City Council

Date of meeting:	13 September 2021
Title of Report:	**Annual Report on Treasury Management Activities for 2020/21**
Lead Member:	Councillor Nick Kelly (Leader)
Lead Strategic Director:	Brendan Arnold (Service Director for Finance)
Author:	Chris Flower (Finance Business Partner for Capital and Treasury Management)
Contact Email:	chris.flower@plymouth.gov.uk
Your Reference:	Finance/CF
Key Decision:	No
Confidentiality:	Part I - Official

Purpose of Report

In order to comply with the Code of Practice for Treasury Management, the Council is required to formally report on its treasury management activities for the year, providing information on the progress and outcomes against the Treasury Management Strategy. This report covers the treasury management activities for financial year 2020/21 including the final position on the statutory Prudential Indicators.

This report:

a) is prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code;
b) confirms capital financing, borrowing, debt rescheduling and investment transactions for the year 2020/21;
c) provides an update on the risk inherent in the portfolio and outlines actions taken by the Council during the year to minimise risk;
d) gives details of the outturn position on Treasury Management transactions in 2020/21;
e) confirms compliance with treasury limits and Prudential Indicators (PIs) and the outlines the final position on the PI's for the year.

Recommendations and Reasons

1. To approve the Treasury Management Annual Report 2020/21

   This is to comply with the CIPFA Code of Practice and discharge our statutory requirement.

Alternative options considered and rejected

None - it is requirement to report to Council on the treasury management activities for the year.

Relevance to the Corporate Plan and/or the Plymouth Plan

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for the Medium Term Financial Plan and Resource Implications:
Into the medium and longer term the Council is facing significant pressures due to the national economic situation, which has led to a reduction in resources for local authorities over the Government's latest spending period. Effective Treasury Management will be essential in ensuring the Council's cash flows are used to effectively support the challenges ahead.

Carbon Footprint (Environmental) Implications:
In 2020/21 the Council invested £5m into the Public Sector Social Impact Fund to invest in carbon reduction projects.

Other Implications: e.g. Health and Safety, Risk Management, Child Poverty:
** When considering these proposals members have a responsibility to ensure they give due regard to the Council's duty to promote equality of opportunity, eliminate unlawful discrimination and promote good relations between people who share protected characteristics under the Equalities Act and those who do not.*
There is an inherent risk to any Treasury Management activity. The Council continues to manage this risk by ensuring all investments are undertaken in accordance with the approved investment strategy, and keeping the counterparty list under constant review.

Appendices
**Add rows as required to box below*

Ref.	Title of Appendix	**Exemption Paragraph Number** (if applic *If some/all of the information is confidential, you must indi why it is not for publication by virtue of Part 1of Schedule of the Local Government Act 1972 by ticking the relevant*						
		1	2	3	4	5	6	7
A								
B								

Background papers:

**Add rows as required to box below*
Please list all unpublished, background papers relevant to the decision in the table below. Background papers are <u>unpublished</u> works, relied on to a material extent in preparing the report, which disclose facts or matters on which the report or an important part of the work is based.

Title of any background paper(s)	Exemption Paragraph Number (if applicable) *If some/all of the information is confidential, you must indicate why it is not for publication by virtue of Part 1of Schedule 12A of the Local Government Act 1972 by ticking the relevant box.*						
	1	**2**	**3**	**4**	**5**	**6**	**7**
Treasury Management Strategy report to Council 24 February 2020							

Sign off:

Fin	pl.21.22.48			Mon Off	LS/36954/AC/12/7/21	HR		Assets		Strat Proc	

Originating Senior Leadership Team member: Brendan Arnold (Service Director for Finance)
Please confirm the Strategic Director(s) has agreed the report? Yes Date agreed: 09/07/2021
Cabinet Member approval: Councillor Nick Kelly (Leader) approved by email Date approved: 14/07/2020

Annual Report on Treasury Management Activities for 2020/21

Executive Summary

The Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) requires the Council to report on the performance of the treasury management function after the financial year end. The approval of this report has been delegated to the Governance and Audit Committee to approve.

The Council's Treasury Management Strategy for 2020/21 was approved by Council on 24 February 2020. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

Borrowing: At 31 March 2021 the Council held £600m (see table 2) of borrowing which was a decrease of £3m on 2019/20. Included in the borrowing is £463m of short term borrowing which the Council borrows from other local authorities at a very low rates on 3-12 month terms.
There is an Interest Rate Risk from holding large amounts of short term borrowing as interest rates could rise and increase the cost of borrowing. The Council reviews the risks on a regular basis and in April 2020 it took out an Interest Rates Swap that fixes the borrowing rate of £75m for twenty years.

