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| Report of the Head of Finance  to  The Governance and Standards Committee  on  23 June 2021 |
| **TREASURY MANAGEMENT OUTTURN POSITION 2020/21** |

**1. SUMMARY**

* 1. This report summarises the transactions undertaken during the 2020/21 financial year as part of the Treasury Management function.

1.2 This report is required under the terms of the Treasury Management and Investment Strategy of the Council. This is to be submitted to full Council in line with the 2009 CIPFA Code of Practice on Treasury Management which was adopted by this Council on 4 March 2010 and to ensure that Members are advised of the impact of the Strategy and that it is being correctly implemented.

**Key decision:** This is not a key decision.

**2. RECOMMENDATION**

**To be resolved by the Governance and Standards Committee**

2.1 That the report be noted and recommended to Council in line with the 2009 CIPFA Code of Practice adopted by the Council.

**3. BACKGROUND**

3.1 The Council’s Treasury Management Strategy has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming year.

3.2 On the 3 March 2020 Council approved the 2020/21 Annual Treasury Management Strategy, which sets out the Treasury Management practices adopted by the Council. The Council’s investment priorities remain the security of capital and good liquidity. Whilst the Council will always seek to obtain the optimum return (yield) on its investments, this will at all times be commensurate with proper levels of security and liquidity.

3.3 The CIPFA Code also recommends that members be informed of Treasury activity and Prudential Indicators at least twice a year. Therefore, this report ensures that the Council is embracing best practice in accordance with CIPFA’s recommendations.

3.4 Treasury Management is defined as: “The management of the Council’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks”.

3.5 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the position at 31 March 2021 and highlights compliance with the Council’s policies.

**4. THE STRATEGY FOR 2020/2021**

4.1 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%.

4.2 This forecast was invalidated by the impact of the Covid-19 pandemic from 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.

4.3 The Government also supplied large 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.

4.4 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.

4.5 Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates. 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. THE ECONOMY AND INTEREST RATES**

5.1 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 extensive 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 was caused than in the first one. The advent of vaccines starting in November 2020, was 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.

5.2 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.

5.3 **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.

5.4 **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 cost in terms of the Government’s budget deficit significantly increasing in 2020/21 and 2021/22 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.

5.5 **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.

5.6 **EU.** Both the roll out and take up of vaccines has been slow in the EU in 2021 which 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.

5.7 **USA.** The US economy did not suffer as much damage as the UK economy due to the pandemic. A $1.9trn (8.8% of GDP) stimulus package was passed 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. It is also planned 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.

**6. BORROWING**

6.1 Long-term borrowing can only be undertaken by the Council to finance capital expenditure. The Council’s Capital Financing Requirement (CFR) represents its underlying need to borrow to finance capital investment as set out in the Treasury Management Strategy for 2020/21. During the period 1 April 2020 to 31 March 2021, no new loans were taken out.

6.2 Short term borrowing is occasionally required for cash flow purposes but the objective is to minimise such requirements in order to maximise interest returns and minimise interest costs. Between 1 April 2020 and 31 March 2021 no short term borrowing was required by the Council to meet its cash flow needs.

6.3 At 31 March 2021 the Council held £90.7m loans (a decrease of £6.0m on 31 March 2020). The amount owed by the Council has been built up over many years, reflecting the capital investment in the past and the interest rates available at the time.

6.4 The portfolio of loans is kept under review to assess whether it would be financially beneficial to restructure or repay any. Debt rescheduling opportunities are limited in the current economic climate and due to the structure of interest rates. Advice in this regard will continue to be taken from Link Asset Services (The Council’s Treasury Management Consultants). The premium charge for early repayment of PWLB debt remains relatively expensive for the loans in the Council’s portfolio and therefore unattractive for debt rescheduling activity. No debt rescheduling has been undertaken during the period from 1 April 2020 to 31 March 2021.

