TREASURY MANAGEMENT ACTIVITY DURING 2020/21

BORROWING REQUIREMENT AND DEBT MANAGEMENT

1. Based on the latest capital programme the Authority and resources available to the authority there is an estimated net increase in borrowing at the 31st March 2021 of £110.5M. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR) while useable reserves and working capital represent the underlying resources available for investments. These are the core drivers of TM Activity and the year-on-year change is summarised in table 1 below.

2. The Authority's current strategy is to maintain borrowing and investments below their underlying levels in order to reduce risk and keep interest costs low which has resulted in a forecast decrease of our internal borrowing of £33.1M as a result of lower useable reserves.

Table 1 – Balance Sheet Summary

	31-Mar-20 Actual £M	31-Mar-21 Strategy £M	31-Mar-21 Forecast £M	31-Mar-21 Forecast Movement in year £M
General Fund CFR	339.58	571.81	404.86	65.28
Housing CFR	169.13	207.52	177.82	8.69
Total CFR	**508.71**	**779.33**	**582.68**	**73.97**
Less Other Debt Liabilities*	(67.83)	(64.43)	(64.43)	3.40
Loans CFR	**440.88**	**714.90**	**518.25**	**77.37**
Less External Borrowing	(277.23)	(231.59)	(387.76)	(110.52)
Internal (over) Borrowing	**163.65**	**483.31**	**130.50**	**(33.15)**
Less Usable Reserves	(174.55)	(121.36)	(141.43)	33.12
Less Working Capital Surplus	(58.01)	(82.94)	(58.01)	0.00
New Borrowing or (Investments)	**(68.91)**	**279.01**	**(68.94)**	**(0.03)**

** finance leases, PFI liabilities and Transferred debt that form part of the authority's total debt*

3. The forecast movement in the CFR is one of the Prudential Indicators (PIs). When the strategy was last updated in February 2020, the forecast CFR for 31st March 2021 was £779.33M, the current forecast is £582.68M, a reduction of £167M. This decrease reflects slippage in borrowing on the capital programme, £166.9M on the General Fund and £29.7M on HRA. Forecast Movement in year is shown in the following table.

Table 2 – Capital Financing Requirement Movement in year

Capital Financing Requirement	**General Fund £M**	**HRA £M**	**Total £M**
Balance Brought forward	339.58	169.13	508.71
New Borrowing	75.21	8.69	83.89
MRP	(6.52)		(6.52)
Appropriations (to) from HRA	0.00	0.00	0.00
Movement in Other Liabilities	(3.40)		(3.40)
Estimated CFR 31 March 2021	**404.86**	**177.82**	**582.68**

4. The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years. This is shown in the tables below together with activity in the year.

5. ***Table 3: Borrowing and Investment Position***

	31-Mar-20 Actual £M	31-Mar-20 Average %	30-Sep-20 Actual £M	30-Sep-20 Average %	31-Mar-21 Forecast £M	31-Mar-21 Forecast %
Long Term Borrowing						
Public Works Loan	257.87	2.88	250.10	2.70	368.40	2.71
LOBO Loans from Banks	9.00	4.89	9.00	4.86	9.00	4.86
	266.87	**2.95**	**259.10**	**2.73**	**377.40**	**2.78**
Short Term Borrowing						
Other Local Authorities	10.00	0.92	0.00	0.39	10.00	0.64
Other	0.36	0.92	0.36	0.39	0.36	0.64
Total External Borrowing	**277.23**	**2.85**	**259.46**	**2.73**	**387.76**	**2.71**
Other Long Term Liabilities						
PFI Schemes	54.00	9.01	52.48	8.82	50.96	9.16
Deferred Debt Charges (HCC)	13.83	2.66	13.64	2.61	13.46	2.70
Total Gross External Debt	**345.06**	**3.87**	**325.59**	**4.08**	**452.18**	**3.65**
Investments:						
Managed In-House						
Government & Local Authority	0.00	0.00	(10.00)	0.11		
Cash (Instant access)	(31.11)	0.34	(30.81)	0.07	(10.00)	0.03
Cash (Notice Account)	0.00	0.00	0.00	0.00	0.00	0.00
Long Term Bonds	(3.01)	5.30	(3.01)	5.30	(3.00)	5.30
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.02)	4.35	(27.00)	3.84	(27.02)	3.00
Total Investments	**(61.15)**	**4.44**	**(70.82)**	**3.89**	**(40.02)**	**2.43**
Net Debt	**283.91**		**254.77**		**412.16**	

