Agenda Item 4

Finance and Audit Scrutiny
Date of meeting: 11th August 2021

Title: Annual Treasury Management Report 2020/21
Lead Officer: Richard Wilson, Principal Accountant (Capital & Treasury) 01926 456801 or email richard.wilson@warwickdc.gov.uk
Portfolio Holder: Cllr Richard Hales & Cllr Mary Noone
Public report / Confidential report Public – not confidential
Wards of the District directly affected: All

Contrary to the policy framework: No
Contrary to the budgetary framework: No
Key Decision: Yes
Included within the Forward Plan: Yes Ref # 1233
Equality Impact Assessment Undertaken: No - not relevant
Consultation & Community Engagement:
Final Decision: No
Accessibility checked: Yes

Officer/Councillor Approval

Officer Approval	Date	Name
Chief Executive/Deputy Chief Executive	16/07/21	Andrew Jones
Head of Service	15/07/21	Mike Snow
CMT	16/07/21	
Section 151 Officer	15/07/21	Mike Snow
Monitoring Officer	16/07/21	Andrew Jones
Finance	21/07/21	Richard Wilson
Portfolio Holder(s)	22/07/21	Cllr Richard Hales & Cllr Mary Noone

1. Summary

1.1. The 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). This report covers the Council's performance for the whole of 2020/21 and is attached as Appendix A

2. Recommendation

2.1. That the Members of the Finance & Audit Scrutiny Committee note the contents of this report in respect of the Council's Treasury Management activities during 2020/21.

3. Reasons for the Recommendations

3.1. The Treasury Management Strategy for 2020/21 and the Council's Treasury Management Practices, in accordance with the Code of Practice for Treasury Management, require that the Treasury Management function reports on its activities during the year by no later than 30 September in the year after that being reported on. This date remains in place despite COVID-19.

3.2. 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 25/3/2020)
- a mid-year (minimum) treasury update report (Finance & Audit Scrutiny 11/11/2020)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

3.3. In addition, this Council receives a half-yearly treasury management update reports for the second half of 2020/21, which accompanies this report.

3.4. 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.

3.5. This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all the above treasury management reports by the Finance & Audit Scrutiny Committee before they were reported to the full Council.

3.6. Consideration of the Council's Treasury Management activities is within the remit of the Finance & Audit Scrutiny Committee on behalf of full Council; consequently, it is appropriate to report the Council's annual performance direct to this Committee.

3.7. The report comments, where appropriate, on the Council's actual performance against what was forecast in the 2020/21 Treasury Management Strategy as well as, in certain instances, latest forecasts. The Council is also required to comment on its performance against its Annual Investment Strategy for the year.

3.8. The report consists of the following Appendices:

Appendix A - Annual Treasury Management Report 2020/21
Appendix B – Glossary of Terms.

4. Policy Framework

4.1. **Fit For the Future (FFF)**

4.1.1. The Council's FFF Strategy is designed to deliver the Vision for the District of making it a Great Place to Live, Work and Visit. To that end amongst other things the FFF Strategy contains several Key projects. This report shows the way forward for implementing a significant part of one of the Council's Key projects.

4.1.2. The FFF Strategy has three strands – People, Services and Money and each has an external and internal element to it, the details of which can be found on the Council's website The table below illustrates the impact of this proposal if any in relation to the Council's FFF Strategy.

4.2. **FFF Strands**

4.2.1. **External impacts of proposals**

The Treasury Management function is an underpinning activity that enables the Council to meet its vision by maximising investment returns and minimising borrowing costs, while managing the risk to the Council's funds and maintaining liquidity, so that the Council can meet its financial obligations through a well-managed cash flow. This protects services and benefits the Council's customers and other stakeholders.

People - Health, Homes, Communities – Treasury Management indirectly enables financial resources to be ready for the Council to meet the following intended outcomes: Improved health for all; Housing needs for all met; Impressive cultural and sports activities; Cohesive and active communities.

Services - Green, Clean, Safe – Treasury Management is a support function towards to overall achievement of the Council's intended outcomes: Becoming a net-zero carbon organisation by 2025; Total carbon emissions within Warwick District are as close to zero as possible by 2030; Area has well looked after public spaces; All communities have access to decent open space; Improved air quality; Low levels of crime and ASB. In terms of becoming a net-zero carbon organisation, the Council aims to disinvest the equity funds from any carbon-related organisations at the earliest opportunity – and no later than the end of 2025 - that the current economic conditions allow, and seek new 'green' investment opportunities that meet the overarching Treasury Management framework that the Council must operate within.

Money - Infrastructure, Enterprise, Employment – Treasury Management is a fundamental part of effective money management and indirectly aids the following intended outcomes: Dynamic and diverse local economy; Vibrant town centres; Improved performance/productivity of local economy; Increased employment and income levels.

4.2.2. **Internal impacts of the proposals**

The Treasury Management function enables the Council to meet its vision, primarily through having suitably qualified and experienced staff deliver the service in accordance with the Council's Treasury Management Practices and the national framework that local government operates.

People - Effective Staff –All staff are properly trained; All staff have the appropriate tools; All staff are engaged, empowered and supported and that the right people are in the right job with the right skills and right behaviours. Staff have access to the Council's treasury management advisers, the Link Group, who provide additional support and training to staff and members.

Services - Maintain or Improve Services – Treasury Management indirectly helps with the following intended outcomes: Focusing on our customers' needs; Continuously improve our processes and Increase the digital provision of services.

Money - Firm Financial Footing over the Longer Term - Treasury Management is a fundamental part of effective both short and long term money management and indirectly aids the following intended outcomes: Better return/use of our assets; Full Cost accounting; Continued cost management; Maximise income earning opportunities and Seek best value for money.

