

CABINET

THURSDAY 19TH AUGUST 2021

COUNCIL

TUESDAY 21ST SEPTEMBER 2021

REPORT OF THE PORTFOLIO HOLDER FOR FINANCE AND CUSTOMER SERVICES

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2020/21

EXEMPT INFORMATION

None

PURPOSE

The Annual Treasury report is a requirement of the Council's reporting procedures. It covers the Treasury activity for 2020/21, and the actual Prudential Indicators for 2020/21.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes in accordance with Regulations issued under the Local Government Act 2003. It also provides an opportunity to review the approved Treasury Management Strategy for the current year and enables Members to consider and approve any issues identified that require amendment.

RECOMMENDATIONS

That Cabinet ask Council to;

1. Approve the actual 2020/21 Prudential and Treasury Indicators within the report and shown at Appendix 1;
2. Accept the Annual Treasury Management Report for 2020/21; and
3. Approve the continuing investment of c. £8m in property funds before March 2022 as previously planned.

EXECUTIVE SUMMARY

This report covers Treasury operations for the year ended 31st March 2021 and summarises:

- the Council's Treasury position as at 31st March 2021; and
- Performance Measurement

The key points raised for 2020/21 are

1. The Council's Capital Expenditure and Financing 2020/21

2. The Council's Overall Borrowing Need
3. Treasury Position as at 31st March 2021
4. The Strategy for 2020/21
5. Borrowing Outturn for 2020/21
6. Investment Outturn for 2020/21
7. Performance Measurement
8. The Economy and Interest Rates
9. Property Funds
10. Other Issues

The Treasury Function has achieved the following favourable results:

- The Council has complied with the professional codes, statutes and guidance;
- There are no issues to report regarding non-compliance with the approved prudential indicators;
- The Council maintained an average investment balance externally invested of £60.571m and achieved an average return of 0.62% (budgeted at £34.306m and an average return of 1.0%).
- This result compares favourably with the Council's own Benchmarks of the average 7 day and the 3 month LIBID rates for 2020/21 of -0.0706% and 0.0150%;
- The closing weighted average internal rate on borrowing is 4.05% (4.05% for 2019/20);
- The Treasury Management Function has achieved an outturn investment income of £377k compared to an original budget of £332k. Investment balances were higher than budgeted throughout the year, however average interest rates started to fall.
- We also received £128k in dividends from our property fund investments (£147k in 2019/20), compared to a budget of £300k. However the net value of the investments has fallen by £206k as at 31st March 2021. At the meeting on 16th December 2020, Members considered the Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2020/21, including a review of the planned investments in property funds, following consideration by Audit & Governance Committee on 29th October 2020 (as the Committee nominated by Council for the scrutiny of Treasury Management functions). It was resolved that the planned investments in property funds be deferred, with a review during Spring 2021 when the situation should be clearer, to inform future investment plans.

Section 9 of this report provides details of the outcome of this further review and, while no one can know the after effects of the pandemic in terms of reduced economic activity, we are seeing signs of recovery and resilience in certain parts of the economy, and consequently the Funds real estate portfolio. Most funds are able to report relatively high collection rates (over 80%) for the current quarter payment dates which is positive – however, while it could, it is not expected that the effects of the furlough scheme measures ending over the coming months will seriously impact the wider economy and real estate markets.

On balance, it is therefore recommended that the remaining property fund investments of c.£8m continue as planned before March 2022

During 2020/21 the Council complied with its legislative and regulatory requirements.

The Executive Director Finance confirms that there was no overall increase in borrowing within the year and the Authorised Limit was not breached.

At 31st March 2021, the Council's external debt was £63.060m (£63.060m at 31st March 2020) and its external investments totalled £57.972m (£55.26m at 31st March 2020).

RESOURCE IMPLICATIONS

There are no financial implications or staffing implications arising directly from the report.

LEGAL/RISK IMPLICATIONS BACKGROUND

The Council is aware of the risks of passive management of the Treasury Portfolio and with the support of Link Asset Services, the Council's current Treasury advisers, has proactively managed its debt and investments during the year.

EQUALITIES IMPLICATIONS

None

SUSTAINABILITY IMPLICATIONS

None

REPORT AUTHOR

If Members would like further information or clarification prior to the meeting please contact Stefan Garner, telephone 01827 709242 or email stefan-garner@tamworth.gov.uk

LIST OF BACKGROUND PAPERS

- Local Government Act 2003;
- Statutory Instruments: 2003 No 3146 & 2007 No 573;
- CIPFA Code of Practice on Treasury Management in Public Services;
- Treasury Management Strategy 2020/21 (Council 25th February 2020);
- Treasury Management Mid-Year Review 2020/21 (Council 15th December 2020);
- Treasury Outturn Report 2019/20 (Council 15th September 2020).

APPENDICES

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Borrowing and Investment Rates

Annual Treasury Management Review 2020/21

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 complied with:

- an annual treasury strategy in advance of the year (Council 25th February 2020)
- a mid-year (minimum) treasury update report (Council 15th December 2020)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, Cabinet has received quarterly Treasury management updates as part of the Financial Healthcheck Reports.

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 provide scrutiny of all of the above Treasury Management Reports to the Audit and Governance Committee. Member training on Treasury Management issues was provided in November 2019 with further training on the Corporate Capital Strategy in February 2020, and will be provided as and when required in order to support members' scrutiny role.

During 2020/21, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows.

