Audit Committee

27th September 2021

Report of: Service Director: Finance

Title: Treasury Management Annual Report 2020/21

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 2020/21, 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 2020–2025 Treasury Strategy identified a medium term borrowing requirement of £215m 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 (£207m at March 2021), 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 2021 was £451m with an average annual interest rate of 4.48%. Investments were £207m at the 31 March 2021 with an average annual interest rate of 0.30%.

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 2020/21 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 Resources Scrutiny 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 2020/21

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

None

Appendix A

Treasury Management Annual Report 2020/21

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 Resources Scrutiny 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 2020/21

5. **UK. Coronavirus.** The first national lockdown in late March 2020 did significant damage to an economy that caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A short second lockdown in November did "lesser" but by the time of the third lockdown in January 2021, businesses and individuals had become more resilient in adapting to working in new ways during a three-month lockdown so less damage than was caused than in the first one.

   The advent of vaccines starting in November 2020, promises to lead to a return to something approaching normal life during the second half of 2021. This has been instrumental in speeding economic recovery and the reopening of the economy. The household saving rate has been "exceptionally" high since the first lockdown in March 2020 and so there is plenty of "pent-up" demand and purchasing power for services in the still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK

economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.

Both the Government and the Bank of England took rapid action in March 2020 to provide support to financial markets to ensure their proper functioning, and to support the economy and to protect jobs.

The **Monetary Policy Committee** cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a £200bn programme of quantitative easing QE. increasing this to £895bn in November 2020.

While Bank Rate remained unchanged for the rest of the year, financial markets were concerned that the MPC could cut Bank Rate to a negative rate; this was firmly discounted at the February 2021 MPC meeting when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

Average inflation targeting. This was a change adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August was that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". This would indicate that even if inflation rises to 2% in a couple of years' time, not expect any action from the MPC to raise Bank Rate – until it is clear that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. This raises the bar for increasing Bank Rate and no increase is expected by March 2024, and possibly for as long as five years. Inflation has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is expected to be temporary.

Government support. The Chancellor has implemented support to businesses by way of cheap loans and other measures, and has protected jobs by paying for workers to be placed on furlough. This support has come at a significant cost in terms of the Government's budget deficit "ballooning" in 20/21 and 21/22 so that the Debt to GDP ratio reaches around 100%.

The Budget on 3rd March 2021 increased fiscal support to the economy and employment during 2021 and 2022 followed by substantial tax rises in the following three years to help pay for the cost of the pandemic. This will help strengthen the economic recovery from the pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%. An area of concern, though, is that the government's debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed long-term debt for floating rate debt; there is, therefore, much incentive for the Government to promote Bank Rate staying low e.g. by using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and / or by amending the Bank's policy mandate to allow for a higher target for inflation.

BREXIT. The final agreement on 24th December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done

on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling has proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

USA. The US economy did not suffer as much damage as the UK economy due to the pandemic. The Democrats won the presidential election in November 2020 and have control of both Congress and the Senate. This enabled the Democrats to pass a $1.9trn (8.8% of GDP) stimulus package in March on top of the $900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly will promote a rapid easing of restrictions and strong economic recovery during 2021. The Democrats are also planning to pass a $2trn fiscal stimulus package aimed at renewing infrastructure over the next decade. Although this package is longer-term, if passed, it would also help economic recovery in the near-term.

At the Federal Reserve September meeting the committee agreed a new inflation target - "to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time." This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan.

It is to be noted that inflation has been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely. There is now some expectation that where the Federal Reserve has led in changing its policy towards implementing its inflation and full employment mandate, other major central banks will follow, as indeed the Bank of England has done so already.

The Federal Reserve expects strong economic growth during 2021 to have only a brief impact on inflation, which explains why it projects US interest rates to remain near-zero through to the end of 2023. The key message is still that policy will remain with near-zero rates and asset purchases – continuing for several more years.

This is likely to result in keeping treasury yields at historically low levels. However, financial markets in 2021 have been concerned that the high amount of fiscal stimulus, on top of highly accommodative monetary policy, could lead to a rapid elimination of spare capacity in the economy and generating higher inflation much quicker than anticipated.

There is also concern as to how and when the Federal Reserve will "wind down" its programme of monthly Quantitative Easing of treasuries. These concerns have pushed treasury yields sharply up in the US in 2021 and is likely to have also exerted some upward pressure on gilt yields in the UK.

