Audit Committee

28th September 2020

Report of: Service Director: Finance

Title: Treasury Management Annual Report 2019/20

Ward: City Wide

Officer Presenting Report: Michael Pilcher, Chief Accountant

Contact Telephone Number: 0117 35 76255

Recommendation

The Audit Committee note the Annual Treasury Management Report for 2019/20, as detailed in Appendix A.

Summary

The Council is required to produce an annual treasury management review of activities and the actual treasury indicators in accordance with Local Government regulations.

The significant issues in the report are:

- The Council has complied with treasury management legislative and regulatory requirements during the period and all transactions were in accordance with the approved Treasury Management Strategy.

- The 2019–2024 Treasury Strategy identified a medium term borrowing requirement of £245m to support the existing and future Capital Programme. The Council's agreed policy is to defer borrowing while it has significant levels of cash balances (£149m at March 2020), noting if the financial environment changes and borrowing was deemed advantageous the Council may borrow over appropriate maturity periods.

- The Council's long term debt at 31 March 2020 was £461m with an average annual interest rate of 4.56%. Investments were £149m at the 31 March 2020 with an average annual interest rate of 0.85%.

Policy

There are no policy implications as a direct result of this report.

Consultation

1. Internal

Executive & Service Directors, and Deputy Mayor – Finance, Governance & Performance.

2. External

Link Asset Services – the Council's external treasury management advisors

Background and Context

1. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also requires reports to full Council mid-year and after the year end. The 2019/20 outturn report is set out as Appendix A.

2. The Code also requires the Council to nominate one of its Committees to have responsibility for scrutiny of its treasury management strategy, policy and activity. Council has delegated that responsibility to the Overview and Scrutiny Management Board and Audit Committee. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

3. Treasury management is defined as:

   "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

Other Options Considered

Not applicable

Risk Assessment

The principal risks associated with treasury management are:

Risk	Mitigation
Loss of investments as a result of failure of counterparties	Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties
Increase in the net financing costs of the authority due to borrowing at high rates of interest / lending at low rates of interest	Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs)

Public Sector Equality Duties

None necessary for this report

Legal and Resource Implications

Legal

The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these. **(Legal advice provided by Tim O'Gara - Service Director: Legal and Democratic Services)**

Financial
(a) Revenues
The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan. Any additional operating costs arising from capital investment must be contained within the revenue budget of the

relevant department.

(b) Capital
Not Applicable
(Financial advice provided by Jon Clayton – Capital and Investments Manager)

Land
Not applicable

Personnel
Not Applicable

Appendices:
Appendix A – Treasury Management Annual Report 2019/20

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985
Background Papers:

None

Appendix A

Treasury Management Annual Report 2019/20

Purpose of the report:

1. Under the CIPFA Code of Practice on Treasury Management (the Code) the Section 151 Officer is required to produce an outturn report on activities in the year to account for how the Strategy set at the start of the year has been implemented. This report meets the requirements of both the Code and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

Background

2. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also requires reports to full Council mid-year and after the year end.

3. The Code also requires the Council to nominate one of its Committees to have responsibility for scrutiny of its treasury management strategy, policy and activity. Council has delegated this responsibility to the Overview and Scrutiny Management Board and Audit Committee. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

4. Treasury management is defined as:

   "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The Economy and Interest Rates for 2019/20

5. **UK. Brexit.** The main issue in 2019 was the repeated battles in the House of Commons to agree a way forward for the UK over the issue of Brexit. This resulted in the resignation of Teresa May as the leader of the Conservative Government, the election of Boris Johnson followed by a general election victory for the Conservative Party that enabled the UK to leave the EU on 31 January 2020. However, there remains much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

   Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 poor at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election.

However, the three monthly GDP statistics in January were disappointing, 0.0% growth. Since then, the whole world has changed as a result of the coronavirus outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to hold rates until March 2020; at this point it was clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for the months while the country is locked down. It also put in place other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to assist them over the lock down period when some firms may have little or no income. However, this will leave open questions as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. This is a rapidly evolving situation so there may be further measures to come from the Bank and the Government.

