East Lothian Council

REPORT TO:	Audit and Governance Committee
MEETING DATE:	15 June 2021
BY:	Executive Director for Council Resources
SUBJECT:	Annual Treasury Management Review 2020-21

1 PURPOSE

1.1 To update the Committee on Treasury Management Activity during 2020-21.

2 RECOMMENDATIONS

2.1 The Committee is asked to note the report.

3 BACKGROUND

3.1 The Council is required by regulations issued under the Local Government Scotland Act 2003 to produce an Annual Treasury Management Review, in accordance with the CIPFA Treasury Management Code of Practice and Prudential Code.

3.2 The review set out in **Appendix 1** updates members on the Treasury Management activity during 2020-21, and reported relative to the indicators set out in the Treasury Management Strategy approved in March 2020. The figures contained within the report are based on the draft unaudited accounts, and therefore remain subject to change during the course of the audit. Members will be kept informed should there be any significant change arising during this period.

4 POLICY IMPLICATIONS

4.1 There are no direct policy implications associated with this report; however the council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 INTEGRATED IMPACT ASSESSMENT

5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

6 RESOURCE IMPLICATIONS

6.1 Financial – There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.

6.2 Personnel - none

6.3 Other - none

7 BACKGROUND PAPERS

7.1 Treasury Management Strategy 2020-21 to 2024-25 – East Lothian Council 3 March 2020.

7.2 Treasury Management Mid-Year Review 2020-21 – Audit & Governance 24 November 2020.

AUTHOR'S NAME	Sarah Fortune
DESIGNATION	Head of Finance
CONTACT INFO	sfortune@eastlothian.gov.uk
DATE	8 June 2021

Annual Treasury Management Review
2020-21

Annual Treasury Management Review 2020-21

1. Introduction

This Council is required by regulations issued under the Local Government in Scotland 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). The review is based on figures contained within the draft unaudited accounts, and should any significant and material changes arise during the course of the audit, updated information will be made available and communicated to members.

During 2020-21 the minimum reporting requirements were that members of the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 03/03/2020)
- a mid-year (minimum) treasury update report (Audit and Governance 24/11/2020)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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 to all of the above treasury management reports by the Audit and Governance Committee with the annual strategy approved by Council.

2. The Council's Capital Expenditure and Financing

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), with expenditure in excess of these resources giving rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. The results from 2019-20 are shown for illustrative purposes.

	2019-20 Actual £m	2020-21 Budget £m	2020-21 Actual £m
General Services			
Capital expenditure	42.260	96.199	35.769
Financed in year	(37.528)	(47.468)	(23.748)
Net borrowing need in year	4.732	48.731	12.021
HRA			
Capital expenditure	29.929	33.540	21.233
Financed in year	(15.134)	(11.217)	(9.092)
Net borrowing need in year	14.795	22.323	12.141
Total Net Borrowing need in year	19.527	71.054	24.162

3. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and deemed 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 but allows the Council some flexibility to borrow in advance of its immediate capital needs if required.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2020 Actual £m	31 March 2021 Budget £m	31 March 2021 Actual £m
General Services			
CFR	258.767	272,222	225,560
External borrowing position	238.944	228,158	193,741
(Under) / over funding of CFR	(19.823)	(44,064)	(31,819)
HRA			
CFR	198.521	218.836	206.609
External borrowing position	180.784	202,329	171,808
(Under) / over funding of CFR	(17.737)	(16,507)	(34,801)
Total (Under) / over funding of CFR	(37.560)	(60.571)	(66,620)

4. Treasury Position as at 31 March 2021

At the beginning and the end of 2020-21 the Council's treasury, (excluding borrowing by PPP and finance leases), position was as follows:

	31 March 2020 Principal £m	31 March 2021 Principal £m
CFR	420	432
Over / (under) borrowing	(38)	(67)
Total external debt	382	365
Total investments	(9)	(9)
Net debt	373	356

The graph below highlights the level of External Debt against approved boundary limits set out within the approved Treasury Strategy.

