Agenda item 9

Cabinet – 21 July 2021

Treasury Management Annual Report 2020/21

Portfolio: Councillor Bird, Leader of the Council

Related portfolios: N/A

Service: Finance

Wards: All

Key decision: No

Forward plan: Yes

1. Aim

1.1 The council is required through regulations issued under the Local Government Act 2003 to produce a year end position statement reviewing treasury management activities and prudential and treasury indicator performance. The Treasury Management year end position statement at Appendix A provides Cabinet with these details, and 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).

1.2 The council is required to note the TM Annual Report is presented to provide assurance that TM performance is in line with budgeted expectations and within the above regulations and Codes that the authority is required to comply with.

2. Summary

2.1 This report sets out the council's 2020/21 year end position for treasury management activities (Appendix A).

2.2 Despite difficult market conditions and historically low interest rates following the reduction of the Bank Of England base rate down to 0.10% in March 2020 the council achieved an average interest rate across all investments of 1.01% compared to budget of 1.59%. In monetary terms this equated to a budgetary pressure of £0.199m.

2.3 This has taken considerable effort and negotiation from the treasury team to secure favourable rates when considering investment options, and through the review and identification of new opportunities for investment.

2.4 Capital expenditure for 2020/21 was £102.837m of which £21.006m will be funded from approved borrowing (Table 2, Appendix A).

2.5 The actual debt position for the Council as at 31 March 2021 is £351.454m, which is within both the operational and authorised limits for external debt agreed at council on 27/02/20.

3. Recommendations

3.1 To note and forward to Council, for consideration and noting (in line with the requirements of the Treasury Management Code of Practice (2017)), the annual position statement for treasury management activities 2020/21 including prudential and local indicators (Appendix A).

4. Report detail - know

Context

4.1 The Treasury Management annual report at Appendix A provides Cabinet with these details, and 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).

The following key points of interest have been extracted from the report:

- The annual report meets the requirement of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.
- Capital expenditure was £102.837m of which £21.006m will be funded from approved borrowing (Table 2, Appendix A).
- The banking environment has continued to be one of the low interest returns. The Bank of England base rate decreased from 0.75% to 0.25% on 11th March 2020 and then reduced further to 0.10% on 19th March 2020, due to the onset of the global Covid-19 pandemic.
- Despite the situation of low interest returns throughout the financial year, the authority has continued to identify appropriate new areas of investment opportunity, reviewed counterparties and limits to reduce exposure to counterparty risk. Together these actions mitigated the budgetary pressure on investment income levels to £0.199m for the 2020/21 financial year.
- To note within the local indicators (Table 11) that the net borrowing cost as a percentage of net council tax requirement 7.02% (3a) and the net borrowing cost as percentage of tax revenue 4.44% (3b) are both within their target upper limits of 20% and 12.50%.

Council Corporate Plan priorities

4.2 Sound financial management of the council's cash balances supports the delivery of council priorities within council's available resources.

Risk management

4.3 Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. It is recognised that the management of risk is as important as maximisation of performance and it is essential that the council has the right balance of risk and reward when making investment decisions. This is supported by treasury management policies which seek to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council.

4.4 The United Kingdom formally left the European Union on 31 January 2020 with a transition period that lasted until 31 December 2020 to enable both parties to negotiate their future relationship. These negotiations resulted in a trade agreement with the EU for goods only with negotiations continuing with respects to services. At present it is hard to quantify what the impact has been to the council due to the impact Covid-19 has had on the UK economy potentially masking any Brexit consequences. The Council has responded to these risks by reviewing counterparties for investments to minimise the risk to any one counter party or class of counter party.

Financial implications

4.5 Treasury management activity forms part of the council's financial framework and supports delivery of the medium term financial strategy. The review of treasury management performance and activity is reviewed through both the treasury management annual report and the mid-year performance review report.

Legal implications

4.6 The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original treasury management code in 1992 and further revisions to the Code in 2002, 2010 and 2017.

Procurement Implications/Social Value

4.7 None directly relating to this report.

Property implications

4.8 None directly relating to this report.

Health and wellbeing implications

4.9 None directly relating to this report.

Staffing implications

4.10 None directly relating to this report.

Reducing Inequalities

4.11 None directly relating to this report.

Climate Change

4.12 None directly relating to this report.

Consultation

4.13 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the S151 Officer, Head of Finance and Deputy Head of Finance - Corporate.

5. Decide

5.1 In line with the Treasury Management Code of Practice (2017) there are a number of reports that are required to be produced and reported publicly each year. The Treasury Management Annual Report forms one of these requirements and as such is being reported to Cabinet for noting and forwarding onto Council for consideration.

6. Respond

6.1 This report is not seeking approval of a decision, in line with the Treasury Management Code of Practice (2017) it is required to be reported for noting and forwarding to Council for consideration.

7. Review

7.1 In line with Treasury Management Code of Practice (2017) this is a backward looking document looking at performance over the previous.