The measures to support jobs and businesses already taken by the Government will result in a large increase in the annual budget deficit in 2020/21 from 2%, to nearly 17%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery.

Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a sharp drop in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing through the last year but it is heading for a large drop. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail markets are suffering.

6. **USA.** Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Federal

Reserve cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US, the Federal Reserve took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, down to 0.00 – 0.25%. Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Federal Reserve which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost $367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be $500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

However, this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. Growth in quarter 1 of 2020 fell by an annualised 5.0% .

EUROZONE. The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The Eurozone economy shrank by 3.6% in the first three months of 2020. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs (targeted longer-term refinancing operations); this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth.

7. **CHINA.** Economic growth has been weakening over successive years, despite rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has control of the virus it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems

8. **JAPAN** has been struggling to stimulate consistent significant GDP growth and to get inflation

up to its target of 2%, despite monetary and fiscal stimulus.

9. **WORLD GROWTH.** The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would "spill" over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the "big" issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

Treasury position as at 31 March 2020

10. The table below indicates the balance of borrowing and investments at the beginning and end of the year and average borrowing cost and investment returns for each period:

	31 March 2019		31 March 2020	
	£m	Average Rate %	£m	Average Rate %
Long Term Debt (fixed rates) - PWLB[1]	311	4.92	341	4.74
Long Term Debt (fixed rates) – LOBOS[2]	70	4.09	70	4.09
Long Term Debt (fixed rates) – Market	50	4.04	50	4.04
Short Term Borrowing	-	-	-	-
Total borrowing	**431**	**4.68**	**461**	**4.56**
Investments	108	0.76	149	0.85
Net Borrowing Position	**323**		**312**	

1Public Works Loan Board

2 Lender option Borrower option (LOBO) ,

11. The total borrowing excludes accrued interest of £5m (£5m at 31/3/19) and the outstanding finance on PFI and service contracts of £141m at 31 March 2020 (£135m at 31/3/19).

12. In addition to the Treasury investments above (£149m), the authority also has long term service investments costing £49m primarily relating to the holdings in Bristol Holdings Company (£37m), Bristol Port Company (£3m) and a property fund to support Homelessness (£9m).

13. The Net debt has decreased by £11m from £323m to £312m primarily due to;
    - Funding of the capital programme financed by Prudential borrowing +£35m as set out in Appendix 1 para 3.
    - Other changes to working capital / provisions (£46m), primarily through the receipt of advance grant funding from Central Government (£33m) to assist the Council's cash-flows as a result of the coronavirus pandemic.

Long Term Borrowing – Strategy and outturn

14. The 2019–2024 Treasury Strategy (approved 26th February 2019) identified a net medium term borrowing requirement of £245m to support the existing and future Capital Programme with the debt servicing costs predominately met from revenue savings from capital investment and

the economic development fund. The £245m was planned to be borrowed in the following periods, 19/20 - £70m, 20/21, £80m, 21/22 - £60m, 22/23 - £15m and 23/24 - £20m.

15. The Council's Strategy is also to defer borrowing while it has significant levels of liquid treasury investments, £149m at March 2020 (£108m at March 2019). However the Strategy also considers where the financial environment changes and borrowing is deemed advantageous the Council will seek to borrow over appropriate maturity periods. Deferring borrowing reduces the "net" revenue interest cost of the Authority as well as reducing the Councils exposure to counter party risk for its investments. The Council recognises that utilising investments in lieu of borrowing clearly has a finite duration and that future borrowing will be required to support capital expenditure (see 2019/20 Treasury Management Strategy approved by Council 26th February 2019).

https://democracy.bristol.gov.uk/documents/s29829/Appendix%204%20-%20Treasury%20Management%20Strategy.pdf

16. Borrowing activity in year was in accordance with the Strategy approved at the beginning of the year**:**

- **Borrowing** – Due to the underlying need to borrow for capital purposes, and to reduce the Council's internal borrowing position, reduce its interest rate risk along with rates dropping to historic low levels, the Council borrowed £30m from the PWLB in two tranches;
    - On 20th August borrowed £20m for 47 years at 1.84%
    - On 5th September borrowed £10m for 46 years at 1.59%

- **PWLB Rate Change** – As mentioned in the Mid-year report, on the 9th October 2019 the Treasury and PWLB announced a 1% increase across all maturities to its new borrowing rates. There was no prior warning that this would happen and the Council will continue to assess financing their external borrowing needs and market borrowing options / proposals while awaiting the outcome of the PWLB consultation (closing date 31st July 2020) where it is anticipated this increase will be reversed for borrowing for non-commercial purposes.