6. *Table 4: Forecast Movement in Gross External Debt during the year*

Movement during the year	2019/20 Actual £M	31-Mar-21 Movement £M	2020/21 Forecast £M
Long-term borrowing Carried Forward	206.34		266.87
Maturities in year	(39.47)		(35.25)
New borrowing in year	100.00		145.77
Net Long Term Borrowing	**266.87**	**110.52**	**377.40**
Short-term borrowing Carried Forward	40.36		10.36
Net Maturities in year	(40.36)		(10.36)
Net new borrowing in year	10.36		10.36
Net Short Term Borrowing	**10.36**	**0.00**	**10.36**
Total Borrowing at 31st March	**277.23**	**110.52**	**387.76**
Other Debt Liabilities	**67.83**	**(3.40)**	**64.43**
Total Debt at 31st March	**345.06**	**107.12**	**452.18**

Please note that these figures do not reflect the accounting convention of moving loans maturing in the year from long term to short term so will differ from the maturity analysis.

7. The maturity analysis of the Council's actual debt at 30th September 2020 is shown in the table below. Debt due in one year includes both short term and long-term

	loans due in year, LOBO loans are shown as uncertain as although they are within the call option they are unlikely to be called in the current interest environment.
8.	***Table 5: Maturity Structure of Borrowing***

Debt Maturity Profile	**Lower Limit %**	**Upper Limit %**	**Actual Debt as at 30/09/2020 £M**	**Average Rate as at 30/09/2020 %**	**% of Debt**	**Compliance with set Limits?**
Under 12 months	0	50	31.11	2.08%	12	Yes
12 months and within 24 months	0	50	8.50	2.69%	3	Yes
24 months and within 5 years	0	50	18.00	1.12%	7	Yes
5 years and within 10 years	0	55	30.00	1.12%	12	Yes
10 years and within 15 years	0	60	34.00	1.66%	13	Yes
15 years and within 20 years	0	60	5.00	4.60%	2	Yes
25 years and within 30 years	0	60	25.00	4.62%	10	Yes
30 years and within 35 years	0	60	36.70	3.54%	14	Yes
35 years and within 40 years	0	65	47.90	3.59%	18	Yes
40 years and within 45 years	0	75	14.25	3.70%	5	Yes
Uncertain*	0	5	9.00	4.86%	3	Yes
* Lobo's			**259.46**	**4.86%**	**100**	

Borrowing Update

9. On 9th October 2019 the PWLB raised the cost of certainty rate borrowing by 1% to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available and new products will be developed; however, the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

