PERFORMANCE SCRUTINY **22 JUNE 2021**

SUBJECT:	**TREASURY MANAGEMENT STEWARDSHIP AND ACTUAL PRUDENTIAL INDICATORS REPORT 2020/21 (OUTTURN)**
REPORT BY:	**CHIEF FINANCE OFFICER**
LEAD OFFICER:	**COLLEEN WARREN – FINANCIAL SERVICES MANAGER**

1. Purpose of Report

1.1 The annual Treasury Management stewardship report is a requirement of the Council's reporting procedures under regulations issued under the Local Government Act 2003. It covers the 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).

2. Executive Summary

2.1 During 2020/21 the Council complied with its legislative and regulatory requirements. The key prudential indicators for the year, with comparators, are as follows:

Actual Prudential Indicators	**2020/21 £000**	**2019/20 £000**
Actual Capital Expenditure	19,589	22,033
Capital Financing Requirement		
General Fund	67,501	68,562
HRA	70,274	62,174
Total	**137,775**	**130,736**
Net borrowing (borrowing less investments)	**89,548**	**89,603**
External debt (borrowing)	**123,448**	**120,153**
Investments		
• Longer than 1 year*		
• Under 1 year	33,900	30,550
• Total	**33,900**	**30,550**

Other prudential and treasury indicators are to be found in section 4.

3. Background

3.1 The prudential system for capital expenditure is now well established. One of the requirements of the Prudential Code is to ensure adequate monitoring of the capital expenditure plans, prudential indicators (PIs) and treasury management response to these plans. This report fulfils that requirement and shows the status of the Prudential Indicators at 31st March 2021. For the 2020/21 financial year the minimum reporting requirements were that members should receive the following reports:

- an annual Treasury Management Strategy in advance of the year (Council 3rd March 2020)
- a mid-year Treasury Update report (Executive 23rd November 2020)
- an annual report following the year describing the activity compared to the strategy (this report)

3.2 Recent changes in the regulatory environment place a much greater onus 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.

3.3 In compliance with the Prudential Code treasury management reports are scrutinised by Performance Scrutiny Committee and reviewed by the Executive prior to reporting to full Council if required. Member training for the Performance Scrutiny and Audit Committees was undertaken on 19th November 2020 and 2nd February 2021 in order to support their roles in scrutinising the treasury management strategy and policies.

4. Summary of Performance against Treasury Management Strategy 2020/21

4.1 The full details of transactions in the year and performance against the Prudential Indicators are included at Appendices A and B.

4.2

Actual Prudential Indicators	**2020/21**	**2019/20**
Actual Capital Expenditure	19,589	22,033
Capital Financing Requirement		
General Fund	67,501	68,562
HRA	70,274	62,174
Total	**137,775**	**130,736**
Financing Costs as a proportion of Net Revenue Stream		
General Fund	22.6%	15.4%
HRA	31.4%	32.2%

4.3 The Chief Finance Officer confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, the Authorised Limit was not breached.

Additional borrowing of £3.5m was taken in 2020/21.

At 31st March 2021, the principal value of the Council's external debt was £123.448m (£120.153m at 31st March 2020) and that of its investments was £33.9m (£30.5m at 31st March 2020).

4.4 The increase in General Fund Financing costs as a % of net revenue stream in 2020/21, when compared with 2019/20, is due additional MRP charges and lower rates of return on investments. The slight decrease in HRA Financing costs results borrowing arrangements being at rates lower than those for borrowing taken previously.

4.5 The financial year 2020/21 continued the challenging environment of previous years; the effect of the Covid 19 pandemic, low investment returns and continuing counterparty risk were the main features.

