Appendix 1

2020-2021 Annual Treasury Management Report

Contents

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1. Introduction

1.1. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management report including a review of activities and the actual Prudential and Treasury Indicators for 2019/20.This report meets the requirements of both the Chartered Institute of Public Finance and Accounting (CIPFA) Code of Practice in Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2. The report includes:

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

1.3. During 2020/21 the Council complied with its legislative and regulatory requirements. Detailed reports have been presented to Overview and Scrutiny Committee, Cabinet and Council throughout the year as part of the Quarterly Corporate Financial Reports.

1.4. Table 1 below provides a summary of the key data for 2020/21:

Table 1: Capital Expenditure, Capital Financing Requirement and Cash Resources

	See also table	2019/20 Actual £000	2020/21 Feb 20 estimate £000	2020/21 Feb 21 estimate £000	2020/21 Actual £000
Capital expenditure	2	4,074	18,900	12,525	5,737
Capital Financing Requirement (CFR)	3	18,505	24,168	23,658	21,227
External debt	4,5,6	12,800	24,168	12,800	12,800
Total Investments (inc. call accounts)	7,8	28,798	18,443	19,718	26,900

2. Capital Expenditure and Financing 2020/21

2.1. The Council incurs 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;
- Un-financed capital expenditure which leads to an increase in the Council's CFR. This increases the Minimum Revenue Provision (MRP see 2.6) charged to the revenue account to ensure that resources are set aside to pay for the asset over its useful life.

2.2. Table 2 below shows the actual capital expenditure and how this was financed.

Table 2: Capital expenditure and financing.

	2019/20 Actual £000	2020/21 Feb 20 estimate £000	2020/21 Feb 21 estimate £000	2020/21 Actual £000
Capital expenditure	**4,074**	**18,900**	**12,525**	**5,737**
Resourced by:				
· Capital receipts	1,263	4,784	553	668
· Capital grants	626	5,865	4,277	894
· Revenue Reserves	1,316	2,090	1,757	645
Unfinanced capital expenditure	**869**	**6,161**	**5,937**	**3,529**

2.3. Explanations of the variances are included within the out-turn report to Council on 29 June 2021. Many schemes are delivered through partnerships with third party organisations and it has taken longer than anticipated to get schemes under way, compounded by the impact of lockdowns.

2.4. The CFR represents the Council's underlying need to borrow for capital expenditure. It increases when the Council incurs capital expenditure and reduces as resources are applied to capital expenditure.

2.5. The CFR is the cumulative unfinanced capital expenditure which has not yet been 'paid for'. It can be understood in terms of an outstanding 'mortgage' balance on the Council's non-current assets.

2.6. There are statutory controls in place to ensure that the cost of capital assets is charged to revenue over the life of the assets. This is the annual MRP charge.

2.7. The total CFR can also be reduced by:

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

2.8. The Council's 2020/21 MRP Policy (as required by MHCLG guidance) was approved as part of the Treasury Management Strategy Report for 2020/21 on 25th February 2020.

2.9. The Council's CFR for the year is shown in Table 3, and represents a key prudential indicator.

Table3: CFR Movement

CFR	2019/20 Actual £000	2020/21 Feb 20 estimate £000	2020/21 Feb 21 estimate £000	2020/21 Actual £000
Opening balance	18,354	18,791	18,505	18,505
Add unfinanced capital expenditure (as above)	869	6,161	5,937	3,529
Less MRP	(719)	(785)	(785)	(807)
Closing balance	18,505	24,168	23,658	21,227

3. Borrowing

3.1. A key prudential indicator is to compare the level of gross debt against the CFR. Gross debt should not exceed the CFR in the medium term in order to remain prudent and to ensure revenue activities are not being funded by borrowing. Table 4 highlights the Council's gross borrowing position against the CFR and shows that the Council has complied with this prudential indicator.

Table 4: Gross Debt v CFR

	31 March 2020 £000	31 March 2021 £000
Gross Debt	12,800	12,800
CFR	18,505	21,227
Over / (under) borrowing	(5,705)	(8,427)

3.2. During 2020/21, the council maintained an under-borrowed position increasing from £5.7m to £8.4m. This means that the capital borrowing need, the CFR, was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

3.3. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However this was, and will continue to be, kept under review to avoid incurring higher borrowing costs in the future when the Council will not be able to avoid new borrowing to finance capital expenditure.

3.4. The Public Works Loans Board (PWLB) lends government money to other public bodies and is the Council's main source of borrowing. On 26th November 2020 Her Majesty's Treasury (HMT) announced its response to the consultation on access to PWLB funding, As a result the margin over gilts charged on local government borrowing reduced back from 180 base percentage points (bps) to 80bps.

