Annexes B & C to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Appendix 1

Draft Treasury Management Annual Report 2020/21

Cardiff Council

Introduction

1. Treasury management activities are the management of the organisation's investments and 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.

2. The Council carries out its treasury management activities in accordance with a code developed for public services and updated in 2017 by the Chartered Institute of Public Finance and Accountancy (CIPFA). The code is currently the subject of a consultation, with an update expected in late 2021.

3. The Council has delegated responsibility for treasury management to the Corporate Director of Resources (S151 Officer). The Council's Treasury Management Practices which are updated annually, identifies specific responsibilities of officers as well as setting out schedules highlighting the way in which treasury activities are managed.

4. On 25th February 2010, Council approved policies and adopted the four clauses of the treasury management code which are replicated in **Annexe A** for information. Council received a report in February 2020 on the Council's Treasury Management Strategy for 2020/21 and a mid-year review in November 2020.

5. The Treasury Management is an integral part of the Council's Strategic and Financial planning framework, with borrowing activities primarily as a consequence of historic and future capital expenditure approved by Council as part of the Council's Capital Investment programme.

6. This report provides members with an annual report for the Council's Treasury Management activities for 2020/21. It covers:-

- the economic background to treasury activities
- treasury investment strategy and outturn for 2020/21
- borrowing strategy and outturn for 2020/21 including debt rescheduling
- compliance with treasury limits and prudential indicators
- treasury management issues for 2020/21.

7. Council requires scrutiny of the accounting, audit and commercial issues of its Treasury Management Strategy and practices to be undertaken by the Council's Governance and Audit Committee. A number of reports were submitted to the Committee to note and review during the year, with committee receiving regular updates on the position and performance of treasury investments and borrowing. A glossary of key treasury management terms is included at Annexe E.

Economic Background

8. The first national lockdown, instigated in response to the COVID-19 pandemic in late March 2020 impacted significantly on economies globally. The impact felt, exceeded the economic downturn experienced post the financial crisis of 2008/09. Further lockdowns in November 2020 and January 2021 were actioned, but businesses and individuals had become more resilient in adapting to working in new ways during the latter part of 2020/21. The advent of vaccines starting in November 2020, were a 'game changer' aiding economic recovery and the eventual reopening of the economy.

9. During 2020/21, financial markets were concerned that the UK Bank Rate would be negative however this was firmly discounted at the February 2021 Monetary Policy Committee (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. 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% inflation target sustainably". That seemed 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.

10. The Chancellor implemented repeated rounds of support to businesses by way of cheap loans and other measures to protect jobs. This support came at a huge cost in terms of the Government's budget deficit ballooning in 2020/21 and 2021/22 so that the Debt to GDP ratio reached around 100%. The UK Budget on 3 March 2021 increased fiscal support to be followed by substantial tax rises in the following three years to help to pay the cost for the pandemic.

11. In respect to Brexit, the final agreement on 24 December 2020 eliminated a significant downside risk for the UK economy. However, 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.

12. Brexit and the pandemic exposed how frail extended supply lines were around the world. In terms of direct impacts on the Council, this will have an impact on costs of construction and availability of materials, increasing risk.

Investments and Outturn

13. The Council's treasury investments include those arising from its own temporary cash balances as well as balances held from activities of Joint Committees such as the Cardiff Capital Region City Deal, for which it is the accountable body.

14. The management of the day-to-day cash requirements of the Council is undertaken in-house with credit advice from Link Asset Services, the Council's Treasury Management advisors. This may involve temporary borrowing pending receipt of income or the temporary lending of surplus funds. Investment balances fluctuate daily and arise from a number of sources including differences in timing of revenue and capital cash flows, reserves, provisions and other balances held for future use.

15. The Council invests with institutions approved by Council as part of its Treasury Management Strategy and in accordance with investment guidelines established by the Welsh Government. As part of the Markets and Financial Instruments Directive II, the Council elected for 'professional' status. The categories, names, periods and size limits on the Council's approved investment list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers and monitored closely in conjunction with the Council's treasury advisors.

16. At 31 March 2021, investments stood at £141.4 million, with a short term investment strategy employed particularly at the start of the year to mitigate against liquidity risk. The Council's choice of investments maintained an approach of security, where the amount invested is that repayable. **Annexe B** shows with whom these investments were held.