Prudential & Treasury Indicators	2019/20 Actual £m	2020/21 Estimate £m	2020/21 Actual £m
Capital Expenditure			
Non HRA	4.734	12.121	1.133
HRA	20.462	12.699	8.396
Total	25.196	24.820	9.529
Capital Financing Requirement			
Non HRA	3.523	2.806	3.612
HRA	68.532	75.255	69.893
Total	72.055	78.061	73.506
Gross Borrowing			
External Debt	63.060	63.060	63.060
Investments			
Longer than 1 year	3.720	-	3.643
Less than 1 year	55.261	27.197	57.972
Total	58.981	27.197	61.615
Net Borrowing	4.079	35.863	1.445

It should be noted that **£27.5m** of Capital scheme spend has been re-profiled into 2021/22 (also including re-profiling from previous years) which has increased investment balances.

Other prudential and treasury indicators are to be found further in this report. The Executive Director Finance confirms that there was no overall increase in borrowing in year and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2020/21 continued the challenging investment environment of previous years, namely low investment returns.

1. The Council's Capital Expenditure and Financing 2020/21

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 internal funds, the capital expenditure would 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.

General Fund	2019/20 Actual £m	2020/21 Estimate £m	2020/21 Actual £m
Capital Expenditure	4.734	12.121	1.133
Financed in year	1.982	11.195	0.933
Unfinanced capital expenditure	2.752	0.926	0.199
HRA	2019/20 Actual £m	2020/21 Estimate £m	2020/21 Actual £m
Capital Expenditure	20.462	12.699	8.396
Financed in year	19.970	10.509	7.035
Unfinanced capital expenditure	0.492	2.190	1.361

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance 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 25th February 2020.

The Council’s CFR for General Fund and the HRA for the year are shown below, and represent a key prudential indicator.

CFR: General Fund	31st March 2020	31st March 2021	31st March 2021
	Actual £m	Budget £m	Actual £m
Opening balance	0.828	1.986	3.523
Add unfinanced capital expenditure (as above)	2.752	0.926	0.199
Less MRP/VRP	(0.056)	(0.106)	(0.110)
Less PFI & finance lease repayments	-	-	-
Closing balance	3.524	2.806	3.612

CFR: HRA	31st March 2020	31st March 2021	31st March 2021
	Actual £m	Budget £m	Actual £m
Opening balance	68.041	73.065	68.532
Add unfinanced capital expenditure (as above)	0.492	2.190	1.361
Less MRP/VRP	-	-	-
Less PFI & finance lease repayments	-	-	-
Closing balance	68.533	75.255	69.893

Borrowing activity is constrained by prudential indicators for net 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.

Gross borrowing and the CFR	31st March 2020 Actual £m	31st March 2021 Budget £m	31st March 2021 Actual £m
Gross borrowing position	63.060	63.060	63.060
CFR	68.532	78.061	73.506

The lower than estimated CFR reflects re-profiling of spend within the capital programme to 2021/22 and lower than forecast borrowing.

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.

Borrowing Limits	GF £m	HRA £m	Total £m
Authorised limit	5.806	79.407	85.213
Maximum gross borrowing position	-	63.060	63.060
Operational boundary	-	63.060	63.060
Average gross borrowing position	-	63.060	63.060
Budgeted financing costs as a proportion of net revenue stream %	(2.17)	28.24	26.07
Actual financing costs as a proportion of net revenue stream %	(5.44)	28.20	22.75

3. Treasury Position as at 31st March 2021

The Council's 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 beginning and the end of 2020/21 the Council's treasury (excluding borrowing by finance leases) position was as follows:

General Fund	31st March 2020 Principal	Rate/Return %	Average Life yrs	31st March 2021 Principal	Rate/Return %	Average Life yrs
	£m			£m		
Total debt	-	-	-	-	-	-
CFR	3.523	-	-	3.612	-	-
Over / (under) borrowing	(3.523)	-	-	(3.612)	-	-
Investments:						
- in house	37.525	1.01	-	40.779	0.62	-
Total investments	37.525	1.01	-	40.779	0.62	-

HRA	31st March 2020 Principal	Rate/Return %	Average Life yrs	31st March 2021 Principal	Rate/Return %	Average Life yrs
	£m			£m		
Fixed rate funding:						
-PWLB	63.060	4.05	34.73	63.060	4.05	33.73
Total debt	63.060	4.05	34.73	63.060	4.05	33.73
CFR	68.532	-	-	69.893	-	-
Over / (under) borrowing	(5.472)	-	-	(6.833)	-	-
Investments:						
- in house	17.736	1.01	-	17.193	0.62	-
Total investments	17.736	0.68	-	17.193	0.62	-