4.6 Key issues to note from activity during 2020/21:

- The Council's total debt (including leases and lease-type arrangements) at 31st March 2021 was £123.448m (Appendix A section 4.4) compared with the Capital Financing Requirement of £137.775m (Appendix A section 3.5). This represents an under-borrowing position of £14.327m, which is currently being supported by internal resources. Additional long-term borrowing will be taken in future years to bring levels up to the Capital Financing Requirement, subject to liquidity requirements, if preferential interest rates are available.
- The Council's Investments at the 31st March 2021 were £33.9m (Appendix A section 4.3), which is £3.35m higher than at 31st March 2020. Average investment balances for 2020/21 were £35.8m, which was higher than estimated balances of £24.7m in the Medium Term Financial Strategy 2020-25 due to high balances being made available through government grants. It should be noted that this refers to the principal amounts of investments held, whereas the investment values included in the balance sheet are based on fair value. In most cases, this will simply be equal to the principal invested, unless the investment has been impaired.
- Actual investment interest earned on balances was £72k compared to £131k estimated in the Medium Term Financial Strategy 2020-25 (Appendix A section 10.2).
- The interest rate achieved on investments was 0.2% which was 0.27% above the target average 7-day LIBID rate (for 2020/21 the average was 0.53%).

4.7 Risk Benchmarking

The following reports the outturn position against the security and liquidity benchmarks in the Treasury Management Strategy.

Security

- The Council's actual average security risk for the portfolio as at 31st March 2020 is 0.007%, which compares with the 0.009% for the budgeted portfolio. This gives the estimated default rate on the investment counterparties which comprise the portfolio at 31st March 2021. This equates to a potential financial loss of £1,355 on the investment portfolio of £19m (£14.9m of our instruments do not have a counterparty credit rating).

- Specified Investments are high security sterling investments (i.e. high credit quality) with a maturity of no more than one year. Non-specified investments are all other investments representing a potentially greater risk; however the risk is still minimal due to the stringent controls over counterparty credit quality contained within the Investment Strategy. The 2020/21 strategy set a maximum limit of 75% of the portfolio to be held in non-specified investments. At 31st March 2021, 85% of the investment portfolio was held in specified investments with the remaining 15% held in deposits with other local authorities. The Chief Finance Officer can report that the investment portfolio was maintained within this limit throughout the year.

Liquidity

In respect of this area the Council set liquidity benchmarks to maintain:

- Liquid short term deposits of at least £5 million available with a week's notice.
- Weighted Average Life benchmark was expected to be 0.25 years (91 days).

The actual liquidity indicators at 31st March 2020 were as follows:

- Liquid short term deposits of £14.9 million as at 31st March 2021.
- Weighted Average Life of the investment portfolio was 0.09 years (32 days). This reflects that larger amounts of investments were deposited in short term accounts to deal with cash flow requirements.

The Chief Finance Officer can report that liquidity arrangements were adequate throughout the year.

4.8 **Benchmarking**

The Council participates in the following benchmarking club:

- The Link Asset Services benchmarking club. Link Asset Services is the Council's treasury management advisors and they offer a benchmarking club for their clients. This is organised on a regional group basis. The group to which City of Lincoln belongs has 9 members within the East Midlands region. The following summary shows performance against the group average, indicating a lower than average risk portfolio, with much lower levels of investment balances achieving a similar level of return.

	City of Lincoln Council	Average
Principal at 31/3/20	£33,900,000	£79,785,814
Weighted Average rate of return at 31/3/21	0.10%	0.18%
Weighted average maturity at 31/3/21	32 days	82 days
Weighted average credit risk at 31/3/21	2.65	2.92

5. Strategic Priorities

5.1 Through its Treasury Management Strategy the Council seeks to reduce the amount of interest it pays on its external borrowing and maximise the interest it achieves on its investments in order to support the Medium Term Financial Strategy and the delivery of the Council's Vision 2020.

6. Organisational Impacts

6.1 Finance - The financial impacts are contained within the main body of the report and within appendices A and B.

6.2 Legal Implications including Procurement Rules - Section 15 of the Local Government Act 2003 requires local authorities 'to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify'. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 in Regulation 24 require local authorities to have regard to the TM Code of Practice. Investment guidance issued by the Ministry for Housing Communities and Local Government (MHCLG) which came into effect from 1st April 2010 requires investment policy to emphasise security and liquidity over income.

