Appendix 2

Annual Treasury Management Report
2020/21

For Noting by Cabinet 14 September 2021

Annual Treasury Management Review 2020/21

Purpose

The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2020/21. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2020/21 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 26 February 2020)
- a mid-year (minimum) treasury update report
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, Members have received quarterly treasury management update reports which were presented to Cabinet and Budget and Performance Panel.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

The Council confirms that it has complied with the requirement under the Code to give prior scrutiny (by Budget and Performance Panel) to all of the above treasury management reports before they were reported to the full Council.

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

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

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- if insufficient financing is available from the above sources, or a decision is taken not to apply such resources, the capital expenditure will give rise to a borrowing need (also referred to as "unfinanced", within the tables and sections below).

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

There is a significant difference between the level of capital expenditure estimated in the 2020/21 Treasury Management Strategy and the actual level of expenditure incurred. General Fund expenditure is £26.21m lower than expected whilst HRA is £1.08m lower. An ambitious Capital Programme was agreed for General Fund for the year with schemes in the Development Pool of £24.56m many of which did not keep pace with officer and member aspirations. Changes to PWLB borrowing rules to exclude lending for commercial investments also led to the abandonment of some planned property acquisitions in year. The delivery of the HRA Capital Programme was impacted by the Covid 19 pandemic.

General Fund (GF) £M	2019/20 Actual	2020/21 Estimate	2020/21 Actual
Capital expenditure	**12.08**	**45.24**	**19.03**
Financed in year	(5.61)	(13.05)	(7.97)
Unfinanced capital expenditure (i.e. reliant on an increase in underlying borrowing need)	**6.47**	**32.19**	**11.06**

HRA £M	2019/20 Actual	2020/21 Estimate	2020/21 Actual
Capital expenditure	**4.08**	**4.12**	**3.04**
Financed in year	(4.08)	(4.12)	(3.04)
Unfinanced capital expenditure (i.e. reliant on an increase in underlying borrowing need)	**0.00**	**0.00**	**0.00**

2. The Council's Capital Financing Requirement 2020/21

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

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury function organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs in purpose from other treasury management arrangements, which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2020/21 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2020/21 on 26 February 2020.

The Council's CFR for the year is shown below, and represents a key prudential indicator. There is a difference of £30.69m between the CFR estimated in the 2020/21 Treasury Management Strategy and the actual closing CFR. As outlined in section 1 this is due to levels of actual capital expenditure not materialising in line with officer and member ambitions.

No borrowing has actually been required against these schemes, however, as cash supporting the Council's reserves, balances and cash flow has been used as an interim measure. The disjoint between the forecast and actual levels of capital expenditure during the year has made the timing of potential borrowing and cash flow decisions more challenging than it might have otherwise been.

CFR (£M): General Fund	31 March 2020 Actual	31 March 2021 Estimate	31 March 2021 Actual
Opening balance	**43.55**	**58.34**	**48.43**
Add unfinanced capital expenditure (as above)	6.47	32.19	11.06
Less MRP	(1.59)	(2.11)	(1.76)
Less finance lease repayments	0.00	0.00	0.00
Closing balance	**48.43**	**88.42**	**57.73**

CFR (£M): HRA	31 March 2020 Actual	31 March 2021 Estimate	31 March 2021 Actual
Opening balance	**39.33**	**38.29**	**38.27**
Add unfinanced capital expenditure (as above)	0.00	0.00	0.00
Less Debt Repayment	(1.06)	(1.04)	(1.05)
Closing balance	**38.27**	**37.25**	**37.22**

CFR (£M): Combined	31 March 2020 Actual	31 March 2021 Estimate	31 March 2021 Actual
Opening balance	**82.88**	**96.63**	**86.70**
Add unfinanced capital expenditure (as above)	6.47	32.19	11.06
Less Debt Repayment, Finance Leases and MRP	(2.65)	(3.15)	(2.81)
Closing balance	**86.70**	**125.67**	**94.95**

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (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.

The Treasury Management Strategy for 2020/21 estimated that new borrowing during the year would be £33m in line with expenditure levels set out in the approved Capital Programme. No new borrowing was, however, undertaken for reasons explained previously.