Background papers

Various financial working papers.

Corporate budget plan and treasury management and investment strategy 2020/21 – Council 27/02/20.

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21 July 2021

Signed:

Councillor M Bird
Leader of the Council

21 July 2021

Appendix A

Annual Treasury Management Report 2020/21

Walsall Council
June 2021

Annual Treasury Management Report 2020/21

Purpose

This council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicator performance. This document therefore reports this position for the 2020/21 financial year. 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 following reports were produced:

- an annual treasury strategy in advance of the year (Council 27/02/2020)
- a mid-year (minimum) treasury update report (Cabinet 09/12/2020)
- an annual review of treasury management policies (Council 25/02/2021)
- an annual report following the year describing the activity compared to the strategy (this report to Cabinet)

In addition, this council's treasury management panel has received regular treasury management update reports throughout 2020/21.

The regulatory environment places an onus 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 also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by Cabinet before they were reported to the full Council. In order to support members' scrutiny role member training on treasury management issues has been available to all members via the e-Learning platform throughout 2020/21 and the Council's external Treasury Management Advisors Link provided a member training session in March 2021.

Summary

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

Table 1 Actual prudential and treasury indicators	2019/20 Actual £m	2020/21 Original £m	2020/21 Revised £m	2020/21 Actual £m
Capital expenditure	69.780	98.360	217.180	102.837
Capital Financing Requirement:				
Including PFI and finance leases	357.159			370.107
Excluding PFI and finance leases	350.430			364.336
External Borrowing	307.612			347.366
Investments	214.485			219.860
Net borrowing	93.127			127.506

Other prudential and treasury indicators are to be found in the main body of this report. The Executive Director of Resources & Transformation (S151 Officer) confirms that borrowing was only undertaken for capital purposes or to support required in year cash-flow requirements.

The challenging environment of low investment returns and uncertainty of counterparty risk has continued in 2020/21. The Bank Of England base rate was reduced to 0.10% in March 2020 due to the effects of Covid-19, which would not have been accounted for in the budget set in February 2020, and therefore added a forecast pressure to investment income immediately at the beginning of the financial year. Counterparty risk has been continually reviewed throughout the financial year to ensure credit ratings exceed the minimum requirements set in Treasury Management policies, and cash was invested primarily in At-Call and Short Term accounts to ensure the council was able to meet unknown levels of expenditure resulting from Covid-19.

The original capital expenditure target of £98.360m for 2020/21 is based on the figure for the 2020/21 capital programme reported in the budget report presented to full Council on the 27th February 2020. This was revised within the financial year to a £217.180m target. The actual spend for 2020/21 is lower than the target due to slippage from 19/20, and amendments to the original capital programme agreed during the year, of which spend will now be incurred in 2021/22.

1. Introduction and background

To set the context of the treasury management environment it is first necessary to provide a review of the economy and interest rates.

2020/21 continued with a challenging investment environment since the reduction of the Bank of England base rate down to 0.10% in March 2020, with namely low investment returns, although levels of counterparty risk have continued to subside. The interest rate forecast at the start of the year was that the low interest rate environment would continue throughout 2020/21. An economic summary is given at the beginning of the borrowing and investment sections.

2. The Council's Capital Expenditure and Financing 2020/21

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.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. The amount to be funded from borrowing for 2020/21 will be £21.006m. It shows an increase in capital expenditure funded from grants mainly due to Growth Fund Projects, for which Walsall is the accountable body for all the Black Country Districts.

Table 2	**2019/20 Actual £m**	**2020/21 Original £m**	**2020/21 Actual £m**
Total capital expenditure	**69.780**	**98.360**	**102.837**
Resourced by:			
- Capital receipts	2.781	5.650	2.268
- Capital grants	53.057	67.040	77.648
- Capital Reserves and Revenue	1.592	0.040	1.915
- Approved Borrowing	12.350	25.630	21.006
	69.780	**98.360**	**102.837**

3. The Council's Overall Borrowing Need

The council's underlying need to borrow for capital expenditure is termed the capital financing requirement (CFR). This figure is a gauge of the council's debt position. The CFR results from the capital activity of the council and which resources have been used to pay for the capital spend. It represents the 2020/21 capital expenditure funded by borrowing (see table 2), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the council.

Reducing the CFR – the council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The council is required to make an annual revenue charge, called the minimum revenue provision (MRP) to reduce the CFR. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can 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 Minimum Revenue Provision (MRP) Policy applied from 2015/16 until 2019/20 was as follows:

Under the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2010, local authorities have a duty to produce an annual statement on its policy for making a minimum revenue provision (MRP).

For the financial years **2008/09** onwards the authority will be adopting the following policies in determining the MRP:

1. For any capital expenditure carried out prior to 31 March 2008 or financed by supported borrowing capital expenditure, the authority will be charging MRP at 2% of the balance at 31 March 2013 (which has been adjusted as per the 2003 regulations, i.e. net of Adjustment A), fixed at the same cash value so that the whole debt is repaid after 50 years.

