Annual Treasury Management Review 2020/21

Melton Borough Council
June 2021

Contents

Annual Treasury Management Review 2020/21

1. Introduction

This 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).

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 26/02/2020)
- a mid-year (minimum) treasury update report (Council 17/12/2020)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Cabinet before they were reported to the full Council. Member training on treasury management issues was undertaken during the year in September 2019 in order to support members' scrutiny role.

Introduction and Background

This report summarises the following:-

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

2. The Council's Capital Expenditure and Financing

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.

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

£'000	31.3.20 Actual	2020/21 Budget	31.3.21 Actual
Capital expenditure	**270**	**1,315**	**462**
Financed in year	270	1,315	462
Unfinanced capital expenditure	**0**	**0**	**0**

£'000 HRA	31.3.20 Actual	2020/21 Budget	31.3.21 Actual
Capital expenditure	**2,849**	**4,832**	**2,454**
Financed in year	2,849	4,832	2,454
Unfinanced capital expenditure	**0**	**0**	**0**

3. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2020/21 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need, (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

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

The Council's 2020/21 MRP Policy, (as required by MHCLG Guidance), was approved as part of the Treasury Management Strategy Report for 2020/21 on 26/12/2020.

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which can impact on the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR (£'000): General Fund	31 March 2020 Actual	31 March 2021 Budget	31 March 2021 Actual
Opening balance	101	89	89
Less finance lease repayments	(12)	(12)	(12)
Closing balance	89	77	77

CFR (£'000): HRA	31 March 2020 Actual	31 March 2021 Budget	31 March 2021 Actual
Opening balance	31,484	31,484	31,484
Closing balance	31,484	31,484	31,484

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2020/21. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

£'000	31 March 2020 Actual	31 March 2021 Budget	31 March 2021 Actual
Gross borrowing position	31,502	31,490	31,490
CFR	31,573	31,561	31,561
Under / over funding of CFR	(71)	(71)	(71)

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

£'000	2020/21
Authorised limit	46,000
Maximum gross borrowing position during the year	31,484
Operational boundary	36,490
Average gross borrowing position	31,484
Financing costs as a proportion of net revenue stream: General Fund HRA	-3.33% 31.19%

4. Treasury Position as at 31st March 2021

The Council's treasury management debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2020/21 the Council's treasury, (excluding borrowing by finance leases), position was as follows:

DEBT PORTFOLIO	31 March 2020 Principal £'000	Rate/ Return %*	Average Life Yrs	31 March 2021 Principal £'000	Rate/ Return %*	Average Life Yrs
Fixed rate funding:						
-PWLB	31,413	3.72%	32	31,413	3.72%	32
CFR	31,484			31,484		
Over / (under) borrowing	(71)			(71)		
Total investments	20,500	1.25%	£18.5m under 1 yr £2m over 1 yr	22,890	0.81%	£20.890m under 1 yr £2m over 1 yr
Net debt	**10,913**	**1.77%**		**8,523**	**1.15%**	

The maturity structure of the debt portfolio was as follows:

