AUDIT COMMITTEE
28 JULY 2021

ITEM NO. ....

TREASURY MANAGEMENT ANNUAL REPORT AND OUTTURN PRUDENTIAL INDICATORS 2020/21

Responsible Cabinet Member - Councillor Charles Johnson, Resources Portfolio

Responsible Director – Elizabeth Davison, Group Director of Operations

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SUMMARY REPORT

Purpose of the Report

1. This report provides important information regarding the regulation and management of the Council's borrowing, investments and cash-flow. It is a requirement of the Council's reporting procedures and by regulations issued under the Local Government Act 2003 to produce an annual treasury management review that covers treasury activity for 2020/21. The report also seeks approval of the Prudential Indicators results for 2020/21 in accordance with the Prudential Code.

Summary

2. The financial year 2020/21 was an unprecedented year with regard to treasury management due to the ongoing Covid-19 pandemic. Cost of borrowing remained low throughout 2020/21 and due to the Covid-19 pandemic the cost of shorter term borrowing is anticipated to remain low for a number of years in the future. However, as Members are aware due to the recent low returns for cash investments new ways to improve investment returns are continually being sought.

3. During 2020/21 the Council complied with its legislative and regulatory requirements. The borrowing need (**Table 1**) was only increased for capital purposes.

4. At 31st March 2021 the Council's external debt was £161.531m which is £20.130m less than the previous year, this reduction relates to not re-borrowing for matured debt due to an increase in the level of monies received by the Council. The average interest rate for borrowing increased from 2.60% in 2019/20 to 2.76% in 2020/21. Investments totalled £59.399m at 31st March 2021 (£56.799m at 31st March 2020) earning interest of 0.60% on short term cash investments and 2.33% on Property Fund units net of costs.

5. Financing costs have been reduced during the year and a saving of £0.265m has been achieved from the original MTFP. The savings are a mixture of reduced interest on debt as well as increased departmental prudential borrowing.

Recommendation

6. It is recommended that:

   (a) The outturn 2020/21 Prudential Indicators within this report and those in **Appendix 1** be noted.

   (b) The Treasury Management Annual Report for 2020/21 be noted.

   (c) This report to be forwarded to Cabinet and Council, in order for the 2020/21 Prudential Indicators to be noted.

Reasons

7. The recommendations are supported by the following reasons:

   (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities.

   (b) To inform members of the Performance of the Treasury Management function.

   (c) To comply with the requirements of the Local Government Act 2003.

Elizabeth Davison
Group Director of Operations

Background Papers

(i) Accounting Records
(ii) Annual Investment Strategy 2020/21
(iii) Prudential Indicators and Treasury Management Strategy Report 2020/21

Peter Carrick: Extension 5401

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Well Being	There are no issues relating to health and wellbeing which this report needs to address
Carbon Impact and Climate Change	There are no issues relating to carbon impact
Diversity	There are no specific implications for diversity
Wards Affected	The proposals affect all wards
Groups Affected	The proposals do not affect any specific group
Budget and Policy Framework	The report does not change the Council's budget or Policy framework but needs to be considered by Council
Key Decision	This is not an Executive decision
Urgent Decision	This is not an Executive decision
Corporate Plan	The proposals in the report support delivery of the Council Plan through appropriate and effective deployment of the Councils Resources
Efficiency	The report outlines movements in the national economic outlook that have enabled officers to take advantage of different types of Investments and changing interest rates to benefit the Revenue MTFP.
Impact on Looked After Children and Care Leavers	Does this report impact on Looked After Children or Care Leavers

MAIN REPORT

Information and Analysis

8. This report summarises:

   (a) Capital expenditure and financing for 2020/21
   (b) The Council's overall borrowing need
   (c) Treasury position at 31st March 2021
   (d) Prudential indicators and compliance issues
   (e) The economic background for 2020/21
   (f) A summary of the Treasury Management Strategy agreed for 2020/21
   (g) Treasury Management activity during 2020/21
   (h) Performance and risk benchmarking

9. Throughout this report a number of technical terms are used, a glossary of terms can be found at the end of this report.