EU. Both the roll out and take up of vaccines has been slow in the EU in 2021, at a time when many countries are experiencing a sharp rise in cases which are threatening to overwhelm hospitals in some major countries; this has led to renewed severe restrictions or lockdowns

during March. This will inevitably put back economic recovery after the economy had staged a rebound from the first lockdowns in Q3 of 2020 but contracted slightly in Q4 to end 2020 only 4.9% below its pre-pandemic level. Recovery will now be delayed until Q3 of 2021 and a return to pre-pandemic levels is expected in the second half of 2022.

Inflation was well under 2% during 2020/21. The ECB did not cut its main rate of -0.5% further into negative territory during 2020/21, it expanded its Quantitative Easing (Pandemic emergency purchase programme - PEPP) in March 2020 and added further to that in its December 2020 meeting when it also expanded its programme of providing cheap loans to banks. The total PEPP scheme of €1,850bn is providing protection to the sovereign bond yields of weaker countries like Italy. There is, therefore, unlikely to be a euro crisis while the ECB is able to maintain this level of support.

China. Following the efforts to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; this has enabled China to recover all of the contraction in Q1 following implementing a programme of monetary and fiscal support that has been effective at stimulating growth.

Japan. Three rounds of government fiscal support in 2020 together with Japan's relative success in containing the virus without draconian measures so far, and the roll out of vaccines gathering momentum in 2021, should help to ensure a strong recovery in 2021 and to get back to pre-virus levels by Q3.

World growth. World growth was in recession in 2020. Inflation is unlikely to be a problem in most countries for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Deglobalisation. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. In March 2021, western democracies implemented sanctions that led to a retaliation by China and is likely to mean that the China / EU investment is at risk.

The pandemic exposed how frail extended supply lines were around the world, likely to lead to a retrenchment of economies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products and vice versa. This is likely to reduce world growth rates.

Central banks' monetary policy. During the pandemic, the governments of western countries have provided fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Federal Reserve and Bank of England have already changed their policy towards

implementing their existing mandates on inflation, (and full employment), to an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.

Treasury position as at 31 March 2021

6. 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 2020		**31 March 2021**	
	£m	**Average Rate %**	**£m**	**Average Rate %**
Long Term Debt (fixed rates) - PWLB[1]	341	4.74	331	4.63
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	**461**	**4.56**	**451**	**4.48**
Investments	149	0.85	207	0.30
Net Borrowing Position	**312**		**244**	

1Public Works Loan Board

2 Lender option Borrower option (LOBO)

7. The total borrowing excludes accrued interest of £5m (£5m at 31/3/20) and the outstanding finance on PFI and service contracts of £133m at 31 March 2020 (£141m at 31/3/20).

8. In addition to the Treasury investments above (£207m), 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), and
   - long term service loans costing £14m, primarily relating to loans to wholly owned subsidiaries (£11m) and external organisations (£3m).
   - These investments and loans support the delivery of council functions, provide service benefits and have positive social impact.

9. The Net debt has decreased by £68m from £312m to £244m primarily due to;
   - Funding of the capital programme financed by Prudential borrowing +£30m as set out in Appendix 1 para 3.
   - Net change in Reserves and provisions – (£61m)
   - Other changes to working capital and balances (£23m)

Long Term Borrowing – Strategy and outturn

10. The 2020–2025 Treasury Strategy (approved 25th February 2020) identified a net medium term borrowing requirement of £215m 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 £215m was planned to be borrowed in the following periods, 20/21, £75m, 21/22 - £50m, 22/23 - £35m, 23/24 - £30m and 24/25 - £25m.

11. The Council's Strategy is also to defer borrowing while it has significant levels of liquid treasury investments, £207m at March 2021 (£149m at March 2020). 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 2020/21 Treasury Management Strategy approved by Council 25th February 2020).

https://democracy.bristol.gov.uk/documents/s46390/Appendix%204%20-%20Treasury%20Management%20Strategy.pdf

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

- **Borrowing** – No borrowing was undertaken as the authority maintained higher levels of investments than originally anticipated for a variety of reasons including the advance receipt of grants and the time taken to progress capital schemes where the source of financing is external borrowing.

  The authority repaid a £10m loan that matured on 20th April 2021 that had an interest rate of 4.875% .

  The Council arranged a short-term credit facility with West of England Combined Authority (WECA) at the start of the financial year because the Council was concerned of the financial risks arising from the pandemic, primarily the loss of local income. This facility added to the existing facilities providing the authority with a pool of resources to draw upon, ensuring the Council maintained adequate levels of liquidity to meet the Council's financial obligations.

  However, as Central Government accelerated the receipt of grant funding, these facilities were not called upon.

- **PWLB Rate Change** – As mentioned in previous Treasury Management reports on the 9th October 2019 the Treasury and PWLB announced a 1% increase across all maturities to its new borrowing rates with no prior warning that this would happen.

