

Report to: **Audit Committee**

Date: **28 October 2021**

Title: **Annual Treasury Management Report 2020/21**

Portfolio Area: **Cllr H Bastone – Finance and Assets**

Wards Affected: **ALL**

Urgent Decision: **N** Approval and clearance obtained: **Y**

Date next steps can be taken: **N/A**

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**Recommendations:**

**That the Audit Committee:**

1. Approves the actual 2020/21 prudential and treasury indicators in this report.
2. Notes the Annual Treasury Management report for 2020/2021.

**1. Executive summary**

- 1.1 Income from investments this year was £207,288 which is £4,288 higher than the budget of £203,000 at an average return of 0.13%. The comparable performance indicator (Benchmark) is the Sterling Overnight Interbank Average rate (SONIA) which was 0.05%. Therefore the Council achieved 0.08% return on investments over the benchmark for 20/21.
- 1.2 Bank Base rate was at an all time low of 0.1% during the majority of the financial year, which was implemented by the Bank of England in order to counter the negative impact of the national lockdown on large swathes of the economy. The Council's return on investments of 0.13% reflects the fact that investments were kept very short term due to the pandemic and concerns over cashflow as there were many unknown variables such as the impact of the pandemic on key income streams.

## **2. Background**

- 2.1 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).
- 2.2 Treasury management is defined as:

“The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks ”
- 2.3 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 (Minute C86/19)
  - A mid-year (minimum) treasury update report (Minute A22/20)
  - An annual review following the end of the year describing the activity compared to the strategy (this report)
- 2.4 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities.

This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

- 2.5 This Council also 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 Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during 2020/21 in order to support Members' scrutiny role.

### **3. The Economy and Interest Rates**

- 3.1 **UK. Coronavirus.** The financial year 2020/21 will go down in history as being the year of the pandemic. The first national lockdown in late March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A short second lockdown in November did relatively little damage but by the time of the third lockdown in January 2021, businesses and individuals had become more resilient in adapting to working in new ways during a three month lockdown, so much less damage was caused than in the first one. The advent of vaccines starting in November 2020, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.
- 3.2 **BREXIT.** The final agreement on 24<sup>th</sup> December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling has proved to be a formidable barrier to trade. This

appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

- 3.3 The **Monetary Policy Committee** cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a £200bn programme of quantitative easing QE (purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields). The MPC increased then QE by £100bn in June and by £150bn in November to a total of £895bn. While Bank Rate remained unchanged for the rest of the year, financial markets were concerned that the MPC could cut Bank Rate to a negative rate; this was firmly discounted at the February 2021 MPC meeting when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.
- 3.4 **Average inflation targeting.** This was the major change adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and **achieving the 2% target sustainably**". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. This sets a high bar for raising Bank Rate and no increase is expected by March 2024, and possibly for as long as five years.

#### 4. Overall Treasury Position as at 31 March 2021

4.1 At the beginning and the end of 2020/21 the Council's treasury position was as follows:

| Treasury Portfolio   | 31 March 2020 |       | 31 March 2021 |       |
|--|---------------|-------|---------------|-------|
|  | £'000         | Rate% | £'000         | Rate% |
| Treasury Investments:  |               |       |               |       |
| Short term – fixed   | 15,500        | 0.91  | 15,600        | 0.01  |
| Money Market Funds   | 16,100        | 0.41  | 23,200        | 0.00  |
| Heritable Bank   | 22            | -     | 11            | -     |
| CCLA – LAPF  | 1,348         | 4.41  | 1,338         | 4.30  |
| CCLA – DIF   | 1,792         | 3.61  | 1,942         | 3.10  |
| <b>Total treasury investments</b>  | <b>34,762</b> |       | <b>42,091</b> |       |
| Treasury External Borrowing  |               |       |               |       |
| PWLB   | 14,567        | 2.49  | 14,474        | 2.49  |
| <b>Total external borrowing (£14.381m of long term borrowing and £94k of short term borrowing)</b> | <b>14,567</b> |       | <b>14,474</b> |       |
| <b>Net treasury investments / (borrowing)</b>  | <b>20,195</b> |       | <b>27,617</b> |       |