Investments: At 31 March 2021the Council held £97m of cash and investments (see table 3) which was a decrease of £9m on 2019/20.

Treasury Management Outturn: The Council had an underspend of £3.602m (see table 4) for the year ended 31 March 2021. Most of the underspend came from the dramatic drop in interest rates following the Covid19 pandemic and the fall in the financial markets. During the year the Council has been able to borrow at very low interest rates. The Council also made savings from reduced borrowing caused by the Covid19 lockdown where capital projects had to stop working or reduce working for a period of time.

Prudential Indicators: The Council meet all of the prudential indicators set in the Treasury Management Strategy 2020/21.

Introduction

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code). This requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a half-year and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital

Strategy, complying with CIPFA's requirement, was approved by full Council on 24 February 2020.

External Context

Economic background (as at June 2021): Economic resurgence from coronavirus pandemic continued to dominate the first quarter of the financial year. In the biggest inoculation programme the country has ever undertaken, over 44 million people in the UK had received their first dose of a COVID-19 vaccine with 32 million also having a second dose.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its June 2021 policy announcement, the BoE expected the economy to experience a temporary period of strong GDP growth and above-target CPI inflation, after which growth and inflation is expected to fall back. There were, however, two-sided risks around this central path, and it is possible that near-term upward pressure on prices could prove somewhat larger than expected. The Bank's Monetary Policy Committee does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

Government initiatives continued to support the economy over the quarter, following the range of measures announced by the Chancellor in the 2021 Budget, which included extending the furlough (Coronavirus Job Retention) scheme until September 2021.

The latest labour market data showed that in the three months to April 2021 the unemployment rate fell to 4.7%, although it is likely that labour market slack has remained higher than implied by this measure. Some individuals stopped looking for work during the pandemic and were therefore recorded as inactive. There is uncertainty around how many of these individuals will resume their search for a job, and when. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 5.6% for the three months February to April 2021. The seemingly high growth partly reflected a base effect from a decline in average pay in the spring of last year, associated with the reduced pay of employees on the furlough scheme.

Annual CPI inflation rose to 2.1% in May on the back of base effects in spring 2020 and partly due to higher energy and commodity prices and supply-side bottlenecks. The BoE expects inflation to exceed 3% for a temporary period. The ONS' preferred measure of CPIH which includes owner-occupied housing was also 2.1% year/year, marginally higher than expectations.

The reimposition of restrictions on activity in the first quarter of calendar 2021 year resulted in GDP falling 1.6% in Q1. GDP growth was strong in April at 2.3% with the partial easing of restrictions on non-essential retail and outdoor hospitality. Housing market activity remained strong, aided by the extension of the stamp duty threshold and an increase in mortgage approvals for house purchases.

The US economy rebounded by 4.3% in Q4 2020 (Oct-Dec) and then an even stronger 6.4%

in Q1 as the recovery continued to be fuelled by $5 trillion worth of pandemic stimulus packages. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period.
The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

Financial markets: Ongoing monetary and fiscal stimulus together with improving economic growth prospects and successful vaccine rollout programmes continued to boost equity markets over the period. The Dow Jones reached a record high during the period while the UK-focused FTSE 250 index was back above pre-pandemic levels and the more internationally focused FTSE 100 had recouped around three-quarters of 2020 losses.

Inflation worries continued during the period but declines in bond yields between April and June suggest bond markets may be expecting any general price increases to be less severe, or more transitory, that was previously thought.

The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.32% by the end of June 2021. Over the same period the 10-year gilt yield fell from 0.80% to 0.71%, despite jumping to 0.90% in May. The 20-year yield declined from 1.31% to 1.21%.

1-month, 3-month and 12-month SONIA bid rates averaged 0.03%, 0.02% and 0.15% respectively over the period.

Credit review: Credit default swap spreads were relatively flat over the period and remain only slightly above their pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, and Santander UK remained an outlier compared to the other ringfenced/retail banks. At the end of June, Santander UK was trading the highest at 52bps and Standard Chartered the lowest at 31bps. The other ringfenced banks were trading between 32 and 34bps while Nationwide Building Society was 38bps.

