ANNEX 1

ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2020/21

Updated November 2021 (Section 6: Table 10)

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1. Purpose

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 the previous financial year as reported at Appendix 1. 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 full Council should receive the following reports:

- an annual Treasury Management Strategy in advance of the year; this was reported to Council on 28 May 2020; this was later than originally scheduled due to disruption of Council meetings during the COVID-19 pandemic;
- a mid-year, (minimum), Treasury Update report; reported to Council on 10 December 2021; and
- an Annual Review following the end of the year (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 regard, as it provides details of the outturn position for treasury activities and highlights compliance with the policies previously-approved by full Council. It will also be presented to the Audit Committee for scrutiny and review.

Member training on treasury management was undertaken in March 2021 in order to support Members in their scrutiny and oversight role.

Table 1: PRUDENTIAL AND TREASURY INDICATORS	**2019/20 Actual £000**	**2020/21 Original Budget £000**	**2020/21 Actual £000**
Capital Expenditure:			
General Fund (see Table 2)	18,890	96,100	25,782
Total	**18,890**	**96,100**	**25,782**
Capital Financing Requirement: In year change			
General Fund	12,279	74,924	30,305
Total	**12,279**	**74,924**	**30,305**
Gross Borrowing:			
Long Term credit arrangements	-	-	-
External Debt	14,000	9,000	9,000
Total	**14,000**	**9,000**	**9,000**
Investments:			
Longer than 1 year	13,000	0	-

Under 1 year	35,000	36,000	36,000
Total	**48,000**	**36,000**	**36,000**
Net Borrowing / (Net Investment)	**(34,000)**	**(27,000)**	**(27,000)**

Link Asset Management continued to provide services as the Council's treasury advisors. Their latest commentary is attached at Appendix 2.

2. Summary

During 2020/21, the Council complied with legislative and regulatory requirements. The key prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are set out below:

The Chief Finance Officer confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, (the Authorised Limit), was not breached.

The challenging investment environment of previous years was amplified in 2020/21, resulting in low investment returns.

<u>COVID-19 Pandemic - Extraordinary Circumstances</u>
The treasury and investment impacts of the COVID-19 pandemic which started in late 2019/20 include:

- Less predictable cashflows due to receipt of planned and additional Government funding at short notice and taking on new responsibilities for paying grant funding to businesses on behalf of Government;
- Incurring unplanned expenses as the authority's emergency response plan was implemented;
- A reduction in income receipts across all services and the Collection Fund.

One of the more significant challenges faced from a treasury management perspective was the revised timescales for receipt of planned and emergency Government funding.

Delays in capital projects due to COVID-19 constraints resulted in significant slippage in the Council's 2020/21 capital programme as displayed in table 1 above.

The Treasury Management Strategy specifies the maximum sums that can be invested with any one organisation. There were periods of time during the year when the Council breached its limit on the maximum sum to be invested in a single institution, as specified in the Treasury Management Strategy. This was due to the receipt of significant emergency funding at short notice from the Government. The breach was subsequently addressed by opening additional investment accounts with new institutions to spread the risk.

3. Introduction and Background

This report provides a summary of the Council's treasury management position for the year with regard to borrowing and investments, including:

- Capital investment activity and the impact of this activity on the Council's

underlying indebtedness (the 'Capital Financing Requirement'); and
- Performance against Prudential and Treasury Management indicators (Appendix 1).

4. Capital Expenditure and Financing

The Council undertakes capital expenditure to acquire or create 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 requirement.

The table below sets out the capital expenditure during 2020/21 and how it was financed.

Table 2: CAPITAL FINANCING	**2019/20 Actual £000**	**2020/21 Original Budget £000**	**2020/21 Actual £000**
Capital Programme Expenditure	18,890	96,100	25,782
Less: amounts not defined as Capital by statute	-	-	(329)
Total Capital Expenditure			**25,453**
Financed By:			
Capital Grants	1,016	1,843	1,994
Capital Receipts	2,099	8,805	4,403
Revenue Contribution	-	10,000	-
Capital Reserves	1,063	-	-
Total Grants & Receipts	**4,178**	**20,648**	**6,396**
Borrowing in Year	14,712	75,452	19,057
Total Finance	**18,890**	**96,100**	**25,453**

5. Overall Borrowing Need

The underlying need to borrow for capital expenditure is the 'Capital Financing Requirement' (CFR). The Council's CFR for the year is set out below and represents a key prudential indicator.

