Appendix A

Treasury Management Annual Report 2020/21

1. Background

1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management. The Treasury Management Strategy for 2020/21 was approved at Council on 20th February 2020.

1.2 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and as a minimum a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA code.

1.3 In carrying out treasury operations the Council has regard to the advice received from it's appointed Treasury Management advisors, Arlingclose Ltd. The current contract for advice expires 31st December 2021.

2. External Context

2.1 **Economic background:** The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

2.2 Some good news came in December 2020 as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK vaccine rollout started in earnest; over 31 million people had received their first dose by 31st March.

2.3 A BREXIT trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline having been agreed with the European Union on Christmas Eve.

2.4 The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE 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. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

2.5 Government initiatives supported the economy and the Chancellor announced in the 2021 Budget a further extension to the furlough (Coronavirus Job Retention) scheme until September 2021. Access to support grants was also widened, enabling more self-employed people to be eligible for government help. Since March 2020, the government schemes have help protect more than 11 million jobs.

2.6 Despite the furlough scheme, 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. Wages rose 4.8% for total pay in nominal terms (4.2% for regular pay) and was up 3.9% in real terms (3.4% for regular pay). Unemployment is still expected to increase once the various government job support schemes come to an end.

2.7 Inflation has remained low over the 12 month period. The annual headline rate of UK Consumer Price Inflation (CPI) fell to 0.7% year/year in March, below expectations (0.8%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 1.0% year/year (in line with expectations).

2.8 GDP (quarter to quarter growth) contracted sharply in 2020 Q2 (Apr-Jun) by 19.5% during the first national lockdown but bounced back in Q3 and Q4 by 16.9% and 1.3% respectively. However, during 2021 Q1 during a further lockdown GDP reduced by 1.5%.

2.9 After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. 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. Joe Biden became the 46th US president after defeating Donald Trump.

2.10 The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

2.11 **Financial markets:** Monetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250. However, they remain lower than their pre-pandemic levels.

2.12 Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook, due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

2.13 **Credit Review:** Due to the uncertainties of the pandemic, a number of UK banks were downgraded in the first half of 2020. Moody's also downgraded the UK sovereign rating to Aa3 with a Stable outlook which then impacted a number of other UK institutions, banks and local government. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

2.14 The vaccine approval and subsequent rollout programme are both credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

3. Local Context

3.1 As at 31st March 2021 the Authority has borrowings of £212m and investments of £52m. This is set out in further detail at **Annex A.** Forecast changes in these sums are shown in the balance sheet analysis in **Table 1** below.

Table 1: Balance Sheet Summary and Forecast

	31/03/20 Actual £m	31/03/21 Actual £m	31/03/22 Estimate £m	31/03/23 Estimate £m	31/03/24 Estimate £m
General Fund CFR	372	403	446	481	476
Less: Other long-term liabilities *	(24)	(22)	(21)	(20)	(18)
Loans CFR	**348**	**381**	**425**	**461**	**458**
Less: External borrowing **	(201)	(190)	(78)	(77)	(77)
Internal (over) borrowing	**147**	**191**	**347**	**384**	**381**
Less: Usable reserves	(106)	(101)	(96)	(90)	(87)
Less: Working capital	(98)	(80)	(75)	(73)	(71)
Investments (or New borrowing)	**57**	**(10)**	**(176)**	**(221)**	**(223)**

* finance leases and PFI liabilities that form part of the Authority's debt

** shows only loans to which the Authority is committed and excludes optional refinancing

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.3 The Authority has an increasing CFR due to the capital programme and will therefore be required to borrow up to £77m over the forecast period 2021/22 to 2023/24.

3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. **Table 1** shows that the Authority expects to comply with this recommendation.

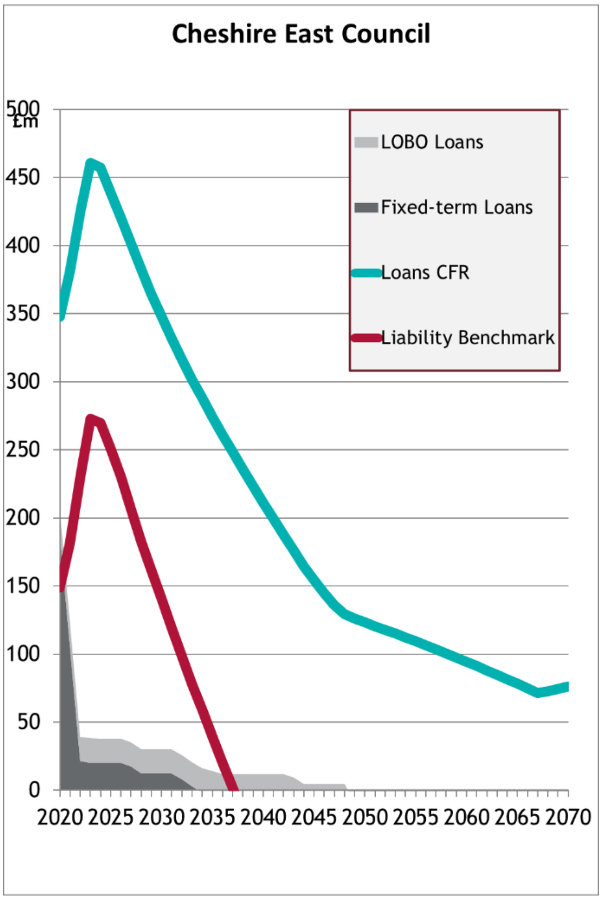
3.5 **Liability Benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £20m at each year-end to maintain a core strategic investment.

