Report to:	**Audit and Governance Committee**
Date:	**28 July 2021**
Title:	**Treasury management annual report 2020/21**
Report of:	**Homira Javadi, Chief Finance Officer**
Cabinet member:	**Councillor Stephen Holt, Cabinet Member for Finance**
Ward(s):	**All**
Purpose of report:	**To report on the activities and performance of the Treasury Management service during 2020/21**
Decision type:	**Budget and Policy Framework**
Officer recommendation(s):	**The Committee is recommended to:** **(1) Note the annual Treasury Management report for 2020/21** **(2) Note the 2020/21 prudential and treasury indicators included.**
Reasons for recommendations:	**Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code) and this has to be reported to Full Council.**
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1 Introduction

1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2020/21. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 During 2020/21 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 5 February 2020)
- a mid-year (minimum) treasury briefing.
- an annual report following the year describing the activity compared to the strategy (this report).

1.3 In addition, Treasury Management updates are included in the quarterly performance management reports, considered by both the Cabinet and Scrutiny Committee. Recent changes in the regulatory environment place a much greater responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members. This report was considered by the Cabinet at its 14 July 2021 meeting.

1.4 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit & Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 16 November 2020, which is to support Members' scrutiny role and further training is expected to take place in 2021-22.

1.5 This report summarises:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement (CFR));
- Reporting of the required prudential and treasury indicators and changes to be approved;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Debt activity and investment activity.
- Economic and Interest Rates

1.6 Treasury Management is an integral part of the Council's overall finances and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium / long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.

1.7 The criteria for lending to Banks are derived from the list of approved counter parties provided by the Council's Treasury Management advisors, Link Asset Services. The list is amended to reduce the risk to the Council by removing the lowest rated counterparties and reducing the maximum loan duration.

1.8 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 was invalidated by the Covid-19 pandemic which caused the Monetary Policy Committee to cut Bank Rate in March 2020, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy.

1.9 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.

1.10 The loan portfolio has produced a level of performance in the period in which performance figures have been calculated. Adding significant value in a period of extremely low interest rates is very difficult. Ironically a period in which there begins to be differentiation in expectations for both the pace and extent of future base rate rises will make the cash sums that can be gained larger, whilst also giving a higher level of risk that the decisions taken might retrospectively prove to be suboptimal. Given that interest rates are unlikely to rise for the next two years, low levels of returns are likely to continue and the cost of getting investment decisions wrong is unlikely to be significant.

EBC Capitalisation Direction

1.11 Similar to other local authorities, EBC took the opportunity to hold discussions with MHCLG about seeking permission for a Capitalisation Directive to help in dealing with 2020/21 deficit and balance the budget in 2021/22. Other councils that have been harder hit by Covid-19 have also requested support using this means across both years.

1.12 A capitalisation directive permits a Council to capitalise revenue expenditure if it is unable to set a balanced budget, has considered all other options, has limited reserves, and is increasing its Council Tax by the maximum permitted. The direction will only be granted in exceptional circumstances, and only the Secretary of State can permit this action legally

1.13 Following the Council seeking further support, on 2nd February 2021, the Minister of State for Regional Growth and Local Government in a letter addressed to the Leader of the Council, states that:

- With respect to the financial year of 2020/21, the Secretary of State is content to approve a total capitalisation direction to fund revenue expenditure not exceeding £6.8m, subject to conditions set out in the capitalisation direction.
- With respect to the financial year of 2021/22, the Secretary of State is minded to approve a capitalisation direction of a total not exceeding £6m. Again, such a direction may be subject to conditions, which would be set out in the capitalisation direction.

1.14 This report has been updated with the capitalisation of £3.55m of spend, attributable to the Capitalisation Directive permitted by the Ministry of Housing, Communities and Local Government (MHCLG), which allows the Council to capitalise the financial impact of the Covid-19 pandemic. This figure is yet to be audited by the MHCLG reviewer and any revisions to this amount will be reported at the future Committee meeting. The capitalisation direction impacts the Council's Capital Expenditure and Financing 2020/21 (see para 2.2 below).