The Council's Capital Expenditure and Financing 2020/21

10. The Council undertakes capital expenditure on long term assets, which is financed either:

    (a) immediately through capital receipts, capital grants, contributions and from revenue; or

    (b) if insufficient financing is available, by borrowing.

11. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flow, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost and then optimise performance.

12. Capital Expenditure forms one of the prudential indicators that are used to regulate treasury activity. Table 1 shows total capital expenditure and how this was financed, compared with what was expected to be spent and how this would have been financed. Actual expenditure was £8.254m less than planned, mostly down to reduced activity in the HRA resulting from the Covid-19 pandemic (and lockdown) which restricted access to social housing properties. However, the mix of funding differs from that which was expected as some schemes progressed quicker than others. This impacted slightly on the borrowing needed to fund expenditure which was £2.198m higher than initially anticipated.

Table 1 – Capital Expenditure and Financing

	2019/20	2020/21		
	Outturn £m	Revised Estimate £m	Outturn £m	Variance £m
General Fund Capital Expenditure	23.111	20.130	20.094	(0.036)
HRA Capital Expenditure	11.963	14.900	6.434	(8.466)
Loans to Joint Ventures etc	7.865	3.253	3.501	0.248
Total Capital Expenditure	**42.939**	**38.283**	**30.029**	**(8.254)**
Resourced by:				
Capital Receipts GF	2.348	0.963	2.538	1.575
Capital receipts Housing	1.432	0.303	0.684	0.381
JV Loans Repaid	0.000	6.485	6.200	(0.285)
Capital Grants	16.705	14.917	11.717	(3.200)
Capital Contributions	0.162	0.000	0.029	0.029
Revenue Contributions - GF	0.956	0.000	0.145	0.145
Revenue Contributions - HRA	7.411	14.597	5.750	(8.847)
Self-Financing - GF	0.000	0.250	0.000	(0.250)
Total Resources	**29.014**	**37.515**	**27.063**	**(10.452)**
Borrowing needed to finance expenditure	**13.925**	**0.768**	**2.966**	**2.198**

The Council's Overall Borrowing Need

13. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). The figure is a gauge for the Council's debt position. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents 2020/21 and prior years' net capital expenditure which has not yet been paid for by revenue or other resources.

14. 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 Public Works Loan Board (PWLB), or the money markets) or utilising temporary cash resources within the Council.

15. 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 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.

16. The total CFR can be reduced each year through a Voluntary Revenue Provision (VRP) or by the application of additional capital financing resources (such as unapplied capital receipts).

17. The Council's CFR for the year is shown in Table 2 and represents a key prudential indicator. The CFR outturn for 2020/21 is £220.685m which is £2.368m higher than approved due to the increased borrowing need required to finance the additional capital expenditure in 2020/21.

18. No MRP repayments were made on the General Fund debt in line with the report to Council on 23 February 2017.

Table 2 - Capital Financing Requirement

	2019/20	2020/21		
	Outturn £m	**Approved Indicator £m**	**31 March Actual £m**	**Variance £m**
Opening Balance	207.347	219.488	219.488	0.000
Add Capital Expenditure financed by borrowing	13.925	0.768	2.966	2.198
Less MRP/VRP Housing	(0.629)	(0.799)	(0.629)	0.170
Less MRP/VRP PFI	(1.155)	(1.140)	(1.140)	0.000
Closing balance	**219.488**	**218.317**	**220.685**	**2.368**

Treasury Position at 31 March 2021

19. Whilst the measure of the Council's underlying need to borrow is the CFR, the Group Director of Operations can manage the Council's actual borrowing position by:

    (a) borrowing to the CFR level; or

    (b) choosing to utilise some temporary cash flows instead of borrowing ("under borrowing"); or

    (c) borrowing for future increases in CFR (borrowing in advance of need, the "over borrowed" amount can be invested).

20. The Council's treasury management 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 and through officer activity detailed in the Council's Treasury Management Practices.