£M	31 March 2020 Actual	31 March 2021 Estimate	31 March 2021 Actual
Gross borrowing position	62.13	94.08	61.08
CFR	86.70	125.67	94.95

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The actual financing costs as a proportion of net revenue stream for General fund are seeing the impact of Renewable Energy Disregard Income from Walney Sub-station for the first time. This has increased the net revenue stream by £3m. Whether this indicator remains lower than the 20.11% originally estimated in the 2020/21 Treasury Management Strategy will be dependent on the actual performance of the Capital Programme against the levels of capital expenditure currently forecast for 2021/22 which remain ambitious.

	2020/21 Actual
Authorised limit	£111.00M
Maximum gross borrowing position	£62.13M
Operational boundary	£94.95M
Average gross borrowing position	£61.78M
Financing costs as a proportion of net revenue stream - GF	14.61%
Financing costs as a proportion of net revenue stream - HRA	20.79%

3. Treasury Position as at 31 March 2021

The Council's debt and investment position is administered to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2020/21 the Council's treasury position was as follows:

DEBT PORTFOLIO	31 March 2020 Principal £M	Average Rate %	Average Life yrs	31 March 2021 Principal £M	Average Rate %	Average Life yrs
Fixed rate funding:						
PWLB	62.13	4.69	33	61.08	4.72	32
Total debt	**63.13**			**61.08**		
CFR	**86.70**			**94.95**		
Over / (under) borrowing	**(24.58**)			**(33.86)**		

The loan repayment schedule is as follows:

	31 March 2020 Actual £M
Under 12 months	1.04
12 months and within 24 months	1.04
24 months and within 5 years	3.12
5 years and within 10 years	5.20
10 years and within 20 years	10.40
20 years and within 30 years	1.08
More than 30 years	39.20

All investments were placed for under one year.

INVESTMENT PORTFOLIO	31 March 2020 £M	31 March 2020 %	31 March 2021 £M	31 March 2021 %
Money Market Funds	16.00	40.00	0.00	0.00
Other Local Authorities	24.00	60.00	22.00	100.00
Total investments	**40.00**		**22.00**	

The average rate of interest payable on PWLB debt in 2020/21 was 4.72%. A total of £2.91M interest was incurred during the year, of which £1.84M was recharged to the HRA.

Interest Payable

	2020/21
Estimate	£2.91M
Actual	£2.91M

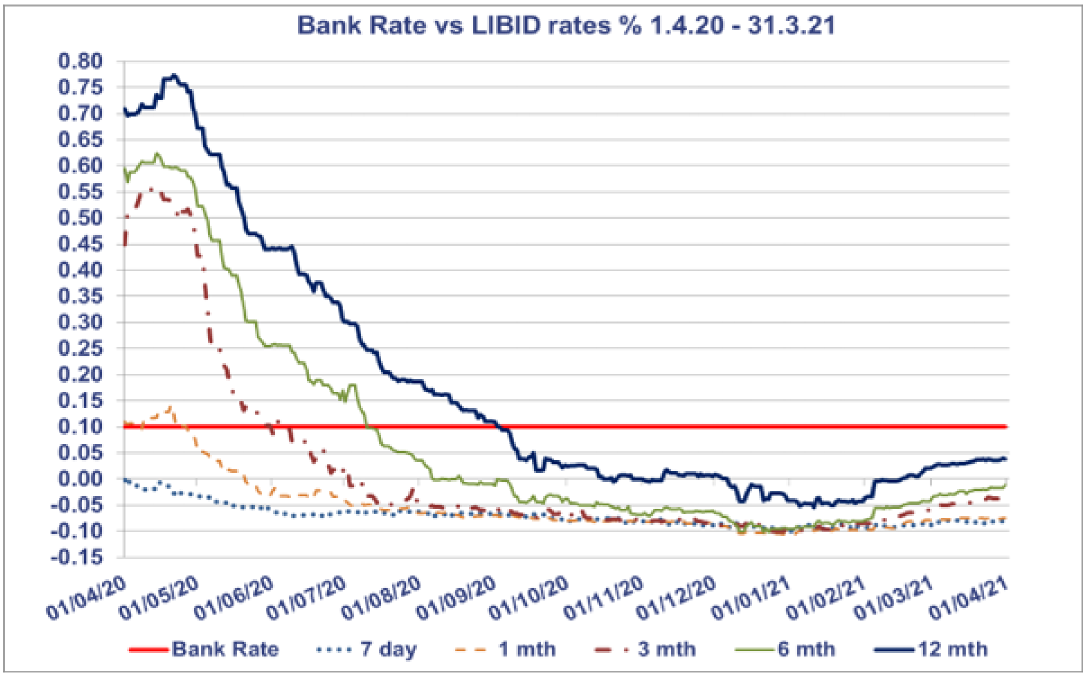
4. The Strategy for 2020/21

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% during the year before rising to end 2022/23 at 1.25%. This forecast was invalidated by the Covid-19 pandemic bursting on to 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.