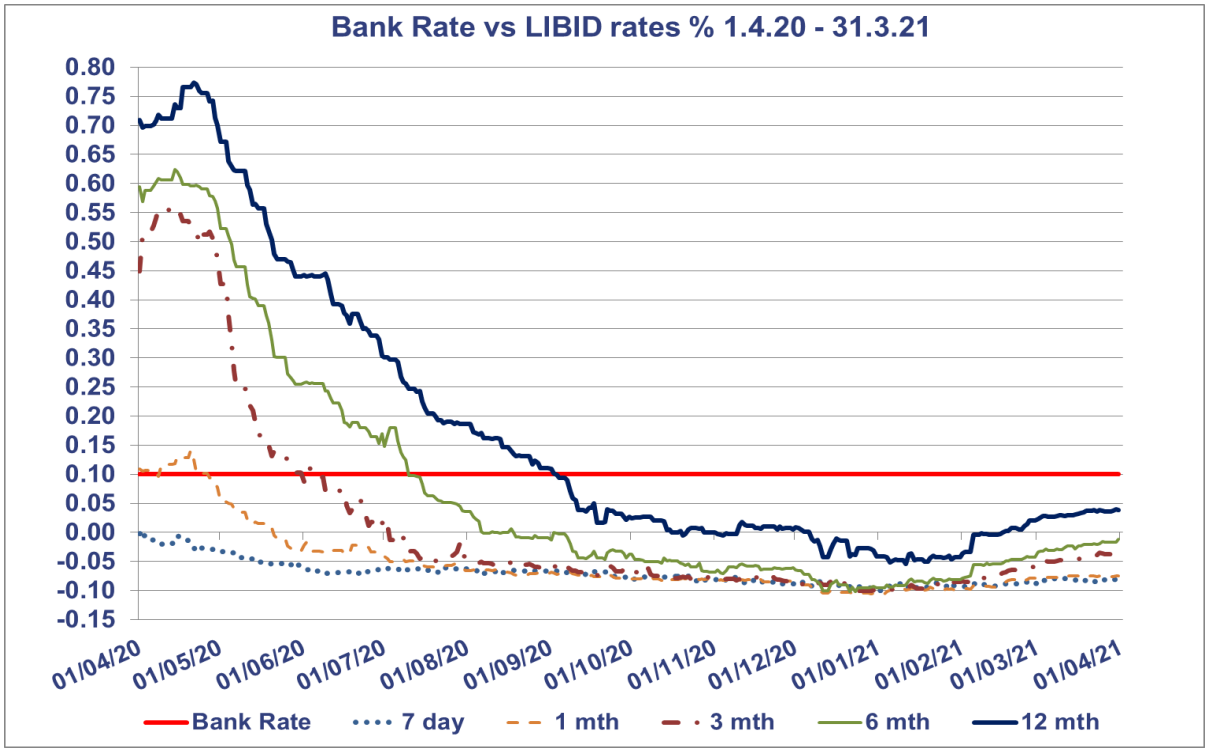
	31 March 2020 Actual £'000	31 March 2021 Actual £'000
24 months and within 5 years	98	2,098
5 years and within 10 years	4,300	2,600
10 years and within 20 years	300	0
20 years and within 30 years	10,000	10,000
30 years and within 40 years	10,840	10,840
40 years and within 50 years	5,875	5,875

The maturity structure of the investment portfolio was as follows:

	31 March 2020 Actual £000	2020/21 Budget £000	31 March 2021 Actual £000
Investments			
Longer than 1 year	2,000	2,000	2,000
Up to 1 year	18,500	15,016	20,890
Total	20,500	17,016	22,890

5. The Strategy for 2020/21

5.1 Investment strategy and control of interest rate risk



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
Low Date	01/04/2020	31/12/2020	29/12/2020	23/12/2020	21/12/2020	11/01/2021
Average	0.10	-0.07	-0.05	0.01	0.07	0.17
Spread	0.00	0.10	0.25	0.66	0.73	0.83

The following commentary has been provided by the Councils Treasury Management advisors.

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%. 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.

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been managed appropriately through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

5.2 Borrowing strategy and control of interest rate risk

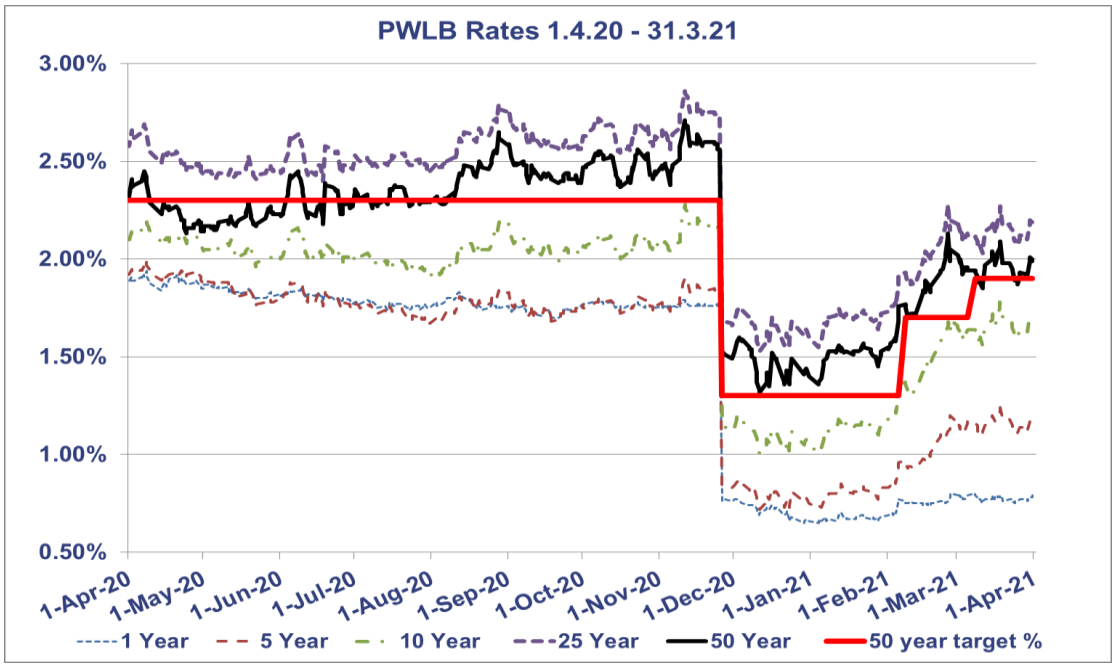
During 2019/20, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

