Agenda Item No. 5

South Ayrshire Council

Report by Head of Finance and ICT to Audit and Governance Panel of 22 June 2021

Subject: Treasury Management Annual Report 2020/21

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1. Purpose

1.1 The purpose of this report is to present, in line with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, the annual report of treasury management activities for 2020/21 (as attached at Appendix 1), and seek Members' consideration of its contents.

2. Recommendation

2.1 It is recommended that the Panel:

2.1.1 considers the Annual Treasury Management Report 2020/21, as attached at Appendix 1; and

2.1.2 remits the Annual Treasury Management Report to the next Leadership Panel meeting on 24 August for approval.

3. Background

3.1 The Council is required through regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicators. 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).

3.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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.

3.3 The Head of Finance and ICT also confirms that the Council has complied with the requirements under the Code, to give prior scrutiny of treasury management reporting to the Council's Audit and Governance Panel prior to submitting the report to Leadership Panel.

3.4 Treasury management in this context is defined as:

'The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

4. Proposals

4.1 The Treasury Management Annual Report for 2020/21 is submitted to this Panel in accordance with the requirements of the CIPFA Code of Practice on Treasury Management, for consideration and thereafter will be remitted to the Leadership Panel on 24 August 2021 for approval.

4.2 ***Executive Summary***

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

Actual Prudential and Treasury Indicators	***2019/20 Actual £'000***	***2020/21 Actual £'000***
Capital Expenditure	**61,896**	**50,838**
Total Capital Financing Requirement (including other long-term liabilities)	341,748	350,040
PPP and Finance Lease	(102,219)	(99,567)
Underlying Borrowing Requirement	**239,529**	**250,473**
Gross External Debt	236,163	238,159
Under (Over) Borrowed	3,365	12,314
Cash/Investments	(51,975)	(73,390)
Net External Debt	**184,188**	**164,769**

4.3 The table above shows that the Council has an under-borrowed position at 31 March 2021 of £12,314m, c 5%. This means the Council has used some internal borrowing from cash/reserves to fund an element of its current capital expenditure requirements. It does not indicate that borrowing for the capital programme has not been under taken; only that internal cash resource has been used as funding, opposed to external borrowing.

4.4 Although this is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates, the Council's under-borrowed position is only 4.916% of its overall under-lying borrowing requirement and is therefore manageable within the current strategy. The strategy for 2020/21 is expected to maintain a marginal under-borrowed position whilst closely monitoring longer term PWLB and market rates in considering new borrowing.

4.5 Other prudential and treasury indicators are included in Appendix 1 to this report. The Head of Finance and ICT also confirms that any borrowing was only undertaken for capital purpose and the statutory borrowing limit (the authorised limit) was not breached during 2020/21.

4.6 The financial year 2020/21 continued the challenging investment environment of previous years, namely low investment returns.

5. Legal and Procurement Implications

5.1 There are no legal implications arising from this report.

5.2 There are no procurement implications arising from this report.

6. Financial Implications

6.1 General Services

6.1.1 ***Interest on Revenue Balances Held*** – the Council originally budgeted to receive £0.171m in interest income (based on a return of 0.75%) to the General Fund in 2020/21. Interest rates for investment remained low, however with the investment strategy out performing both the budget and benchmark this resulted in an enhanced return.

Investment income to the General Fund out-turned at £0.204m, a surplus of £0.33m. Interest was also received to the Council's Repairs and Renewals Fund and Insurance Fund to the value of £0.022m.

6.1.2 ***Capital Financing Costs*** - the Council originally budgeted £12.605m for financing costs and expenses on debt for 2020/21. This budget consisted of £5.507m in loan principal, £6.925m in interest and £0.173m in expenses. During 2020/21, a pragmatic approach was taken when considering the borrowing requirements to fund capital expenditure. The borrowing strategy during 2020/21 resulted in savings as under-noted:

	Budget £'000	**Out-turn £'000**	**Variance £'000**
Principal	5,507	5,507	0
Interest	6,925	6,180	745
Expenses	173	205	(32)
Capital Financing costs	**12,605**	**11,892**	**713**
Investment income	**(171)**	**(204)**	**33**
Total Debt charges	**12,434**	**11,688**	**746**

The borrowing strategy undertaken in 2020/21 resulted in an overall saving to the General Services of £0.746m.