- **Rescheduling –** No debt rescheduling activity was undertaken in 2019/20. As set out in the Treasury Mid-Year report the total life cycle cost of rescheduling loans on a discounted cash-flow basis has been reviewed with no loans providing a positive cash-flow benefit to the authority. This would in part be due to the large early repayment penalties that the authority will incur, circa £362m penalty to repay the £341m of PWLB loans early as at 31st March 2020 (the penalty at 31/03/19 was £261m).

Annual Investment Strategy and Outturn

17. Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the Monetary Policy Committee would be able to increase Bank Rate until the Brexit issue was settled. However, there was an expectation that Bank Rate would rise after this, but would only rise to 1.0% during 2020.

    Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September.

These rates fluctuated through the months of November to February following events around Brexit. When the coronavirus outbreak hit the UK in February/March, rates initially fell sharply but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

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 followed from 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.

18. Security of capital remained the Council's main investment objective. This was maintained by following the Council's policy for assessing institutions to which the council might lend. 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.).

19. Treasury Investments held by the Council - the Council maintained an average balance of £168m (£128m 2018/19) of internally managed funds. The internally managed funds received an average return of 0.85% (0.76% 2018/19). The comparable performance indicator is the average 7-day LIBID rate, which was 0.54%.

Compliance with Treasury Limits and Treasury Related Prudential Indicators

20. The Council can confirm that:

- All treasury related transactions were undertaken by authorised officers and within the limits and parameters approved by the Council;
- All investments were to counterparties on the approved lending list
- The Council operated within the Prudential Indicators within Appendix 1.

Performance Indicators set for 2019/20

21. One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt, and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

22. The following performance indicators have been set:

- Debt – Borrowing – Average rate of borrowing for the year compared to the average available.
  A blended long term borrowing rate achieved of 1.76% (47 years) vs. average for the year of 2.41% for the same duration.

- Investments – Internal returns above the 7 day LIBID rate
  Average rate for the year 0.85% vs. annual average 7 day LIBID of 0.54%

Consultation and scrutiny input

23. The report has been discussed with the Council's external treasury management advisers and internally with Strategic & Service Directors, and Deputy Mayor – Finance, Governance & Performance.

Risk Assessment

24. The principal risks associated with treasury management are:

Risk	**Mitigation**
Loss of investments as a result of failure of counterparties	Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties
Increase in the net financing costs of the authority due to borrowing at high rates of interest / lending at low rates of interest	Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs)

Public sector equality duties:

25. There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Environmental checklist / eco impact assessment

26. There are no proposals in this report which have environmental impacts

Legal and Resource Implications

27. Legal- the Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

Advice provided by Tim O'Gara (Service Director: Legal and Democratic Services)

Financial

(a) Revenue

28. The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan.

    Advice given by Jon Clayton (Capital and Investment Manager)

(b) Capital

29. There is no direct capital investment implications contained within this report.

Land

30. There are no direct implications for this report.

Personnel

31. There are no direct implications for this report.

Appendices:

Appendix 1: Treasury Management Annual Report 2019/20

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

Background Papers:

32. Treasury Management Strategy 2019/20

    https://democracy.bristol.gov.uk/documents/s29829/Appendix%204%20-%20Treasury%20Management%20Strategy.pdf

Appendix 1

Annual Report on the Treasury Management Service 2019/20 (Incorporating Outturn Prudential Indicators)

Introduction

1. This report summarises:

   - The capital activity during the year
   - What resources the Council applied to pay for this activity;
   - The impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
   - The reporting of the required prudential indicators;
   - Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
   - A summary of interest rate movements in the year;
   - The detailed debt activity;
   - The detailed investment activity;
   - Local Issues