4.3. **Supporting Strategies**

4.3.1. Each strand of the FFF Strategy has a number of supporting Strategies. The Treasury Management function is consistent with the relevant supporting strategies. Following the Treasury Management principles of Security, Liquidity and Yield (SLY) maximises financial stability in order for the Council to operate effectively.

4.4. **Changes to Existing Policies**

The Treasury Management function is in accordance with existing policies including the recommendation to divest from direct ownership of fossil fuels companies or commingled funds that include fossil fuel public equities and corporate bonds by *no later than* 2025, in pursuance of the Council's Climate Emergency Declaration.

4.5. **Impact Assessments**

There are no impacts of new or significant policy changes proposed in respect of equalities.

5. Budgetary Framework

5.1. The Treasury Management Strategy has a significant impact on the Council's budget through its objective of maximising investment income and minimising interest payable whilst ensuring the security and liquidity of financial resources.

5.2. The Council relies on interest received to fund the services it provides. The gross interest received in 2020/21, including non-Treasury Management interest, was £748,200. The interest paid to the HRA on its balances was £225,000, with a net of £523,200 retained by the General Fund. The table below compares this with budgeted figures:

	Original 2020/21 Budget £'000	Latest 2020/21 Budget £'000	2020/21 Actual £'000
Gross investment interest	945	602	748
less HRA allocation	-437	-155	-225
Net interest to General Fund	**508**	**447**	**523**

5.3. The reasons for the increase against the latest budget are a combination of higher than expected returns on investments, and higher than expected levels of year-end reserves and balances, especially for the HRA, in part due to a slower rate of capital expenditure than assumed.

5.4. Borrowing costs to the HRA from the 2012 Self-Financing of £4.766m are unchanged from previous financial years and are charged directly to the HRA. The expected borrowing for new HRA capital expenditure had not been drawn down as at 31 March 2021. The £12 million PWLB loan taken during 2019/20 is charged to the General Fund and the full year interest costs are £220,800.

6. Risk Management

6.1. The Council maintained a cautious approach, as advocated by the regulatory framework, given experience from the 2008 financial crisis and the COVID-19 pandemic, with investments subject to low counterparty risk considerations, with relatively low returns compared to borrowing rates.

6.2. Investing the Council's funds unavoidably creates some risk, as would simply leaving the funds in a bank account. Treasury Management aims to manages risk through the application of the SLY principle: Security(S) ranks uppermost followed by Liquidity (L) and finally Yield(Y).

6.3. In addition to credit ratings themselves, the Council has regard to any ratings watch notices issued by the rating agencies, as well as articles in the Financial press, market data and intelligence from benchmarking groups. It will also use Credit Default Swap (CDS) data as supplied by its treasury advisers (Link Asset Services) to determine the suitability of investing with counterparties.

6.4. Although not used in 2020/21, Corporate Bonds and Floating Rate Notes (FRNs) introduce counterparty credit risk into the portfolio by virtue of the fact that it is possible that the institution invested in could become bankrupt, leading to the loss of all or part of the Council's investment. This is mitigated by only investing in Corporate Bonds or FRNs with a strong Fitch credit rating, in this case 'A', and issued as Senior Unsecured debt which ranks above all other debt in the case of a bankruptcy.

6.5. Covered Bonds also reduce risk since the bond is 'backed' by high quality assets such as prime residential mortgages, ensuring that if the bond issuer defaults there are sufficient assets that can be realised in order to repay the bond in full. Again, these were not used during 2020/21.

6.6. While Corporate Equity Funds can help to ensure capital security in real (as opposed to nominal) terms, they can risk capital loss due to market price fluctuations. This was evidenced with extreme movements worldwide in March 2020 as the extent and far-reaching consequences of COVID-19 saw investors ‘take flight’. However, 2020/21 experienced a significant recovery for both equity funds, demonstrating that this type of investment must be regarded as a relatively long-term commitment to smooth out movements such as those seen over the last 18 months, both cyclical and in response to crises.

6.7. Under current (temporary) five-year accounting requirements, the Council is required to take revaluation gains or losses to the Financial Instruments Revaluation Reserve, which has lessened the likely use of the Investment Rate Volatility Reserve, set up in February 2018 to mitigate against any adverse losses. Further details are contained in Appendix A.

7. Alternative Option(s) considered

7.1. As explained in section 1 and paragraph 3.1, the Code of Practice mandates that Annual Treasury Management Performance must be reported by 30 September after that financial year has closed.

7.2. The Council has announced that it will seek to divest from fossil fuels at the earliest opportunity; no later than the end of 2025, and ideally by the end of 2022. The previous heavy losses that the General Fund would have incurred from divestment from these Funds at 31 March 2020 are not currently an issue at the time of writing due to the current valuations of the funds. The limiting factor is now staff capacity around other key priorities, including the new finance system, the audit of the 2020/21 Statement of Accounts and work in support of the Warwick/Stratford Councils alignment.

7.3. The Council may consider varying its investment vehicles or counterparty limits; however this would alter the potential credit and liquidity risks.