7. Risk Implications

7.1 The Council has the freedom to adopt its own treasury management policies. The CIPFA code of practice, which specifies the format and frequency of reporting, is part of the risk management procedures for treasury.

8. Recommendation

8.1 That Performance Scrutiny Committee notes the actual prudential indicators contained within appendices A and B.

8.2 That Performance Scrutiny Committee notes the annual treasury management report for 2020/21.

Key Decision	No
Do the Exempt Information Categories Apply?	No
Call in and Urgency: Is the decision one to which Rule 15 of the Scrutiny Procedure Rules apply?	No

How many appendices does the report contain?	2
List of Background Papers:	Link Annual Stewardship Reports for 2020/21 Medium Term Financial Strategy 2020-25 and 2021-26 Prudential Indicators 2020/21 – 2021/22 and Treasury Management Strategy 2020/21 and 2021/22
Lead Officer:	Colleen Warren – Financial Services Manager

Appendix A

Annual Report on the Treasury Management Service and Actual Prudential Indicators 2020/21

1. Introduction

1.1 The Council undertakes capital expenditure on long-term assets. These activities can 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.

Capital expenditure activity is regulated by the CIPFA Prudential Code, which requires actual outturn to be reported in the following areas: -

- Capital expenditure;
- Capital Financing Requirement;
- Debt;
- Ratio of financing costs to net revenue stream.

The remaining prudential indicators are included to make the annual reporting comprehensive and to comply with the requirements of the Treasury Management Code.

1.2 Part of the Council's treasury activities is to address any borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimise performance. This area of activity is regulated by the CIPFA Code of Practice on Treasury Management.

1.3 Wider information on the regulatory requirements is shown in section 11.

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

2.1 This forms one of the required prudential indicators and shows total capital expenditure for the year and how this was financed.

	2020/21 Actual £'000	2020/21 Revised Estimate £'000	2019/20 Actual £'000
General Fund capital expenditure	3,212	5,117	10,057
HRA capital expenditure	16,377	19,690	11,976
Total capital expenditure	**19,589**	**24,807**	**22,033**
Resourced by:			
Capital receipts	1,633	2,588	1,534
Capital grants & contributions	4,553	8,571	1,758
Direct Revenue Financing	663	2,589	202
Major repairs reserve	4,044	5,380	6,789
Un-financed capital expenditure (additional need to borrow)	**8,696**	**5,679**	**11,750**

2.2 Further details on 2020/21 Capital Expenditure and Financing can be found in the Financial Performance Detailed Outturn 2020/21 report elsewhere on the agenda.

3. The Council's Overall Borrowing Need

3.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position and represents 2020/21 and prior years' net capital expenditure that has not yet been charged to revenue or other resources.

3.2 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.

3.3 The General Fund element of the CFR is reduced each year by a statutory revenue charge (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) or depreciation.

3.4 The Council's MRP policy for 2020/21 was approved by Council on 3rd March 2020 as part of the Prudential Indicators 2020/21 – 2022/23 and Treasury Management Strategy 2020/21.

3.5 The Council's CFR for the year is shown below, and represents a key prudential indicator. The CFR includes leasing schemes which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract. During the year land appropriations resulted in an appropriation between the General Fund and HRA CFR.

Capital Financing Requirement General Fund	**31 March 2021 Actual £'000**	**31 March 2021 Revised Estimate £'000**	**31 March 2020 Actual £'000**
Opening balance 1 April	68,562	68,562	61,803
Plus un-financed capital expenditure	597	1,002	7,884
Finance leases	(105)	(105)	(237)
Less MRP/VRP*	(1,552)	(1,553)	(758)
Land Appropriation	0	0	20
Closing balance 31 March	**67,502**	**67,906**	**68,562**

Capital Financing Requirement HRA	**31 March 2021 Actual £'000**	**31 March 2021 Revised Estimate £'000**	**31 March 2020 Actual £'000**
Opening balance 1 April	62,174	62,174	58,328
Plus un-financed capital expenditure	8,099	4,677	3,866
Land Appropriation	0	0	(20)
Closing balance 31 March	**70,273**	**66,851**	**62,174**

* includes finance lease repayments

4. Treasury Position at 31st March 2021

4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Chief Finance Officer and the treasury team manage the Council's actual borrowing position by either:

- borrowing to the CFR,
- choosing to temporarily utilise some flow funds instead of borrowing (under-borrowing)
- borrowing for future increases in the CFR (borrowing in advance of need).