2. For any capital expenditure carried out after 1 April 2008 being financed by borrowing the authority will be adopting the asset life method (option 3). This is where MRP will be based on the capital expenditure divided by a determined asset life or

profile of benefits to give annual instalments. The annual instalment may be calculated by the equal instalment method, annuity method or other methods as justified by the circumstances of the case at the discretion of the S151 Officer.

3. The authority will treat the asset life as commencing in the year in which the asset first becomes operationally available. Noting that in accordance with the regulations the authority may postpone the beginning of the associated MRP until the financial year following the one in which the asset becomes operational, there will be an annual adjustment for Assets Under Construction.

4. In all years, the CFR for the purposes of the MRP calculation will be adjusted for other local authority transferred debt.

5. The Section 151 officer shall on an annual basis review the level of MRP to be charged, as calculated as per paragraphs 1, 2 and 3 above to determine if this is at a level, which is considered prudent. Dependant on this review the Section 151 officer shall be able to adjust the MRP charge (the total cumulative adjustment will never exceed the calculated CFR variance of £24.6m identified when reviewing the current MRP policy during 2015/16). The amount of MRP charged shall not be less than zero in any financial year.

It is proposed that the Minimum Revenue Provision from 2020/21 onwards will be:

Under the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2018, local authorities have a duty to produce an annual statement on its policy for making a minimum revenue provision (MRP).

For the financial years **2020/21** onwards the authority will be adopting the following policies in determining the MRP:

1. For all existing capital expenditure balances within the Capital Financing Requirement (CFR) held as at 1 April 2020 MRP will be applied on an annuity basis with the write down period determined by asset lives up to the maximum allowable by the regulations set out above.

2. For all capital expenditure incurred from 1 April 2020 MRP will be applied on an annuity basis with the write down period determined by asset lives up to the maximum allowable by the regulations set out above.

3. The authority will treat the asset life as commencing in the year in which the asset first becomes operationally available. Noting that in accordance with the regulations the authority may postpone the beginning of the associated MRP until the financial year following the one in which the asset becomes operational, there will be an annual adjustment for Assets Under Construction.

4. If determined by the S151 Officer the annual instalment may be calculated by the equal instalment method or other appropriate methods dependant up on the nature of the capital expenditure.

5. In all years, the CFR for the purposes of the MRP calculation will be adjusted for other local authority transferred debt, finance lease and Private Finance Initiative (PFI).

6. The S151 officer shall on an annual basis review the level of MRP to be charged, as calculated as per paragraphs 1, 2 and 3 above to determine if this is at a level, which is considered prudent. The amount of MRP charged shall not be less than zero in any financial year.

The council's CFR for the year 2020/21 is shown below in Table 3, and represents a key prudential indicator (PrI4). It includes Private Finance Initiative (PFI) and leasing schemes from the balance sheet which increase the council's borrowing need – although no borrowing is normally required against these schemes as a borrowing facility is included in the contract (if applicable). It shows that in 2020/21 the council's CFR has increased by £12.949m from £357.159m to £370.108m.

Table 3 CFR (£m)	31 March 2020 Actual £m	31 March 2021 Actual £m
Opening balance	**357.673**	**357.159**
Add capital expenditure funded from approved borrowing (as above)	12.350	21.006
Less MRP	-12.864	-8.057
Closing balance	**357.159**	**370.108**

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the council's external borrowing, net of investments, must only be for a capital purpose, or to fund expected in year cash-flow requirements. This essentially means that the council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR. Table 4 below highlights the council's net borrowing position (£127.506m) against the CFR excluding PFIs and Finance leases (£364.336m) because the debt liability for these are not in the net borrowing position of the council. The council has complied with this prudential indicator.

Table 4 Gross borrowing and the CFR (£m)	31 March 2020 Actual £m	31 March 2021 Actual £m
Gross Borrowing	**312.330**	**351.454**
Net borrowing position	**93.127**	**127.506**
CFR – excluding PFIs and Finance Leases	**350.430**	**364.336**
Long term Assets	**574.650**	**617.858**
Net Borrowing % of Long term Assets	**16.21%**	**20.64%**

Another measure of prudency is the proportion of net to fixed assets. Table 4 shows that the net borrowing position of the council as at 31/03/21 is £127.506m which represents 20.64% of the value of the council's long term assets which are valued on the council's balance sheet at that date.

Other key Prudential Indicators are shown in Table 5 below:

Table 5 **Prudential and Borrowing Limits**	**31 March 2020 Actual £m**	**31 March 2021 Actual £m**
1. Authorised limit	**458.391**	**472.173**
2. Maximum gross borrowing in year	**307.568**	**351.454**
3. Operational boundary	**416.719**	**429.248**
4. Average gross borrowing	**310.182**	**327.489**
5. Financing costs as proportion of net revenue stream	**4.31%**	**5.17%**

1. **The authorised limit** - the authorised limit is the "affordable borrowing limit" set by the council as required by section 3 of the Local Government Act 2003. The council does not have the power to borrow above this level without the prior approval of full Council. Table 5 demonstrates that during 2020/21 the council's maximum gross borrowing was within its authorised limit.