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.

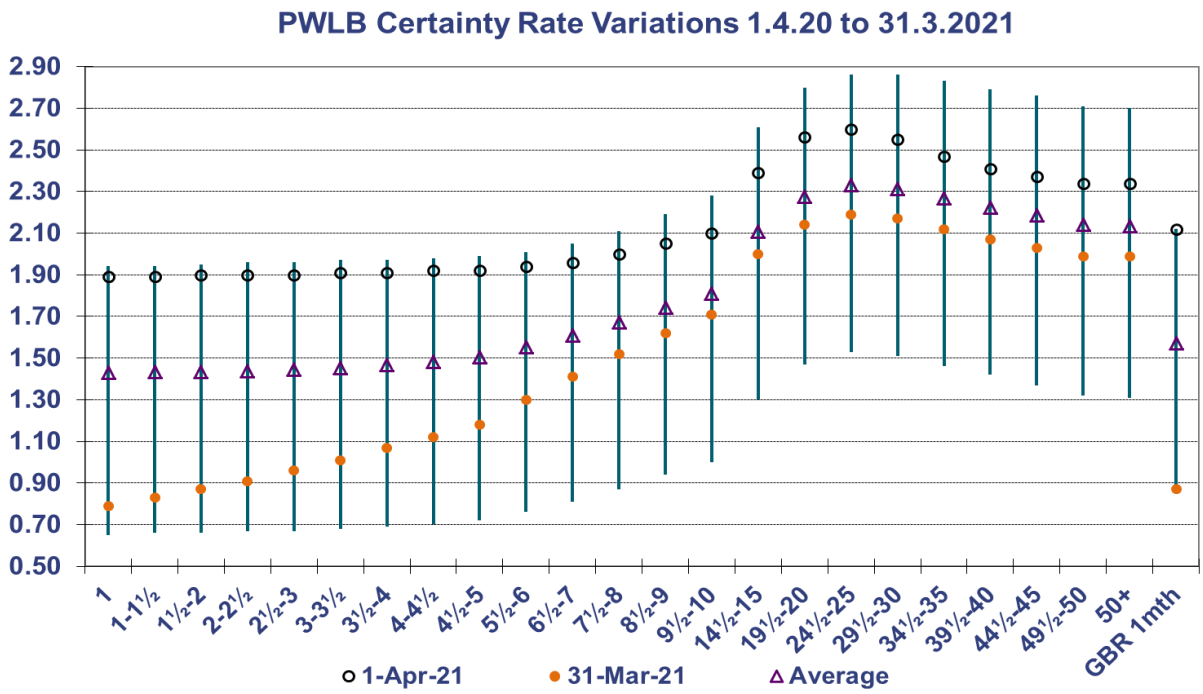
Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director for Corporate Services therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks.

Forecasts at the time of approval of the treasury management strategy report for 2020/21 were as follows.

