AUDIT COMMITTEE 2 JULY 2021

TREASURY MANAGEMENT ANNUAL OUTTURN REPORT 2020/21

1. PURPOSE

1.1. New Forest District Council has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2017. The CIPFA Code requires the Council to approve a treasury management strategy before the start of the year and a semi-annual and annual treasury outturn report. The purpose of this report is therefore to meet this obligation by providing an update on the performance of the treasury management function during 2020/21.

2. SUMMARY

2.1. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and provides an update on the performance of the treasury management function during 2020/21.

2.2. The Council's treasury management strategy was most recently updated and approved at a meeting of Full Council in February 2021. The Council has borrowed and invested 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 are therefore central to the Council's treasury management strategy.

2.3. Treasury management in the context of this report is defined as:

"The management of the organisation'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."

2.4. This annual report sets out the performance of the treasury management function during 2020/21, to include the effects of the decisions taken and the transactions executed in the past year.

2.5. Hampshire County Council's Investments & Borrowing Team has been contracted to manage the Council's treasury management balances since March 2014 but overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

2.6. All treasury activity has complied with the Council's revised Treasury Management Strategy and Investment Strategy for 2020/21, and all relevant statute, guidance and accounting standards. In addition support in undertaking treasury management activities has been provided by the Council's treasury advisers, Arlingclose.

2.7. 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 latest iteration of the Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council in February 2021.

3. EXTERNAL CONTEXT

3.1. The following sections outline the key economic themes currently in the UK against which investment and borrowing decisions were made in 2020/21.

Economic commentary

3.2. The coronavirus pandemic dominated 2020/21, resulting in significant levels of government borrowing and expenditure to support the economy, with the UK also agreeing a Brexit trade deal within the period.

3.3. The Bank of England (BoE) held Bank Rate at 0.1% throughout the year and extended its Quantitative Easing programme by £150bn to £895bn in November 2020. The Bank expects Gross Domestic Product (GDP) to remain low in the near-term but believes that the easing of restrictions is likely to lead to a strong recovery in growth later in 2021, with inflation forecast to increase in the near-term. The economic outlook has improved but downside risks remain, such as a further increase in unemployment when the furlough scheme ends.

3.4. Inflation remained low during 2020/21, with the annual headline rate of UK Consumer Price Inflation (CPI) rising to 0.7% year-on-year in March 2021, below expectations and below the BoE's 2% target. Unemployment was higher for the three months to March 2021 than for the same period the previous year, while periods of GDP contractions and growth over the year largely mirrored the tightening and easing of restrictions, creating some significant quarterly swings.

Financial markets

3.5. Monetary and fiscal stimulus helped provide support for equity markets which rose over the period. In the UK, the FTSE indices performed reasonably well during the period to November 2020 before being buoyed in December by both the vaccine approval and Brexit deal.

3.6. 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.

Credit review

3.7. After spiking in March 2020, credit default swap spreads subsequently declined to broadly pre-pandemic levels. Credit default swaps are used as an indicator of credit risk, where higher premiums indicate higher perceived risks.

3.8. Moody's downgraded the UK sovereign rating to Aa3 with a stable outlook during the period and this change had an impact on a number of other UK institutions, banks and local government.

3.9. 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 pandemic and the effects of lockdowns and restrictions. This uncertainty means the Council's treasury management advisors, Arlingclose, continue to recommend maximum durations of 35 days for unsecured investments with banks and building societies on their list of recommended counterparties.

4. LOCAL CONTEXT

4.1. At 31 March 2021 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £141.9m, while usable reserves and working capital which are the underlying resources available for investment were £49.9m (principal invested plus gains on investments with a variable net asset value). These factors and the year-on-year change are summarised in Table 1.

Table 1: Capital Financing Summary

	31/03/20 Balance £m	Movement £m	31/03/21 Balance £m
General Fund CFR	7.8	1.8	9.6
Housing Revenue Account CFR	1.9	4.1	6.0
HRA Settlement	130.4	(4.1)	126.3
Total CFR	140.1	1.8	141.9
Financed By:			
External Borrowing	131.2	(4.3)	126.9
Internal Borrowing	8.9	6.1	15.0
Total Borrowing	140.1	1.8	141.9

4.2. The General Fund CFR (and so internal borrowing) has increased as resources have been required to finance direct property investment during 2020/21, albeit mitigated in part through the application of Minimum Revenue Provision (MRP). The Housing Revenue Account (HRA) CFR has increased as internal borrowing has been used to finance new dwellings purchased pursuant to the housing delivery strategy.