  Following a consultation, on the 25th November 2020 this increase was reversed but a prohibition was introduced denying access to borrowing from the PWLB for any local authority that plans to purchase any asset primarily for yield regardless of how this purchase is funded.

- **Rescheduling –** No debt rescheduling activity was undertaken in 2020/21. 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 £270m penalty to repay the £331m of PWLB loans early as at 31st March 2021 (the penalty at 31/03/20 was £362m).

Annual Investment Strategy and Outturn

13. 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 Bank Rate would continue at the start of the year at 0.75 % before rising to end 2022/23 at 1.25%. This forecast changed by the Covid-19 pandemic in March 2020 which caused the Monetary Policy Committee to cut Bank Rate in March, first to 0.25% and then to 0.10%, in order to counter the negative impact of the national lockdown to 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 "cash-starved" businesses to survive during 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 falling significantly.

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

14. 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.).

15. Treasury Investments held by the Council - the Council maintained an average balance of £194m (£168m 2019/20) of internally managed funds. The internally managed funds received an average return of 0.30% (0.85% 2019/20). The comparable performance indicator is the average 7-day LIBID rate, which was negative 0.07% .

Compliance with Treasury Limits and Treasury Related Prudential Indicators

16. 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 2020/21

17. 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.

18. The following performance indicators have been set:
    - Debt / Borrowing – Average rate of borrowing for the year compared to the average available.
      No borrowing undertaken during the year

    - Investments – Internal returns above the 7 day LIBID rate
      Average rate for the year 0.30% vs. annual average 7 day LIBID of negative 0.07%

Consultation and scrutiny input

19. 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

20. 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:

21. 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

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

Legal and Resource Implications

23. 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

24. 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

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

Land

26. There are no direct implications for this report.

Personnel

27. There are no direct implications for this report.

Appendices:

Appendix 1: Treasury Management Annual Report 2020/21

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

Background Papers:

28. Treasury Management Strategy 2020/21
https://democracy.bristol.gov.uk/documents/s46390/Appendix%204%20-%20Treasury%20Management%20Strategy.pdf

Appendix 1

Annual Report on the Treasury Management Service 2020/21 (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 2020/21

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.

	2019/20 Actual £m	2020/21 Original Budget £m	2020/21 P9 - Final Budget £m	2020/21 Actual £m
Non-HRA capital expenditure	129*1	212	157	127*1
HRA capital expenditure	49	80	50	39
Total capital expenditure	**178**	**292**	**207**	**166**
Resourced by:				
Capital receipts	31	55		35
Capital grants	53	98		74
HRA Self Financing	26	35		22
Prudential borrowing	35	85		30
Revenue	21	19		4
Service Concession Contract – Waste Vehicles*1	12	-		1
Total Resources	**178**	**292**		**166**

*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 2020/21 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 2020/21 MRP Policy (as required by CLG Guidance) was approved on the 25th February 2020.

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 2020 Actual £m	General Fund 31 March 2021 Actual £m	HRA 31 March 2020 Actual £m	HRA 31 March 2021 Actual £m	Total CFR 31 March 2021 Actual £m
Opening balance	**602**	**625**	**245**	**245**	**870**
Add unfinanced capital expenditure (as above)	35	30	-	-	30
Less MRP/VRP	(4)	(5)	-	-	(5)
Less application of Capital Resources	(14)	(1)			(1)
PFI, Service Concession and finance lease adjustments	6	(8)	-	-	(8)
Closing balance	**625**	**641**	**245**	**245**	**886**

Treasury Position at 31 March 2021

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 2020		31 March 2021	
	Principal £m	**Average Rate %[2]**	**Principal £m**	**Average Rate %[2]**
Fixed Interest Rate Debt	341	4.74	331	4.63
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	141	-	133	-
Total Debt	**602**	**4.56**	**584**	**4.48**
Debt administered of behalf of Unitary Authorities (Ex Avon Debt)	(41)	-	(39)	-
Revised Debt	561	4.56	545	4.48
Capital Financing Requirement	870		886	
Over/(Under) borrowing	(309)		(341)	
Investment position				
Investments (Fixed & Call)	149	0.85	207	0.30
Net borrowing position (excl leasing arrangements)	**312**	**-**	**244**	**-**

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 2020 £m**		**31 March 2021 £m**	
	Principal £m	**Average Rate%**	**Principal £m**	**Average Rate%**
General Fund	216	4.41	211	4.26
HRA	245	4.68	240	4.68
Total	461	4.56	451	4.48

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

	Approved Min Limit%	**Approved Max Limit%**	**31 March 2020**		**31 March 2021**	
			Actual £m	**%**	**Actual £m**	**%**
Under 12 Months	0	20	10	2	-	-
1 to 2 years	0	20	-	-	5	1
2 to 5 years	0	40	10	2	20	4
5 to 10 years	0	40	49	11	34	8
10 years and over	25	100	392	85	392	87
Total			**461**	**100**	**451**	**100**

14. The Council hold £70m of LOBOS with maturities averaging 40 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 the 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. The authority, as planned, did not undertake further borrowing while the authority maintained higher levels of investments than originally anticipated. This was due to a variety of reasons including the receipt of grants in advance and the time taken to progress capital schemes where the source of financing was external borrowing.