17. A selection of performance indicators and benchmarking charts in relation to investments is included in **Annexe C.** The main areas to highlight at 31 March 2021 are as follows:-

    - Counterparty exposure against the maximum allowed directly with an organisation. This shows that at 31 March 2021 no exposure limits set were breached. This was also the case during the course of the year.
    - Investments held with different institutions as a percentage of the total shows that investments are diversified over a number of organisations and this was a strategy applied where possible during the course of the year.
    - The geographic spread of investments as determined by the country of origin of relevant organisations. All investments are in sterling and countries are rated AA and above as per our approved criteria.

18. Using historic data adjusted for current financial market conditions, the probability of any default is low at circa 0.01% of the investments outstanding, i.e. £11,170.

19. All investments held at 31 March 2021 are deemed recoverable. Accordingly, no impairment losses are reflected in the Council's 2020/21 Statement of Accounts arising from the Council's treasury management activities.

20. The overall level of interest receivable from treasury investments totalled £0.364 million in 2020/21. The average returns achieved compared to current industry benchmarks are shown in the table below.

	Return on Investment 2019/20		Return on Investment 2020/2021	
	Benchmark 7day / 3month (%)	**Achieved (%)**	**Benchmark 7day / 3month (%)**	**Achieved (%)**
In-house	0.53 / 0.63	0.85	(0.02) / 0.00	0.22

21. The benchmarks are the average of the 7-day London Interbank Bid Rate (LIBID) and 3-month LIBID respectively. These represent the average rate during the course of the year for investments for those periods. Performance exceeded benchmarks, due to availability of notice accounts offering higher deposit rates and undertaking longer term deposits where appropriate. As can be seen from the benchmarks, investment rates plunged during 2020/21 to near zero or into negative territory. Following a review led by the Bank of England, LIBOR will be phased out during 2021 and this means that the current LIBID investment benchmark will also be removed. The intention is to replace LIBID with the Sterling Overnight Index Average rate (SONIA) when the changes to LIBOR and LIBID have been completed.

22. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with massive amounts of credit so that banks could help cash-starved businesses to survive the lockdown. 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. These reductions will be reflected in interest receivable assumptions for 2021/22 and future years.

23. The Council continued to take a cautious approach to investing and 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.

Borrowing and Outturn

24. Borrowing is undertaken to finance the Council's capital programme and manage any short-term cash flow requirements. The main sources of borrowing are identified in the table below.

25. At 31 March 2021, the Council had £810.7 million of external borrowing. This was predominantly fixed interest rate borrowing from the Public Works Loan Board (PWLB) payable on maturity.

31 March 2020			31 March 2021	
£m	**Rate (%)**		**£m**	**Rate (%)**
698.9		Public Works Loan Board	698.9	
51.0		Market (Lender Option Borrower Option)	51.0	
20.6		Welsh Government	22.5	
58.3		Local Authorities and other	38.3	
828.8	**4.11**	**Total External Debt**	**810.7**	**4.17**

26. All borrowing is in the name of the Council and a single pool of debt is maintained rather than having separate loans for the HRA. Total interest payable on external debt during 2020/21 was £34.0 million of which £12.7 million was payable by the Housing Revenue Account (HRA). In total £38.1 million was set aside from General Fund and HRA revenue budgets in line with the Councils approved policy on prudent provision for debt repayment.

27. Extracts from the borrowing strategy approved by Council in February 2020 are shown below.

> *The Council's Borrowing Strategy for 2020/21 and the capital financing revenue budgets included in the MTFP will consider all options to meet the long-term aims of:*
> - *promoting revenue cost stability to aid financial planning and avoid a stop-start approach to service delivery, although it is recognised that this may have a financial impact*
> - *pooling borrowing and investments to ensure the whole Council shares the risks and rewards of treasury activities*
> - *Ensuring borrowing plans are aligned to known capital expenditure spending plans and financial reserve levels*
> - *achieving a balanced maturity profile*
> - *having regard to the effects on current and future Council Tax and Rent Payers.*

> *External verses internal borrowing*
> Whilst interest rates for borrowing are greater than interest rates the Council receives for investments (the cost of carry), it makes financial sense to use any internal cash balances held in the short-term to pay for capital expenditure and minimise costs (internal borrowing), rather than undertake external borrowing. However, there is a risk that the Council may have to borrow at higher rates when it does actually need to borrow in future and so this position is kept under continuous review.

28. During 2020/21, the Council repaid £21.2 million of maturing loans. Interest free loans totalling £3.1 million were received from the Welsh Government in respect of Town Centre loan scheme and energy efficiency schemes. The overall effect of these transactions during the year was to increase the average rate on the Council's borrowing

to 4.17% at 31 March 2021 primarily due to the maturity of lower rate short term borrowing.

