Treasury Management Outturn Report 2020/21

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Key Messages

All investment and borrowing transactions were in line with the principles approved in the 2020-21 Annual Treasury Strategy Statement and the Annual Ethical Investment Strategy.

No new borrowing was taken in 2020/21. Capital expenditure has been financed by internal borrowing. This avoids cost but increases exposure to future interest rates

During 2020/21 Bank of England Base Rates remained at 0.1% and inflation regularly dropped below target levels (2%).

Director of Finance and Commercial Services' Overview

The Council is required, under the Local Government Act 2003, to produce an annual review of Treasury Management activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2020/21, the Full Council received the annual Treasury Management Strategy Statement (TMSS), whilst Cabinet were presented with the 2019/20 Outturn Report and a Mid-Year Treasury Management Update Report.
The regulatory environment places responsibility on Members for the review and scrutiny of TM policy and activities. This report is therefore important, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

The Strategy for 2020/21

The expectation for interest rates within the Treasury Management Strategy for 2020/21 anticipated that the Bank Rate would increase by 0.25% to 1.0% by the end of the financial year. However, this was prior to the impact of Covid19 and the government cut rates in March 2020 to try to stimulate the economy. The potential for the bank rate turning negative seems to have dissipated in recent months but investment returns have fallen throughout the year and are unlikely to bounce back strongly in the short to medium term.

The Treasury Management Strategy anticipated steady increases in borrowing costs, and given Sheffield's under borrowed position (using temporarily available cash balances to delay external borrowing, avoiding interest payments) we expected to take significant borrowing before rates started to rise. Borrowing rates did increase steadily but the Authority didn't need to borrow, so interest cost was lower than anticipated. The main reasons for the absence of borrowing were the large amounts of government grants received which supported the cash position, and the fact that some borrowing was taken late in 19/20 to mitigate the potential risks to cash-flow at the start of the pandemic, when market conditions could potentially have become very uncertain.

The Council operated within the Prudential Indicator Limits for 2020/21 set by the authority (see annex for details of limits).

The impact of the Coronavirus outbreak has been unprecedented this year. The Council started the year with a strong cash position, and cash balances have increased through the year as additional grants and support have been received from Government.	<u>Coronavirus Impact</u> The full extent of the impact from Coronavirus will not be known for some time. The impact this year on Treasury and the financing of debt has been a large influx of grant funding early in the year. This influx allowed the deferral of new borrowing, which in turn kept interest costs lower than forecast, but increases the Council's internal borrowing position. Current economic forecasts are positive, with the Bank of England upgrading their GDP growth forecasts and at the same time reducing their forecasts for peak unemployment. Strong market growth usually leads to lower Government gilts demand and therefore higher PWLB borrowing costs. What has been abundantly clear this year is that the outlook can change very quickly, so we will continue to monitor economic forecasts and take advice from our treasury advisors to make the right decisions at the right time in terms of new borrowing. <u>Recommendations</u> 1. Approve the actual 2020/21 prudential and treasury indicators in this report 2. Note the annual Treasury Management Outturn report for 2020/21

Key Messages	Outturn Report
Slippage in major capital investment projects, such as the Heart of the City Programme, has seen the CFR increase slightly less than expected Within the overall CFR total, the HRA's CFR remains unchanged – as expected. No external borrowing was required in year Investment balances increased as a result of additional Government funding, with funds kept in highly liquid assets.	The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The CFR grows when the Council uses borrowing to fund capital projects but falls as we put money aside each year to repay that debt. The money we put aside to repay the debt each year is known as our 'minimum revenue provision' (MRP), and mimics depreciation charges that are used in the private sector. The table below shows the outturn for 2019/20 and 2020/21, and the 2020/21 budget position including PFI liabilities.

	2019/20 Actual (£m)	2020/21 Actual (£m)	2020/21 Budget From TMS (£m)
General Fund CFR (non PFI)	817	844	849
General Fund - PFI Liabilities	373	360	360
Overall General Fund CFR	1190	1204	1209
HRA CFR	346	346	346
Total CFR	1536	1550	1569

After adjusting for PFI liabilities of £360m, the overall underlying financing requirement of the Authority was £1,198m (an increase of 1.6% on the 2019/20 figure). This is lower than the increase forecast in the budget.

Actual capital investment for 2020/21 was £122.6m, this is lower than the planned £154.5m set out in the TMSS. Capital Expenditure financed by borrowing was £47.5m, £26.9m lower than anticipated at the start of the year.

