Paper B

SOMERSET
County Council

Annual Treasury Management Outturn Report 2020-21

Cabinet Member(s): Cllr Mandy Chilcott – Cabinet Member for Resources
Local Member(s) and Division: All
Lead Officer: Jason Vaughan – Director of Finance (Section 151 Officer)
Author: Alan Sanford – Principal Investment Officer
Contact Details: alsanford@somerset.gov.uk or (01823) 359585

1. Summary / Background

1.1. The Annual Treasury Management Outturn Report is a requirement of the CIPFA Treasury Management Code and covers the Treasury Management activity for 2020-21. This report:

- Is prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code.
- Gives details of the outturn position on treasury management transactions in 2020-21.
- Presents details of capital financing, borrowing, and investment activity.
- Reports on the risk implications of treasury decisions and transactions.
- Confirms compliance with treasury limits and Prudential Indicators or explains non-compliance.

2. Recommendations

2.1. This is a formal report and the Cabinet is asked to approve it and submit it to Full Council on 21st July 2021.

3. Reasons for recommendations

3.1 The Local Government Act 2003 requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services. The Code requires Full Council to receive as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close. This is the full-year review for 2020-21.

4. Other options considered

4.1. None. The adoption of the TM full year review for 2020-21 is a regulatory requirement.

5. Links to County Vision, Business Plan and Medium-Term Financial Strategy

5.1. Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver the Somerset County Plan.

6. Consultations and co-production

6.1. None. The adoption of the TM **full year review for 2020-21** is a regulatory requirement.

7. Financial and Risk Implications

7.1. There are no specific financial or risk implications associated with this outturn report. The risks associated with Treasury Management are dealt with in the Annual Treasury Management Strategy, Annual Investment Strategy, and Treasury Management Practice documents.

8. Legal and HR Implications

8.1. Treasury Management must operate within specified legal and regulatory parameters as set out in the summary, and in more detail in the TMPs.

8.2. There are no HR implications.

9. Other Implications

9.1. Equalities Implications

There are no equalities implications.

9.2. Community Safety Implications

There are no community safety implications.

9.3. Sustainability Implications

There are no sustainability implications.

9.4. Health and Safety Implications

There are no health and safety implications.

9.5. Health and Wellbeing Implications

There are no health and wellbeing implications.

9.6. Social Value

Not applicable

10. Scrutiny comments / recommendations:

10.1. The Audit Committee is the body responsible for ensuring effective scrutiny of the treasury management strategy and policies.

11 Introduction and Background

The Council's treasury management activities are regulated by a variety of professional codes, statutes, and guidance. A more detailed outline of these, including the Treasury Management Framework and Policy is given at **appendix A**.

Somerset County Council (SCC) has adopted the CIPFA Code of Practice for Treasury Management and operates its treasury management service in compliance with this Code and the requirements in **appendix A**. The Code requires as a minimum, a formal report on treasury activities and arrangements to Full Council mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities and enable those with ultimate responsibility/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

Whilst headline figures can be a useful guide to performance, they should not be viewed in isolation. It is important to also assess performance against the stated objectives and specific needs of SCC during the year, and to take a wider view in relation to timeframes and overall risk management. There are many factors and circumstances that affect treasury activity and performance that are not immediately apparent from statistical reports. Activities undertaken may be directly attributable to good risk management or preferred risk tolerances. Some limitations to purely statistical analyses are outlined in **appendix B.**

Useful comparison has been further eroded as many Local Authorities are investing in non-financial assets, with the primary aim of generating profit. Others are entering into very long-term investments or are providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects. It is impossible to standardise and meaningfully compare returns, particularly for a given timeframe, and it is also extremely difficult to understand, quantify, and compare risks.

12 Treasury outturn and performance

12.1 Economic background

Financial markets are constantly changing, both proactively in anticipation of upcoming scenarios and events, and reactively, in response to news and outcomes. Whilst it is important to review and report on performance, it must be borne in mind that Treasury decisions are made in dynamic conditions. It is important therefore to give some background and context to Treasury performance.

The coronavirus pandemic dominated 2020-21, leading to almost the entire world being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt.

Some good news came in December 2020 as two COVID-19 vaccines were given approval and the UK vaccine rollout started in earnest; over 31 million people had received their first dose by 31st March.

A Brexit trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline having been agreed with the European Union on Christmas Eve.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion at its November 2020 meeting.

Inflation has remained low over the 12-month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation (CPI) at 0.7% year on year in March, below expectations (0.8%) and still well below the Bank of England's 2% target.