External borrowing has reduced as a result of the repayment of the maturing HRA Public Works Loan Board (PWLB) debt.

4.3. The Council's strategy was to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, to reduce risk and keep interest costs low. The treasury management position at 31 March 2021 and the change during the year is shown in Table 2.

Table 2: Treasury Management Summary

	31/03/20 Balance £m	Movement £m	31/03/21 Balance £m	31/03/21 Rate %
Long-term borrowing	(126.9)	4.3	(122.6)	3.32
Short-term borrowing	(4.3)	-	(4.3)	2.41
Total borrowing	(131.2)	4.3	(126.9)	3.29
Long-term investments	18.4	(1.9)	16.5	3.81
Short-term investments	20.1	5.0	25.1	0.29
Cash and cash equivalents	18.3	(10.0)	8.3	0.03
Total investments	56.8	(6.9)	49.9	1.42
Net borrowing	(74.4)	(2.6)	(77.0)	

Note: the figures in Table 2 are from the balance sheet in the Council's statement of accounts adjusted to exclude operational cash.

4.4. The increase in net borrowing of £2.6m shown in Table 2 reflects a reduction in investment balances of £6.9m partially offset by the repayment at maturity of borrowing of £4.3m, in line with the Council's policy on internal borrowing. Further details are provided in the Borrowing Activity and Treasury Investments Activity sections of this report.

5. BORROWING UPDATE

5.1. In November 2020 the PWLB published its response to the consultation on 'Future Lending Terms'. The rate at which local authorities can borrow from the PWLB is defined by a margin above gilts; following the response to the consultation the margin above gilts on PWLB loans was reduced from 1.8% to 0.8%, however restrictions were introduced meaning that this rate would only be available to authorities not planning to purchase investment assets primarily for yield in the current or next two financial years. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

5.2. As part of the borrowing process authorities are now 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.

5.3. The Council 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, if required.

6. BORROWING ACTIVITY

6.1. At 31 March 2021 the Council held £126.9m of loans, a decrease of £4.3m which was a maturity in the year. The vast majority of the outstanding loans are in relation to the resettlement of the HRA in 2012/13. The year-end treasury management borrowing position and year-on-year change are summarised in Table 3.

Table 3: Borrowing Position

	31/03/20 Balance £m	Movement £m	31/03/21 Balance £m	31/03/21 Rate %	31/03/21 WAM* years
Public Works Loan Board	(131.2)	4.3	(126.9)	3.29	15.8
Total borrowing	(131.2)	4.3	(126.9)	3.29	15.8

* Weighted average maturity

Note: the figures in Table 3 are from the balance sheet in the Council's statement of accounts adjusted to exclude accrued interest.

6.2. The Council'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. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

6.3. Short-term interest rates have remained much lower than long-term rates and the Council has therefore considered it to be more cost effective in the near term to use internal resources than to use additional borrowing. In line with this strategy £4.3m of PWLB loans was allowed to mature without refinancing.

6.4. This borrowing strategy has been monitored by Arlingclose and has enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

7. TREASURY INVESTMENT ACTIVITY

7.1. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year the Council's investment balances have ranged between £48.0m and £126.4m due to timing differences between income and expenditure. During 2020/21 the UK central government distributed funding through grant schemes to support small and medium term businesses which resulted in more pronounced movements in the Council's investment balances. The year-end investment position and the year-on-year change are shown in Table 4.

Table 4: Treasury investment position

Investments	31/03/2020 Balance £m	Movement £m	31/03/2021 Balance £m	31/03/21 Rate %	31/03/21 WAM* years
Short term Investments					
- Banks and Building Societies:					
- Unsecured	4.1	5.0	9.1	0.04	0.0
- Secured	4.0	(4.0)	-	-	-
- Money Market Funds	15.3	(10.1)	5.2	0.01	0.0
- Local Authorities	9.0	8.0	17.0	0.31	0.2
- Registered Providers	4.0	(4.0)	-	-	-
- Cash Plus Funds	2.0	-	2.0	0.93	0.0
	38.3	**(5.0)**	**33.3**	**0.23**	**0.1**
Long term investments					
- Banks and Building Societies:					
- Secured	3.0	-	3.0	0.42	1.9
- Local Authorities	3.0	(3.0)	-	-	-
	6.0	**(3.0)**	**3.0**	**0.42**	**1.9**
High yield investments					
- Pooled Property Funds**	7.6	-	7.6	4.22	N/A
- Pooled Equity Funds**	3.0	-	3.0	6.09	N/A
- Pooled Multi-Asset Funds**	3.0	-	3.0	4.39	N/A
	13.6	**-**	**13.6**	**4.67**	**N/A**
TOTAL INVESTMENTS	**57.9**	**(8.0)**	**49.9**	**1.45**	**0.3**