Table 2: Liability Benchmark

	31/03/20 Actual £m	31/03/21 Actual £m	31/03/22 Estimate £m	31/03/23 Estimate £m	31/03/24 Estimate £m
Loans CFR	348	381	425	461	458
Less: Usable reserves	(106)	(101)	(96)	(90)	(87)
Less: Working capital	(98)	(80)	(75)	(73)	(71)
Plus: Minimum investments	20	20	20	20	20
Liability Benchmark	**164**	**220**	**274**	**318**	**320**

3.6 Following on from the medium-term forecasts in table 2 above the long-term liability benchmark assumes minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in **Chart 1.**

Chart 1: Liability Benchmark Chart



4 Borrowing Strategy

4.1 The Authority currently holds loans of £190m, a decrease of £11m since 31 March 2020. The funding of Government iniatives to businesses and individuals to tackle the effects of COVID lockdowns via the Council has lead to increased fluctuations in cash during 2020/21. This has reduced the need to borrow.

4.2 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

4.3 With short term interest rates remaining much lower than long-term rates and high levels of liquidity in the markets, the Authority considered it more cost effective in the near term to use internal resources and borrow rolling temporary / short-term loans instead. The cost (including fees) in 2020/21 was around 0.73%. A full list of temporary borrowings as at 31/03/2021 is shown below in Table 3.

Table 3 – Current Temporary Borrowing

Lender	Start	Maturity	Rate %	£m
Devon & Somerset Fire	03/08/20	06/04/21	0.50	5.0
London Borough of Bromley	17/09/20	06/04/21	0.45	5.0
Derbyshire Pension Fund	07/09/20	07/04/21	0.29	5.0
North & Tyne Combined Authority	08/10/20	08/04/21	0.45	5.0
London Borough of Bromley	21/09/20	12/04/21	0.42	5.0
Wandsworth	15/03/21	15/04/21	0.10	5.0
N Ireland Housing Exec	04/08/20	16/04/21	0.30	10.0
Cheshire West & Chester	18/03/21	19/04/21	0.76	6.0
Perth & Kinross	21/09/20	21/04/21	0.40	5.0
Bournemouth	22/03/21	22/04/21	0.10	5.0
PCC Hampshire	23/10/20	23/04/21	0.25	4.0
Hampshire Fire	23/10/20	23/04/21	0.25	1.0
Nottingham City	24/03/21	26/04/21	0.07	5.0
Somerset	21/09/20	04/05/21	0.40	5.0
Maldon	22/02/21	24/05/21	0.15	2.0
Runnymede	22/02/21	24/05/21	0.15	3.0
Nottingham City	22/03/21	24/05/21	0.08	5.0
N Ireland Housing Exec	25/09/20	25/05/21	0.25	4.0
North Tyneside	21/09/20	21/06/21	0.45	5.0
London Borough of Richmond	22/03/21	22/06/21	0.12	5.0
Kensington & Chelsea	08/03/21	08/09/21	0.20	5.0
Wokingham	11/09/19	10/09/21	0.90	5.0
TOTAL				**105.0**

4.4 The cost of temporary borrowing in 2020/21 is £508,000 which is lower than the budgeted £630,000. This is due to the continued low interest rate environment and the reduced need to borrow due receipt of Government COVID grants prior to onward payment to business and individuals.

4.5 **PWLB:** In November 2020, the PWLB published its response to the consultation on 'Future Lending Terms'. From 26th November the margin on PWLB loans above gilt yields was reduced from 1.8% to 0.8% providing that the borrowing authority can confirm that it is not planning to purchase 'investment assets primarily for yield' in the current or next two financial years. The Council is not planning to purchase any such investment assets which makes PWLB funding more affordable again if short term rates were to increase or market liquidity disappear.

4.6 **LOBO's:** The Authority holds £17m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBO's had options during 2020/21 but no changes were proposed.