Table 3: CAPITAL FINANCING REQUIREMENT (CFR)	2019/20 Actual £000	2020/21 Original Budget £000	2020/21 Outturn £000
Opening balance	18,826	31,105	31,105
Add unfinanced capital expenditure	12,446	75,452	30,571
Less MRP/VRP	(167)	(528)	(266)
Less PFI & finance lease repayments	-	-	-
In year change in CFR	12,279	74,924	30,305
Cumulative Capital Financing Requirement (CFR)	**31,105**	**106,029**	**61,411**

The Council's treasury team ensures that sufficient cash is available to meet capital expenditure plans and cash flow requirements. This may be sourced through borrowing from external bodies, such as the Government's Public Works Loan Board (PWLB), other local authorities or private sector lenders, or by utilising available cash balances on a temporary basis.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that the costs of borrowing to fund capital assets are charged to the revenue budget over the life of the asset. In order to achieve this the Council is required to make an annual charge to the revenue budget, the Minimum Revenue Provision (MRP) to reduce its CFR. This is effectively repayment of the associated borrowing.

The CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The 2020/21 MRP Policy (as required by MHCLG Guidance) was approved by Council as part of the Treasury Management Strategy for 2020/21 on 28 May 2020.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and that borrowing is only used for a capital purpose, the Council has to ensure that its gross external borrowing does not, except in the short term, exceed the total of the CFR 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 confirms that the Council is not borrowing to support revenue expenditure. The table below sets out the Council's gross borrowing position against its CFR and confirms that the Council has complied with this prudential indicator.

Table 4: GROSS BORROWING POSITION	2019/20 Actual £000	2020/21 Original Budget £000	31 March 2020 (2020/21) Actual £000
Gross External Borrowing Position (Table 1)	**14,000**	**9,000**	**9,000**
Cumulative CFR (Table 3)	31,105	106,029	61,411
(Under) / Over Funding of CFR	**(17,105)**	**(97,029)**	**(52,411)**

The Authorised Limit - the Authorised Limit is the 'affordable borrowing limit' required by section 3 of the Local Government Act 2003. Once this has been approved, the Council does not have authority to borrow above this level without formal adoption of a revised Limit. The table below confirms that the Council has maintained gross borrowing within its Authorised Limit during 2020/21

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 confirms the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the 'Net Revenue Stream' (the Council's revenue budget).

TABLE 5: COST of CAPITAL AGAINST NET REVENUE STREAM	2020/21
Authorised Limit	£162m
Maximum gross borrowing position during the year	£9m
Operational Boundary	£152m
Average gross borrowing position	£9m
Net financing costs as a proportion of Net Revenue Stream	(3.77)%

6. Treasury Position at 31 March 2021

The Council's debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks across all treasury management activities. Procedures and controls to achieve these objectives are well established both through officer and Member reporting and through officer activity as set out in the Council's Treasury Management Practices. At the end of 2020/21 the Council's treasury position was as follows:

Table 6: DEBT PORTFOLIO	31 March 2020 Principal £000	Rate / Return %	Average Life (years)	31 March 2021 Principal £000	Rate / Return %	Average Life (years)
Fixed rate funding:						
PWLB	-	-	-	-	-	-
Lincolnshire County Council	6,000	1.00%	9 months	-	-	-
Portsmouth City Council	3,000	1.00%	9 months	-	-	-
Portsmouth City Council	5,000	1.20%	1.3 years	5,000	1.20%	3 months
Elmbridge Borough Council	-	-	-	4,000	1.70%	9 months
Total	**14,000**	**1.07%**		**9,000**	**1.45%**	
Variable Rate Funding:						
PWLB	-	-	-	-	-	-
Market Loans	-	-	-	-	-	-
Total Debt	**14,000**	**1.07%**		**9,000**	**1.45%**	
CFR (Table 3)	31,105			61,411		
Over / (Under) Borrowing	**(17,105)**			**(52,411)**		

