City of BRADFORD
METROPOLITAN DISTRICT COUNCIL

Report of the Director of Finance to the meeting of Governance and Audit to be held on 24 June 2021

A

Subject:

Annual Treasury Management Report 2020-21

Summary statement:

This report shows the Council's Treasury Management activities for the year ending 31 March 2021

Chris Chapman
Director of Finance & IT

Report Contact: David Willis
Phone: (01274) 432361
E-mail: David.Willis@Bradford.gov.uk

Portfolio: Corporate Services

Overview & Scrutiny Area:

Corporate Services

1. Introduction

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2020-21. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

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

- an annual treasury strategy in advance of the year (Council 08/12/2020)
  (Due to the cancellation of Full Council meetings in March and May the 2020-21 strategy went to the next available Full Council meeting)
- a mid-year (minimum) treasury update report (Council 08/12/2020)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code, to give prior scrutiny to all of the above treasury management reports by the Governance and Audit Committee before they were reported to the Full Council.

2. Overall Treasury Position as at 31 March 2021

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

	31 March 2020 Principal £'m	Rate/ Return	31 March 2021 Principal £'m	Rate/ Return
Fixed rate funding:				
-PWLB	299.7		297.8	
-Market	36.2		36.2	
-Other	0.4		0.4	
PFI and other finance leases	163.0		154.9	
Short term borrowing	10.0		0.0	
Total debt	**509.3**	4.89%	**489.3**	4.87%
CFR	710.7		698.8	
Over / (under) borrowing	(201.4)		(209.5)	
Total investments	95.1	0.8%	133.3	0.13%
Net debt	**414.2**		**356.0**	

Prudential Indicators

3.1The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

Actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. The Table below shows that capital expenditure was severely affected during 2020-21 by the impact of Covid-19. The first lock down last summer and the subsequent need to introduce social distancing measures and adopt different working practices both pushed back planned start dates for new projects and increased the length of the project timetables due to a reduced ability to undertake tasks in parallel by between 3 to 6 months.

	2019-20 Actual £'m	**2020-21 Estimate as at Q2 £'m**	**2020-21 Actual £'m**
Capital expenditure	**80.6**	**133.5**	**63.9**
Financed in year	51.1	71.0	49.3
Unfinanced capital expenditure	**29.5**	**62.5**	**14.6**

A reduced spend has also meant that spend funded by borrowing is lower than Budget, impacting on overall borrowing need.

3.2 The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure, which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so the underlying borrowing need. Any capital expenditure above, which is not immediately paid for through a revenue or capital resource, will increase the CFR.

To ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2019-20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2020-21. The table over

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

	31 March 2020 Actual £'m	31 March 2021 Budget £'m	31 March 2021 Actual £'m
Capital Financing Requirement	710.7	749.0	698.8
Gross borrowing position	509.3	499.0	489.3
(Under) / over funding of CFR	**(201.4)**	**(250.0)**	**(209.5)**

3.3 Treasury Indicators

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2020-21 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2020-21 £'m
Authorised limit	730.0
Maximum gross borrowing position during the year	489.3
Operational boundary	720.0
Financing costs as a proportion of net revenue stream	11.9%

The maturity structure of the debt portfolio was as follows:

	31 March 2020 Actual £'m	31 March 2021 Actual £'m
Under 12 months	11.8	5.5
12 months and within 24 months	5.5	15.5
24 months and within 5 years	31.7	22.3
5 years and within 10 years	57.8	59.3
10 years and within 20 years	53.5	56.9

20 years and within 30 years	0	5.0
30 years and within 40 years	95.2	94.1
40 years and within 50 years	90.8	75.4

