REPORT

SUBJECT:	**TREASURY OUTTURN REPORT 2020/21**
MEETING:	**Governance & Audit Committee**
DATE:	**3rd November 2021**
DIVISIONS/WARD AFFECTED:	**All**

1. PURPOSE:

1.1. During 2020/21, the Council's treasury management activity was underpinned by CIPFA's Code of Practice on Treasury Management 2011 ("the Code"), which required local authorities to annually produce Prudential Indicators and a Treasury Management Strategy Statement on their likely financing and investment activity. The Code also recommended that members are informed of treasury management activities at least twice a year. The S151 Officer reports twice a year (mid-year report and this year-end report) on Treasury activity to the Governance & Audit Committee who provide scrutiny of treasury policy, strategy and activity on behalf of the Council.

2. RECOMMENDATIONS:

2.1. That Governance & Audit Committee note the results of treasury management activities and the performance achieved in 2020/21 as part of their delegated responsibility to provide scrutiny of treasury policy, strategy and activity on behalf of the Council.

3. SUMMARY OF ISSUES:

3.1. In respect of external influences, the COVID-19 pandemic dominated 2020/21 and was the driving influence behind economic conditions experienced during the year. Alongside this, and for the first three quarters of the year Brexit negotiations continued to add to the uncertainty experienced in the UK economy, with a trade deal only being agreed in December 2020.

3.2. The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting.

3.3. Government initiatives supported the economy and the Chancellor announced in the 2021 Budget a further extension to the furlough (Coronavirus Job Retention) scheme until September 2021. Access to support grants for various sectors continued during the year with the Authority itself benefiting from £20m of grant funding from the Welsh Governments Local Government Hardship Fund whilst also passporting more than £41m to other businesses and individuals in the County.

3.4. Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

3.5. In a local context the treasury strategy of the Authority remained as keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce counterparty risk and keep interest costs low.

3.6. At the 31st March 2021 the Authority had a borrowing Capital Financing Requirement (CFR) of £186.8m and gross external borrowing of 182.8m. Borrowing has reduced year-on-year by £4.1m which primarily relates to the temporary high borrowing balance at the previous year end due to the pandemic outbreak alongside the delay in expending budgeted capital expenditure during the year.

3.7. In year, the Authority's total treasury investments increased by £11.4m to £39m primarily due to higher temporary year end balances relating to the receipt of large amounts of grant towards the end of March 2021. The Authority continues to hold a minimum of £10m of investments to meet the requirements of a professional client under the Mifid II regulations (Markets in financial instruments directive).

3.8. £3m of the Authority's investments are held in externally managed strategic pooled multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total return 15.72%, comprising a 4.59% income return which is used to support services in year, and 11.13% of unrealised capital loss. It is important to note that the high capital return during the year merely represents the recovery of the funds capital losses following the severe depressions in their value at the end of March 2020 due to the pandemic outbreak. These capital gains therefore reverse the unrealised prior year losses which were held on the Authorities balance sheet.

3.9. As shown in section 11 the Authority achieved a saving of £236,000 against net treasury budgets of £3.75m primarily due to lower overall borrowing costs than budgeted as rates remained at extremely low levels during the year.

3.10. As reported in sections 12 and 13, the Authority complied with the Cipfa code of practice on treasury management and the approved 2020/21 Treasury management strategy, during the year.

3.11. The ongoing COVID-19 pandemic will continue to have a significant financial impact on the Authority and consequently its treasury management activity during the 2021/22 financial year. At the time of writing it is felt that the existing Treasury Strategy approved for the 2021/22 financial year provides the required flexibility both in terms of investment and borrowing approach to respond the challenges faced. The mid-year treasury report for 2021/22 will give a further update on the dynamic situation.

