Lincolnshire
COUNTY COUNCIL
Working for a better future

Open Report on behalf of Andrew Crookham, Executive Director - Resources

Report to:	**Overview and Scrutiny Management Board**
Date:	**01 July 2021**
Subject:	**Treasury Management Annual Report 2020/21**

Summary:

This report has been prepared in accordance with the reporting recommendations of the CIPFA Code of Practice 2017 and details the results of the Council's treasury management activities for the financial year 2020/21. The report compares this activity to the Treasury Management Strategy for 2020/21, approved by the Executive Councillor for Resources, Communications, and Commissioning on 20 March 2020. It will also detail any issues arising in treasury management during this period.

Actions Required:

The Overview and Scrutiny Management Board is requested to review the contents of the report and pass any comments onto the Executive Councillor for Resources, Communications, and Commissioning.

1. Background

1. Introduction and Background

1.1. Treasury Management relates to the policies, strategies and processes associated with managing the cash and debt of the Council through appropriate borrowing and lending activity. It includes the effective control of the risks associated with the lending and borrowing activity and the pursuit of optimum performance consistent with the risks.

1.2. This Annual Treasury Report will cover the following matters for the year 2020/21:

- **Economic overview and interest rate review**.
- **Treasury Investments** - Treasury investment policy, risk appetite, treasury activity and return, comparing this with treasury strategy.
- **Long Term Borrowing** - Capital expenditure plans, borrowing requirement and activity, control of interest rate risk, debt rescheduling activity and internal borrowing position, comparing this with treasury strategy.

- **Other treasury issues** arising during 2020/21.

1.3. For reference, a **Key Points Summary** arising from this report has been included in the Conclusion in Section 6 of this report.

1.4. For further reference, a list of abbreviations used throughout this report is shown in **Appendix A**.

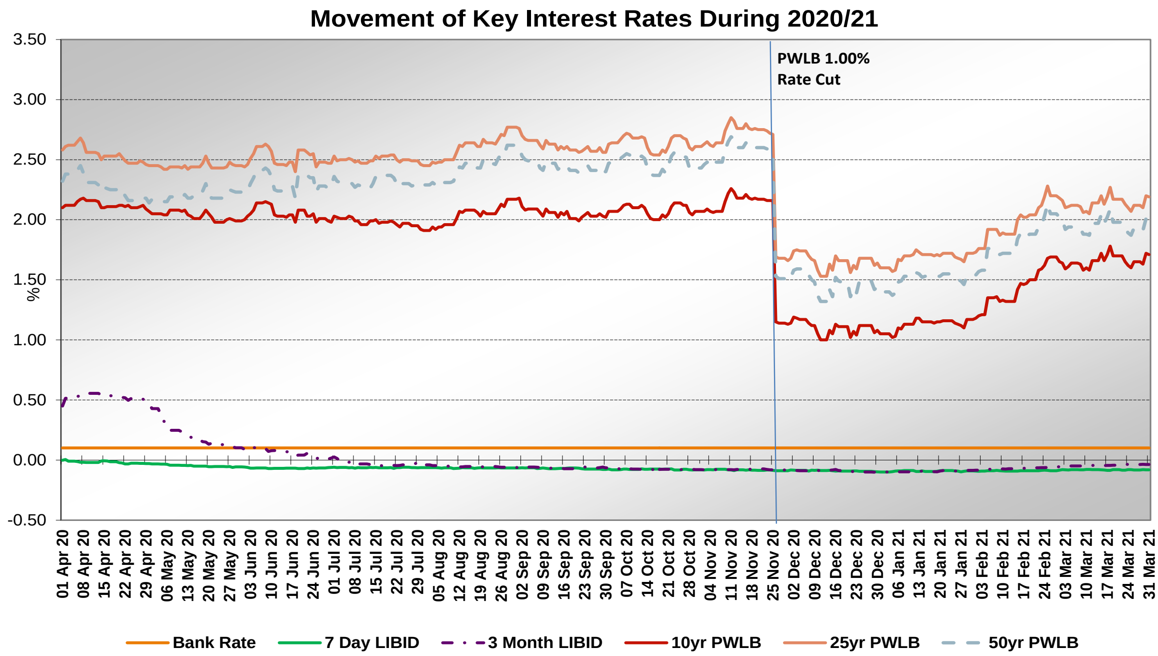
2. Economic Overview and Interest Rate Review 2020/21

2.1. At the time of setting the Strategy in March 2020, both short term bank rate and long term rates were forecast to rise only moderately by no more than 0.25% in 2020/21 and this was set before the full impact of Covid-19 played out and assumed deal on Brexit would be agreed.