Maturity Structures

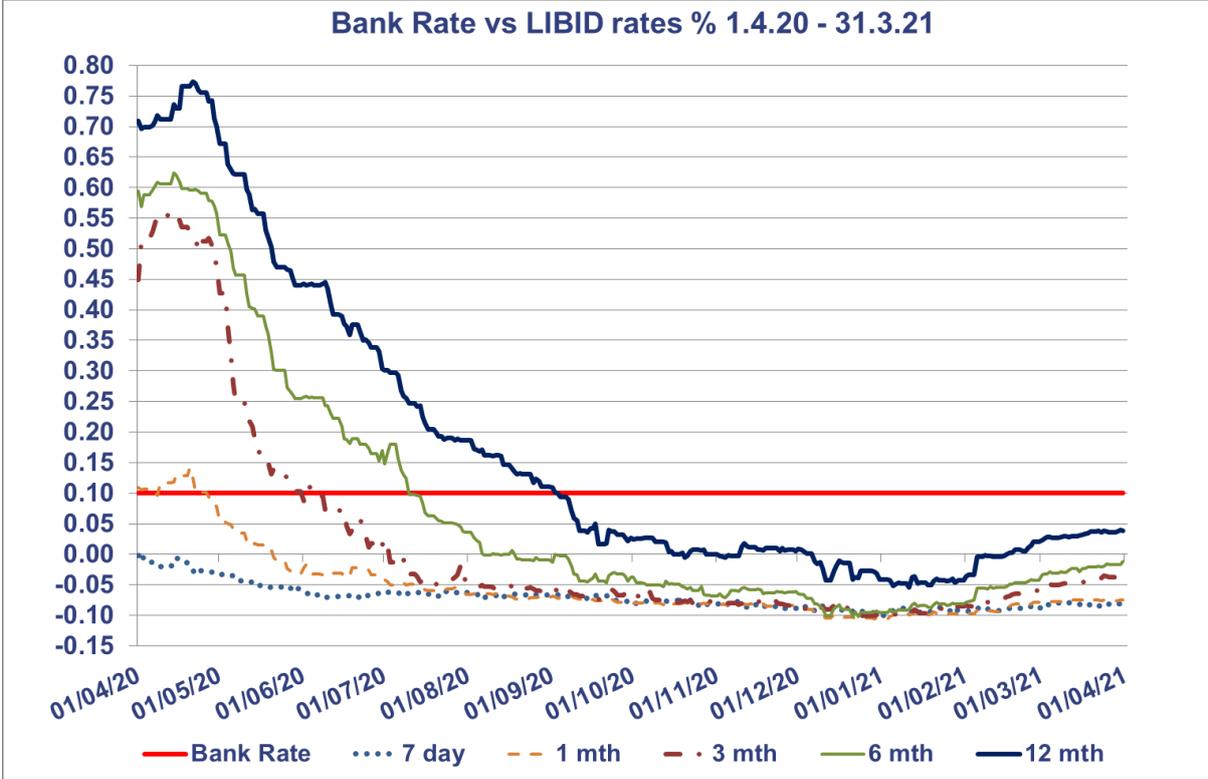
The maturity structure of the debt portfolio was as follows:

Duration	31st March 2020 Actual £m	2020/21 original limits %	31st March 2021 Actual £m
Under 12 months	-	20	-
12 months and within 24 months	-	20	-
24 months and within 5 years	-	25	-
5 years and within 10 years	-	75	-
10 years and within 15 years	5	100	5
15 years and within 50 years	58	100	58

All investments held by the Council were invested for up to one year, with the exception of £3.8m invested in property funds, which are held for the longer-term, 5 – 10 years.

4. The Strategy for 2020/21

4.1 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

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 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.

4.2 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 very low and minimising counterparty risk on placing investments also needed to be considered.

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 and incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

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 the Council 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 Executive Director Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

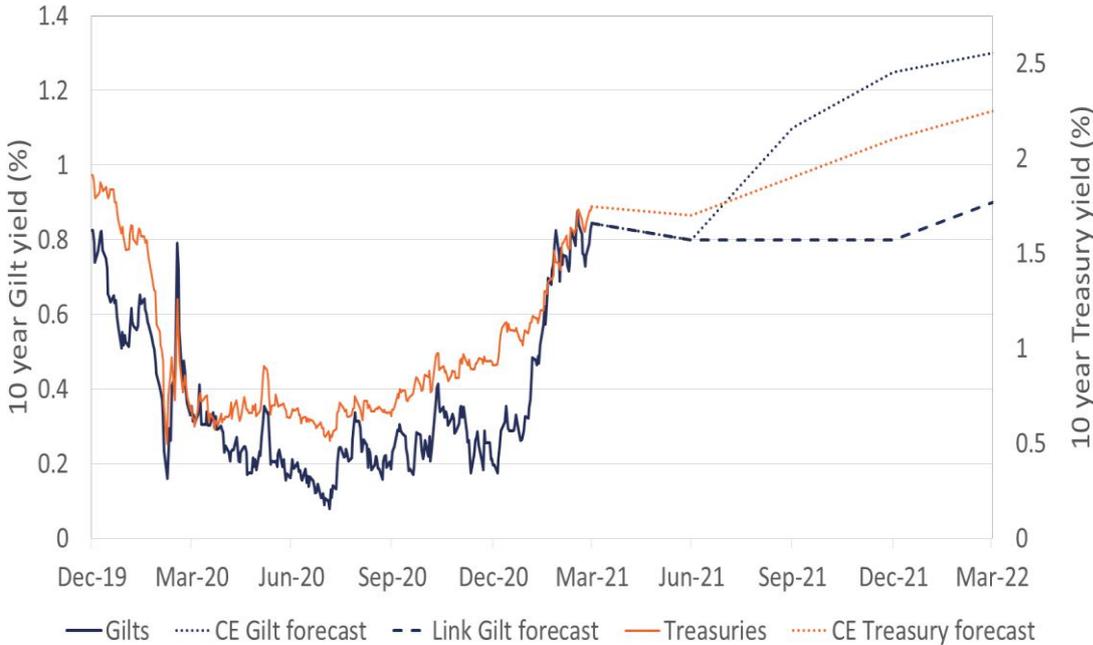
- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding 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.

PWLB Borrowing Rates

PWLB rates are based on, and are determined by, 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 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.