4.2 The following is a list of the Council's investments at 31 March 2021.

#### Fixed Term Deposits

| Amount             | Investment             | Interest rate |
|--------------------|------------------------|---------------|
| £3,500,000         | Barclays Bank plc      | 0.05%         |
| £2,500,000         | Barclays Bank plc      | 0.01%         |
| £3,600,000         | Debt Management Office | 0.00%         |
| £5,000,000         | Lloyds Bank plc        | 0.03%         |
| £1,000,000         | Lloyds Bank plc        | 0.10%         |
| <b>£15,600,000</b> | <b>Total</b>           |               |

#### Money Market Funds

| Amount             | Investment                    | Interest rate |
|--------------------|-------------------------------|---------------|
| £6,000,000         | Aberdeen Standard Investments | 0.00%         |
| £6,000,000         | BlackRock                     | 0.00%         |
| £5,200,000         | Deutsche                      | 0.00%         |
| £6,000,000         | LGIM                          | 0.01%         |
| <b>£23,200,000</b> | <b>Total</b>                  |               |

## **CCLA Funds**

| <b>Amount</b>     | <b>Investment</b>              | <b>Dividend Yield</b> |
|-------------------|--------------------------------|-----------------------|
| £1,338,007        | CCLA – Property Fund           | 4.30%                 |
| £1,942,283        | CCLA – Diversified Income Fund | 3.10%                 |
| <b>£3,280,289</b> | <b>Total</b>                   |                       |

- 4.3 At 31 March 2021, the Council had investments of £1.5million with the CCLA Property Fund and £2million with the CCLA Diversified Income Fund. On 29 March 2018, the Council made the decision to invest £500,000 in the CCLA Local Authority Property Fund and £1million in the CCLA Diversified Income Fund in 2018/19. The investment was increased from £1.5m to £3.5m at Council on 21<sup>st</sup> February 2019 (Minute CM53/18).
- 4.4 The investment was made with a view to a long term commitment. The bid market value as at 31 March 2021 for the Council’s investments were £1,338,007 (Local Authorities Property Fund) and £1,942,283 (Diversified Income Fund).

### **Investment in the South West Mutual Bank**

- 4.5 In 2018/19 the Council approved making a £49,995 investment in the South West Mutual Bank which took the form of a shareholding in the Bank. As the investment was supporting the local economy, it was financed from the business rates pilot gain.
- 4.6 In addition to supporting the local economy, the new Mutual will promote inclusive growth. In particular, it will help make banking more local, provide branch facilities in rural locations, recycle the savings of local people and businesses back into the regional economy, promote financial inclusion and improve access to credit for small and medium sized businesses. The ethos behind the new Mutual was consistent with the Council’s corporate strategy themes of communities and enterprise.
- 4.7 The investment did not have the primary purpose of deriving a financial return and the Council recognised at the time that the funds utilised may not necessarily be returned to the Council. Therefore the investment was written down to Nil during 2018/19.

- 4.8 The coronavirus pandemic and its economic consequences have caused significant delay to the planned timetable for obtaining a banking licence. Investment conditions were severely impacted during the year under review. The Directors took early mitigating actions to protect the Society's financial position by reducing costs significantly. This required reducing the use of contractors and placing staff on furlough, consequently reducing the rate of progress in preparing to apply for a banking licence.
- 4.9 Furthermore, the Directors have had to consider the implications of two material issues.
- 4.10 First, a long-awaited ruling from the FCA (Financial Conduct Authority) Mutuels Register received at the end of May 2021 is disadvantageous for Societies registered under the Co-operative and Community Benefit Societies Act 2014 that are seeking to establish a start-up bank. Inflexibility about the price at which shares can be issued is likely to make it harder to raise capital. The Directors are pursuing a solution to this which they will update members on in due course.
- 4.11 Secondly, independent legal advice on competition law was sought. The Directors believe the outcome of this exercise was positive for the Society's business model, commercial viability and member benefit, but it did require significant management and board time and attention given the importance of the issue.
- 4.12 The formal licence application is expected to take up to 12 months. Preparations to make a formal application are very dependent on fundraising and could take between 9 and 18 months. While this delay is disappointing, the Directors consider that the ability of the Society to have continued through these challenging circumstances is a positive result.
- 4.13 The Directors' fundraising plans remained unchanged in that, the next round of fundraising is planned to finance the Society's activities through to obtaining a provisional banking licence (Authorisation With Restrictions) at which point a third major fundraising will be required to capitalise the bank in order to commence trading.