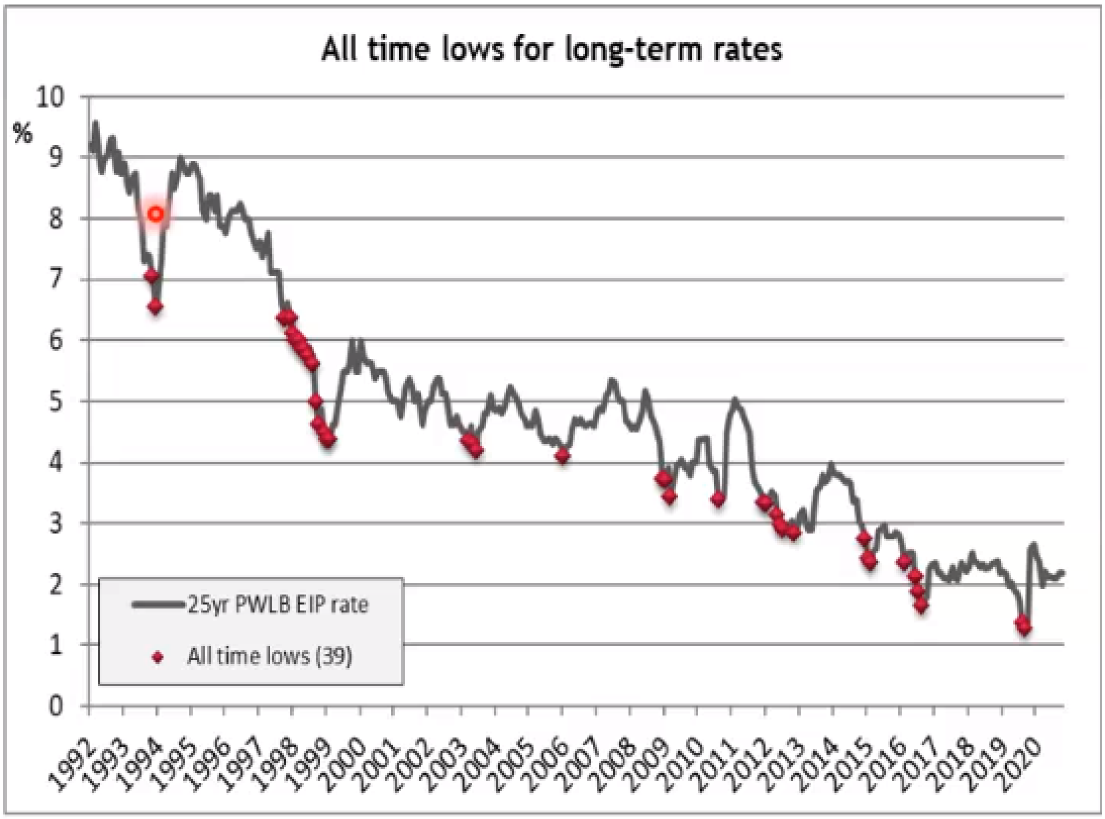
The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new HRA loans to 0.80% above equivalent gilt yields the value of this discount is 1% below the rate at which the authority usually borrows from the PWLB), available from 12th March 2020 and £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

The consultation titled "Future Lending Terms" allows key stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals on allowing authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield without impeding their ability to pursue their core policy objectives of service delivery, housing, and regeneration. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

The consultation closed on 31st July 2020 with the announcement and implementation of the new lending terms expected towards the end of year or early next year.

10. **Municipal Bonds Agency (MBA)**: The MBA revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor.

	As reported previously if the Authority were to consider future borrowing through the MBA, it would report to full council before engaging and seek advice from our financial advisors.
Borrowing Strategy during Period	
11.	At 30th September 2020 the Authority held £259.46M of loans, (a decrease of £17.77M since 31st March 2020), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans are summarised in Table 3 and 5 above.
12.	The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.
13.	In keeping with these objectives, no new borrowing was undertaken, and existing loans were allowed to mature whilst useable cash levels have remained above our minimum level of £10M. However this will not be sustainable as cash level drop through the year and we expect to have to borrow up to £11OM to cover the ongoing capital programme (£84M) and to refinance debt maturing in year. It is expected that short term borrowing will be taken from the end of December until a decision has been taken with regards to long term borrowing.
14.	The authority has an increasing CFR (see table 1 above) and even with increased borrowing we expect to remain below our CFR limit. It is estimated that the authority will have internal borrowing of £130.5M at the end of the year. This strategy enables the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
15.	The PWLB were the Council's preferred source of long-term borrowing given the transparency and control that its facilities continue to provide, but PWLB funding margins have lurched quite substantially in the last year and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields plus 0.80%, i.e. the PWLB HRA borrowing rate. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.
16.	However due to the continued depressed markets and the 'cost of carry' associated with long term debt, the Council will defer long term borrowing and continue to use internal resources to finance the capital programme to minimise the cost of TM by keeping debt interest payments as low as possible without compromising the longer-term stability of the portfolio. This will be kept under review during 2020/21 with the need to resource an increasing capital programme and if opportunities arise as with the borrowing taken in 2020/21. Our advisors assist with this 'cost of carry' and breakeven analysis.
17.	The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing will be maintained.
18.	The chart below shows the pattern of the 25 year PWLB rate since 1992, the rise in 2019 is where the 1% over gilts was implemented, but otherwise it has been a downward trend.



