TITLE: 2020/21 TREASURY OPERATIONS ANNUAL PERFORMANCE REVIEW

Committee: Finance and Assets Committee

Date: 22nd July 2021

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[W42]

1.0 ISSUE

1.1 To report on the Council's treasury operations during the 2020/21 financial year.

1.2 This report reviews the Treasury Management activity during the financial year 2020/21 and reports on the prudential indicators as required by CIPFA's Treasury Management Code of Practice.

2.0 RECOMMENDATION

2.1 Members are asked to note the contents of this report on the Council's treasury operations during 2020/21, including the prudential and treasury indicators as set out in Appendix 1 and recommend to Full Council approval of the report.

3.0 BACKGROUND / INTRODUCTION

3.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators each year, this is the report 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).

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

- an annual treasury strategy in advance of the year (received by Council on the 20th February 2020);
- a mid-year treasury update report, (this was reviewed by Finance and Assets Committee on 26th November 2020 and approved by Full Council on the 23rd February 2021);
- an annual review following the end of the year, describing the activity compared to the strategy (this report).

4.0 RESULTS

4.1 Cash investments totalled £18.865 million as at 31st March 2021, an increase of £7.988 million on the previous year. The Council's cash investments were all for periods of less than one year.

4.2 The large increase in cash is mainly down to four events,

- Additional Government funding, awarded to assist councils with issues arising from the Covid-19 pandemic, this included
  - Additional un-ringfenced grant funding for councils
  - Business Rates funding provided in advance to assist with cashflow
  - Grant funding for businesses held by Council between award and payment out to businesses;
- the Council's overall revenue underspend for the year as reported in the financial outturn report (linked to the above);
- additional CIL and Section 106 receipts;
- the non-purchase of additional Waste fleet as was forecast in the original budget.

4.3 The original loans to ECTC were repaid on 31st March 2021 as previously agreed. The Council also on this date, paid to ECTC two further loans to the combined value of £4.9 million as agreed by Council on the 16th July 2020.

4.4 Interest received during the financial year was £281,725, which was £64,685 above the budget of £217,040. This figure was made up of £26,820 from investment in money markets and other short, fixed term investments and £254,905 from the loans to ECTC.

4.5 The average rate of return on cash investments held during the year (this excludes the loan to ECTC) was 0.147%. This was above the benchmark 7 day LIBID compound rate (London Inter-bank Bid Rate) which was 0.070%.

5.0 CONCLUSIONS

5.1 The size of the Council's investment portfolio is relatively small. Meaning that investment decisions have to be made primarily to accommodate cashflow requirements as opposed to optimising investment returns. Despite these pressures, opportunities for some pro-active investment decisions were taken during the year when opportunity arose, with funds being moved to fixed term investments and away from overnight accounts.

5.2 During the financial year the Council operated within its approved treasury limits and prudential indicators.

6.0 APPENDIX

6.1 Annual Treasury Management Review 2020/21

BACKGROUND DOCUMENTS	LOCATION	CONTACT OFFICER
Treasury Management Strategy as approved by Council on 20th February 2020	Room 104 The Grange Ely	Ian Smith (01353) 616470 E-mail: ian.smith@eastcambs.gov.uk

Annual Treasury Management Review
2020/21

East Cambridgeshire District Council
April 2021

Annual Treasury Management Review 2020/21

1. Introduction

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of 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).

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 20/02/2020)
- a mid-year (minimum) treasury update report (Council 23/02/2021)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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 Council confirms that it complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports, this by the Finance and Assets Committee, before they were reported to the full Council.

No member training on treasury management issues was undertaken during the year, mostly as a consequence of the Covid-19 pandemic.

2. The Council's Capital Expenditure and Financing

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.

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

£000	31.3.20 Actual	2020/21 Revised Budget	31.3.21 Actual
Capital expenditure	**2,364**	**11,871**	**7,159**
Financed in year	2,896	1,963	1,979
Unfinanced capital expenditure	**-532**	**9,908**	**5,180**

3. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

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 ensures that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2020/21. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

£000	31.3.20 Actual	2020/21 Original Budget	31.3.21 Actual
CFR General Fund (£m)	11,761	11,655	11,051
Gross external borrowing position	0	1,000	0
Under / over funding of CFR	11,761	10,655	11,051

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, 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 are 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.