21. The Council's total debt outstanding at 31 March 2021 was £161.531m. In addition to this, a liability of £10.358m relating to the PFI scheme and Finance Leases brings the total to £171.889m. The Council's revised CFR position was estimated to be £218.317m, however, the actual out turn position was £220.685m. When comparing this to our actual borrowing of £171.889m this meant that the Council was "under borrowed" by £48.796m. This "under borrowed" amount was financed by internal borrowing which means that the amount that could have been invested externally was reduced to cover this. The reduced under borrowed position still has

the dual effect of reducing costs to the MTFP because borrowing costs are generally greater than investment returns and it reduces counterparty risk by reducing our exposure to banks and other financial institutions.

22. The treasury position at 31 March 2021, including investments compared with the previous year is shown in table 3 below.

Table 3 – Summary of Borrowing and Investments

Treasury Position	31 March 2020		31 March 2021	
	Principal £m	Average Rate %	Principal £m	Net Annualised Average Rate %
General Debt - Fixed Rate Debt, Market and Public Works Loan Board (PWLB)	156.661	2.97%	136.531	2.98%
Property Fund Borrowing	25.000	1.41%	25.000	1.42%
Total Debt	**181.661**	**2.60%**	**161.531**	**2.76%**
Cashflow Investments up to 6 months	21.800	0.91%	19.400	0.09%
Capital Investments over 6 months	5.000	1.05%	10.000	0.96%
Property Fund Investment - net of costs	29.999	2.20%	29.999	2.33%
Total Investments	**56.799**		**59.399**	
Net borrowing position	**124.862**		**102.132**	

Prudential Indicators and Compliance Issues

23. Some prudential indicators provide an overview while others are specific limits on treasury activity. These indicators are shown below:

24. **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 (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) 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.

Table 4 – Gross Borrowing Compared with CFR

	31 March 2020 Actual £m	31 March 2021 Approved Indicator £m	31 March 2021 Actual £m
Gross Borrowing Position	**181.661**	**188.760**	**161.531**
PFI and Finance Lease Liability	**11.498**	**10.358**	**10.358**
CFR Excluding PFI & leases	**207.991**	**207.959**	**210.327**
CFR	**219.489**	**218.317**	**220.685**

25. **The Authorised Limit –** The Authorised Limit is the "Affordable Borrowing Limit" required by section 3 of the Local Government Act 2003. The Council does not have power to borrow above this level.

26. **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 both acceptable, subject to the Authorised Limit not being breached.

27. **Actual financing costs as a proportion of net revenue expenditure -** 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 expenditure. The actual for this indicator has risen from the previous year due to an increase in the Financing costs outturn.

Table 5 – Key Prudential Indicators

	Actual 2019/20 £m	Original Approved Limits 2020/21 £m	Revised Approved Limits 2020/21 £m	Actual Total Liabilities Borrowing + PFI/ leases 2020/21 Maximum £m
Approved Indicator – Authorised Limit	**193.159**	**237.342**	**229.233**	**171.889**
Approved Indicator – Operational Boundary	**193.159**	**197.118**	**188.018**	**171.889**
Financing costs as a percentage of net revenue expenditure	**2.02%**	**2.37%**	**2.55%**	**2.39%**

28. At 31st March 2021 the total liabilities were £171.889m which is below both the approved Authorised Limit and the approved Operational Boundary. The Operational Boundary is the point at which we expect borrowing to be, but it can be lower or higher. Borrowing cannot exceed the Authorised Limit.

29. A further four prudential indicators are detailed in Appendix 1.

Economic Background for 2020/21

30. A summary of the general economic conditions that have prevailed through 2020/21 provided by Link Asset Services, the Council's treasury management advisors is attached at **Appendix 2.**

Summary of the Treasury Management Strategy agreed for 2020/21

31. The revised Prudential Indicators anticipated that during 2020/21 the Council would need to borrow £0.768m to finance part of its capital programme, whereas the actual outturn figure was £2.966m.

32. The Annual Investment Strategy stated that the use of specified (usually less than 1 year) and non-specified (usually more than 1 year) investments would be carefully balanced to ensure that the Council has appropriate liquidity for its operational needs. In the normal course of the Council's business it is expected that both specified and non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

33. Longer term instruments (greater than one year from inception to repayment) will only be used where the Council's liquidity requirements are safeguarded. An estimate of long term investments (over 1 year) were included in the report on the Prudential Indicators update these were as follows £50m for 2019/20 and £50m for 2020/21. No other investments of over 1 year duration have been made during 2020/21.