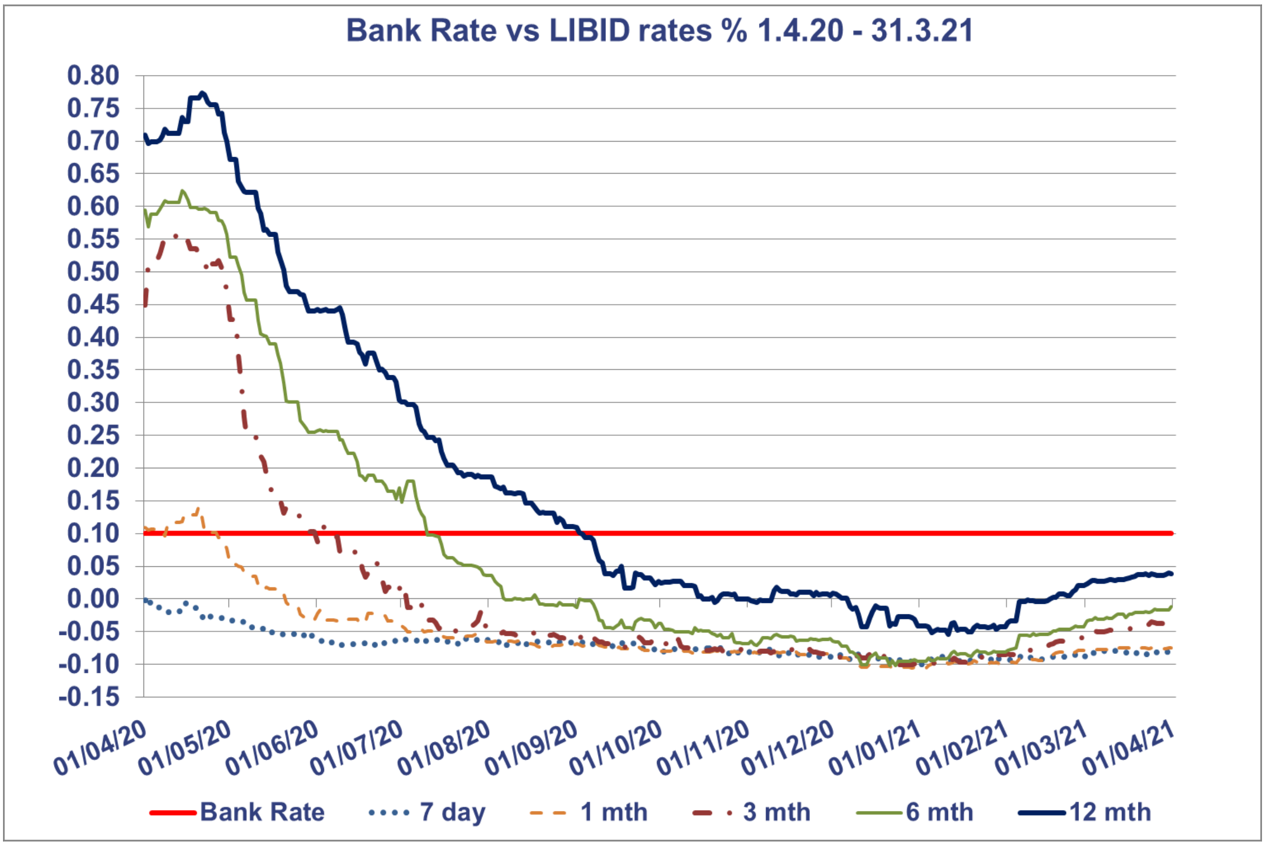
Appendix A

2020/21 Annual Treasury Management Report

1. Investment strategy and control of interest rate risk

1.1. 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%.

1.2. 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. The tables below shows rate movements during the year:



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	-	0.14	0.56	0.62	0.77
High Date	1/4/20	2/4/20	20/4/20	8/4/20	14/4/20	21/4/20
Low	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
Low Date	1/4/20	31/12/20	29/12/20	23/12/20	21/12/20	11/1/21
Average	0.10	-0.07	-0.05	0.01	0.07	0.17
Spread	-	0.10	0.25	0.66	0.73	0.83

1.3. With taking a cautious approach to investing, the Council is 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 2008 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.

1.4. 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, i.e. borrowing is deferred. External borrowing would have incurred an additional carrying 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.

2. Borrowing strategy and control of interest rate risk

2.1. During the last financial year 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 low and minimising counterparty risk on placing investments also needed to be considered.

2.2. A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns. This must be balanced against potential interest rate increases, which could cause higher interest costs once long-term loans are taken.

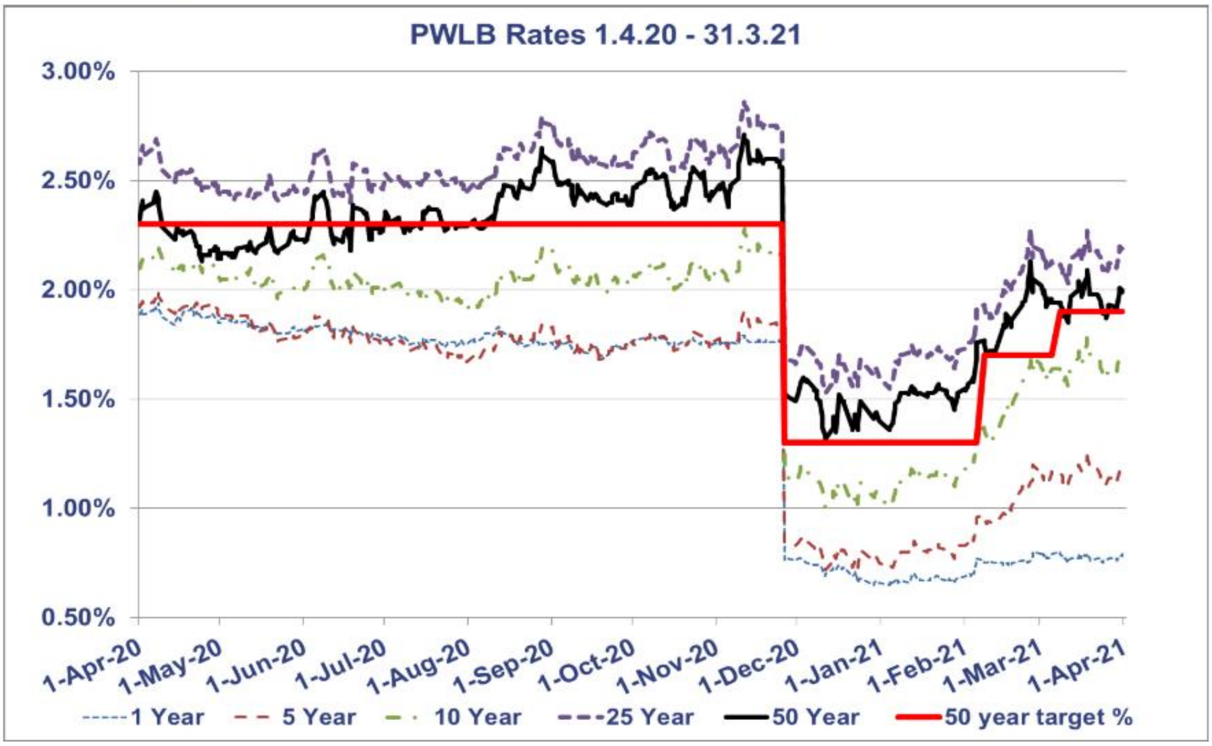
2.3. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure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