6.2 Housing Revenue Account (HRA)

6.2.1 ***Interest on HRA Revenue Balances Held*** – the HRA budgeted to receive investment income of £0.075m on its revenue balances in 2020/21 based on achieving an interest rate of 0.75%. Similar to the General Fund the investment strategy was able to out-perform both budget and

benchmark resulting in a return of £0.110m in investment income a surplus of £0.035m

6.2.2 ***Capital Financing Costs*** - the HRA budgeted £4.164m for financing costs on debt for 2020/21. This consisted of £1.282m in loan principal, £2.812m in interest and £0.070m in expenses:

	Budget £'000	**Out-turn £'000**	**Variance £'000**
Principal	1,282	1,282	0
Interest	2,812	2,407	405
Expenses	70	80	(10)
Capital Financing costs	**4,164**	**3,769**	**395**
Investment income	**(75)**	**(110)**	**35**
	4,089	**3,659**	**430**

The borrowing strategy undertaken in 2020/21 resulted in an overall saving to the HRA of £0.430m.

6.3 In total, net debt financing costs were under spent by £1.108m, and when added to an over achievement in interest income of £0.68m resulted in an overall surplus of £1.176m which was reflected in the Council and HRA financial position at 2020/21.

7. Human Resources Implications

7.1 Not applicable.

8. Risk

8.1 ***Risk Implications of Adopting the Recommendations***

8.1.1 There are no risks associated with adopting the recommendations.

8.2 ***Risk Implications of Rejecting the Recommendations***

8.2.1 If the recommendations are rejected, then the Council will be non-compliant with the requirements contained in 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).

9. Equalities

9.1 The proposals in this report have been assessed through the Equality Impact Assessment Scoping process. There are no significant potential positive or negative equality impacts of agreeing the recommendations and therefore an Equalities Impact Assessment is not required. A copy of the Equalities Scoping Assessment is attached as Appendix 2.

10. Sustainable Development Implications

10.1 ***Considering Strategic Environmental Assessment (SEA)*** - This report does not propose or seek approval for a plan, policy, programme or strategy or document otherwise described which could be considered to constitute a plan, programme, policy or strategy.

11. Options Appraisal

11.1 An options appraisal has not been carried out in relation to the subject matter of this report.

12. Link to Council Plan

12.1 The matters referred to in this report contribute to Commitment 1 of the Council Plan: Fair and Effective Leadership/ Leadership that promotes fairness.

13. Results of Consultation

13.1 There has been no public consultation on the contents of this report.

13.2 Consultation has taken place with Councillor Brian McGinley, Portfolio Holder for Resources and Performance, and the contents of this report reflect any feedback provided.

Background Papers	**CIPFA Code of Practice for Treasury Management in Local Authorities** **Report to South Ayrshire Council of 5 March 2020 - Treasury Management Strategy - 2020/21** **Report to South Ayrshire Council of 19 January 2021 – Treasury Management Mid-Year Report 2020/21**
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Appendix 1

South Ayrshire Council

Treasury Management Annual Report 2020/21

Introduction

In accordance with the requirements of the CIPFA Code of Practice on Treasury Management in the Public Services, this report covers the following:

- Section 1 - The Council's Capital Expenditure and Financing 2020/21;
- Section 2 – The Council's overall borrowing need;
- Section 3 – Treasury Position as at 31 March 2021;
- Section 4 – The Strategy for 2020/21;
- Section 5 – The Economy and Interest Rates
- Section 6 – Borrowing Rates in 2020/21;
- Section 7 – Borrowing Out-turn 2020/21; and
- Section 8 – Investment Rates and Out-turn 2020/21.
- Section 9 – Other Issues

Section 1 The Council's Capital Expenditure and Financing 2020/21

1.1 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 have 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.

1.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual expenditure, how this was financed and the resulting borrowing requirement.