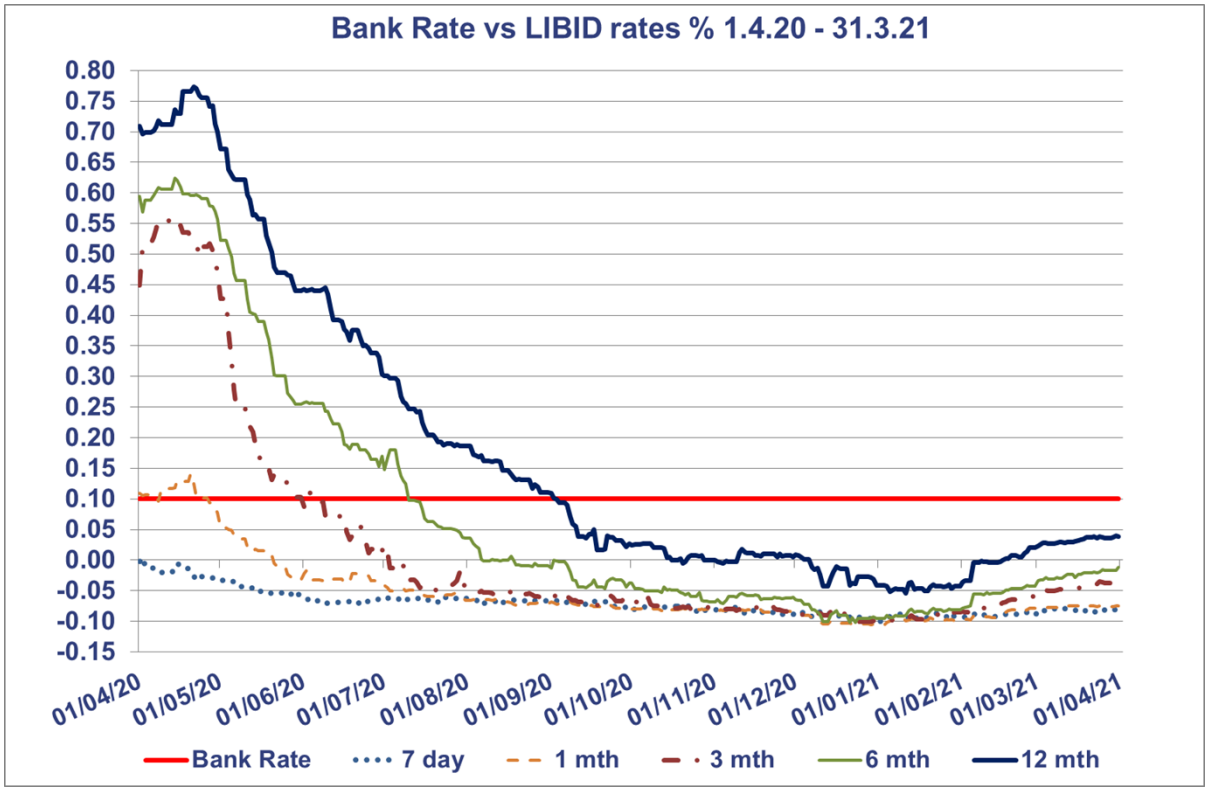
4. The Treasury Strategy for 2020-21

4.1 Investment strategy and control of interest rate risk

Investment returns which had been low during 2019-20, plunged during 2020-21 to near zero or even into negative territory. Most local authority lending managed to avoid negative rates and one feature of the year was the growth of inter local authority lending.

The expectation for interest rates within the treasury management strategy for 2020-21 was that Bank Rate would continue at the start of the year at 0.75 % before rising to end 2022-23 at 1.25%. This forecast was invalidated by the Covid-19 pandemic bursting onto the scene in March 2020 which caused the Monetary Policy Committee to cut Bank Rate in March, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The Government supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

The graph and table over illustrate bank rates for the 2020-21 year.



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
Low Date	01/04/2020	31/12/2020	29/12/2020	23/12/2020	21/12/2020	11/01/2021
Average	0.10	-0.07	-0.05	0.01	0.07	0.17
Spread	0.00	0.10	0.25	0.66	0.73	0.83

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far abler to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

4.2 Investment Outturn 2020-21

The Council's investment position at the end of 2020-21 is summarised below.

INVESTMENT PORTFOLIO	2019-20		2020-21	
	£m	%	£m	%
Treasury investments				
Banks	36.3	38	87.5	66
Building Societies - rated	0.0	0	9.3	7
DMADF	53.8	57	36.5	27
Treasury Bills	5.0	5	0	0
Money Market Funds	0.0	0	0.0	0
Total managed in house	**95.1**	**100**	**133.3**	**100**

The maturity structure of the treasury investment portfolio was as follows:

	2019-20 Actual £'m	2020-21 Actual £'m
Investments		
Longer than 1 year	0.0	0.0
Up to 1 year	95.1	133.3

Investments held by the Council - The Council maintained an average balance of £119m of internally managed funds. The internally managed funds earned an average rate of return of 0.13%. The comparable performance indicator is the average 7-day LIBID rate, which was -0.0699%. The total investment income was £152k.