The Council's Capital Expenditure and Financing 2019/20

2. The Council undertakes capital expenditure to invest in the acquisition and enhancement of long-term assets. These activities may either be:

   - Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

   - If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

3. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2018/19 Actual £m	2019/20 Original Budget £m	2019/20 P10 - Final Budget £m	2019/20 Actual £m
Non-HRA capital expenditure	93	184	114	129*1
HRA capital expenditure	37	52	48	49
Total capital expenditure	**130**	**236**	**162**	**178**
Resourced by:				
Capital receipts	11	43		31
Capital grants	44	64		53
HRA Self Financing	23	26		26
Prudential borrowing	32	91		35
Revenue	20	12		21
Service Concession Contract – Waste Vehicles*1	-	-		12
Total Resources	**130**	**236**		**178**

*1 – Technical accounting adjustment required for Waste Service Concession Contract in accordance with International Financial Reporting Standards.

The Council's Overall Borrowing Need

4. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. It represents 2019/20 and prior years' net capital expenditure that has not yet been paid for by revenue or other resources.

5. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

6. Reducing the CFR – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy, the Council is required to make an annual revenue charge to reduce the CFR – effectively a repayment of the Non-Housing Revenue Account (HRA) borrowing need. There is no statutory requirement to reduce the HRA CFR.

7. This statutory revenue charge is called the Minimum Revenue Provision - MRP. The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

8. The Council's 2019/20 MRP Policy (as required by CLG Guidance) was approved on the 26th February 2019.

9. The Council's CFR for the year is shown below, and represents a key prudential indicator. Accounting rule changes in previous years has meant that PFI schemes are now included on the balance sheet, which increases the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR	General Fund 31 March 2019 Actual £m	General Fund 31 March 2020 Actual £m	HRA 31 March 2019 Actual £m	HRA 31 March 2020 Actual £m	Total CFR 31 March 2020 Actual £m
Opening balance	**578**	**602**	**245**	**245**	**847**
Add unfinanced capital expenditure (as above)	32	35	-	-	35
Less MRP/VRP	(2)	(4)	-	-	(4)
Less application of Capital Resources[1]	-	(14)			(14)
PFI, Service Concession and finance lease adjustments	(6)	6	-	-	6
Closing balance	**602**	**625**	**245**	**245**	**870**

1 – Relates to the application of Capital Receipt for the element of the Cattle Market Road site re-development that was originally financed from prudential borrowing . The capital receipt generated following the sale of this site to the University of Bristol.

Treasury Position at 31 March 2020

10. Whilst the Council's gauge of its underlying need to borrow is the CFR, Finance can manage the Council's actual borrowing position by either:

- Borrowing to the CFR; or
- Choosing to utilise some temporary internal cash flow funds in lieu of borrowing or
- Borrowing for future increases in the CFR (borrowing in advance of need).

11. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

	31 March 2019		31 March 2020	
	Principal £m	**Average Rate %[2]**	**Principal £m**	**Average Rate %[2]**
Fixed Interest Rate Debt	311	4.92	341	4.74
Variable Interest Rate Debt	-	-	-	-
Market Debt – LOBO[1]	70	4.09	70	4.09
Market Debt	50	4.04	50	4.04
PFI / Service Contracts	135	-	141	-
Total Debt	**566**	**4.68**	**602**	**4.56**
Debt administered of behalf of Unitary Authorities (Ex Avon Debt)	(43)	-	(41)	-
Revised Debt	523	4.68	561	4.56
Capital Financing Requirement	847		870	
Over/(Under) borrowing	(324)		(309)	
Investment position				
Investments (Fixed & Call)	108	0.76	149	0.85
Net borrowing position (excl leasing arrangements)	**323**	**-**	**312**	**-**

1 Lender option Borrower option (LOBO) , 2 reflect the average rate for the year taking account of new loans and repayments.