Treasury Management Activity during 2020/21

Borrowing Strategy

34. This reduced during 2020/21by £20.130m in total. During the year and mainly due to the ongoing Covid-19 pandemic, the Council has received approximately £70m in additional grant funding from the government which has aided cashflow and allowed the Council to have a more flexible approach to its borrowing strategy.

35. During 2020/21, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the CFR), 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.

36. A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

37. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years (see table 6 below). 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.

Table 6 – net borrowing

	Market Loans (incl. other Local Authorities)			Total
	Amount £m	Length of Loan	Interest Rate %	£m
New Loans Taken				
	2.000	1 year	0.90%	
	3.000	1 year	0.90%	
	5.000	1 year	0.90%	
	5.000	1 year	0.20%	
				15.000
Loans Repaid				
	(5.000)	2 years	1.45%	
	(5.000)	22 months	1.40%	
	(2.000)	1 year	1.02%	
	(3.000)	1 year	1.02%	
	(5.000)	1 year	0.83%	
	(5.000)	9 months	0.80%	
	(5.000)	5 months	0.80%	
	(5.000)	1 year	1.00%	
				(35.000)
Total New Borrowing	(20.000)			(20.000)

38. The additional funding was utilised to not replace maturing short term loans.

39. **Summary of Debt Transactions –**The consolidated rate of interest still increased from 2.60% to 2.76% due to the above transactions as the majority of the debt repaid was at a lower interest rate than the longer term debt still held.

Investment Position

40. **Investment Policy –** the Council’s investment policy for 2020/21 is governed by the MHCLG Guidance which has been implemented in the annual investment strategy for 2020/21 approved by Council on 20 February 2020.

41. The investment activity during the year conformed to the approved Strategy and the Council had no liquidity difficulties.

42. 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.

43. 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.

44. 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.

45. 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. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

46. Investments held by the Council consist of temporary surplus balances, capital receipts and other funds. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. These include investments in Money Market Funds, the Government's Debt Management Office and bank short term notice accounts. Short term investments of up to a year earned interest of £175k on an average balance of £29.088m which equated to an annual average interest rate of 0.60%

47. The Council also has longer term investments which consist of the property funds and the returns are shown below in **Table7**.

Table 7 – Longer Term 6 months to 5 years - Property Funds

	Original Budget 2020/21	**Actual 2020/21**
Daily average level of Investments	**£29.999m**	**£29.999m**
Interest earned (gross)	**£1.061m**	**£1.054m**
Average Rate of Return on Investment Interest earned (gross)	**3.54%**	**3.51%**
Average Rate of Return on Investment (net of costs)	**2.31%**	**2.33%**

Performance and Risk Benchmarking

48. A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance.

49. The following reports the current position against the benchmarks originally approved.

50. Security – The Council's maximum security risk benchmarks for the current portfolio of investments, when compared to historic default tables was set as follows:

    0.077% historic risk of default when compared to the whole portfolio

51. **Table 8** shows that there has been a fluctuation in the historic levels of default over the year although still well below the benchmark. This is mainly due to some longer term investments actually being made for shorter terms i.e. up to six months rather than 1 year as these investments were better value than longer term investments and were also a better fit with how the council was expecting to utilise investments. It also shows more emphasis being placed on counterparties with a higher credit rating.

52. The investment portfolio was maintained within this overall benchmark during this year as shown in Table 8.

Table 8

Maximum	Benchmark 2020/21	Actual June 2020	Actual October 2020	Actual January 2021	Actual March 2021
Year 1	0.077%	0.009%	0.005%	0.003%	0.013%

53. The counterparties that we use are all high rated therefore our actual risk of default based on the ratings attached to counterparties is virtually nil.

54. Liquidity – In respect of this area the Council set liquidity facilities/benchmark to maintain

    (a) Bank Overdraft £0.100M

    (b) Liquid short term deposits of at least £3.000M available within a weeks' notice.