6.5 Tables 1 and 2 below summarise the long term borrowings outstanding as at 31 March 2021.





6.6 Details of the £90.652 million shown in the tables above are as follows:

* £86.016 million is borrowed from the PWLB.
* £136 thousand is short-term borrowing from the Racecourse Trust.
* £4.5 million is a market loan.

6.7 A £1.5 million PWLB loan is due for repayment on 23 November 2021, and a further £3.0 million PWLB loan on 28 March 2022.

**7. INVESTMENTS**

7.1 Due to the inherent risk involved in investing security of capital has remained the Council’s main investment objective. This has been maintained by following the Council’s counterparty policy as set out in its Treasury Management Strategy for 2020/21.

7.2 At 31 March 2021 the Council had a total of £27.994 million invested. Table 3 below shows where these investments were placed.



7.3 All the Council’s investments are within the agreed maximum limits as set out in the Annual Treasury Management Strategy for 2020/21.

7.4 21.4% (£6.0m) of the Council’s investments are currently held with the Debt Management Office (DMO). These are short-term investments of between 1 day and up to 2 months; these are timed to mature to meet specific items of expenditure such as Precept payments and monthly salaries.

7.5 24.98% (£6.994m) of the investments are held in an instant access call account with Svenska Handelsbanken; this is the highest rate of return the Council can achieve with this type of account and provides a balance that can be used instantly if any unexpected expenditure is incurred.

7.6 The remaining investments (£15m) are for periods of 3, 6 or 12 months, dependent upon credit ratings. This also provides better opportunity to take advantage of any increases in interest rates offered when the short-term investments mature.

7.7 The banking contract with Lloyds Bank was extended until March 2025 after a competitive tendering process was carried out.

7.8 In order for the Council to be able to meets its liabilities it was agreed that a maximum balance of £3 million could be held in the Lloyds current account.  This balance is in addition to the approved level of fixed term investments that can be held with the Lloyds banking group in accordance with the criteria as set out in the Treasury Management Strategy.

7.9 Appendix 2 is the Counterparty list at 31 March 2021 which uses information extracted from credit rating reports supplied by Link. This is updated on a weekly basis and shows all the counterparties that meet the minimum criteria for short term, long term and sovereign ratings as defined in the Annual Treasury Management Strategy. Some of these counterparties are unavailable to the Council for various reasons; such as minimum investment levels or minimum lengths of investments which are above the approved maximum limits.

**8. RATE OF RETURN**

8.1 The Head of Finance assesses the rates available from the market and the projected impact of rate changes in the future to determine the institution and period of investment to be made.

8.2 Table 4 shows the actual return on investments during 2018/19, 2019/20 and 2020/21 in comparison with the Base Rate, the 7-day money market rate and the rate provided by the Council’s bank; Lloyds PLC.



8.3 The average rate of return has decreased from 0.75% to 0.22% as a result of the Bank of England Monetary Policy Committee decreasing the bank rate by 0.65% in March 2020. Therefore, longer term investments achieved lower rates.

8.4 The budget for investment income for 2020/21 was £100,000 compared against actual investment income achieved of £54,921, a decrease of £115,059 over the income in 2019/20.

8.5 The Council received a newsflash update from Link on 31 March 2020, which included a review of its interest rate forecast following the initial Government and Bank of England response to the coronavirus epidemic, and on the assumption that the virus would be ‘defeated’ in the UK over a 6 to 12 months period. Forecasts were that the base rate would remain at 0.10% for at least the next 2 years.

8.6 Further newsflashes were received during the year, with the latest on 9 March 2021 extending the forecast for base rate to remain at 0.10% by an additional year to March 2024.

**9. PRUDENTIAL INDICATORS**

9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. Underpinning the Prudential system for borrowing is the fundamental objective that any investment in assets needs to be both affordable and remain within sustainable limits.

9.2 The Council sets its own affordable borrowing limits, which it monitors against actual performance. Two statutory borrowing limits are set, these are an Authorised Limit which should not be breached and an Operational Boundary which is based on the same estimates as the Authorised Limit but reflects the most likely (that is prudent) but not worst case scenario, without the additional headroom which is included in the Authorised Limit. The Prudential indicators are included in the Treasury Management Strategy, approved by Council on 3 March 2020.

