North Devon Council
Report Date: 5th July 2021

Topic: Annual Treasury Management Report 2020/21

Report by: Head of Resources

1. INTRODUCTION
   1.1. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is 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. RECOMMENDATIONS
   2.1 The Committee is asked to recommend to full Council that:
   - The annual treasury management report for 2020/21 be noted;
   - The actual 2020/21 prudential and treasury indicators be approved.

3. REASONS FOR RECOMMENDATIONS

   3.1 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).

   3.2 During 2020/21 the minimum reporting requirements were that the full Council should receive the following reports:
   - an annual treasury strategy in advance of the year (Council 26/02/2020)
   - a mid year treasury update report (Council 25/11/2020)
   - an annual review following the end of the year describing the activity compared to the strategy (this report)

   3.3 This Council confirms that it has complied with the requirements under the Code to give prior scrutiny to all the above treasury management reports by the Policy Development Committee before they were reported to the full Council.

northdevon COUNCIL

4. REPORT

4.1 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	2019/20 Actual	2020/21 Estimate	2020/21 Actual
Capital expenditure	**5,454**	**10,412**	**6,171**
Financed in year	(4,910)	(7,449)	(5,786)
Unfinanced capital expenditure	**544**	**2,963**	**385**

- *Estimate from the Mid-Year Treasury Management Report*

4.2 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 Council's unfinanced capital expenditure

Reducing the CFR – the Council's 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 borrowing need.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR £000	31 March 2020 Actual	31 March 2021 Estimate	31 March 2021 Actual
Opening balance	4,711	4,746	4,746
Add unfinanced capital expenditure (as above)	544	2,963	385
Less MRP	(509)	(540)	(540)
Closing balance	4,746	7,169	4,591

Slippages to the capital programme spend during 2020/21 moving to a later year have resulted in the Capital Financing Requirement (CFR) reducing by £2.578m from the Mid-Year 2020/21 estimate and an actual reduction of £0.155m on the March 2020 actual CFR.

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. 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 Estimate	31 March 2021 Actual
Gross borrowing position	1,250	1,500	500
Total CFR	**4,746**	**7,169**	**4,591**
Over / (under) funding of CFR	(3,496)	(5,669)	(4,091)

- *Estimate from the Mid-Year Treasury Management Report*

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.

	2020/21 £
Authorised limit	22.5m
Maximum gross borrowing position during the year	1.25m
Operational boundary	2.25m
Average gross borrowing position	0.57m
Financing costs as a proportion of net revenue stream	3.71%

4.3 Treasury Position as at 31st March 2021

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

DEBT PORTFOLIO **£000**	31 March 2020 Principal	Rate/ Return	31 March 2021 Principal	Rate/ Return
Total debt (PWLB)	1,250	2.04%	500	1.56%
CFR	4,746		4,591	
Over / (under) borrowing	(3,496)		(4,091)	
Total investments	17,121	0.71%	23,844	0.16%
Net debt/(investments)	(15,871)		(23,344)	

As at 31st March 2021, the Council had a balance of circa £12m of advanced government funding in relation to Covid-19. This was either to be paid out in business support grants through the early period of 2021/22 with any residual balance returned to central government.

The maturity structure of the debt portfolio was as follows:

	31 March 2020 actual	2020/21 Estimate limits	31 March 2021 actual
Under 12 months	£0.75m (60%)	60%	£0m
12 months and within 24 months	£0m	60%	£0m
24 months and within 5 years	£0m	100%	£0m
5 years and within 10 years	£0.50m (40%)	100%	£0.50m (100%)
10 years and above	£0m	90%	£0m

All investments were for maturities less than one year

INVESTMENT PORTFOLIO **£000**	31 March 2020 Actual	31 March 2021 Actual
Treasury investments		
Banks	16,250	22,780
TOTAL TREASURY INVESTMENTS	**16,250**	**22,780**