2 The Council's Capital Expenditure and Financing 2020/21

2.1 The Council undertakes capital expenditure on 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.

2.2 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 Estimate £m**	**2020/21 Revised Estimate £m**	**2020/21 Actual £m**
General Fund	14.3	18.3	4.6	5.1
Capitalisation Direction	-	-	6.8	3.6
HRA capital expenditure	4.5	12.7	12.0	3.6
Commercial Activities/nonfinancial investments	15.0	9.6	15.3	3.8
Total capital expenditure	**33.8**	**40.7**	**38.7**	**16.0**
Resourced by:				
• Capital receipts (including capitalisation direction funding)	3.6	2.3	15.9	4.1
• Capital grants/external funding	2.6	1.6	3.9	2.7
• Capital Reserves	4.2	6.3	8.3	2.7
• Revenue	0.5	3.7	1.8	-
Use of internal balances/ borrowing	**23.4**	**26.9**	**8.8**	**6.5**

3 <u>The Council's overall borrowing need</u>

3.1 The Capital Financing Requirement (CFR) represents the Council's total underlying need to borrow to finance capital expenditure, i.e. capital expenditure that has not been resourced from capital receipts, capital grants and contributions or the use of reserves. Some of this borrowing is from the internal use of cash balances.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

3.3 **Reducing the CFR** – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR. The total CFR can also be reduced by:

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

3.4 The Council's 2020/21 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2020/21 on 5 February 2020. The Council's CFR for the year is shown below and represents a key prudential indicator. The figures include a credit sales agreement on the balance sheet, which increases the Council's borrowing need, the CFR.

CFR	**31 March 2020 Actual £m**	**1 April 2020 Original Estimate £m**	**31 March 2021 Actual £m**
Opening balance	149.9	177.0	172.8
Add unfinanced capital expenditure (per table 2.0)	23.4	26.9	6.5
Less MRP	(0.5)	(1.2)	(1.0)
Closing balance	**172.8**	**202.7**	**178.3**

3.5 Under the annuity methodology, MRP will be lower in the early years and increases over time. This is considered a prudent approach as it reflects the time value of money (i.e. the impact of inflation) as well as providing a charge that is better matched to how the benefits of the asset financed by borrowing are consumed over its useful life. That is, a method that reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years.

3.6 In the case of all capital spend financed by Prudential Borrowing; this will be subject to MRP under option 3: Asset life method – equal instalments charged over the estimated life of the asset. MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction), i.e., where expenditure is capitalised, the Authority shall charge annual Minimum Revenue Provision using the asset life method with a proxy 'asset life' of no more than 20 years.

3.7 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the Authorised Limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term, the Council's external borrowing net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2019/20 plus the expected changes to the CFR over 2020/21 and 2021/22. This indicator allows the Council some flexibility to borrow in advance of its immediate capital need in 2020/21. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2020 Actual £m	**1 April 2020 Original Estimate £m**	**31 March 2021 Actual £m**
GF - Borrowing	69.2	72.6	56.4
HRA - Borrowing	42.6	43.6	47.8
Commercial Activities	50.4	62.0	55.2
Net borrowing position	**162.2**	**178.2**	**159.4**
CFR – General Fund	79.8	97.1	75.3
CFR - housing	42.6	43.6	47.8
Commercial Activities/non-financial investments	50.4	62.0	55.2
CFR	**172.8**	**202.7**	**178.3**

3.8 **The Authorised limit** - the Authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. 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.

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.

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

Descriptions	**2020/21**
Authorised limit	£225.4m
Operational boundary	£210.4m
Financing costs as a proportion of net revenue stream:	
Non HRA	11.8%
HRA	11.1%

4 Treasury Position as at 31 March 2021

4.1 The Council's debt and investment position is organised by staff within Financial Services in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.