Link Group Interest Rate View	9.11.20													
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.80	1.80	1.80	1.80	1.80	1.90	1.90	1.90	1.90	1.90	2.00	2.00	2.00	2.00
10 yr PWLB	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30
25 yr PWLB	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70	2.70	2.70	2.80	2.80	2.80	2.80
50 yr PWLB	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.60

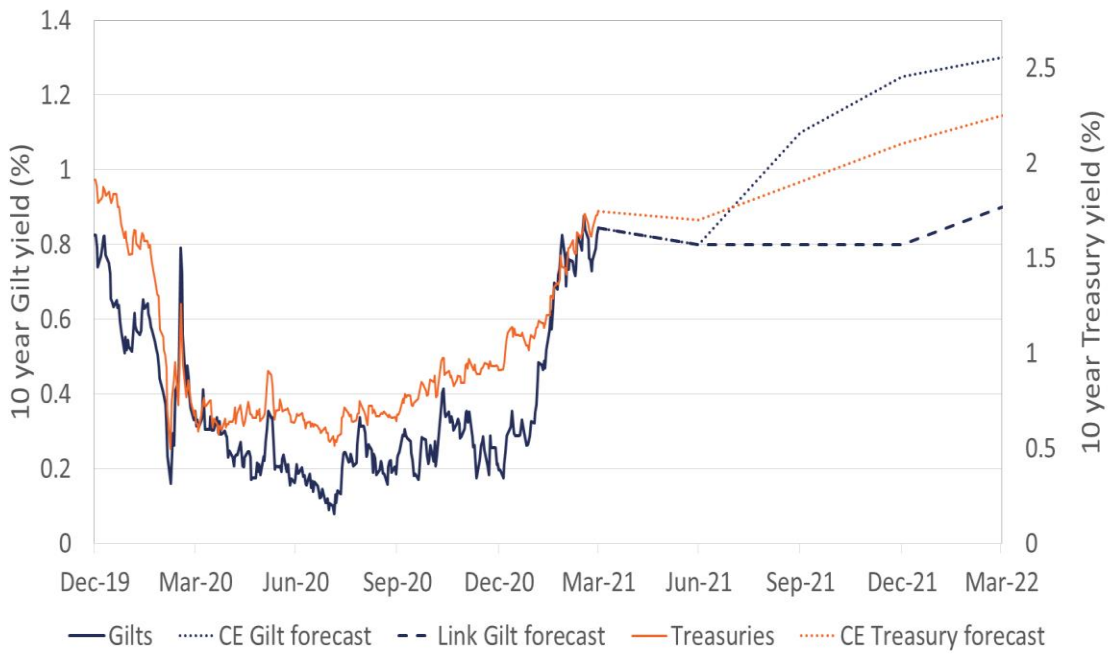


	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Low date	04/01/2021	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.94%	1.99%	2.28%	2.86%	2.71%
High date	08/04/2020	08/04/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.43%	1.50%	1.81%	2.33%	2.14%
Spread	1.29%	1.27%	1.28%	1.33%	1.39%



PWLB rates are based on 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. We have seen, over the last two years, 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.

Graph of UK gilt yields v. US treasury yields



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.

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%.

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

- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

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% by March 2024 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.

6. Borrowing Outturn

There were no borrowing requirements during 2020/21.

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Investment Outturn

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 26th February 2020. This 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.).

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

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£'000)	31 March 2020	31 March 2021
Balances	2,414	1,449
Earmarked reserves	11,757	16,493
Provisions	587	595
Usable capital receipts	6,012	5,149
Total	**20,770**	**23,686**

Investments held by the Council

- The Council maintained an average balance of £27.8m of internally managed funds.
- The internally managed funds earned an average rate of return of 0.81%.
- The comparable performance indicator is the average 7-day LIBID rate, which was 0.0706%.
- This compares with a budget assumption of £13m investment balances earning an average rate of 0.81%.
- Total investment income was £283,650 compared to a budget of £286,800

9. Other Issues

1. IFRS 9 fair value of investments
Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS 9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This was effective from 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve / non cash backed throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

In 2020-21 there was a reduction in the valuation of the property fund of £13k but at present this is just a notional loss. The fund value could reduce further over the course of 2021/22 but in the long term the fund managers expect the fund value to return to previous levels as the economy recoveries from Covid. Moving forward the Council has previously approved the establishment of a reserve in order to help offset any potential deficits that might arise in future in advance of the statutory override being removed. In line with the 2020-21 budget a provision of £60k has been made as part of the close down process as part of the managed contributions in the medium term to build up a reserve fund to be called on in the future if required.

2. Non-treasury management investments.
The Council has not purchased any specific commercial properties to generate income.