Table 7: INVESTMENT PORTFOLIO	31 March 2020 Principal £000	Rate/ Return %	Average Life (years)	31 March 2021 Principal £000	Rate/ Return %	Average Life (years)
Investments:						
- In-House	35,000	0.50%	1 year	23,000	0.01%	1 year
- With Brokers	13,000	1.56%	2.5 years	13,000	1.58%	5 months
Total Investments	**48,000**	**0.90%**	**1.67 years**	**36,000**	**0.69%**	**0.75 years**

The maturity structure of the debt portfolio is set out below:

Table 8: INVESTMENT PORTFOLIO	31 March 2020 Actual	2020/21 Original Limits	31 March 2021 Actual
Under 12 months	64%	100%	100%
12 months and within 24 months	36%	100%	0
24 months and within 5 years	0%	100%	0
5 years and within 10 years	0%	100%	0
10 years and within 20 years	0%	100%	0

20 years and within 30 years	0%	100%	0
30 years and within 40 years	0%	100%	0
40 years and within 50 years	0%	100%	0

The limit for maturity structure of the debt portfolio at 100% reflects the fact that the Council has little external borrowing at present.

Table 9: INVESTMENT PORTFOLIO	**Actual 31 March 2020 £000**	**Actual 31 March 2020 %**	**Actual 31 March 2021 £000**	**Actual 31 March 2021 %**
Treasury investments				
Banks	5,000	10%	-	-
Building Societies - rated	18,000	38%	13,000	36%
Local authorities	-	-	-	-
Money Market Funds	25,000	52%	23,000	64%
Total	**48,000**	**100%**	**36,000**	**100%**
Bond funds	-	-	-	-
Property funds	-	-	-	-
Total managed externally	-	-	-	-
TOTAL TREASURY INVESTMENTS	**48,000**	**100%**	**36,000**	**100%**

Table 10: INVESTMENT PORTFOLIO (updated November 2021)	**Actual 31-Mar 2020 £000**	**Actual 31-Mar 2020 %**	**Actual 31-Mar 2021 £000**	**Actual 31-Mar 2021 %**
Non-Treasury Investments				
Third party loans & share capital:				
Subsidiaries – Greensand Property Holdings Ltd	12,482	21%	13,258	23%
Companies – Horley Business Park Development LLP	594	1%	602	1%
Associate – Pathway for Care Ltd [1]	1,100	2%	1100	2%
Investment Property	45,531	76%	43,373	74%
Total Non-Treasury Investments	**59,707**	**100%**	**58,333**	**100%**
Treasury investments	48,000	45%	36,000	38%

Table 10: INVESTMENT PORTFOLIO (updated November 2021)	Actual 31-Mar 2020 £000	Actual 31-Mar 2020 %	Actual 31-Mar 2021 £000	Actual 31-Mar 2021 %
Non-Treasury investments	59,707	55%	58,333	62%
Total – All Investments	**107,707**	**100%**	**94,333**	100%

The maturity structure of the investment portfolio is set out below:

Table 11: ALL TREASURY INVESTMENTS	2019/20 Actual £000	2020/21 Budget £000	2020/21 Actual £000
Investments:			
Longer than 1 year	23,000	13,000	13,000
Up to 1 year	25,000	23,000	23,000
Total	**48,000**	**36,000**	**36,000**

7. Borrowing Outturn 2020/21

Loans were drawn during the year to fund the net unfinanced capital expenditure.

Table 12: LOANS						
Lender	**Principal**	**Type**	**Interest Rate**	**Start date**	**Maturity Date**	**Duration**
Short-term Market Loan	£4m	Fixed Interest Rate	1.70%	18/12/2020	20/12/2021	12 months

This compares well with the 2020/21 budget assumption that long term borrowing would be at an interest rate of 2.70%.

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.

8. Investment Outturn 2020/21

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance and was implemented in the Treasury Management Strategy approved by the Council on 28 May 2020. The Policy sets out the approach for choosing investment counterparties based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, such as rating outlooks, credit default swaps and bank share prices etc.