2.4. Against this background and the risks within the economic forecast, caution was adopted with the Treasury operations. The Treasury team monitored interest rates in financial markets and adopted a pragmatic strategy based on the following principle to manage interest rate risks:

- During 2020/21 advice stated that there was a limited risk of a significant change in long and short term rates than expected. Therefore, it was decided to postpone the draw down of further long-term General Fund or HRA, to minimise these additional debt holding costs.

2.5. 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	11.8.20										
	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month average earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
6 Month LIBID	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
12 Month LIBID	0.20	0.20	0.20	0.20	0.20	0.20	0.20	-	-	-	-
5yr PWLB Rate	1.90	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50



2.6. 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. Over the last two years we have seen 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.

2.7. 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.

2.8. 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%.

2.9. 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 9 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 11 March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and on 25 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:** gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate:** gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate:** gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate:** gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate:** gilt plus 60bps (G+60bps)

2.10. 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% until September 2023 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.

3. Borrowing Outturn

3.1. **Borrowing** – Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year. There is no naturally maturing debt until 2053.

3.2. **Rescheduling** - No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling economically unviable. This is expected to remain the case for several years.

3.3. **Summary of debt transactions** – The £148.157m debt portfolio had an average interest rate of 3.28% and incurred £4.986m interest in cash terms, of which £4.766m was charged to the HRA, relating to the Self-Financing borrowing incurred in 2011/12.

4. Investment Outturn

4.1. **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 25 March 2020. The 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.).

4.2. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

4.3. **Resources** – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as below, showing an increase of £11.689 million (16.7%):

Balance Sheet Resources	31/3/20 £'000	31/3/21 £'000	Movement £'000
Balances (GF, Collection Fund)	1,174	-5,250	-6,424
Balances (HRA)	7,983	7,507	-476
Earmarked reserves / other balances$	47,872	67,309	19,437
Provisions	5,656	4,235	-1,421
Capital Receipts Reserve	7,257	7,830	573
Total	**69,942**	**81,631**	**11,689**

$ - see paragraph 8.13 for more information

4.4. **Investments held by the Council**

- The Council maintained an average balance of £75.5m of internally managed funds.
- The internally managed funds earned an average rate of return of 0.47%.
- The comparable performance indicator is the average 7-day and up to 3-months LIBID rate, which was 0.17%.
- This compares with a latest budget assumption of £82.1m investment balances earning an average rate of 0.54%.
- Investment income excluding externally managed funds and non-treasury management interest was £523,200, compared to a latest budget of £447,200.
- During 2020/21 the Council made investments of £245.826m and had repayments of £264.114m, a net reduction of £18.288m.

4.5. **Investments held by fund managers**

The Council uses two external fund managers to invest part of its cash balances. The performance of the managers (capital movement and dividend) against the benchmark FTSE All-Share return was:

Fund Manager	Investment held (nominal) £'000	Return	Benchmark
Columbia Threadneedle	3,000	23.5%	18.2%
Royal London	3,000	22.3%	18.2%
Total	**6,000**	**22.9%**	**18.2%**

4.6. The budget assumption on the average investment balances of £6.0m was a 3.75% dividend investment return and the actual return was 3.77%. However, in a reversal of the 2019/20 position, this was been dwarfed by unrealised capital gains of £1.3m (excluding dividends), as shown below, offsetting the even larger on-paper 'loss' for 2019/20:

Fund Manager	Balance at 31/3/20 £'000	Dividend 20/21 £'000	Gain £'000	Balance at 31/3/21 £'000
Columbia Threadneedle	2,569	96	692	3,357
Royal London	2,553	97	634	3,284
Total	**5,122**	**193**	**1,326**	**6,641**

4.7. Due to the statutory override in place (see paragraph 5.2 below) this 'gain' or 'loss' in capital value does not have to be charged to revenue in the year, shielding the Council Tax charge from short-term fluctuations, but should the equity funds be disposed of any gains or losses actually realised do have to be charged to revenue in that year.

4.8. The amount of the two equity funds invested in fossil fuels at 31 March 2021 was 4.9% for Columbia Threadneedle and 6.5% for Royal London; for reference at 31 March 2020 the respective figures were 4.9% and 8.6%.

5. Other Issues

5.1. **IFRS 9** – The introduction of the 2020/21 Accounting Code of Practice affected the valuation of investments. The key considerations for this Council were:

- Expected credit loss (ECL) model. Whilst this should not be material for the Council's routine 'vanilla' treasury investments such as bank deposits, this is likely to be problematic for some funds that are not currently used (e.g. property funds), and also for non-treasury management investments dealt with in the Council's capital strategy e.g. longer dated service investments, loans to third parties or loans to subsidiaries (see paragraph 5.3 below). The Council's assessment of the ECL of investments was that the level of the potential impairment was immaterial.
- The valuation of investments previously valued under the 'available for sale' category - e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar - has been changed to Fair Value through the Profit and Loss (FVPL).