## **5. The Strategy for 2020/21**

### **Investment strategy and control of interest rate risk**

- 5.1 Investment returns which had been low during 2019/20, plunged during 2020/21 to near zero or even into negative territory. Most local authority lending managed to avoid negative rates and one feature of the year was the growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2020/21 was that Bank Rate would continue at the start of the year at 0.75 % before rising to end 2022/23 at 1.25%. 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.
- 5.2 Whilst 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.
- 5.3 The Treasury Management Strategy Report for 2020/21 was approved by the Council on 30 April 2020 (Minute – C86/19).

### **Borrowing strategy and control of interest rate risk**

- 5.4 During 2019/20, the Council's capital borrowing need, (the Capital Financing Requirement), was fully funded with loan debt.
- 5.5 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.



5.6 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.

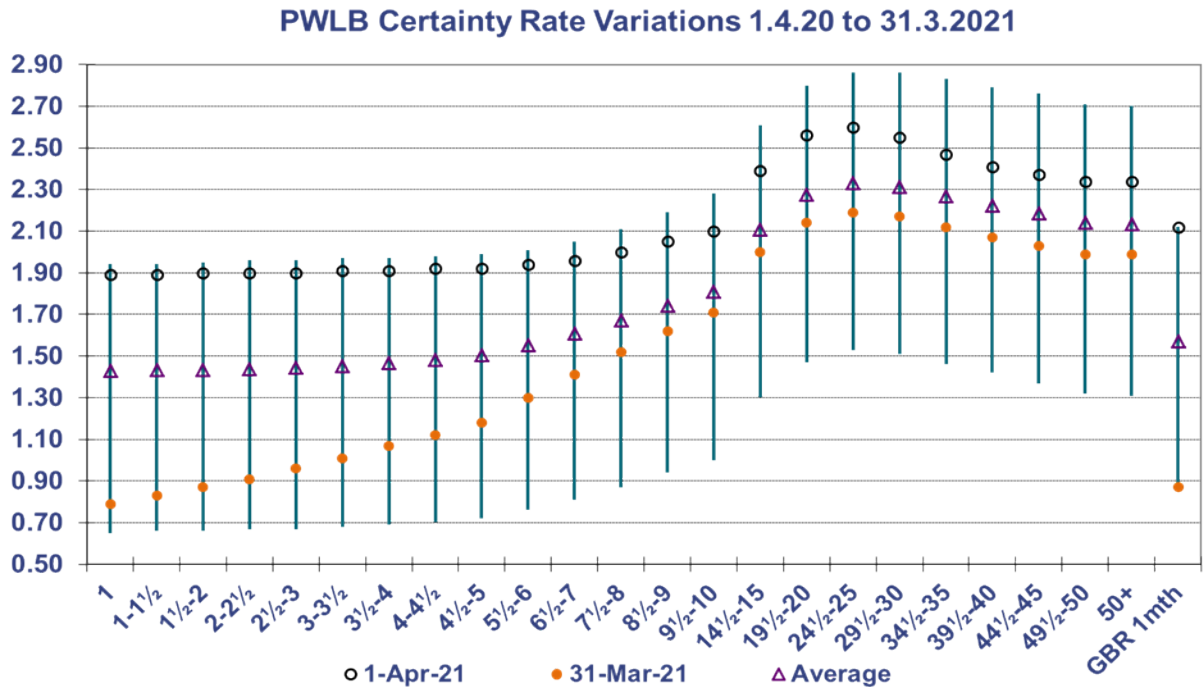
5.7 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Strategic Finance (S.151 Officer) therefore monitored interest rates in financial markets and adopted a pragmatic approach to changing circumstances:

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.
- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