5. Borrowing

5.1 Borrowing strategy and control of interest rate risk

Borrowing is undertaken to fund net unfinanced capital expenditure and naturally maturing debt and also to maintain cash flow liquidity requirements During 2020-21, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance & IT therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

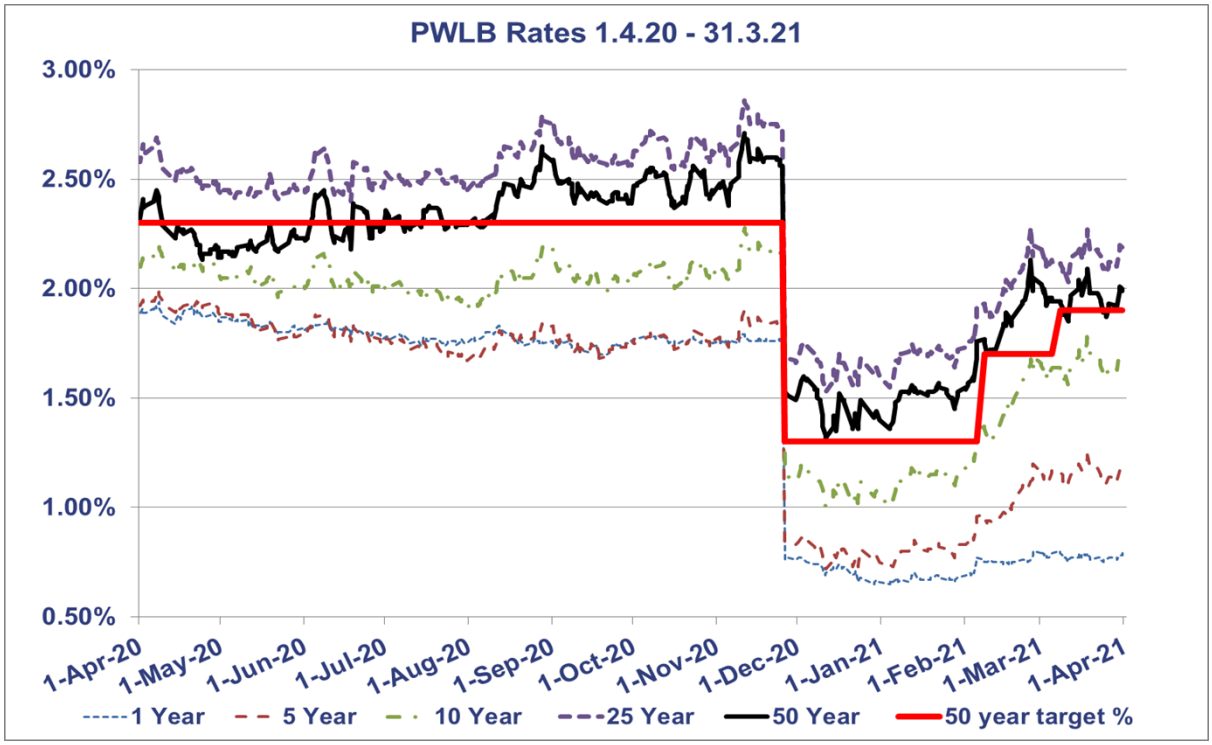
- If it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- If it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2020-21 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Below are Links forecasts for interest rates set at 8th March 2021 and over is a graph showing rates for the 2020-21 year.

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



PWLB rates are based on, and are determined by, gilts (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have seen over the last two years, many bond yields up to 10 years in the Eurozone turn negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession.

Gilt yields fell sharply from the start of 2020 and then spiked up during a financial markets melt down in March caused by the pandemic hitting western countries; this was rapidly countered by central banks flooding the markets with liquidity. While US treasury yields do exert influence on UK gilt yields so that the two often move in tandem, they have diverged during the first three quarters of 2020-21 but then converged in the final quarter. Expectations of economic recovery started earlier in the US than the UK but once the UK vaccination programme started making rapid progress in the new year of 2021, gilt yields and PWLB rates started rising sharply as confidence in economic recovery rebounded. Financial markets also expected Bank Rate to rise quicker than in the forecast tables in this report.