5 Investment Strategy

5.1 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. Due to the overriding need for short term borrowing, other than £20m invested strategically in managed funds, the investments are generally short term for liquidity purposes. On occasions higher balances than expected have been held due to the timing of receipt of COVID related grants.

5.2 The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.3 The maximum amount that can be invested with any one organisation is set in the Treasury Management Strategy Report. The maximum amount and duration of investments with any institution depends on the organisations credit rating, the type of investment and for banks and building societies, the security of the investment. Generally credit rated banks and building societies have been set at a maximum value of £6m for unsecured investments and £12m for secured investments. Any limits apply to the banking group that each bank belongs to. Limits for each Money Market fund have been set at a maximum value of £12m per fund with a limit of 50% of total investments per fund. There is also a maximum that can be invested in all Money Market Funds at any one time of £50m. Due to their smaller size, unrated Building Societies have a limit of £1m each.

5.4 Investment limits were breached on 1st April 2020 following the sudden receipt of £95.5m finding from the Government for onward payment to small businesses as COVID relief grants. For the Council to hold this amount of cash at any point in time is highly unusual and the limits and number of Counterparties immediately available were insufficient to keep within approved limits. Funds were distributed as far as practical breaching the limits with six counterparties of which five were brought back within limits by 15th April and the remaining one by 24th April.

5.5 This breach of limits was reported at the time by the s.151 Officer to the Chief Executive, Portfolio Holder for Finance, ICT & Communications and the Chair of the Audit & Governance Committee. A report was also presented to the Audit & Governance Committee on 20th May 2020. There have been no further breaches of limits.

5.6 Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. The net return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.1% in March, are now at or very close to zero; fund management companies have temporarily lowered or waived fees to avoid negative net returns.

5.7 Treasury Management income for 2020/21 is £990,000 which is higher than the budgeted £600,000.

- The average daily investment balance including managed funds during 2020/21 is £61m

- The average annualized interest rate received on in-house investments during 2020/21 is 0.18%

- The average annualized interest rate received on the externally managed funds during 2020/21 is 4.58%

5.8 The Authority's total average interest rate on all investments in 2019/20 is 1.62%. The returns continue to exceed our benchmark, the London Inter-bank Bid Rate for 7 days at 0.05% (average 2020/21), and our own performance target of 0.60% (Base Rate for 2020/21 + 0.50%).

Table 4 – Interest Rate Comparison

Comparator	Average Rate 2020/2021
Cheshire East	1.62%
LIBID 7 Day Rate	0.05%
LIBID 3 Month Rate	0.11%
Base Rate	0.10%
Target Rate	0.60%

5.9 As the Authority holds a large amount of reserves and working capital, £20m of this has been placed in strategic investments in order to benefit from higher income returns whilst spreading risk across different asset classes.

5.10 The investments are in five different funds which are all designed to give an annual income return between 4% and 5% but which have different underlying levels of volatility. By spreading investments across different types of fund, the intention is to dampen any large fluctuations in the underlying value of the investments.

Table 5 –Strategic Investments

Fund Manager	Asset Class	Invested £m	Current Value £m
CCLA	Property	7.5	7.7
Aegon	Multi Asset	5.0	5.0
Fidelity	Equity - Global	4.0	4.0
Schroders	Equity - UK	2.5	2.1
M & G	Bonds	1.0	1.0
TOTAL		20.0	19.8

5.11 The value of these investments does vary. The effects of COVID-19 on financial markets and values of underlying assets has been considerable. Fund values at 31st March 2021 were slightly lower than the amounts invested, but is a significant increase since April 2020. However, these investments all continue to deliver high levels of income return.