Table 1

Item	***2019/20 Actual £'000***	***2020/21 Estimate per Strategy***	***2020/21 Actual***
General Fund capital expenditure	39,102	66,766	33,334
HRA capital expenditure	22,794	39,295	17,504
Total	**61,896**	**106,061**	**50,838**
Resourced by:			
Government Grant and Other	(18,569)	(18,444)	(14,651)
Other funding identified	(18,263)	(14,383)	(18,455)
Borrowing :	**25,064**	**73,234**	**17,732**

1.3 The reason for the movement between planned expenditure/funding and actual out-turns for 2020/21 can be found in the General Services and HRA 2020/21 capital monitoring reports presented to Leadership Panel throughout 2020/21. The largest examples (by value) of reprofiling of spend in to 2021/22 being:

- Carrick Academy - £1.8m
- Shared Campus project (Glenburn and St Ninians PS's) - £1.5m
- Archive Registration Centre and Ayr Grammar School - £1.2m
- Early Learning and Childcare projects - £3.8m
- Ayr Leisure Facility - £3.5m
- Craigie Additional Sporting Facility - £3.5m
- Office Accommodation and Riverside project - £3.5m
- Hanger Space - £2.8m
- HRA Major component replacement programme - £14.7m
- HRA New Builds - £7.3m

Section 2 The Council's overall Borrowing Need

2.1 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 indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2020/21 unfinanced capital expenditure (Table 1), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

2.2 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 manages the Council's cash position to ensure that sufficient cash is available to meet not only the capital plans but also to manage the daily cash flow requirements of funding its revenue commitments of payroll, suppliers, benefits etc.

2.3 This borrowing for capital expenditure may be sourced through 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 (internal borrowing).

2.4 ***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 scheduled debt amortisation as a loan repayment, to reduce the CFR. This is effectively a repayment of the borrowing need and 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 also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- by charging more than the scheduled debt amortisation for loans repayment.

2.5 The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's CFR, however no borrowing is actually required against these schemes as a borrowing facility is included in these contracts.

The undernoted table shows the Council's underlying borrowing requirement, inclusive of PPP and Finance lease arrangements, as at 31 March 2021.

Table 2

Capital Financing Requirement	**31 Mar 2020 £'000**	**31 Mar 2021 £'000**
Opening Balance	**301,593**	**341,751**
Add unfinanced capital expenditure	25,064	17,732
Add new OLTL obligations (PPP)	25,216	993
Less loans fund repayment	(6,616)	(6,789)
Less PPP/ finance lease repayment	(3,506)	(3,645)
Closing Balance	**341,751**	**350,042**

The borrowing activity is constrained by prudential indicators for gross borrowing, CFR, and by the authorised limit. The increasing CFR position reflects the Council's capital programme expenditure in 2020/21 and the resulting borrowing requirements to fund this investment.

2.6 ***Gross Borrowing and the CFR*** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure.

This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs.

The table below highlights the Council's gross borrowing position against the CFR.

Table 3

Item	***31 March 2020 £'000***	***31 March 2021 £'000***
Capital Financing Requirement (CFR)	341,748	350,040
Gross External Borrowing Position (including PPP and finance Lease)	338,383	337,726
Net Under/ (Over) Borrowed Position	**3,365**	**12,314**

The table above shows the CFR in an under-borrowed position at 31 March 2021 of £12,314m. This means the Council has used some internal borrowing from cash/ reserves to fund an element of its current capital expenditure requirements

This is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates. The current strategy for

2021/22 is expected to maintain this under-borrowed position whilst closely monitoring longer term PWLB and market rates and consideration of potentially re-financing some of the temporary loan debt with longer term

2.7 ***Borrowing Prudential Indicators***

- **The Authorised Limit** – **Table 4** - the authorised limit is the maximum borrowing limit, beyond which the Council does not have the power to borrow. Table 4 below demonstrates that during 2020/21 the Council has maintained gross borrowing within its authorised limit.

- **The Operational Boundary – Table 4** – the operational boundary is the expected borrowing position of the Council during the year with headroom for daily cash flow variations. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

  The operational boundary position will be reviewed and updated in 2021/22 treasury reporting.
- **Actual Financing Costs as a Proportion of Net Revenue Stream** – **Table 5 -** this indicator identifies the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream of the Council.