At the close of the day on 31 March 2021, all gilt yields from 1 to 5 years were between 0.02 – 0.42% while the 10-year and 25-year yields were at 0.96% and 1.41%.

HM Treasury imposed **two changes of margins over gilt yields for PWLB rates in 2019-20** without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and **on 25th November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates;** the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The new margins over gilt yields are as follows: -.

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not forecast to rise from 0.10% by March 2024 as the Bank of England has clearly stated that it will not raise rates until inflation is sustainably above its target of 2%; this sets a high bar for Bank Rate to start rising.

5.2 Borrowing Outturn 2020-21

£1.815m of loans matured in July 2020 with an average rate of interest of 9.8%. Due to the high cash balances no new loans were undertaken this year.

Summary of debt transactions – management of the debt portfolio resulted in a fall the value of the debt by £1.815m and the average interest rate of 0.03%, representing net General Fund savings of £179K p.a.

5.3 Borrowing in advance of need
The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

5.4 Rescheduling
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

6. Other considerations

6.1 None

7.Changes to the Treasury Management Policy

7.1 None

8. Other Issues

8.1 No issues

9. Financial and Resources Appraisal

9.1 The financial implications are set out in section 1 to 8 of this report

10. Risk Management and Governance Issues

10.1 The principal risks associated with treasury management are:

Risk: Loss of investments as a result of failure of counterparties.
Mitigation: Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties.

Risk: That the Council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or new borrowing (Liquidity risk).
Mitigation: Ensuring that a minimum proportion of investments are held in short term investments for cash flow purposes.

Risk: The level of investments and surplus cash is higher than needed to fund short term timing differences.
Mitigation: Cash flow forecasting and capital expenditure monitoring.

Risk: Increase in the net financing costs of the Council due to borrowing at high rates of interest.
Mitigation: Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking mostly long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

Risk: Higher interest rates increase borrowing making it more difficult to self-finance capital schemes. Debt servicing becomes less affordable and less sustainable and crowds out revenue spend.
Mitigation: To pause, delay or defer capital schemes. Also review opportunities to borrow in the future at current interest rates.

Risk: Return on non-treasury investments lower than expected.
Mitigation: Review and analysis of risk prior to undertaking non-treasury investments.

Risk: The Council's Minimum Revenue Policy charges an insufficient amount to the Revenue Estimates to repay debt.
Mitigation: Align the Minimum Revenue Policy to the service benefit derived from the Council's assets.

Risk: Associated with cash management, legal requirements and fraud.
Mitigation: These risks are managed through:

- Treasury Management Practices covering all aspects of Treasury management procedures including cash flow forecasting, documentation, monitoring, reporting and division of duties.
- All Treasury management procedures and transactions are subject to inspection by internal and external auditors. The Council also employs external financial advisors to provide information on market trends, credit rating alerts, lending criteria advice and investment opportunities.

Risk: Anticipated borrowing is lower than expected because the 2021-22 capital programme is underspent. This is explained in more detail below, together with the actions being taken to reduce these risks:
Mitigation: The Council is required to set a balanced budget for its revenue estimates; so in broad terms, income received will match expenditure over the 2021-22 financial year. The 2021-22 revenue estimates cause only temporary cash flow differences, for example when income is received in a different month to when the expenditure is incurred.

However, the 2021-22 capital budget will cause a cash flow shortfall in the long term, which generates a borrowing requirement. While some of the capital budget is funded immediately, mainly with Government grants, other elements are not funded initially, leading to the cash flow deficit that requires borrowing.

Managing borrowing is part of the Treasury Management role. To help in its management, the Treasury Strategy identifies the element within the capital budget that is not funded straightaway, to anticipate the Council's borrowing requirement.

However, when the capital budget is underspent, the Council has a lower borrowing requirement than anticipated. This risk is managed in practice because the Council only borrows when there is an actual cash flow shortage. The uncertainty around spend against the capital budget makes cash flow management more difficult. For example, it is less likely that the Council would take advantage of a short-term fall in interest rates, without more certainty around the timing of any borrowing need. Actions that have taken place to manage the risks relating to this uncertainty in the timing of capital spend are: Councillor and Officer challenge sessions on the capital budget; increased scrutiny of the capital forecasts in the quarterly monitoring, and the collection of additional documentation around the critical paths of individual schemes.