29. As part of its loan portfolio, the Council has six Lender Option Borrower Option (LOBO) loans totalling £51 million. These are where the lender can request a change in the rate of interest payable by the Council on pre-determined dates. The Council at this point has the option to repay the loan, but this option is conditional and would require the lender to ask for an increase in the current rates to trigger such an event. Apart from the option to increase rates these loans are comparable to PWLB and have no other complications such as variation in interest rates or complex terms.

30. Interest rates on the LOBO's held range between 3.81% and 4.35% which are not unreasonable given the council's average rate. Details of the loans are shown in the table below.

31. None of the LOBO's had to be repaid during 2020/21. £24 million of the LOBO loans are subject to the lender having the right to change the rate of interest payable during the next financial year. The Council has the right to refuse the change, triggering early repayment and the need to re-finance. This is a manageable refinancing risk as LOBO's form a relatively low proportion of the Council's overall borrowing at 6.29%.

£m	Rate	Potential Repayment Date	Option Frequency	Full Term Maturity
6	4.28%	21/05/2021	6 months	21/11/2041
6	4.35%	21/05/2021	6 months	21/11/2041
6	4.06%	21/05/2021	6 months	23/05/2067
6	4.08%	01/09/2021	6 months	23/05/2067
5	4.10%	16/01/2023	5 years	17/01/2078
22	3.81%	21/11/2020	5 years	23/11/2065

32. In accordance with the strategy, the Council has been in a position of undertaking internal borrowing which is when it uses temporary cash balances it holds in the short term instead of undertaking external borrowing. The level of internal borrowing is £30 million as at 31 March 2021, and this is confirmed by a comparison of the Council's external level of debt and its Capital Financing Requirement at 31 March 2021 as shown later in this report.

33. In October 2019, the Government introduced an unexpected policy increase of 100 (1%) basis points in PWLB rates on top of the then current margin over gilt yields of 80 basis points and in March 2020, started a consultation process for reviewing PWLB borrowing for different types of local authority capital expenditure.

34. On 25 November 2020, the Chancellor announced the conclusion to the review and the standard and certainty margins were reduced by 1%. However, a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchases of 'assets for yield'.

35. In summary, an approach of avoiding new borrowing by running down cash balances currently results in short term savings and this was the approach taken in 2020/21, where new borrowing was limited (except for £3.1 of specific loans from Welsh Government referred to in Para 28). PWLB borrowing policy changes were also a key factor in decision making in terms of timing of borrowing. The borrowing strategy will continue to look at options to manage the Council's future borrowing requirement, taking a cautious approach and taking advantage of rates to secure long term certainty where possible.

Debt Rescheduling

36. No debt rescheduling or early repayment of debt was undertaken during 2020/21. The main obstacle remains the level of premium (penalty) that would be chargeable on early repayment by the PWLB. The premium payable on the balance of PWLB loans at 31 March 2021, which are eligible for early repayment (£693 million), is £474 million. This premium is payable primarily because:-

- Interest rates on loans of equivalent maturities compared to those held are currently lower
- A penalty rate or lower early repayment rate was introduced by HM Treasury in November 2007, which increased the cost of premiums and reduced flexibility of Local Authorities to make savings. This has been a significant thorn in the ability of local authorities to manage debt more effectively.

37. The Council has previously considered the opportunity for early repayment of LOBO loans but any required premiums payable are unviable. Whilst the cost of premiums can be spread over future years, options for restructuring that have been considered result in an adverse Net Present Value (NPV). Whilst there may have been short terms savings, these were outweighed by potentially longer-term costs and not deemed cost effective.

Compliance with treasury limits and prudential indicators

38. During the financial year the Council operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy. The actual outturn is shown in the following paragraphs and compared to the original estimates contained in the 2020/21 Budget Report. Future year's figures are taken from the Budget Report for 2021/22 and will be updated in the Budget Report for 2022/23.