12. The fixed Interest rate debt is apportioned between the General Fund and HRA as set out in the table below.

Fixed Interest Rate Debt	**31 March 2019 £m**		**31 March 2020 £m**	
	Principal £m	**Average Rate%**	**Principal £m**	**Average Rate%**
General Fund	186	4.68	216	4.41
HRA	245	4.68	245	4.68
Total	431	4.68	461	4.56

13. The maturity structure of the debt portfolio (excluding accrued interest) was as follows:

	Approved Min Limit%	**Approved Max Limit%**	**31 March 2019**		**31 March 2020**	
			Actual £m	**%**	**Actual £m**	**%**
Under 12 Months	0	20	-	-	10	2
1 to 2 years	0	20	10	2		
2 to 5 years	0	40	5	1	10	2
5 to 10 years	0	40	54	13	49	11
10 years and over	25	100	362	84	392	85
Total			**431**	**100**	**461**	**100**

14. The Council hold £70m of LOBOS with maturities averaging 41 years. Inherent within these loan instruments are options (averaging an option every 3.5 years) that could give rise to the debt being repaid early. These loans are regularly reviewed with the current and expected structure of interest rates. The risk of the lenders exercising their options is currently low for the short to medium term. Therefore, the maturity of these loans in above table is based on their maturity date, 10 years and over.

15. The Council will continually review these loans in accordance with economic forecasts and will update the maturity structure of the debt portfolio accordingly and assess the future re-financing risks exposed to the authority and report any changes within future monitoring reports.

16. The authority's borrowing strategy is to delay borrowing and use its existing resources to support the Capital Programme to reduce its exposure to counterparty risk and the net interest cost of the authority.

17. 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 this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

    As the Council has an underlying need to borrow for capital purposes, the need to reduce the Council's internal borrowing position and manage its interest rate risk, along with rates dropping to historic low levels, it was on this basis that the Council borrowed £30m from the PWLB in two tranches;

    - On 20th August borrowed £20m for 47 years at 1.84%
    - On 5th September borrowed £10m for 46 years at 1.59%

18. In addition if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than expected, perhaps arising from an acceleration in bank rate, an increase in world economic activity or a sudden increase in inflation risks, then further borrowing would have been considered. Most likely, further fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be over the short to medium term.

Prudential Indicators and Compliance Issues

19. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

20. **Gross Borrowing and the CFR** - In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement over the medium term. This essentially means that the Council is not borrowing to support revenue expenditure. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2019 Actual £m	31 March 2020 Actual £m
Gross borrowing position	431	461
CFR (excluding PFI)	712	729

21. **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by Section 3 of the Local Government Act 2003. Once agreed the authorised limit cannot be breached. The Council does not have the power to borrow above this level. The table below demonstrates that during 2019/20 the Council has maintained gross borrowing within its Authorised Limit.

22. **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

23. **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2019/20 £m
Authorised Limit	970
Operational Boundary	660
Average gross borrowing position (including PFI)	584
Financing costs as a proportion of net revenue stream: General Fund HRA	 6.74% 8.16%

Borrowing Rates in 2019/20

24. Gilt yields were on a generally falling trend during the last year until the coronavirus crisis. Since then, gilt yields have fallen sharply to unprecedented lows. Central banks have also started quantitative easing which will act to maintain downward pressure on government bond yields at a time when there is going to be a large and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% and 25-year yields were at 0.83%.

    As referred above HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019-20 without any prior warning;

    the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates.

    That increase was then partially reversed for some forms of borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased

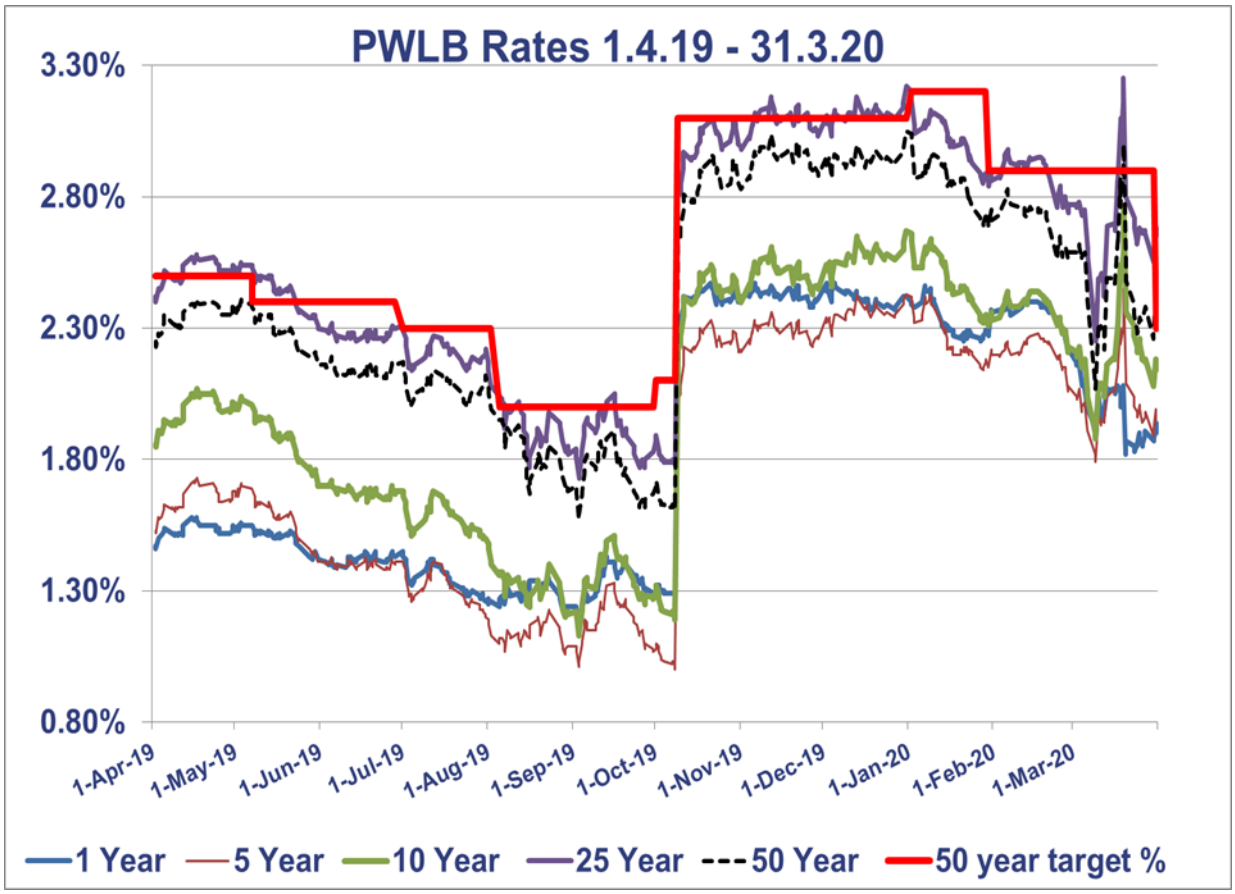
spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ended on the 31st of July 20 and are awaiting the outcome.

Following the changes on 11 March 2020 the current margin for PWLB loans are as follows: -

- PWLB Rate is gilt plus 180 basis points
- PWLB HRA Rate is gilt plus 80bps

There is likely to be little upward movement in PWLB rates over the next two years as it will take economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020-21.

The impact on PWLB rates is highlighted in the graph below.