* Weighted average maturity, excluding pooled funds

** The rates provided for pooled fund investments are reflective of annualised income returns over the year to 31 March 2021 based on the market value of investments at the start of the year.

Note: the figures in Table 4 are from the balance sheet in the Council's statement of accounts but adjusted to exclude operational cash, market value adjustments and accrued interest.

7.2. Investment balances have reduced as cash has been utilised in financing the Council's Capital Programme, including the provision of equity and loans to the Council's wholly owned group of housing companies.

7.3. The CIPFA Code and Government guidance both require the Council 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 Council's objective when investing money is therefore to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults against the risk of receiving unsuitably low investment income. The Council's Treasury Management Strategy Statement (TMSS) sets out how it will manage and mitigate these risks.

7.4. The security of investments has been maintained by following the counterparty policy and investment limits within the TMSS, taking advice from Arlingclose on changes in counterparty credit worthiness, and making use of secured investment products that provide collateral. The Council invests in liquid investments to ensure money is available when required to meet its financial obligations, spreading these investments across a number of counterparties to mitigate operational risk.

7.5. In delivering investment returns, the Council has operated against a backdrop in which the UK Bank Rate was cut to 0.10% in March 2020 in response to the coronavirus pandemic. It has remained at this rate throughout the year, having an impact on rates across the market. Returns had been at or around 0% for liquid investment options such as Money Market Funds (MMFs), bank call accounts and the UK Government's Debt Management Account Deposit Facility (DMADF) and have not been significantly higher for other short-term options like fixed duration loans to other local authorities and bank notice accounts. Investment income has therefore largely come from investments arranged at fixed rates of interest prior to the pandemic and through the Council's investments in pooled funds.

7.6. The Council benchmarks the performance of its internally managed investments against that of other Arlingclose clients. Internally managed investments include all investments except externally managed pooled funds but do include MMFs. The performance of these investments against relevant measures of security, liquidity and yield are shown in Table 5, providing data for the quarter ended 31 March 2021 and at the same date in 2020 for comparison.

Table 5: Investment benchmarking (excluding pooled funds)

	Credit rating	Bail-in exposure	Weighted average maturity (days)	Rate of return
31.03.2020	AA	46%	159	0.85%
31.03.2021	AA-	42%	106	0.22%
Similar LAs	A+	65%	40	0.13%
All LAs	A+	63%	14	0.15%

7.7. Table 5 shows the average credit rating of the portfolio was lower at 31 March 2021 than at the same time the previous year, largely as a result of the effect of the pandemic on credit ratings across the market, including that of the UK Government. Bail-in exposure was lower than at the same time in 2020, as the Council held greater investment balances with other local authorities, who are not subject to bail-in-risk, while the weighted average maturity of investments was lower as the Council held lower long-term balances due to the availability of appropriate longer term investments combined with the prudent management of liquid investment balances during an uncertain economic market. In addition there were timing differences between receiving and spending of Covid grants. The average rate of return (0.22%) was lower than at 31 March 2020, which is reflective of returns at or close to 0% for many investments across the market. The Council compared favourably with the other local authorities included in the benchmarking exercise across all metrics.

Externally managed pooled funds

7.8. In order to minimise the risk of receiving unsuitably low investment income, the Council has continued to invest a proportion of steady core balances in externally managed pooled funds as part of its higher yielding strategy.

7.9. The CIPFA Code requires the Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the Council's investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long-term security of the Council's investments.

7.10. The Council's investments in pooled funds fell considerably in value when the coronavirus pandemic hit world markets but have since recovered well. This recovery means these investments are now worth only marginally less in aggregate than the initial sums invested, as shown in Table 6, demonstrating the importance of taking a longer term approach and being able to ride out periods of market volatility, ensuring the Council is not a forced seller at the bottom of the market.