4.2 It should be noted that 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 (outstanding interest due to be paid and received as at 31st March), or where the carrying amount is based on fair values .

4.3 During 2020/21 the Chief Finance Officer managed the borrowing position to £123.448 million. The treasury position at the 31st March 2020 compared with the previous year was:

	31 March 2021		**31 March 2020**	
	Principal £'000	**Average Rate (full year)**	**Principal £'000**	**Average Rate (full year)**
Borrowing Position				
Fixed Interest Rate Debt	123,448	3.25%	120,153	3.62%
Variable Interest Rate Debt	0	N/a	0	N/a
Total Debt (borrowing) *	123,448	3.25%	120,153	3.62%
Capital Financing Requirement (borrowing only)	137,775	N/A	130,736	N/A
Over/(under) borrowing	(14,327)	N/A	(10,583)	N/A
Investment Position				
Fixed Interest Investments	19,000	0.41%	12,000	0.98%
Variable Interest Investments	14,900	0.10%	18,550	0.49%
Total Investments **	33,900	0.20%	30,550	0.67%
Net Borrowing Position	**89,548**		**89,603**	

* Excludes local Bonds & Mortgages and other long-term liabilities (e.g. finance leases)

** The interest rate given differs from the interest rate given in Paragraph 4.6 of the main report because the rates above are for investments held at 31 March whereas the average rate of investment is for investments held during 2020/21.

4.4 The total debt position also includes other long term liabilities such as finance leases and embedded leases within service contracts. The total debt position at 31st March 2021 was £123,448 million as shown below:

	31 March 2021 Actual £'000	**31 March 2021 Revised Estimate £'000**	**31 March 2020 Actual £'000**
Gross borrowing	123,448	121,000	120,153
Other long term liabilities	0	0	105
Total External debt	**123,448**	**121,000**	**120,258**

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

	31 March 2021 Actual £'000	31 March 2020 Actual £'000
Under 12 months	7,710	9,705
12 months and within 24 months	8,215	2,710
24 months and within 5 years	6,072	5,160
5 years and within 10 years	10,696	9,565
10 years and above	90,755	93,013
Total	**123,448**	**120,153**

4.6 The maturity structure of the investment portfolio was as follows:

	31 March 2021 Actual £'000	31 March 2020 Actual £'000
Longer than 1 year	0	0
Under 1 year	33,900	30,550
Total	**33,900**	**30,550**

5. The Strategy for 2020/21

5.1 The Council's overall core borrowing objectives are:

- To reduce the revenue costs of debt in line with the targets set for the Chief Finance Officer by Council (see local indicators).
- To manage the Council's debt maturity profile, leaving no one future year with a high level of repayments that might cause problems in re-borrowing.
- To effect funding at the cheapest cost commensurate with future risk.
- To forecast average future interest rates and borrow accordingly i.e. short term/variable when rates are 'high', long term/fixed when rates are 'low'.
- To monitor and review the level of variable rate loans in order to take greater advantage of interest rate movements.
- To proactively reschedule debt in order to take advantage of potential savings as interest rates change. Each rescheduling exercise will be considered in terms of the effect of premiums and discounts on the General Fund and the Housing Revenue Account.
- To manage the day-to-day cash flow of the Authority in order to, where possible, negate the need for short-term borrowing. However, short-term borrowing will be incurred, if it is deemed prudent to take advantage of good investment rates.