5.8 The current Interest Rate forecast at August 2021 is below:

| Link Group Interest Rate View |        | 10.8.21 |        |        |        |        |        |        |        |        |        |  |
|-------------------------------|--------|---------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--|
|                               | 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   | 0.25   | 0.25   | 0.25   | 0.50   |  |
| 3 month ave earnings          | 0.10   | 0.10    | 0.10   | 0.10   | 0.10   | 0.10   | 0.10   | 0.30   | 0.30   | 0.30   | 0.50   |  |
| 6 month ave earnings          | 0.10   | 0.10    | 0.10   | 0.10   | 0.10   | 0.10   | 0.20   | 0.30   | 0.40   | 0.50   | 0.50   |  |
| 12 month ave earnings         | 0.20   | 0.20    | 0.20   | 0.20   | 0.20   | 0.30   | 0.30   | 0.40   | 0.50   | 0.60   | 0.70   |  |
| 5 yr PWLB                     | 1.20   | 1.20    | 1.20   | 1.30   | 1.30   | 1.30   | 1.40   | 1.40   | 1.40   | 1.50   | 1.50   |  |
| 10 yr PWLB                    | 1.60   | 1.60    | 1.70   | 1.70   | 1.80   | 1.80   | 1.90   | 1.90   | 1.90   | 2.00   | 2.00   |  |
| 25 yr PWLB                    | 1.90   | 2.00    | 2.10   | 2.20   | 2.30   | 2.30   | 2.30   | 2.40   | 2.40   | 2.40   | 2.50   |  |
| 50 yr PWLB                    | 1.70   | 1.80    | 1.90   | 2.00   | 2.10   | 2.10   | 2.10   | 2.20   | 2.20   | 2.20   | 2.30   |  |

5.9 Actual PWLB borrowing rates - the graph below shows, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



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

5.10 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.

- 5.11 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%.
- 5.12 HM Treasury imposed **two changes of margins over gilt yields for PWLB rates in 2019/20** without any prior warning. The first took place on 9<sup>th</sup> October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11<sup>th</sup> March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and **on 25<sup>th</sup> 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.
- 5.13 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)
- 5.14 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 for 2020/21

6.1 Details of the loans outstanding at 31 March 2021 are shown below:

| <b>Lender</b>            | <b>Type and Date Borrowing taken out</b>          | <b>Maturity</b> | <b>Interest Rate %</b> | <b>Principal held at 31 March 2020<br/>£'000</b> | <b>Principal held at 31 March 2021<br/>£'000</b> |
|--------------------------|---|-----------------|------------------------|--|--|
| PWLB – 23 maturity loans | Fixed Interest Rate<br>Borrowed in May 2018       | 5-19 Years      | 2.41*                  | 5,490  | 5,490  |
| PWLB – Annuity           | Fixed Interest Rate<br>Borrowed in December 2019  | 50 Years        | 3.09                   | 5,100  | 5,056  |
| PWLB – Annuity           | Fixed Interest Rate<br>Borrowed in September 2019 | 50 Years        | 1.97                   | 3,977  | 3,928  |
| <b>Total</b>             |   |                 |                        | <b>14,567</b>                                    | <b>14,474</b>                                    |

\*Average interest rate

### Repayments

6.2 During 2020/21 the Council repaid interest of £413,783 at an average rate of 2.49%.

### Borrowing in advance of need

6.3 The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

## Debt rescheduling

- 6.4 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 for 2020/21

- 7.1 **Investment Policy** – the Council’s investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 30 April 2020 (Minute – C86/19). 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.).
- 7.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.
- 7.3 **Resources** – the Council’s cash balances comprise revenue and capital resources and cash flow monies. The Council’s core cash resources comprised as follows:

| <b>Balance Sheet Resources £'000</b> | <b>31 March 2020</b> | <b>31 March 2021</b> |
|--------------------------------------|----------------------|----------------------|
| General Fund Balance                 | 2,010                | 2,122                |
| Earmarked Reserves                   | 13,998               | 21,494*              |
| Usable Capital Receipts              | 3,059                | 2,848                |
| Provisions                           | 1,611                | 1,636                |
| Other                                | 405                  | (6,816)              |
| <b>Total</b>                         | <b>21,083</b>        | <b>21,284</b>        |

\* Earmarked Reserves temporarily increased due to a technical accounting adjustment where Councils were compensated for the business rates holidays that were announced by the Government for the retail, hospitality and leisure sectors in 2020/21. This temporary increase in reserves will reverse back out again in the 2021/22 Accounts, to fund the deficit on the Collection Fund. Therefore this is not money which is available for the Council to spend and it is important that this is not misinterpreted in the Accounts, as this is a national issue.

## **8. Other Issues 2020/21**

### **IFRS 9 fair value of investments**

- 8.1 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 throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

## **9. Outcomes/outputs**

- 9.1 Income from investments this year was £207,288 which is £4,288 higher than the budget of £203,000.
- 9.2 Income from investments this year was £207,288 which is £4,288 higher than the budget of £203,000 at an average return of 0.13%. The comparable performance indicator (Benchmark) is the Sterling Overnight Interbank Average rate (SONIA) which was 0.05%. Therefore the Council achieved 0.08% return on investments over the benchmark for 20/21.