Capital Expenditure

39. The "Prudential Code" requires the Council to estimate the capital expenditure that it plans to incur over the Medium Term. The actual capital expenditure incurred in 2020/21 and estimates of capital expenditure for the current and future years as set out in the Budget Report of March 2021 are as follows:-

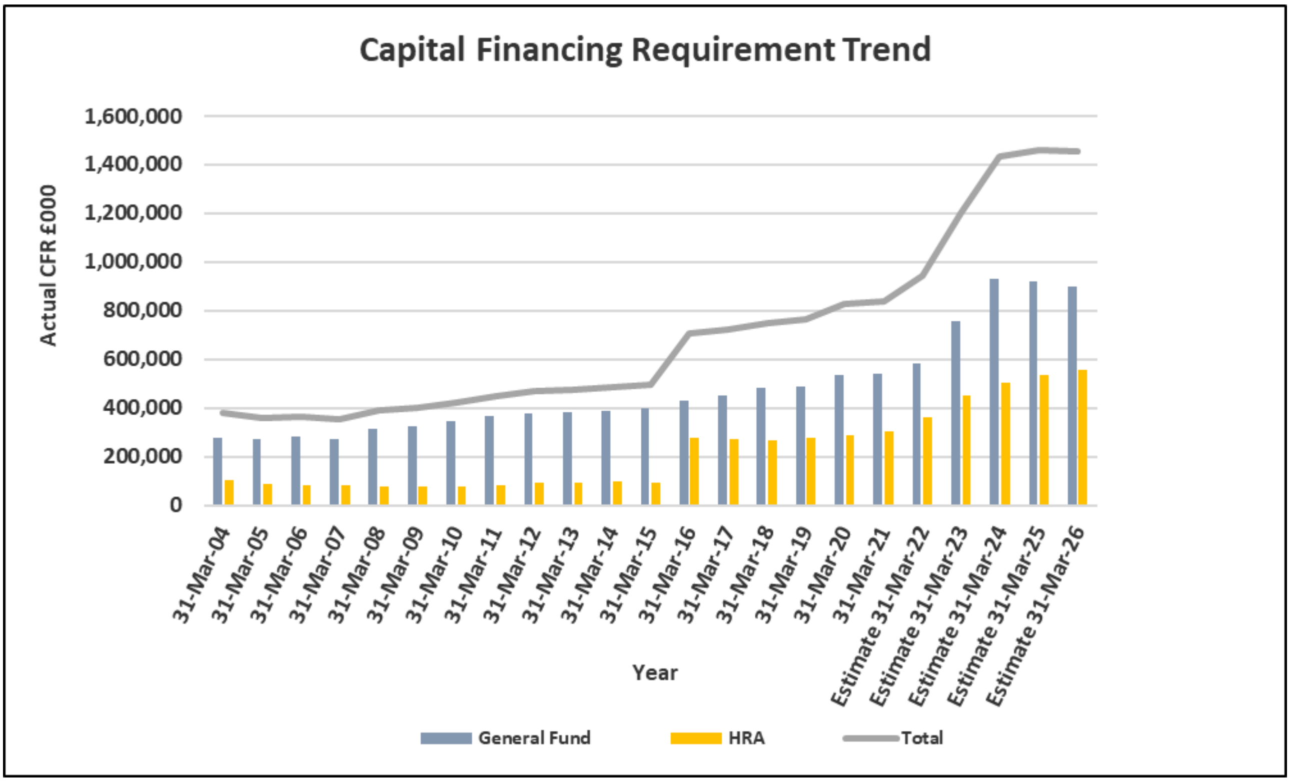
Capital Expenditure							
	2020/21 Actual £m	2020/21 Original Estimate £m	2021/22 Estimate Month 4 £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
General Fund	112	137	168	251	271	121	69
Housing Revenue Account	54	57	66	118	91	70	51
Total	**166**	**194**	**234**	**369**	**362**	**191**	**120**

Capital Financing Requirement (CFR) – The Borrowing Requirement (Excluding Landfill Provision)

40. Where capital expenditure has been incurred without a resource to pay for it i.e. when proposed to be paid for by supported or unsupported borrowing, this will increase what is termed the Council's Capital Financing Requirement (CFR) which is the Council's underlying need to borrow. The Council is required to make a prudent provision for the repayment of historic capital expenditure from its revenue budget in line with its agreed policy which reduces the CFR. Calculation of the CFR is summarised in the table below and results in the need to borrow money.

Movement	Opening Capital Financing Requirement (CFR)
+	Capital expenditure incurred in year
-	Grants, contributions, reserves and receipts used for capital expenditure
-	Prudent Minimum Revenue Provision and Voluntary Repayment
=	**Closing Capital Financing Requirement (CFR)**

41. The chart below shows the trend in the CFR including the Housing Revenue Account. The latter includes the £187 million payment made from the HRA to HM Treasury to exit the subsidy system in 2015/16 and also future expenditure to create new Council owned affordable housing in accordance with the Housing 30 Year Business Plan. The increase for the general fund relates to previous commitments and new expenditure commitments primarily those assumed to pay for themselves from future income or savings such as the indoor arena, City Deal and the 21st century school's financial model. Future projections of the CFR are based on the timing of the Capital investment programme and resources deemed available to fund it.