Impact of the Covid-19 pandemic on treasury activities

3.12. Since the outbreak of the pandemic the Council has needed to monitor the impact on cash flow closely. Throughout 2020/21 the Authority received significant amounts of Welsh Government funding to support small and medium businesses during the pandemic through grant schemes. £41m was received throughout the financial year and temporarily invested in short-dated, liquid instruments and invested with other Local Authorities. In addition to the business grants, the Council has seen an increase in Covid related expenditure, a reduction in income across services, and a decrease in the collection of Council Tax and Non-Domestic Rates (NDR) and the Council has also implemented the NDR Relief Scheme for retail, leisure and hospitality businesses who received 100% relief.

3.13. All of the above has had a significant impact on cash flow, however aside from the beginning of the year when temporary additional short-term borrowing was required, Welsh Government have mitigated the impact by reimbursing increased expenditure and income losses through the Hardship fund. Welsh Government have also reimbursed the business grants in a timely manner, and front-loaded a significant portion of the Revenue Support Grant payments to the Council in April 2020, as well as providing a grant to support the cash flow of the 100% rate reliefs. In addition slippage on the capital programme and a net revenue underspend during the year also assisted with cash flow and delayed the need to borrow longer term within 2020/21.

4. INTRODUCTION

4.1. The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

4.2. The Authority's treasury management strategy for 2020/21 was approved by Council on 5th March 2020. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the risk of loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

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

4.4. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by Council on 19th September 2019 and has subsequently been updated and approved by Council on 11th March 2021.

5. External Context

5.1. **Economic background (as at 31st March 2021):** The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

5.2. Some good news came in December 2020 as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK vaccine rollout started in earnest; over 31 million people had received their first dose by 31st March.

5.3. A Brexit trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline having been agreed with the European Union on Christmas Eve.

5.4. The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

5.5. Government initiatives supported the economy and the Chancellor announced in the 2021 Budget a further extension to the furlough (Coronavirus Job Retention) scheme until September 2021. Access to support grants was also widened, enabling more self-employed people to be eligible for government help. Since March 2020, the government schemes have help protect more than 11 million jobs.

5.6. Despite the furlough scheme, unemployment still rose. Labour market data showed that in the three months to January 2021 the unemployment rate was 5.0%, in contrast to 3.9% recorded for the same period 12 months ago. Wages rose 4.8% for total pay in nominal terms (4.2% for regular pay) and was up 3.9% in real terms (3.4% for regular pay). Unemployment is still expected to increase once the various government job support schemes come to an end.

5.7. Inflation has remained low over the 12 month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation (CPI) fell to 0.4% year/year in February, below expectations (0.8%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 0.7% year/year (1.0% expected).

5.8. After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower pace than the 41.7% rise in the prior quarter. When released, figures for Q1 (Jan-Mar) 2021 are expected to show a decline given the national lockdown.

5.9. After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. The US recovery has been fuelled by three major pandemic relief stimulus packages totalling over $5 trillion. The Federal Reserve cut its main interest rate to between 0% and 0.25% in March 2020 in response to the pandemic and it has remained at the same level since. Joe Biden became the 46th US president after defeating Donald Trump.

5.10. The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

5.11. **Financial markets:** Monetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

5.12. Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

5.13. The 5-year UK benchmark gilt yield began the financial year at 0.18% before declining to -0.03% at the end of 2020 and then rising strongly to 0.39% by the end of the financial year. Over the same period the 10-year gilt yield fell from 0.31% to 0.19% before rising to 0.84%. The 20-year declined slightly from 0.70% to 0.68% before increasing to 1.36%.

5.14. 1-month, 3-month and 12-month SONIA bid rates averaged 0.01%, 0.10% and 0.23% respectively over the financial year.

5.15. The yield on 2-year US treasuries was 0.16% at the end of the period, up from 0.12% at the beginning of January but down from 0.21% at the start of the financial year. For 10-year treasuries the end of period yield was 1.75%, up from both the beginning of 2021 (0.91%) and the start of the financial year (0.58%).