Table 4

Item	*2019/20 £'000*	*2020/21 £'000*
Authorised Borrowing Limit External Debt	**414,821**	**424,375**
Borrowing	236,163	238,159
Other Long Term Liabilities	102,219	99,567
Total	**338,382**	**337,726**
Operational Boundary External Debt	**358,382**	**377,726**
Borrowing	236,163	238,159
Other Long Term Liabilities	102,219	99,567
Total	**338,382**	**337,726**

Table 5

Ratio of Financing Costs to Net Revenue Stream	***Actual 2019/20***	***Actual 2020/21***
General Services	6.33%	6.97%
HRA	10.79%	11.17%
Total	**7.02%**	**7.72%**

Section 3 Treasury Position

3.1 The Council's debt and investment position is administered 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, and through officer activity detailed in the Council's Treasury Management Practices.

At the end of 2020/21 the Council 's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 6

	Borrowing position as at 31 March 2020		***Borrowing position as at 31 March 2021***		***Change in year***
	£'000	***Average interest rate %***	***£'000***	***Average interest rate %***	***£'000***
Long Term Borrowing					
Public Works Loans Board	139,961	4.57	143,958	4.20	3,997
Market – Fixed	5,000	1.24	8,000	1.44	3,000
LOBO (Option Loans)	41,200	4.52	41,200	4.52	0
Total Long Term Borrowing	**186,161**		**193,158**		**6,997**
Short Term Borrowing	50,000	0.97	45,000	0.75	(5,000)
Total External Borrowing	**236,161**	**2.83**	**238,158***	**2.73**	**1,997**
CFR (underlying borrowing need)	239,526		250,472		(10,946)
Over (Under) Borrowing	**(3,365)**		**(12,314)**		**(8,949)**
Investments	**(51,975)**	**0.72**	**(73,390)**	**0.53**	**(21,415)**

* The carrying amount of loans on the Council's balance sheet as at 31 March 2021 is £239.000m. The difference between this figure and the external borrowing shown in Table 6 above is £0.842m of equivalent interest rate accounting adjustments required by the Code of Practice on local authority accounting.

3.2 **Table 7** below details the profile of the Council's loan maturity periods as at 31 March 2021.

Table 7

Maturity analysis of Debt Outstanding at 31 March 2021	***PWLB £'000***	***Market £'000***	***LOBO (Option) £'000***	***Temp Borrowing***	***Total £'000***
Maturing within 1 year	725	5,000	0	45,000	50,725
Maturing 1 to 2 years	4,774	0	3,000	0	7,774
Maturing 2 to 5 years	5,075	0	0	0	5,075
Maturing 5 to 10 years	12,410	0	3,000	0	15,410
Maturing 10 to 20 years	33,303	0	0	0	33,303
Maturing 20 to 30 years	9,005	0	10,500	0	19,505
Maturing 30 to 40 years	58,666	0	5,000	0	63,666
Maturing 40 to 50 years	20,000	0	9,700	0	29,700
Maturing > 50 years	0	0	10,000	0	10,000
Total	***143,958***	***5,000***	***41,200***	***45,000***	***235,158***

3.3 **Loans fund -** where a local authority has a Housing Revenue Account, the HRA should be reported separately from the General Fund. The reporting on the commitment to repay loans fund advances is for repayments only and does not include any interest costs. The Loans Fund balances are set out in Table 8 and Table 8(a) below:

Table 8 – Loans Fund Advances to General Fund

Loans Fund	**31 March 2020 (£'000)**	**31 March 2021(£'000)**
Opening Balance	159,366	169,639
Add advances	15,799	15,158
Less repayments	(5,526)	(5,507)
Closing Balance	**169,639**	**179,290**

Table 8(a) – Loans Fund Advances to HRA

Loans Fund	**31 March 2020 (£'000)**	**31 March 2021(£'000)**
Opening Balance	59,325	67,501
Add advances	9,266	2,574
Less repayments	(1,090)	(1,282)
Closing Balance	**67,501**	**68,793**

Section 4 Strategy for 2020/21

4.1 Investment returns which had been low during 2019/20, dropped 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 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 the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with large amounts of cheap credit so that banks could help businesses to survive the lockdown. The Government also supplied large 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 dropped.