- **The authorised limit** - the Council has kept within its authorised external borrowing limit as shown in the table below.
- **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. This indicator is set at the start of the financial year and is as per the Treasury Strategy.

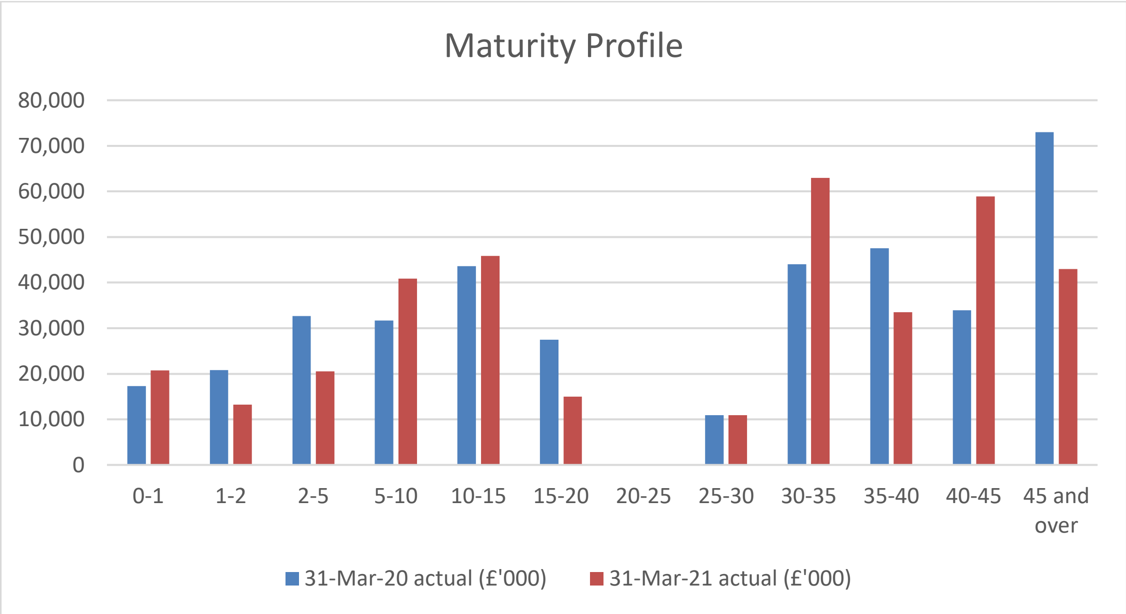
	2019-20 Actual £m	2020-21 Budget £m	2020-21 Actual £m
Authorised limit	481	550	550
External Debt	382	430	365
Operational Boundary	420	491	491

As at 31 March 2021 the average interest rate for all external debt was 3.56% (3.52% 31 March 2020) and the average life across all loans was 26 years (26 years 2020)

The maturity structure and profile of the debt portfolio is set out in the tables below:

	31-Mar-20 Actual £m	(Paid) or New Loan* 2020-21 £m	31-Mar-21 Actual £m	Net movement** 2020-21 £m
Under 12 months	17.27	-17.28	20.77	3.50
12 months and within 24 months	20.77		13.23	-7.54
24 months and within 5 years	32.68		20.52	-12.16
5 years and within 10 years	31.69		40.88	9.19
10 years and within 15 years	43.61		45.84	2.23
15 years and within 20 years	27.50		15.00	-12.50
20 years and within 25 years	-		-	
25 years and within 30 years	10.90		10.90	0.00
30 years and within 35 years	44.00		63.00	19.00
35 years and within 40 years	47.50		33.50	-14.00
40 years and within 45 years	33.90		58.90	25.00
45 years and over	73.00		43.00	-30.00
Total	382.82	-17.28	365.54	-17.28

* More detail on this is set out in Section 6 below
** Net movement shows the change between the maturity bands for existing loans



5. The strategy for 2020-21

5.1 Investment strategy and control of interest rate risk

The Council's approved investment strategy by priority is; security, liquidity and then return. The Council adopts a prudent approach to managing risk and followed the approved 2020-21 Strategy where investments were only considered where the type of investment and exposure to risk was low or very low. Limits were set for fixed and variable interest rate exposure which were not exceeded during the year.