Investment activity during the year conformed to the approved Policy and the Council experienced no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. Core cash resources comprised usable reserves as follows:

Table 13: USABLE RESERVES	2019/20 Actual	2020/21 Actual
	£000	£000
General Fund Balance	7,939	2,331
Earmarked Reserves	33,652	37,558
Usable Capital Receipts	581	7,361
Capital Grants Unapplied	21,396	21,396
Total	**63,568**	**68,646**

Investments - the Council maintained an average balance of £36m of investments in 2020/21 which earned an average rate of return of 0.51%. This compares with a (pre-pandemic) budget assumption of £36m investment balances earning an average rate of 0.93%. The comparable external performance indicator is the average 12-month LIBID uncompounded rate, which was 0.17%. The Council's average rate of return of 0.51% is mainly driven by the fixed investments made prior to the pandemic where interest rates were most favourable.

9. Other Treasury Management Matters

Pooled Investment Funds. The Council had no pooled investment funds during the year.

Non-treasury management investments. The Council's current approach to making property investment decisions is set out in its Capital Investment Strategy which explains how investment decisions are made, how delivery is approached and how risks are managed. In order to support investment decisions, the Council relies on the principles established in its evolving Commercial Investment Strategy and powers under the Localism Act 2011. This forms the framework for maximisation of new and existing income streams to secure financial sustainability.

APPENDIX 1

PRUDENTIAL AND TREASURY INDICATORS

1.1 PRUDENTIAL INDICATORS	2019/20 Actual £000	2020/21 Original Budget £000	2020/21 Actual £000
Capital Expenditure			
General Fund (Table 2)	18,890	96,100	25,454
Ratio of net financing costs to net revenue stream			
General Fund	(4.99)%	4.95%	(3.77)%
Gross Debt			
Brought forward 1 April	12,000	14,000	14,000
Carried forward 31 March	14,000	9,000	9,000
In year borrowing requirement	2,000	(5,000)	(5,000)
Capital Financing Requirement			
Opening CFR (Table 3)	18,826	31,105	31,105
In year CFR change (Table 3)	12,279	74,924	30,305
Closing CFR (Table 3)	31,105	106,029	61,411
Annual change in Capital Financing Requirement			
General Fund	12,279	74,924	30,305

1.2 TREASURY MANAGEMENT INDICATORS	2019/20 Actual £000	2020/21 Original Budget £000	2020/21 Actual £000
Authorised Limit for External Debt			
Borrowing	80,000	161,000	161,000
Other long-term liabilities	-	500	500
Total	**80,000**	**161,500**	**161,500**
Operational Boundary for External Debt			
Borrowing	70,000	151,000	151,000
Other long-term liabilities	-	500	500
Total	**70,000**	**151,500**	**151,500**
Actual External Debt	**14,000**	**9,000**	**9,000**