2.2. The graph below shows what actually happened:

- **Short Term Rates**: Due to measures to tackle the Covid-19 pandemic, Base Rate was cut to 0.10% by the end of March 2020 and it has remained at that level since. Short Term LIBID rates have fallen below zero as LIBOR rates have fallen close to zero. The Bank of England is not expected to move Base Rate further for a considerable period, as impacts on the economy due to Covid-19 play out, although negative interest rates have been ruled out for the time being.

- **Long term rates**: Long term rates fell by up to 1.0% in March 2020 as the Covid-19 pandemic effects on the economy took hold and they remained relatively flat over the period until 26 November 2020, when the PWLB reduced its rates by 1.0% across all periods following a review and consultation over how it operates. Since this cut, rates gradually rose again by around 0.50% to the end of March 2020, as confidence in the economic recovery rebounded with the success of the vaccine rollout.



2.3. **UK Coronavirus.** The financial year 2020/21 will go down in history as being the year of the pandemic. The first national lockdown in late March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A short second lockdown in November did relatively little damage but by the time of the third lockdown in January 2021, businesses and individuals had become more resilient in adapting to working in new ways during a three month lockdown so much less damage was caused compared to the first one. The advent of vaccines starting in November 2020, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity during Quarter 1 of 2022 (January to March).

2.4. **Bank Rate.** Both the Government and the Bank of England took rapid action in March 2020 at the height of the crisis to provide support to financial markets to ensure their proper functioning, and to support the economy and to protect jobs. The MPC cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a £200bn programme of quantitative easing (QE) (purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields). The MPC then increased QE by £100bn in June and by £150bn in November to a total of £895bn. The Bank Rate remained unchanged for the rest of the year and is not expected to change for the foreseeable future. Negative rates were discounted on the basis that banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

2.5. **CPI Inflation** has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern to the MPC who have indicated that they will not raise the Bank Rate until they can clearly see that the level of inflation is going to be persistently above target if it takes no action.

2.6. **Budget Deficit.** The Chancellor has implemented repeated rounds of support to businesses by way of cheap loans and other measures, and has protected jobs by paying for workers to be placed on furlough. This support has come at a huge cost in terms of the Government's budget deficit ballooning in 2020/21 and 2021/22 so that the Debt to GDP ratio has now reached around 100%. The Budget on 3 March 2021 announced fiscal support to the economy and employment during 2021 and 2022 followed by substantial tax rises in the following three years to help to pay the cost for the pandemic. This is planned to help further strengthen the economic recovery from the pandemic and return the Government's finances to a balanced budget on a current expenditure and income basis by 2025/26 and stop the Debt to GDP ratio rising further from 100%. With the Government's debt at such a high level, with mainly variable rate debt due to QE operations, it is now twice as sensitive to interest rate rises as before the pandemic. There is, therefore, much incentive for the Government to promote the Bank Rate staying low by using fiscal and monetary policy measures in the coming years.

2.7. **Brexit.** The final agreement on 24 December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

2.8. **USA**: The US economy did not suffer as much damage as the UK economy due to the pandemic. The Democrats won the presidential election in November 2020 and have control of both Congress and the Senate, although power is more limited in the latter. This enabled the Democrats to pass a $1.9trn (8.8% of GDP) stimulus package in March on top of the $900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly to hit the target of giving a first jab to over half of the population within the President's first 100 days, will promote a rapid easing of restrictions and strong economic recovery during 2021. The Democrats are also planning to pass a $2trn fiscal stimulus package aimed at renewing infrastructure over the next decade. Although this package is longer-term, if passed, it would also help economic recovery in the near-term. The Fed has also indicated that they do not intend to raise rates until they can clearly see that the level of inflation is going to be persistently above target if it takes no action. It expects strong economic growth during 2021 to have only a transitory impact on inflation, which explains why the majority of Fed officials project US interest rates to remain near-zero through to the end of 2023. However concerns on the impact to inflation over the sheer amount of fiscal stimulus undertaken and how and when the Fed will eventually wind down its QE programme have pushed treasury yields sharply up in the US in 2021 and is likely to have also exerted some upward pressure on gilt yields in the UK.

