£6,349,066	2.24%	18.1 years
Market Debt	£2,000,000	1.75%	2.8 years	£2,000,000	1.75%	1.8 years
Total debt	**£8,551,902**	**2.12%**	**16.8 years**	**£8,349,066**	**2.12%**	**15.8 years**
Capital Financing Requirement	£14,184,794			£14,666,611		
Over/(under) borrowing	**(£5,632,892)**			**(£6,317,545)**		
Short Term investments	(£22,657,445)	0.91%		(£23,746,820)	0.37%	
Net debt	(£14,105,543)			(£15,397,754)		

The interest rates in the table above are based on the loans and investments outstanding at the year end, and are not necessarily the same as the average rate payable during the financial year.

The maturity structure of the debt portfolio was as follows:

	31st March 2020 £	**31st March 2021 £**
Less than one year	202,836	207,286
Between one and two years	207,286	2,211,841
Between two and five years	3,284,178	1,929,939
Between five and ten years	857,602	0
Over ten years	4,000,000	4,000,000
	8,551,902	**8,349,066**

Investment Portfolio	**31st March 2020 £**	**31st March 2020 %**	**31st March 2021 £**	**31st March 2021 %**
Banks	10,036,000	0.65%	10,320,000	0.10%
Local Authorities	8,000,000	1.01%	7,000,000	0.59%
Money Market Funds	3,650,000	0.48%	5,472,000	0.01%
Property Fund	971,445	4.34%	954,820	3.81%

The return on the Lothbury Property Fund comprises both rental income and interest income gross of fees.

4.5 The Strategy for 2020/21

Investments

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 the 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 which caused the Monetary Policy Committee to cut the 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 issued significant 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.

Whilst 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 during 2020/21. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

On 2nd December 2019 the Council invested the sum of £1m in the Lothbury Property Trust Fund. However, the onset of the COVID-19 pandemic led to a fall in the value of this investment of around £30,000 at 31st March 2020. The fund value fell further to a low point of £936,202 at the end of September 2020, before recovering to £954,820 by the end of the financial year. The fund has shown further signs of recovery in the early part of 2021/22, reaching £970,471 by 31st May 2021. Officers will continue to monitor performance of the fund, and will invite the fund managers to attend a future Member meeting to give an update on the fund.

Borrowing

During 2020/21, the Council maintained its gross borrowing within the CFR. This meant that the capital borrowing need 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 has continued to be a prudent strategy as investment returns were particularly low during 2020/21 as a result of the impact of the pandemic on the economy.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

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 the Council 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 Strategic Director (S151) 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.

4.6 Borrowing Outturn

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year. As a result, gross borrowing has fallen slightly from £8,551,902 to £8,349,066 to 31st March 2021. The movement is summarised in the following table:

	£
Balance at 1st April 2020	**8,551,902**
New borrowing in year	0
Loans repaid in year	(202,836)
Balance at 31st March 2020	**8,349,066**

The total interest payable in 2020/21, excluding finance leases, was £179,975 (£78,407 in 2019/20), and the average interest rate payable was 2.12% (2.36% in 2019/20). The increase in interest payable includes the full year impact of new borrowing of £6m taken out in 2019/20 to fund the leisure centre refurbishments.

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.

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.

4.7 Investment Outturn

The Council's investment policy is governed by guidance issued by the Ministry for Housing, Communities and Local Government (MHCLG), which has been implemented in the annual investment strategy approved by the Council on 20th 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.).

The investment activity during the year conformed to the approved strategy with one exception, that being that the £8m counterparty limit in respect of deposits in HSBC Call Account was exceeded on 22 occasions during the year. This arose when officers had difficulty in placing funds due to the higher than normal balances relating to business grants funding received from the government. The Council experienced no liquidity difficulties during the financial year.

Interest on in house investments amounted to just £89,672 (£214,834 in 2019/20), over £5,000 lower than budgeted. The average rate of return for 2020/21 was 0.28%, well below the average of 0.83% achieved in 2019/20. The comparable performance indicator is the average 7-day LIBID rate which was 0.07% uncompounded for 2020/21.

In addition to this the Council achieved a return of £36,391 interest and rental income on its property fund investment during 2020/21, equivalent to 3.81% for the year (4.34% in 2019/20).

5. What will it cost and are there opportunities for savings?

5.1 Not applicable

6. What are the risks and how can they be reduced?

6.1

Current Risk	Actions to reduce the risks
That external borrowing might not be undertaken at the most advantageous rate	Treasury officers maintain regular contact with the Council's advisors, Link Asset Services, who monitor movements in interest rates on our behalf. The aim is always to drawdown loans when interest rates are at their lowest point.
Credit risk – the risk that other parties might fail to pay amounts due, e.g. deposits with banks etc	The Annual Investment Strategy sets the criteria through which the Council decides with whom it may invest. The lending list is updated regularly to reflect changes in credit ratings.
Liquidity risk – the Council might not have sufficient funds to meet its commitments	Daily monitoring of cash flow balances. Access to the money markets to cover any short term cash shortfall.
Refinancing and maturity risk – the risk that the Council might need to renew a loan or investment at disadvantageous interest rates	Monitoring of the maturity profile of debt to make sure that loans do not all mature in the same period. Monitoring the maturity profile of investments to ensure there is sufficient liquidity to meet day to day cashflow needs.

7. Other options considered

7.1 None. It is a legislative requirement that the Council receives an annual report covering its treasury activities for the financial year.

8. Environmental impact

8.1 No environmental impact directly arising from this report.

9. Other significant issues

9.1 In preparing this report, the author has considered issues related to Human Rights, Legal Matters, Human Resources, Equalities, Public Health Inequalities, and Climate Local and there are no areas of concern.

10. Appendix

10.1 Appendix A – Prudential and Treasury Indicators

11. Background paper(s)

11.1 None.

12. Report author's contact details

Nick Brown	Strategic Finance Manager
Nick.Brown@blaby.gov.uk	0116 272 7625