5.16. German bund yields continue to remain negative across most maturities.

5.17. **Credit review:** After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, albeit Santander UK is still an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The other ringfenced banks were trading around 33 and 34bps while Nationwide Building Society was 43bps.

5.18. Credit rating actions to the period ending September 2020 have been covered in previous outturn reports. Subsequent credit developments include Moody's downgrading the UK sovereign rating to Aa3 with a stable outlook which then impacted a number of other UK institutions, banks and local government. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

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

6. LOCAL CONTEXT

6.1. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.20 Actual £m	Movement Actual £m	31.3.21 Actual £m
General Fund CFR	189.5	(0.2)	189.2
Less: *Other debt liabilities	(2.4)	(0.0)	(2.4)
Borrowing CFR	**187.0**	(0.2)	**186.8**
External borrowing	(186.9)	4.1	(182.8)
Internal borrowing	0.1	3.9	4.1
Less: Usable reserves	(18.5)	(10.0)	(28.5)
Less: Working capital	(9.3)	(5.3)	(14.6)
(Net Investments) at 31st March 2021	**(27.6)**	(11.4)	**(39.0)**

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

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

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

Table 2: Treasury Management Summary

	31.3.20 Balance £m	31.3.20 Rate %	Movement £m	31.3.21 Balance £m	31.3.21 Rate %
Long-term borrowing	93.2	3.5	(7.6)	85.5	3.6
Short-term borrowing	93.7	1.0	3.5	97.2	0.3
Total borrowing	**186.9**	**2.2**	**(4.1)**	**182.8**	**1.9**
Long-term investments	0.0	N/A	0.0	0.0	N/A
Short-term investments	(3.0)	0.5	(17.0)	(20.0)	0.03
Pooled Funds	(2.7)	4.3	(0.3)	(3.0)	4.59
Cash and cash equivalents	(21.9)	Included in ST above	5.9	(16.0)	0.1
Total investments	**(27.6)**	**0.9**	**(11.4)**	**(39.0)**	**0.4**
Net Borrowing	**159.3**		**(15.5)**	**143.8**	

6.4. The balance of short term investments at the 31st March 2021 was significantly higher than the previous year end reflecting the fact that at 31st March 2020 the majority of cash balances were being held in very liquid instruments (Cash & cash equivalents) as a direct result of the uncertainty created by the outbreak of the pandemic. At 31st March 2021 treasury circumstances had returned to a comparatively more stable footing and consequently cash balances were being held in investments that reflected the future expected cash flow requirements of the Authority.

7. BORROWING UPDATE

7.1. In November 2020 the PWLB published its response to the consultation on 'Future Lending Terms'. From 26th November the margin on PWLB loans above gilt yields was reduced from 1.8% to 0.8% providing that the borrowing authority can confirm that it is not planning to purchase 'investment assets primarily for yield' in the current or next two financial years. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. As part of the borrowing process authorities will now be required to submit more detailed capital expenditure plans with confirmation of the purpose of capital expenditure from the Section 151 Officer. The PWLB can now also restrict local authorities from borrowing in unusual or large amounts.

7.2. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management. Misuse of PWLB borrowing could result in the PWLB requesting that Authority unwinds problematic transactions, suspending access to the PWLB and repayment of loans with penalties.

7.3. Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

7.4. The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able to take advantage of the reduction in the PWLB borrowing rate if considered cost effective.

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

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

7.7. *UK Infrastructure Bank*: In his March 2021 budget the Chancellor confirmed that a UK Infrastructure Bank will be set up with £4bn in lending earmarked for local authorities from the summer of 2021. Loans will be available at gilt yield plus 0.60%, 0.20% lower than the PWLB certainty rate. A bidding process to access these loans is likely with a preference to projects likely to help the government meet its Net Zero emissions target. However other "high value and complex economic infrastructure projects" may also be considered.