2.9. **EUROZONE**: Both the roll out and take up of vaccines has been disappointingly slow in the EU in 2021, at a time when many countries are experiencing a sharp rise in cases which are threatening to overwhelm hospitals in some major countries; this has led to renewed severe restrictions or lockdowns during March. This will inevitably put back economic recovery after the economy had staged a rapid rebound from the first lockdowns in Quarter 3 (Q3) of 2020 but contracted slightly in Q4 to end 2020 only 4.9% below its pre-pandemic level. Recovery is expected to be delayed until Q3 of 2021 and a return to pre-pandemic levels is expected in the second half of 2022. Inflation was well under 2% during 2020/21. **The ECB** did not cut its main rate of -0.5% further into negative territory during 2020/21. It embarked on a major expansion of its QE operations in March 2020 and added further to that in its December 2020 meeting when it also greatly expanded its programme of providing cheap loans to banks. The total QE scheme of €1,850bn is providing protection to the sovereign bond yields of weaker countries like Italy. There is, therefore, unlikely to be a euro crisis while the ECB is able to maintain this level of support.

2.10. **WORLD GROWTH**: World growth was in recession in 2020. Inflation is unlikely to be a problem in most countries for some years due to the creation of excess production capacity and depressed demand caused by the Coronavirus crisis. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. In March 2021, western democracies implemented limited sanctions against a few officials in charge of government policy on the Uighurs in Xinjiang; this led to a much bigger retaliation by China and is likely to mean that the China / EU investment deal then being negotiated will be torn up. After the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products and vice versa. This is likely to reduce world growth rates.

3. Treasury Investments 2020/21

Treasury Investment Policy

3.1. The Council's treasury investment policy, governed by the MHCLG investment guidance, is implemented in the Council's Annual Investment Strategy for Treasury Investments 2020/21, that was approved by the Executive Councillor for Resources, Communications, and Commissioning on 20 March 2020, after being scrutinised by the Overview and Scrutiny Management Board on 27 February 2020.

3.2. The policy sets out the Council's approach for choosing authorised investment counterparties with appropriate limits (amount and maturity) that meet the risk appetite set by the Council. This selection is based on credit ratings issued by the three main credit rating agencies, supplemented by additional market data such as rating outlooks, credit default swaps and bank share prices. The Council's treasury advisors, Link Asset Services (LAS), provide the Council this data in the form of a creditworthiness matrix of suggested counterparties and limits, which the Council follows. **Appendix B** shows the Council's Authorised Lending List at 31 March 2021, based on this creditworthiness approach, together with a key explaining the credit rating scores.

3.3. **Note: The treasury investment policy relates to treasury investments only. The policy relating to non-treasury investments, held for service or commercial reasons, is covered in the Council's Capital Strategy.**

Treasury Investment Risk Appetite

3.4. The Council prioritises the **security of capital** and the **liquidity of investments**, over and above the **return** achieved on its treasury investments and hence the risk appetite set for its treasury investments is **low.**

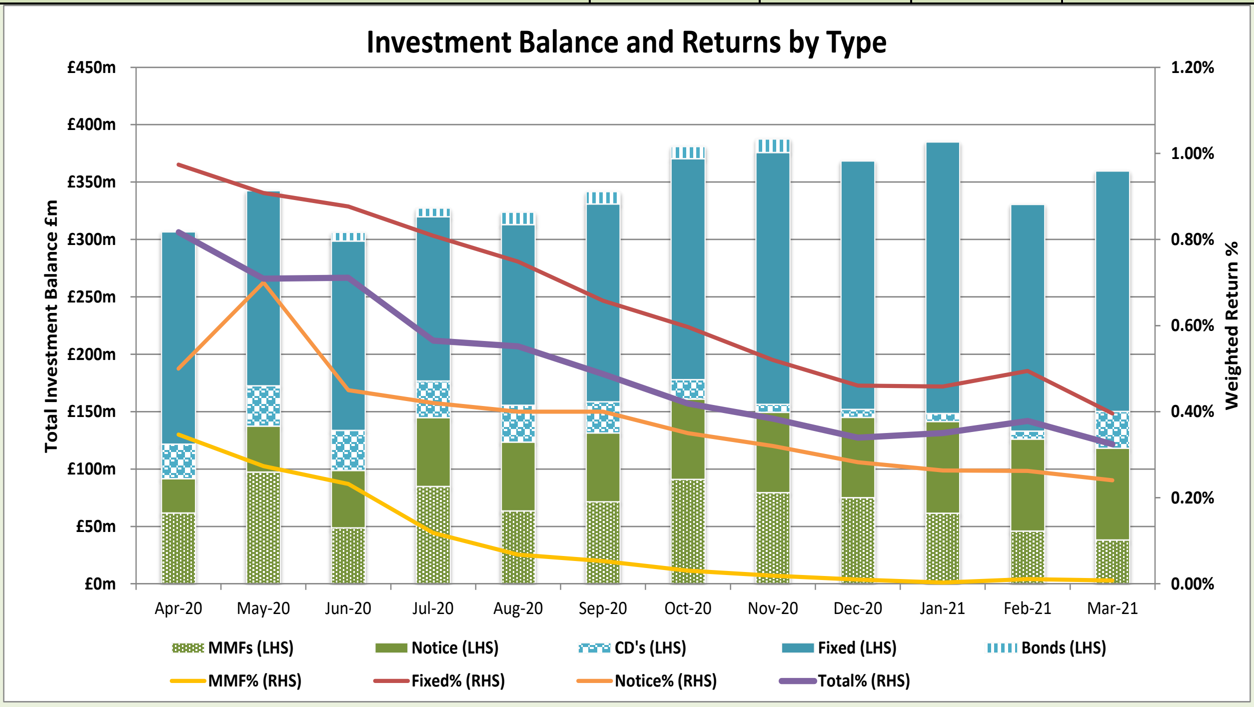
3.5. As such, in addition to LAS's credit methodology, the Council also maintains a minimum limit of **A+ Long Term Rating (two out of three agencies)** for all its Counterparties, excluding part-nationalised UK banks, and a **minimum limit AA- Sovereign Rating, (two out of three agencies)** for any Country in which a Counterparty is based to ensure investments are only placed with highly credit rated financial institutions and hence the return achieved is commensurate with this level of risk taken. For information the UK Sovereign Rating is currently AA-.