5.2. Following the consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG), on IFRS 9 the Government introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds, effective from 1 April 2018. The statutory override currently applies for five years from this date, subject to any further extension. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve (the Financial Instruments Revaluation Reserve) throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency. The net gain credited in 2020/21 was £1,309,549, reducing the cumulative 'loss' at 31 March 2021 to £94,585.

5.3. **Non-treasury management investments**. These predominantly include long-term debtors, where the borrower repays interest in addition to the principal lent to them. All interest rates are above "soft loan" rates (defined as preferential terms below normal 'market' rates). During 2020/21 the Council made new long-term loans for capital purposes of £350,000. Details of these loans and the due diligence taken is outlined in the Statement of Accounts 2020/21; none have required impairment under the IFRS 9 ECL model. The purpose of these loans is to stimulate economic development in the District rather than an overriding purpose of income generation, which is a minor consideration with these loans.

5.4. Paragraph 2.9 above outlines the Government's response to its consultation on PWLB lending to local government, preventing a council deemed to be borrowing 'Debt For Yield' (i.e. in order to make a *commercial* return) over its 3-year capital programme ,will be prevented from taking **any** PWLB borrowing in that financial year, even for housing purposes, and would have to repay any loans already taken (with a premium). Given the Council's deferred and pending borrowing requirements, this is a significant consideration.

6. Capital expenditure and financing

6.1. 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.

6.2. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure of £44.760m and how this was financed.

Capital expenditure	**2019/20 Actual £'000**	**2020/21 Budget £'000**	**2020/21 Actual £'000**
General Fund	7,671	17,279	11,275
HRA	20,183	37,277	33,135
Commercial activities* / non-financial investments (long-term loans to third parties)	530	350	350
Total (A)	**28,384**	**54,906**	**44,760**

* The Council has not made any 'commercial activities' where yield is the primary purpose

Financing of capital expenditure	2019/20 Actual £'000	2020/21 Budget £'000	2020/21 Actual £'000
Capital receipts	3,641	1,895	815
Capital grants and contributions	5,537	11,458	5,215
Reserves	18,367	14,395	9,528
Revenue contributions	298	336	422
Subtotal (B)	**27,843**	**28,084**	**15,980**
Net borrowing need for the year (A – B)	**541**	**26,822**	**28,780**

7. Treasury limits and prudential indicators

7.1. The Prudential Capital Finance system, introduced in 2004, is regulated by a number of 'Prudential Indicators', a number of which are relevant for treasury management purposes and are included in the Annual Strategy Report. The table below shows the 2020/21 outturn against the budget and previous year's budget:

Prudential Indicators (1)	2019/20 Actual £'000	2020/21 Budget £'000	2020/21 Actual £'000
Authorised Limit for External Debt			
Borrowing	192,728	283,907	283,907
Other Long term Liabilities	30	1,012	1,012
Total	**192,758**	**284,919**	**284,919**
Operational Boundary for External Debt			
Borrowing	173,728	261,907	261,907
Other Long term Liabilities	30	1,012	1,012
Total	**173,758**	**262,919**	**262,919**
Actual External Debt at Year End			
Long Term Borrowing	148,157	175,639	148,157
Long Term Liabilities	30	30	12
Total	**148,187**	**175,669**	**148,169**

7.2. Due to the delay in some capital expenditure and the deferral of existing borrowing requirements, actual external debt did not increase during the year and did not exceed either the Authorised Limit or the Operational Boundary.

Prudential Indicators (2)	**2019/20 Actual £'000**	**2020/21 Budget £'000**	**2020/21 Actual £'000**
Actual Capital Expenditure for Year			
General Fund	8,201	17,629	11,625
Housing Revenue Account	20,183	37,277	33,135
Overall	**28,384**	**54,906**	**44,760**
Capital Financing Requirement			
General Fund	20,676	88,802	23,836
Housing Revenue Account	135,738	158,952	161,160
Total CFR	**156,414**	**247,754**	**184,996**
Gross borrowing position	148,187	175,669	148,169
Under (-) / over funding of CFR	-8,227	-72,085	-36,827

7.3. The under funding of £36.827m represents borrowing for capital expenditure already incurred that has not yet been taken, relying on 'internal borrowing'.

Prudential Indicators (3)	**2019/20 Actual %**	**2020/21 Budget %**	**2020/21 Actual %**
Financing Costs as a % of Net Revenue Stream			
General Fund	-1.87%	0.81%	-0.31%
Housing Revenue Account	38.40%	42.01%	39.01%
Overall	**24.85%**	**24.16%**	**17.53%**

7.4. As no new borrowing took place in the year the actual financing costs were below budget and only slightly higher than for the previous financial year.

7.5. The indicators were complied with, as the only external borrowing outstanding at the year-end was the pre-existing £136.157m PWLB debt in respect of the HRA Self Financing Payment and new £12m General Fund PWLB debt for previous expenditure on leisure centres. This debt is all fixed rate, maturing from years 33 to 42 (2053 to 2062) and, therefore, within indicators shown above.

7.6. Below are the indicators relating to borrowing:

Upper limit to fixed interest rate and variable interest rate exposures

Exposure limits	**Strategy Report**	**Actual**
Upper Limit Fixed Rate	100%	100%
Upper Limit Variable Rate	30%	30%

Upper and lower limits respectively for the maturity structure of borrowing

Strategy 2020/21	Fixed		Variable	
Period	**Upper**	**Lower**	**Upper**	**Lower**
Under 12 months	20%	0%	100%	0%
12 months and within 24 months	20%	0%	100%	0%
24 months and within 5 years	20%	0%	100%	0%
5 years and within 10 years	20%	0%	100%	0%
10 years and above	100%	0%	n/a	n/a

7.7. The final indicator monitors the amount invested for periods longer than 365 days which in 2020/21 was set at 70% of the investment portfolio subject to a maximum of £30 million at any one time. During 2020/21 the Council entered into no investments for 365 days or over, assuring compliance with the indicator.