8. BORROWING STRATEGY

8.1. At 31st March 2021 the Authority held £182.8m of loans, a decrease of £4.1m from 31st March 2020, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.20 Balance £m	31.3.20 Weighted Average Rate %	31.3.20 Weighted Average Maturity (years)	Balance movement £m	31.3.21 Balance £m	31.3.21 Weighted Average Rate %	31.3.21 Weighted Average Maturity (years)
Public Works Loan Board	89.1	3.2	15.5	(14.9)	74.2	3.5	17.4
Banks (LOBO)	13.6	4.8	21.8	0.0	13.6	4.8	20.8
Welsh Gov Interest Free	5.2	0.0	4.2	(0.2)	5.1	0.0	3.4
Local authorities/Other	78.9	0.9	0.3	11.0	89.9	0.1	0.2
Total borrowing	**186.9**	**2.2**	**9.2**	**(4.1)**	**182.8**	**1.9**	**8.8**

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

8.3. With short-term interest rates remaining much lower than long-term rates, the Authority considered it more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead where possible. The net movement in temporary / short-term loans is shown in table 3 above.

8.4. The Authority has slipped forward £27m of its capital expenditure plans financed from borrowing due to delays in the 2020/21 capital programme which has subsequently resulted in a temporary lower funding requirement and is the primary reason for the overall reduction in borrowing year-on-year.

8.5. The Authority over the medium term has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the borrowing need based on realistic projections, it was decided not to enter into any medium to longer term borrowing during the financial year.

8.6. The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and longer-term borrowing was maintained.

8.7. PWLB funding margins have lurched quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

8.8. **LOBO loans**: The Authority continues to hold £13.6m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

9. <u>TREASURY INVESTMENT ACTIVITY</u>

9.1. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £10m and £69m due to timing differences between income and expenditure. The investment position at year end is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.20 Balance £m	**Net Movement £m**	**31.3.21 Balance £m**	**31.3.21 Income Return %**	**31.3.21 Weighted Average Maturity days**
Banks & building societies (unsecured)	(2.0)	0.0	(2.0)		
Government (incl. local authorities	(10.9)	(9.1)	(20.0)	Average 0.13%	Up to 180 days
Money Market Funds	(12.0)	(2.0)	(14.0)		
Multi asset income, Pooled funds	(2.7)	(0.3)	(3.0)	4.59%	N/A
Total investments	**(27.6)**	**(11.4)**	**(39.0)**		

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

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

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

9.5. The net return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.1% in March, are now at or very close to zero; fund management companies have temporarily lowered or waived fees to avoid negative net returns.

9.6. Given the increasing risk and low returns from short-term unsecured bank investments, the Authority has continued to diversify into more secure and/or higher yielding asset classes as shown in table 5 above. Consequently investment risk has continued to be diversified but the average income return has deteriorated year-on-year reflecting a falling interest rate environment.

9.7. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return** **%**
31.03.2020	AA-	4.01	64%	2	0.44
31.03.2021	AA-	4.26	44%	11	0.00
Similar LAs	AA-	4.12	34%	70	0.1
All LAs	A+	4.63	63%	14	0.15

9.8. £3m of the Authority's investments are held in externally managed strategic pooled multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total return of 15.72%, comprising a 4.59% income return which is used to support services in year, and 11.13% of unrealised capital gain.

9.9. During the initial phase of the pandemic in March 2020, the sharp falls corporate bond and equity markets had a negative impact on the value of the Council's pooled fund holdings and was reflected in the 31st March 2020 fund valuations with most funds registering negative capital returns over a 12 month period. Since March 2020 there here has been improvement in market sentiment which is reflected in an increase in capital values of these short-dated, strategic bond, equity and multi-asset income funds in the Authority's portfolio. It is important to note that these capital gains therefore reverse unrealised prior year capital losses which were held on the Authorities balance sheet.