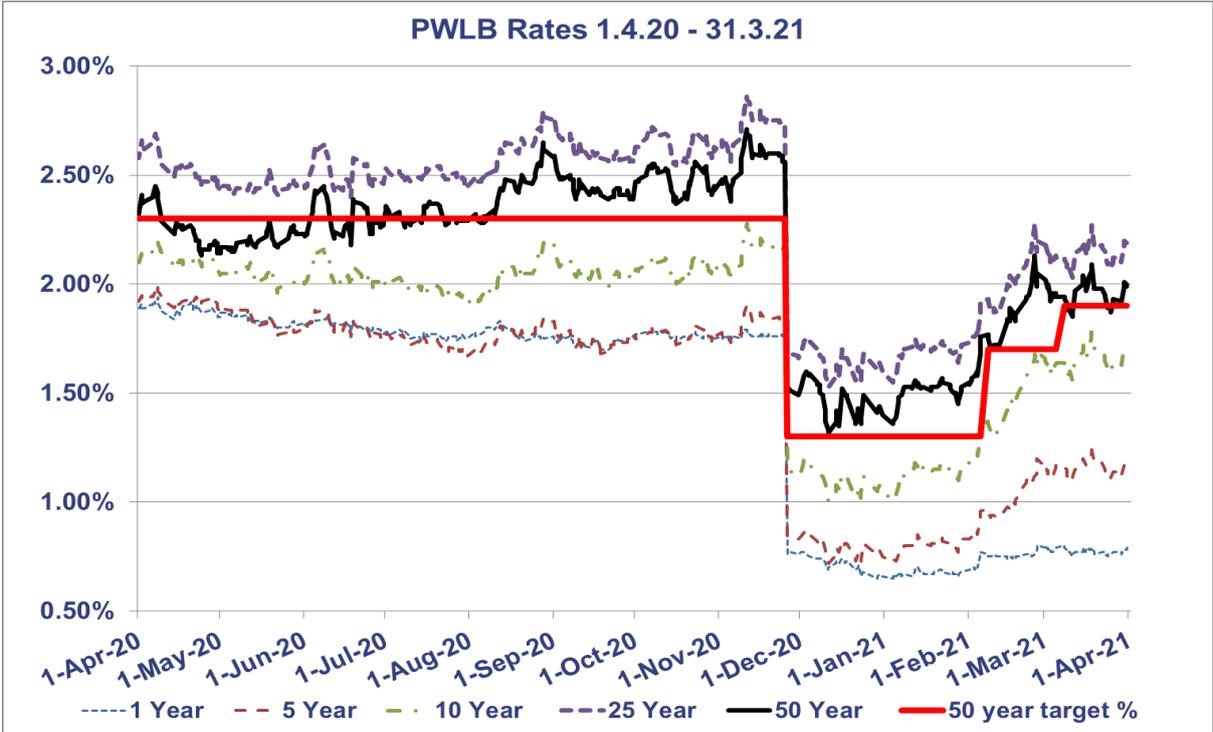
At the close of the day on 31st March 2021, all gilt yields from 1 to 5 years were between 0.19 – 0.58% while the 10-year and 25-year yields were at 1.11% and 1.59%.

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.

The graph and tables for PWLB rates below and in Appendix 2 show, 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.



5. Borrowing Outturn for 2020/21

Treasury Borrowing

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Borrowing in Advance of Need

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.

Rescheduling

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

6. Investment Outturn for 2020/21

Investment Policy – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 25th 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 the following:

Balance Sheet Resources General Fund	31 st March 2020 £m	31 st March 2021 £m
Balances	6.882	8.002
Earmarked Reserves	9.387	18.108
Provisions	2.032	2.637
Usable Capital Receipts	17.279	17.307
Capital Grants Unapplied	0.256	0.295
Total GF	35.836	46.349

Balance Sheet Resources HRA	31 st March 2020 £m	31 st March 2021 £m
Balances	6.252	5.611
Earmarked Reserves	7.789	11.251
Provisions	-	-
Usable Capital Receipts	2.896	2.680
Total HRA	16.937	19.542
Total Authority Resources	52.773	65.891

Investments held by the Council – the Council maintained an average balance of £60.571m of internally managed funds. The internally managed funds earned an average rate of return of 0.62%. The comparable performance indicator is the average 7-day LIBID rate which was -0.0706%. This compared with a budget assumption of £34.306m investment balances earning an average rate of 1.0%.

7. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table in section 3). The Council's performance indicators were set out in the Annual Treasury Management Strategy Statement.

This service has set the following local performance indicator:

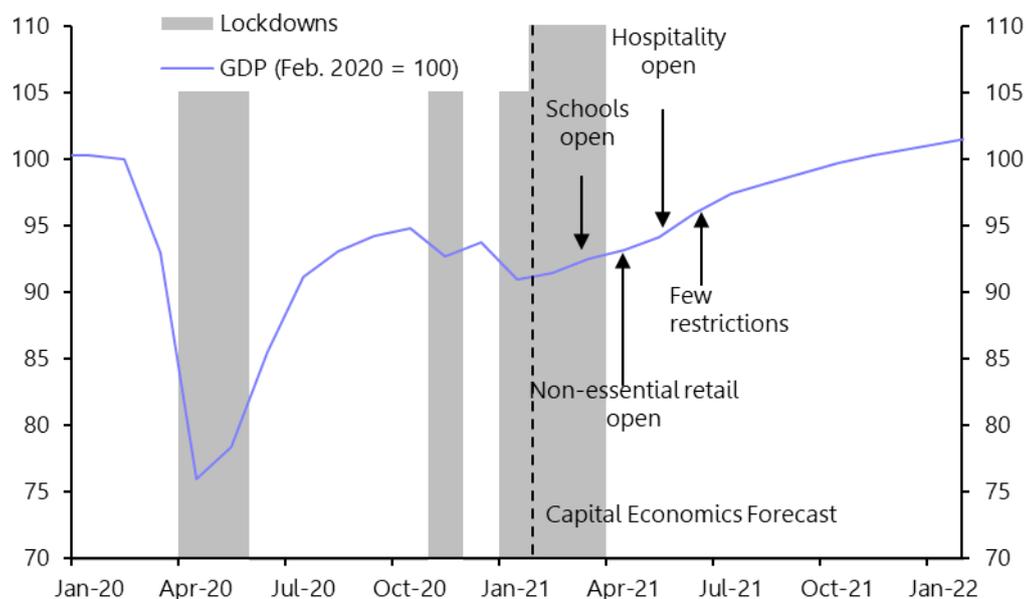
➤ *Average external interest receivable in excess of 3 month LIBID rate;*