    (c) Weighted Average Life benchmark is expected to be 146 days with a maximum of 1 year.

55. Liquidity arrangements have been adequate for the year to date as shown in **Table 9**.

Table 9

	Benchmark	Actual June 2020	Actual October 2020	Actual January 2021	Actual March 2021
Weighted Average life	**146 days to 1 year**	**113 days**	**62 days**	**30days**	**90 days**

56. The figures are for the whole portfolio of cash flow investments deposited with Money Market funds on a call basis (i.e. can be drawn on without notice) as well as call accounts that include a certain amount of notice required to recall the funds.

57. Yield - In respect of this area performance indicators relating to interest rates for borrowing and investments were set with reference to comparative interest rates. For borrowing, the indicator is the average rate paid during the year compared with the previous year. Investment rates are compared with a representative set of comparative rates.

Risk

58. The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:-

(a) The Local Government Act 2003(the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity.

(b) The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2017/18).

(c) Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act.

(d) The SI requires the Council to undertake any borrowing activity with regard to the CIFPA Prudential Code for Capital Finance in Local Authorities.

(e) The SI also requires the Council to operate the overall treasury function with regard to the CIPFA code of Practice for Treasury Management in Public Services.

(f) Under the Act the Department for Communities and Local Government has issued Investment Guidance to structure and regulate the Council's investment activities.

(g) Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

59. The Councils Treasury Management function has complied with all of the relevant statutory and regulatory requirements, which limit the levels of risk associated with

its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low risk approach.

60. Officers of the Council are aware of the risks of passive management of the treasury portfolio and, with the support of Capita Asset Services, the Council's advisers, have proactively managed the debt and investments over the year.

Treasury Management Budget

61. There are three main elements within the Treasury Management Budget:-

(a) Long Term capital investments including Property Funds which earns interest, this comprises of the Council's revenue and capital balances, unused capital receipts, reserves and provisions.

(b) Cash flow interest earned – the authority has consistently had positive cash flow. Unlike long term capital investments it does not represent any particular sum but it is the consequence of many different influences such as receipts of grants, the relationship between debtors and creditors, cashing of cheques and payments to suppliers.

(c) Debt servicing costs – This is the principal and interest costs on the Council's long term debt to finance the capital programme.

Table 10 - Changes to the Treasury Management Budget 2020/21

	£m	£m
Original Treasury Management Budget		**0.895**
Debt		
Reduced interest payable on debt	**(0.150)**	
Further savings on MRP due to increased departmental borrowing	**(0.176)**	**(0.326)**
Investments		
Increased investment income including property funds etc		**(0.403)**
Transfer to IFRS 9 reserve		**0.500**
Other Costs		
Less reduced brokerage charges		**(0.036)**
Outturn Treasury Management Budget 2020/21		**0.630**

62. The savings relate to a reduction in the interest payable on debt due to the cost of short term borrowing and reduced debt levels as well as increased departmental borrowing. There has also been an increase in the interest received on investments due to the cashflow levels, this has been offset by a transfer to a reserve to mitigate the potential realisation of IFRS 9 whereby the Council might need to show any capital loss of its investments through fair value in its single entity accounts unless the Government extends the end date.

Conclusion

63. The Council's treasury management activity during 2020/21 has been carried out in accordance with Council Policy and within legal limits. Financing costs have been reduced during the year and a saving of £0.265m achieved from the original MTFP.