Investment returns which had been low during 2019-20, plunged during 2020-21 to near zero or even into negative territory. The expectation for interest rates within the treasury management strategy for 2020-21 was that Bank Rate would continue at the start of the year at 0.75 % before rising to end 2022-23 at 1.25%. This forecast was invalidated by the Covid-19 pandemic from 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 negative impact of the national lockdown on the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with cheap credit so 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.

5.2 Borrowing strategy and control of interest rate risk

During 2020-21 the Council continued to maintain an under-borrowed position. This meant that the capital borrowing need (the Capital Financing Requirement) was not fully funded by external borrowing as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This was a prudent strategy as investment returns were low and minimising of counterparty risk on investments needed to be considered.

The policy of avoiding new borrowing where possible by close monitoring of cash balances is kept under continual review to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

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.

The table below shows the interest rate forecasts from our Treasury advisors. As of 31 March 2021 the bank interest rate is forecast to remain at 0.10% and PWLB rates may gradually increase over the next 3 years.

Link Group Interest Rate View	8.3.21												
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.40	1.40	1.40	1.40
10 yr PWLB	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	1.90
25 yr PWLB	2.10	2.10	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.50	2.50	2.50	2.50
50 yr PWLB	1.90	1.90	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.30	2.30	2.30	2.30

HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019-20 without any prior warning. The first took place on 9 October 2019, adding an additional 1% (100 basis point) margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11 March 2020, but not for mainstream non-HRA capital schemes.

A consultation was then held with local authorities and on 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme.

The new margins over gilt yields are:

- **PWLB Standard Rate** - gilt plus 100 basis points
- **PWLB Certainty Rate** - gilt plus 80 basis points
- **PWLB HRA Standard Rate** - gilt plus 100 basis points
- **PWLB HRA Certainty Rate** - gilt plus 80 basis points
- **Local Infrastructure Rate** - gilt plus 60 basis points

There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not forecast to rise from 0.10% by March 2024.

	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%

6. Borrowing Activity during 2020-21

Borrowing – the following loans were taken during the year:-

Lender	Principal	Type	Interest Rate	Maturity	Date
Renfrewshire Council	£ 10m	Fixed interest rate	0.08%	6 months	15/02/2021
Total	**£10m**				

This was a short term loan. The budget assumption of borrowing at an interest rate of 3.20% was for long term borrowing.

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.

Repayments
The following loans were repaid in full during the year:-

Lender	Principal	Type	Interest Rate	Maturity	Date
PWLB	£14m	Fixed interest rate	4.20%	10 years	24/09/2020
PWLB	£0.662m	Fixed interest rate	8.375%	25 years	03/08/2020
Salix	£0.025m	Interest free	0.00%	3.5 years	01/10/2020
Total	**£14.687m**				

Instalments of £2.5m were also paid on 10 loans which are payable as an Annuity or EIP (equal instalments of principal) basis rather than on maturity.

7. Investment Activity for 2020-21

Investment Policy
The Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the annual investment strategy approved by the Council on 3 March 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 as set.

Investments held by the Council
During 2020-21 and in accordance with the approved strategy 2 short term investments were made and repaid. Any other surplus cash balances were held in the Council's bank account, which is an interest bearing account.