8. Annual investment strategy and investment performance

8.1. The Government guidance on local government investments requires the production of an Annual Investment Strategy that includes an outline of the investment vehicles that the Council would use and separates them off into Specified and Non-Specified investments. The 2020/21 Annual Investment Strategy was approved in March 2020.

8.2. The in-house function has invested the Council's cash funds in fixed term money market deposits, equity funds and Money Market Funds. No Corporate Bonds or Certificates of Deposit (CD's) were used during 2020/21. The table below illustrates the performance for the year of the in-house function for each category invested in (please refer to the second half year report for a detailed breakdown):

Vehicle	Return (annualised) £'000	Benchmark (annualised) £'000	Perform-ance £'000
Money Markets	9.2	7.8	1.5
Money Market Funds	15.3	28.8	-13.5
Call Accounts	0.6	1.5	-0.9
Total	**25.2**	**38.1**	**-12.9**

8.3. **Money Market Investments**: the outperformance below was in the period up to 6 months, mostly where we had locked into longer rates before the COVID-19 crisis struck.

Period	**Investment Return** (annualised)	**LIBID Benchmark** (annualised)	**Out/(under) performance**
Up to 7 days			
Annual performance	-	0.05%	n/a
Annual interest	£0	£0	£0
Over 7 days & up to 3 months			
Annual performance	0.38%	0.17%	0.21%
Annual interest	£3,710	£1,678	£2,032
Over 3 months & up to 6 months			
Annual performance	0.39%	0.19%	0.20%
Annual interest	£36,929	£17,758	£19,171
Over 6 months to 365 days			
Annual performance	0.23%	0.34%	-0.11%
Annual interest	£20,676	£30,197	-£9,521
366 days and Over			
Annual performance	-	-	n/a
Annual interest	£0	£0	£0
Total Interest For Year	**£61,315**	**£49,633**	**£11,682**

8.4. **Money Market Funds**: Under IFRS 9 there were changes to investment categories, with most Constant Net Asset Value (CNAV) funds, other than those invested in Government bonds, being re-categorised as Low Volatility Net Asset Value (LVNAV).

8.5. The in-house function utilised AAA rated LVNAV (Deutsche, Goldman Sachs, Invesco, Standard Life and Federated) Money Market Funds and Variable Net Asset Value, VNAV, (Federated and Royal London) funds to assist in managing its short term liquidity needs.

8.6. The table below illustrates the performance of these funds for the full year:

Money Market Fund	Investment Return (annualised)	LIBID Benchmark (annualised)	Out/(under) performance
Deutsche			
Annual performance	0.06%	0.08%	-0.02%
Annual interest	£3,250	£4,933	-£1,683
Goldman Sachs			
Annual performance	0.09%	0.08%	0.01%
Annual interest	£520	£471	£49
Invesco			
Annual performance	0.11%	0.08%	0.03%
Annual interest	£8,140	£5,448	£2,692
Standard Life			
Annual performance	0.13%	0.08%	0.05%
Annual interest	£13,078	£7,683	£5,395
Federated Constant Net Asset Value (CNAV)			
Annual performance	0.15%	0.08%	0.07%
Annual interest	£4,800	£2,565	£2,235
Federated Variable Net Asset Value (VNAV)			
Annual performance	0.27%	0.08%	0.19%
Annual interest	£16,438	£4,745	£11,693
Royal London Cash Plus Account (VNAV)			
Annual performance	1.23%	0.08%	1.15%
Annual interest	£74,859	£4,778	£70,081
Total Interest For Year	**£121,085**	**£30,623**	**£90,462**

8.7. The 'Up to 7 days' LIBID rate is the benchmark for the LV/CNAV funds and it can be seen that they all made returns in excess of this. The VNAV fund benchmark is based on the 6 month LIBID rate (plus a margin of 0.0625%) and the returns include fees and so are not directly comparable with the benchmark.

8.8. **Call Accounts**: The Council operates two Call accounts with HSBC and Svenska Handelsbanken. In the case of the HSBC account interest is no longer paid but it does offer a relatively low risk place for surplus balances. The Svenska Handelsbanken account is a 35-day notice account that became less attractive against the rate available in the Money Markets for three-month fixed investments. The performance of these call accounts are shown in the table below:

Call Account	Investment Return (annualised)	LIBID Benchmark (annualised)	Out/(under) performance
HSBC Business Deposit Account			
Rate for year	-	0.07%	-0.07%
Value of interest earned in year	£0	£127	-£127
Svenska Handelsbanken Account			
Rate for year	0.07%	0.07%	-
Value of interest earned in year	£684	£1,447	-£763
Total Interest For Year	**£684**	**£1,574**	**-£890**

8.9. The Annual Investment Strategy (Appendix B of the Treasury Management Strategy 2020/21) anticipated that the Council would have an average investment balance of £66.9m during the year. The actual average investment balance was £75.5m due, in part, to lower HRA capital expenditure than anticipated and additional Government grants.

8.10. Paragraph 3.11 of the Annual Investment Strategy makes reference to a 70% maximum long term investments holding for 'non-specified' investments, with a cap of £30m. Based on the average investment balance of £75.5m, a maximum of £30.0m could have been invested for more than 365 days at any one time. However, there were no investments during the year for more than 365 days, due to expectations that core investment balances would be minimal towards the end of the year. Therefore, the Council did not exceed the 70% limit on longer term investments, nor did it contravene the requirement to hold at least 30% of its portfolio in short term (365 days or less) investments.