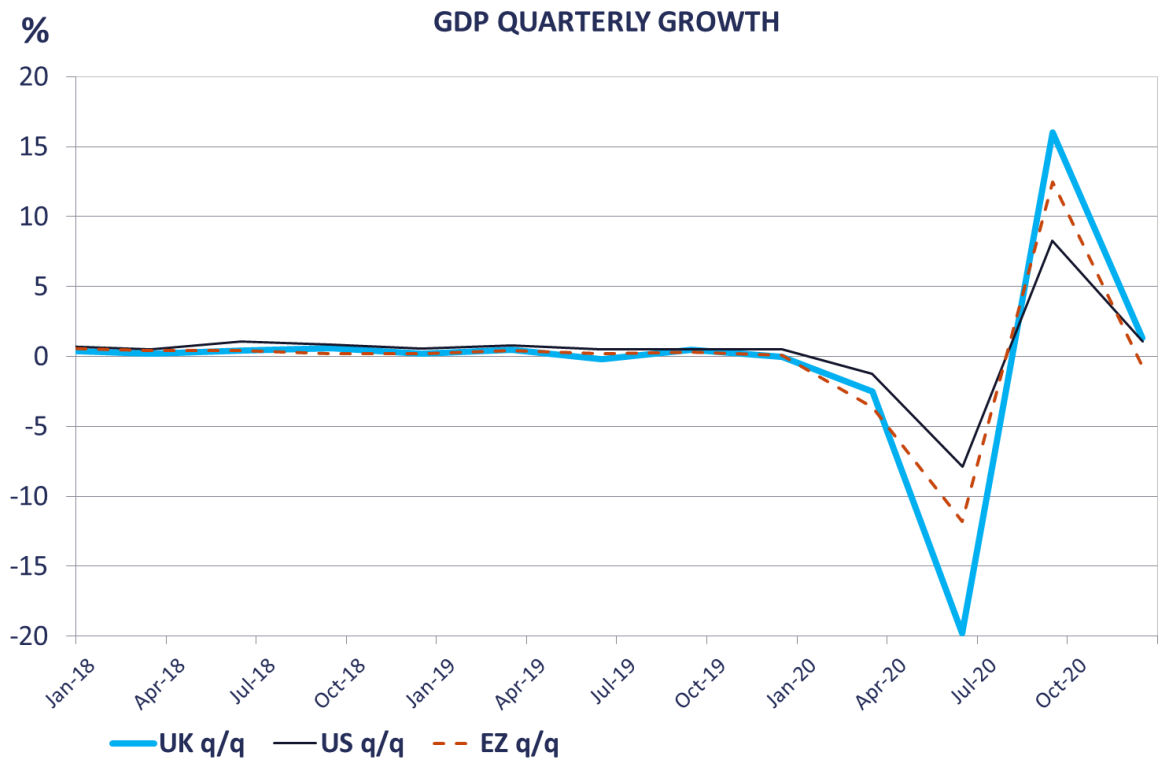
3. Changes in risk appetite
Any investments outside of the current strategy would be brought to Member's attention and subject to sign off. Rick management is a key part of this.

5. Counterparty limits
At the start of the pandemic, the limit for MMF investments was increased to £6m in view of the timing and level of Government grants to help deal with the coronavirus outbreak. Now that the effects of this are slowing down, the limit for MMF will return back to previous levels of £3m per fund.