3.5. In order to access PWLB borrowing Councils need to complete an annual return splitting the capital programme for the current year and next three years between the following six categories

- Service Spending
- Housing
- Economic Regeneration
- Preventative Action

- Treasury Management
- Investment assets bought primarly for yield.

If the Council has any capital scheme which falls into the last category investment assets bought primarily for yield, then they will be unable to access PWLB funding.

What category a scheme falls into is determined by the Council's Section 151 Officer.

3.6. There are strict criteria which schemes have to meet to fall into each category, with the last category being the catch all category. A full review of the capital programme has been completed and the Council currently has no schemes that are deemed to fall into the final category, Investment assets brought primarily for yield. As a result when conditions are right the Council will be able to access the PWLB for borrowing.

3.7. Included in the Prudential Code are a number of other indicators for debt, the levels for which are shown in Table 5

Table 5: Summary of Debt and Debt Indicators

	2020/21 £000
Gross Debt	12,800
Authorised limit	30,415
Operational boundary	24,200
Estimate of Financing Costs : Net revenue stream (Feb 20 estimate)	8.53%
Estimate of Financing Costs : Net revenue stream (Feb 21 estimate)	15.14%
Actual of Financing Costs : Net revenue stream	8.39%

3.8. The Authorised limit; is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. This is the level of debt that while not desirable, could be afforded in the short term, but is not sustainable in the longer term. Once set the Council does not have the power to borrow above the authorised limit.

3.9. The Operational Boundary; is the limit beyond which external debt is not normally expected to exceed. This is set at a level consistent with the borrowing need (CFR) plus an allowance for unexpected expenditure.

3.10. As demonstrated in Table 5 the council has maintained gross borrowing within both its authorised limit and operational boundary for 2020/21.

3.11. The ratio of financing costs to net revenue stream identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income). This shows the percentage amount of the net revenue stream which is spent before the Council provides any services. For 2020/21 the actual was 8.39%, which came in below estimates for the year, due to no increase in borrowing and hence interest payable.

3.12. In addition to the previously mentioned indicators for debt it is also important to be aware of the maturity structure of borrowing and limits places on fixed and variable rate debt. These are shown in Table 6 below.

Table 6 Maturity Structure of Debt and Limits on Fixed and Variable rate debt.

	31 March 2020	31 March 2021	31 March 2021
	Actual	**Approved**	**Actual**
Fixed Interest Borrowings:			
Under 12 months	0.00%	Up to 25%	0.00%
12 Months to 2 Years	0.00%	Up to 25%	0.00%
2 - 5 Years	0.00%	Up to 25%	0.00%
5 to 10 years	0.00%	Up to 100%	0.00%
10 to 20 years	0.00%	Up to 100%	0.00%
20 to 30 Years	6.25%	Up to 100%	6.25%
30 to 40 Years	93.75%	Up to 100%	93.75%
40 years plus	0.00%	Up to 100%	0.00%
	100.00%		**100.00%**
Limits on Borrowing at	**£m**	**£m**	**£m**
Fixed rate	12.8	30.4	12.8
Variable rate (maturing<1 year)	0	0	0

4. Investments

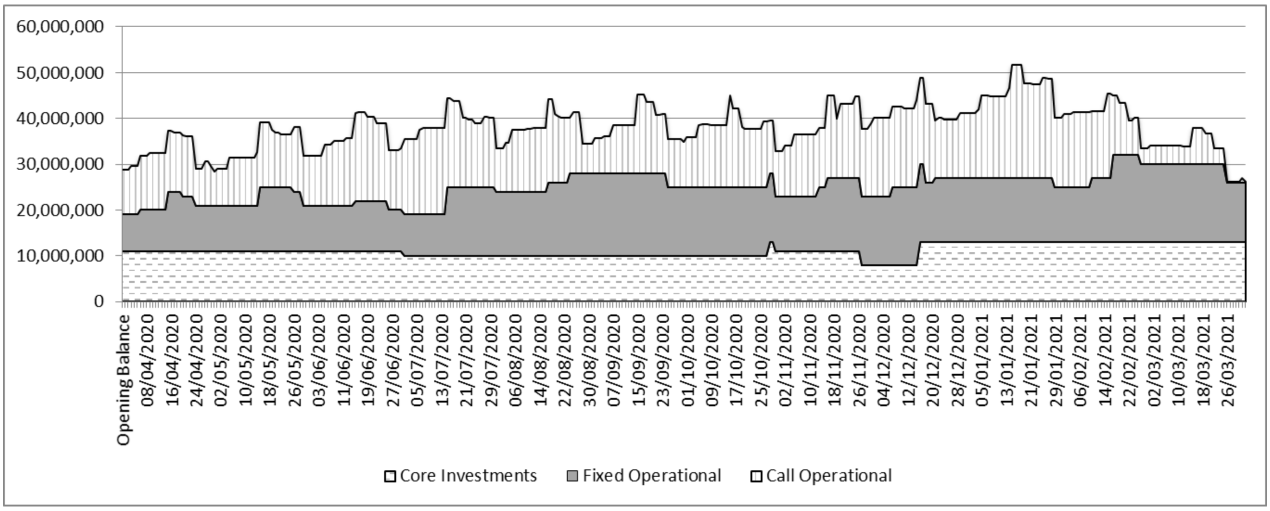
4.1. The Council's investments are all managed in house by the Council's finance team, with the objective to manage risk to ensure the security of investments and maintain adequate liquidity for revenue and capital activities. Procedures and controls to achieve this are well established both through member reporting and officer activity detailed in the Council's Treasury Management Practices.