6. Actual Debt Management Activity during 2020/21

6.1 Borrowing

6.1.1 Long term borrowing, totalling £8m, was taken in 2020/21; short term borrowing of £5m was taken in 2020/21; PWLB, short term and annuity borrowing of £9.705m was repaid in 2020/21; new borrowing of £3.5m was taken in 2020/21.

6.1.2 The average rate achieved for borrowing (excluding finance and embedded leases) in 2020/21 was 3.25%, which compares favourably to the target of 4.75% (2019/20 3.62% actual compared to the target of 4.75%). The decrease in rate is due to short term borrowing through other local authorities replacing PWLB borrowing at favourable rates.

	31 March 2021 Actual £'000	**31 March 2020 Actual £'000**
Interest payable on borrowing	3,912	3,895
- General Fund	1,485	1,471
- HRA	2,427	2,424
Interest payable on finance leases	2	21
- General Fund	2	21
- HRA	0	0

6.2 Rescheduling

6.2.1 No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Prudential Indicators and Compliance Issues

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

7.2 Net Borrowing and the CFR

7.2.1 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 2020/21 plus the expected changes to the CFR over 2020/21 and 2021/22 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs 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 2021 Actual £'000	31 March 2021 Revised Estimate £'000	31 March 2020 Actual £'000
Net borrowing position	89,548	101,000	89,603
Capital Financing Requirement	137,775	134,757	130,736

7.3 The Authorised Limit and Operational Boundary

7.3.1 The Authorised Limit is the "Affordable Borrowing Limit" required by section 3 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.

7.3.2 The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

7.3.3 The table below shows the highest borrowing position reached in the year (including temporary borrowing and other long term liabilities) compared to the Authorised Limit and Operational Boundary.

	2020/21 £'000
Authorised Limit (revised estimate)	152,148
Maximum gross borrowing position during 2020/21	127,448
Operational Boundary (revised estimate)	137,148
Average gross borrowing position during 2020/21	120,482
Minimum gross borrowing position during the year	117,448

7.4 Actual financing costs as a proportion of net revenue stream

7.4.1 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.

Financing costs as a proportion of net revenue stream -	2020/21 Actual %	2020/21 Revised Estimate %	2019/20 Actual %
General Fund	22.6%	23.8%	15.4%
HRA	31.4%	30.9%	32.2%

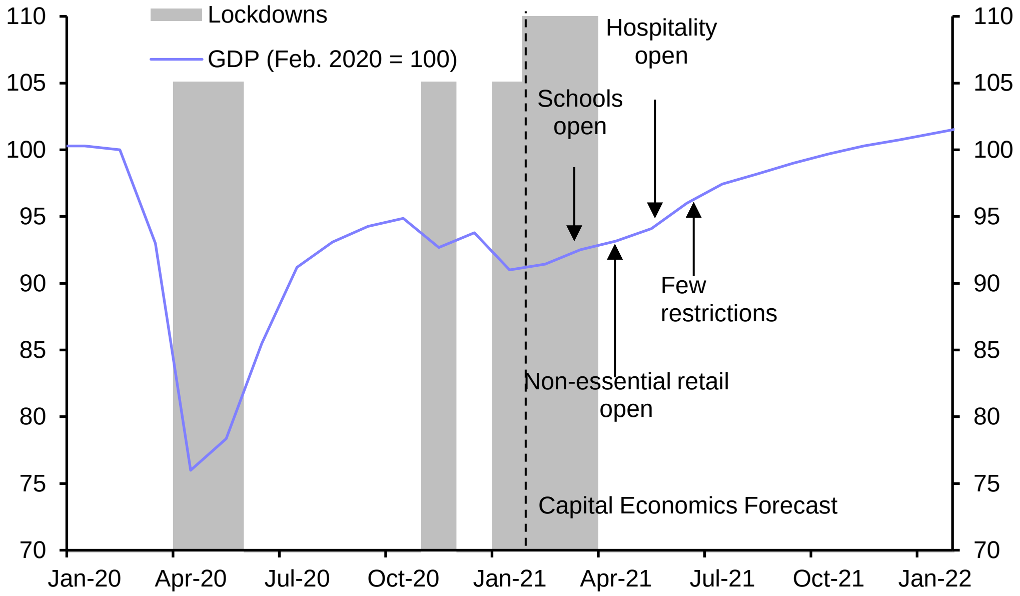
The increase in General Fund Financing costs as a % of net revenue stream in 2020/21, when compared with 2019/20, is due to increased MRP charges and lower rates of return on investments.