5. The Economy and Interest Rates (supplied by Link Asset Services)

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 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.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.



6. Borrowing Strategy and Control of Interest Rate Risk

During 2020/21, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement set out in paragraph 2), was not fully funded with loan debt. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when the authority may not be able to avoid new borrowing to finance capital expenditure

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Section 151 Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risk:

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

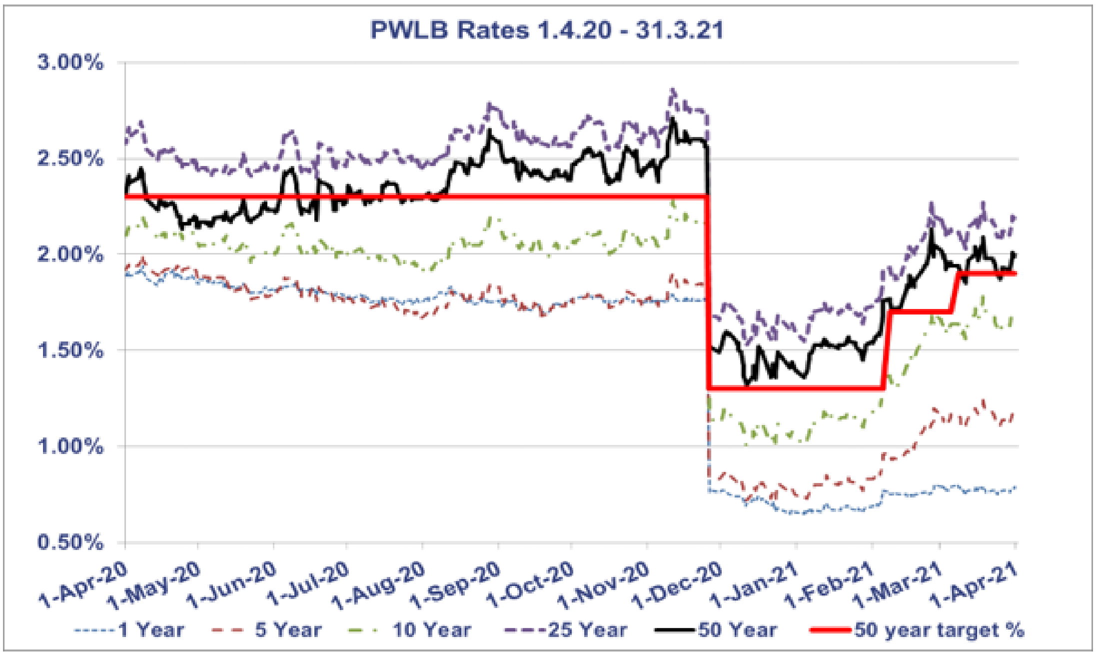
- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

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

Forecasts at the time of approval of the treasury management strategy report for 2020/21 were as follows:

	Mar-20	Mar-21	Mar-22	Mar-23
Bank Rate	0.75	0.75	1.00	1.25
3 Month LIBID	0.70	0.90	1.20	1.30
6 Month LIBID	0.80	1.00	1.40	1.50
12 Month LIBID	0.90	1.20	1.60	1.70
5yr PWLB rate	2.30	2.50	2.90	3.10
10yr PWLB rate	2.50	2.70	3.10	3.30
25yr PWLB rate	3.00	3.30	3.70	3.90
50yr PWLB rate	2.90	3.20	3.60	3.80

PWLB borrowing rates - the graph and table for PWLB rates below show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year:



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Low date	04/01/2021	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.94%	1.99%	2.28%	2.86%	2.71%
High date	08/04/2020	08/04/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.43%	1.50%	1.81%	2.33%	2.14%
Spread	1.29%	1.27%	1.28%	1.33%	1.39%

7. Borrowing Outturn for 2020/21

Borrowing
No long-term borrowing was undertaken during the year.

