Report

Cabinet

Part 1

Date: 7 July 2021

Subject **Report on Treasury Management covering the Financial Year 2020/21**

Purpose This report is to inform the Cabinet of treasury activities undertaken for the financial year ending 31 March 2021.

Author Head of Finance / Assistant Head of Finance

Ward All

Summary In line with the agreed Treasury Management Strategy, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows. Current forecasts indicate that in the future, temporary borrowing will continue to be required to fund normal day-to-day cash flow activities and longer-term borrowing will increase to fund new commitments in the current capital programme as well as the impact of reduced capacity for 'internal borrowing'.

During the financial year the Council's net borrowing decreased by £25.4m from £153.8m at 31 March 2020 to £128.4m at 31 March 2021.

All borrowing and investments undertaken during the year was expected and within the Council's agreed limits

Proposal That Cabinet:

1. Note and provide comment on the Annual Report on Treasury Management for the Financial Year 2020/21.

2. Note and provide comment that 2020/21 Prudential Indicators for Treasury Management were in line with those set by Council in February 2020.

Action by Head of Finance / Assistant Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance

Signed

Background

1. In June 2009 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Authority to approve a treasury management annual report after the end of each financial year.

2. Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation to have regard to the CIPFA Code.

3. The Authority both borrows and invests 'cash' and as such is exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

4. The 2020/21 Treasury Management Strategy was approved by the Council as part of the Capital Strategy in February 2020 and can be viewed via the following link

   https://democracy.newport.gov.uk/documents/s17728/06%20Council%20Report%20Capital%20Strategy%20and%20Treasury%20Strategy%202020.pdf?LLL=0

5. This report presents the following information:

   - details of capital financing, borrowing, debt rescheduling and investment transactions
   - reports on the risk implications of treasury decisions and transactions
   - details the outturn position on treasury management transactions in 2020/2021
   - confirms compliance with treasury limits set and Prudential code

6. This report has been presented at the Audit Committee meeting in May and was noted with no additional comments or feedback to be added to this report, for Cabinets or Councils attention.

BORROWING STRATEGY / ACTIVITY

Short and Long Term Borrowing

1. Whilst the Council has significant long-term borrowing requirements, the Council's current strategy of funding capital expenditure utilises 'internal borrowing' rather than undertaking new borrowing where it can i.e. we defer taking out new long term borrowing and fund capital expenditure from the Council's net cash resources rather than investing them – which it has because of its 'cash-backed' reserves and, to a lesser extent, day to day positive cash-flows, for as long as we can. The Council may undertake borrowing early if, there is the need for future borrowing and it feels it can minimise risk of future interest rate rises while providing value for money, this will be in line with advice from our treasury advisors.

   By using this strategy the Council can also minimise cash holding at a time when counterparty risk remains relatively high, especially with the current economic implications during Covid-19. The interest rates achievable on the Council's investments are also significantly lower than the current rates payable on long-term borrowing and this remains the main reason for our current 'internally borrowed' strategy.

   At 31 March, the level of internal borrowing was about £107m, mainly in relation to the Council's level of cash backed reserves. At current rates, this saves about £2.4m in interest costs annually compared to physically borrowing this level of cash. As the Council spends its reserves over the medium to long term (PFI reserves, Capital reserves, Invest to Save reserves in particular), then the internal borrowing will have to be replaced with actual external borrowing and this interest cost will be unavoidably incurred.

2. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.

3. As shown in Appendix B, as at 31 March 2021 the level of borrowing has decreased by £13.1m to £153.2m. This decrease is in relation to the short term / temporary borrowing the Council undertook at the end of March 20 to support the cash flow of providing grants to businesses in response to the Covid-19 pandemic. This was reimbursed by Welsh Government and subsequently the borrowing was repaid in June 2020, as planned. In March 21 the Authority undertook borrowing on a short term basis in order to cover normal day to day cash flow activities.

4. A minimal amount of new long-term borrowing was required to be taken out in the second half of the financial year totalling £94k. This borrowing was from Salix which was interest free and was linked to a specific energy efficiency project. Current estimates within our cash-flow indicates there is the potential that additional long-term borrowing will be required in the second half of next financial year to fund the capital programme, and whilst slippage on that is included in the cash-flow, what actually happens in the year in regard to delivery of projects will influence this significantly.

   This however does not change the Council's 'need to borrow commitment' as these schemes are in the Council's plans – but does impact on when actual borrowing is taken out, towards that commitment level.