9.10. Similar to many other property funds, dealing (i.e. buying or selling units) in the CCLA Local Authorities' Property Fund was suspended by the fund in March 2020 and lifted in September. There was also a change to redemption terms for the CCLA Local Authorities Property Fund; from September 2020 investors are required to give at least 90 calendar days' notice for redemptions.

9.11. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates.

9.12. Following the cut in Bank rate from 0.75% to 0.10% in March 2020, the Authority had expected to receive significantly lower income from its cash and short-dated money market investments, including money market funds in 2020/21, as rates on cash investments are close to zero percent. Income from most of the Authority's externally managed funds were also expected be lower than in 2019/20 and earlier years. Whilst the arrival and approval of vaccines against COVID-19 and the removal of Brexit uncertainty that had weighed on UK equities were encouraging developments, dividend and income distribution was dependent on company earnings in a very challenging and uncertain trading environment as well as enforced cuts or deferral required by regulatory authorities. However despite these factors it was pleasing to note that when comparing 2021/22 to 2020/21, the Council received 0.30% more by way of income distribution on its portfolio of £3m.

10. <u>NON-TREASURY INVESTMENTS</u>

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

10.2. The Authority held a book value of £30.6m of such non-financial asset investments at the 31st March 2021 (£31.0m as at 31st March 2020) made up of:

- Oak Grove Solar Farm £5.1m NBV
- Castlegate Business Park & service loan £7.5m NBV
- Newport Leisure Park & service loan £18.0m NBV

10.3. The rest of the Authority's Investment Properties have been held for over a decade and are retained purely for income or capital gain :

- Agricultural Properties £29.8m NBV
- Industrial Properties and Retail Units £3.2m NBV

10.4. Returns on the Newport leisure park investment were severely impacted by the COVID-19 restrictions in place and consequently the Authority looked to legitimately recover the income losses it suffered from the Welsh Government Local Government hardship fund. The remaining investments were largely unaffected by the restrictions in place. Overall, non-treasury investments continued to generate approximately £1.7m of investment income for the Authority after taking account of direct costs and contributes to supporting the Authority's ongoing revenue budget.

11. TREASURY PERFORMANCE

11.1. The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget as shown in the table below:

Table 6: Performance

Interest Payable	**Actual £'000**	**Budget £'000**	**Over/ (under)**
PWLB	2,717	2,849	(132)
Market loans	651	653	(2)
Short term loans	355	504	(149)
Total Interest payable on borrowing	**3,723**	**4,006**	**(282)**
Interest Receivable	**Actual £'000**	**Budget £'000**	**Over/ (under)**
Invested cash short term	(18)	(252)	234
Pooled Funds	(124)	Included above	(124)
Finance lease income	(64)	Included above	(64)
Total income from Investments	**(206)**	**(252)**	**46**
Net Over/(Under)spend	**3,518**	**3,754**	**(236)**

12. COMPLIANCE

12.1. The Section 151 officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in tables below.

12.2. Compliance with the authorised limit and operational boundary for external debt is demonstrated in the table below:

Table 7: Debt Limits

	2020/21 Maximum during year £m	**31.3.21 Actual £m**	**2020/21 Operational Boundary £m**	**2020/21 Authorised Limit £m**	**Complied? Yes/No**
Borrowing	195.8	182.8	210.8	230.0	Yes
PFI, Finance Leases & Other LT liabs	2.4	2.4	3.9	5.4	Yes
Total debt	**198.2**	**185.2**	**214.7**	**235.4**	**Yes**

12.3. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Table 8: Investment Limits

	31.3.21 Maximum	2020/21 Limit	Complied? Yes
Local Authorities per counterparty	£2m or 10%	£2m or 10%	Yes
Banks per counterparty, rating A- or above	£2m	£2m	Yes
Any group of pooled funds under the same management	£2m	£2m	Yes
Limit per non-UK country	£2m	£4m	Yes
Money Market Funds	£2m or 10%	£2m or 10%	Yes
Investments over 1 year	£0m	£6m	Yes