Whilst the assumed benchmark for local authorities is the 7 day LIBID rate, a higher target is set for internal performance.

The actual return of 0.62% compared to the average 3 month LIBID of 0.0150% (0.605% above target).

8. The Economy and Interest Rates

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 than was caused than in the first one. The advent of vaccines starting in November 2020 was 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.



Both the Government and the Bank of England took rapid action in March 2020 at the height of the crisis to provide support to financial markets to ensure their proper functioning, and to support the economy and to protect jobs.

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 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.

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. Inflation has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern to the MPC.

Government support. The Chancellor has implemented repeated rounds of support to businesses by way of cheap loans and other measures, and has protected jobs by paying for workers to be placed on furlough. This support has come at a huge cost in terms of the Government's budget deficit ballooning in 20/21 and 21/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3rd March 2021 increased fiscal support to the economy and employment during 2021 and 2022 followed by substantial tax rises in the following three years to help to pay the cost for the pandemic. This will help further to strengthen the economic recovery from the

pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%. An area of concern, though, is that the government's debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed long-term debt for floating rate debt; there is, therefore, much incentive for the Government to promote Bank Rate staying low e.g. by using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and / or by amending the Bank's policy mandate to allow for a higher target for inflation.

BREXIT. The final agreement on 24th 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.

USA. The US economy did not suffer as much damage as the UK economy due to the pandemic. The Democrats won the presidential election in November 2020 and have control of both Congress and the Senate, although power is more limited in the latter. This enabled the Democrats to pass a \$1.9trn (8.8% of GDP) stimulus package in March on top of the \$900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly to hit the target of giving a first jab to over half of the population within the President's first 100 days, will promote a rapid easing of restrictions and strong economic recovery during 2021. The Democrats are also planning to pass a \$2trn fiscal stimulus package aimed at renewing infrastructure over the next decade. Although this package is longer-term, if passed, it would also help economic recovery in the near-term.

After Chair Jerome Powell spoke on the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed a new inflation target - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. There is now some expectation that where the Fed has led in changing its policy towards implementing its inflation and full employment mandate, other major central banks will follow, as indeed the Bank of England has done so already. The Fed expects strong economic growth during 2021 to have only a transitory impact on inflation, which explains why the majority of Fed officials project US interest rates to remain near-zero through to the end of 2023. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping treasury yields at historically low levels. However, financial markets in 2021 have been concerned that the sheer amount of fiscal stimulus, on top of highly accommodative monetary policy, could be over-kill leading to a rapid elimination of spare capacity in the economy and generating higher inflation much quicker than the Fed expects. They have also been concerned as to how and when the Fed will

eventually wind down its programme of monthly QE purchases of treasuries. These concerns have pushed treasury yields sharply up in the US in 2021 and is likely to have also exerted some upward pressure on gilt yields in the UK.

EU. Both the roll out and take up of vaccines has been disappointingly slow in the EU in 2021, at a time when many countries are experiencing a sharp rise in cases which are threatening to overwhelm hospitals in some major countries; this has led to renewed severe restrictions or lockdowns during March. This will inevitably put back economic recovery after the economy had staged a rapid rebound from the first lockdowns in Q3 of 2020 but contracted slightly in Q4 to end 2020 only 4.9% below its pre-pandemic level. Recovery will now be delayed until Q3 of 2021 and a return to pre-pandemic levels is expected in the second half of 2022.

Inflation was well under 2% during 2020/21. **The ECB** did not cut its main rate of -0.5% further into negative territory during 2020/21. It embarked on a major expansion of its QE operations (PEPP) in March 2020 and added further to that in its December 2020 meeting when it also greatly expanded its programme of providing cheap loans to banks. The total PEPP scheme of €1,850bn is providing protection to the sovereign bond yields of weaker countries like Italy. There is, therefore, **unlikely to be a euro crisis** while the ECB is able to maintain this level of support.

China. After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth.

Japan. Three rounds of government fiscal support in 2020 together with Japan's relative success in containing the virus without draconian measures so far, and the roll out of vaccines gathering momentum in 2021, should help to ensure a strong recovery in 2021 and to get back to pre-virus levels by Q3.

World growth. World growth was in recession in 2020. Inflation is unlikely to be a problem in most countries for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Deglobalisation. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. In March 2021, western democracies implemented limited sanctions against a few officials in charge of government policy on the Uighurs in Xinjiang; this led to a much bigger retaliation by China and is likely to mean that the China / EU investment deal then being negotiated, will be torn up. After the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products and vice versa. This is likely to reduce world growth rates.

