Appendix 1 - Treasury Management Outturn Report 2020/21

1. Introduction

1.1. The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

1.2. The Authority's treasury management strategy for 2020/21 was approved at a full Council meeting on 24 February 2020. The Authority has borrowed and invested substantial sums of money and is therefore 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 remains central to the Authority's treasury management strategy.

1.3. 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 under the Local Government Act 2003 to have regard to the CIPFA Code.

1.4. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24 February 2020.

2. External Context (provided by the Council's treasury management advisor, Arlingclose)

Economic background

2.1. The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut its Bank Rate to 0.10% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

2.2. The Bank of England (BoE) held the Bank Rate at 0.10% 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.

2.3. 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 2021. 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.

2.4. 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 helped protect more than 11 million jobs.

2.5. 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.

2.6. 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 over 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 over year (1.0% expected). 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.

2.7. 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.

2.8. 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

2.9. 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.

2.10. 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.

2.11. 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.

2.12. 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

2.13. 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.

2.14. 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 revised Barclay's outlook to stable (from negative).

2.15. 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.

3. Local Context

3.1. On 31st March 2021, the Authority had net borrowing of £555.9m 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

Type of Liability	31.03.20 Actual £m	31.03.21 Actual** £m
General Fund CFR	449.2	505.5
HRA CFR	274.3	332.3
Total CFR **	**723.5**	**837.8**
Less: *Other debt liabilities	(28.2)	(28.2)
Borrowing CFR – comprised of:	**695.3**	**809.6**
- External borrowing	531.7	555.9
- Internal borrowing	163.6	253.7

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

3.2. 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 continued to pursue its long-standing strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk.

3.3. The treasury management position on 31st March 2021 and the change over the year is shown in Table 2 below.

Table 2: Treasury Management Summary

Type of Borrowing / Investment	31.03.20 Balance (£m)	Movement (£m)	31.3.21 Balance (£m)	31.3.21 Rate (%)
Long-term borrowing	506.7	(9.8)	496.9	3.26
Short-term borrowing	25.0	34.0	59.0	0.18
Total borrowing	**531.7**	**24.2**	**555.9**	**2.93**
Long-term investments	0.0	0.0	0.0	0.0
Short-term investments	15.0	(10.0)	5.0	1.00
Cash and cash equivalents	77.3	(65.3)	12.0	-0.02
Total investments	**92.3**	**(75.3)**	**17.0**	**0.28**
Net borrowing	**439.4**	**99.5**	**538.9**	

4. Borrowing Update

4.1. 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.

4.2. 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.

4.3. 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.

4.4. 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.

Municipal Bonds Agency (MBA)

4.5. The MBA revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The

agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor.

4.6. If the Authority were to consider future borrowing through the MBA, it would first ensure that it had thoroughly scrutinised the legal terms and conditions of the arrangement and taken proper advice on these.

UK Infrastructure Bank

4.7. In his March 2021 budget, the Chancellor confirmed that a UK Infrastructure Bank will be set up with £4bn in lending earmarked for local authorities from the summer of 2021. Loans will be available at gilt yield plus 0.60%, 0.20% lower than the PWLB certainty rate. A bidding process to access these loans is likely with a preference to projects likely to help the government meet its Net Zero emissions target. However other “high value and complex economic infrastructure projects” may also be considered.

Borrowing strategy during the period

4.8. At 31st March 2021, the Authority held £555.9m of loans, an increase of £24.2m compared to 31st March 2020), as part of its strategy for funding previous and current years’ capital programmes. Outstanding loans on 31st March 2021 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.20 Balance £m	Net Movement £m	31.03.21 Balance £m	31.03.21 Weighted Average Rate %	31.03.21 Weighted Average Maturity (years)
Public Works Loan Board	381.7	(9.8)	371.9	2.77	27.47
Banks (LOBO)	125.0	0.0	125.0	4.72	39.19
Local authorities (short-term)	25.0	34.0	59.0	0.18	0.67
Total borrowing	**531.7**	**24.2**	**555.9**	**2.93**	**27.26**

4.9. 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.