13. TREASURY MANAGEMENT INDICATORS

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

13.2. **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating and credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Table 9: Credit Risk

	31.3.21 Actual	2020/21 Target	Complied?
Portfolio average credit	AA-/4.26	A-/5.0	Yes

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

Table 10: Maturity Structure of borrowing

	31.3.21 Actual	Lower Limit	Upper Limit	Complied?
Under 12 months	53%	0%	60%	Yes
12 months and within 24 months	1%	0%	20%	Yes
24 months and within 5 years	6%	0%	30%	Yes
5 years and within 10 years	7%	0%	30%	Yes
10 years and above	5%	0%	100%	Yes
20 years and above	27%	0%	30%	Yes

13.4. **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 11: Principal invested for period longer than a year

	2020/21	2021/22	2022/23
Actual principal invested for 365 days & beyond year end	£0m	£0m	£0m
Limit	£6m	£6m	£6m
Complied?	Yes	Yes	Yes

14. OTHER ISSUES

14.1. **CIPFA consultations:** In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. These are principles-based consultations and will be followed by more specific proposals later in the year.

14.2. In the Prudential Code the key area being addressed is the statement that "local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed". Other proposed changes include the sustainability of capital expenditure in accordance with an authority's corporate objectives, i.e. recognising climate, diversity and innovation, commercial investment being proportionate to budgets, expanding the capital strategy section on commercial activities, replacing the "gross debt and the CFR" with the liability benchmark as a graphical prudential indicator.

14.3. Proposed changes to the Treasury Management Code include requiring job specifications and "knowledge and skills" schedules for treasury management roles to be included in the Treasury Management Practices (TMP) document and formally reviewed, a specific treasury management committee for MiFID II professional clients and a new TMP 13 on Environmental, Social and Governance Risk Management.

14.4. IFRS 16: The implementation of the new IFRS 16 Leases accounting standard has been delayed for a further year until 2022/23.

15. REASONS

15.1. The Authority's Treasury Management Strategy for 2020/21 was underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011.

15.2. The code requires the Authority to set a treasury strategy each financial year for financing and investment activities and recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

16. RESOURCE IMPLICATIONS

16.1. The outturn position is explained in the report, there are no other resource implications arising directly from this report.

17. CONSULTEES

17.1. Deputy Chief Executive, Chief Officer - Resources (Section 151 officer)

Arlingclose – Treasury Management Advisors to Monmouthshire CC

18. BACKGROUND PAPERS

Glossary of treasury terms

19. AUTHORS:

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Background paper: Glossary of Treasury Terms

Authorised Limit	The affordable borrowing limit determined in compliance with the Local Government Act 2003 (English and Welsh authorities) and the Local Government in Scotland Act 2003. This Prudential Indicator is a statutory limit for total external debt. It is set by the Authority and needs to be consistent with the Authority's plans for capital expenditure financing and funding. The Authorised Limit provides headroom over and above the *Operational Boundary* to accommodate expected cash movements. Affordability and prudence are matters which must be taken into account when setting this limit. (see **also** *Operational Boundary*, below)
Balances and Reserves	Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
Bail-in	Refers to the process which the banking regulatory authorities will use to restructure a financial institution which is failing or likely to fail. Unsecured creditors of and investors in that financial institution will participate in its restructure who will, as a consequence, incur a non-recoverable loss (commonly referred to as a 'haircut') on their obligation/investment. Local authority investments with banks and building societies such as term deposits, certificates of deposit, call accounts and non-collateralised bonds are unsecured investments and are therefore vulnerable to bail-in.
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". This rate is also referred to as the 'repo rate'.
Bond	A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.
Capital Expenditure	Expenditure on the acquisition, creation or enhancement of capital assets
Capital Financing Requirement (CFR)	The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
Capital growth	Increase in the value of the asset (in the context of a collective investment scheme, it will be the increase in the unit price of the fund)
Capital receipts	Money obtained on the sale of a capital asset.
CIPFA	Chartered Institute of Public Finance and Accountancy
Constant Net Asset Value (CNAV)	Also referred to as Stable Net Asset Value. A term used in relation to the valuation of 1 share in a fund. This means that at all times the value of 1 share is £1/€1/US$1 (depending on the currency of the fund). The Constant NAV is maintained since dividend income (or interest) is either added to the shareholders' account by creating shares equal to the value of interest earned or paid to the shareholder's bank account, depending on which option is selected by the shareholder.
Collective Investment Schemes	Funds in which several investors collectively hold units or shares. The assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'Pooled Funds'). Unit Trusts and Open-Ended Investment Companies are types of collective investment schemes / pooled funds.