2. **Maximum Gross borrowing** – is the peak level of borrowing in year.

3. **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 is acceptable subject to the authorised limit not being breached. In 2020/21 the council's average borrowing position was less than the operational boundary.

4. **Average Gross Borrowing** – is an estimate of the borrowing level in the year see Table 7 for analysis of Borrowing.

5. **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. Net revenue stream is defined as Net Council Tax Requirement plus Standard Spending Assessment (previously Formula Grant).

4. Prudential Indicators

The following tables show performance against statutorily required prudential and local indicators.

Table 6 – Prudential Indicators		Actual 2019/20	Target 2020/21	Position 31-Mar-21	Variance to target	
		£m	£m	£m	£m	%
PrI 1	Capital Expenditure	69.780	217.180	102.837	(114.343)	(53%)
PrI 2	Ratio of financing costs to net revenue stream	4.31%	3.78%	5.17%	1.39%	37%
PrI 3	Estimates of the incremental impact of new capital investment decisions on Council Tax	£15.36	£28.49	£28.49	0.00	0%
PrI 4	Capital Financing Requirement	381.564	380.886	380.886	0.000	0%
PrI 5	Authorised Limit for external debt	458.391	472.173	472.173	0.000	0%
PrI 6	Operational Limit for external debt	416.719	429.248	429.248	0.000	0%

Ref	Prudential Indicator	Actual 2019-20 £m	Target 2020/21 £m	Position 31-Mar-21 £m
PrI 7	Gross Borrowing exceeds capital financing requirement	No	No	No
PrI 8	Authority has adopted CIPFA Code of Practice for Treasury Management	Yes	Yes	Yes
PrI 9	Total principle sums invested for longer than 365 days must not exceed	15.0	25.0	15.0

Ref	Prudential Indicator	Upper Limit	Lower Limit	Actual 2020/21	Position 31-Mar-21
PrI 10	Fixed Interest Rate Exposure	95%	40%	**95%**	**94%**
PrI 11	Variable Interest Rate Exposure	45%	0%	**5%**	**6%**
PrI 12	***Maturity Structure of Borrowing:***				
	Under 12 months	25%	0%	**7%**	**10%**
	12 months and within 24 months	25%	0%	**7%**	**22%**
	24 months and within 5 years	40%	0%	**32%**	**20%**
	5 years and within 10 years	50%	5%	**2%**	**1%**
	10 years and above	85%	30%	**53%**	**47%**

PRL 5 (authorised limit for external debt) and PRL 6 (operational limit for external debt) were approved by Council on the 27 February 2020 and the CIPFA Code of Practice only allows these limits to be changed by Council and therefore the actual limit and the target remain the same. The actual debt position for the Council as at 31 March 2021 is £351.454m.

Key variances are because of the following reasons:-

<u>Prl 1 Total capital expenditure - variation of £114.343m</u>
The original £98.360m target for 2020/21 is based on the figure for the 2020/21 capital programme reported in the budget report presented to full Council on the 27th February 2020. This was revised within the financial year to a £217.180m target. The actual spend for 2020/21 is lower than the target due to slippage from 19/20, and amendments to the original capital programme agreed during the year, of which spend will now be incurred in 2021/22.

<u>Prl 12 Maturity Structure of Borrowing</u>
For the purpose of the maturity profile indicator the next call date on a LOBO loan is assumed; as it is the right of the lender to require repayment. However due to the low interest rate environment it is unlikely that in the medium term that any of the LOBO's will be called.

5. Treasury Position at 31st 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 within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the council's treasury management practices. At the beginning and the end of 2020/21 the council's treasury position was as shown below in **Table 7**:

Table 7 Loans and Investments	Opening Balance £m	Average Rate At 31/03/20 %	Movement in Year £m	Closing Balance £m	Average Rate At 31/03/21 %
PWLB loans	195.571	3.38%	0.042	195.613	3.38%
Market Loans	95.000	4.49%	0.000	95.000	4.49%
Total Borrowing over 12 months excluding WMCC debt	**290.571**	**3.74%**	**0.042**	**290.613**	**3.74%**
Temporary Loans	6.961	0.87%	41.000	47.961	0.87%
Total borrowing excluding WMCC debt	**297.532**	**3.68%**	**41.043**	**338.575**	**3.34%**
WMCC Debt	14.798	6.50%	-1.918	12.880	6.50%
Gross Borrowing	**312.330**	**3.81%**	**39.124**	**351.454**	**3.45%**
Waste Disposal & Cannock Chase Debtor	-4.718	6.50%	0.630	-4.088	6.50%
Borrowing	**307.612**	**3.77%**	**39.754**	**347.366**	**3.42%**
CFR less PFI finance & leases	350.430		13.906	364.336	
Under/(Over) Borrowing	42.818		53.660	16.970	
Debt as % of CFR	**88%**			**95%**	
Call Accounts	46.485	0.63%	-10.125	36.360	0.10%
Short Term Investments	124.000	1.24%	14.500	138.500	0.68%
Long Term Investments	44.000	1.65%	1.000	45.000	1.57%
Total Investments	**214.485**	**1.50%**	5.375	**219.860**	**0.59%**
Net Borrowing Position	**93.127**		34.379	**127.506**	