## **10. Options available and consideration of risk**

- 10.1 The Treasury Management Strategy is risk averse with no investments allowed for a period of more than a year and very high credit rating is required, together with a limit of £6m per counterparty. This has resulted in only a small number of institutions in which the Council can invest (see Appendix A).
- 10.2 The Council's treasury management activities and interest rates are reviewed daily to ensure cash flow is adequately planned with surplus funds being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.
- 10.3 The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to Members' attention in treasury management update reports.

## 11. Proposed Way Forward

11.1 The Council's treasury activities and interest rates will continue to be monitored daily and appropriate action taken to mitigate risk whilst optimising investment return where possible.

## 12. Compliance with Treasury Limits and Prudential Indicators

12.1 During 2020/21 the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement. The Council's Prudential Indicators for 2020/21 are detailed and shown in Appendix B.

## 13. Implications

| Implications   | Relevant to proposals Y/N | Details and proposed measures to address  |
|--|---------------------------|---|
| Legal/Governance   | Y                         | Statutory powers are provided by the Local Government Act 1972 Section 151 and the Local Government Act 2003  |
| Financial Implications to include reference to value for money | Y                         | <p>Income from investments this year was £207,288 which is £4,288 higher than the budget of £203,000 at an average return of 0.13%. The comparable performance indicator (Benchmark) is the Sterling Overnight Interbank Average rate (SONIA) which was 0.05%. Therefore the Council achieved 0.08% return on investments over the benchmark for 20/21.</p> <p>Consideration of the Annual Treasury Report forms an essential component of the Council's systems for public accountability. It also provides a platform for future investment planning.</p> |
| Risk   | Y                         | <p>The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation.</p> <p>The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines.</p>   |

|   |   |   |
|---|---|---|
|   |   | The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and Members. |
| Supporting Corporate Strategy                       |   | The income from treasury management supports all the Council's corporate strategy themes.   |
| Climate Change - Carbon / Biodiversity Impact       |   | No direct carbon/biodiversity impact arising from the recommendations.  |
| <b>Comprehensive Impact Assessment Implications</b> |   |   |
| Equality and Diversity                              | N | None directly arising from this report.   |
| Safeguarding  | N | None directly arising from this report.   |
| Community Safety, Crime and Disorder                | N | None directly arising from this report.   |
| Health, Safety and Wellbeing                        | N | None directly arising from this report.   |
| Other implications                                  | N | None directly arising from this report.   |

## **Supporting Information**

### **Appendices:**

Appendix A – Lending list as at 26 March 2021

Appendix B - Prudential and Treasury Indicators 2020/21

### **Background Papers:**

Annual treasury strategy in advance of the year (Council 30 April 2020 – Minute C86/19)

A mid-year treasury update report (Audit Committee 9 February 2021 – Minute A22/20)

## **Approval and clearance of report**

| <b>Process checklist</b>                | <b>Completed</b> |
|---|------------------|
| Portfolio Holder briefed                | <b>Yes</b>       |
| SLT Rep briefed                         | <b>Yes</b>       |
| Relevant Exec Director sign off (draft) | <b>Yes</b>       |
| Data protection issues considered       | <b>Yes</b>       |
| Accessibility checked                   | <b>Yes</b>       |