3.6. The Covid-19 pandemic has not resulted in increased Credit Risk as Central Banks across the world have supported both their economies and banking sectors during the year. As such there have been no significant credit rating changes to Counterparties on the Authorise Lending List during the year.

Treasury Investment Activity 2020/21

3.7. The Council's treasury investment position and movement in activity during 2020/21 is shown as follows:

INVESTMENT PORTFOLIO	31.3.20 £m	Annual Return %	31.3.21 £m	Annual Return %
Treasury Investments:				
Money Market Liquidity Funds	63.105	0.71%	38.225	0.10%
Notice Accounts	40.000	0.94%	80.000	0.35%
Fixed Deposits, CD's & Bonds	185.000	1.03%	241.450	0.68%
Total Treasury Investments	**288.105**	**0.98%**	**359.675**	**0.52%**



Maturity Structure	31.3.2020		31.3.2021	
Weighted Average Maturity (WAM)	**114 Days**		**114 Days**	
Liquidity	£103.105m	35.79%	£118.225m	32.87%
< 1 Month	£15.000m	5.21%	£20.000m	5.56%
1-3 Months	£75.000m	26.03%	£82.950m	23.06%
3-6 Months	£45.000m	15.62%	£91.500m	25.44%
6-9 Months	£18.000m	6.25%	£20.000m	5.56%
9-12 Months	£20.000m	6.94%	£22.000m	6.12%
1-2 Years	£12.000m	4.17%	£5.000m	1.39%
Total	**£288.105m**	**100.00%**	**£359.675m**	**100.00%**

3.8. The investment balances shown above are made up of general and earmarked reserves, Pension Fund cash (£74.1m at 31 March 2021 / £12.1m at 31 March 2020), income received but not yet used/spent and general movement of working capital. The data shows that the investment balance at 31 March 2021 was some £71.5m higher than the previous year. This is predominantly due to the higher Pension Fund balance at the year end. The cash of the Pension Fund is pooled with that of the Council's cash for investment purposes and the Pension Fund received £50m cash in March following the redemption of a Fund. For strategic asset allocation reasons this redemption will be left as cash for at least six months and will therefore remain within the investment balance of the Council.

3.9. The average value of investments during 2020/21 was £348m, some £50m higher than the previous year. This is a consequence of receiving a huge amount of Covid-19 finance from Government during the year to pass onto businesses/individuals for support or to finance additional Covid-19 services. This extra funding had two major effects during the year on investments, that of disrupting normal cash flow and creating uncertainty of cash flow timings and flooding the market with liquidity in general, thus leading to plummeting liquidity rates.

3.10. The graph at 3.7 above shows how the investment fund balance fluctuated per month over the year and also how these funds were invested by type of investment, split between investments held for liquidity (Money Market Funds and Notice accounts)(green bars) as opposed to fixed term investments (blue bars) held for return. It shows that liquidity investments remained high throughout the year to manage the uncertainty of cashflow, at the same time as returns on liquidity, especially Money Market funds, fell to nearly zero (yellow line).

3.11. All investments made during the year were in line with the strategy, including making some one and two year investments where possible to lock into higher rates above benchmark levels and lengthen the Weighted Average Maturity (WAM) of the fund which ended the year at 114 days, the same as the previous year. The table above shows the maturity profile of the investments made in light of this strategy which is very similar to the previous year.

