REPORT to :	Audit & Governance Committee
LEAD OFFICER:	Head of Financial Services
DATE:	29th June 2021

WARD/S AFFECTED: All

Treasury Management Annual Report 2020/21

1. PURPOSE

1.1 To formally report the Treasury outturn for 2020/21, as also reflected in the 2020/21 Outturn Corporate Monitoring Report (8th July Executive Board).

2. RECOMMENDATIONS

2.1 Audit and Governance Committee is recommended to note the Outturn position for 2020/21.

3. BACKGROUND

3.1 In February/March 2020 the Council agreed a Treasury Management Strategy and Minimum Revenue Provision (MRP) Policy for 2020/21. An update to the MRP policy was approved by Finance Council in March 2021.

3.2 The CIPFA Treasury Management Code required the Council to approve a Treasury Management Strategy (including various Treasury Management indicators) before the start of each financial year, and to consider the outturn after each year end. This report is to update Audit and Governance Committee on the overall outturn position for 2020/21.

4. KEY ISSUES AND RISKS

4.1 Treasury Priorities

The Council has operated within CIPFA and statutory guidance and requirements in respect of Treasury Management practice. The approved Treasury Management Policy Statement, together with the more detailed Treasury Management Practices and each year's Annual Strategy have all emphasised the importance of security and liquidity over yield.

5. 2020/21 OUTTURN

5.1 Original Strategy for 2020/21

5.1.1 The Strategy for 2020/21 was approved by Executive Board on 12th March 2020. The main aspects of the strategy are outlined below :

- With short-term interest rates expected to continue to be lower than long-term rates it was acknowledged, for another year, that it may continue to be more cost effective not to borrow and instead reduce the level of investments.

- Long-term borrowing would be taken if it became apparent that there was a risk of significantly increased interest rates.

- Any balances over and above those required to maintain basic liquidity could be invested either in the medium term (out to a year) or the longer term (over a year). Priority was given to security of funds and liquidity (accessibility) over yield (or return).

- The limits to investment by reference to amount, duration and credit rating were largely unchanged from those applying in previous years.

5.2 Economic Review 2020/21

5.2.1 The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

Some good news came in December 2020 as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency. The UK vaccine rollout started in earnest; over 31 million people had received their first dose by 31st March.

A Brexit trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline having been agreed with the European Union on Christmas Eve.

5.2.2 The Bank of England held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

5.2.3 Government initiatives supported the economy and the Chancellor announced in the 2021 Budget a further extension to the furlough (Coronavirus Job Retention) scheme until September 2021. Access to support grants was also widened, enabling more self-employed people to be eligible for government help. Since March 2020, the government schemes have help protect more than 11 million jobs.

5.2.4 Despite the furlough scheme, unemployment still rose. Labour market data showed that in the three months to January 2021 the unemployment rate was 5.0%, in contrast to 3.9%

recorded for the same period 12 months ago. Wages rose 4.8% for total pay in nominal terms (4.2% for regular pay) and was up 3.9% in real terms (3.4% for regular pay). Unemployment is still expected to increase once the various government job support schemes come to an end.

5.2.5 Inflation has remained low over the 12 month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation fell to 0.4% year/year in February, below expectations (0.8%) and still well below the Bank of England's 2% target. The Office for National Statistics' preferred measure of Consumer Price Index including Housing Costs which includes owner-occupied housing was 0.7% year/year (1.0% expected).

After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% quarter on quarter, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower pace than the 41.7% rise in the prior quarter. When released, figures for Q1 (Jan-Mar) 2021 are expected to show a decline given the national lockdown.

5.2.6 Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

5.2.7 In November 2020 the Public Works Loan Board (PWLB) published its response to the consultation on 'Future Lending Terms'. From 26th November the margin on PWLB loans above gilt yields was reduced from 1.8% to 0.8% providing that the borrowing authority can confirm that it is not planning to purchase 'investment assets primarily for yield' in the current or next two financial years. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. As part of the borrowing process authorities will now be required to submit more detailed capital expenditure plans with confirmation of the purpose of capital expenditure from the Section 151 Officer. The PWLB can now also restrict local authorities from borrowing in unusual or large amounts.