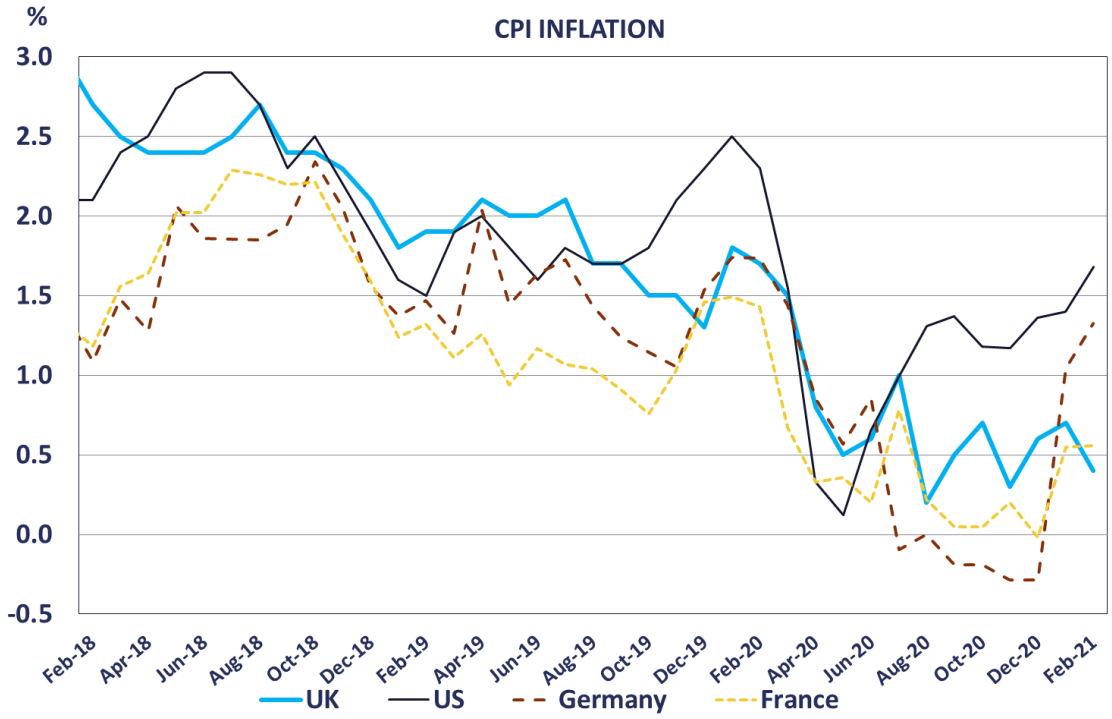
6. IFRS 16
The implementation of IFRS16 bringing currently off balance sheet leased assets onto the balance sheet, has been delayed until 2022/23.

Appendix 1: Graphs

UK, US and EZ GDP growth



Inflation UK, US, Germany and France



Appendix 3: Investment Portfolio

Investments held as at 31st March 2021 compared to our counterparty list:

Melton Borough Council

Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default	Expected Credit Loss (£)
Santander UK Plc	1,500,000	0.10%		Call	A	0.000%	2
Santander UK Plc	3,000,000	0.40%		Call	A	0.000%	4
MMF Invesco	2,390,000	0.01%		MMF	AAAm		
Standard Chartered Bank	1,000,000	1.10%	07/04/2020	06/04/2021	A	0.001%	8
Standard Chartered Bank	1,000,000	1.15%	30/04/2020	29/04/2021	A	0.004%	37
Qatar National Bank	1,000,000	1.03%	01/05/2020	30/04/2021	A	0.004%	39
Qatar National Bank	2,000,000	0.85%	05/06/2020	04/06/2021	A	0.008%	168
First Abu Dhabi Bank PJSC	1,000,000	0.50%	15/06/2020	14/06/2021	AA-	0.005%	48
First Abu Dhabi Bank PJSC	1,000,000	0.42%	30/06/2020	29/06/2021	AA-	0.006%	57
Goldman Sachs International Bank	2,000,000	0.13%	02/11/2020	03/08/2021	A+	0.016%	323
Qatar National Bank	1,000,000	0.52%	13/11/2020	12/11/2021	A	0.029%	292
First Abu Dhabi Bank PJSC	2,000,000	0.11%	01/12/2020	30/11/2021	AA-	0.016%	311
Qatar National Bank	1,000,000	0.49%	22/02/2021	21/02/2022	A	0.042%	422
Qatar National Bank	1,000,000	0.52%	08/03/2021	07/03/2022	A	0.044%	440
Borrower - Funds	**Principal (£)**	**Interest Rate**	**Start Date**	**Maturity Date**			
CCLA Property Fund	2,000,000						
Total Investments	**£22,890,000**	**0.41%**				**0.012%**	
Total Investments - excluding Funds	**£20,890,000**	**0.44%**				**0.012%**	**£2,152**
Total Investments - Funds Only	**£2,000,000**	**0.00%**					

Note: An historic risk of default and expected credit loss are only provided if a counterparty has a counterparty credit rating and are not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio's historic risk of default and expected credit loss therefore measure the historic risk of default and expected credit loss attached only to those investments for which a counterparty has a counterparty credit rating and also do not include investments which are not rated.

The Historic Risk of Default column is based on the lowest long term rating. If clients are using this % for their Expected Credit Loss calculation under IFRS 9, please be aware that the Code does not recognise a loss allowance where the counterparty is central government or a local authority since relevant statutory provisions prevent default. For these instruments, the Expected Credit Loss will be nil. Please note that we are currently using Historic Default Rates from 1990-2020 for Fitch, 1983-2020 for Moody's and 1981-2020 for S&P.