There were only a small number of credit rating actions over the period. Fitch revised a number of Singaporean and Australian banks as well as Close Brothers to stable, and also upgraded Coventry Building Society to 'A' (from 'A-'). Towards the end of the period Fitch revised the United Kingdom's outlook to stable from negative.

S&P also revised some Australian banks to stable, as well as Transport for London, which a week or so later received a £1.08 billion bailout from the UK government. S&P also downgraded the long- and short-term ratings of DZ Bank (Germany) to A+ and A-1 from AA- and A-1+ respectively. In late June S&P took further rating actions, upwardly revising the outlooks for a number of UK and European banks from negative to stable, or in the case of Barclays and Nationwide from stable to positive.

The successful vaccine rollout programme is credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

Local Context

On 31st March 2021, the Council had net borrowing of £628m (see table 2) arising from its revenue and capital income and expenditure, a decrease of £12m on 31/03/2020. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors and the year-on-year change are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31/03/20 Actual £m	2020/21 Movement £m	31/03/21 Actual £m
General Fund CFR	568	-3	565
Less: Other debt liabilities *	-119	-6	-125
Borrowing CFR	**449**	**-9**	**440**
Less: Usable reserves	-60	0	-60
Less: Working capital	-39	-3	-42
Net borrowing	**350**	**-12**	**338**

* *finance leases, PFI liabilities and transferred debt that form part of the Council's total debt.*

During the year, the CFR decreased due to a slowdown of the capital programme during the Covid lockdown restrictions and the Council received government grants is advance, which reduced the need to borrow. The Council has however, a five years forecast to increase the CFR in order to deliver capital programme investment in the City. The Council's net borrowing has decreased in the year as detailed in table 1 above.

Borrowing Update

In November 2020 the Public Works Loan Board (PWLB) published its response to the consultation on 'Future Lending Terms'. From 26th November 2020 the margin on PWLB loans above gilt yields was reduced from 1.8% to 0.8% providing that the borrowing authority can confirm that it is not planning to purchase 'investment assets primarily for yield' in the current or next two financial years.

As part of the borrowing process authorities will now be required to submit more detailed capital expenditure plans with confirmation of the purpose of capital expenditure from the Section 151 Officer. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB. The Council, however, can invest in commercial property in Plymouth as long as the main purpose is for regeneration, job creation or safeguarding jobs and other local improvement reasons.

Competitive market alternatives may or may not be available for authorities with or without access to the PWLB according to market circumstances. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders and therefore this will affect the cost of borrowing for commercial loans or bonds.

Borrowing Activity

At 31st March 2021, the Council held £603m of loans, (a decrease of £3m on 31/03/2020 see table 2) as part of its strategy for funding previous years' capital programmes. See table 2 below.

Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The Council's main objective when borrowing has been to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

Interest Rate Swap

The Council has £463m of short term borrowing which it borrows from other local authorities at a very low rates on 3-12 month terms. The Council has an Interest Rates Risk (the risk that interest rates may go up). If interest rates increase by 1% it would cost the Council £4.63m additional interest on its revenue budget.

The Council has been reviewing the Interest Rate Risk on a regular basis and it has taken actions to mitigate some of this risk.

To Hedge against this risk the Council took out an Interest Rate Swap in April 2020 for £75m at a fixed rates of 0.56% for 20 years.

The interest rate swap is a contract where one party swaps a variable rate payment stream (the Council's short term borrowing) with the other party's fixed rate payments (the Bank).

The Council is looking at further measures to mitigate the Interest Rate Risk in the future and it reviews the situation on a regular basis with advice from it Treasury Management advisors.

The treasury management position at 31st March 2021 and the change during the year is shown in Table 2 below.

Table 2: Borrowing Activity

	Balance on 01/04/2020 £m	Movement £m	Balance on 31/03/2021 £m	Avg Rate %
Public Works Loan Board	44	0	44	5.76%
Banks - LOBOs	66	0	66	4.34%
Other Loans	28	-1	27	
Short Term Borrowing	465	-2	463	0.6%
TOTAL BORROWING	603	-3	600	
Other Long Term Liabilities	119	6	125	-
TOTAL EXTERNAL DEBT	722	3	725	-
Less Total Investments (see table 3)	-106	-9	-97	
Net Borrowing	616	-12	628	

LOBO (Lender's Option Borrower's Option)
The Council continues to hold £64m of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

Municipal Bonds Agency (MBA):
The MBA revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor. A planned third bond issuance by Warrington Borough Council was withdrawn in early December after the reduction in PWLB borrowing rates.