The under borrowing position the council has represents additional external borrowing the council could choose to take if required, however this has currently been financed by internal borrowing – utilising the Council's accumulated cash reserves rather than taking out new external borrowing. This position will continue to be monitored and additional external borrowing may be undertaken if required for cash flow purposes.

The true under borrowed position at the beginning of the year was £49.779m, and at the end of the year was £64.931m. This is because the under/(over) positions in the table above include temporary loans taken to fund upfront pension payments made in April 2020 for the following 3 financial years, which should be removed to show the true under borrowed position.

6. The Borrowing Strategy for 2020/21 and Economic Context

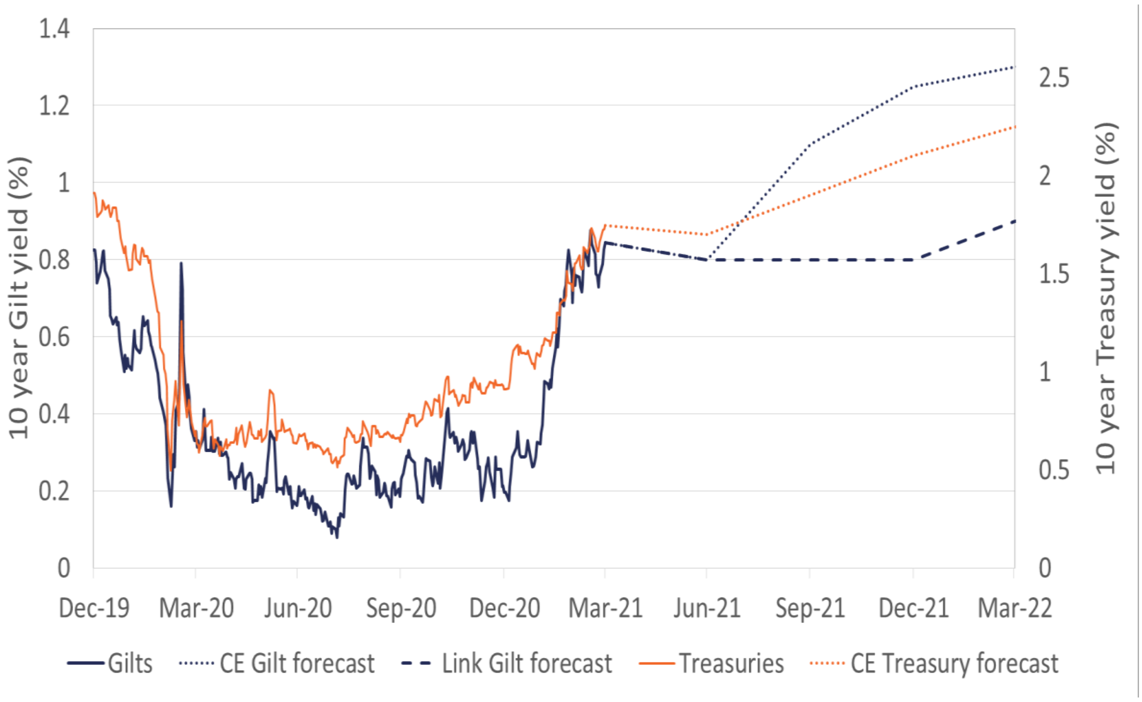
During 2020-21, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was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

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.

7. Borrowing Outturn for 2020/21

PWLB rates are based on, and are determined by, 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.

Graph of UK gilt yields v. US treasury yields



Gilt yields fell sharply from the start of 2020 and then spiked up during a financial markets melt down in March caused by the Covid-19 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 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 0.19 – 0.58% while the 10-year and 25-year yields were at 1.11% and 1.59%.