5. In regards to LOBOs, no loans were called during the period. All £30m outstanding is subject to potential change of interest rates by the lender (which would automatically trigger a right to the Council to repay these loans) prior to the end of this financial year. Should a change of interest rate be requested, then it will be considered in detail and a decision on how we proceed will be made in conjunction with our treasury advisors.

6. Looking at the overall cash position of the Council we need to look at the net borrowing position which shows that overall there has been a decrease in net borrowing of £25.4m during the 2020/21 financial year to £128.4m, as shown by Appendix B. This is partly due to the level of investments increasing by £12.3m to £24.8, (including £19.8m held on very short-term periods).

INVESTMENTS ACTIVITY / POSITION

7. The Council's strategies in this area of Treasury Management are (i) to be a short term and relatively low value investor, consistent with the pursuit of an 'internal borrowing strategy' and (ii) investment priorities should follow the priorities of security, liquidity and yield, in that order.

8. All investments are currently placed on a temporary basis and are placed in high security institutions, in line with our other strategy in this area, dealing with our investing priorities of (i) security (ii) liquidity and (iii) yield, in that order. At the 31 March 2021 £15m was placed with various local authorities, at an average rate of 0.24%, and £9.8m with banks and building societies. The maximum maturity date of any of these investments held was 19 April 2020.

   Included within the investment figure of £24.8m on the 31 March 2021, of which £19.8m is held on very short-term.

9. The Council does not hold any long-term (more than 364 days) treasury investments as at 31 March 2021.

10. Due to the pandemic the Authority kept more cash available at very short notice than is normal to cover any unexpected calls on cash flow. Currently there is not much demand for very short term investment within the market place, with very unattractive (minimal) interest rates being offered, and a potential for negative interest rates remaining a possibility into medium term. So it remains sensible to utilise excess cash balances to avoid further borrowing rather than investing those resources, given the minimal returns that investments are providing.

11. January 2018 saw the implementation in the UK of the second Markets in Financial Instruments Directive (MiFID II), where firms will be obliged to treat all local authorities as retail clients unless they opt up to professional client status and meet certain criteria. These criteria include holding a minimum of £10m investment balance and employing knowledgeable and experienced staff to carry out investment transactions. So whilst it is anticipated that investment levels will reduce, there will always be a need to demonstrate an investment balance of at least £10million.

IMPACT OF COVID-19 PANDEMIC

12. Since the early days of the pandemic the Council has been monitoring the impact on cash flow closely. Throughout 2021 the Authority received a significant amount of Welsh Government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £70.8m was received throughout the financial year and temporarily invested in short-dated, liquid instruments such as call accounts and invested with other Local Authorities. In addition to the business grants, the Council has seen an increase in Covid related expenditure, a reduction in income across services, and a decrease in the collection of Council Tax and Non-Domestic Rates (NDR) and the Council has also implemented the NDR Relief Scheme for retail, leisure and hospitality businesses who received 100% relief.

13. All of the above would have had a significant impact on cash flow, however aside from the beginning of the year when the additional short-term borrowing was required, WG have mitigated the impact by reimbursing increased expenditure through the 'hardship fund' and through 'loss of income' claims. WG have also repaid the business grants in a timely manner, and front-loaded a significant portion of the Revenue Support Grant payments to the Council into April 2020, as well as providing a grant to support the cash flow of the 100% rate reliefs. This has certainly assisted with cash flow throughout the 20/21 financial year and the Council was only required to take out short term borrowing in March 2021 to cover usual day to day treasury management activities. In additional slippage on the capital programme and net revenue underspend has also assisted with cash-flow and delayed the need to borrow long term within 2020/21 itself. As already said, this does not reduce the need to borrow commitment the Council has but does slow down the pace at which that borrowing is taken up towards that commitment level.

14. As part of the 2020/21 budget setting process a proposal was included to generate more interest receivable income. The council is required as part of regulatory framework to have to have at least £10m investment balance in order to retain its classification as 'professional clients'. The Council currently invests its funds over short-term, low-risk instruments such as other local authorities and central government and because of the low risk nature of these – income from these are also very low. As part the MTFP and the 2020/21 Treasury Management Strategy the Council would undertake larger, long-term investments in riskier financial instruments such as pooled funds, and other instruments. Essentially, investments in stock market and property funds in order to generate more income. Whilst the Council put in place the necessary processes in order to start using pooled funds such as CCLA, following the pandemic CCLA actually stopped all new investments for the first few months of the financial year. Due to the market volatility as a result of Covid-19 it was felt that it was not prudent to begin investing in more riskier financial funds, especially as the full impact of Covid-19 could not be quantified. However, this will be something that we will look to begin in 2021/22 if conditions allow and with advice from Treasury Advisers.