42. The CFR as at 01 April 2020 was £829 million. The actual CFR as at 31 March 2021, estimates for current and future years (estimated in the March 2021 budget) are shown in the table below and exclude non cash backed provisions in relation to Landfill after care provision:-

Capital Financing Requirement (Excludes landfill provision)							
	2020/21 Actual £m	**2020/21 Original Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**
General Fund	540	544	584	755	930	920	900
Housing Revenue Account	301	326	362	449	505	538	555
Total CFR	**841**	**870**	**946**	**1,204**	**1,435**	**1,458**	**1,455**
External Debt	**811**						
Over / (Under) Borrowing	**30**						

43. By comparing the CFR at 31 March 2021 (£841 million) and the level of external debt at the same point in time (£811 million), it can be seen that the Council is internally borrowed.i.e. it is using internal cash balances to finance its capital expenditure as at 31 March 2021 (£0 *million at 31 March 2020).*

44. As set out in the March 2021 Budget Report, the CFR is forecast to increase over the next five years due to capital programme investment in existing assets, major projects

including the arena, development of new affordable housing, and the 21st century school's programme. Forecasts will be updated in the 2022/23 Budget Report.

Actual External Debt

45. The Code requires the Council to indicate its actual external debt at 31 March 2021 for information purposes. This was £811 million as shown in the earlier paragraphs.

Affordable Borrowing Limit

46. The Council has a statutory duty under section 3 of the Local Government Act 2003 and supporting regulations to determine and keep under review how much it can afford to borrow and to enter into credit arrangements (the "Affordable Borrowing Limit"). This cannot be breached without Council approval. Council must have regard to the Prudential Code when setting this limit which is intended to ensure that total capital investment remains within sustainable limits and that the impact upon future council tax/rent levels is affordable.

47. During 2020/21 the Council remained within the authorised limit of £1,126 million set for that year.

Operational Boundary

48. The operational boundary is the estimated level of external borrowing set at the start of the year and is subject to the level and timing of borrowing decisions during the year. The actual level of borrowing can therefore be below or above this initial estimate, but what cannot be breached is the affordable borrowing limit mentioned above. The boundary was estimated to be £870 million at 31 March 2021, to match the forecast for the CFR when setting the 2020/21 budget in March 2020.

Maturity Structure of Fixed Rate Borrowing

49. The maturity structure remains within the limits below approved as part of the 2020/21 strategy below. These limits are set to avoid having large amounts of debt maturing in a short space of time, thus being exposed to significant liquidity risk and interest rate risk.

	31-Mar-20			31-Mar-21			
	Loans to Maturity		Upper limit	Loans to Maturity		Loans if LOBO's Paid Early	
	%	£m	%	%	£m	%	£m
Under 12 months	2.6	21.2	10	3.33	27.0	6.29	51.0
12 months and within 24 months	3.3	27.0	10	2.80	22.7	3.42	27.7
24 months and within 5 years	3.7	30.5	15	1.65	13.4	4.36	35.4
5 years and within 10 years	6.5	53.8	20	8.18	66.3	8.18	66.3
10 years and within 20 years	21.0	174.3	30	21.62	175.3	21.62	175.3
20 years and within 30 years	20.4	169.0	35	20.97	170.0	19.49	158.0

30 years and within 40 years	25.6	212.7	35	26.24	212.7	26.24	212.7
40 years and within 50 years	16.3	135.3	35	14.59	118.3	10.40	84.3
50 years and within 60 years	0.6	5.0	15	0.62	5.0	0.00	0.0

50. The maturity profile of the Council's borrowing as at 31 March 2021 is also shown in a chart in **Annexe D**. In the medium to long term, efforts will be made to restructure loans maturing in 2056/57 and to review LOBO maturities in order to reduce refinancing risk. Benchmarking previously undertaken has demonstrated that the Council's maturity profile is not inconsistent with other local authorities where information is available.