The slight decrease in HRA Financing costs results from replacement borrowing being available at rates which are lower than previous borrowing.

8. Economic Background for 2020/21

The following commentary on the economic conditions for 2020/21 is provided by Link Asset Services, the Council's treasury management advisers.

8.1 **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.

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, although power is more limited in the latter. 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 to hit the target of giving a first jab to over half of the population within the President's first 100 days, 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.

After Chair Jerome Powell spoke on the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed a new inflation target - that *"it would likely be appropriate 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 actually 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 to be in the pipeline; long-term bond yields duly rose after the meeting. There is now some expectation that where the Fed 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 Fed expects strong economic growth during 2021 to have only a transitory impact on inflation, which explains why the majority of Fed officials project US interest rates to remain near-zero through to the end of 2023. The key message is still that policy will remain unusually accommodative – 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 sheer amount of fiscal stimulus, on top of highly accommodative monetary policy, could be over-kill leading to a rapid elimination of spare capacity in the economy and generating higher inflation much quicker than the Fed expects. They have also been concerned as to how and when the Fed will eventually wind down its programme of monthly QE purchases 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 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.

China. After a concerted effort 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. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term 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 limited sanctions against a few officials in charge of government policy on the Uighurs in Xinjiang; this led to a much bigger retaliation by China and is likely to mean that the China / EU investment deal then being negotiated, will be torn up. After the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. 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 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.

9. Investment Position

9.1 The Council's investment policy is governed by MHCLG Guidance, which has been implemented in the Annual Investment Strategy approved by Council on 3rd March 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.

9.2 The Council's longer-term cash balances comprise primarily revenue and capital resources, although these are influenced by cash flow considerations. The Council's core cash resources comprised as follows, and meet the expectations of the budget.

Balance Sheet Resources (draft) - General Fund	31 March 2021 £'000	31 March 2020 £'000
Balances	2,670	2,522
Earmarked reserves	19,156	6,513
Provisions	2,353	2,405
Usable capital receipts	623	802
Total	**24,802**	**12,242**
Balance Sheet Resources (draft) - HRA	**31 March 2021 £'000**	**31 March 2020 £'000**
Balances	1,075	976

Earmarked reserves	2,595	825
Usable capital receipts	3,889	4,345
Total	**7,559**	**6,146**
Total General Fund & HRA	**32,361**	**19,461**

Please note that at the time of writing the year end position is yet to be finalised and the balance sheet resources are draft figures.

10. Investments Held by the Council

10.1 The Council does not have the expertise or resources to actively use a wide range of investment products and therefore performance tends to be more stable but lower over the longer term than for professionally managed funds (whose performance may fluctuate more). The Council maintained an average balance of £35.804m and received an average return of 0.20%. The comparable performance indicator is the average 7-day LIBID rate, which was -0.07%. Based on the average investment balance this performance margin of 0.27% in the Council's favour.

10.2 In 2020/21, £72k interest was earned on balances (£242k in 2019/20). This is £59k less than the £131k estimated in the Medium Term Financial Strategy 2020-25. The analysis of this result is shown in the table below.

	MTFS 2020-25 Budget £'000	**Outturn 2020/21 £'000**
Interest earned - General fund & other commitments	89	49
- HRA	42	23
Total interest earned	**131**	**72**
Average balance invested in year	28,073	35,804
Average interest rate achieved	0.85%	0.20%

* The interest rate given differs from that given in Paragraph 4.3 of the main report because this is an average interest for the year whereas the interest rate given in paragraph 4.3 is a rate for balances at 31 March 2021.