£000	2020/21
Authorised limit	10,000
Maximum gross borrowing position during the year	0
Operational boundary	1,000
Average gross borrowing position	0
Financing costs as a proportion of net revenue stream	0%

4. Treasury Position as at 31st March 2021

At the beginning and the end of 2020/21 the Council's treasury, position was as follows:

INVESTMENT PORTFOLIO	31.3.20 Actual £000	31.3.20 Actual %	31.3.21 Actual £000	31.3.21 Actual %
Treasury investments				
Banks	3,094	28.4	7,465	39.6
Local authorities	1,000	9.2	0	0
Money Market Funds	6,783	62.4	11,400	60.4
TOTAL TREASURY INVESTMENTS	10,877	100	18,865	100

Non Treasury investments				
Loan to East Cambs Trading Company	4,220	100	4,900	100
TOTAL NON TREASURY INVESTMENTS	4,220	100	4,900	100

Treasury investments	10,877	72.0	18,865	79.4
Non Treasury investments	4,220	28.0	4,900	20.6
TOTAL OF ALL INVESTMENTS	15,097	100	23,765	100

The maturity structure of the investment portfolio was as follows:

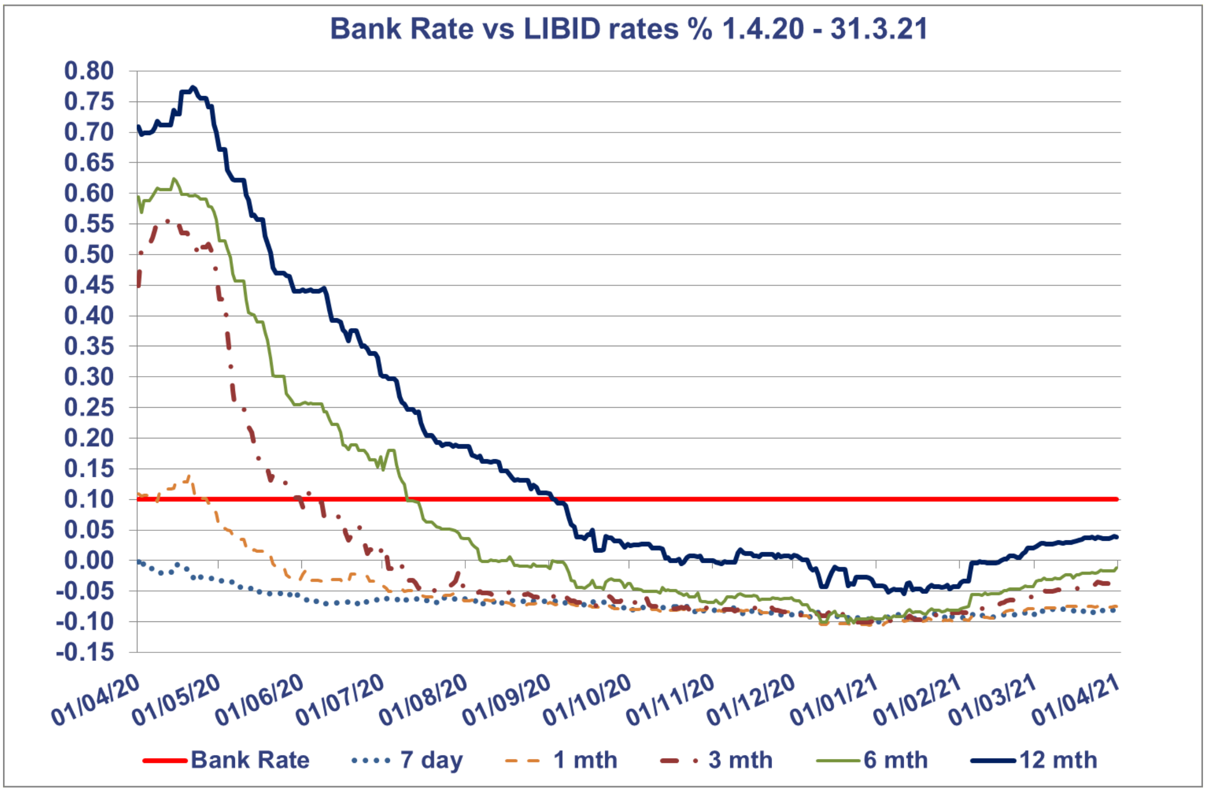
All Money Market investments and the amount held in the Council's main bank account with NatWest are in cash and as such we have instant access to them.