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 increased slightly from previous years due to taking advantage of opportunities to obtain enhanced interest rates compared to the current market. However there has also been the continued 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.

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4.2 In this scenario, the treasury strategy was to slightly reduce temporary borrowing from £50m to £45m but to still take advantage in the short-term market which offered cheap funding, particularly in the inter local authority markets and to also fund the majority of the Council and HRA additional borrowing requirements from long term external borrowing (PWLB).

Section 5 Economy and Interest Rates

5.1 **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 then increased 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 increasing 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.

5.2. **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 European Central Bank (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, Pandemic Emergency Purchases Programme (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.

5.3 **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 Federal Reserve's (Fed) 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-performing 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 too much 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.

5.4 **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.

5.5 **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.

5.6 **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 not go ahead. 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 large 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.

Section 6 Borrowing Rates in 2020/21

6.1 ***PWLB Borrowing Rates -***

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

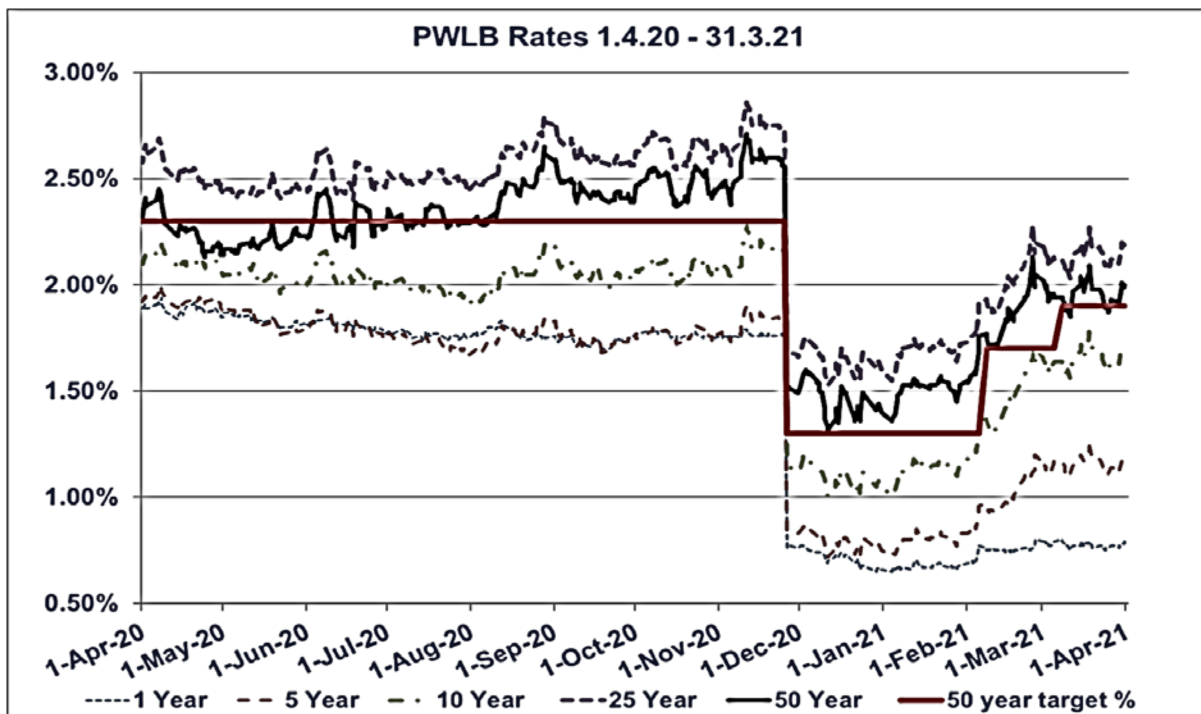
Gilt yields fell sharply from the start of 2020 and then spiked up during a financial market meltdown in March caused by the pandemic hitting western countries; this was rapidly countered by central banks flooding the markets with liquidity. While US treasury yields do exert influence on UK gilt yields so that the two often move in tandem, they have diverged during the first three quarters of 2020/21 but then converged in the final quarter. Expectations of economic recovery started earlier in the US than the UK but once the UK vaccination programme started making rapid

progress in the new year of 2021, gilt yields and 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)
- PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

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



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

Section 7 Borrowing Out-turn for 2020/21

7.1 During 2020/21 the Council funded part of the capital borrowing requirement in the short-term market, reducing temporary borrowing to £45.000m, at March 2021. However, additional long-term borrowing (PWLB) of £5.000m was also undertaken, taking advantage of low interest rates and gaps in the borrowing maturity profile. Due to low interest rates advantage was also taken of a long-term market borrowing (LA) of £3.000m. The Council were in an under-borrowed position of £12.314m for 2020/21. 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.