4.10. In keeping with these objectives, no new long-term borrowing was undertaken, while £9.8m of existing loans were allowed to mature without replacement. This strategy enabled the Authority to reduce net borrowing costs and reduce overall treasury risk.

4.11. 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 short-term loans instead. The net movement in temporary / short-term loans is shown in Table 3 above.

4.12. The Authority has a significant capital programme which extends into the foreseeable future. A large proportion of this will be financed by borrowing, which the Authority will have to undertake in coming years. The Authority’s treasury advisor, Arlingclose undertakes a weekly ‘cost of carry’ analysis which informs the Authority on whether it is

financially beneficial to undertake borrowing now or delay this for set time periods based on PWLB interest rate forecasts.

4.13. Any borrowing which is taken prior to capital expenditure taking place, and reducing the extent of the Authority's internal borrowing, would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing, creating an immediate cost for revenue budgets. The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing is maintained.

LOBO Loans

4.14. The Authority continues to hold £125m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at 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.

5. Treasury Investment Activity

5.1. The Authority received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. The funds received were temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds and disbursed by the end of December 2020.

5.2. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £17.0 and £166.6 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

Investments	31.03.20 Balance £m	Net Movement £m	31.03.21 Balance £m	31.03.21 Rate of Return %	31.03.21 Weighted Average Maturity (Days)
Banks & building societies (unsecured)	0.0	0.0	0.0	0.00	
Money Market Funds	0.0	0.0	0.0	0.00	
UK Government:					
- Local Authorities	15.0	(10.0)	5.0	1.00	26
- Debt Management Office	77.3	(65.3)	12.0	-0.02	1
Total investments	**92.3**	**(75.3)**	**17.0**	**0.28**	**8**

5.3. 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.

5.4. Continued downward pressure on short-dated cash rate brought net returns on money market funds (MMFs) close to zero even after some managers had temporarily lowered

their fees. At this stage, although close to nil, negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain slight positive net yields, but the possibility of negative rates cannot be ruled out.

5.5. Deposit rates with the Debt Management Office (DMO) have continued to fall and are now largely around zero.

5.6. The return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.10% in March, are now at or very close to zero. In many instances, the fund management companies have temporarily lowered or waived fees to avoid negative net returns.

5.7. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (Days)	Rate of Return
31.03.2020	3.40	AA	0%	56	0.23%
31.03.2021	3.91	AA-	0%	8	0.28%
Similar Local Authorities	4.78	A+	69%	33	0.21%
All Local Authorities	4.63	A+	63%	14	0.15%

Scoring:
AAA = highest credit quality = 1; D = lowest credit quality = 26
Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Non-Treasury Investments

5.8. 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 the Ministry of Housing, Communities and Local Government (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

5.9. The Authority lends money to third parties such as its subsidiaries, local businesses, local charities, local residents and its employees to support local public services and stimulate local economic growth. These transactions are often treated as capital expenditure and included within the Authority's capital programme. The main risk when making service loans is that the borrower may be unable to repay the principal lent and/or the interest due. To limit this risk, it will be ensured that any new loans made will remain proportionate to the size of the Authority.

5.10. The Authority also hold properties which are classified as 'investment properties" in the Authority's Statement of Accounts. These properties which are all within the local area, and the revenue stream associated with these (net of the costs of maintaining the properties) forms a modest part of the Authority's annual budget, therefore contributing to the resources available to the Authority to spend on local public services.