If the Council intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

UK Infrastructure Bank:
In his March 2021 budget the Chancellor confirmed that a UK Infrastructure Bank will be set up with £4bn in lending earmarked for local authorities from the summer of 2021. Loans will be available at gilt yield plus 0.60%, 0.20% lower than the PWLB certainty rate.

A bidding process to access these loans is likely with a preference to projects likely to help the government meet its Net Zero emissions target. However, other "high value and complex economic infrastructure projects" may also be considered.

Other Long Term Liabilities
Although not classified as borrowing, the Council has other capital finance from Private Finance Initiatives and Finance Leases etc. and as at 31st March 2021 this amounted to £125m. PFI and finance leases are other ways of financing capital however this is quite often more expensive and is paid over a number of years. The Council's current PFI debt will be repaid by 2040.

The liability for the PFI scheme has increased the requirement for finance and therefore we increased our Operational Boundary and Authorised limit to allow for this.

Minimum Revenue Provision (MRP)
MRP is a charge to the revenue budget that is made each year for monies to repay the Council's borrowing.

Under regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 SI 2003/146, as amended, local authorities are required to charge to their revenue account, for each financial year, MRP for the cost of their unfinanced capital expenditure.

The Council uses the annuity method to calculate its MRP and spreads the cost of the borrowing over the economic life of the assets and this takes into account the time value of money.

Investment Activity

At the end of March 2020 the Council received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. The Council has continued to receive various funding to support the local economy during the pandemic. These funds have been temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds so that it was available to pay out as soon as it could.

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2020/21 the Council's investment and cash balances ranged between £80 and £110 million due to timing differences between income and expenditure. The year-end investment position and the year-on-year change in show in table 3 below.

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Table 3: Investment Activity in 2019/20

Investments	Balance on 01/04/2020 £m	Movement £m	Balance on 30/03/2021 £m	Avg Rate/Yield (%)
Short term Investments (Banks and call accounts)	18	-6	12	0.1%
Covered Bonds and Loans	0	0	0	-
Money Market Funds	33	-3	30	0.1%
Other Pooled Funds	55	0	55	2.0%
TOTAL INVESTMENTS	**106**	**-9**	**97**	
Increase/ (Decrease) in Investments £m			-9	

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Externally Managed Pooled Funds:
The Council continues to hold £55m invested in externally managed Pooled Funds (bond, equity, multi-asset and property) with the CCLA, Schroder and Fidelity and has generated a total return for the year of £1.093m. Investment income has been used to support services in year.

During the initial phase of the pandemic in March 2020, the sharp global financial falls affected the values of all investments. The falls in corporate bond and equity markets had a negative impact on the value of the Council's pooled fund holdings and was reflected in the 31st March 2020 fund valuations of £50.914m with most funds registering negative capital values over a 12 month period. Since March 2020 there has been improvement in market sentiment which is reflected in an increase in capital values of these short-dated, strategic bond, equity and multi-asset income funds in the Council's portfolio. The recovery in UK equities has lagged those of US and European markets.

As at 31 March 2021 the value of the pooled investments were £54.965m (nominal value £55.000m) so had recovered much of the losses sustained through the financial crash and are likely to continue to grow slowly as the economy continues to recover.

It should be noted that the capital value of the Council's Pooled Investment will fluctuate dependent on market conditions. Any unrealised capital losses will not have an impact on the revenue budget or General Fund. The capital value would only be realised if the funds were sold.

The Pooled investments have no defined maturity date, but are available for withdrawal after a notice period. The Council continues to review regularly its investment in these funds together with advice from its Treasury Management advisors.

Other Non-Treasury Holdings and Activity

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance of the Ministry of Housing, Communities and Local Government's (MHCLG), in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Council held £259m of direct property investment under its Regeneration and Property Fund.

These non-treasury investments generated £2.556m of investment income for the Council after taking account of direct costs, representing a net revenue return of 1.3% after allowing for payment to a void reserve and payment to a lifecycle maintenance reserve. The gross return is higher than the return earned on treasury investments but reflects the additional risks to the Council of holding such investments.