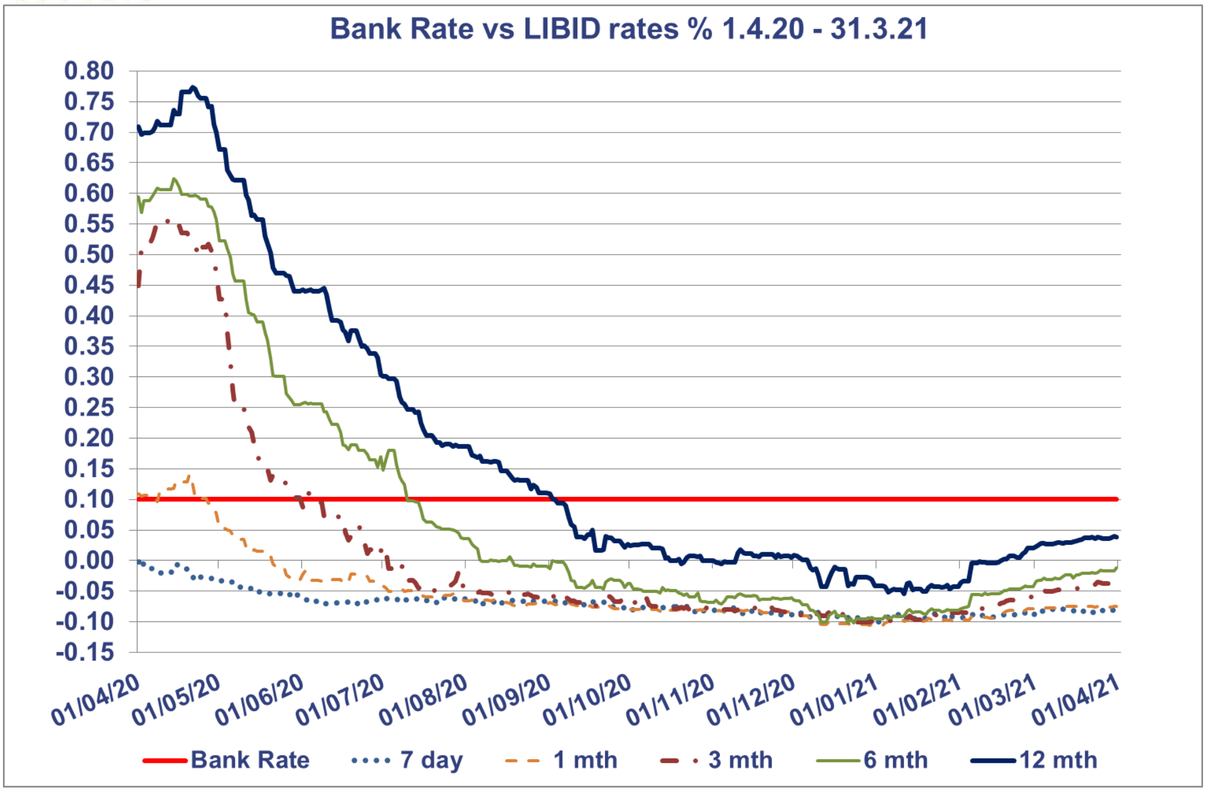
During 2020/21, the Council made no material non-treasury investments in property with the sole purpose of generating an income stream.

4.4 The Strategy for 2020/21

Investment strategy and control of interest rate risk - 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. 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 kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. 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 the counterparty risk exposure, by having fewer investments placed in the financial markets.



Borrowing strategy and control of interest rate risk - During 2020-21, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

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 Section 151 Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

- 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.