Gross external debt, excluding PFI liabilities, has reduced by a net £10.7m to £858m compared to 2019/20. This is because no new debt has been taken but loans have matured in year.

As the 20120/21TMSS predicted, the overall CFR position for the Housing Revenue Account's (HRA) of £346m is unchanged on last year. The HRA CFR primarily relates to legacy housing investment, such as the Decent Homes programme.

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Key Messages:	External Context: The Economy and Interest Rates Source: Link Asset Services
The UK's Growth saw one of the largest contractions globally, though positive data and sentiment has began to emerge moving in to 2021. UK Base Rates have remained at 0.1% all year, and the likelihood of future increases looks low in the near term. Inflation has fallen below Bank of England target levels (2%), and commentary from the Bank indicates they may be more willing to accept over 2% if for short durations. Brexit remained a cause of major uncertainty for most of the year.	**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, and 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 than was caused than in 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, 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. 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 **Monetary Policy Committee** 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 increased then QE by £100bn in June and by £150bn in November to a total of £895bn. While Bank Rate remained unchanged for the rest of the year, financial markets were concerned that the MPC could cut Bank Rate to a negative rate; this was firmly discounted at the February 2021 MPC meeting when it was established that commercial 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. **Average inflation targeting.** This was the major change adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and ***achieving the 2% target sustainably***". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise the Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if the Bank takes no action to raise Bank Rate. This sets a high bar for raising Bank Rate and no increase is expected by March 2024, and possibly

	for as long as five years. 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. **BREXIT.** The final agreement on 24th 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 has 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. **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. **EU.** 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 Q3 of 2020 but contracted slightly in Q4 to end 2020 only 4.9% below its pre-pandemic level. Recovery will now 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 (PEPP) 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 PEPP 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. **China.** After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. **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.

Deglobalisation. 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. 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.

Key Messages:

Investment rates fell significantly during 2020/21, and the forecast is for these lower rates to continue in the near to medium term.
Margins on PWLB loans decreased from 1.8% to 0.8% in Dec 20. This change made borrowing cheaper but with tighter restrictions on what borrowing can be used for.

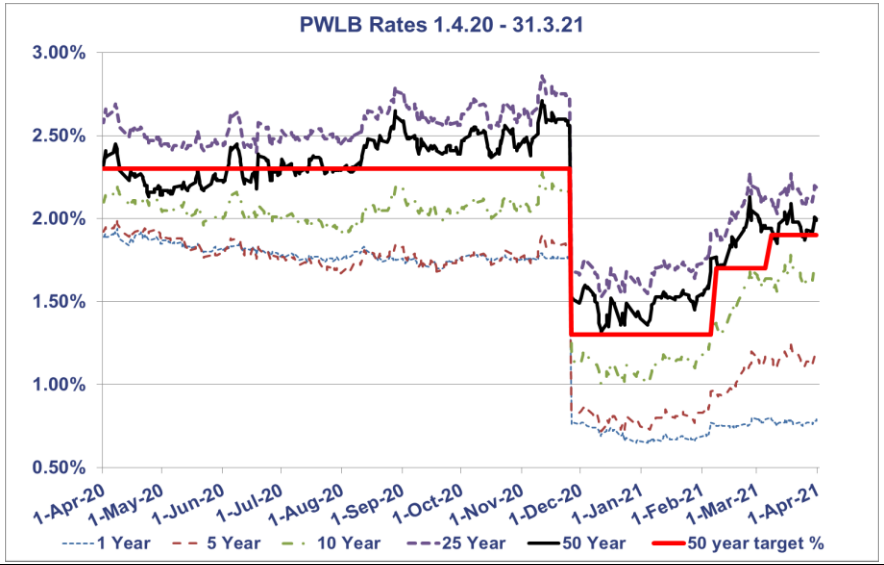
The Council's investment policy continues to apply a cautious approach, with investments made in low-risk counterparties; but with correspondingly low returns.

Borrowing and Investment Rates

Investment returns underperformed significantly compared to the Treasury Strategy for 2020/21. The forecast for returns was set long before the effects of the Corona Virus could be comprehended let alone incorporated. The bank rate dropped to 0.1% and average returns have been approximately at this level. The priority has been keeping investments very liquid, although same day liquidity offers a near zero return. Average rates have been slightly higher due to some longer (but less than 1 year) lending to other Local Authorities.