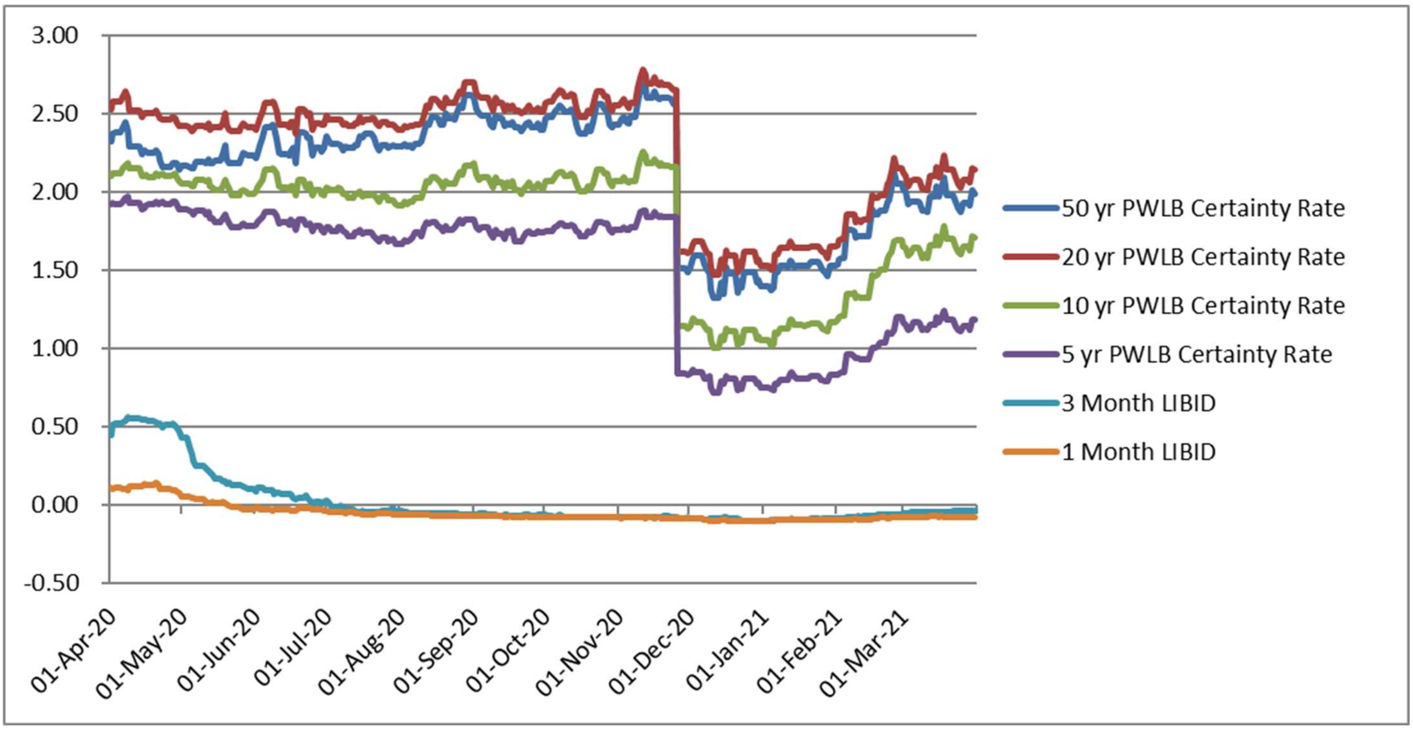
Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management. Misuse of PWLB borrowing could result in the PWLB requesting that Authority unwinds problematic transactions, suspending access to the PWLB and repayment of loans with penalties.

Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

The Authority is not currently planning to purchase any investment assets primarily for yield within the next three years and so is able to take advantage of the reduction in the PWLB borrowing rate.

5.2.8 The pattern of interest rates over the year is summarised in the chart below. Local government long-term borrowing costs are set by the PWLB - these directly mirror gilt yields. As reflected in the chart below, on 26 November 2020 the PWLB decreased the margin it charges over gilt yields by 1%, reversing the 1% increase they implemented in October 2019. Nominal investment rates, measured through the London Inter-Bank Bid Rate (LIBID), are also shown.

Interest Rate Movements in 2020/21 –



5.3 Treasury Management Performance 2020/21

5.3.1 By 31st March 2021, the Council had net borrowing of around £165M, arising from its revenue and capital income and expenditure, a decrease of £11M from the previous year.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in the table below.