Central banks' monetary policy. During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend

the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.

9. Investment in Property Funds

Investment in property funds was included within the Commercial Investment Strategy, with the aim of generating improved returns of c.4-5% p.a. (plus asset growth) being long term investments of between 5 – 10 years (minimum) in order to make the necessary returns (after set up costs). Utilising the capital receipt proceeds of the sale of the Golf Course, a budget of £12m was allocated to long-term investment in a number of property funds. To date, the Council has invested £1.85m with Schrodgers UK Real Estate Fund and £2m with Threadneedle Property Unit Trust, total investment £3.85m.

At the meeting on 16th December 2020, Members considered the Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2020/21, including a review of the planned investments in property funds, following consideration by Audit & Governance Committee on 29th October 2020 (as the Committee nominated by Council for the scrutiny of Treasury Management functions). It was resolved that the planned investments in property funds be deferred, with a review during Spring 2021 when the situation should be clearer, to inform future investment plans.

During March 2020, the majority of property valuation firms in the UK concluded unanimously that they were faced with an unprecedented set of circumstances on which to base a valuation judgement and thus were required to include a 'Material Valuation Uncertainty' clause to their valuations. The result was that the majority of UK property funds suspended dealing.

As time has progressed and more transactional evidence post the lockdown became available the Material Valuation Uncertainty clause was lifted. This in turn means the Managers approved the lifting of the suspension of the Funds with dealing in the Funds resuming during October 2020.

The latest Investment Property Forum (IPF) Consensus Forecasts were revised down over the forecast horizon, with notable downgrades to the outlook for 2021. The Investment Property Forum Consensus Forecasts Spring 2021 Survey of Independent Forecasts for UK Commercial Property Investment in May 2021 has subsequently demonstrated, over the second quarter, the 2021 All Property average growth rate rose almost 1%, to -1.7% (still below May 2020's projection of -1.3%).

For 2022, the expectation for the All Property average is stronger than three months ago – now 0.9% from 0.4% previously. Other than Offices, all sector ranges increased over the quarter, with Retail Warehouses recording the greatest improvement of over 1% to average -0.9%.

Sector rental growth forecasts for the remaining three years of the survey have broadly strengthened, with All Property averages of 1.7% in 2023 and 2024 and 1.6% in 2025. The All Property forecast now lies at 4.4% (from 2.1% in February).

Mirroring capital value expectations, total return forecasts are likely to peak in 2022. The average All Property total return forecast now stands at 6.9% (6.6% previously), with sector forecasts ranging between 2.3% (Shopping Centres) to 9.2% (Industrials).

In each of the three remaining survey years, most sector averages weaken, resulting in the All Property averages falling from 6.4% in 2023 to 5.6% by 2025, when the best-performing sector may prove to be Retail Warehouses, currently predicted to deliver a total return of 6.9%.

The following table illustrates the evolution of the average All Property forecasts for the current year and 2022, as well as over five years, from February 2020:

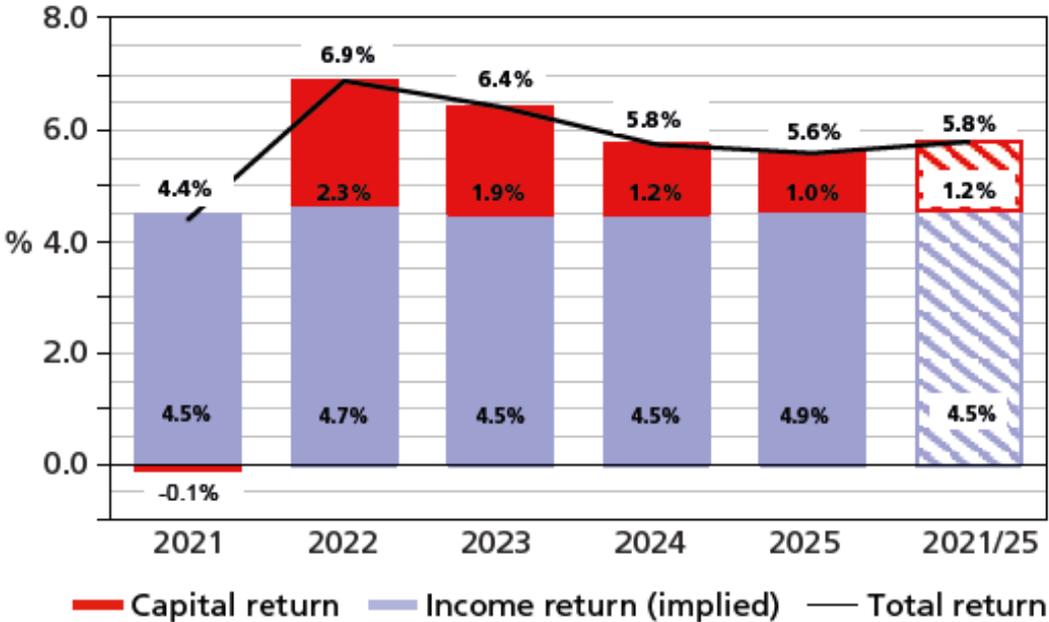
All Property Average by Forecast Month

Month of forecast (no. contributors)	Rental value growth (%)				Capital value growth (%)				Total return (%)			
	2021	2022	2023	2021/25	2021	2022	2023	2021/25	2021	2022	2023	2021/25
March (5)	-2.2	0.5	1.5	0.5	-1.3	0.6	0.8	0.3	3.2	5.2	5.3	4.8
April (4)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
May (12)	-1.7	0.9	1.8	0.8	0.0	2.1	2.2	1.3	4.4	6.8	6.6	5.9
All Forecasters (21)	-1.7	0.9	1.7	0.8	-0.1	2.3	1.9	1.2	4.4	6.9	6.4	5.8