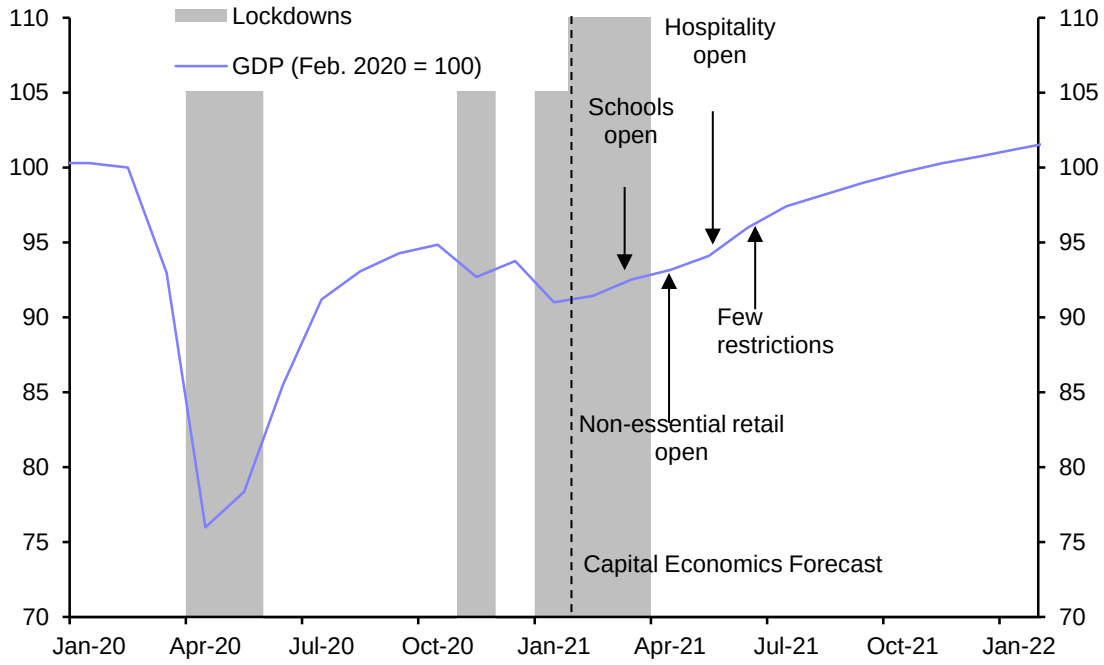
1.3 MATURITY STRUCTURE OF FIXED RATE BORROWING DURING 2020/21	Target upper limit	Target lower limit	Actual
Under 12 months	100%	0%	100%
12 months and within 24 months	100%	0%	0%
24 months and within 5 years	100%	0%	0%
5 years and within 10 years	100%	0%	0%
10 years and within 20 years	100%	0%	0%
20 years and within 30 years	100%	0%	0%
30 years and within 40 years	100%	0%	0%
40 years and within 50 years	100%	0%	0%
Maturity structure of Investments during 2020/21	upper limit	lower limit	
Longer than 1 year	£20m	£0m	£0m
Up to 1 year	£13m	£0m	£36m
Total	£33m	£0m	£36m

APPENDIX 2

LINK ASSET SERVICES COMMENTARY – April 2021

The Economy and Interest Rates

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 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 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.*



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 Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it 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.*

***Government support.** 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 20/21 and 21/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3rd March 2021 increased 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 will help further to strengthen the economic recovery from the pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%. An area of concern, though, is that the government's debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed long-term debt for floating rate debt; there is, therefore, much incentive for the Government to promote Bank Rate staying low e.g. by using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and / or by amending the Bank's policy mandate to allow for a higher target for inflation.*

***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.*

*After Chair Jerome Powell spoke on the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed a new inflation target - that "it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time." This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial*

markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. There is now some expectation that where the Fed has led in changing its policy towards implementing its inflation and full employment mandate, other major central banks will follow, as indeed the Bank of England has done so already. The Fed 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. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping treasury yields at historically low levels. However, financial markets in 2021 have been concerned that the sheer amount of fiscal stimulus, on top of highly accommodative monetary policy, could be over-kill leading to a rapid elimination of spare capacity in the economy and generating higher inflation much quicker than the Fed expects. They have also been concerned as to how and when the Fed will eventually wind down its programme of monthly QE purchases of treasuries. These concerns 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.