## APPENDIX A

| Counterparty as at 26th March 2021                |   | Fitch Rating |            |           |         | Moody's Ratings |            |           | S&P Ratings |    |              | Suggested Duration |              |
|---|---|--------------|------------|-----------|---------|-----------------|------------|-----------|-------------|----|--------------|--------------------|--------------|
|   |   | Long Term    | Short Term | Viability | Support | Long Term       | Short Term | Long Term | Short Term  |    |              |                    |              |
| <b>United Kingdom</b>                             |   |              |            |           |         |                 |            |           |             |    |              |                    |              |
| <b>AAA Rated and Government Backed Securities</b> | Collateralised LA Deposit*                  |              |            |           |         |                 |            |           |             |    |              | Y - 60 mths        |              |
|   | Debt Management Office                      |              |            |           |         |                 |            |           |             |    |              | Y - 60 mths        |              |
|   | Multilateral Development Banks              |              |            |           |         |                 |            |           |             |    |              | Y - 60 mths        |              |
|   | Supranationals                              |              |            |           |         |                 |            |           |             |    |              | Y - 60 mths        |              |
|   | UK Gilts                                    |              |            |           |         |                 |            |           |             |    |              | Y - 60 mths        |              |
|   |   |              |            |           |         |                 |            |           |             |    |              |                    |              |
| <b>Banks</b>                                      | Abbey National Treasury Services PLC        | NO           | A+         | F1        |         | 1               | SB         | A1        | P-1         |    |              | R - 6 mths         |              |
|   | Al Rayan Bank PLC                           | NO           |            |           |         |                 | SB         | A1        | P-1         |    |              | R - 6 mths         |              |
|   | Bank of Scotland PLC (RFB)                  | NO           | A+         | F1        | a       | 5               | SB         | A1        | P-1         | NO | A+           | A-1                | R - 6 mths   |
|   | Barclays Bank PLC (NRFB)                    | NO           | A+         | F1        | a       | 5               | SB         | A1        | P-1         | SB | A            | A-1                | R - 6 mths   |
|   | Barclays Bank UK PLC (RFB)                  | NO           | A+         | F1        | a       | 1               | NO         | A1        | P-1         | SB | A            | A-1                | R - 6 mths   |
|   | Close Brothers Ltd                          | NO           | A-         | F2        | a-      | 5               | NO         | Aa3       | P-1         |    |              |                    | R - 6 mths   |
|   | Clydesdale Bank PLC                         | NO           | A-         | F2        | bbb+    | 5               | SB         | Baa1      | P-2         | NO | A-           | A-2                | G - 100 days |
|   | Co-operative Bank PLC (The)                 | NO           | B          | B         | b-      | 5               | SB         | B3        | NP          |    |              |                    | N/C - O mths |
|   | Goldman Sachs International Bank            | NO           | A+         | F1        |         | 1               | SB         | A1        | P-1         | SB | A+           | A-1                | R - 6 mths   |
|   | Handelsbanken Plc                           | NO           | AA         | F1+       |         | 1               |            |           |             | SB | AA-          | A-1+               | O - 12 mths  |
|   | HSBC Bank PLC (NRFB)                        | NO           | AA-        | F1+       | a       | 1               | SB         | A1        | P-1         | SB | A+           | A-1                | O - 12 mths  |
|   | HSBC UK Bank Plc (RFB)                      | NO           | AA-        | F1+       | a       | 1               | NO         | Aa3       | P-1         | SB | A+           | A-1                | O - 12 mths  |
|   | Lloyds Bank Corporate Markets Plc (NRFB)    | NO           | A+         | F1        |         | 1               | SB         | A1        | P-1         | NO | A            | A-1                | R - 6 mths   |
|   | Lloyds Bank Plc (RFB)                       | NO           | A+         | F1        | a       | 5               | SB         | A1        | P-1         | NO | A+           | A-1                | R - 6 mths   |
|   | National Bank of Kuwait (International) PLC | SB           | AA-        | F1+       |         | 1               |            |           |             | SB | A            | A-1                | O - 12 mths  |
|   | NatWest Markets Plc (NRFB)                  | NO           | A+         | F1        | WD      | 1               | PO         | A3        | P-2         | NO | A-           | A-2                | G - 100 days |
|   | Santander UK PLC                            | NO           | A+         | F1        | a       | 2               | SB         | A1        | P-1         | NO | A            | A-1                | R - 6 mths   |
|   | SMBC Bank International PLC                 | NO           | A          | F1        |         | 1               | SB         | A1        | P-1         | SB | A            | A-1                | R - 6 mths   |
| Standard Chartered Bank                           | NO  | A+           | F1         | a         | 5       | SB              | A1         | P-1       | SB          | A  | A-1          | R - 6 mths         |              |
| <b>Building Societies</b>                         | Coventry Building Society                   | NO           | A-         | F1        | a-      | 5               | NO         | A2        | P-1         |    |              | R - 6 mths         |              |
|   | Leeds Building Society                      | NO           | A-         | F1        | a-      | 5               | NO         | A3        | P-2         |    |              | G - 100 days       |              |
|   | Nationwide Building Society                 | NO           | A          | F1        | a       | 5               | SB         | A1        | P-1         | SB | A            | A-1                | R - 6 mths   |
|   | Nottingham Building Society                 |              |            |           |         |                 | NO         | Baa2      | P-2         |    |              | N/C - O mths       |              |
|   | Principality Building Society               | NO           | BBB+       | F2        | bbb+    | 5               | NO         | Baa2      | P-2         |    |              | N/C - O mths       |              |
|   | Skipton Building Society                    | NO           | A-         | F1        | a-      | 5               | SB         | Baa1      | P-2         |    |              | G - 100 days       |              |
|   | West Bromwich Building Society              |              |            |           |         |                 | NO         | Ba3       | NP          |    |              | N/C - O mths       |              |
| Yorkshire Building Society                        | NO  | A-           | F1         | a-        | 5       | NO              | A3         | P-2       |             |    | G - 100 days |                    |              |
| <b>Nationalised and Part Nationalised Banks</b>   | National Westminster Bank PLC (RFB)         | NO           | A+         | F1        | a       | 5               | SB         | A1        | P-1         | NO | A            | A-1                | B - 12 mths  |
|   | Royal Bank of Scotland Group Plc (RFB)      | NO           | A+         | F1        | a       | 5               | SB         | A1        | P-1         | NO | A            | A-1                | B - 12 mths  |