NON-TREASURY INVESTMENTS

15. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government's (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held such investments in:

- directly owned property such as office and commercial units of £10.8m
- loans to local businesses and landlords £4.7m
- shareholding in subsidiaries £0.3m

OTHER YEAR-END TREASURY MATTERS

Economic background and Counter Party Update

16. Appendix A outlines the underlying economic environment during the financial year, as provided by the Council's Treasury Management Advisors 'Arlingclose'.

17. As discussed previously in this report the Council does not have any long-term treasury investments, and the investments that it currently undertakes is mainly with other local authorities which are deemed very secure, therefore the risk is currently 'low'. There were no significant changes in credit ratings advised in the first half of the financial year that had implications for the approved lending list. The long-term rating of Santander UK, the Council's bankers, remains at A+; above the Council's minimum level of A-.

Compliance with Prudential Indicators approved by Council

18. The Authority measures and manages its exposures to treasury management risks using various indicators which can be found in Appendix B. The Authority has complied with the Prudential Indicators for 2020/21, set in February 2020 as part of the Treasury Management Strategy. Details of treasury-related Prudential Indicators can be found in Appendix B.

PWLB new lending terms

19. Members will be aware that the PWLB increased interest rates on loans in the autumn of 2019 following concerns about the level of Local Government debt, in particular for commercial activities

20. A consultation was held this year, with the PWLB response published in November 2020. From 26th November the interest rates on PWLB loans was reduced from 1.8% to 0.8%, provided that authorities can confirm that they are not involved in "debt for yield" activity within the next two financial years. It will also restrict authorities from accessing the PWLB to buy commercial assets primarily for yield. To be able to access the lower rates Authorities will be required to submit detailed capital expenditure plans with confirmation from the Section 151 Officer on the purpose of the capital expenditure.

21. 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.

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds available for investment will also alleviate the risk.	Members, Head of Finance, Treasury staff, based on advice from treasury advisors
Interest Rates moving adversely against expectations	Low	Low	Future expectations for higher short term rates are subdued. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Governments that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to Council for approval. Thus the only option available is consider the report and provide comments to the Council.

Preferred Option and Why

Note the contents of the report in relation to Treasury activities and all Treasury Indicators met. Provide any comments necessary to Council on the contents of the report.

Comments of Chief Financial Officer

Decisions made on treasury matters will be made with a view to comply with the Treasury Management Strategy, Prudential Indicators, taking advice, where needed, from our Treasury Advisers.

Comments of Monitoring Officer

There are no legal issues arising from the report. All borrowing and investments undertaken during the year were in accordance with the Council's Treasury Management Strategy and within agreed limits.

Comments of Head of People and Business Change

There are no direct HR implications associated with the report.

The Council is required to approve a treasury management annual report at the end of each financial year. The Well-being of Future Generations Act requires public bodies to balance short-term needs with the needs to safeguard the ability to also meet long-term needs. As stated in this report, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows but current forecasts indicate that in future temporary borrowing will continue to be required and longer-term borrowing will increase to fund the capital programme, which is currently also supplemented through a reduced investment strategy. This annual report align with the well-being goal of a Prosperous Wales.

Comments of Cabinet Member
N/A.

Local issues
N/A

Scrutiny Committees
N/A

Equalities Impact Assessment and the Equalities Act 2010
The Equality Act 2010 contains a Public Sector Equality Duty which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better informed decision-making and policy development and services that are more effective for users. In exercising its functions, the Council must have due regard to the need to: eliminate unlawful discrimination, harassment, victimisation and other conduct that is prohibited by the Act; advance equality of opportunity between persons who share a protected characteristic and those who do not; and foster good relations between persons who share a protected characteristic and those who do not. The Act is not overly prescriptive about the approach a public authority should take to ensure due regard, although it does set out that due regard to advancing equality involves: removing or minimising disadvantages suffered by people due to their protected characteristics; taking steps to meet the needs of people from protected groups where these differ from the need of other people; and encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.

Children and Families (Wales) Measure
N/A

Wellbeing of Future Generations (Wales) Act 2015
This report is a backwards looking report of the treasury management activities of the Council. It shows that we followed the treasury management strategy and the compliance with prudential code and treasury management indicators. This links into the long-term objectives of the authorities and ensures that the council's activities are carried out in an affordable, prudent and sustainable manner.

Crime and Disorder Act 1998
Section 17(1) of the Crime and Disorder Act 1998 imposes a duty on the Local Authority to exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area.