4.2 Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2020/21, the Council's treasury position was as follows:

Description	31 March 2020 Principal	Rate/ Return	31 March 2021 Principal	Rate/ Return
Fixed rate funding:				
-PWLB	£125.7m		£122.4m	
-Market	£36.5m		£37.0m	
Total debt	**£162.2m**	**2.52%**	**£159.4m**	**2.10%**
CFR	£172.8m		£178.3m	
Over/ (under) borrowing	(£10.6m)		(£18.9m)	
Total investments (excl. cash)		**£0m**	**£0m**	

The Council held cash balances of £4.1m in current and call accounts which earned an average of 0.07%.

4.3 The maturity structure of the debt portfolio was as follows:

	31 March 2020 Actual £m	1 April 2020 Original limits £m	31 March 2021 Actual £m
Under 12 months	37.71	20.0	40.21
12 months and within 24 Mths.	5.21	4.0	5.45
24 months and within 5 years	10.74	22.0	8.12
5 years and within 10 years	13.98	2.1	13.60
10 years and above	94.52	103.2	92.07

The exposure to fixed and variable rates was as follows:

	31 March 2020	1 April 2020	31 March 2021

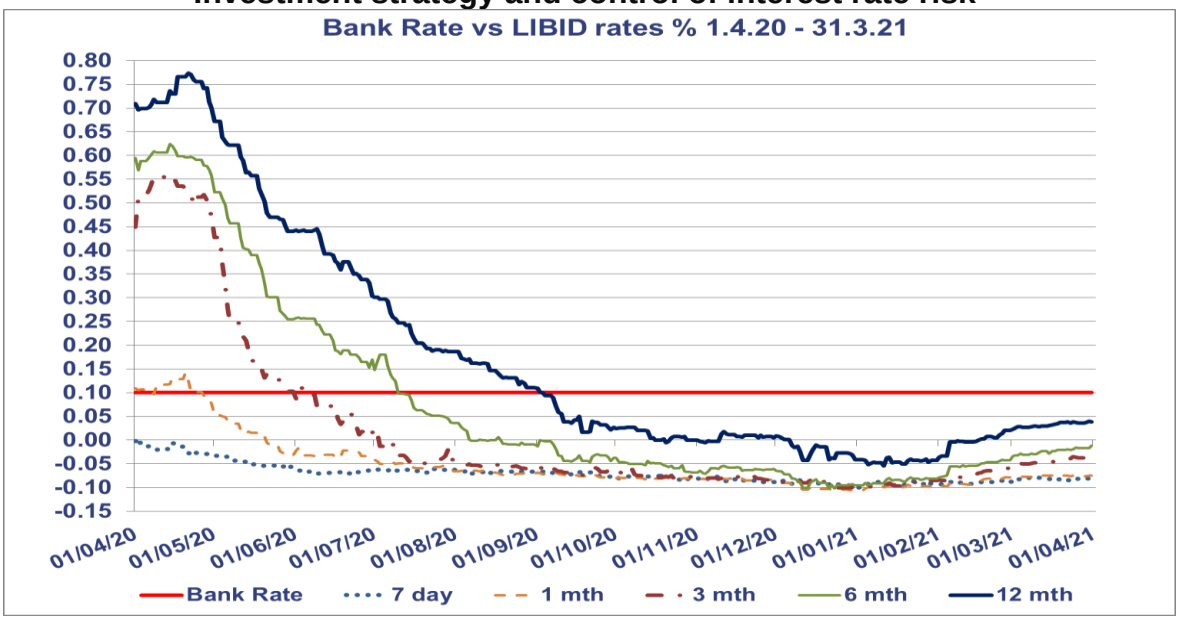
	Actual £m	Original limits £m	Actual £m
Principal - Debt Fixed rate	162.1	151.3	159.4
Principal – Investments Variable rate	0	N/a	0

5 The Strategy for 2020/21

5.1 In a relatively short period since the onset of the COVID-19 pandemic, the global economic fallout was sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, businesses, and individuals.

5.2 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.

Investment strategy and control of interest rate risk



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
Low Date	01/04/2020	31/12/2020	29/12/2020	23/12/2020	21/12/2020	11/01/2021
Average	0.10	-0.07	-0.05	0.01	0.07	0.17
Spread	0.00	0.10	0.25	0.66	0.73	0.83

5.3 The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with massive amounts of cheap

credit so that banks could help cash-starved businesses to survive the lockdown. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

5.4 The Council does not have sufficient cash balances to be able to place deposits for more than a month so as to earn higher rates from longer deposits. 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.