Lender's Option Borrower's Option Loans (LOBOs)	
19.	The council continues to hold £9M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS had options during the year, none of which were exercised by the lender, but if they were it is likely that they would be replaced by a PWLB loan.
Other Debt Activity	
20.	Although not classed as borrowing the Council has previously raised capital finance via Private Finance Initiative (PFI). The mid-year balance was £52.5M and will fall to £51M after further repayment in year.
21.	In addition, the Authority holds debt in relation to debt transferred from Hampshire County Council on the 1st April 1997 when we became a unitary authority which is being repaid over 50 years at £0.4M per annum, the balance at 30th September was £13.5M.
INVESTMENT ACTIVITY	
22.	Both the CIPFA and MHCLG's Investment Guidance requires the council to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low income returns.
23.	The initial reaction to the COVID crisis in March meant that short term liquidity became difficult and Government sought to assist cash flow by providing up front funding as far as possible, both in terms of the grants to businesses administered by the Council on its behalf and the funding to the local authority itself (under the business rates retention scheme).

24. Continued downward pressure on short-dated cash brought net returns on money market funds close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.

On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities

The impact of COVID-19 will continue during the year and will be reported at each quarter and as part of the mid-year Treasury Report to Governance Committee.

25. As a result of the grant funding year end investment balances were higher than expected and have remained so during the year to date but are expected to fall throughout the year to an estimated £40M by the end of the year, as we have a number of debt maturities and an ongoing capital programme, but this will be dependent on actual capital spend and movement in balances. Investment balances have ranged between £114M and £61M during the year and are currently £71M.

This supports our decision to only borrow for cash flow purposes at this stage as savings on borrowing costs more than offset the loss on short term investments.

Movement in year is summarised in the table below:

26. ***Table 6: Investment activity during the year***

	Balance on 01/04/2020 £M	Investments Repaid £M	New Investments £M	Balance on 30/09/2020 £M	(Increase)/ Decrease in Investment for Year £M	Average Life of Investments Life
Multi- National Bonds (not subject to bail in)	(3.01)			(3.01)	(0.00)	1.75 years
Money Market Funds and Call Account	(31.11)	201.72	(201.42)	(30.81)	0.30	1 day
Government & Local Authority	0.00	159.00	(169.00)	(10.00)	(10.00)	
Managed Externally (CCLA Pooled funds)	(27.02)	0.02		(27.00)	0.02	Unspecified
Total Investments	**(61.14)**	**360.74**	**(370.42)**	**(70.82)**	**(9.68)**	

27. Security of capital has remained the council's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its TM Strategy Statement for 2020/21. The council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio, which is supplied by our advisors. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual
Portfolio average credit rating	A	AA-

28.	Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating is A-) across rating agencies Fitch, S&P and Moody's); for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. The authority also used secured investments products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.
Credit Developments and Credit Risk Management	
29.	The UK sovereign rating was downgraded to AA- in March which was followed by a number of actions on UK and also non-UK banks from early April onwards, this then stabilised, and it has been relatively quiet for credit changes for the names on our counterparty list. There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days. Further information is available in Appendix 1, Economic Background.
30.	**Benchmarking:** Our advisors produce quarterly benchmarking which shows the breakdown of our investments and how we compare to their other clients and other English Unitary. Details can be seen in Appendix 3. It shows that on average the return on our internal investments at 0.43% is higher than the average of 0.27% and our overall return including the Local Authority Property Fund (income only) is 1.79% as opposed to the average of 0.90%. This has been achieved without impacting on our average credit rating which at AA- is in line with both other Local Authorities and Unitary Authorities.
Liquidity Management	
31.	In keeping with the MHCLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and call accounts. There is no perceived risk that the Council will be unable to raise finance to meet its commitments. The Council also has to manage the risk that it will be exposed to replenishing a significant proportion of its borrowing at a time of unfavourable interest rates. The Council would only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.
Externally Managed Funds	
32.	The Council has invested £27M in property funds which offer the potential for enhanced returns over the longer term but will be more volatile in the shorter term. These funds are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.
33.	Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that