The Economic Background for 2020/21 (see Section 8) sets out the economic conditions during this period, resulting in still falling deposit rates. The Coronavirus outbreak prompted a sharp reduction in the Bank of England base rate - below is Link's forecast for interest rates at 31 March 2021.

Link Group Interest Rate View 8.3.21	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.40	1.40	1.40	1.40
10 yr PWLB	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	1.90
25 yr PWLB	2.10	2.10	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.50	2.50	2.50	2.50
50 yr PWLB	1.90	1.90	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.30	2.30	2.30	2.30

11. Risk Benchmarking

The regulatory framework also requires the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance (i.e. rate achieved compared with the 7-day LIBID). Security and liquidity benchmarks are used to assess the level of risk in the investment portfolio and whether sufficient liquidity is being maintained.

11.1 The following reports the current position against the benchmarks originally approved in the 2020/21 Treasury Management Strategy.

Security

- The Council's security risk for the portfolio as at 31st March 2021 is 0.007%, which compares with the 0.009% for the budgeted portfolio. This gives the estimated default rate on the investment counterparties which comprise the portfolio at 31st March 2020. This equates to a potential financial loss of £1,355 on the investment portfolio of £19m - £14.9m of the portfolio is not subject to historic counterparty risk information
- Specified Investments are high security sterling investments (i.e. high credit quality) with a maturity of no more than one year. Non-specified investments are all other investments representing a potentially greater risk however the risk is still minimal due to the stringent controls over counterparty credit quality contained within the Investment Strategy. The 2020/21 strategy set a maximum limit of 75% of the portfolio to be held in non-specified investments. At 31st March 2020, 85% of the investment portfolio was held in specified investments. The Chief Finance Officer can report that the investment portfolio was maintained within this limit throughout the year.

Liquidity

In respect of this area the Council set liquidity benchmarks to maintain:

- Liquid short term deposits of at least £5 million available with a week's notice.
- Weighted Average Life benchmark was expected to be 0.25 years (91 days).

The actual liquidity indicators at 31st March 2021 were as follows:

- Liquid short term deposits of £14.9 million as at 31st March 2021.
- Weighted Average Life of the investment portfolio was 0.09 years (32 days).

11.2 **Performance Indicators set for 2020/21**

11.3 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury management function over the year. The Chief Finance Officer set 8 local indicators for 2019/20, which aim to add value and assist the understanding of the main prudential indicators. These indicators, detailed in Appendix B, are:

- Debt – Borrowing rate achieved against average 7 day LIBOR.
- Investments – Investment rate achieved against average 7 day LIBID.
- Average rate of interest paid on the Councils Debt during the year – this will evaluate performance in managing the debt portfolio to release revenue savings.
- The amount of interest on debt as a percentage of gross revenue expenditure.
- Limit on fixed interest rate investments
- Limit on fixed interest rate debt
- Limit on variable rate investments
- Limit on variable rate debt

Regulatory Framework, Risk and Performance

12. The Council's treasury management activities are regulated by a variety of professional codes, 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 were made in 2020/21);
- 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 ODPM 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.

12.1 The Council has complied with all of the above relevant statutory and regulatory requirements, which limit 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.

13. The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Capita Asset Services, the Council's advisers, has proactively managed its treasury position over the year. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.