Consultation
N/A

Background Papers
Report to Council February 2020: Capital Strategy and Treasury Strategy.
Report to Council - Mid Year Treasury Management Monitoring Report

Dated: 24 June 2021

APPENDIX A - Arlingclose - Treasury Advisors Perspective

External Context

Economic background: 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 (MHRA). 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.

The Bank of England (BoE) 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.

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.

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.

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

After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, 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.

After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. The US recovery has been fuelled by three major pandemic relief stimulus packages totalling over $5 trillion. The Federal Reserve cut its main interest rate to between 0% and

0.25% in March 2020 in response to the pandemic and it has remained at the same level since. Joe Biden became the 46th US president after defeating Donald Trump.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

Financial markets: Monetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

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.

The 5-year UK benchmark gilt yield began the financial year at 0.18% before declining to -0.03% at the end of 2020 and then rising strongly to 0.39% by the end of the financial year. Over the same period the 10-year gilt yield fell from 0.31% to 0.19% before rising to 0.84%. The 20-year declined slightly from 0.70% to 0.68% before increasing to 1.36%.

1-month, 3-month and 12-month SONIA bid rates averaged 0.01%, 0.10% and 0.23% respectively over the financial year.

The yield on 2-year US treasuries was 0.16% at the end of the period, up from 0.12% at the beginning of January but down from 0.21% at the start of the financial year. For 10-year treasuries the end of period yield was 1.75%, up from both the beginning of 2021 (0.91%) and the start of the financial year (0.58%).

German bund yields continue to remain negative across most maturities.

Credit review: After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, albeit Santander UK is still an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The other ringfenced banks were trading around 33 and 34bps while Nationwide Building Society was 43bps.

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. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

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.

Appendix B - 2020-21 Treasury Activities

Local Context

On 31st March 2020, the Authority had net borrowing of £128.4m arising from its revenue and capital income and expenditure. 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 Table 1 below.

Table 1: Balance Sheet Summary

	31.3.21 Actual £m
General Fund CFR	281
Less: *Other debt liabilities	41
Borrowing CFR	**240**
Less: Usable reserves	(107)
Less: Working capital inc. non-treasury investments	4
Net borrowing	**129**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 31st March 2021 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.20 Balance £m	**Movement £m**	**31.3.21 Balance £m**	**31.3.21 Rate %**
Long-term borrowing	150.6	(3.0)	147.6	3.6
Short-term borrowing	-	5.6	5.6	0.1
Cash and cash equivalents	15.7	(15.7)	-	-
Total borrowing	**166.3**	**(13.1)**	**153.2**	**3.7**
Long-term investments	0	-	-	-
Short-term investments	0	(5.0)	(5.0)	0.0
Cash and cash equivalents	(12.5)	(7.3)	(19.8)	0.2
Total investments	**(12.5)**	**(12.3)**	**(24.8)**	**0.2**
Net borrowing	153.8	(25.4)	128.4	3.9

The table above shows the overall cash position and shows significant movement in both the borrowing and investment levels of the Council, however overall the NET borrowing position for the Council has decreased by £25.4m.

Borrowing Update

In November 2020 the 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 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.

Borrowing Strategy during the year

At 31st March 2021 the Authority held £153.2m of loans, a decrease of £13.1m from 31st March 2020, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.20 Balance £m	Net Movement £m	31.3.21 Balance £m	31.3.21 Weighted Average Rate %	31.3.21 Weighted Average Maturity (years)
Public Works Loan Board	105.7	(3.7)	102.0	3.8	19.0
Banks (LOBO)	30.0	-	30.0	4.4	33.2
Banks (fixed-term)	5.0	-	5.0	3.8	56.9
Local authorities (long-term)	-	-	-	-	-
Local authorities (short-term)	15.0	(10.0)	5.0	0.1	-
Other inc. WG loans	9.9	0.7	10.6	-	0.5
Accrued interest	0.7	(0.1)	0.6		
Total borrowing	**166.3**	**(13.1)**	**153.2**	**3.6**	**22.3**

The Authority'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 the Authority's long-term plans change being a secondary objective.

In keeping with these objectives, no new borrowing was undertaken. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

With short-term interest rates remaining much lower than long-term rates and temporary investments earning Bank Rate or lower, the Authority considered it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead, as per our Treasury Management Strategy. The net movement in temporary / short-term loans is shown in table 3 above.

LOBO loans: The Authority continues to hold £30m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

Other Debt Activity

After £0.8m repayment of prior years' Private Finance Initiative and finance leases liabilities, total debt other than borrowing stood at £41.5m on 31st March 2021, taking total debt to £194.7m.