Corporate Bonds	Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Corporate Bond Funds	Collective Investment Schemes investing predominantly in bonds issued by companies and supranational organisations.
CPI ***Also see RPI***	Consumer Price Index. (This measure is used as the Bank of England's inflation target.)
Credit Default Swap (CDS)	A Credit Default Swap is similar to an insurance policy against a credit default. Both the buyer and seller of a CDS are exposed to credit risk. Naked CDS, i.e. one which is not linked to an underlying security, can lead to speculative trading.
Credit Rating	Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.
Cost of carry	When a loan is borrowed in advance of requirement, this is the difference between the interest rate and (other associated costs) on the loan and the income earned from investing the cash in the interim.
Credit default swaps	Financial instrument for swapping the risk of debt default; the buyer effectively pays a premium against the risk of default.
Diversification / diversified exposure	The spreading of investments among different types of assets or between markets in order to reduce risk.
Derivatives	Financial instruments whose value, and price, are dependent on one or more underlying assets. Derivatives can be used to gain exposure to, or to help protect against, expected changes in the value of the underlying investments. Derivatives may be traded on a regulated exchange or traded 'over the counter'.
ECB	European Central Bank
Federal Reserve	The US central bank. (Often referred to as "the Fed")
Floating Rate Notes	A bond issued by a company where the interest rate paid on the bond changes at set intervals (generally every 3 months). The rate of interest is linked to LIBOR and may therefore increase or decrease at each rate setting
GDP	Gross domestic product – also termed as "growth" in the economy. The value of the national aggregate production of goods and services in the economy.
General Fund	This includes most of the day-to-day spending and income. (All spending and income related to the management and maintenance of the housing stock is kept separately in the HRA).
Gilts (UK Govt)	Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged': being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
Housing Revenue Account (HRA)	A ring-fenced account of all housing income and expenditure, required by statute

IFRS	International Financial Reporting Standards
Income Distribution	The payment made to investors from the income generated by a fund; such a payment can also be referred to as a 'dividend'
Investments - **Secured** - **unsecured**	Secured investments which have underlying collateral in the form of assets which can be called upon in the event of default Unsecured investments do not have underlying collateral. Such investments made by local authorities with banks and building societies are at risk of bail-in should the regulator determine that the bank is failing or likely to fail.
Liability Benchmark	Term in CIPFA's Risk Management Toolkit which refers to the minimum amount of borrowing required to keep investments at a minimum liquidity level (which may be zero).
LOBOs	LOBO stands for 'Lender's Option Borrower's Option'. The underlying loan facility is typically long term and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at predetermined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the 'option' to either accept the new imposed fixed rate or repay the loan facility.
LVNAV (Low Volatility Net Asset Value)	From 2019 Money Market Funds will have to operate under a variable Net Value Structure with minimal volatility (fluctuations around £1 limited to between 99.8p to 100.2p)
Maturity	The date when an investment or borrowing is repaid.
Maturity profile	A table or graph showing the amount (or percentage) of debt or investments maturing over a time period. The amount or percent maturing could be shown on a year-by-year or quarter-by-quarter or month-by-month basis.
MiFID II	MiFID II replaced the Markets in Financial Instruments Directive (MiFID I) from 3 January 2018. It is a legislative framework instituted by the European Union to regulate financial markets in the bloc and improve protections for investors.
Money Market Funds (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Minimum Revenue Provision	An annual provision that the Authority is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets
Non-Specified Investments	Term used in the Communities and Local Government Guidance and Welsh Assembly Guidance for Local Authority Investments. It includes any investment for periods greater than one year or those with bodies that do not have a high credit rating, use of which must be justified.
Net Asset Value (NAV)	A fund's net asset value is calculated by taking the current value of the fund's assets and subtracting its liabilities.
Operational Boundary	This is the limit set by the Authority as its most likely, i.e. prudent, estimate level of external debt, but not the worst case scenario. This limit links directly to the Authority's plans for capital expenditure, the estimates of the Capital Financing Requirement (CFR) and the estimate of cashflow requirements for the year.