7.2 During 2021/22 focus will be on monitoring longer term rates and looking to borrow longer term to meet the CFR and at the same time look to maintain the temporary borrowing of £45.000m on the short-term market.

7.2 During 2020/21 the actual borrowing and repayments of external debt transacted are shown in Table 10 below. This shows temporary borrowing being reduced and longer term borrowing being undertaken, a prudent position in the current interest rate environment. The Council's policy is to ensure that not more than 25% of long-term loans are due to mature within any financial year. The indicator for maturing debt of 22% (within one year) is 3% below the maturity limit indicator.

Table 10

Loan Type	**Borrowed 2020/21 £'000**	**Repaid 2020/21 £'000**	**Net £'000**
PWLB	5,000	(1,004)	3,996
Market Loans	3,000	0	3,000
Temporary borrowing	63,500	(68,500)	(5,000)
	71,500	**(69,504)**	**1,996**

7.3 ***Debt Re-scheduling*** – no external debt was re-scheduled during 2020/21 as the average differential of 1% between PWLB new borrowing rates and premature redemption rates made early repayment of loans expensive and unviable due to the premiums that would be payable.

Section 8 Investment Rates, Out-turn and Policy in 2020/21

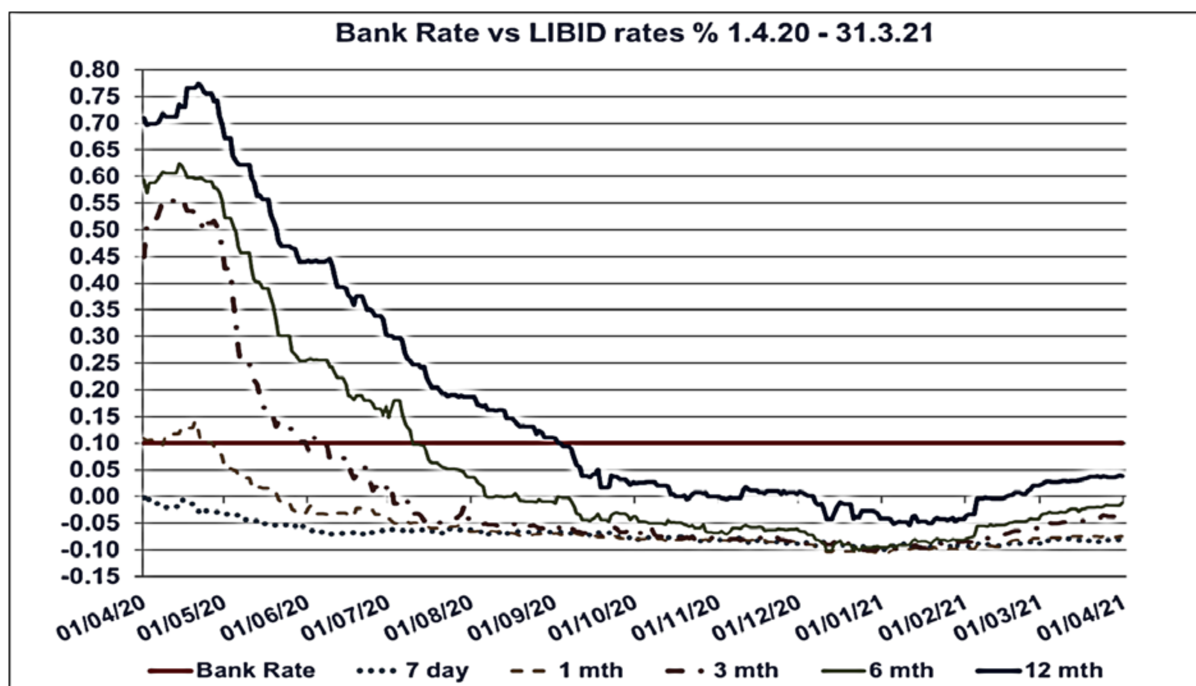
8.1 The Council's investment policy is governed by Scottish Government investment regulations, which have been implemented in the annual investment strategy approved by the Council on 5th March 2020. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the