3.12. Temporary borrowing of £40.5m was taken when required during the year to cover liquidity shortfalls at an average cost of 0.08%, below money market fund yield levels. This was in line with strategy and as an alternative to drawing on higher yielding Notice Accounts. No temporary borrowing remained outstanding at 31 March 2021.

3.13. A full list of the investments held at 31 March 2021, compared to Link's creditworthiness list, and changes to credit rating of counterparties during March 2021 are shown in **Appendix C**.

Treasury Investment Return and Benchmarking Results

3.14. The table below shows the Council's annualised investment return for 2020/21 based on the above activity against the benchmark return for internal investments (weighted 7 day LIBID and 3 month LIBID market rates to reflect low risk appetite taken), compared to the previous year, and also the actual versus budgets investment income earned as a result. The significant underspend in both the Capital and Revenue budgets in 2019/20 was also a contributory factor to the surplus investment income achieved over that budgeted, shown below.

	2019/20	2020/21
Annualised Investment Return	0.98%	0.52%
Annualised Benchmark Rate	0.61%	0.07%
Outperformance	**0.37%**	**0.45%**
Total Investment Return Income	£2.42m	£1.78m
Budgeted Investment Return Income	£2.00m	£1.30m
Surplus Investment Return Income	**£0.42m**	**£0.48m**

3.15. The table highlights how the investment return and income have fallen sharply in 2020/21 as a result the impact of Covid-19 on the economy and interest rates. Despite this the investment benchmark was exceeded by 0.45% and the budgeted investment return was exceeded by £480k. The significant underspend in both the Capital and Revenue budgets in 2020/21 was a contributory factor to the surplus investment income achieved over that budgeted.

3.16. The level of return achieved directly correlates with the level of risk taken with investments. To demonstrate this, **Appendix D** shows the performance of a variety of major asset classes over several years ranked by riskier assets first (risk to capital loss). The Council has set its risk appetite at the bottom of this spectrum, including Money Market Funds held for liquidity and 3 to 12 month LIBID money market deposits.

3.17. The Council's investment return was also benchmarked against analysis as at 31 March 2021, provided by LAS, which comprised a mixture of 14 other Councils in the East Midlands area and 13 English Counties. The results of this benchmarking are detailed below.

Link Benchmarking – Position at 31/3/2021			
	LCC	Benchmark Group(14)	English Counties (13)
31st March Return %	0.32%	0.18%	0.23%
Risk Banding	0.22% -0.32%	0.13% - 0.24%	0.18% -0.28%
Performance	Above	Inline	Inline
Risk Weighted Score (Duration/Credit Quality)	2.45	2.92	2.40
WAM (days)	114	82	85

3.18. The benchmarking results show that the Council is above par with the investment returns achieved by its LAS comparators in 2020/21, mainly as a result of having a longer WAM (duration of investments). This is a good result given the low risk nature of the Counterparties allowed on the Council's Lending List (restricted to a Long Term minimum rating of A+), which does not apply to other comparators. LAS calculate a risk banding return that should be achievable for the level of risk being taken on investments and the Council has performed above this banding.

4. Long Term Borrowing 2020/21

Capital Expenditure Plans and Borrowing Requirement 2020/21

4.1. The Council's capital expenditure plans are the key driver of treasury management activity, as they set the long term borrowing requirement plans for the Council.

4.2. The Council is required by regulation to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities 2017 (referred to as the 'Prudential Code') when assessing the **affordability**, **prudence** and **sustainability** of its capital investment plans. It does this by setting a series of **Prudential Indicators** that ensure and demonstrate the Council's capital expenditure plans remain affordable, prudent and sustainable.

4.3. **Appendix E** shows a summary of the actual Prudential Indicators for 2020/21, compared to those estimated and approved by the County Council at its meeting on 21 February 2020, along with the Council Budget 2020/21. It can be confirmed that no Prudential Indicators were breached during 2020/21.

4.4. Extracted from these Prudential Indicators, shown in the table below, is the Council's **net capital expenditure** for 2020/21 and the resulting **borrowing requirement** for 2020/21 (the element of this expenditure which is not to be financed straight away from cash resource or grants, hence to be financed at a future date by borrowing). Plans were revised during 2020/21 from that agreed by the County Council and both actual spending and borrowing requirement were under budget for the year.