In-House Investment Returns:

8.11. The Annual Investment Strategy, approved in March 2020, anticipated that the in-house portfolio would achieve a 0.76% return for 2020/21. The actual rate was 0.69%, as shown below:

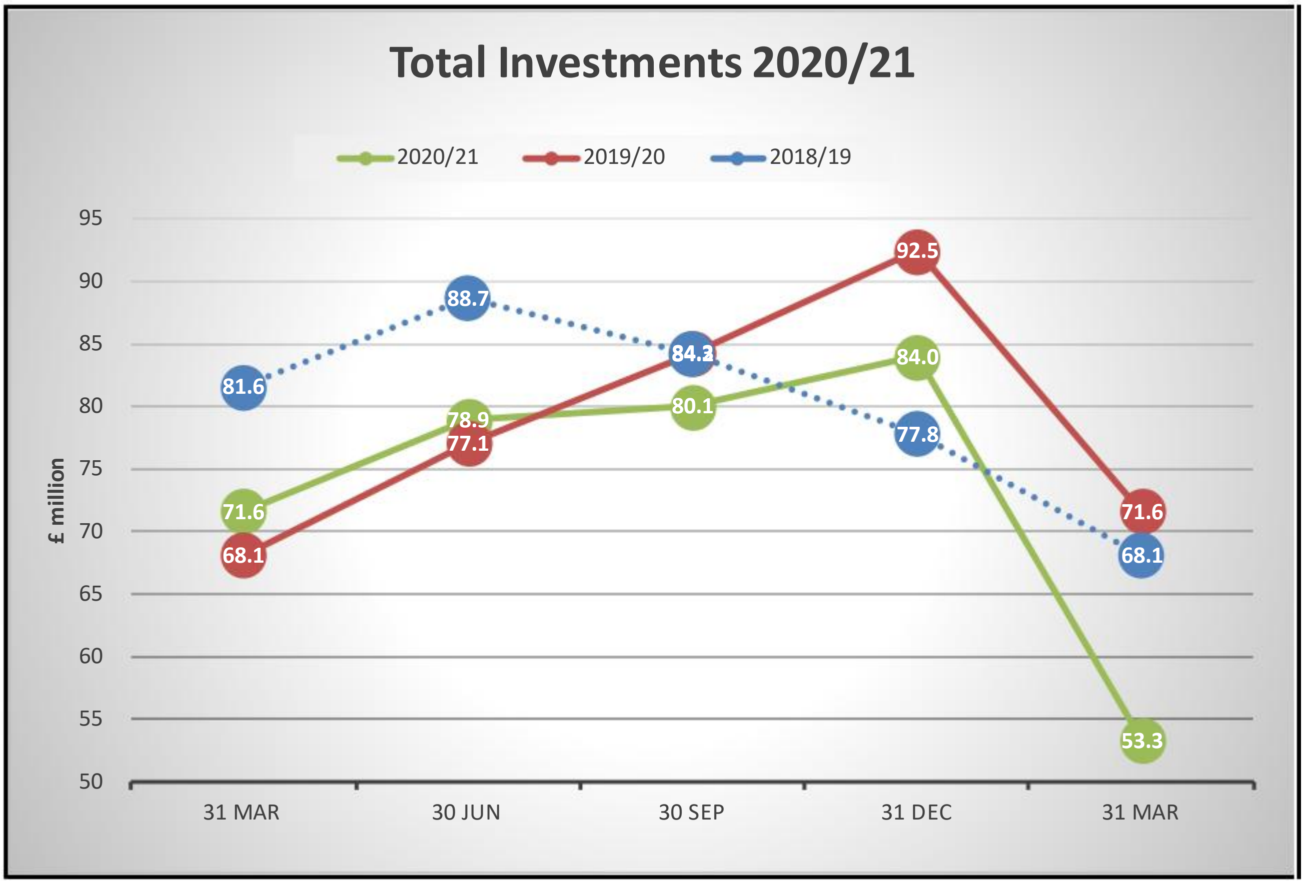
Year	Interest Received £'000	Interest Rate Achieved %
2019/20 Actual	737.6	0.93%
2020/21 Original	508.1	0.76%
2020/21 Latest	447.2	0.54%
2020/21 Outturn	523.2	0.69%

8.12. An analysis of the overall investments of the Council as at 31 March 2021, split between in-house and externally managed, is shown in the table below, with the previous half-year figures shown for comparison purposes:

Fund	Closing Balance 31 Mar 21 £'000	Closing Balance 30 Sept 20 £'000
Money Markets	33,000	35,503
Money Market Funds	12,334	35,561
Business Reserve Accounts incl. Call Accounts	2,003	3,000
Total In House Investments	**47,337**	**74,064**
Corporate Equity Funds (nominal)	6,000	6,000
Total Investments	**53,337**	**80,064**

8.13. The performance of the corporate equity funds was discussed in paragraphs 4.5 to 4.8 above.

8.14. The graph below shows how the total of the Council's investments varies through the year according to its cash flows, comparing 2020/21 (green solid line) with the previous two years (2019/20 red solid, 2018/19 blue dots). It shows that during the first quarter of the financial year (April to June) the Council's investments were above 2019/20 but then below that year's values, falling significantly in the last quarter of 2020/21, when capital expenditure, especially HRA purchase, excelerated and exceeded routine flows in from Council Tax, NNDR and COVID-19 related Government grants. In terms of the latter, the Council does have larger than usual balances being carried forward in the Business Rate Retention Volatility Reserve for these, and it is expected that these will be depleted over the next couple of years, putting additional pressures on cash balances. Some of the depletion in balances will be addressed when loans from the PWLB are taken, to replace 'internal borrowing'.