17. 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

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

19. **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 2020 Actual £m	**31 March 2021 Actual £m**
Gross borrowing position	461	451
CFR (excluding PFI)	729	753

20. **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 2020/21 the Council has maintained gross borrowing within its Authorised Limit.

21. **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.

22. **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.

	2020/21 £m
Authorised Limit	970
Operational Boundary	664
Average gross borrowing position (including PFI)	593
Financing costs as a proportion of net revenue stream: General Fund HRA	 6.88% 8.81%

Borrowing Rates in 2020/21

23. Gilt yields fell sharply from the start of 2020 and then rose in March caused by the pandemic. This was quickly countered by central banks flooding the markets with liquidity. While US treasury yields do exert influence on UK gilt yields so that the two often move in tandem, they have diverged during the first three quarters of 2020/21 but then converged in the final quarter. Expectations of economic recovery started earlier in the US than the UK but once the UK vaccination programme started making progress in the new year of 2021, gilt yields and PWLB rates started rising 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%.

24. HM Treasury imposed two changes of 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, at least partially, reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes.

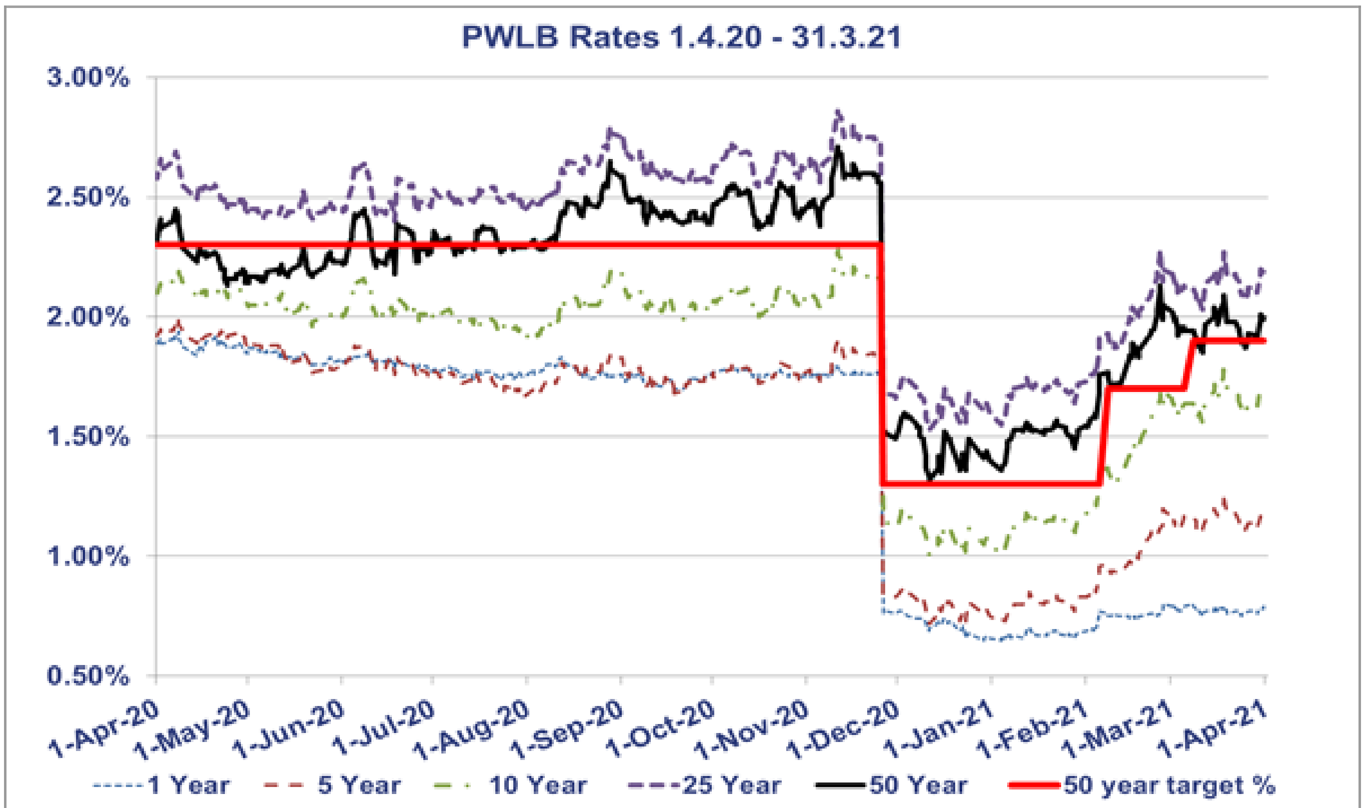
    A consultation was then held with local authorities and on 25th November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; with the previous additional 1% margin being reversed but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority that plan to purchase assets primarily for yield within a local authority's three-year capital programme.