	Original Budget at 1/4/2020 £m	Final Budget at 31/3/2021 £m	Actual at 31/3/2021 £m	Underspend £m
Net Capital Expenditure Programme 2020/21	137.923	111.769	**52.235**	59.534
Borrowing Requirement 2020/21	137.893	90.537	**28.313**	62.224

<u>Capital Financing Requirement, Borrowing Strategy and Control of Interest Rate Risk 2020/21</u>

4.5. **The Capital Financing Requirement** (CFR) is another Prudential Indicator shown in Appendix E. It is a measure of the amount of capital expenditure that the Council has already spent that has yet to be funded from cash resources or the Council's total indebtedness or **need to borrow for capital financing purposes**. Credit arrangements (finance leases and PFI) are also included in the CFR as they have the same practical impact as borrowing. The CFR is increased each year by the **new borrowing / credit arrangement** requirement, as highlighted in the table above, and reduced each year by the **Minimum Revenue Provision (MRP)**, a provision the Council has to set aside to repay its debt each year.

4.6. In fulfilling the underlying need to borrow to finance its capital expenditure plans, the Council has flexibility when it takes external borrowing to ensure borrowing is taken at a time when interest rates are at their lowest (thereby controlling interest rate risk) and to minimise cost of carry (where borrowing costs exceed investment return, until utilised by capital expenditure). The Council utilises its own internal cash resource to finance borrowing requirement not taken externally and this is known as **Internal Borrowing**.

4.7. A benefit of internal borrowing is the reduction of Counterparty risk as a reduced cash balance leads to reduced investments made and in times when investment returns are low this is a prudent strategy. Cash resource is depleted by internal borrowing and therefore there is an ultimate limit as to how much internal borrowing can be done before cash resource is put at risk. The Council tries to maintain the **level of internal borrowing at 15% of CFR** in order to maintain a suitable level of cash resource. However for 2020/21 the level of internal borrowing was increased to 20%, given the excess cash balance held in the year as explained in 3.8 and 3.9 above.

4.8. Another Prudential Limit states that external borrowing should not exceed the CFR two years hence in order to ensure that borrowing remains prudent and affordable and not undertaken for revenue purposes. Appendix E shows that the Council has maintained this limit.

4.9. The table below shows the final CFR position for 2020/21 and how this is split between External and Internal Borrowing.

CFR 2020/21		£m	£m	%
Opening CFR Balance at 1.4.2020			616.220	
Net Capital Expenditure 2020/21		52.235		
Financed by Cash Resource:	Grants	9.401		
	Capital Receipts	(2.690)		
	Reserves	(4.080)		
	Revenue	(7.751)		
Add: Borrowing Requirement 2020/21			28.313	
Less: Minimum Revenue Provision 2020/21			(20.235)	
Closing CFR Balance at 31.3.2021			**624.298**	**100.0%**
Represented By:				
External Borrowing (Including Credit Arrangements)			**496.296**	**79.5%**
Internal Borrowing			**128.002**	**20.5%**

External Borrowing Activity 2020/21

4.10. The Strategy for 2020/21 stated that new external borrowing would be undertaken in all periods with the aim of achieving an even spread of maturity profile and keeping an increase in the average cost of the Council's debt to a minimum. Borrowing would be undertaken at a time appropriate to coincide with an identified dip in borrowing rates available.

4.11. The Council's actual borrowing position as at 31 March 2021 and activity during 2020/21, is detailed in the table below:

Borrowing Activity 2020/21	Market Debt (LOBO) £m	PWLB Debt £m	Total £m	% Cost
Opening Balance at 1.4.2020	20.000	481.540	501.540	3.757%
New Borrowing in 2020/21	0.000	0.000	0.000	
Borrowing Matured/Repaid in 2020/21	0.000	(14.354)	(14.354)	
Debt Rescheduling:- Borrowing Repaid in 2020/21 Borrowing Replaced in 2020/21	 (0.000) 0.000	 0.000 0.000	 (0.000) 0.000	
Closing Balance at 31.3.2021	**20.000**	**467.186**	**487.186**	**3.743%**
Authorised Limit For External Debt 2020/21			**715.305**	

4.12. The table above shows that no new external borrowing was taken during the year with the Borrowing Requirement for 2020/21 met in full from internal borrowing in an attempt to reduce surplus cash balances held in the year and to save on borrowing costs.

4.13. **Appendix F** shows this maturity profile at 31 March 2021, including the variability effect of the £20m LOBO debt held. The graph shows that no debt maturing in any one year exceeds 9.83% of the total debt portfolio.