Source: IPF Survey of Independent Forecasts for UK Commercial Property Investment Spring 2021

The 2021 total return averages rose by 2.25% over the quarter (from February’s average of 2.1%) and next year’s average also showed an increase, of 0.29% (previously averaging 6.6%). However, the following three years’ projections have weakened, down 0.25%, 0.59% and 0.72% lower for 2023, 2024 and 2025 respectively (from 6.7%, 6.3% and 6.3% last quarter). Despite weaker forecasts for these later years, improved projections for 2021 and 2022 support a modest improvement in the five-year average (from 5.6% pa previously).

All Property total return forecasts



Source: IPF Survey of Independent Forecasts for UK Commercial Property Investment Spring 2021

While no one can know the after effects of the pandemic in terms of reduced economic activity, we are seeing signs of recovery and resilience in certain parts of the economy, and consequently the Funds real estate portfolio. For most funds, the strategic position, resilient tenant base and the Fund Management Teams' efforts, has maximised rent collection during this challenging period being able to report relatively high collection rates (over 80%) for quarter is positive.

To date, the Council has invested £1.85m with Schroders UK Real Estate Fund and £2m with Threadneedle Property Unit Trust, total investment £3.85m – however, capital values had fallen by £291k to 30th September 2020, mainly since 31st March 2020 (£163k), but have since recovered, through capital growth since then, to £126k at 30th June 2021. It should also be noted that investments in property are subject to fluctuations in value over the economic cycle and should also yield capital growth in the longer term as the economy grows. As can be seen from the following table, fund valuations have improved significantly since the falls during 2020.

Fund Valuations	Investment	Valuation 31/03/2019	Valuation 31/03/2020	Valuation 31/03/2021	Valuation 30/06/2021
Schroders UK Real Estate Fund	1,848,933	1,897,716	1,884,412	1,848,933	1,873,930
Valuation Increase / (reduction)		48,783	35,479	0	24,996
Threadneedle Property Unit Trust	2,000,249	1,921,884	1,836,032	1,794,439	1,849,290
Valuation Increase / (reduction)		(78,365)	(164,216)	(205,810)	(150,958)
Total	3,849,182	3,819,601	3,720,444	3,643,372	3,723,220
Valuation Increase / (reduction)		(29,581)	(128,738)	(205,810)	(125,962)

Fund reductions also need to be balanced against the dividends received (which support the revenue budget). The Council received £128k in dividends from its property fund investments in 2020/21 (£147k in 2019/20), £383k in total compared to the valuation reduction of £206k over the same period.

Fund Valuations	Dividend Returns 31/03/2019	Dividend Returns 31/03/2020	Dividend Returns 31/03/2021	Dividend Returns 30/06/2021	Estimated Return p.a.	
Schroders UK Real Estate Fund	48,118	56,638	52,898	19,167	2.8%	for 2021/22 - First Qtr only to 30/06/21
Cumulative return	48,118	104,756	157,654	176,821		
Threadneedle Property Unit Trust	60,056	90,274	75,452	19,947	4.2%	
Cumulative return	60,056	150,329	225,781	245,728		
Total	108,174	146,911	128,350	39,115		
Cumulative return	108,174	255,085	383,435	422,550		
Annual Revenue % Return	2.8%	3.8%	3.3%	1.0%	3.6%	
Annual Overall % Return	2.0%	1.2%	1.3%	3.1%		
Cumulative Gain / (loss)	78,593	126,348	177,625	296,588		

Internal Treasury Return Achieved %	0.9%	1.0%	0.8%	0.6%	0.5%	
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The funds achieved a return of 3.3% in 2020/21, 3.8% during 2019/20 and 2.8% in 2018/19 compared to internal investments with banks and other Councils of less than 1%.

The MTFS includes budgeted income of £300k for 2021/22 (£480k pa from 2022/23) arising from investment of the full £12m budgeted, however, due to uncertainty around arrangements for Brexit and the associated impact on the economy, and then the further uncertainty and questions over the potential outlook for future property fund returns as a result of the coronavirus, any further investment in property funds had been delayed until there is more clarity.

Conclusions

While risk is inherent in investment decisions, property fund investments provide investors with a strong level of return over the medium to longer term investment time horizon – which is why the Council was clear at the outset that the investments would be longer term (at least 10 years) in order to benefit from capital growth and generating significantly improved annual investment returns supporting the revenue budget. The overall return is made up of income, achieved via rental streams and capital via the changing value of underlying properties within a fund. While the second element is the most volatile from a year-to-year perspective, the income produced by the funds is relatively stable.

While no one can know the after effects of the pandemic in terms of reduced economic activity, we are seeing signs of recovery and resilience in certain parts of the economy, and consequently the Funds real estate portfolio. Most funds are able to report relatively high collection rates (over 80%) for the current quarter payment dates which is positive – however, while it could, it is not expected that the effects of the furlough scheme measures ending over the coming months will seriously impact the wider economy and real estate markets.

There will be secondary market investment opportunities available with a potential discount of up to 5% on purchase costs, which needs to be considered with the potential for capital gains in the coming months.

On balance, it is therefore suggested that the remaining property fund investments of c.£8m continue as planned before March 2022.