Permitted Investments	Term used by Scottish Authorities as those the Authority has formally approved for use.
Pooled funds	See Collective Investment Schemes (above)
Premiums and Discounts	In the context of local authority borrowing, (a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and (b) the discount is the gain arising when a loan is redeemed prior to its maturity date. If on a £1 million loan, it is calculated* that a £100,000 premium is payable on premature redemption, then the amount paid by the borrower to redeem the loan is £1,100,000 plus accrued interest. If on a £1 million loan, it is calculated that a £100,000 discount receivable on premature redemption, then the amount paid by the borrower to redeem the loan is £900,000 plus accrued interest. PWLB premium/discount rates are calculated according to the length of time to maturity, current market rates (plus a margin), and the existing loan rate which then produces a premium/discount dependent on whether the discount rate is lower/higher than the coupon rate. *The calculation of the total amount payable to redeem a loan borrowed from the Public Works Loans Board (PWLB) is the present value of the remaining payments of principal and interest due in respect of the loan being repaid prematurely, calculated on normal actuarial principles. More details are contained in the PWLB's lending arrangements circular.
Private Finance Initiative (PFI)	Private Finance Initiative (PFI) provides a way of funding major capital investments, without immediate recourse to the public purse. Private consortia, usually involving large construction firms, are contracted to design, build, and in some cases manage new projects. Contracts can typically last for 30 years, during which time the asset is leased by a public authority.
Prudential Code	Developed by CIPFA and introduced on 01/4/2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.
Prudential Indicators	Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators between authorities.
PWLB	Public Works Loans Board. It is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.
Quantitative Easing	In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It "does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller's bank account. So the seller has more money in their bank account, while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy". Source: Bank of England
Registered Provider of Social Housing	Formerly known as Housing Association
Revenue Expenditure	Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges

RPI	Retail Prices Index. A monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent. Pensions and index-linked gilts are uprated using the CPI index.
SORP	Statement of Recommended Practice for Accounting (Code of Practice on Local Authority Accounting in the United Kingdom).
Specified Investments	Term used in the CLG Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than 1 year. UK government, local authorities and bodies that have a high credit rating.
Supported Borrowing	Borrowing for which the costs are supported by the government or third party.
Supranational Bonds	Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry an AAA rating in their own right. Examples of supranational organisations are those issued by the European Investment Bank, the International Bank for Reconstruction and Development.
Treasury Management Code	CIPFA's Code of Practice for Treasury Management in the Public Services. The current Code is the edition released in autumn 2011.
Temporary Borrowing	Borrowing to cover peaks and troughs of cash flow, not to fund spending.
Term Deposits	Deposits of cash with terms attached relating to maturity and rate of return (interest)
Unsupported Borrowing	Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.
Usable Reserves	Resources available to finance future revenue and capital expenditure
Variable Net Asset Value (VNAV)	A term used in relation to the valuation of 1 share in a fund. This means that the net asset value (NAV) of these funds is calculated daily based on market prices.
Working Capital	Timing differences between income/expenditure and receipts/payments
Yield	The measure of the return on an investment instrument