4.14. The table also shows that no debt rescheduling was undertaken in 2020/21 and the balance of LOBO debt still remains at £20m, all held with BAE Systems Pension Fund. This is well within the LOBO limit set in the Strategy of 10% of total external debt (equating to £48.7m). A limit is set on this type of borrowing to limit the amount of variability within the debt portfolio for debt repayment.

4.15. Total long term debt outstanding at 31 March 2021 fell to £487.186m and is well within the Council's Authorised Limit for External Debt of £715.305m. This is the Council's statutory 'Affordable Borrowing Limit' as per the Local Government Act 2003, which should not be breached and is also another Prudential Indicator.

External Borrowing Cost and Benchmarking Position

4.16. The table below shows the interest cost of the Council's total external debt. This is benchmarked against the average cost of debt that was available from the PWLB in the year. Savings in the cost of borrowing was due to no external debt taken in the year together with significant underspend of the capital programme in 2020/21 which has been carried forward to 2021/22.

	2019/20		2020/21	
	% Cost	£m	% Cost	£m
Long Term Borrowing Outstanding at 31st March.	-	501.540	-	487.186
Actual Interest Cost of External Debt	3.757%	18.809	3.743%	18.484
Budgeted Cost of External Debt	-	21.858	-	22.093
Underspend		**£3.049m**		**£3.609m**
New Borrowing Taken and Average Cost	1.848%	50.000	-	0.000
Benchmark Cost of Borrowing Available in Year (50 Year PWLB)	2.320%	-	2.140%	-
Outperformance	**0.472%**	**£0.236m**	**0.0%**	**£0.000m**

Internal Borrowing Activity 2020/21

4.17. The borrowing requirement (CFR) not taken externally is known as 'internal borrowing' and this utilises the internal balances of the Council to finance the capital spend. The level of internal borrowing is adjusted for amounts carried forward along with any capital programme underspends each year and also for adjustment to borrowing taken for any voluntary repayment of debt or excess borrowing taken for maturing debt in excess of MRP level. The balance of internal borrowing at 31 March 2021 stood at £128.002m and the table below shows how this balance has been derived.

Internal Borrowing 2020/21	£m	£m
Internal Borrowing Balance BF		104.965
Original Borrowing Requirement 2020/21	90.537	
Less Underspend Carried Forward	(62.224)	
Adjustment for Voluntary /Maturing Debt	(5.067)	
Final Borrowing Requirement 2020/21		23.246
Actual External Borrowing Undertaken		(0.209)
Internal Borrowing Balance CF		**128.002**

The £62.224m carry forward of internal borrowing for 2020/21 will be carried forward to 2021/22, along with the Capital Programme and Borrowing Requirement underspends. The Council will take external borrowing in 2021/22, after adjusting for debt repayments and underspends to ensure internal borrowing remains around 20% of CFR in order that sufficient cash balance is maintained.

4.18. It is worth pointing out that the internal borrowing balance detailed above can be taken externally at any time if investment interest rate yield curves reverse and move higher than long term borrowing rates in the future. This would bring internal borrowing down below 20%.

5. Other Treasury Management Issues

5.1. Public Works Loan Board (PWLB); Future Lending Terms Consultation

The Government increased the margin on all PWLB debt by 1% in October 2019 and the Chancellor's Budget on 11 March 2020 clarified some of the rationale behind the rate increase, whilst stating that it did not support the use of cheap long-term PWLB funding for commercial type ventures and so intended not to lend for this type of activity. To counteract funding commercial activities:

- The Government issued a consultation, the deadline for response being July 2020, on revising the terms of PWLB lending (process and interest rates), to ensure Councils continue to invest in housing, infrastructure and front-line services (i.e. non-commercial activities).
- Immediately cut the PWLB margin for social housing projects by 1%, back to the pre-October increase level.

- Made an extra £1.15bn of discounted loans available for local infrastructure projects at a margin of only 0.60%.

In response to this Consultation, on 25 November 2020, a new PWLB lending procedure was introduced requiring Councils to confirm they do not plan to buy investment assets primarily for yield (i.e. for commercial activity), through the Government Delta System on an annual basis. Any purchase of investments assets for this purpose declared would automatically exclude a Council from future borrowing from the PWLB for any reason.

Councils that could confirm no such investments for commercial reasons were automatically subject to a new Certainty Rate from the PWLB for borrowing that was once again reduced by the 1% margin previously increased in 2019.

I can confirm that at 31 March 2021 the Council had no commercial investments held purely for return or any plans to undertake any and as such can now benefit from the reduced Certainty Rates from the PWLB for external borrowing during 2021/22.

6. Conclusion

<u>Key Points Summary</u>:

- This report relates to Treasury Investments only. Non-Treasury Investments made for service reasons are covered in the Council's Capital Strategy.