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

5.6 During 2020/21, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

5.7 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.
The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

5.8 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Chief Finance Officer, therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks. If it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

5.9 Interest rate forecasts expected only gradual rises in medium- and longer-term fixed borrowing rates during 2020/21 and the two subsequent financial years.

Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

Coronavirus Impact

5.10 The full extent of the impact from Coronavirus continue to be accessed and analysed. However, the immediate risk to the financial markets coupled with additional burdens on Council spending and uncertainty over funding have increased the need to manage larger cash balances. The projection of gradual rises in interest rates that formed the Bank of England Monetary Policy Committee's guidance at the start of the period eased through the year.

5.11 As the Council's borrowing rates are directly linked to market expectations this gives rise to the potential that our borrowing rates will remain close to all-time lows for some time. With the Council's Capital Programme and re-financing commitments over the next few years, our ability to secure good value in our borrowing has significant implications for the spending plans of Council as a whole.

6 Borrowing Outturn for 2020/21

6.1 **Treasury Borrowing**.

Borrowing – The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. No new loans were drawn down from PWLB in 2020/21 to fund the net unfinanced capital expenditure and/or to replace maturing loans. Interest rates for PWLB borrowing was between 1.59% and 2.21% compared with a budget assumption of 2.4%. Various temporary loans were taken to cover cash flow requirements. All loans drawn were for fixed rate and are detailed in Appendix A.

6.2 In taking this decision, the Council carefully considered achieving best value, the risk of having to borrow at higher rates at a later date, the carrying cost of the difference between interest paid on such debt and interest received from investing funds which would be surplus until used, and that the Council could ensure the security of such funds placed on temporary investment.

- **Rescheduling** – no debt rescheduling was carried out during the year as there was no financial benefit to the Council.
- **Repayment** – £760k of long term PWLB debt was repaid at maturity on 24 March 2021 and £2.5m was an instalment repayment for the repayment (EIP) loans. Various temporary loans were repaid during the year, see Appendix A.
- **Summary of debt transactions** – the overall position of the debt activity resulted in a fall in the average interest rate by 0.2%, representing a saving to the General Fund.

7 Interest Rates in 2020/21

7.1 The tight monetary conditions following the financial crisis continued through 2020/21 with little material movement in the shorter-term deposit rates. With many financial institutions failing to meet the Council's investment criteria, the opportunities for investment returns were limited. The PWLB rates (including the 0.2% reduction for Certainty Rate) at the beginning, average and end of the year are provided below.

Term	Interest Rate March 2020	Average Rate	Interest rate April 2021
1 Year	1.90%	1.42%	0.79%
5 Years	1.95%	1.50%	1.19%
10 Years	2.14%	1.81%	1.70%
25 Years	2.58%	2.32%	2.19%
50 Years	2.39%	2.13%	1.99%

8 Investment Outturn for 2020/21

8.1 **Investment Policy** – the Council's investment policy is governed by MHCLG guidance, which was been implemented in the annual investment strategy approved by the Council on 5 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.).

8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

8.3 **Resources** – the Council's longer-term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2020 £m	31 March 2021 £m
Balances	2.03	2.00
Earmarked reserves	6.86	7.13
HRA	5.88	5.88
Major Repairs Reserve	1.15	2.98
Capital Grants & Contributions	1.95	1.44
Usable capital receipts	6.26	4.54
Total	**24.13**	**23.97**

8.4 **Investments held by the Council** - the Council maintained an average balance of £7.0m of internally managed funds. The internally managed funds earned an

average rate of return of 0.07%. The comparable performance indicator is the average 7-day LIBID rate, which was (0.07%).

9 The Economy and Interest Rates Forecast

9.1 The Council's treasury advisor, Link, provides the following forecast as at March 2021:

Link Asset Services Interest Rate View	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	3.10	3.10	3.20	3.20	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.80	3.80	3.90	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.80

The Economy and Interest Rates Forecast is attached as Appendix B.