Risk: Coronavirus. The level of uncertainty in the future path of economic growth, unemployment, fiscal and monetary policy make it very difficult to accurately assess the impact on investments, capital spend and borrowing for the Council. The scale of impact will depend on the length of any lockdown and the depth of any recessionary impact.
Mitigation: Cash investments will be mainly held short term due to the uncertainties caused by the virus and we will continue to monitoring the situation and report any changes in the next Treasury report.

11. Legal Appraisal

11.1 Any relevant legal considerations are set out in the report

12. Other Implications

12.1 Equality & Diversity – no direct implications
12.2 Sustainability implications – no direct implications
12.3 Green house Gas Emissions Impact – no direct implications
12.4 Community safety implications – no direct implications
12.5 Human Rights Act – no direct implications
12.6 Trade Unions – no direct implications
12.7 Ward Implications – no direct implications
12.8 Implication for Corporate Parenting – no direct implications
12.9 Issues arising from Privacy Impact Assessment– no direct implications

13. Not for publications documents

13.1 None

14. Options

14.1 None

15. Recommendations

15.1 That the report be noted by the Governance and Audit Committee and passed to Full Council for adoption at the next available meeting.

16. Appendices

Appendix 1 Prudential and Treasury Indicators
Appendix 2 Borrowing and Investment Rates
Appendix 3 Approved Countries for Investment as at 31/03/21

Appendix 1: Prudential and Treasury Indicators

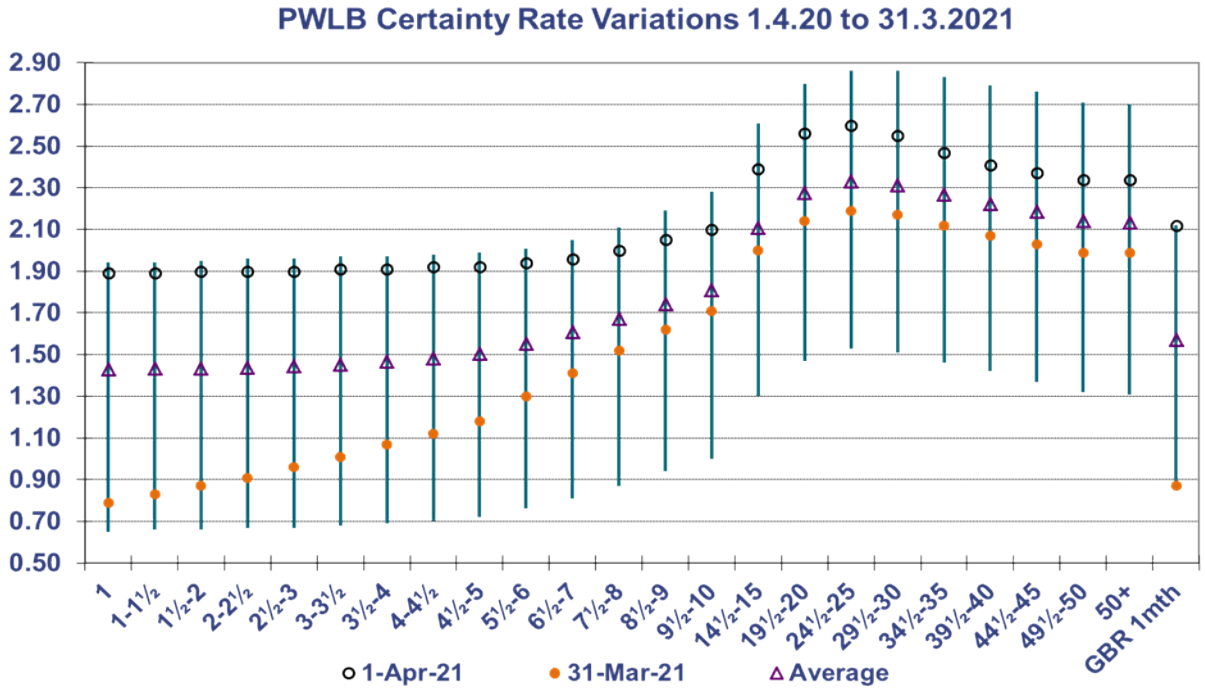
1. PRUDENTIAL INDICATORS	2019-20 Actual £'000	2020-21 Estimate £'000	2020-21 Actual £'000
Capital Expenditure	80,620	133,500	63,907
Ratio of financing costs to net revenue stream	12.5%	15.2%	11.9%
Gross borrowing requirement General Fund	509,300	552,000	489,356
Capital Financing Requirement	710,701	749,000	698,764