Date of Investment	Borrower	Amount	Interest rate	Date repaid
19/08/20	Standard Chartered Sustainable	£ 5m	0.16%	19/11/20

19/08/20	Lloyds 95 day notice	£ 5m	0.20% to 27/11/20 then 0.10%	15/03/21
	Total	£10m		

The Council also has the following loans to third parties which fall under the scope of the Council's approved Investment Strategy

	Loan balance at 31 March 2020 £m	**Loan balance at 31 March 2021 £m**
East Lothian Housing Association	8.959	8.712
East Lothian Investments	0.228	0.128

Under accounting standard IFRS9 effective from 1 April 2018, an expected credit loss for all loans to third parties must be obtained and recognised in the Council's Income and Expenditure account within Surplus/Deficit on Provision of Services. This was £36k for 2019-20 and increased to £70k for 2020-21 to reflect the current general economic climate.

Investments held by fund managers

The Council uses Investec as external fund managers to invest cash balances on behalf of the 4 Common Good Funds and the ELC Charitable Trusts. The performance of the managers against the benchmark return was:

	Investments held 31 March 2020 £m	**Investments held 31 March 2021 £m**	**Return**	**Benchmark**
Charitable Trusts	2.994	3.644	24.75%	21.96%
Common Good Funds	3.012	3.679	25.10%	21.96%
Total	6.006	7.323	£1.317m	

The increase this year is due to the recovery of the financial markets after significant negative impact of Covid-19 on the financial markets at the end of 2019-20.
The return achieved was above the benchmark for both portfolios.

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2019-20	2020-21	2020-21
	Actual £m	Budget £m	Actual £m
Capital Expenditure			
General Services	42.260	96.199	35.769
HRA	29.929	33.540	21.233
TOTAL	72.189	129.739	57.002
Ratio of financing costs to net revenue stream			
General Services	6.55%	6.03%	5.62%
HRA	32.23%	31.92%	28.56%
Gross borrowing requirement - General Services			
brought forward 1 April	225.804	230.789	221.870
carried forward 31 March	221.870	272.222	225.561
in year borrowing requirement	(3.934)	41.433	3.691
Gross borrowing requirement - HRA			
brought forward 1 April	187.528	200.567	198.521
carried forward 31 March	198.521	218.836	206.609
in year borrowing requirement	10.993	18.269	8.088
CFR			
General Services	221,870	272.222	225.560
HRA	198.521	218.836	206.609
TOTAL	420,391	491.058	432.170
Annual Change in Capital Financing Requirement			
General Services	(3.934)	41.433	3.691
HRA	10.993	18.269	8.088
TOTAL	7.059	59.702	11.779
Annual Impact of Capital Investment Decisions			
General Services – Debt per Band D equivalent	£4,522	£5,389	£4,504
HRA – Debt per dwelling	£22,457	£24,476	£23,149

2. TREASURY MANAGEMENT INDICATORS	2019-20 Actual £m	2020-21 Budget £m	2020-21 Actual £m
Authorised Limit for External Debt -			
Borrowing	481	550	550
Other long term liabilities	37	36	36
Total	518	586	586
Operational Boundary for External Debt -			
Borrowing	420.391	491.056	491.056
Other long term liabilities	36.897	35.352	35.352
Total	457.288	526.408	526.408
Actual External Debt			
Borrowing	382.831	430.487	365.549
Other long term liabilities	36.897	35.352	35.352
Total	419.728	465.839	400.901
3. LOANS FUND			
General Services			
Opening balance	226	230	222
Add advances	5	49	12
Less repayments	(9)	(7)	(8)
Closing balance	222	272	226
HRA			
Opening balance	187	201	199
Add advances	15	22	12
Less repayments	(4)	(4)	(4)
Closing balance	198	219	207
Total			
Opening balance	413	431	421
Add advances	20	71	24
Less repayments	(13)	(11)	(12)
Closing balance	420	491	433

ABBREVIATIONS USED IN THIS REPORT

CFR: capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

GDP: gross domestic product – a measure of the growth and total size of the economy.

HRA: housing revenue account.

LIBID: the London Interbank Bid Rate is the rate bid by banks on deposits i.e., the rate at which a bank is willing to borrow from other banks. It is the "other end" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend).

MPC: the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

PPP: Private Public Partnership – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

PWLB: Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

RPI: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – CPI. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.