    The new margin over gilt yields for local authority borrowing is the is a gilt plus 80 basis points.

    There is likely to be only a marginal rise in gilt yields and PWLB rates over the next three years

as Bank Rate is not forecast to rise from 0.10% until circa 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%.

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



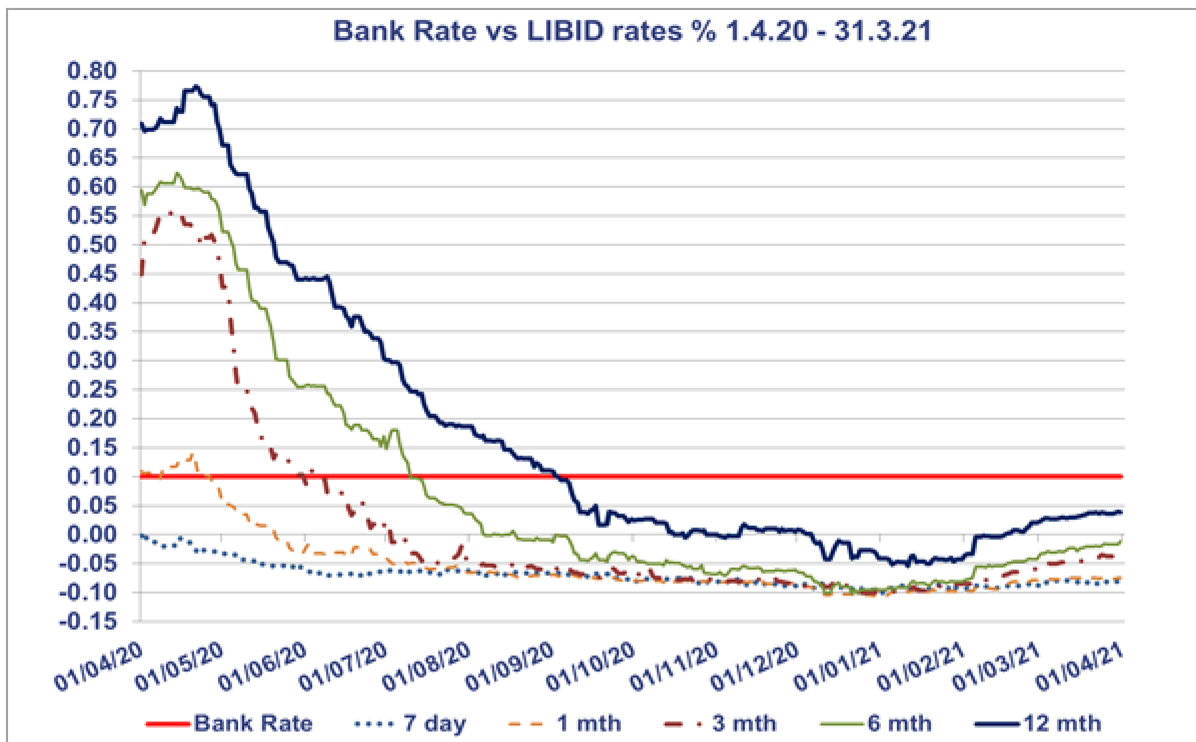
25. **Summary of Debt Transactions –** The authority repaid a £10m loan that matured on 20th April 2021 that had an interest rate of 4.875%.

26. The average rate of interest for the debt portfolio is 4.48%.

Investment Rates in 2020/21

27. Investment returns which had been low during 2019/20, plunged at the start of the financial year to near zero and even into negative territory caused by the Covid-19 pandemic. Bank Rate was reduced to 0.10% in March 2020 with the expectation that Bank Rate will remain at this level for the foreseeable future until circa March 2024 when an increase in bank is forecast.

    The impact on investment rates is highlighted in the graph 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 25th 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, 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.