Table 6: Higher yielding investments – market value performance

	Amount invested	Market value at 31/03/21	Gain / (fall) in capital value	
			Since purchase	2020/21
	£m	£m	£m	£m
Pooled property funds	7.60	7.47	(0.13)	(0.02)
Pooled equity funds	3.00	3.05	0.05	0.78
Pooled multi-asset funds	3.00	2.97	(0.03)	0.34
Total	13.60	13.49	(0.11)	1.10

7.11. The Council's investments in pooled funds target long-term price stability and regular revenue income and bring significant benefits to the revenue budget. As shown in Table 7 the annualised income returns have averaged 4.28% pa (per annum) since purchase, contributing to a total return of 18.53%.

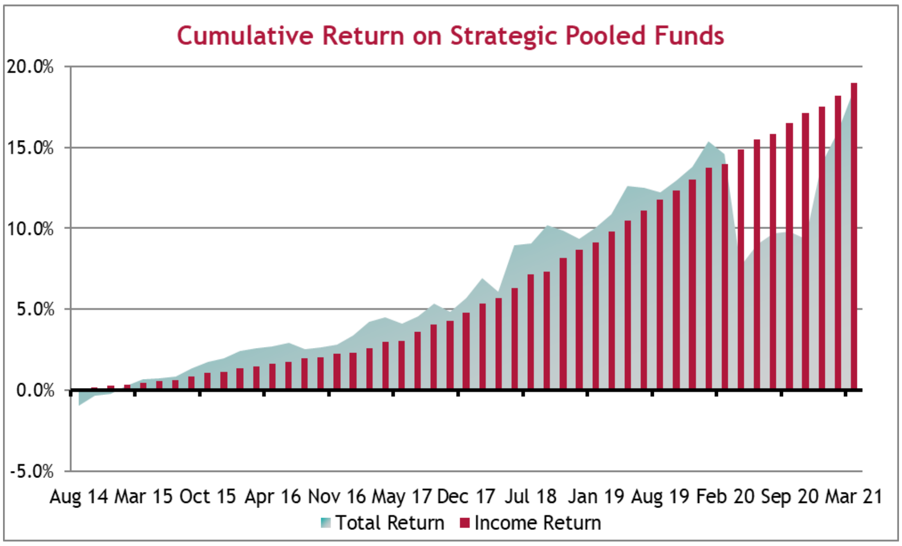
Table 7: Higher yielding investments – income and total returns since purchase

	Annualised income return	Total return
	%	%
Pooled property funds	4.18	19.19
Pooled equity funds	4.77	22.26
Pooled multi-asset funds	4.04	13.14
Total	4.28	18.53

7.12. Following advice from Arlingclose, the Council made prudent income forecasts for 2020/21 to reflect the impact of the pandemic and the challenging market conditions being faced by the investment managers of its pooled funds, identifying the potential impact in its revised budget. Actual income returns from pooled fund investments were more positive than this prudent forecast resulting in income of £0.63m, which was about

19.5% lower than in 2019/20. This is compared with the 25% to 30% reduction that could reasonably have been anticipated given the pandemic's impact on property rental income, company dividends and bond yields. The Council's pooled fund investments continue to deliver income returns far in excess of what could be generated from cash investments and accounted for 76% of the Council's total income from its treasury investments, despite making up only 15% of the average investment balance.

7.13. The cumulative total return from the Council's investments in pooled equity, property and multi-asset funds since purchase is shown in the following graph. This highlights that the Council has benefited from strong and steady income returns over time and the way that capital values have recovered since March 2020.



7.14. The IFRS 9 accounting standard that was introduced in 2018/19 means that annual movements in the capital values of investments need to be reflected in the revenue account on an annual basis, although a five year statutory override was put in place for local authorities that exempts them from complying with this requirement.

7.15. Pooled fund investments have no defined maturity date but are available for withdrawal after a notice period and their performance and continued suitability in meeting the Council's investment objectives is monitored regularly and discussed with Arlingclose.

8. FINANCIAL IMPLICATIONS

8.1. The outturn for debt interest paid (HRA) in 2020/21 matched the budget set at £4.3m.

8.2. The outturn for investment income received in 2020/21 was £0.82m on an average investment portfolio of £88.45m, therefore giving a yield of 0.93%. By comparison, investment income received in 2019/20 was £1.29m on an average portfolio of £78.64m with a yield of 1.64%.