4.2. At the beginning and end of 2020/21 the Council's investment position was as follows:

Table 7 Investment Position

	31 March 2020 Principal £000	Rate/ Return %	31 March 2021 Principal £000	Rate/ Return %
Call Accounts	9,798	0.71%	900	0.11%
Cash Flow (Operational)	8,000	0.81%	13,000	0.26%
Core Cash	11,000	0.91%	13,000	0.46%
Total Investments	**28,798**	**0.81%**	**26,900**	**0.25%**

4.3. Chart 1 shows how investment balances have fluctuated over the course of the year.



4.4. Investment returns remained low during 2020/21 with the Bank of England Bank Rate remaining at 0.10% resulting in the return on the investment of £96k, which is £135k below the budget of £221k. This is as a result of the reductions in bank rates in March 2020 in a bid to tackle the economic fall out of the Covid-19 pandemic.

4.5. However the Council's investments have outperformed the relevant benchmarks as shown in table 8, below. This is a result a stepped maturity profile for deposits.

Table 8 Investment Performance

	Average Annual Return	Benchmark	Variance
Call Accounts	0.11%	-0.08%	0.18%
Cash Flow (Operational)	0.26%	0.02%	0.24%
Core Cash	0.46%	0.07%	0.40%

Non-Treasury Investments

4.6. The Council owns and has previously purchased properties that are now classified as investments. These properties were purchased or developed for economic development reasons, to provide employment opportunities in areas where the market had failed to do so and are now classified as investment properties.

An example, is the investment in 2015 to create the Mint Works, which came about due to the Council recognising that there was a lack of start-up units for businesses in the district and stepping in to meet this need.

4.7. The Council continues to hold 25 investment properties with a fair value of £3.847m, all of which are within the boundaries of SLDC. After expenses the Council earned £0.214m in income from occupiers, creating a return on investment of 5.56% down from 8.32% in 2019/20. The return on investment has fallen as a result of not being able to let one site due to the national and local lockdowns for the Covid-19 Pandemic.

5. The Economy and Interest Rates

5.1. The expectation for interest rates within the treasury management strategy for 2020/21 was that Bank Rate would continue at the start of the year at 0.75% before rising to end 2022/23 at 1.25%. This forecast was invalidated by the Covid-19 pandemic which in March 2020 saw the Monetary Policy Committee cut Bank Rates, first to 0.25% and then to 0.10%, in order to counter the negative impact of the national lockdown on large swathes of the economy.

5.2. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with substantial amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The Government also supplied significant levels of grant funding 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, and as a result investment earnings rates plummeted.

5.3. The implementation of a vaccination programme in November 2020, 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. It is expected that the UK economy could recover its pre-pandemic level of economic activity in quarter 1 of 2022.

5.4. In August 2020 the Bank of England signified a change in its inflation targeting policy, with the following statement

*"it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and **achieving the 2% target sustainably**".*

This 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 bank rate increases with no increase expected until March 2024.

5.5. Inflation has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is expected to be a temporary short lived factor and so not a concern to the MPC.

5.6. Regarding Brexit a final agreement on 24th December 2020 eliminated a significant downside risk for the UK economy.

6. Conclusions

6.1. The Council has operated in line with its Treasury and Prudential Indicators and overall investments have performance over benchmark investment rates despite coming in under budget. This was down to the impact of the Covid-19 pandemic on the bank and money market rates.

6.2. The capital programme out-turn has led to no new borrowing being required as cash reserves have been used to fund capital. The borrowing position will continue to be kept under review.