- Bank Base rate has remained at 0.10% over 2020/21 and the MPC is not expected to move this for the foreseeable future to support the economy's recovery from the pandemic. Short term rates (LIBID) are now also negative. Long term rates remained relatively flat until 26 November 2020 where they were cut by 1% due to PWLB procedural changes. They have drifted upward since then to end the year 0.50% higher due to a rebound in economic recovery.

- The financial year 2020/21 will be remembered as the year of the pandemic as economies across the world, including the UK, took a nose dive as Governments have tried to support their nations through lockdown. The way in which the UK and the US have led the world implementing a fast vaccine program has been instrumental in speeding economic recovery and coming out of lockdown. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity by March 2022.

- The main impact of the pandemic on treasury activity in 2020/21 was to cash flows, with normal cash flows disrupted by the injection of Government Support for Covid-19 measures throughout the year and extra Covid-19 expenditure measures taken to support businesses and individuals in Lincolnshire. This uncertainty of cash flow has required a larger proportion of investments to be held in liquidity instruments than normal, which are yielding the lowest return.

- The Council's risk appetite for its treasury investments remains low, as it prioritises security of capital and liquidity over return. The Council has outperformed the benchmark set for this risk level, by 0.45%, which equated to £0.48m in monetary terms. It also outperformed benchmarking comparators whilst having a lower risk profile, primarily by having a longer weighted average maturity of investments.

- Short term borrowing at less than investment rate levels was taken during the year to support predicted liquidity shortfalls, in line with the Strategy.

- The Council adheres to the CIPFA Prudential Code for Capital Finance by setting Prudential Indicators to ensure its capital plans are affordable, prudent and sustainable. All prudential limits have been adhered to with no breaches in 2020/21.

- Both capital expenditure and hence its borrowing requirement for 2020/21 were significantly underspent in the region of £62m. This will be carried forward into 2021/22.

- The Council's CFR at 31 March 2021 (or underlying need to finance its capital expenditure plans by borrowing) has been met by a combination of both external and internal borrowing as follows:

External Borrowing	£496.3m	79.5%
Internal Borrowing	<u>£128.0m</u>	20.5%
CFR	£616.3m	

- No new external borrowing was taken in 2020/21; £14.4m of debt was repaid which has reduced the total cost of the Council's external debt to 3.743%, equating to £18.5m borrowing interest paid in 2020/21, £3.6m under budget.

- No debt rescheduling was undertaken in 2020/21.

- Internal borrowing was increased in 2020/21 by £23.0m after balances brought forward and carried forward, outturn borrowing requirement and external debt taken, leaving the balance of internal borrowing at £128m which, at 20.5% is in line with the target level for internal borrowing that has been increased to 20% of the CFR, as the general level of cash surplus has increased to support this new level.

- New PWLB terms for process and interest rates were published in November 2020, following a Consultation from MHCLG. These terms preclude Councils from taking PWLB borrowing if they have taken commercial investments purely for return, but the Certainty Rate for those councils with no such investments was reduced by 1 % for any new borrowing required. The Council has no such commercial investments at 31 March 2021 and is free to utilise this new Certainty rate for 2021/22.

7. Consultation

a) Risks and Impact Analysis

Risk & Impact Analysis for Treasury Management forms TMP1 of the Treasury Management Practices, as required by the CIPFA Code of Practice 2017. A Risk Register which details the main risks for Treasury Management has been completed and is reviewed annually. Both the TMPs and the Risk Register are held in the Treasury Files held on IMP at County Offices.

8. Appendices

These are listed below and attached at the back of the report	
Appendix A	Glossary of Abbreviations Used in this Report
Appendix B	Authorised Lending List at 31 March 2021 and Credit Rating Key
Appendix C	Investment Analysis Review at 31 March 2021 - Link Asset Services Ltd
Appendix D	Risk and Reward per Asset Class 2020/21 and Comparative Years
Appendix E	Prudential Indicators - Actuals Compared to Estimate 2020/21
Appendix F	LCC Long Term Borrowing Maturity Profile as at 31 March 2021

9. Background Papers

The following background papers as defined in the Local Government Act 1972 were relied upon in the writing of this report.

Document title	Where the document can be viewed
Treasury Management Strategy Statement and Annual Investment Strategy 2020/21 - 20/3/2020	https://lincolnshire.moderngov.co.uk/ieDecisionDetails.aspx?ID=590
Council Budget 2020/21 - 21/2/2020	https://lincolnshire.moderngov.co.uk/ieListDocuments.aspx?CId=120&MId=5627&Ver=4

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