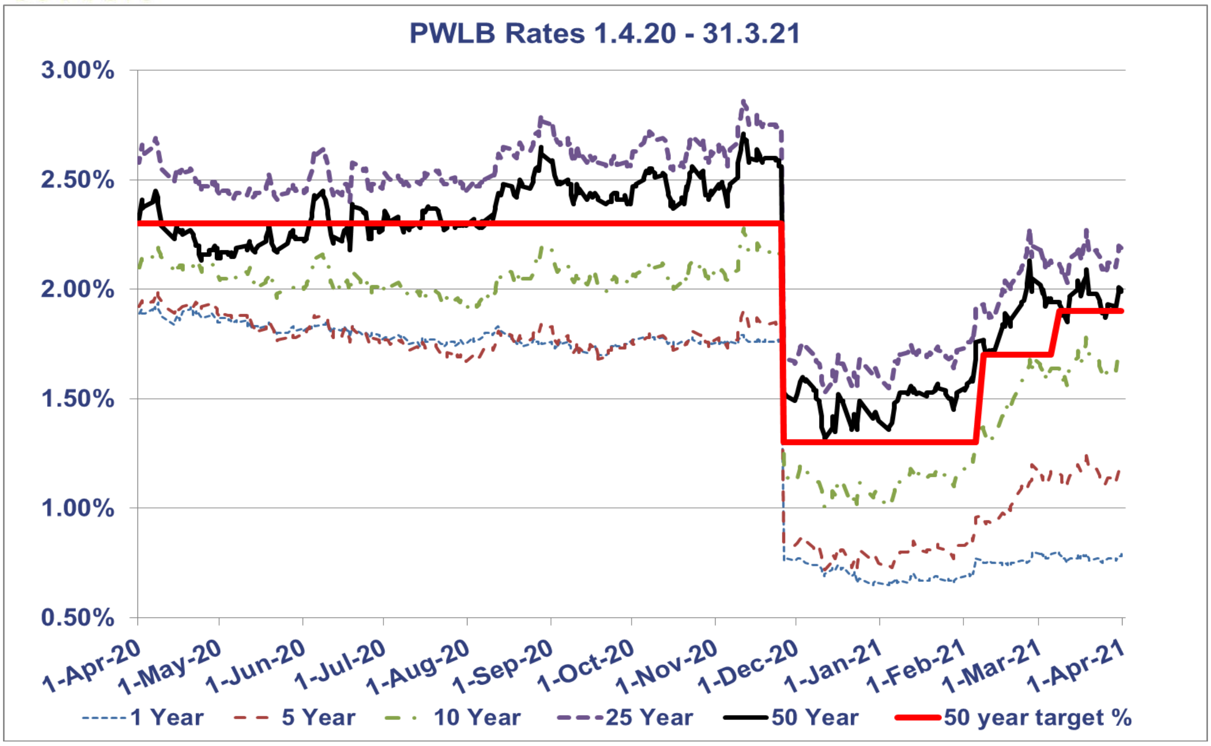
- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden 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.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2020/21 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

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)

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.



4.5 Borrowing Outturn

In May 2020 a PWLB loan of £0.75m matured, leaving the Council's total external borrowing at £0.5m. Whilst the borrowing strategy prudently anticipated a further £1m of external borrowing might be required, cash flow balances and investment concerns, both counterparty risk and low investment returns, meant that no new external borrowing was undertaken during the year.

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.

No debt rescheduling was done during the year as it was not a viable option.

4.6 Investment Outturn

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which was implemented in the annual investment strategy approved by the Council in 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
General Fund Balance	1,161	1,211
Earmarked reserves	5,336	7,715
Provisions	763	725
Usable capital receipts/grants	3,168	2,436
Total	**10,428**	**12,087**

Investments held by the Council - the Council maintained an average balance of £35m of internally managed funds. The internally managed funds earned £52,650 interest at an average rate of return of 0.16%. The comparable performance indicator is the average 7-day LIBID rate, which was -0.07%. This compares with a budget assumption of £50,000 investment interest.

5. RESOURCE IMPLICATIONS
   5.1. As detailed in the report

6. EQUALITIES ASSESSMENT
   6.1. There are not any equalities implications anticipated as a result of this report, as the purpose of the report is to present the Council's financial position only.

7. CONSTITUTIONAL CONTEXT
   7.1. Part 4 Financial Procedure Rules (Article 13.8) / Article 4.4
   7.2. delegated power

8. STATEMENT OF CONFIDENTIALITY
   8.1. This report contains no confidential information or exempt information under the provisions of Schedule 12A of 1972 Act.

9. STATEMENT OF INTERNAL ADVICE
   9.1 The author (below) confirms that advice has been taken from all appropriate Councillors and Officers

Jon Triggs, Head of Resources