Brent	**Audit & Standards Advisory Committee** 11 May 2021 **Report from the Director of Finance**

2020/21 Treasury Management Outturn Report

Wards Affected:	All
Key or Non-Key Decision:	N/A
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	Open
No. of Appendices:	Three **Appendix 1** – Debt and Investment Portfolio **Appendix 2** – Prudential Indicators **Appendix 3** - Internal Investments: Average Rate vs Credit Risk
Background Papers:	Treasury Management Strategy Report to Council – 19 February 2020
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1. Introduction

1.1 This report updates members on Treasury Management activity and confirms that the Council has complied with its Prudential Indicators for 2020/21.

2. Recommendations

2.1 The Audit and Standards Advisory Committee is asked to consider and note the 2020/21 Treasury Management outturn report, in compliance with CIPFA's Code of Practice on Treasury Management (the Code).

2.2 Note that for 2020/21 the Council has complied with its Prudential Indicators which were approved by Full Council on 19 February 2020 as part of the Council's Treasury Management Strategy Statement and Capital Strategy Statement.

3. Background

3.1 The Council's treasury management activity is underpinned by the CIPFA Code, which requires authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year.

3.2 This report also fulfils the Council's obligations under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Investment Guidance.

3.3 The Council has borrowed money over the long term to support investment in the Council's infrastructure and also invests cash balances held for short periods. It is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are central to the Council's treasury management strategy.

Economic Background

1.4 The coronavirus pandemic dominated 2020/21. 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.

1.5 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.

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

1.7 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 in November 2020. 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.

1.8 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.

1.9 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.

1.10 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).

1.11 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.

Financial markets

1.12 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.

1.13 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.

1.14 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%.

1.15 1-month, 3-month and 12-month SONIA bid rates averaged 0.01%, 0.10% and 0.23% respectively over the financial year.

Local Context

1.16 On 31st March 2020, the Council had borrowing of £598.8m arising from its revenue and capital income and expenditure. The table below summarises the Council's borrowing activity during 2020/21. The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) was £928.1m at 31/03/2021 and had net borrowing of £659.1m.

Table 1: CFR and Borrowing Summary

	Balance on 01/04/2020	Borrowing Repaid	New Borrowing	Balance on 31/03/2021	Average Rate	Average Life
	£m	£m	£m	£m	%	Years
CFR	**821.8**			**928.1**		
Short Term Borrowing	**133.0**	(158.0)	142.0	**117.0**	0.21%	0.54
Long Term Borrowing	**465.8**	(3.7)	80.0	**542.1**	3.96%	31.6
TOTAL BORROWING	**598.8**	**(161.7)**	**222.0**	**659.1**		

1.17 Internal borrowing is a treasury management practice whereby the Council utilises its cash balances on a temporary basis until the original plans for the cash falls due. This delays the need to borrow externally and as a result the net borrowing for 2020/21 was £269m lower than the Capital Finance Requirement.

1.18 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. Councils 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 Councils 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.

1.19 With short-term interest rates remaining much lower than long-term rates, the Council considered it more cost effective in the near term to utilise a mixture of short-term loans and long-term loans throughout the year to fund the borrowing requirement.

1.20 The Council 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, as a result the Council secured an additional £80m of long term borrowing from PWLB at a rate of 1.64% to support its activities in March 2021.

1.21 The detailed borrowing portfolio for the Council is shown in table 2 below.

Table 2: Borrowing Position

	Balance on 01/04/2020	Net Movement	Balance on 31/03/2021	Average Rate	Average Life
	£m	£m	£m	%	(years)
Public Works Loan Board	300.3	76.3	376.6	4.23%	29.3
Banks (LOBO)	70.5	0.0	70.5	4.64%	43.9
Banks (fixed-term)	15.0	0.0	15.0	4.27%	36.3
Other (fixed-term)	80.0	0.0	80.0	2.01%	22.5
Local authorities (short-term)	133.0	(16.0)	117.0	0.21%	0.54
TOTAL BORROWING	**598.8**	**60.3**	**659.1**		

1.22 The Council has £70.5m exposure to LOBO loans - Lender's Option Borrower's Option of which £41m of these can be "called" during 2020/21. Under the LOBO arrangements lenders can exercise their rights at set times to amend the interest rate on the loan. At that point, the Borrower can accept the revised terms or reject them and repay the loan without penalty. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion. This risk is mitigated by the fact that the Council's current cash holdings mean that any repayment could be accommodated by reducing deposits. Due to the current low interest rates, no banks exercised their option during the year.