Treasury Management Outturn 2020/21

Table 4. Treasury Management Outturn Position 2020/21

	2020/21 Budget	2020/21 Outturn	Year End Variance
	£m	£m	£m
Interest Payable	9.796		
LOBO and other long term loans		2.287	
PWLB (Public Works Loan Board)		2.150	
Temporary loans		3.832	
Other Interest and charges		0.088	
Recharge to Departments for Unsupported Borrowing (in accordance with business cases)	(14.000)	(14.450)	
Total Interest Payable	**(4.204)**	**(6.093)**	**(1.889)**
Interest Receivable	(2.285)		
Pool Funds		(1.093)	
Money Market Fund		(0.089)	
Other Interest		(1.783)	
Total Interest Receivable	**(2.285)**	**(2.965)**	**(0.680)**
Other Payments	0.288	0.097	
Debt Management	0.450	0.507	
Amortised Premiums	0.650	0.544	
Total Other Charges	**1.388**	**1.341**	**(0.047)**
Minimum Revenue Provision	**16.766**	**15.780**	**(0.986)**
TOTAL	**11.665**	**8.063**	**(3.602)**

The Council's Treasury Management Outturn for the year was an underspend of £3.602m which has helped the Council balance the budget for 2020/21. The main savings have come from a dramatic fall in interest rates following the Covid pandemic and the worldwide financial crash. The Bank of England cut the bank rate to 0.1% and the Council has benefitted from the fall in the cost of borrowing of its £463m of short-term borrowing.

The Covid lockdown slowed the Council's capital programme, therefore reduced the amount of new borrowing that it had expected to take out, and therefore made further savings from loan repayments (Minimum Revenue Provision).

The Covid pandemic and financial crash affected the capital value of the Council's investments in pooled funds but these have recovered and we expect these to improve over the next 12 months as the global economy improves. Despite the fall in the value of these funds the investment income has held up and provides the Council a good rate of return against the bank and money market returns of between zero to 0.1%.

The Treasury Management Outturn does not include the returns from the Council's investments in the purchasing commercial assets, as this is included in the Place revenue outturn and referred to in Other Non-Treasury Holdings and Activity section above.

Following the cut in Bank rate from 0.75% to 0.10% in March 2020, the Council had expected to receive significantly lower income from its cash and short-dated money market investments, including money market funds in 2020/21, as rates on cash investments are close to zero percent.

Money Market Funds (MMF): Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.

Deposit rates with the Debt Management Account Deposit Facility (DMADF) have continued to fall and are now largely around zero.

The Treasury Management budget is a held as a separate budget under the Finance Department of the Council's General Fund. Whilst interest costs are less than the budget there are a number of factors that contribute to the final position. Whilst the Council not only borrows to finance capital expenditure, it also has to maintain a daily net cash surplus position.

The costs of borrowing to finance 'invest to save' capital schemes is charged to departments. The figures above include the borrowing implications of decisions to utilise the Asset Investment Fund to acquire assets to earn a revenue return which is accounted for in directorate's budgets.

Compliance with Prudential Indicators

The Section 151 Officer confirms compliance with its Prudential Indicators for 2020/21, which were set in the Treasury Management Strategy 2020/21.

The Following indicators are set and monitored each year:

- Estimates of Capital Expenditure;
- Estimates of Capital Financing Requirement;
- Gross Debt and the Capital Financing Requirement;
- Operation Boundary for External Debt;
- Authorised Limit for External Debt;
- Ratio of Financing Costs to Net Revenue Stream ;
- Incremental Impact of Capital Investment Decisions.

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2020/21 Limit	2020/21 Actual	Complied
Upper limit on fixed interest rate exposure	100%	23%	✓
Upper limit on variable interest rate exposure	100%	77%	✓

Fixed rate borrowings are those where the rate of interest is fixed for the whole financial year or more. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	Upper Limit	Lower Limit	31.03.2021 Actual	Complied
Under 12 months	90%	10%	77%	✓
12 months and within 24 months	40%	0%	0%	✓
24 months and within 5 years	40%	0%	2%	✓
5 years and within 10 years	50%	0%	2%	✓
10 years and above	80%	10%	19%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end were:

	2020/21	2021/21	2022/23
Limit on principal invested beyond year	£45m	£50m	£50m
Actual	£0m	£0m	£0m
Complied	✓	✓	✓

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual	Complied
Portfolio average credit rating	A	AA-	✓

Liquidity: The Council does not keep large amounts of cash in call accounts so that it reduces the cost of carrying excess cash. To mitigate the liquidity risk of not having cash available to meet unexpected payments the Council has access to borrow additional, same day, cash from other local authorities.

<u>Other</u>

IFRS 16: CIPFA/LASAAC has proposed delaying the implementation of the new IFRS 16 Leases accounting standard for a further year to 2021/22.