The TMSS predicted a modest increase in borrowing rates during the year, but with significant volatility month on month (an example of this volatility in PWLB rates is shown in the graph below). HM Treasury agreed to remove the 1% margin increase in Dec 20 which made borrowing attractive again. However the Council's significant cash balances and the cost to carry (i.e. the interest received on our cash balances, would be much less than the interest paid for the borrowing), meant this was not the right time for SCC to borrow.

Rates are forecast to increase but only very gradually, the increases in the chart below during February and March 21 are because of the UK's relatively positive economic data. A Brexit agreement was reached in Dec 20 removing some uncertainty, but the main impact has resulted from regaining control of the pandemic from the December – January spike. A stronger pound will also have contributed to this increase.



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Key Messages:
The strategy to reduce under-borrowing was postponed this year due to high cash balance and slippage in the capital programme.
The overall level of capital investment being funded through prudential borrowing is less than originally expected in the TMS.

Borrowing Outturn for 2020/21

The table below shows the breakdown for capital expenditure that should have been financed by external borrowing during the year. However, SCC did not externalise any of this borrowing need during 2020/21. The result of this is that the Council's under borrowed position increases as does the associated interest rate risk to which the Authority is exposed. Under-borrowing means that the Council is currently financing some of its capital expenditure from its own cash balances, rather than borrowing externally to fund this expenditure.

	£000	£000
Original borrowing estimate per 20/21 TMS		**74,400**
Expenditure on Schemes creating a Borrowing need:		
Heart of the City	28,159	
Leisure Facilities	14,004	
Essential Compliance	4,033	
Other	1,337	
Total Borrowing needed:		47,533
Variance to TMSS		**- 26,867**

The 2020/21 TMS aimed to slightly reduce the level of internal borrowing. However, during the year investment balances have dramatically increased and new borrowing would have added to this. The strength of the cash position and the continuing low rate allowed deferral of 20/21 borrowing

Under borrowing remains at sustainable levels, but still carries significant interest rate risk – if interest rates do begin to rise. However, significant rate increases are not anticipated in the near future.

Key Messages:

Net borrowing for the year saw a repayment of £10.7m

Some of the borrowing repaid was short-term borrowing which typically attract lower level of interest rates.

The PWLB removed the additional 1% to their margin in Dec20. Underlying rates remained low, though showed some increases towards the end of the year.

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Details of the borrowing taken and repaid in 2020/21 are shown in the table below:

Loan Repayments and Borrowing 2020/21						
New Borrowing				Loans Repaid		
Counterparty	Amount (£000)	term (Years)	Interest Rate (%)	Counterparty	Amount (£000)	Original Rate (%)
				PWLB	£1,723	10.5
				Derbyshire CC	£4,000	2.05
				SCR CA	£5,000	2.10
	nil				**10,723**	
Net borrowing				Net Repayments	**10,723**	

Borrowing rates remain low. Current rates and forecasts for future rates have remained lower than anticipated in the Treasury Strategy. New debt was taken due to the cost of carry and the very strong cash position.

As at 31 March 2021, the loans portfolio, excluding PFI liabilities, totalled £857m, and indicates the Council is under borrowed by £332m – an increase of £41m on 2019/20 (£285m), this is a result of not externalising the borrowing need caused by the capital programme.

Key Messages:	Debt Rescheduling
There has been no debt rescheduled during 2012-21	No rescheduling was done during the year as differential between PWLB new borrowing and premature repayment rates made rescheduling unviable.
	Investment Outturn
	Ethical Investment Policy
Investment balances held by the Council were expected to decrease during the year - but this turned out not to be the case.	The Council's Investment Policy is set out in the annual Investment Strategy approved by Full Council in March each year. The policy outlines 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, etc. In addition, the Council commits to not holding any direct investments in fossil fuels or, to the best of their knowledge, companies involved in tax evasion or grave misconduct.
Investment balances increased by £97m compared to 31 March 2020 – primarily as a result of additional government grant support related to the Coronavirus pandemic.	The investment activity during the year conformed to the approved Investment Strategy. Investments held by the Council The Council maintained an average balance of £217m of internally managed funds compared to the Council only having funds for day to day cash flow purposes. As at 31st March 2021, investments were £265m; up £97m on the previous year. The Council had no liquidity difficulties during the year.
Investment returns remain subdued – due to market conditions and the policy to invest in low-risk counterparties.	The internally managed funds earned an average rate of return of 0.11% compared to 0.85% in the previous year. This should still be judged a good achievement given the state of the market The Council would not plan to have such high cash balances under normal circumstances, the timing and amount of Government grants has created the situation. It is expected cash balances will slowly fall, though there remains much uncertainty as to how Central Government will fund Local Authorities for their medium-term Covid-19 pressures.