9. Equity Funds

9.1. The two equity funds commenced in April 2017, each with a £3m nominal balance. Paragraphs 4.5 to 4.7 show the returns for 2020/21. The half-year treasury management report to this meeting has more details on these funds in section 11.

Fund	Value of Fund 31 Mar 21 £'000	Value of Fund 31 Mar 20 £'000
Royal London UK Equity Fund	3,284.0	2,552.8
Columbia Threadneedle UK Equity Income Fund	3,356.8	2,568.7
Total Equity Funds	**6,640.8**	**5,121.5**

9.2. For comparison purposes, the total value of funds at 30 September 2020 was £5.507m.

9.3. History has shown that these funds may present volatile returns over the short-term, as witnessed by the last 18 months, but in the long-term they provide returns greater than many other investment instruments. Also, equity funds are perceived to be less risky and more liquid that other similar 'pooled' investment vehicles, such as property funds.

9.4. The inclusion of corporate equity funds in the Council's Investment Strategy was on the basis that these funds should be held for at least five years. To 'cash-out' early to meet the Climate Change Emergency Declaration may have a significant financial cost if financial markets suffer another reversal of fortune, which will need to be monitored. More details are in paragraph 5.2 above.

10. Performance measurement

10.1. In addition to the in-house local benchmarks referred to in this document the Council participates in the Link Group Investment Benchmarking Club. This benchmarks the investment returns and also the maturity and credit risk inherent in the portfolio. The Council is part of a local group which consists of district and county councils and this Council's performance over the past year is reflected in the tables below:

Table A - Weighted Average Rate of Return (WARoR)

	WDC WARoR %	Local Group WARoR %	Link Asset Services Model WARoR %	Performance against Link Asset Services Model Band
June Quarter	0.72	0.53	0.51	Above
September Quarter	0.44	0.37	0.31	Above
December Quarter	0.27	0.26	0.21	Above
March Quarter	0.13	0.36	0.18	Inline
Average for Year	**0.39**	**0.38**	**0.30**	

10.2. Table A shows that the Council's average return was above Link Group model portfolio rate of return and comparable with the local group, based on the risk in its portfolio. However, this has to be assessed against the slightly lower average credit risk taken in this Council's portfolio, as shown below.

Table B - Weighted Average Credit Risk

	WDC	Local Group
June Quarter	2.59	2.34
September Quarter	2.51	2.46
December Quarter	1.96	2.28
March Quarter	2.33	2.50
Average for Year	**2.35**	**2.40**

10.3. This benchmark measures the average credit risk in the portfolio according to the institutions invested in and corresponds to the duration limits in Link Group's suggested credit methodology using a sliding scale of 1 to 7 where 1 indicates the least risk of default.

11. External treasury management advisers

11.1. Link Group continues to provide our Treasury Management Advisory service.

Appendix B

Glossary of Treasury Management related terms

LAS: Link Asset Services, Treasury Solutions – the Council's treasury management advisers.

CE: Capital Economics - is the economics consultancy that provides Link Asset Services, 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.

CNAV: Constant Net Asset Value refers to funds that use amortised cost accounting to value all of their assets. They aim to maintain a Net Asset Value (NAV), or value of a share of the fund, at £1 (or currency equivalent) unless mark-to-market pricing of underlying assets moves outside of stipulated boundaries, and calculate their price to 2 decimal places, known as 'penny rounding'. Typical examples of such funds are government Money Market Funds.

COVID-19: a highly infectious respiratory disease caused by a new coronavirus. The disease was discovered in China in December 2019 and then spread around the world to become a pandemic, causing an unprecedented public health crisis and major economic impacts.

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.

Financial Instruments Revaluation Reserve: IFRS 9 'Financial Instruments – earmarking of gains not available to fund services' specifies that balances in the General Fund (or HRA balance) relating to unrealised, or volatile, gains from financial instruments classified as 'fair value through profit or loss' should be earmarked and not regarded as available to fund services. The Financial Instruments Revaluation Reserve (FIRR) holds the ciuumulative value of such gains or losses.

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.

FTSE: The Financial Times Stock Exchange, now known as FTSE Russell Group, is a British financial organization that specializes in providing index offerings for the global financial markets Informally known as the "Footsie".

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 - United States, Canada, France, Germany, Italy, Japan, and 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.

HRA: Housing Revenue Account.

IFRS: International Financial Reporting Standard.

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

LIBID: The London Inter Bank 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).

LIBOR: The London Inter Bank Offered Rate is the interest rate at which banks offer to lend funds (wholesale money) to one another in the international interbank market. It is a key benchmark rate that reflects how much it costs banks to borrow from each other but in the UK is expected to be replaced by SONIA. Outside the London markey this is referred to as IBOR.

LVNAV: Low Volatility Net Asset Value (LVNAV) Money Market Funds are short-term MMFs. Funds are primarily invested in money market instruments, deposits and other short-term assets. Units in the fund are purchased or redeemed at a constant price so long as the value of the underlying assets do not deviate by more than 0.2% (20bps) from par (i.e. 1.00).

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).

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.

SONIA: Sterling Over Night Index Average is the effective reference for overnight indexed swaps for unsecured transactions in the Sterling market. The SONIA itself is a risk-free rate. Unlike LIBOR it is backward looking measure.

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.

VNAV: While CNAV and LVNAV funds use amortised cost accounting to value most or all of their assets, Variable Net Asset Value (VNAV) funds use mark-to-market pricing, meaning the unit price will change in light of changes to mark-to-market valuation of underlying assets, and dealing prices for VNAV funds are rounded to four decimal places. All funds except select types of Money Market Funds are priced on this basis.

VRP: A Voluntary Revenue Provision to repay debt, in the annual budget, which is additional to the annual MRP charge (see above definition).