Balance Sheet Summary	**31 Mar 2020 £M**	**2020/21 Movement £M**	**31 Mar 2021 £M**
General Fund CFR	300.7	(2.2)	298.5
Less: CFR re Debt -			
Managed by Lancashire County Council (LCC)	(15.3)	0.1	(15.2)
Re Private Finance Initiative (PFI) Arrangements	(69.5)	0.2	(69.3)
Loans/Borrowing CFR	**215.9**	**(1.9)**	**214.0**
Less: Usable Reserves and Working Capital	(39.6)	(9.0)	(48.6)
Net Borrowing	**176.3**	**(10.9)**	**165.4**

5.3.2 During the year the Council has undertaken a review of its Minimum Revenue Provision (MRP) policy, with it's treasury management consultants, Arlingclose. The revised policy was approved at Finance Council in March 2021. Under the Council's MRP Policy,

(a) the MRP charge to the accounts in respect of both PFI debt and debt managed by LCC has been less than the actual debt repaid, and
(b) the MRP charge to the accounts in respect of the Council's own capital spend financed from borrowing has decreased this year as a result of the change in policy.

The Council's CFR has decreased as a result of the MRP charge and capital receipts applied this year being in excess of the capital spend in 2020/21.

5.3.3 The following table summarises debt and investments at the start and end of the year:

	31 Mar 2020 Principal (£M)	Rate/ Return	Average Life (Yrs)	31 Mar 2021 Principal (£M)	Rate/ Return	Average Life (Yrs)
Fixed Rate Funding:						
Public Works Loan Board	131.7	3.68%	18.3	127.4	3.73%	17.9
Market Debt (Long Term)	10.3	4.47%	34.7	10.3	4.48%	32.9
Market Debt (Short Term)	84.0	0.95%		78.3	0.39%	
	226.0			**216.0**		
Variable Rate Funding:						
Public Works Loan Board	0.0			0.0		
Market Debt	8.0	4.50%	21.0	8.0	4.50%	20.0
	8.0			**8.0**		
Loans Taken by Blackburn with Darwen Borough Council	**234.0**			**224.0**		
Debt from PFI Arrangements	63.4			61.6		
Debt Managed by LCC	14.1	2.15%		13.6	2.25%	
Total Debt	**311.5**			**299.2**		

Total Investments	**57.5**	**0.67%**		**58.6**	**0.06%**	

In summary, the key changes to the Council's overall debt position across the year were:

(a) A decrease in the level of short term borrowing, from £84M to £78.3M,
(b) Principal repayments of £4.3M on PWLB EIP (Equal Instalment of Principal) loans
(c) Repayments of part of the outstanding PFI debt recognised on the balance sheet for Building Schools for the Future (BSF), and of debt managed by LCC.

No debt rescheduling was undertaken, because the premiums payable on early repayment of PWLB debt made it uneconomic to do so.

5.3.4 Short term loans were taken for a range of durations at various points across the year. Investment balances have been unusually high during this year, impacted by the governments response to the COVID-19 pandemic.

Across the year, the Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change.

The degree to which long-term debt was less than CFR rose slightly to around £69M from £66M, as a result of the current years capital spend being financed by short-term borrowings.

The deliberate strategy of taking short-term loans continued to deliver large savings on borrowing costs.

5.3.5 In summary, the outturn position in respect of interest costs and income, and MRP charges, was as follows:

Outturn 2019/20 £'000		**Original Budget 2020/21 £'000**	**Outturn 2020/21 £'000**
5,770	Interest paid on borrowing – long term debt	5,741	5,675
378	Interest paid on borrowing – short term debt	850	638
305	Interest paid on debt managed by LCC	312	298
6,057	PFI interest paid	6,087	5,909
(188)	Interest – treasury/other minor elements	(115)	(72)
(1,060)	Interest and dividends from BSF investments	(100)	-
6,021	MRP on Council borrowing	6,316	5,367
165	MRP on PFI debt	179	179
340	MRP on debt managed by LCC	340	142

5.3.6 Interest paid on borrowing in 2020/21 was around £0.47M down on the original estimate, reflecting both lower short-term interest rates and the decision not to take on new long-term debt in year. Interest on short-term borrowings increased from £0.378M last year to £0.638M this year, mainly as a result of the additional borrowings taken at the start of this year for the 3 years pension prepayment made in April 2020.

5.3.7 The average investment balance over the year has increased to £56M (£27M in 2019/20). Investment balances have been unusually high during this year, because of funds received from central government. Funds received from central government included both grants received in advance of their usual payment dates and additional funds in respect of extra costs and the distribution of grants to businesses, in relation to the response to the COVID-19 pandemic (see Weekly Balances **Appendix 1**).