The fixed term investment with Santander (£5 million) had a maturity date of 2nd May 2021.

The loan to East Cambs Trading Company is due to be paid back by / in 2023.

5. The Strategy for 2020/21

5.1 Investment strategy and control of interest rate risk



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 was invalidated by the Covid-19 pandemic bursting onto the scene 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 hugely negative impact of the national lockdown on large swathes of the economy. 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.

This authority 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.

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 above and 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.

5.2 Borrowing strategy and control of interest rate risk

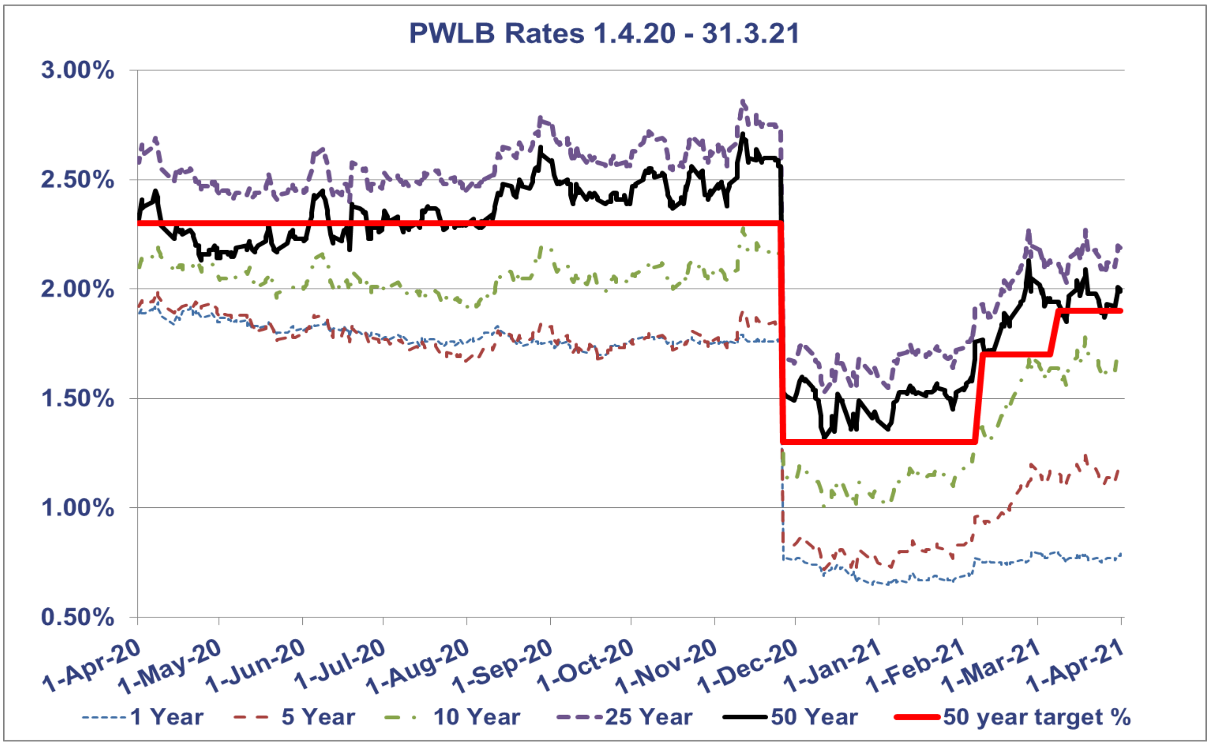
During 2019-20, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Finance Manager therefore monitored interest rates in financial markets and adopted a pragmatic strategy.

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.

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



PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M. Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have seen over the last two years, many bond yields up to 10 years in the Eurozone turn negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession.

Gilt yields fell sharply from the start of 2020 and then spiked up during a financial markets melt down in March caused by the pandemic hitting western countries; this was rapidly 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 rapid progress in the new year of 2021, gilt yields and gilt yields and PWLB rates started rising sharply as confidence in economic recovery rebounded. Financial markets also expected Bank Rate to rise quicker than in the forecast tables in this report.