9.3 During the financial year the Council has, at all times operated within the treasury limits and prudential indicators as set out in the Councils Treasury Management Strategy.

9.4 These indicators are based on estimates of expected outcomes and are key indicators of affordability. The outturn for the Prudential Indicators is shown in Appendix 1.

**10 OPTIONS AVAILABLE**

10.1 The transactions shown are historical and they were made in accordance with delegated powers and within the approved Treasury Management Practices and the CIPFA Code of Practice. As such these cannot be changed.

10.2 There are no indications that any of the investments made by the Council are in risk or not being repaid. Therefore, it is not proposed to take out money invested with existing financial institutions before its maturity date. This would result in penalties and the loss of interest if undertaken.

**11. RISK ASSESSMENT OF RECOMMENDATIONS AND OPTIONS**

**11.1 General Assessment of Risk**

11.1 In terms of risk; the collapse of financial institutions during 2008/09 and the subsequent ‘credit crunch’ has made the identification of those organisations which meet the Council’s requirements more difficult and the unstable economic climate throughout the world has meant that previously internationally regarded institutions and countries have had their ratings reduced or are on alert. Therefore, risks assessed in previous years as low have increased to the current assessment of medium in terms of likelihood and high in terms of financial impact and actions have been put in place to help address this increased risk.

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| Risk | Risk Assessment | Risk  Rating | Risk management |
| **Financial**  That the transactions shown are incorrect or inappropriate  That investments are lost due to placing money with institutions which are not secure | Impact on lawfulness of transactions and future decision making  Loss of Investments  High interest payments  Loss of investments in the current economic climate is a major issue as institutions fail as a result of the credit crunch and the economic situation in their countries | Low  Low  Low  Medium / High | Procedures are in place to ensure that only lawful and appropriate transactions take place in line with the Council’s Treasury Management and Investment Strategy and CIPFA Code on Treasury Management  Additional information is used from the Council’s Treasury Management consultants providing a weekly review of institutions.  A bi-monthly review of the Treasury Management positions and strategy is undertaken by senior Financial Services officers and changes made as appropriate. |
| **Reputational**  That the Council is borrowing from or investing with inappropriate organisations resulting in the loss of investments | Council assets need to be safe and there is confidence in their management. In the current climate there are few institutions which have retained either high ratings or stable outlooks.  In terms of reputation, the Council would be one of many major institutions affected by events over which there is little control | Medium | A bi-monthly review of the Treasury Management positions and strategy is undertaken by senior Financial Services officers and changes made as appropriate. |

**12. ALIGNMENT TO COUNCIL PRIORITIES**

12.1 The sound management of the Council’s cash is directly related to all the Council’s priorities.

**13. IMPLICATIONS**

1. Relevant Legislation: The adoption of CIPFA’s Code of Practices (both for Treasury Management and the Prudential Code) are a legislative requirement.
2. Human Rights: No impact
3. Equality and Diversity: No impact.
4. Climate change and environmental sustainability: No impact.
5. Crime and Disorder: No impact.
6. Budget / Resource: This report does not have any direct budgetary implications. Treasury Management activities however generate income from investments and incur cost of borrowing. Budgets are set based on known or anticipated market conditions and on the anticipated level of investments and borrowing during the year.

**14. COMMENTS OF STATUTORY OFFICERS**

**Deputy Section 151 Officer –** Investments placed within financial institutions have been done in line with the Treasury Management Strategy, which sets out the Treasury Management Practices adopted by this Council. The position of those financial institutions are monitored in conjunction with Link Asset Services, the Council’s Treasury Management Advisors.

**Deputy Monitoring Officer –** Treasury management is a critical responsibility of the Council and the measures outlined in this report provide assurance that effective control and management of the risks associated with those decisions are in place.

**15. CONSULTATION**

No consultation is required for this report.

**16. BACKGROUND PAPERS**

None

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**Appendix 1**







**Appendix 2**