three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Fig 2 and 3 below shows the bank rate and average of short-term rates generally available in the market for investment period up to 1 year.

Fig 2



Money Market Investment Rates 2020/21

Fig 3

	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

8.3 **Investment Out-turn –** the Council maintained an average balance of £57.6m of internally managed investment funds. The internally managed funds earned an average rate of return of 0.56%.

The comparable performance indicator is the average 3-Month LIBID rate which was 0.02%.

Table 11

	Average Value of Investments Held	*Rate of Return*	*Benchmark Return**
Investments	£57.572m	0.56%	0.02%

**The benchmark return used is the 3 month London Inter-bank bid rate (LIBID) of 0.02%. This represents the average rate that would be realised if deposits were placed on the inter-bank money market for continuing periods of 3 months throughout 2020/21.*

8.4 **Investment Policy** – the Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the Annual Investment strategy approved by the Council on 5 March 2020. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year met with the approved strategy, and the Council had no liquidity difficulties.

8.5 **Current Council Investments held at 31 March 2021.**

Table 12

Class	Type	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal £000
Deposit	Fixed	07/08/2020	06/08/2021	Cambridgeshire County Council	Maturity	0.80	5,000
Deposit	Fixed	12/08/2020	11/08/2021	Slough Borough Council	Maturity	1.00	5,000
Deposit	Fixed	07/09/2020	06/09/2021	London Borough of Croydon	Maturity	0.65	5,000
Deposit	Fixed	09/10/2020	10/10/2022	Rotherham Metropolitan Borough Council	Maturity	0.90	5,000
Deposit	Fixed	09/12/2020	08/12/2021	Liverpool City Council	Maturity	0.25	5,000
Deposit	Fixed	05/01/2021	04/01/2022	Derbyshire County Council	Maturity	0.25	5,000
Deposit	Fixed	30/03/2021	31/08/2021	London Borough of Haringey	Maturity	0.10	5,000
Deposit	Fixed	31/03/2021	30/09/2021	Goldman Sachs Bank	Maturity	0.245	5,000
Deposit	Fixed	31/03/2021	30/09/2021	Goldman Sachs Bank	Maturity	0.245	5,000
Fixed Total							**45,000**
Deposit	Variable	10/05/2016	-	Bank of Scotland (Call A/c)	Variable	0.05	15,390
Deposit	Variable	11/06/2020	-	Bank of Scotland (95d)	Variable	0.05	3,000
Deposit	Variable	11/08/2020	-	Santander (95d)	Variable	0.40	10,000
Call Total							**28,390**
Overall Total							**73,390**

Section 9 Other Issues

9.1 **Sources of borrowing** - Although PWLB remains a low risk source of long term borrowing due to recent rate changes and the ongoing consultation with local

authorities on the future of PWLB borrowing other borrowing institutions may be looked at to remove the reliance on PWLB for long term borrowing needs.

9.2 **Changes in risk appetite** - The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. South Ayrshire Council has a low risk appetite and as such would look at all aspects before making any changes to the current strategy and members would be made fully aware of any such changes.

9.3 **IFRS 16** - The implementation of IFRS 16 bringing currently off-balance sheet leased assets onto the balance sheet has had an additional delay and not now due to be implemented till 2022/23 due to Covid-19. However, this may attract additional audit scrutiny due to this delay. Work is currently ongoing in this area and will be progressed throughout 2021/22 with members being advised on any developments.

9.4 **Increase to Liquidity level** – Treasury Strategy for 2021/22 South Ayrshire's liquidity level was increased from £10m to £15m. This was to recognise the need to keep sufficient liquidity due to level of grants etc. that have come from Scottish Government to help deal with the coronavirus outbreak.