5.11. The balances of non-treasury investments as at 31st March 2021 were as follows:

Table 6: Non-treasury investment balances

Non-Treasury Investments	31.03.21 Balance £m	Loss Allowance £m	31.03.21 Balance £m	Weighted Average Rate of Return %	Net Total Revenue £m
Subsidiaries	17.5	0.0	17.5	0.00	0.0
Local Businesses	2.1	(0.7)	1.4	5.20	0.1
Local Charities	49.3	(43.5)	5.8	3.00	0.2
Local Residents	0.1	0.0	0.1	4.00	0.0
Employees	0.0	0.0	0.0	0.00	0.0
Commercial Properties*	88.6	0.0	88.6		
Total investments	**157.6**	**(44.2)**	**113.4**		**0.3**

*corporate finance are assessing the full impact of the commercial properties revenue in 20/21

5.12. The largest balance above relates to Alexandra Palace debts (shown under local charities). There is a large amount of historic debt that a provision was created for, however this has not been written off.

5.13. Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's Statement of Accounts for 2018/19 onwards are shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arranges in place to recover overdue repayments.

5.14. The Authority assesses the risk of loss before entering into and whilst holding service loans by weighing up the service outcomes any such loan could provide against the creditworthiness of the recipient. This is done on a case-by-case basis, given the low number of such arrangements. This forms part of the Authority's capital programme, further details of which are in the Authority's annual medium term financial strategy.

Treasury Performance

5.15. Treasury investments generated an average rate of return of 0.44% in the year. The Authority's treasury investment income for the year was £498k against a budget of £137k.

5.16. Borrowing costs for 2020/21 were £16.8m (£10.7m HRA, £6.1m General Fund) against a budget of £21.4m (£16.4m HRA, £5.0m General Fund).

5.17. Investment income in the Authority's 2020/21 budget was set against a very different economic backdrop. Bank Rate, which was 0.75% until February 2020, now stands at 0.10%. In light of these changes, interest earned from short-dated money market investments has been significantly lower.

6. Compliance

6.1. The Director 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.

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

Table 7: Debt Limits

	31.03.21 Actual £m	2020/21 Operational Boundary £m	2020/21 Authorised Limit £m	Complied?
Borrowing	555.9	929.6	979.6	Yes
PFI and Finance Leases	28.2	28.1	30.9	Yes
Total debt	**584.1**	**957.7**	**1,010.5**	**Yes**

6.3. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure, however, Haringey's debt remained well below this limit at all points in the financial year.

Treasury Management Indicators

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

Security

6.5. The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.03.21 Actual	2020/21 Target	Complied?
Portfolio average credit score	3.91 (AA-)	7.0 (A-)	Yes

Liquidity

6.6. The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	31.03.21 Actual	2020/21 Target	Complied?
Total cash available within 3 months	17.0	10.0	Yes

Interest Rate Exposures

6.7. 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	31.03.21 Actual	2020/21 Target	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.45m	£1m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.45m	£1m	Yes

6.8. The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing

6.9. 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	12.41%	50%	0%	Yes
12 months and within 24 months	0.53%	40%	0%	Yes
24 months and within 5 years	3.40%	40%	0%	Yes
5 years and within 10 years	0.00%	40%	0%	Yes
10 years and within 20 years	23.13%	40%	0%	Yes
20 years and within 30 years	8.99%	40%	0%	Yes
30 years and with 40 years	23.65%	50%	0%	Yes
40 years and within 50 years	27.88%	50%	0%	Yes
50 years and above	0.00%	40%	0%	Yes

6.10. 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.

6.11. The Authority has used short term borrowing (under 1 year in duration) from other local authorities extensively in recent years, as an alternative to longer term borrowing from PWLB, due to lower interest rates, and corresponding revenue savings. Short term borrowing exposes the Authority to refinancing risk: the risk that rates rise quickly over a short period of time and are at significantly higher rates when loans mature, and new borrowing has to be raised. With this in mind, the Authority has set a limit on the total amount of short-term local authority borrowing, as a proportion of all borrowing.

Short term borrowing	Limit	31.03.21	Complied?
Upper limit on short-term borrowing from other local authorities as a percentage of total borrowing	30%	11%	Yes

Principal Sums Invested for Periods Longer than a year

6.12. 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:

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	Nil	Nil	Nil
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	Yes	Yes	Yes

7. Other: CIPFA Consultations

7.1. 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.

7.2. 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.

7.3. 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.