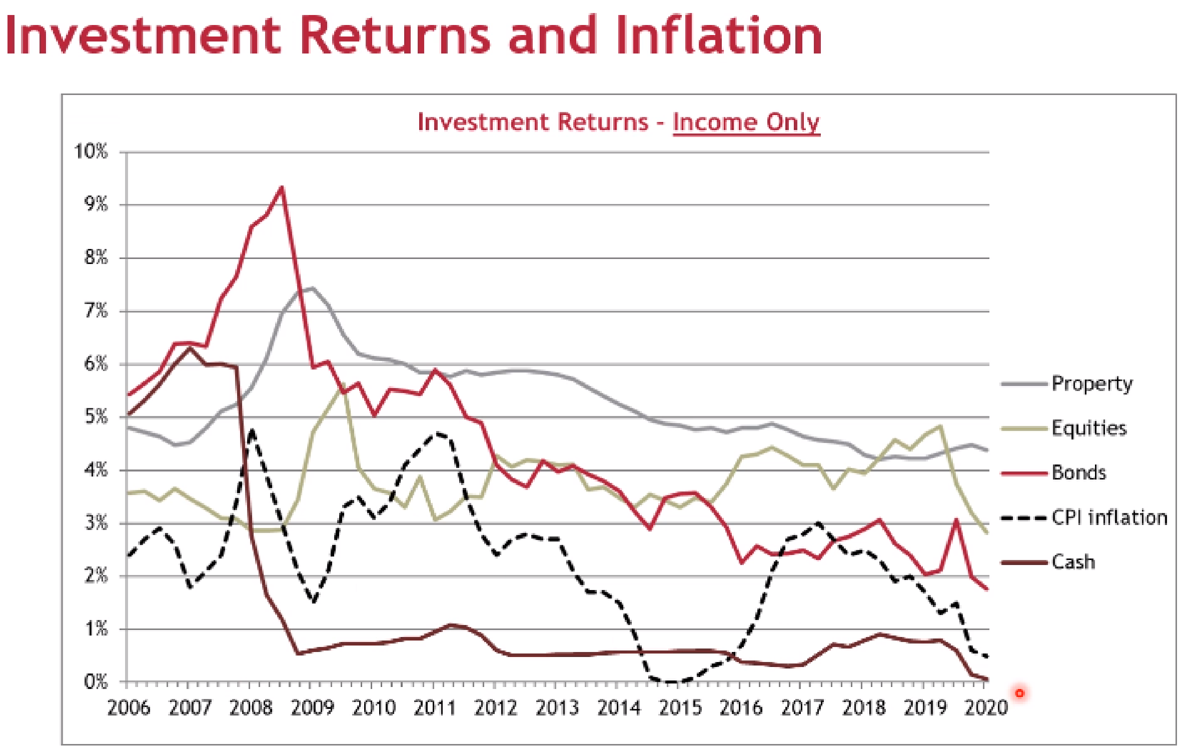
over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained.

34. During 2019/20 this investment returned £1.2M at an average yield of 3.84% against the initial investment, however since the onset of the COVID-19 pandemic and the current global economic environment, the value of the fund fell to £26.47M at 31st March 2020 a reduction of £0.53M against the original investment.

This trend has continued into 2020/21 and the fund is currently valued at £25.37M, £1.63M lower than original investment. This notional "loss" will only be a cost to the Authority at the point the investment is sold as the Authority is using the alternative fair value through profit and loss (FVPL) accounting and can defer the funds' fair value losses to the Pooled Investment Fund Adjustment Account until 2023/24, by which time it is anticipated that the global economic environment will have improved.

The estimated return for the year has improved from the last quarter and is now expected to be about 85% of that for 2019/20, £1.03M.

35. The chart below demonstrated that despite the recent fall in returns that property is the highest returning investment especially in relation to cash.



Non – Treasury Investments

36. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

37. Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment being used to fund council services, known as the Property investment fund (PIF).

38. All of the properties remain fully let and the tenants are meeting their financial obligations under the leases. The rate of return on these investment in 2020/21 is

	expected to be 6.03% gross and 2.13% net (after borrowing costs of £1.2M) which represents a contribution to the revenue account of around £0.63M.