Appendix 2

south AYRSHIRE COUNCIL
Comhairle Siorrachd Àir a Deas
Making a Difference Every Day

South Ayrshire Council
Equality Impact Assessment
Scoping Template

Equality Impact Assessment is a legal requirement under the Public Sector Duty to promote equality of the Equality Act 2010. Separate guidance has been developed on Equality Impact Assessment's which will guide you through the process and is available to view here: https://www.south-ayrshire.gov.uk/equalities/impact-assessment.aspx

Further guidance is available here: https://www.equalityhumanrights.com/en/publication-download/assessing-impact-and-public-sector-equality-duty-guide-public-authorities/

The Fairer Scotland Duty ('the Duty'), Part 1 of the Equality Act 2010, came into force in Scotland from 1 April 2018. It places a legal responsibility on Councils to actively consider ('pay due regard to') how we can reduce inequalities of outcome caused by socio-economic disadvantage, when making strategic decisions. See information here: Interim Guidance for Public Bodies in respect of the Duty, was published by the Scottish Government in March 2018.

1. Policy details

Policy Title	**Treasury Management Annual Report 2020/21**
Lead Officer (Name/Position/Email)	Tim Baulk Head of Finance and ICT Tim.Baulk@south-ayrshire.gov.uk

2. Which communities, groups of people, employees or thematic groups do you think will be, or potentially could be, impacted upon by the implementation of this policy? Please indicate whether these would be positive or negative impacts

Community or Groups of People	Negative Impacts	Positive impacts
Age – men and women, girls & boys	No	No
Disability	No	No
Gender Reassignment (Trans/Transgender Identity)	No	No
Marriage or Civil Partnership	No	No
Pregnancy and Maternity	No	No
Race – people from different racial groups, (BME) ethnic minorities and Gypsy/Travellers	No	No
Religion or Belief (including lack of belief)	No	No
Sex – gender identity (issues specific to women & men or girls & boys)	No	No
Sexual Orientation – person's sexual orientation i.e. LGBT+, lesbian, gay, bi-sexual, heterosexual/straight	No	No
Thematic Groups: Health, Human Rights & Children's Rights	No	No

3. What likely impact will this policy have on people experiencing different kinds of social disadvantage? (Fairer Scotland Duty). Consideration must be given particularly to children and families.

Socio-Economic Disadvantage	Negative Impacts	Positive impacts
Low Income/Income Poverty – cannot afford to maintain regular payments such as bills, food, clothing	No	No
Low and/or no wealth – enough money to meet Basic living costs and pay bills but have no savings to deal with any unexpected spends and no provision for the future	No	No
Material Deprivation – being unable to access basic goods and services i.e. financial products like life insurance, repair/replace broken electrical goods, warm home, leisure/hobbies	No	No
Area Deprivation – where you live (rural areas), where you work (accessibility of transport)	No	No
Socio-economic Background – social class i.e. parent's education, employment and income	No	No

4. Do you have evidence or reason to believe that the policy will support the Council to:

General Duty and other Equality Themes **Consider the 'Three Key Needs' of the Equality Duty**	**Level of Negative and/or Positive Impact (High, Medium or Low)**
Eliminate unlawful discrimination, harassment and victimisation	Low Impact
Advance equality of opportunity between people who share a protected characteristic and those who do not	Low Impact
Foster good relations between people who share a protected characteristic and those who do not. (Does it tackle prejudice and promote a better understanding of equality issues?)	Low Impact
Increase participation of particular communities or groups in public life	Low Impact
Improve the health and wellbeing of particular communities or groups	Low Impact
Promote the human rights of particular communities or groups	Low Impact
Tackle deprivation faced by particular communities or groups	Low Impact

5. Summary Assessment

Is a full Equality Impact Assessment required? (A full Equality Impact Assessment must be carried out if impacts identified as **Medium and/or High**)	**YES** ☐ **NO** ☑

Rationale for decision:

This report presents to the Panel the annual report of treasury management activities for 2020/21. Their decision on this has no specific equality implications.

Signed : Tim Baulk **Head of Finance and ICT**

Date: 15 June 2021