9.2 At the close of the day on 31 March 2021, all gilt yields from 1 to 5 years were between 0.19 – 0.58% while the 10-year and 25-year yields were at 1.11% and 1.59%. HM Treasury imposed two changes 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 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme.

10 Executive Summary and Conclusion

10.1 During 2020/21, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	**2019/20 Actual £m**	**2020/21 Original Estimate £m**	**2020/21 Actual £m**
Capital expenditure	33.8	40.7	16.0
Total Capital Financing Requirement:			
• General Fund	79.8	97.1	75.3
• HRA	42.6	43.6	47.8
• Commercial Activities	50.4	62.0	55.2
• Total	172.8	202.7	178.3
Net borrowing	162.2		159.4
External debt	162.2		159.4
Investments (all under 1 year)	-		-

10.2 Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the Authorised limit), was not breached. The financial year 2020/21 continued the challenging environment of previous years; low investment returns, and continuing counterparty risk continued.

11 Other

11.1 CIPFA consultations: In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. These are principles-based consultations and will be followed by more specific proposals later in the year.

11.2 In the Prudential Code the key area being addressed is the statement that "local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed". Other proposed changes include the sustainability of capital expenditure in accordance with an authority's corporate objectives, i.e., recognising climate, diversity and innovation, commercial investment being proportionate to budgets, expanding the capital strategy section on commercial activities, replacing the "gross debt and the CFR" with the liability benchmark as a graphical prudential indicator.

11.3 Proposed changes to the Treasury Management Code include requiring job specifications and “knowledge and skills” schedules for treasury management roles to be included in the Treasury Management Practices document and formally reviewed, a specific treasury management committee for MiFID II professional clients and a new TMP 13 on Environmental, Social and Governance Risk Management.

11.4 **IFRS 16:** The implementation of the new IFRS 16 Leases accounting standard has been delayed for a further year until 2022/23.

12 Corporate plan and council policies

12.1 The priority themes were considered as part of the overall Capital Programme which forms part of the Treasury Management Strategy.

13 Financial appraisal

13.1 Financial appraisals were considered as part of the overall Capital Programme which forms part of the Treasury Management Strategy.

14 Legal implications

14.1 Comment from the Legal Services Team is not necessary for this routine monitoring report.

15 Risk management implications

15.1 Risks relating to the timing of borrowing and terms of borrowing are considered and advice is provided by Link. Risk management is considered for each of the schemes within the Capital Programme.

16 Equality analysis

16.1 Equality issues are considered

17 Appendices

17.1
- Appendix A – Temporary loans taken during 2020/21.
- Appendix B - The Economy and Interest Rates

18 Background papers

The Background Papers used in compiling this report were as follows:
CIPFA Treasury Management in the Public Services code of Practice (the Code)
Cross-sectorial Guidance Notes
CIPFA Prudential Code
Treasury Management Strategy and Treasury Management Practices.
Link Asset Services Citywatch and interest rate forecasts

Appendix A

Temporary loans taken during 2020/21

Lender - Temp Debt	£m	Start Date	End Date	Rate
POLICE AND CRIME COMMISSIONERS OF GWENT - GWENT	5.0	29-Jun-20	30-Oct-20	0.14%
Sevenoaks District Council	3.0	21-May-20	23-Nov-20	0.55%
North Yorkshire County Council	5.0	21-May-20	23-Nov-20	0..55%
Police and Commissioner for Northumbria	10.0	07-Jul-20	07-Jan-21	0.70%
North Yorkshire County Council	5.0	23-Nov-20	22-Nov-21	0.25%
North Yorkshire County Council	5.0	24-Nov-20	23-Nov-21	0.25%
Tendring District Council	3.0	30-Oct-20	30-Jul-21	0.20%
Hertfordshire County Council	7.0	23-Nov-20	24-May-21	0.10%
Gwynedd Council	5.0	10-Feb-21	10-May-21	0.03%
Wokingham Borough Council	10.0	15-Mar-21	15-Sep-21	0.12%