Chart 2 – Current Investments by Counterparty Type

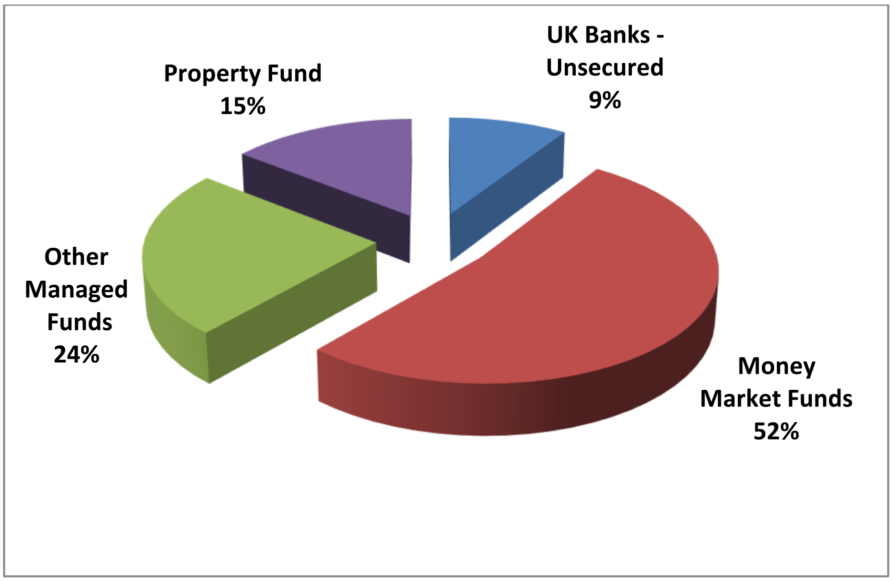


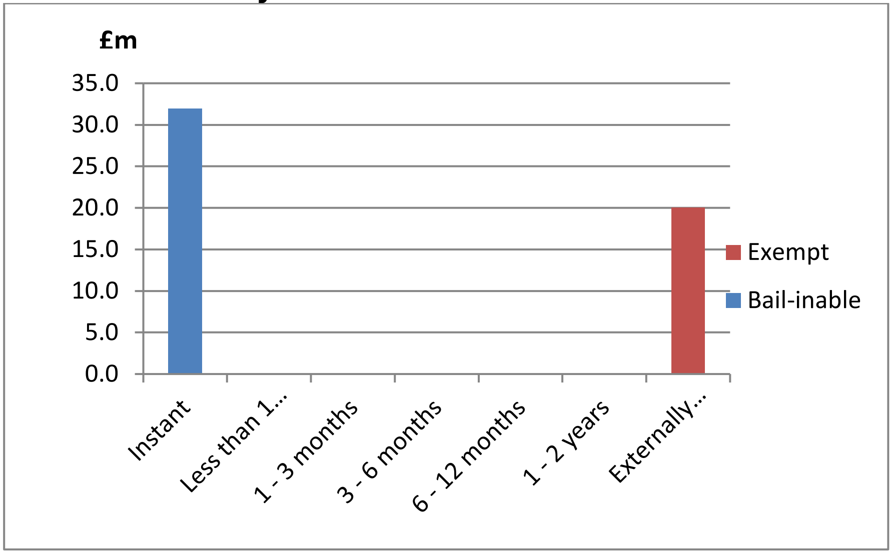
Table 6 – Types of Investments and Interest Rates at 31st March 2021

Instant Access Accounts	Average Rate %	£m
Money Market Funds	0.02	27.1
Barclays Call Account	0.01	4.8

Externally Managed Funds	£m
Property Fund	7.5
Other Managed Funds	12.5

Summary of Current Investments	£m
TOTAL	**51.9**

Chart 3 – Maturity Profile of Investments



Note: Bail-inable means that in the event of default the counterparty may be required to use part of the investments as their own capital in which case the Council would not get back as much as they invested. This would apply with most bank and Building Society investments.

6 Treasury Management Indicators

6.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

6.2 **Interest Rate Exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The upper limit on the one-year revenue impact of a 1% rise in interest rates is:

Interest Rate Risk Indicator	Limit
Upper limit on one-year revenue impact of a 1% **rise** in interest rates	£545,000
Actual impact in 2020/21 of increase in interest rates	£0

6.3 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. Rates fell in 2020/21 so there were no pressures from increasing rates. The Council remained a net borrower in 2020/21 so any fall in rates would lead to savings rather than incurring additional cost. The limit and the actual impact from a fall in rates were therefore £0.

6.4 **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. Lower limits have been set at

0%. The upper limits on the maturity structure of borrowing which were set in February 2021 and the actual maturity profiles as at 31 March 2021 are:

Refinancing rate risk indicator	Upper Limit	Actual
Under 12 months	70%	68%
12 months and within 24 months	35%	0%
24 months and within 5 years	35%	0%
5 years and within 10 years	75%	6%
10 years and within 20 years	100%	9%
20 years and above	100%	17%

6.5 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The upper limit for loans maturing in under 12 months is relatively high as short term funding is currently considerably cheaper than alternatives.

6.6 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

Price Risk Indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£25m	£15m	£10m
Actual amounts committed beyond year end	£0m	£0m	£0m

Annex A: Existing Investment & Debt Portfolio Position

	31/03/21 Actual Portfolio £m	31/03/21 Average Rate for the year %
External Borrowing:		
PWLB – Fixed Rate	61	4.44%
Local Authorities	105	0.64%
LOBO Loans	17	4.63%
Other	7	0.10%
Total External Borrowing	**190**	**2.74%**
Other Long Term Liabilities:		
PFI	21	-
Finance Leases	1	-
Total Gross External Debt	**212**	-
Investments:		
Managed in-house		
Short-term investments:		
Instant Access	32	0.02%
Managed externally		
Property Fund	8	4.46%
Other Managed Funds	12	4.65%
Total Investments	**52**	**1.78%**
Net Debt	**160**	-