Overall, interest and dividends received fell significantly to £0.07M in 2020/21 (£1.2M in 2019/20). Following the bank rate cuts in March 2020, investment interest rates have fallen to historically low rates during the year. Funds have continued to be invested for short periods, and sometimes with the government's Debt Management Office, to manage risk – this also contributed to the relatively low returns. Interest earned on treasury cash investments decreased, from £0.19M to £0.07M, and the average rate of return fell to 0.10% (against 0.69% in 2019/20).

Last year a one off windfall of around £1M was generated for the council by the restructuring of the second of the BSF PFI debt frameworks. The council is no longer receiving PFI investment receipts following the sale of the investments, which was agreed in March 2020 and completed in October 2020.

5.3.8 The impact of the revised MRP Policy introduced during this year, can be seen in the lower MRP costs in 2020/21, which, at £5.7M, were significantly lower than they would have been under the previous policy. The final MRP costs at outturn were £1.2M lower than those reported in the previous monitoring report, following the approval of the revised policy by Finance Council in March 2021.

5.3.9 The position with regard to performance against Treasury/Prudential Indicators in 2020/21 is summarised in **Appendix 2**. There was no breach of the Authorised Borrowing Limit or the Operational Boundary (set for management purposes).

Outturn capital spend was £21M, which is below the £40M anticipated at the start of the year.

At 31 March 2021 the Council's total borrowings of £299.1M were temporarily in excess of the Capital Financing Requirement of £298.5M, this was due to slippage on a number of capital schemes. Statutory guidance is that debt should remain below the CFR, except in the short-term. The Council's debt has returned to a level below the CFR by the 31 May 2021, with total borrowing of £292.9M at that date.

5.4 Treasury Management Consultancy

5.4.1 The Council is now contracted up to 31 March 2026 to receive treasury management support from Arlingclose Limited. Arlingclose have been awarded a new contract to provide services following the conclusion of a tender process in March 2021. They provide advice and information on the Council's investment and borrowing activities, although responsibility for final decision-making remains with the Council and its officers.

5.4.2 Over the period, in providing support to the Council, Arlingclose have reviewed the Council's Treasury management procedures and activities. They have provided member training; ongoing officer training; support for and review of treasury decisions, reports and strategies; feedback on accounting for treasury activities; benchmarking with other authorities; guidance on borrowing and investment opportunities; forecasts of interest rates; and regular updates on credit ratings and other information on credit quality. The quality of the support provided has been of a high standard.

5.5 Counterparty Update

5.5.1 Credit rating actions to the period ending September 2020 have been covered in previous outturn reports. Subsequent credit developments include Moody's downgrading the UK sovereign rating to Aa3 with a stable outlook which then impacted a number of other UK institutions, banks and local government.

5.5.2 After spiking in March 2020, Credit Default Swap spreads, an indicator of market confidence in banks, declined over the remaining period of the year to broadly pre-pandemic levels.

5.5.3 The vaccine approval and subsequent rollout programme are both credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

5.6 Risk Management

5.6.1 The Council's key priorities for managing its investments are the security and liquidity of its funds, before seeking the best rate of return. Most surplus cash is therefore held as short-term investments with the UK Government, highly rated banks and pooled funds.

5.6.2 The Council's primary objective for the management of its debt is to ensure its long-term affordability. The largest part of its loans is from the Public Works Loan Board at long-term fixed rates of interest.

5.6.3 A combination of short duration investments and long duration debt exposes the Council to the risk of falling investment income during periods of low interest rates. However, the risk of low investment returns is viewed as of lower priority compared to the benefits of optimising the security and liquidity of investments, and the savings made on borrowing costs. Also, though the Council has no long term investments, it is hedged against the investment return risk by its short term debt.

5.6.4 The Council is holding a significant element (£78.3M) in short-term loans from other local authorities. If the medium to long-term cost of debt were to move upwards, it may be necessary to restructure the Council's debt quickly, and cope with an increased cost of borrowing. This issue remains under review, with regular updates from Arlingclose.

6. FINANCIAL IMPLICATIONS

The financial implications arising from the 2020/21 Treasury Outturn have been incorporated into Corporate Budget Monitoring Reports.