Despite the furlough scheme, unemployment still rose. Labour market data showed that in the three months to February 2021 the unemployment rate was 4.9%, in contrast to 3.9% recorded for the same period 12 months ago.

After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower pace than the 41.7% rise in the prior quarter.

After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. The Federal Reserve cut its main interest rate to between 0% and 0.25% in March 2020 where it has remained.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

Financial markets: Monetary and fiscal stimulus helped provide support for equity markets which rose over the period. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

The 5-year UK benchmark gilt yield began the financial year at 0.18% before declining to -0.03% at the end of 2020 and then rising strongly to 0.39% by the end of the financial year. Over the same period the 10-year gilt yield fell from 0.31% to 0.19% before rising to 0.84%. The 20-year declined slightly from 0.70% to 0.68% before increasing to 1.36%.

1-month, 3-month, 6-month, and 12-month LIBID (London Interbank Bid) rates averaged -0.05%, 0.01%, 0.07%, and 0.17% respectively over the period.

A more detailed commentary on the year's events, and tables of relevant rates throughout the year, is in **appendix C**.

12.2 The Treasury Position as at 31st March 2021

The Treasury position as at 31st March 2021 and a comparison with the previous year is shown in the table below. More detail behind the figures is given in **appendix D**.

Table 1 – Debt Portfolio

	Balance on 31-03-2020 £m	**Debt Matured / Repaid £m**	**New Borrowing £m**	**Balance on 31-03-2021 £m**	**Increase/ Decrease in Borrowing £m**
Short Term Borrowing	0.00	0.00	0.00	0.00	0.00
PWLB	159.05	0.00	0.00	159.05	0.00
LOBOs	108.00	0.00	0.00	108.00	0.00
Fixed Rate Loans	57.50	0.00	0.00	57.50	0.00
Total Borrowing	**324.55**	**0.00**	**0.00**	**324.55**	**0.00**

Table 2 – Debt interest

	31-03-2020 Rate %	**31-03-2021 Rate %**	**Increase/ Decrease Rate %**
Short Term Borrowing	0.00	0.00	0.00
PWLB	4.59	4.59	0.00
LOBOs	4.74	4.74	0.00
Fixed Rate Loans	4.73	4.73	0.00
Total Borrowing	**4.66**	**4.66**	**0.00**

The Council's need to borrow for capital purposes is determined by the Capital Programme and Capital Strategy. Council Members were aware of the major projects identified for 2020 to 2023. Capital projects identified were to be funded using a combination of grant, capital receipts, and contributions.

Although timing of capital expenditure is never totally predictable, it was envisaged that borrowing of up to £113m (including externalising all internal borrowing) may have been necessary.

As the differential between investment earnings and debt costs remained negative during 2020-21, a passive borrowing strategy, borrowing funds as they were required was deemed to be most appropriate. With capital spending less than anticipated, no new borrowing was undertaken. The benefits of this strategy were monitored and weighed against the risk of shorter-term rates rising more quickly than expected.

During 2020-21, there were no scheduled debt maturities. The PWLB portfolio remained the same.

Table 3 – Investments as at 31st March 2021

	Balance as at 31-03-2020 £m	**Rate of Return at 31-3-2020 %**	**Balance as at 31-03-2021 £m**	**Rate of Return at 31-03-2021 %**
Short-Term Balances (Variable)	42.09	0.54	75.63	0.04
Comfund (Fixed)	127.00	0.90	160.00	0.39
Pooled Funds	15.00	4.63	40.00	2.97
Total Investments	**184.09**	**1.12**	**275.63**	**0.67**

Table 4 - Investment balances by type

	31 March 2020 £m	31 March 2021 £m	Change
Money Market Funds	27.09	25.63	-1.46
Notice Bank Accounts	75.00	60.00	-15.00
Time Deposits - Banks	25.00	20.00	-5.00
Time Deposits - LAs	42.00	130.00	+88.00
Pooled Funds	15.00	40.00	+25.00
Total Investments	**184.09**	**275.63**	**+91.54**

Table 5 - Breakdown of investment balances by source

	31 March 2020 £m	31 March 2021 £m	Change
ENPA / SWC	-0.04	0.04	+0.08
Organisations in the Comfund	7.40	7.22	-0.18
LEP – Growth Deal Grant	15.77	41.69	+25.92
CCG Prepayment	0.00	31.60	+31.60
Earmarked funds held on other decision-making bodies behalf	13.10	11.55	-1.55
Total Externals	**36.23**	**93.10**	**+56.87**
SCC	147.86	182.53	+34.67
Total Investments	**184.09**	**275.63**	**+91.54**

Total investments as at 31st March 2021, including unspent LEP money, stood at over £275m, an increase of nearly £92m from 2020.