Long Term Loans taken during 2020/21

Lender - Long Term Debt	£m	Start Date	End Date	Rate

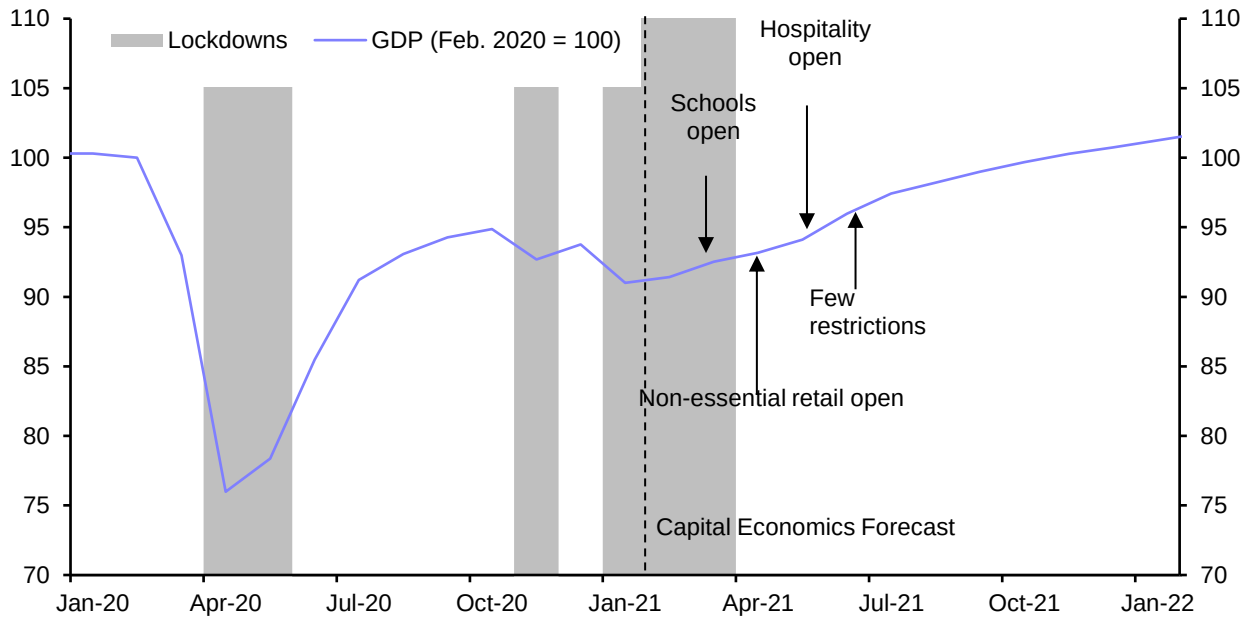
Maturity loans – repayment is due in full at maturity.
EIP loans – loans are repaid over the term of the loan in equal instalments paid half yearly.

The long-term borrowing interest rates vary between 1.59% and 2.21% compared with a budget assumption of borrowing at an interest rate of 2.4%.

Appendix B

The Economy and Interest Rates by Link Treasury Services Limited

UK. Coronavirus. The financial year 2020/21 will go down in history as being the year of the pandemic. The first national lockdown in late March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A short second lockdown in November did relatively little damage 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 much less damage than was caused than in the first one. The advent of vaccines starting in November 2020, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy. In addition, 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 stored up 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 at the height of the crisis 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 (purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields). The

MPC increased then QE by £100bn in June and by £150bn in November to a total of £895bn. 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 the major 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 a new phrase in the policy statement, namely 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". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. This sets a high bar for raising 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 a temporary short-lived factor and so not a concern to the MPC.

Government support. The Chancellor has implemented repeated rounds of 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 huge 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 to pay the cost for the pandemic. This will help further to 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.

EU. Both the roll out and take up of vaccines has been disappointingly 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 rapid 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 embarked on a major expansion of its QE operations (PEPP) in March 2020 and added further to that in its December 2020 meeting when it also greatly 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.

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.

Central banks' monetary policy. During the pandemic, the governments of western countries have provided massive 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 Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting 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.