7. LEGAL IMPLICATIONS

7.1 Under the Local Government Act 2003, local authorities determine locally their levels of capital investment and associated borrowing. The Prudential Code has been developed to support local authorities in taking these decisions, and the Council is required by Regulation to have regard to the Code when carrying out its duties under Part 1 of the Local Government Act 2003.

7.2 The Department for Communities and Local Government issued Guidance on Local Government Investments, under the Local Government Act 2003, effective from 1st April 2010. Authorities must manage their investments within an approved strategy, setting out what categories of investment they will use and how they will assess and manage the risk of loss of investments.

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8. POLICY IMPLICATIONS, RESOURCE IMPLICATIONS, CONSULTATIONS

None

9. STATEMENT OF COMPLIANCE

The recommendations are made further to advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation and an equality analysis and impact assessment has been considered. The recommendations reflect the core principles of good governance set out in the Council's Code of Corporate Governance.

VERSION:	**0.01**

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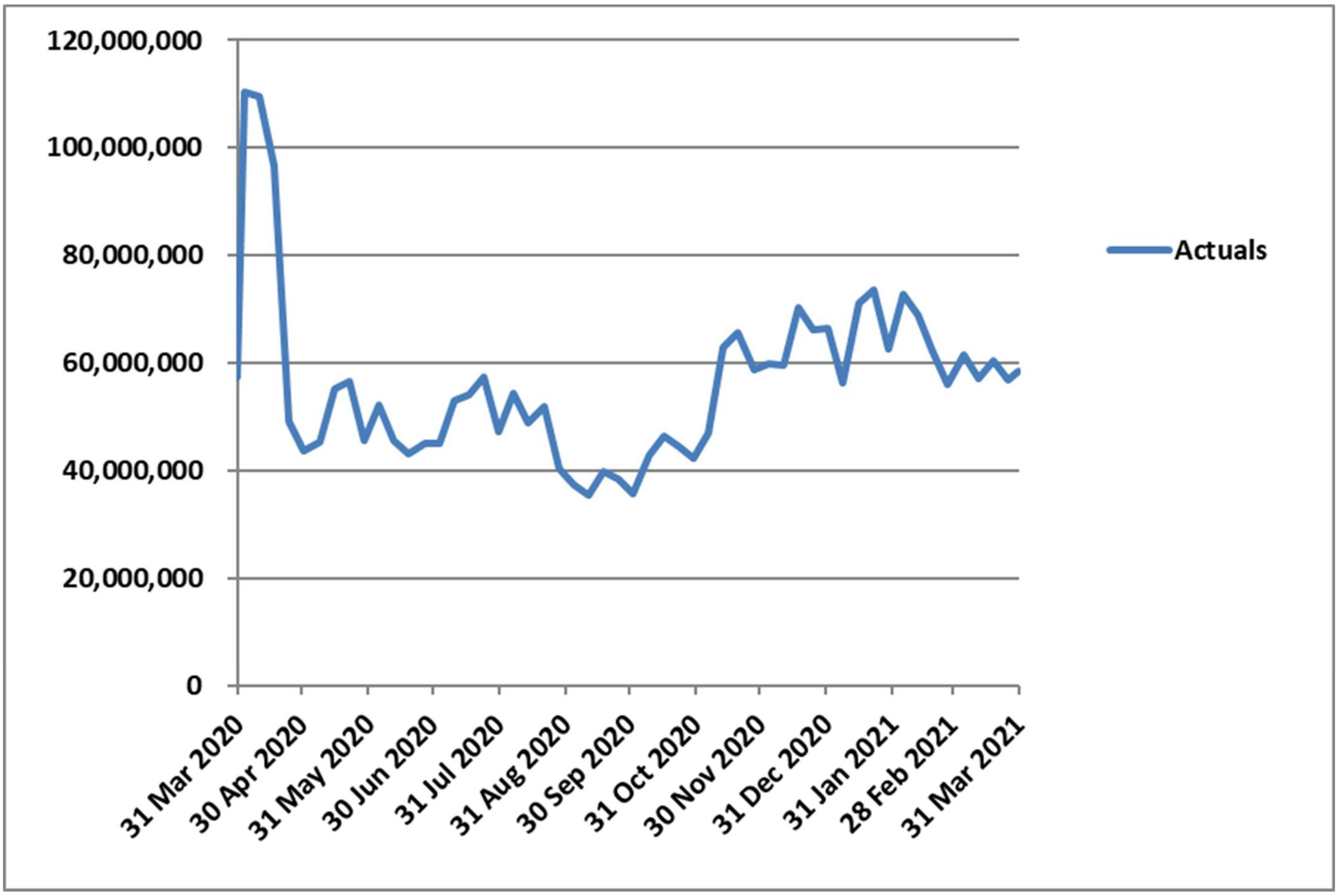
	Simon Ross, Head of Finance	extn 5569