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.*

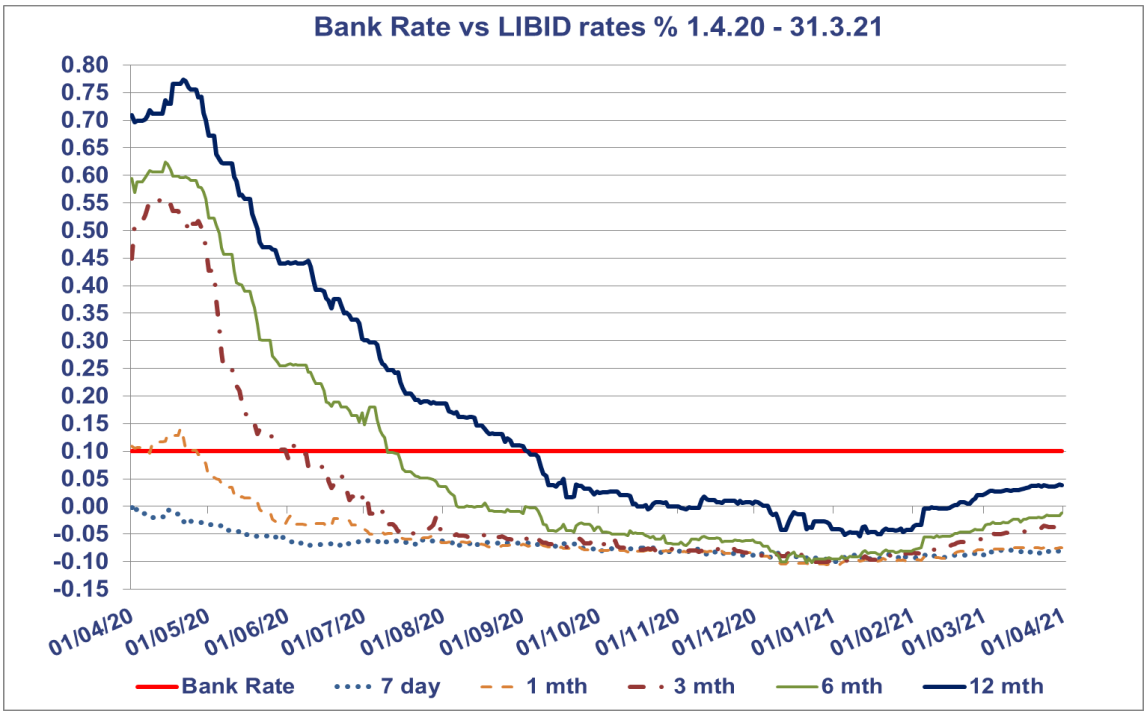
Japan. *Three rounds of government fiscal support in 2020 together with Japan's relative success in containing the virus without draconian measures so far, and the roll out of vaccines gathering momentum in 2021, should help to ensure a strong recovery in 2021 and to get back to pre-virus levels by Q3.*

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. 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.*

Central banks' monetary policy. *During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.*

Investment strategy and control of interest rate risk



	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

For authorities that have sufficient cash balances to place longer term investments -

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 also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

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 more able 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 counterparty risk exposure, by having fewer investments placed in the financial markets.

For authorities with minimal cash balances that can only be placed out for up to one month.

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 also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

This authority does not have sufficient cash balances to be able to place deposits for more than a month so as to earn higher rates from longer deposits. 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 more able 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.

Borrowing strategy and control of interest rate risk

During 2019/20, 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 authority 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 therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks (please adapt this outline to what you actually did in the year):

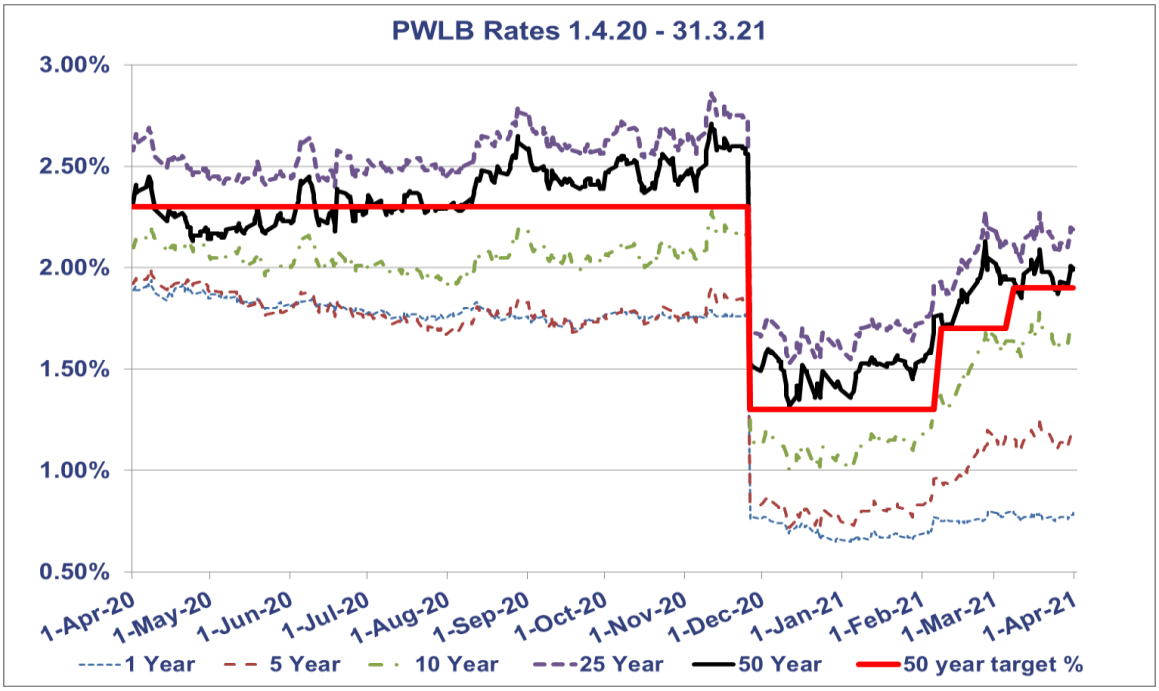
- *if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding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