Borrowing in advance of need
The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

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

8. Investment Outturn for 2020/21

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 26 February 2020. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

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

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£M)	General Fund		HRA		**TOTAL**	
	31/03/20	**31/03/21**	**31/03/20**	**31/03/21**	**31/03/20**	**31/03/21**
Balances	5.05	7.81	2.86	3.29	7.91	11.10
Earmarked reserves	15.32	25.74	10.59	11.59	25.91	37.33
Provisions	6.23	7.14	0.00	0.00	6.23	7.14
Working Capital	21.06	11.81	2.89	4.48	23.95	16.29
Total	**47.66**	**52.50**	**16.34**	**19.36**	**64.00**	**71.86**
Amount Over/(Under) Borrowed						**(33.86)**
Baseline Investment Balances						**38.00**

Within General Fund Earmarked Reserves for 2020/21 is £8.121m in respect of business rates deficit/section 31 grant which will be utilised during 2021/22 to discharge the Collection Fund deficit arising in 2020/21 due to the Covid 19 pandemic. There are also unapplied grants totalling £0.84m in respect of Covid 19 support grant and the Covid Hardship fund.

Investments held by the Council - the Council maintained an average investment balance of £38.5M of internally managed funds. The average rate of interest earned for the year as a whole was 0.15%. The weighted average rate of interest being earned on the investment portfolio at the end of both years is also given. These rates are compared to the base rate and average 3-month LIBID rate at the end of the year.

	2019/20	2020/21
Lancaster CC Investments full year	0.74%	0.15%
Lancaster CC Investments weighted average at 31 March	0.80%	0.08%
Base Rate	0.10%	0.10%
3 Month LIBID	0.70%	-0.04%

The actual interest earned in 2020/21 was £56K.

10. Other Risk Management Issues

Many of the risks in relation to treasury management are managed through the setting and monitoring of performance against the relevant Prudential and Treasury Indicators and the approved Investment Strategy, as discussed above.

The Authority's Investment Strategy is designed to engineer risk management into investment activity by reference to credit ratings and the length of deposit to generate a pool of counterparties, together with consideration of other creditworthiness information to refine investment decisions. The Council is required to have a strategy is required under the CIPFA Treasury Management Code, the adoption of which is another Prudential Indicator. The strategy for 2020/21 complied with the latest Code of Practice (December 2017) and relevant Government investment guidance.

Annex A

LANCASTER CITY COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

Last reported to Council on 24 February 2021

This reflects the revised CIPFA Treasury Management Code of Practice (Code updated in 2017).

1. This organisation defines its treasury management activities as:

   "The management of the authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks.

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Annex B

Treasury Management Glossary of Terms

- **Annuity –** method of repaying a loan where the payment amount remains uniform throughout the life of the loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.

- **Call account –** instant access deposit account.

- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.

- **Credit Rating** – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's, and Moody's. They currently analyse credit worthiness under four headings (but see changes referred to in the strategy):

  - **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.

  - **Long Term Rating –** the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.

  - **Individual/Financial Strength Rating** – a measure of an institution's soundness on a stand-alone basis based on its structure, past performance and credit profile.

  - **Legal Support Rating –** a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

  The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

- **DMADF and the DMO –** The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.

- **EIP –** Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal, therefore the interest due with each payment reduces as the principal is eroded, and so the total amount reduces with each instalment.

- **Gilts** – the name given to bonds issued by the U K Government. Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt.

E.g. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as 8%/1.45 = 5.5%.
See also PWLB.

- **LIBID** – The London Inter-Bank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time.

- **LIBOR** – The London Inter-Bank Offer Rate, the rate at which banks with surplus funds are offering to lend them to other banks, again published at 11am each day.

- **Liquidity** – Relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **Maturity** – Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.

- **Money Market Fund (MMF)** – Type of investment where the Council purchases a share of a cash fund that makes short term deposits with a broad range of high quality counterparties. These are highly regulated in terms of average length of deposit and counterparty quality, to ensure AAA rated status.

- **Policy and Strategy Documents** – documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.

- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.

- **Link Asset Services** – Link Asset Services are the City Council's Treasury Management advisors. They provide advice on borrowing strategy, investment strategy, and vetting of investment counterparties, in addition to ad hoc guidance throughout the year.

- **Yield** – see Gilts

Members may also wish to make reference to *The Councillor's Guide to Local Government Finance.*