2. TREASURY MANAGEMENT INDICATORS	2019/20 Actual £'000	2020-21 Estimate £'000	2020-21 Actual £'000
Authorised Limit for external debt -			
borrowing	346,300	550,000	334,426
other long term liabilities	163,000	180,000	154,930
TOTAL	**509,300**	**730,000**	**489,356**
Operational Boundary for external debt -			
borrowing	346,300	540,000	334,426
other long term liabilities	163,000	180,000	154,930
TOTAL	**509,300**	**720,000**	**489,356**
Actual external debt	509,300	552,000	489,356

Maturity structure of fixed rate borrowing during 2020-21	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	90%	0%
20 years and within 30 years	90%	0%
30 years and within 40 years	90%	0%
40 years and within 50 years	90%	0%
Maturity structure of investments during 2020-21	upper limit	lower limit
Longer than 1 year	£20m	£0m

Appendix 2: Borrowing and Investment Rates

a) PWLB borrowing rates

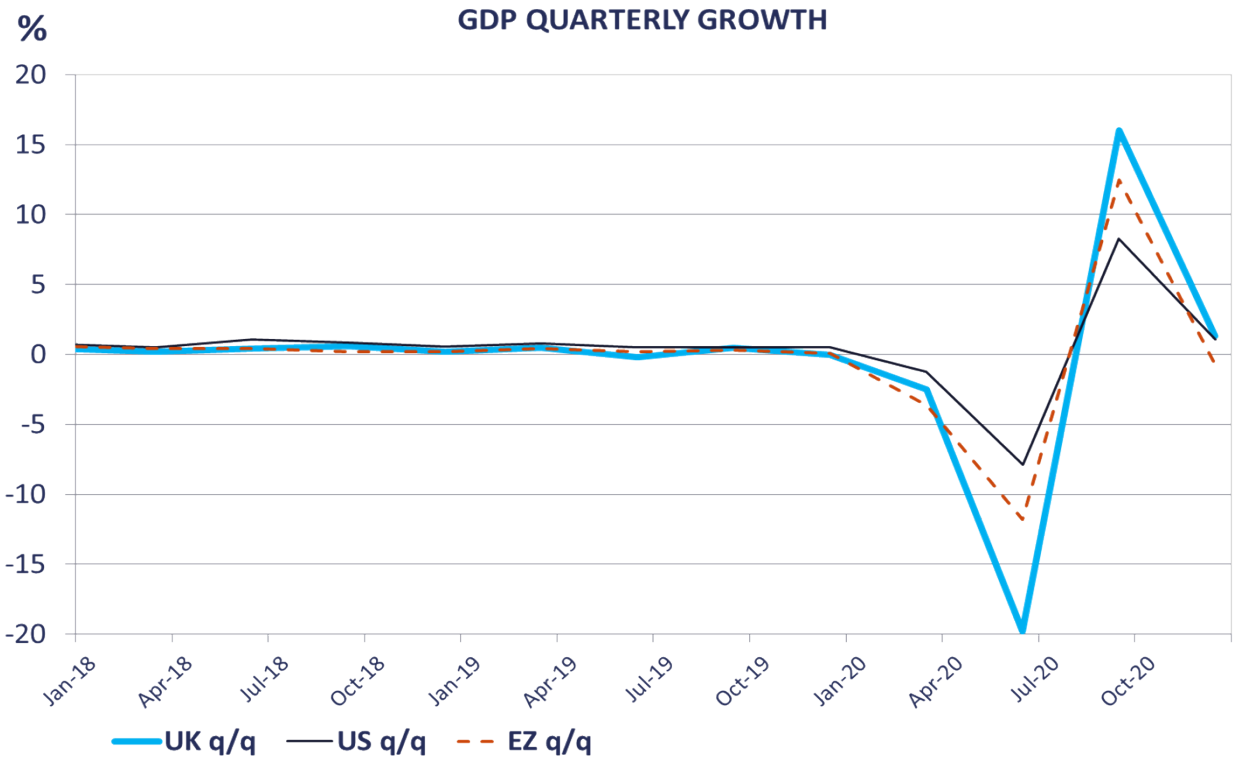


	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Low date	04/01/2021	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.94%	1.99%	2.28%	2.86%	2.71%
High date	08/04/2020	08/04/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.43%	1.50%	1.81%	2.33%	2.14%
Spread	1.29%	1.27%	1.28%	1.33%	1.39%

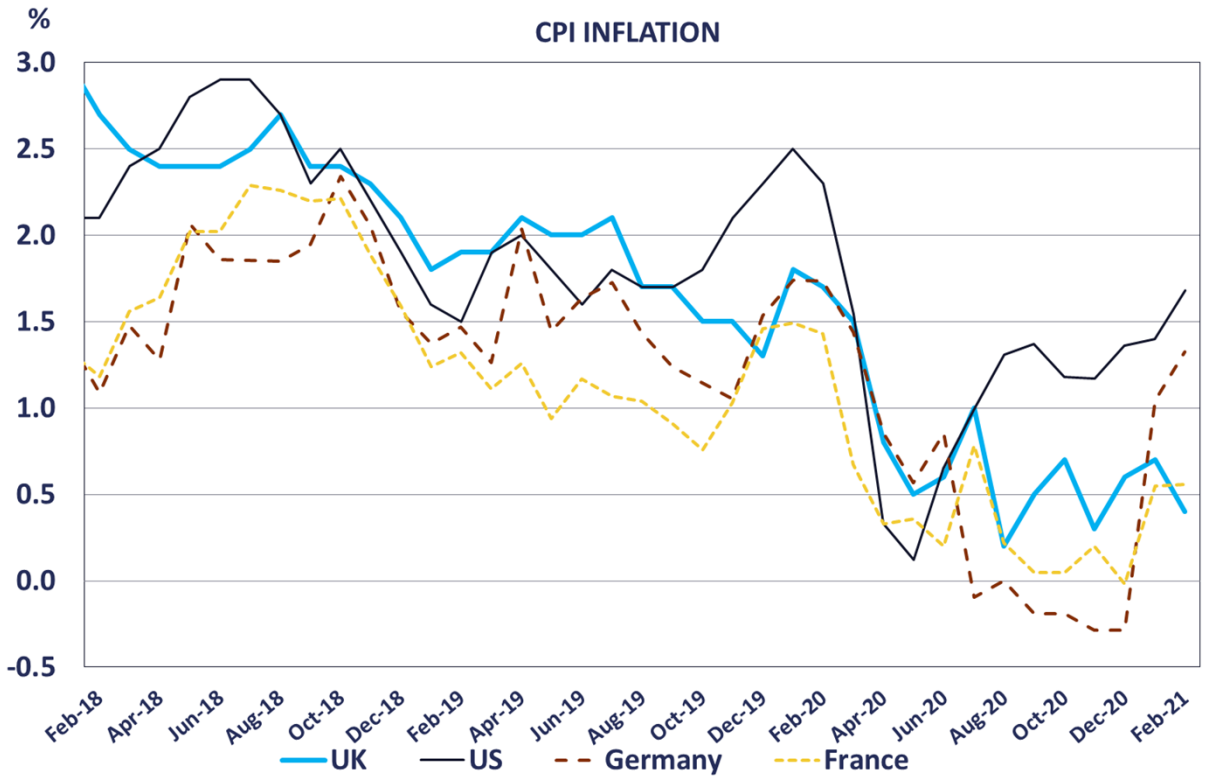
b) Money market investment rates and forecasts 2020/21

	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
Low Date	01/04/2020	31/12/2020	29/12/2020	23/12/2020	21/12/2020	11/01/2021
Average	0.10	-0.07	-0.05	0.01	0.07	0.17
Spread	0.00	0.10	0.25	0.66	0.73	0.83

c) UK, US and EZ GDP growth



d) Inflation UK, US, Germany and France



Appendix 3: Approved countries for investments as at 31st March 2021

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Hong Kong
- Qatar
- **U.K.**