13.1 Shorter-term variable rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

Appendix B

Prudential and Treasury Indicators 2020/21

1. PRUDENTIAL INDICATORS	2020/21 Actual	2020/21 Estimated	2019/20 Actual
Capital Expenditure	**£'000**	**£'000**	**£'000**
General Fund	3,212	5,117	10,057
HRA	16,377	19,690	11,976
TOTAL	19,589	24,807	22,033
Ratio of financing costs to net revenue stream	**%**	**%**	**%**
General Fund	22.9%	22.0%	15.4%
HRA	31.4%	31.6%	32.2%
Borrowing requirement General Fund	**£'000**	**£'000**	**£'000**
Borrowing requirement at 1 April	68,562	68,562	61,803
Borrowing requirement at 31 March	67,501	67,906	68,562
In-year borrowing requirement	597	5,679	6,759
Borrowing requirement HRA	**£'000**	**£'000**	**£'000**
Borrowing requirement at 1 April	62,174	62,174	58,353
Borrowing requirement at 31 March	70,274	66,851	62,174
In-year borrowing requirement	8,099	4,677	3,846
Net Debt	**£'000**	**£'000**	**£'000**
Actual borrowing less investments	89,548	101,000	89,603
CFR	**£'000**	**£'000**	**£'000**
General Fund	67,501	67,906	68,562
HRA	70,274	66,851	62,174
TOTAL	137,775	134,757	130,736
Annual change in Capital Financing Requirement	**£'000**	**£'000**	**£'000**
General Fund	(1,060)	(656)	6,759
HRA	8,099	4,677	3,846
TOTAL	7,039	4,021	10,605

2. TREASURY MANAGEMENT INDICATORS	2020/21 Revised	2020/21 Estimated	2019/20 Actual
Authorised Limit for external debt –	**£'000**	**£'000**	**£'000**
Borrowing	123,448	150,768	120,153
Other long term liabilities	0	1,380	105
TOTAL	123,448	152,148	120,258
Operational Boundary for external debt -	**£'000**	**£'000**	**£'000**
Borrowing	123,448	135,948	120,153
Other long term liabilities	0	1,200	105
TOTAL	123,448	137,148	120,258
Actual external debt	**£'000**	**£'000**	**£'000**
General Fund	52,909	54,805	55,154
HRA	70,539	66,195	65,113
TOTAL	123,448	121,000	120,258
Upper limit for fixed interest rate exposure	**£m**	**Target £m**	**£m**
Net principal re fixed rate borrowing / investments	104.5	120	112.5
Upper limit for variable rate exposure	**£m**	**Target £m**	**£m**
Net principal re variable rate borrowing / investments	14.9	49.9	25.1
Upper limit for total principal sums invested for over 1 year	**£’000**	**£**	**£’000**
(per maturity date)	0	5	Nil

Maturity structure of fixed rate borrowing during 2020/21	Actual %	Upper limit %	Lower limit %
Under 12 months	6%	40	0
12 months and within 24 months	7%	40	0
24 months and within 5 years	5%	60	0
5 years and within 10 years	9%	80	0
10 years and above	74%	100	10

Local Indicators Treasury Management Indicators

	2020/21 Actual %	2020/21 Revised %	2019/20 Actual %
Debt - Borrowing rate achieved i.e. temporary borrowing (loans of less than 1 year)	Achieved 0.40% LIBOR 0.054% +0.36%	Less than 7 day LIBOR	No new short term borrowing taken in 19/20

	2020/21 Actual %	2020/21 Revised %	2019/20 Actual %
Investment rate achieved	Achieved 0.2% LIBID - 0.07% +0.27%	Greater than 7 day LIBID	Achieved 0.84% LIBID 0.53% +0.21%

	2020/21 Actual %	2020/21 Revised %	2019/20 Actual %
Average rate of Interest Paid on Council Debt (%)	3.25%	3.75%	3.62%

	2020/21 Actual %	2020/21 Target %	2019/20 Actual %
Interest on Debt as a % of Gross Revenue Expenditure	3.6%	4.4%	4.1%
General Fund	1.88%	2.43%	2.14%
HRA	8.02%	8.09%	8.72%

	2020/21 Actual (ave) %	2020/21 Target %	2019/20 Actual %
Upper limits on fixed interest rate investments	56%	100%	46%

	2020/21 Actual %	2020/21 Target %	2019/20 Actual %
Upper limits on fixed interest rate debt	100%	100%	100%

	2020/21 Actual (ave) %	2020/21 Target %	2019/20 Actual %
Upper limits on variable interest rate investments	44%	75%	54%

	2020/21 Actual %	2020/21 Target %	2019/20 Actual %
Upper limits on variable interest rate debt	0%	40%	0%