Ratio of financing costs to net revenue stream

51. This indicator identifies the trend in the cost of capital financing, showing the percentage of the Council's revenue budget that is committed for this purpose. Financing costs include:

- interest payable on borrowing and receivable on treasury investments
- penalties or any benefits receivable on early repayment of debt
- prudent revenue budget provision for repayment of capital expenditure paid for by borrowing and
- re-imbursement of borrowing costs from directorates in respect of Invest to Save/Earn schemes.

52. For the General Fund, net revenue stream is the amount to be met from non-specific WG grants and Council Tax, whilst for the HRA it is the amount to be met from rent payers.

Ratio of financing costs to Net Revenue Stream							
	2020/21 Original Estimate %	**2020/21** Actual %	**2021/22** Estimate %	**2022/23** Estimate %	**2023/24** Estimate %	**2024/25** Estimate %	**2025/26** Estimate %
General Fund – **Net** Capital Financing Budget	4.61	4.73	4.68	4.81	5.19	5.40	5.34
General Fund – **Gross** Capital Financing Budget	6.94	6.99	7.27	7.42	8.82	9.76	9.56
HRA	34.66	32.72	33.93	34.09	36.70	38.00	38.53

53. Although there may be short term implications, invest to save/earn schemes are intended to be net neutral on the capital financing budget. However, there are risks that the level of income, savings or capital receipts anticipated from such schemes will be delayed or will not materialise. This would have a detrimental long-term consequence on the Revenue budget and requires careful monitoring when considering future levels of additional borrowing.

54. Accordingly, an additional local indicator is calculated for the general fund to support decision making and is shown in the table below for the period up to 2025/26. These

indicators, which will be updated in the budget proposals report for 2022/23, show capital financing costs of the Council as a percentage of its controllable budget, excluding treasury investment income:

Capital Financing Costs as percentage of Controllable Budget									
	2011/12 Actual %	2020/21 Original Estimate %	2020/21 Actual %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %	Difference 11/12-25/26 %
Net	13.47	11.21	11.34	11.00	11.40	12.52	13.11	12.98	(3.64)
Gross	15.17	16.02	16.37	17.02	17.51	21.19	23.59	23.13	52.47

55. An increasing percentage indicates that a greater proportion of the controllable budget is required for capital financing costs which are committed in the long term. The requirement to meet these additional costs can only come from future savings or from increases in Council Tax. An increasing ratio limits the scope for additional borrowing in future years and reduces the Council's overall flexibility when making decisions on the allocation of its revenue resources. The percentages take into account the impact on the controllable base budget of the level of savings having to be found in 2021/22 and over the medium term. They are based on future assumptions in respect to Aggregate External Financing, council tax income and housing rents at a point in time. Any adverse change in these variables may have a significant impact on the outlook for this indicator.

Principal Invested for over 364 days

56. An upper limit for principal invested over 364 days was set at £90 million and this was not breached during the year, primarily due to the strategy adopted of minimising the period for which investments were made during 2020/21

Treasury Management issues for 2021/22 and future years

57. Whilst this report is primarily backward looking in relation to Treasury Activities for 2020/21, some key issues for 2021/22 are:

- The timing of external borrowing to pay for the Council's longer term need to borrow and securing some certainty whilst interest rates remain low.
- Highlighting need for the Council to ensure compliance with HM Treasury revised lending policies and processes aimed to prevent borrowing undertaken to fund investment purely for financial gain. It should be noted that any such expenditure would preclude any borrowing from the PWLB.
- Maximising value from temporary cash balances and avoiding negative interest rates in a low interest rate environment.
- Assessing the impact of and implementing changes expected in respect of treasury skills, processes and reporting requirements likely to be introduced as part of the CIPFA Treasury Management Code update.

- Understanding and developing processes and impact on Capital and Treasury Management indicators in respect to Lease accounting and reporting changes introduced as part of International Financial Reporting Standard 16 in 2022/23.
- Updating the Treasury Management Strategy for the 2022/23 budget in line with any updates to the Capital Investment Programme forecasts and scheme delivery including the impact of major regeneration projects.
- Ongoing financial market uncertainty.

58. In accordance with the Council's Treasury Management Policy, Council will receive a further update on Treasury Management issues as part of the 2021/22 Mid-Year Treasury Management report in November 2021.

Christopher Lee
Corporate Director Resources
28 September 2021

The following Annexes are attached:-
Annexe A – Treasury Management Policy and Four Clauses of Treasury Management
Annexe B – Investments at 31 March 2021
Annexe C – Investment charts at 31 March 2021
Annexe D – Maturity analysis of debt as at 31 March 2021
Annexe E – Glossary of Treasury Management terms