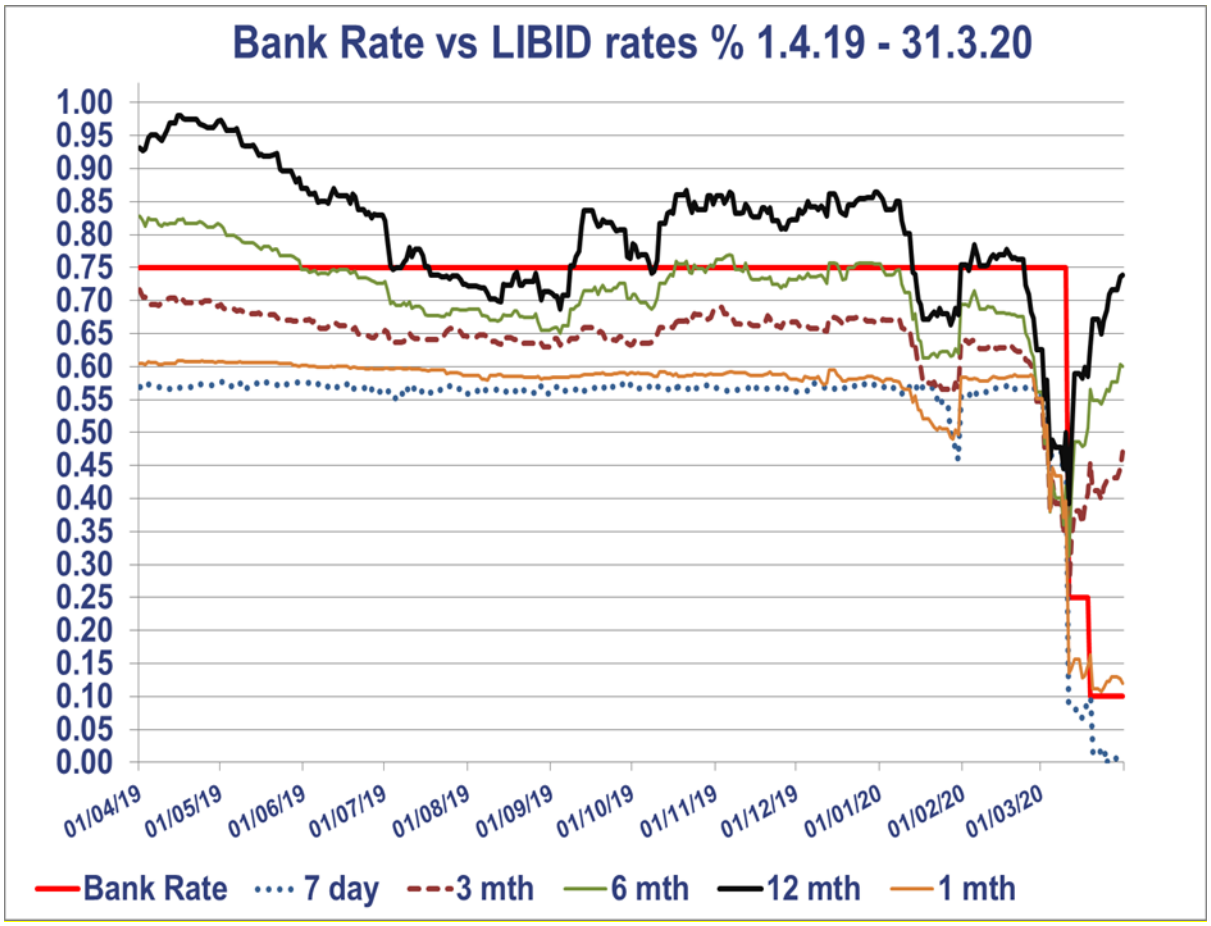
25. **Summary of Debt Transactions –** The authority took out 2 new PWLB loans during 2019/20. £20m was taken out in August at a rate of 1.84% and £10m taken out in September at rate of 1.59%.

26. The average rate of interest for the debt portfolio is 4.56%.

Investment Rates in 2019/20

27. Investment interest rates remained low during the year with the expectation of Bank Rate remaining at 0.75% until Brexit is settled. In March the MPC reduced the base rate to 0.10% to deal with the financial threat to the economy following the outbreak of the coronavirus.

    Initially investments fell in March but then rose sharply back up again due to a shortage of liquidity in financial markets as highlighted in the table below.



28. The Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 26th February 2019. 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, and the Council had no liquidity difficulties.

Local Issues

29. **Ethical Investment Policy-** The "Ethical Investment Policy" was approved by Cabinet on 15th December 2011 (updated February 2015). There are no breaches to report.

Regulatory Framework, Risk and Performance

30. The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

    - The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
    - The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made);
    - Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
    - The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
    - The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
    - Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities.
    - Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

31. The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

32. The Council has ensured that the principles of security, liquidity and yield have been adhered to within the treasury operation. This implies that the safeguarding of the principal investment with a suitable counterparty remains the Council's highest priority followed by liquidity (i.e. ease of access to the principal amount deposited) and yield (i.e. return) on investment.