Treasury Investment Activity

Throughout 2021 the Authority received a significant amount of Welsh Government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £70.8m was received, temporarily invested in short-dated, liquid instruments such as call accounts and invested with other Local Authorities. £70.3m was disbursed by the end of March.

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £24.78m and £65.8m million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.20 Balance £m	Movement £m	31.03.21 Balance £m	31.03.21 Income Return %	31.03.21 Weighted average maturity Years
Banks & building societies (unsecured)	-	9.8	9.8	0.1	-
Government (incl. local authorities)	12.5	2.5	15.0	0.3	-
Total investments	**12.5**	**12.3**	**24.8**	**0.4**	**-**

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.

Deposit rates with the Debt Management Account Deposit Facility (DMADF) have continued to fall and are now largely around zero.

The net return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.1% in March, are now at or very close to zero; fund management companies have temporarily lowered or waived fees to avoid negative net returns.

In the Treasury Management Strategy it was agreed that the Authority will move into higher risk/higher yield investments such as pooled funds. However, this has been delayed while the Authority reviewed its risk appetite. While an increased income target had been included in the 2020/21 budget, due to the current economic uncertainty surrounding Covid-19, the Authority has invested into secure institutions such as local authorities and Central Government.

In November 2019 the Welsh Government published new Statutory Guidance on Local Government Investments to be effective from the 2020/21 financial year. This involves a complete re-write along the lines of the guidance issued last year by the Ministry of Housing, Communities and Local Government (MHCLG) for local authorities in England.

The definition of investments is widened to include “all of the financial and non-financial assets a local authority has invested money into primarily or partially for the purpose of generating a surplus including investment property” providing it has been made using the power to invest contained in the Local Government Act 2003. In addition, loans to wholly-owned companies or associates, to a joint venture, or to a third party count as investments, irrespective of the purpose or legal power used.

<u>Non-Treasury Investments</u>

The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government’s (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held such investments in:

- directly owned property such as office and commercial units of £10.8m
- loans to local businesses and landlords £4.7m
- shareholding in subsidiaries £0.3m

These investments generated £1m of investment income for the Authority after taking account of direct costs.

Compliance

The Head of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	H1 Maximum	**31.03.21 Actual**	**2020/20 Operational Boundary**	**2020/21 Authorised Limit**	**Complied?** Yes/No
Borrowing	192.8	153.2	230	240	□
PFI and Finance Leases	42	41.5	43	43	□
Total debt	**234.8**	**194.7**	**273**	**283**	□

Table 8: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£2m per country
Registered providers and registered social landlords	£5m in total
Unsecured investments with building societies	£5m in total
Money market funds	£10m in total
Real estate investment trusts	£10m in total

Above table only shows limits where the Council have invested money in during the year, excluding the UK Central Government.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	**31.3.21 Actual**	**2020/21 Limit**	**Complied?**
Upper limit on fixed interest rate exposure	100%	100%	✓
Upper limit on variable interest rate exposure	0	50%	✓

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	31.03.21 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	5%	60%	0%	□
12 months and within 24 months	3%	40%	0%	□
24 months and within 5 years	18%	40%	0%	□
5 years and within 10 years	7%	40%	0%	□
10 years and within 20 years	18%	30%	0%	□
20 years and within 30 years	15%	20%	0%	□
30 years and within 40 years	20%	20%	0%	□
40 years and within 50 years	8%	20%	0%	□
50 years and above	7%	20%	0%	□

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2019/20	2020/21	2021/22
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	10	10	10
Complied?	□	□	□

<u>Other</u>

CIPFA consultations: In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. These are principles-based consultations and will be followed by more specific proposals later in the year.

In the Prudential Code the key area being addressed is the statement that "local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed". Other proposed changes include the sustainability of capital expenditure in accordance with an authority's corporate objectives, i.e. recognising climate, diversity and innovation, commercial investment being proportionate to budgets, expanding the capital strategy section on commercial activities, replacing the "gross debt and the CFR" with the liability benchmark as a graphical prudential indicator.

Proposed changes to the Treasury Management Code include requiring job specifications and "knowledge and skills" schedules for treasury management roles to be included in the Treasury Management Practices (TMP) document and formally reviewed, a specific treasury management committee for MiFID II professional clients and a new TMP 13 on Environmental, Social and Governance Risk Management.

IFRS 16: The implementation of the new IFRS 16 Leases accounting standard has been delayed for a further year until 2022/23.