10. Other Issues

International Financial Reporting Standard (IFRS) 9 – Financial Instruments.

The 2018/19 Accounting Code of Practice introduced changes in way investments are valued and disclosed in the Council's Statement of Accounts. Key considerations are:-

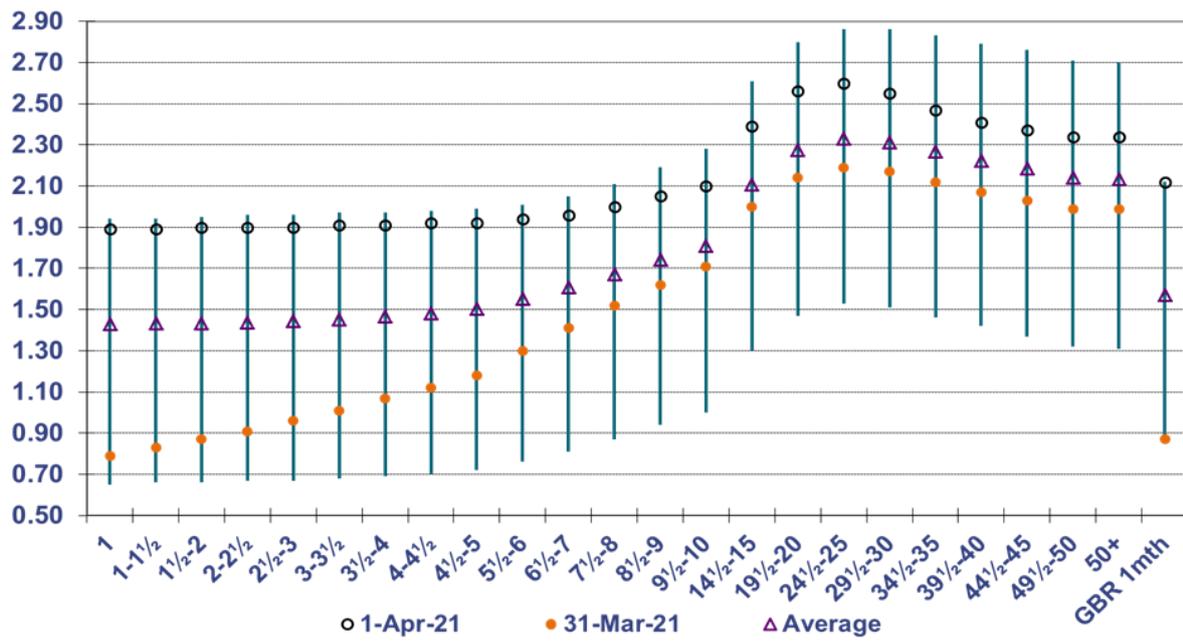
- Expected credit loss model. Whilst not material for vanilla treasury investments such as bank deposits, this does impact our investment in property funds
- The valuation of investments previously valued under the available for sale category e.g. equity related to the “commercialism” agenda, property funds, equity funds and similar, will be changed to **Fair Value through the Profit and Loss (FVPL)**.

Following the consultation undertaken by the Ministry of Housing, Communities and Local Government [MHCLG] on IFRS9, 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 1st April 2018, and 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.

1. PRUDENTIAL INDICATORS	2019/20	2020/21	2020/21
Extract from budget and rent setting report	Actual	Original	Actual
Capital Expenditure	£m	£m	£m
Non - HRA	4.734	12.121	1.133
HRA	20.462	12.699	8.396
TOTAL	25.196	24.820	9.529
Ratio of financing costs to net revenue stream	%	%	%
Non - HRA	(9.39)	(2.17)	(5.44)
HRA	27.44	28.24	28.20
Gross borrowing requirement General Fund	£m	£m	£m
brought forward 1 April	0.828	1.986	3.523
carried forward 31 March	3.580	2.912	3.723
in year borrowing requirement	2.752	0.926	0.199
Gross borrowing requirement HRA	£m	£m	£m
brought forward 1 April	68.041	73.065	68.532
carried forward 31 March	68.533	75.255	69.893
in year borrowing requirement	0.492	2.190	1.361
	£m	£m	£m
Gross debt	63.060	63.060	63.060
Capital Financing Requirement	£m	£m	£m
Non – HRA	3.524	2.806	3.612
HRA	68.533	75.255	69.893
TOTAL	72.057	78.061	73.506
Annual change in Capital Financing Requirement	£m	£m	£m
Non – HRA	2.696	0.820	0.089
HRA	0.492	2.190	1.361
TOTAL	3.188	3.010	1.450

2. TREASURY MANAGEMENT INDICATORS	2019/20	2020/21	2020/21
	Actual	Original	Actual
	£m	£m	£m
Authorised Limit for external debt - General Fund			
borrowing	5.235	5.806	5.806
other long term liabilities	-	-	-
TOTAL	5.235	5.806	5.806
Authorised Limit for external debt - HRA			
borrowing	79.407	79.407	79.407
other long term liabilities	-	-	-
TOTAL	79.407	79.407	79.407
Operational Boundary for external debt - General Fund	£m	£m	£m
borrowing	-	-	-
other long term liabilities	-	-	-
TOTAL	-	-	-
Operational Boundary for external debt - HRA	£m	£m	£m
borrowing	63.060	63.060	63.060
other long term liabilities	-	-	-
TOTAL	63.060	63.060	63.060
Actual external debt	£m	£m	£m
	63.060	63.060	63.060

PWLB Certainty Rate Variations 1.4.20 to 31.3.2021



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
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%
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%

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