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. 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; 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. The new margins over gilt yields are as follows: -.

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not forecast to rise from 0.10% by 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%; this sets a high bar for Bank Rate to start rising.

6. Investment Outturn

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on XXXX. 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.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£000)	31 March 2020	31 March 2021
Earmarked reserves	**9,625**	**10,849**
CIL / Section 106	**5,486**	**8,582**
Provisions	**1,385**	**5,283**
Usable capital receipts	**1,449**	**1,472**
Cash / Debtors	**4,693**	**3,730**
Internal Borrowing	**-11,761**	**-11,051**
Total	**10,877**	**18,865**

Investments held by the Council

- The Council maintained an average balance of £18.273 million of internally managed funds.
- Interest of £26,820 was earned on the Council's investments during 2020/21.
- The internally managed funds earned an average rate of return of 0.147%.
- The comparable performance indicator (as detailed in the Treasury Strategy for 2020/21) is the average 7-day LIBID compound rate, which was 0.070%.

- **ABBREVIATIONS USED IN THIS REPORT**

- **ALMO:** an Arm's Length Management Organisation is a not-for-profit company that provides housing services on behalf of a local authority. Usually an ALMO is set up by the authority to manage and improve all or part of its housing stock.

- **LAS:** Link Group, Treasury solutions – the council's treasury management advisers.

- **CE:** Capital Economics - is the economics consultancy that provides Link Group, Treasury solutions, with independent economic forecasts, briefings and research.

- **CFR:** capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

- **CIPFA:** Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

- **CPI:** consumer price index – the official measure of inflation adopted as a common standard by countries in the EU. It is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

- **ECB:** European Central Bank - the central bank for the Eurozone
- **EU:** European Union
- **EZ:** Eurozone -those countries in the EU which use the euro as their currency

- **Fed:** the Federal Reserve System, often referred to simply as "the Fed," is the central bank of the United States. It was created by the Congress to provide the nation with a stable monetary and financial system.

- **FOMC:** the Federal Open Market Committee – this is the branch of the Federal Reserve Board which determines monetary policy in the USA by setting interest rates and determining quantitative easing policy. It is composed of 12 members--the seven members of the Board of Governors and five of the 12 Reserve Bank presidents.

- **GDP:** gross domestic product – a measure of the growth and total size of the economy.

- **G7:** the group of seven countries that form an informal bloc of industrialised democracies--the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom--that meets annually to discuss issues such as global economic governance, international security, and energy policy.

- **Gilts:** gilts are bonds issued by the UK Government to borrow money on the financial markets. Interest paid by the Government on gilts is called a coupon and is at a rate that is fixed for the duration until maturity of the gilt, (unless a gilt is index linked to inflation); while the coupon rate is fixed, the yields will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.

- **IMF:** International Monetary Fund - the lender of last resort for national governments which get into financial difficulties.

- **LIBID:** the London Interbank Bid Rate is the rate bid by banks on deposits i.e., the rate at which a bank is willing to borrow from other banks. It is the "other end" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend).

- **MHCLG:** the Ministry of Housing, Communities and Local Government -the Government department that directs local authorities in England.

- **MPC:** the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

- **MRP:** minimum revenue provision -a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).

- **PFI:** Private Finance Initiative – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

- **PWLB:** Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

- **QE:** quantitative easing – is an unconventional form of monetary policy where a central bank creates new money electronically to buy financial assets, such as government bonds, (but may also include corporate bonds). This process aims to stimulate economic growth through increased private sector spending in the economy and also aims to return inflation to target. These purchases increase the supply of liquidity to the economy; this policy is employed when lowering interest rates has failed to stimulate economic growth to an acceptable level and to lift inflation to target. Once QE has achieved its objectives of stimulating growth and inflation, QE will be reversed by selling the bonds the central bank had previously purchased, or by not replacing debt that it held which matures. The aim of this reversal is to ensure that inflation does not exceed its target once the economy recovers from a sustained period of depressed growth and inflation. Economic growth, and increases in inflation, may threaten to gather too much momentum if action is not taken to 'cool' the economy.

- **RPI**: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – CPI. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

- **TMSS:** the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

- **VRP:** a voluntary revenue provision to repay debt, in the annual budget, which is additional to the annual MRP charge, (see above definition).