8.3. The budget for interest payable (HRA) has been reduced within the base budget for 2021/22, in reflection of the principal repayments commencing from 2017/18. The interest earning target for 2021/22 has been set based on an average investment portfolio of £69m and a return of 0.75%..

9. NON-TREASURY INVESTMENTS

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

9.2. This could include service investments for operational and/or regeneration reasons as well as commercial investments which are made mainly for financial reasons.

9.3. The Council's existing non-treasury investments are listed in Table 8.

Table 8 – Non-treasury investments

	31/03/21 Asset value £m	31/03/21 Annual rate of return
Hythe Marina	2.54	4.57%
Saxon Inn Calmore	0.18	6.89%
Meeting House Lane	0.14	-
New Milton Health Centre	2.54	5.40%
Ampress Car Park	2.12	4.85%
Employment Land at Crow Lane	2.01	-
The Parade Salisbury Road Totton	1.43	7.66%
1-3 Queensway New Milton	0.88	8.21%
Unit 1 Nova Business Park	0.54	6.51%
Total investment properties	**12.38**	**4.73%**
Lymington Town Hall	3.45	2.88%
Hardley Industrial Estate	3.86	6.27%
Total income earning properties	**7.31**	**4.67%**
Grand total	**19.69**	**4.71%**

9.4. Three investment property purchases were made in 2020/21 pursuant to the Council's adoption of the Asset Investment Strategy in February 2017. All are included above and are all immediately income earning (with the Rate of Return reflecting an annualised calculation).

9.5. The Investment Property note within the Annual Financial Report gives further information on the net gains / losses, and fair value movements.

10. COMPLIANCE REPORT

10.1. The Council confirms compliance of all treasury management activities undertaken during 2020/21 with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

10.2. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 9.

Table 9: Debt limits

	2020/21 Maximum £m	31/03/21 Actual £m	2020/21 Operational Boundary £m	2020/21 Authorised Limit £m	Complied
Total debt	131.4	126.9	159.8	176.9	✓

10.3. 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.

11. TREASURY MANAGEMENT INDICATORS

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

Interest rate exposures

11.2. The following indicator shows the sensitivity of the Council's current investments and borrowing to a change in interest rates.

Table 10 – Interest Rate Risk Indicator

	31/03/21 Actual	Impact of +/- 1% interest rate change
Sums subject to variable interest rates		
Investment	£49.9m	+/- £0.3m
Borrowing	£0.0m	+/- £0.0m

11.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity structure of borrowing

11.4. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the Treasury Management Strategy Statement.

Table 11: Refinancing rate risk indicator

	31/03/21 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	3%	25%	0%	✓
12 months and within 24 months	3%	25%	0%	✓
24 months and within 5 years	10%	25%	0%	✓
5 years and within 10 years	16%	25%	0%	✓
10 years and above	67%	100%	0%	✓

Principal sums invested for periods longer than a year

11.5. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end were:

Table 11: Price risk indicator

	2020/21	2021/22	2022/23
Actual principal invested beyond a year	£16.6m	£14.6m	£13.6m
Limit on principal invested beyond a year	£40m	£40m	£40m
Complied	✓	✓	✓

11.6. The table includes investments in strategic pooled funds of £13.6m as although these can usually be redeemed at short notice, the Council intends to hold these investments for at least the medium-term.

12. OTHER

CIPFA Consultations

12.1. 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.

12.2. 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, such as 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.

12.3. 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.

IFRS 16

12.4. CIPFA/LASAAC has proposed delaying the implementation of the new IFRS 16 Leases accounting standard for a further year to 2022/23.

13. CRIME AND DISORDER AND ENVIRONMENTAL IMPLICATIONS

13.1. None arising directly from this report.

14. RECOMMENDATIONS

Members are recommended to:

14.1. consider the performance of the treasury function detailed in this report.

Further information	Background papers
Please contact: Gemma Farley Principal Accountant Investments & Borrowing Hampshire County Council gemma.farley@hants.gov.uk Alan Bethune Executive Head of Financial (S151) and Corporate Services New Forest District Council alan.bethune@nfdc.gov.uk	The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance Local Government Act 2003 SI 2003/3146 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 Treasury Management Strategy Report 2020/21 Audit Committee – 24 January 2020 Council – 24 February 2020 Treasury Management Mid-Year Monitoring Report 2020/21 Audit Committee – 23 October 2020 Treasury Management Strategy Report 2021/22 Audit Committee – 29 January 2021 Council – 25 February 2021