| Key                         |                      |
|-----------------------------|----------------------|
| <b>Watches and Outlooks</b> | <b>Duration</b>      |
| SB Stable Outlook           | Yellow - Y 60 Months |
| NO Negative Outlook         | Blue - B 12 Months   |
| NW Negative Watch           | Orange - O 12 Months |
| PO Positive Outlook         | Red - R 6 Months     |
| PW Positive Watch           | Green - G 100 Days   |
| EO Evolving Outlook         |                      |
| EW Evolving Watch           |                      |

## APPENDIX B

### **PRUDENTIAL AND TREASURY INDICATORS 2020/21**

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

#### **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 tables below show the actual capital expenditure and how this was financed.

| <b>Capital Expenditure</b> | <b>2019/20<br/>Actual<br/>£000</b> | <b>2020/21<br/>Estimate<br/>£000</b> | <b>2020/21<br/>Actual<br/>£000</b> |
|----------------------------|------------------------------------|--------------------------------------|------------------------------------|
| General Fund services      | 4,691                              | 8,482                                | 5,645                              |
| Community Housing          | -                                  | 5,400                                | -                                  |
| Capital investments*       | 4,996                              | 15,370                               | -                                  |
| <b>TOTAL</b>               | <b>9,687</b>                       | <b>29,252</b>                        | <b>5,645</b>                       |

\*Capital investments relate to areas such as capital expenditure on investment properties. In 2020/21 there was no capital expenditure spent on investment properties. The estimate for 2020/21 included possible headroom for expenditure on further investment properties within the Council's Investment Property portfolio and community housing schemes.

| <b>Capital Expenditure and Financing</b> | <b>2019/20 Actual<br/>£000</b> | <b>2020/21 Estimate<br/>£000</b> | <b>2020/21 Actual<br/>£000</b> |
|--|--------------------------------|----------------------------------|--------------------------------|
| Capital Expenditure                      | 9,687                          | 29,252                           | 5,645                          |
| <b>Financed by:</b>                      |                                |                                  |                                |
| External sources                         | (2,261)                        | (1,285)                          | (1,400)                        |
| Own resources                            | (2,189)                        | (4,557)                          | (2,393)                        |
| <b>Unfinanced capital expenditure</b>    | <b>5,237</b>                   | <b>23,410</b>                    | <b>1,852</b>                   |

*NB. Please note that the estimate for 2020/21 represents the approved capital programme for that year. However, actual capital spend includes not only expenditure on projects within that capital programme, but also expenditure on schemes carried forward from previous capital programmes.*

The Capital expenditure estimate for 2020/21 reflects the recommendations within the Commercial Investment Strategy.

### **The Council's Borrowing Need (the Capital Financing Requirement)**

The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

| <b>CFR</b>                                    | <b>2019/20 Actual<br/>£000</b> | <b>2020/21 Estimate<br/>£000</b> | <b>2020/21 Actual<br/>£000</b> |
|---|--------------------------------|----------------------------------|--------------------------------|
| Opening balance                               | 6,291                          | 11,387                           | 11,494                         |
| Add unfinanced capital expenditure (as above) | 5,237                          | 23,410                           | 1,852                          |
| Less MRP/VRP                                  | (34)                           | (344)                            | (344)                          |
| <b>Closing balance</b>                        | <b>11,494</b>                  | <b>34,453</b>                    | <b>13,002</b>                  |

The estimate for 2020/21 included possible headroom for expenditure on further Investment properties within the Council's Investment Property portfolio and community housing schemes.