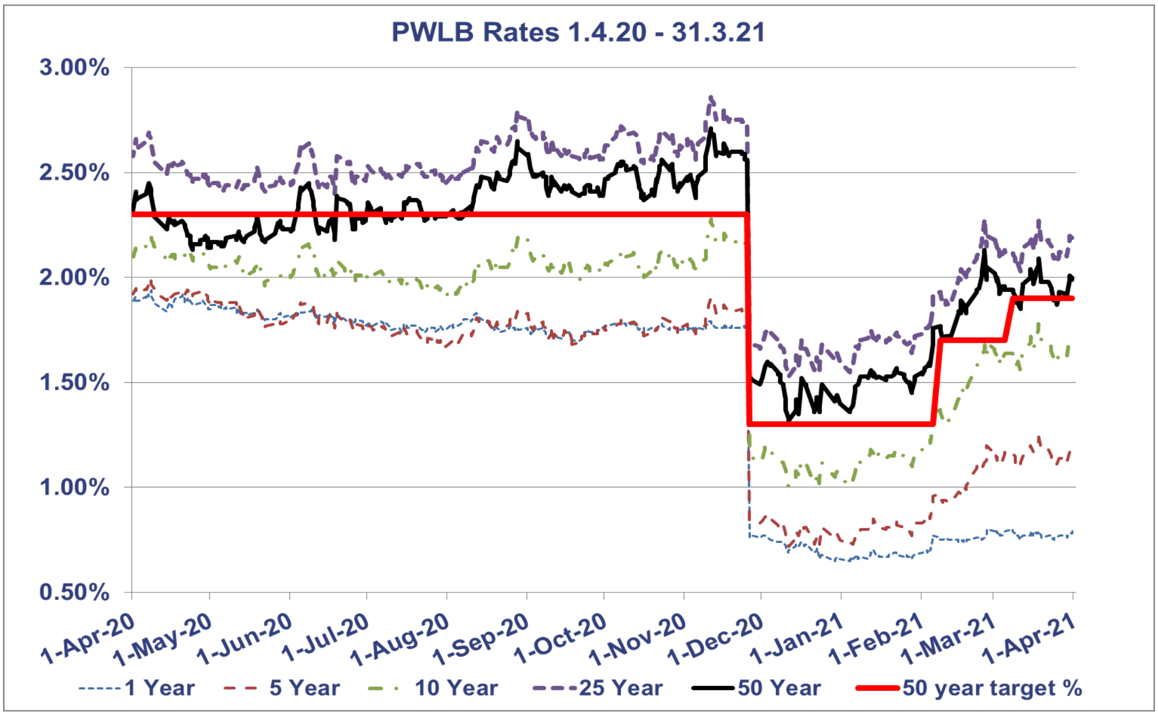
HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019/20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing 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)

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.



8. Investments in 2020/21 and Economic Context

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 in the current climate.

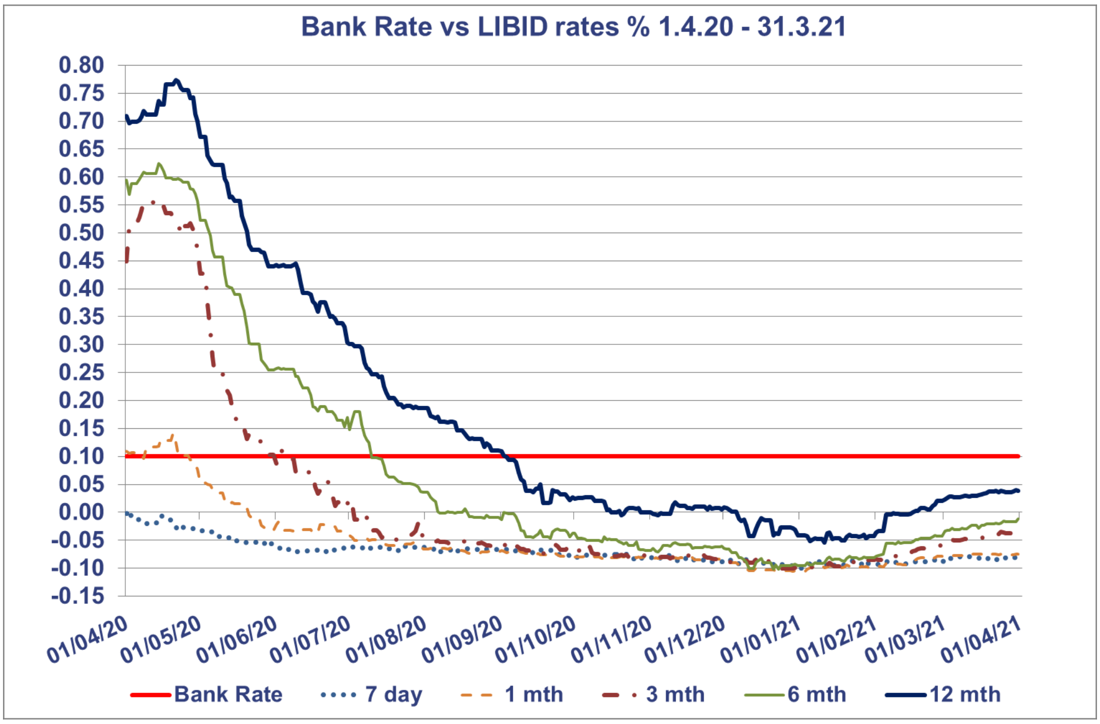


Table 9 within the report details the authority's investments by call, short and long term. The 7 day rate above (average of -0.05% across the year) is a fair comparator for at-call and the 12 month LIBID (average of 0.05% across the year) for short term investments.