DATE:	June 2021
BACKGROUND PAPER:	Treasury Management strategy for 2020/21 approved at Executive Board 12th March 2020.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31 Mar 2020
30 Apr 2020
31 May 2020
30 Jun 2020
31 Jul 2020
31 Aug 2020
30 Sep 2020
31 Oct 2020
30 Nov 2020
31 Dec 2020
31 Jan 2021
28 Feb 2021
31 Mar 2021
Actuals

Performance against Treasury & Prudential Indicators 2020-21 (approved by Council 24 Feb ‘20/ Exec Board 12 Mar ’20) Appendix 2

<table>
<tr><th></th><th>Indicator 2020/21</th><th>As Approved Mar 20</th><th>Current Monitoring</th><th>Commentary</th></tr>
<tr><td></td><td>Estimated Capital Expenditure</td><td>£40M</td><td>£21M</td><td></td></tr>
<tr><td></td><td>Estimated Total Capital Financing Requirement at End of Year</td><td>£307.3M
(incl projections re LCC debt £15.0M and accumulated PFI/lease debt £69.3M)</td><td>£298.5M
(incl LCC debt £15.2M and accumulated PFI/lease debt £69.3M)</td><td></td></tr>
<tr><td></td><td>Estimated Ration of Financing Costs to Net Revenue Stream</td><td>13.68%</td><td>10.87%</td><td></td></tr>
<tr><td></td><td>Outturn External Debt Prudential Indicators</td><td><table>
<tr><td>LCC Debt</td><td>15.0M</td></tr>
<tr><td>PFI Elements (no lease)</td><td>69.3M</td></tr>
<tr><td>Remaining Elements</td><td>276.5M</td></tr>
<tr><td>Operational Boundary</td><td>360.8M</td></tr>
<tr><td>Authorised Borrowing Limit</td><td>370.8M</td></tr>
</table></td><td><table>
<tr><th>Borrowing to Date</th><th>£M</th></tr>
<tr><td>LCC Debt</td><td>13.6</td></tr>
<tr><td>PFI Elements</td><td>61.6</td></tr>
<tr><td>BwD</td><td>223.9</td></tr>
<tr><td>Total</td><td>299.1</td></tr>
</table></td><td>LCC debt and BSF PFI debt will both fall across the year, as debt payments are made</td></tr>
<tr><td></td><td>Variable Interest Rate Exposure</td><td>£116.4M</td><td>Exposure to Date £32.6M</td><td>Limit not breached during the year</td></tr>
<tr><td></td><td>Fixed Interest Rate Exposure</td><td>£267.2M</td><td>Exposure to Date £132.7M</td><td>Limit not breached during the year</td></tr>
<tr><td></td><td>Prudential Limits for Maturity Structure of Borrowing</td><td><table>
<tr><th>Lower Limit</th><th>Upper Limit</th><th>Period (Years)</th></tr>
<tr><td>0%</td><td>50%</td><td><1</td></tr>
<tr><td>0%</td><td>30%</td><td>1-2</td></tr>
<tr><td>0%</td><td>30%</td><td>2-5</td></tr>
<tr><td>0%</td><td>30%</td><td>5-10</td></tr>
<tr><td>25%</td><td>95%</td><td>>10</td></tr>
</table></td><td><table>
<tr><th colspan="3">Actual Maturity Structure to Date</th></tr>
<tr><th>Period (Years)</th><th>£M</th><th>%</th></tr>
<tr><td><1</td><td>90.2</td><td>40%</td></tr>
<tr><td>1-2</td><td>3.5</td><td>2%</td></tr>
<tr><td>2-5</td><td>26.7</td><td>12%</td></tr>
<tr><td>5-10</td><td>27.4</td><td>13%</td></tr>
<tr><td>>10</td><td>76.1</td><td>34%</td></tr>
<tr><td>Total</td><td>223.9</td><td>100%</td></tr>
</table></td><td></td></tr>
<tr><td></td><td>Total Investments for Longer than 364 Days</td><td>£7M</td><td>No Long Term Investments Made</td><td></td></tr>
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