Investment Activity

1.23 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £18m and £182m due to timing differences between income and expenditure.

1.24 Both the CIPFA Code and government guidance require the Council 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 Council'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. The table below summarises investment activity during 2020/21.

	Balance on 01/04/2020	Investments made	Investments repaid	Balance on 31/03/2021	Average Rate	Average Life
	£m	£m	£m	£m	%	Days
Fixed term deposits	**0.2**	20.0	(0.2)	**20.0**	0.01%	32
Deposits with the UK DMO	**104.7**	3,102.6	(3,207.3)	**(0.0)**	0.07%	2
Money Market Funds and notice deposits	**5.0**	702.3	(624.6)	**82.7**	0.06%	
TOTAL INVESTMENTS	**109.9**	**3,824.9**	**(3,832.1)**	**102.7**	**0.06%**	**32**

1.25 Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2020/21 which defined "high credit quality organisations" as those having a long-term credit rating of A- or higher that are domiciled in the UK or overseas where the sovereign rating is AA+ or higher.

1.26 Throughout the first three months of the pandemic, the Council moved the majority of its investments into highly secure deposits with the UK Debt Management Account Deposit Facility whilst the impact of financial markets was uncertain. The investments are made for a fixed duration to ensure liquidity. This has lead to a high value of investments made and repaid during the first half of the year. The Council also maintained £5m in high quality money market funds to ensure liquidity for urgent payments including procuring Personal Protective Equipment (PPE). As markets stabilised, the Council moved its investment balance back into money market funds.

1.27 The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.1%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.

1.28 The inter-local authority market has remained above zero throughout the year but rates have remained extremely low. There is limited availability for investments with local authorities for less than one-month so the Council utilised money market funds to manage these short-term differences between income and expenditure.

1.29 There was a downward movement in short-term investments throughout the year the Council's existing short-term borrowing matured and the Council's internal resources were utilised. The new borrowing undertaken in March 2021 has brought this balance back to similar levels as the closing position last year.

Credit developments and credit risk management

1.30 During the year 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.

1.31 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 Council's counterparty list recommended by our 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.

1.32 The Council is holding funds across a range of money market funds and a short term deposit in a local authority at the end of the year to maintain a diverse portfolio and ensure availability of cash for unexpected payments.

Yield

1.33 The Council's average cash balance during 2020/21 was £82.2m and interest earned was £0.04m, an average return of 0.05% (2019/20 – average cash balance of £85.2m and interest earned was £0.7m or 0.83%). The low rates of return on the Council's short-dated money market investments reflect prevailing market conditions and the Council's objective during 2020/21 of optimising returns commensurate with the principles of security and liquidity. The Council had sufficient capacity within the Capital Financing Budget to cover the reduction in investment income whilst benefitting from the reduction in short-term borrowing costs.

1.34 The Council only had exposure to negative interest rates for one deposit held overnight with the UK DMO in December 2020. The deposit was made as part of our contingency arrangements due to a system issue on the day. The loss incurred on this deposit was £43.

1.35 In response to the coronavirus pandemic, the Bank of England's Monetary Policy Committee (MPC) cut official interest rates to a new all-time low of 0.1% in March 2020. The market had seen a significant downward trend from February 2020 onwards, which affected the investment return throughout 2020/21.

Update on Investments with Icelandic Banks

1.36 The Council recovered 98% of its £10 million deposit with Heritable Bank. The investment concluded in 20/21 with a final repayment of £95k received in July 2021.

Compliance

1.37 The Council confirms that it has complied with its Prudential Indicators for 2020/21, which were approved by the Council on 19 February 2020 as part of the Council's Treasury Management Strategy Statement.

1.38 In accordance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2020/21. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Further information is set out in Appendix 1, 2 and 3.

Investment Training

3.34 The needs of the Council's treasury management staff for training in investment management are kept under review and considered as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

3.35 During 2020/21 staff attended training courses, seminars and conferences provided by both Arlingclose, CIPFA and a variety of other organisations.

4. Financial Implications

4.1 Already noted within the report as this is the Treasury Management Outturn Report.

5. Legal Implications

5.1 None identified.

6. Diversity Implications

6.1 None identified.

7. Staffing Implications

7.1 None identified.

<u>Report sign off:</u>

MINESH PATEL
Director of Finance