Resources – the council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations.

Investment Policy – the council's investment policy is governed by central Government guidance, which was implemented in the Annual Investment Strategy approved by Council on 27th February 2020. This policy set out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by KPMG survey of Building Societies and an analysis of Common Equity Tier (CET1) levels. The investment activity during the year conformed to the approved Strategy, and the council had no liquidity difficulties.

At the end of 2020/21 Walsall's investment balance was £5.375m higher than that at the start of the year. **Table 8** below shows an age profile of the investments.

Table 8: Changes in Investments during 2020/21	Opening Balance £m	Closing Balance £m	Movement in Year £m
At Call accounts	46.485	36.360	-10.125
Between 31 days and 365 days	124.000	138.500	14.500
Over 365 days	44.000	45.000	1.000
Total	**214.485**	**219.860**	**5.375**

Investments held by the council - the council maintained an average balance of £221m of internally managed funds. The internally managed funds earned an average rate of return of 0.59%.

Recognising the continuation of the stresses on the world banking system, enhanced priority has continued to be given to security and liquidity. To reduce counterparty risk to the maximum possible extent the investment portfolio was spread across a range of appropriately credit rated / analysed institutions. **Table 9** shows the outturn on investment income in 2020/21.

Table 9 Investments Interest – Gross Income	2020/21 Approved Cash Limit £m	Outturn at 31 March 2021 £m	Over /(under) achieved cash limit £m	% Target Rate	% Average Rate achieved
Call Account investments	0.090	0.072	(0.018)	0.60%	0.10%
Short Term Investments	1.230	1.092	(0.138)	1.10%	0.68%
Long Term Investments	0.248	0.143	(0.105)	1.65%	1.57%
Property Fund	1.169	1.231	0.062	3.90%	4.10%
Total	**2.737**	**2.538**	**(0.199)**	**1.59%**	**1.01%**

9. Performance Measurement

One of the key requirements in the CIPFA Code of Practice on Treasury Management is the formal introduction of performance measurements relating to investments, debt and capital financing activities. **Table 10** below shows that Walsall has consistently achieved a higher average return on it's investments and has reduced it's average rate it pays for its borrowing. The figures for 2011/12 to 2014/15 are derived from the the CIPFA treasury management benchmarking club. For 2015/16 onwards, as a number of authorities no longer participate in this benchmarking exercise, the figures set out are based on a review of reports issued by the authorities statistical neighbours. Comparative figures for 2020/21 are not yet available.

Table 10 Comparison of Walsall with other councils Average Interest Rates	Walsall Rate Received %	Average Rate Received %	Walsall Rate Paid %	Average Rate Paid %
2011/12	1.80	1.20	4.53	4.53
2012/13	2.14	1.11	4.47	4.52
2013/14	1.29	0.85	4.51	4.26
2014/15	1.09	0.77	4.61	4.14
2015/16	1.08	0.76	4.54	4.18
2016/17	0.86	0.76	3.99	4.34
2017/18	1.32	0.73	3.42	4.06
2018/19	1.37	1.10	3.83	4.15
2019/20	1.50	1.00	3.34	4.05
2020/21	0.59		3.42	

Council approved the following local performance indicators, the majority of which were complied with during the year, **Table 11** provides the indicators for March 2021.

Table 11 - Local Indicators		Actual 2019/20	Target 2020/21	Position 31-Mar-21	Variance to target	
		£m	£m	£m	value	%
L1	Full compliance with Prudential Code.	YES	YES	YES	N/A	N/A
L2	Average length of debt. (Years)	19.05	Lower Limit 15 Years, Upper Limit 25 Years	16.23	N/A	N/A
L3a	Net borrowing costs as % of net council tax requirement.	6.06%	20.00%	7.02%	(12.98%)	(64.92%)
3b	Net borrowing costs as % of Tax Revenue.	3.78%	12.50%	4.44%	(8.06%)	(64.51%)
L4	Net actual debt vs. operational debt.	73.82%	85.00%	80.92%	(4.08%)	(4.80%)

L5	Average interest rate of external debt outstanding excluding OLA.	3.69%	3.35%	3.46%	0.11%	3.15%
L6	Average interest rate of external debt outstanding including OLA.	3.86%	3.53%	3.54%	0.01%	0.17%
L7	Gearing effect of 1% increase in interest rate.	3.92%	5.00%	3.58%	(1.42%)	(28.40%)
L8	Average interest rate received on STI vs. At Call rate	n/a	50.00%	580.00%	530.00%	1060.00%
L9	Average interest rate received:					
L9a	At Call investments.	0.63%	0.60%	0.10%	(0.50%)	(83.33%)
L9b	Short Term Investments.	1.24%	1.10%	0.68%	(0.42%)	(38.18%)
L9c	Long Term Investments.	1.65%	1.65%	1.57%	(0.08%)	(4.85%)
L9d	Property Fund Investments	4.16%	3.90%	4.10%	0.20%	5.25%
L10	Average interest rate on all ST investments (ST and At Call).	1.11%	1.04%	0.46%	(0.58%)	(55.57%)
L11a	Average rate on all investments (excluding property fund)	1.20%	1.11%	0.59%	(0.52%)	(46.65%)
L11b	Average Rate on all investments (including property fund)	1.50%	1.59%	1.01%	(0.44%)	(30.34%)
L12	% daily bank balances within target range.	100%	99%	100%	1.00%	1.01%