Annex 1: Outturn Position with General Fund & HRA Split

Authority	**31 March 2020 Principal**	**Rate/ Return**	**31 March 2021 Principal**	**Rate/ Return**
Total debt	869	*3.92%*	858	*3.90%*
CFR	1163		1190	
Over / (under) borrowing	-294		-332	
Total investments	168	*0.85%*	265	*0.11%*
Net debt	701		593	

General Fund	**31 March 2020 Principal**	**Rate/ Return**	**31 March 2021 Principal**	**Rate/ Return**
Total debt	589	*3.59%*	579	*3.56%*
CFR	817		844	
Over / (under) borrowing	-228		-265	
Total investments	168	*0.85%*	265	*0.11%*
Net debt	421		314	

HRA	**31 March 2020 Principal**	**Rate/ Return**	**31 March 2021 Principal**	**Rate/ Return**
Total debt	279	*4.63%*	279	*4.60%*
CFR	346		346	
Over / (under) borrowing	-67		-67	
Total investments	0	*n/a*	0	*n/a*
Net debt	279		279	

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Annex 2: Prudential and Treasury Indicators

During 2020/21, the Council complied with its legislative and regulatory requirements including 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 key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Debt remained below the operational limit (the level not expected to be exceeded) and the Authorised Limit (The limit which cannot be exceeded without cabinet approval) throughout the year. The CFR was £141m bellow the Authorised limit and gross debt £472m below.

Actual prudential and treasury indicators	**2019/20 Actual £0**	**2020/21 Actual £0**	**2020/21 Estimate (TMS £0**
Capital expenditure:			
General Fund	71,360	84,990	106,500
HRA	57,126	37,652	48,000
Total	128,486	122,642	154,500
Capital Financing Requirement:			
General Fund	1,190,146	1,204,089	1,220,000
HRA	345,867	345,867	345,867
Total	1,536,013	1,549,956	1,565,867
Gross debt	1,241,400	1,218,151	1,280,100
Net External debt (gross debt less investments)	1,073,277	953,550	1,209,300
Investments			
Longer than 1 year	0	0	Nil
Under 1 year	168,123	264,601	70,800
Total	168,123	264,601	70,800
Operational Limit	1,640,000	1,650,000	
Authorised Limit	1,640,000	1,690,000	

The Council's net external debt (loans plus PFI balances less investments) has decreased by £119.7m, whilst our overall need for borrowing, which is represented by the CFR, has increased by £13.9m.

Movements in Net Debt	2020/21 Movement £000
New Borrowing	0
Repaid Borrowing	-10,700
Less PFI Repayments	-12,526
Less increase in Investment	-96,478
Total	-119,704

The CFR increases when we use borrowing to fund capital projects, whilst external debt goes up when we take on new loans or other credit arrangements such as PFI liabilities.

Net Debt has decreased and the table above shows the significance of the increased investment balances on the movement.

These deposits were placed with an array of AAA rated, instant access money market funds, fixed-term and call account deposits with banks and a few smaller investment with other Local Authorities. This investment policy meant that we sought to minimise security risks and increase the liquidity of our deposits. Deposit returns were relatively low at 0.11% (albeit above the average UK Bank Base Rate of 0.10% during 2020/21).

External debt payments haven't changed dramatically in year.

Financing Cost to Revenue looks significantly better but is a result of increases to revenue that are expected to be temporary and the unwinding of one-off higher costs in the previous year.

Financing Costs as a proportion of Revenue

Ratio of financing costs to net revenue stream:	Outturn 2019/20 Act	Outturn 2020/21
Non-HRA Including PFI)	20.9%	14.8%
Non-HRA Excluding PFI)	9.2%	7.5%
HRA	8.9%	8.8%

The information in the above takes account of the actual costs associated with external loans plus accounting adjustments for items such as MRP and premiums and discounts adjustment. While the Non HRA ratios have changed significantly the actual cost of servicing external loans has changed very little this year, the changes are as a result of the Items below.

A significant increase in one off government funding has increased the net revenue position by around 17% which has reduced the ratio this year. We expect this to reverse somewhat next year.

The other main impact is as a result of adjustments made to HRA balances last year following audit recommendations which saw higher costs in 2019/20. The reduction this year is an unwinding of last those adjustments and sees PFI MRP costs returning to normal levels as was expected.

There has been no significant shift in the HRA ratio.