## **The Council's Gross Debt and the Capital Financing Requirement**

Statutory guidance states that debt should remain below the capital financing requirement, except in the short-term. As can be seen from the indicator below, the debt is slightly higher than the CFR by £1.47m in 2020/21. This is only a short term position as this will finance future capital expenditure such as Dartmouth Health Hub in 2021/22, which will be incurred within the time frame of the forward approved Capital Financing Requirement estimates.

|                               | <b>2019/20<br/>Actual<br/>£000</b> | <b>2020/21<br/>Estimate<br/>£000</b> | <b>2020/21<br/>Actual<br/>£000</b> |
|-------------------------------|------------------------------------|--------------------------------------|------------------------------------|
| Debt                          | 14,567                             | 34,015                               | 14,474                             |
| Capital Financing Requirement | 11,494                             | 34,453                               | 13,002                             |
| Over/(under) funding of CFR   | 3,073                              | (438)                                | 1,472                              |

The estimate for 2020/21 included possible headroom for expenditure on further Investment properties within the Council's Investment Property portfolio and community housing schemes.

### **AFFORDABILITY PRUDENTIAL INDICATORS**

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans.

These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

#### **Ratio of financing costs to net revenue stream**

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

The financing costs were increased in the 2020/21 estimate to reflect the headroom within the Commercial Investment Strategy, and this therefore increased this indicator.

|                                  | <b>2019/20<br/>Actual</b> | <b>2020/21<br/>Estimate</b> | <b>2020/21<br/>Actual</b> |
|----------------------------------|---------------------------|-----------------------------|---------------------------|
| Financing costs (£)              | (165,967)                 | 1,074,067                   | 550,144                   |
| Proportion of net revenue stream | (1.9%)                    | 11.4%                       | 5.85%                     |

## **TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY**

**The Operational Boundary** – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

| <b>Operational Boundary</b> | <b>2019/20</b> | <b>2020/21</b> |
|-----------------------------|----------------|----------------|
|                             | <b>£</b>       | <b>£</b>       |
| Borrowing                   | 70,000,000     | 70,000,000     |
| Other long term liabilities | -              | -              |
| Total                       | 70,000,000     | 70,000,000     |

**The Authorised Limit for External Debt** – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

| <b>Authorised limit</b>     | <b>2019/20</b> | <b>2020/21</b> |
|-----------------------------|----------------|----------------|
|                             | <b>£</b>       | <b>£</b>       |
| Borrowing                   | 75,000,000     | 75,000,000     |
| Other long term liabilities | -              | -              |
| Total                       | 75,000,000     | 75,000,000     |

South Hams District Council's current level of borrowing as at 31 March 2021 was £14.474 million.

As part of the Budget Setting process, Members approved an overall Borrowing Limit of £75million.

The maturity analysis of fixed rate borrowing is as follows, with the maximum and minimum limits for fixed interest rates maturing in each period:

| Refinancing rate risk indicator | Approved minimum limits | Approved maximum limits | Actual 31 March 2020 |              | Actual 31 March 2021 |              |
|---------------------------------|-------------------------|-------------------------|----------------------|--------------|----------------------|--------------|
|                                 | %                       | %                       | £million             | %            | £million             | %            |
| Less than 1 year                | 0%                      | 10%                     | 0.092                | 0.6          | 0.094                | 0.6          |
| Between 1 and 2 years           | 0%                      | 30%                     | 0.094                | 0.7          | 0.096                | 0.7          |
| Between 2 and 5 years           | 0%                      | 50%                     | 1.016                | 7.0          | 1.384                | 9.6          |
| Between 5 and 10 years          | 0%                      | 75%                     | 2.347                | 16.1         | 2.361                | 16.3         |
| More than 10 years              | 0%                      | 100%                    | 11.017               | 75.6         | 10.539               | 72.8         |
| <b>Total</b>                    |                         |                         | <b>14.566</b>        | <b>100.0</b> | <b>14.474</b>        | <b>100.0</b> |