<u>Investment Training</u>

Officers have undergone the following training during the year all of which have been online:

Arlingclose – Changes to IFRS 9 Impairment of Financial Instruments
Arlingclose – Principles of Treasury Management Workshop
CIPFA – Implementing new Treasury Management Regulatory Framework
Arlingclose – Investments workshop 2020
Arlingclose – Regular financial market updates 2020-21
Grant Thornton - Accounts Closedown Workshops for Local Authority Accountants
Arlingclose – Hedge Accounting Training

Prudential Indicators 2020/21

The Local Government Act 2003 requires the Council to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

This report compares the approved indicators with the outturn position for 2019/20. Actual figures have been taken from or prepared on a basis consistent with, the Council's statement of accounts.

Capital Expenditure: The Council's capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2020/21 Actual £m
General Fund	105.471
Total Expenditure	**105.741**
Capital Receipts	1.843
Grants (e.g. gov't, HLF, LEP, Environment Agency)	43.724
Contributions, S106 & CIL (neighbourhood element)	1.768
Borrowing	58.406
Total Financing	**105.741**

Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.2021 Actual £m
General Fund	**565**
Total CFR	**565**

The CFR fell by £4m in the year to £565m (2020 £569m) from capital expenditure financed by debt outweighs resources put aside for debt repayment.
The increase in CFR shows that the Council is increasing its borrowing to pay for capital expenditure in the city.

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Actual Debt: The Council's actual debt at 31 March 2021 was as follows:

	31.03.21 Estimate £m	31.03.21 Actual £m	Difference £m
Borrowing	603	600	-3
PFI liabilities & other Finance leases	119	125	6
Total Debt	**722**	**725**	**3**

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt below.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely (i.e. prudent, but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary	31.03.21 Boundary £m	31.03.21 Actual Debt £m	Complied
Borrowing	875	603	✓
Other long-term liabilities	135	125	✓
Total Debt	**1010**	**728**	✓

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003.

It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	31.03.21 Boundary £m	31.03.21 Actual Debt £m	Complied
Borrowing	950	603	✓
Other long-term liabilities	145	125	✓
Total Debt	**1095**	**728**	✓

Other

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. The revised codes are yet to be released. However, from feedback documents the following changes are likely:

Prudential Code:

- Clarification and definitions to define commercial activity and investment, and that an authority must not borrow to invest for the primary purpose of commercial return.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- Proportionality will be included as an objective; new indicators for net income from commercial and service investments to net revenue stream.
- A specific objective around commercial investment with the intention of embedding good practice across authorities.

Treasury Management Code:

- - Inclusion of the liability benchmark as a mandatory treasury indicator.
- - Implementation of a treasury management knowledge and skills framework.
- - Incorporating ESG issues as a consideration within TMP 1 Risk Management.

Outlook for the remainder of 2021/22

The medium-term global economic outlook has continued to improve with the rollout of vaccination programmes. The UK has continued to benefit from its initial rapid vaccine rollout and has shifted focus onto second vaccinations to increase protection to counter a third wave of Covid variant.

The opening up of the UK economy in Q2/Q3 will continue to prompt a sharp increase in GDP.

While downside risks seem to have fallen somewhat after recent trends in GDP and labour, the upside risks remain relatively balanced with the MPC reiterating its commitment not to tighten policy until there is clear evidence that the recovery is eliminating spare capacity in the economy.

Inflation has moved above the Bank of England's 2% target. Alongside the increase in commodity prices, the MPC has acknowledged the prospect of a sharper upturn in inflation, with the potential CPI could rise above 3% in the coming months. However, the nature of the commodity price rise and the base effect easing, this is likely a more transitory effect.

Upward pressure on gilt yields could continue in the short term due to the preponderance of strong data, but this is likely to ease once inflation fears recede as the effect of weak base effects subsides and growth figures return to more normal levels.

Arlingclose expects Bank Rate to remain at the current 0.10% level. The risk of movement in Bank Rate in the short term is low.

Gilt yields could continue to increase in the short term but will begin to plateau and reduce once the market's expectation of rises in Bank Rate and inflation fears subside. Longer term yields may face upward pressure towards the end of Arlingclose's forecast period as the economy moves back to a sustained footing and policy expectations start to strengthen.

Downside risks remain – the damage from the pandemic will have lasting effects and there is the risk of further virus mutations due to the uneven global rollout of vaccines. Downside risks also arise from potential future vaccine shortages as the global demand for vaccines increases.