Outcome of Consultation

64. No formal consultation has been undertaken regarding this report.

Appendix 1

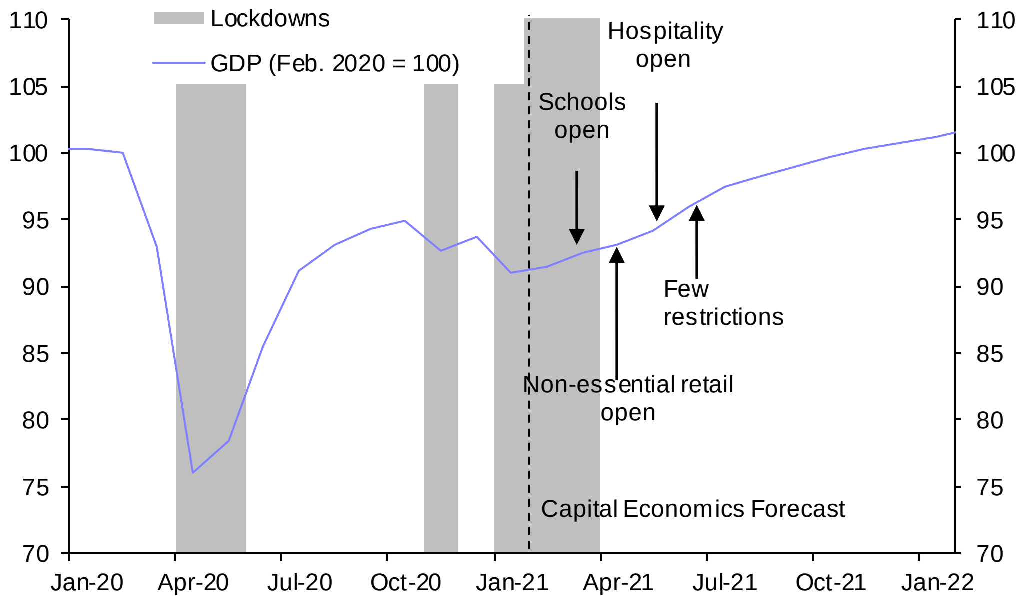
Additional Prudential Indicators not reported in the body of the report

		2019/20 Actual	2020/21 Approved Indicator	2020/21 Outturn
1	**limits on fixed interest rates**	**79%**	**100%**	**88%**
2	**limits on variable interest rates**	**21%**	**40%**	**12%**
3	**Maturity structure of fixed interest rate borrowing (upper Limit)**			
	Under 12 months	**21%**	**40%**	**12%**
	12 months to 2 years	**27%**	**50%**	**22%**
	2 years to 5 years	**38%**	**60%**	**25%**
	5 years to 10 years	**45%**	**90%**	**35%**
	10 years and above	**100%**	**100%**	**100%**
4	**Maximum Principal funds invested greater than 364 days**	**£50m**	**£50m**	**£50m**

Appendix 2

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, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.



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 then QE by £100bn in June and by £150bn in November to a total of £895bn. While Bank Rate remained unchanged for the rest of the year, financial markets were concerned that the MPC could cut Bank Rate to a negative rate; this was firmly discounted at the February 2021 MPC meeting when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

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.

Glossary of Terms

Capital Financing Requirement (CFR)	This is the Councils underlying need to borrow which can be traced back to the Councils Balance Sheet and the value of the Councils assets which have yet to be paid for.
Minimum Revenue Provision (MRP)	Monies set aside from the revenue budget to repay accumulated debt.
Call	Investments that can be returned without a period of notice
Counterparty	Institutions, Banks etc. that with make investments or take out loans with.
Specified Investments	Investments in Banks and Building Societies with a high credit rating for periods of less than 1 year
Non-Specified Investments	Investments in un-rated Building Societies and any investments in Banks and Building Societies for more than 1 year.
Operational Liquidity	Working Cash flow
Authorised Limit	Maximum amount of borrowing that could be taken in total.
Operational Boundary	The expected amount of borrowing assumed in total.
PWLB	Public Works Loan Board. The Governments lending body to Local Authorities
Discount	Amount payable by the PWLB when loans are repaid if the current loan rate is less than the rate borne by the original debt
Yield Curve	Is a graph that shows the relationship between the interest rate paid and length of time to repayment of a loan.
Gilts	Government Borrowing Bonds
Spreads	The difference between the highest rate of interest and the lowest rate of interest earned/charged on any one particular maturity period i.e. 1 year, 2 year 5 year etc.
LIBID	London Interbank Bid Rate. The average rate at which a bank is willing to borrow from another bank.
LIBOR	London Interbank Offer Rate. The average rate at which a bank is willing to lend to another bank. LIBOR is always higher than the corresponding bid rate and the difference between the two rates is known as the spread.