Key variances are because of the following reasons:-

L3a - Net borrowing costs as % of net council tax requirement (variance of -64.92%). The target figure of 20.00% represents an upper limit of affordable net borrowing costs as a percentage of the net council tax requirement for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favourable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.

L3b - Net borrowing costs as % of Tax Revenue (variance of -64.51%). The target figure of 12.50% represents an upper limit of affordable net borrowing costs as a percentage of tax revenues for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favourable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.

L5 & L6 – The targets set at the beginning of the year factored in borrowing at lower rates for capital expenditure. This borrowing was not required to be taken out during this financial year which has impacted upon this variance adversely as the rate for this year would have included the new borrowing at lower rates.

L8 – Average rate achieved on Short Term Interest vs At Call Rate – The target is to achieve a 50% better rate on short term investments vs the current At Call rate (i.e. do nothing other than leave all cash in overnight At Call accounts). Due to historic low interest rates on At-Call investments the percentage variances as a consequence are very high, yet favourable. The average At Call rate was 0.10%, creating a 50% above target of 0.15%. The short term interest rate achieved was actually 0.68%, which results in a 530% favourable variance above the At Call rate. Due to historic low interest rates on At-Call investments the percentage variances as a consequence are very high, yet favourable.

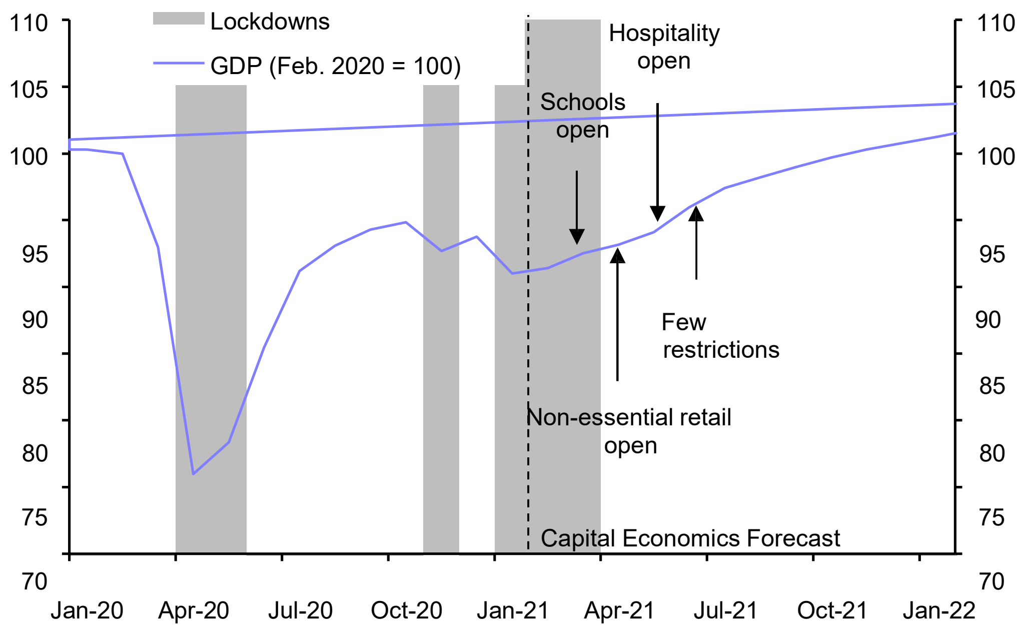
L9a-9d –At Call, Short Term, Long Term, Property Fund investment rates – The bank of England base rate was cut twice in March 2020 due to Covid-19, which has had a significant impact on all rates for the foreseeable future. The Treasury service do seek to minimise this impact by securing favourable rates on the property fund, which is currently exceeding the set target as well as seeking the most competitive rates available on all other investments.

L10 – Average interest rate on all ST investments (ST & At Call) – The authority's short term investment rate is now below target as the previously favourable short term rates within the financial year have now expired and due to Covid-19 it has been difficult to secure favourable rates again. At call rates were consistently poor throughout the year due to the rate cuts in March 2020. Overall, the combined rate achieved is 0.46% vs a target of 1.04%.

L11 & 11a – These two average rate indicators across all investments are below target similarly to above due to the base rate cuts in March 2020.

10. 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 (MPC) cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a £200bn programme of quantitative easing (QE) (purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields). The MPC 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.