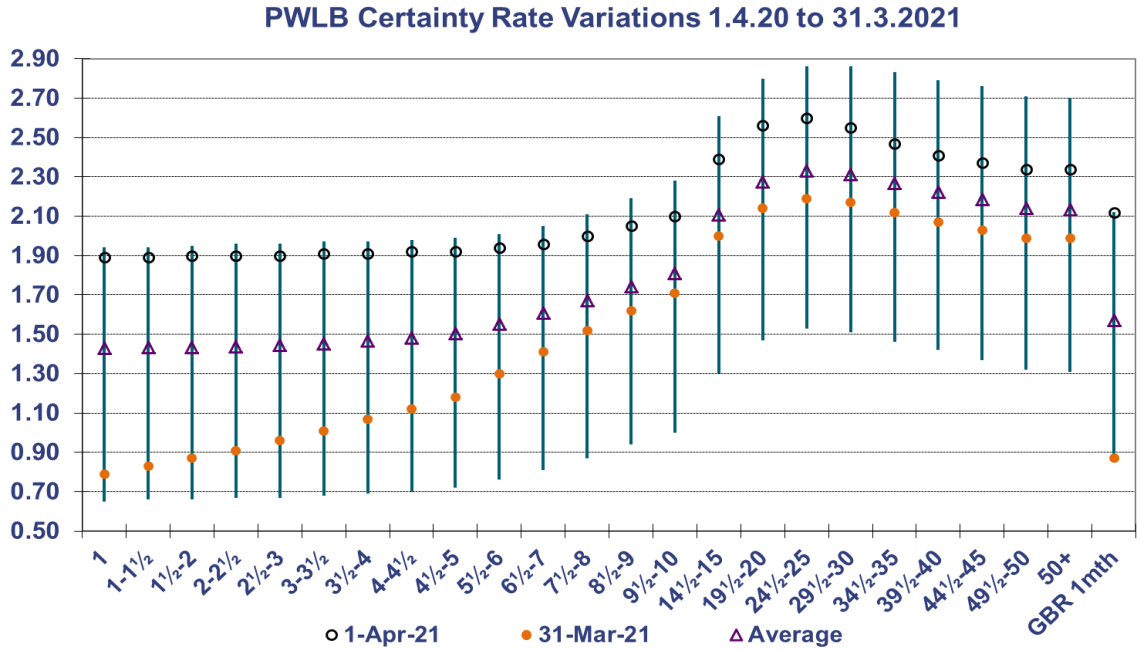
Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2020/21 and the two subsequent financial years. Variable, or short-term rates,

Forecasts at the time of approval of the treasury management strategy report for 2020/21 were as follows:-

Link Asset Services Interest Rate View	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	3.10	3.10	3.20	3.20	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.80	3.80	3.90	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.80



	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%



PWLB rates are based on gilt (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.