The investments balance was inflated in late March as SCC received £30m+ in the last few days of March, £25m+ related to a prepayment from the Somerset CCG, and various Health grants from Central Government.

The Comfund investment of £160.0m was £33.0m higher, whilst short term balances were £33.5m higher mostly due to the CCG money mentioned above. During the year, a further £25m was invested in Pooled Funds (£15m in the Royal London Investment Grade Short-Dated Credit Fund, and £10m in the M&G Strategic Corporate Bond Fund), bringing Pooled Fund investment to £40m.

Revenue balances held on behalf of others at year-end increased by £0.08m. Investment in the Comfund by external bodies decreased slightly, from £7.40m to £7.22m. Three large grants of £25.6m, £12.8m, and £17.7m, and a decrease in spending by the LEP meant an increase of £25.9m of that money. £61.5m was managed on behalf of others at year-end 2021, an increase of £25.3m, plus prepayments of £31.6m made by the NHS Clinical Commissioning Group (CCG).

The cash managed on behalf of others includes that of Exmoor National Park Authority (ENPA) and South West Councils (SWC). SCC continues to manage revenue balances on their behalf, and under contractual arrangements sweeps their cash into the SCC account daily, from where it is lent into the market in the name of SCC. There are arrangements in place for the allocation of interest received on these amalgamated balances, and SCC should not be at a disadvantage as rates paid to ENPA and SWC should always be less than those achieved by the investments.

The same principle holds for the Comfund external investors (a limited group of not-for-profit organisations with links to SCC) but here, the rate achieved is passed on to investors and an admin fee is charged.

In addition, during 2020-21, SCC was retained to manage the Local Enterprise Partnership (LEP) Growth Deal Grant on behalf of the other Enterprise Partners. Further grants of £25.6m, £12.8m, and £17.7m were received during the year and added to the £15.77m already held. £41.69m was held on behalf of the LEP at year-end.

12.3 Summary of performance

During the year, Council treasury management policies, practices, and activities remained compliant with relevant statutes and guidance, namely the MHCLG investment guidance issued under the Local Government Act 2003, and the CIPFA Treasury Management and Prudential Codes. The Council can confirm that it has complied with its Prudential Indicators for 2020-21.

At year-end, with no new debt taken, total debt stood at £324.55m, with an average rate paid on total borrowings of 4.66%.

Security of capital remained the Council's main investment objective. This was achieved by following the counterparty policy as set out in the Annual Treasury Management Strategy, and by the approval method set out in the Treasury Management Practices. SCC has continuously monitored counterparties, and all ratings of proposed counterparties have been subject to verification on the day, immediately prior to investment.

For all the economic turmoil during the year, there were minimal credit rating changes during the period; however, in April 2020 Fitch Ratings applied a negative outlook to most UK Banks, and S&P followed suit in May, and also included several European and Australian Banks. Fitch did downgrade Rabobank and ANZ from AA- to A+, S&P did likewise with HSBC. Moody's reduced Nationwide from Aa3 to A1.

There continues to be much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic. While the UK and Non-UK banks on the Arlingclose counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks remained at 35 days throughout the year, for new deposits.

As duration advice has been limited to 35-days on new bank lending (and the number of counterparties recommended has been significantly reduced by Arlingclose), there have been minimal opportunities to use banks, as they are either not in the market in this period, or rates have been negligible or even negative. In order to place deposits for longer maturities, and to pick up a better yield, more deposits have been placed with UK Local Authorities. At times, this too has been difficult, as the deluge of money from Central Government has increased liquidity and reduced the number of Local Authorities looking to borrow money. At times there have been no Local Authorities looking to borrow money, and this has kept rates suppressed

Outside of Arlingclose advice, SCC continues to hold £15m in a 95-day notice account with Santander UK, and an Instant Access account with Handelsbanken Plc, the UK arm of the 6th strongest commercial bank in the world.

After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels.

The average Credit Rating of the SCC investment portfolio (excluding pooled funds) as at 31st March 2021 was AA-. To give this some perspective, the United Kingdom Government is rated AA- by two of the three main ratings agencies, the other being one notch higher at AA.

An account of issues and any restrictions implemented throughout the year can be found in **appendix G.**

Liquidity. In keeping with the MHCLG guidance, the Council maintained a sufficient level of liquidity through the use of call accounts, Money Market Funds, and short-term deposits. SCC did not need to borrow short-term money during the year.

Yield (excluding Pooled Funds). Interest of over £1m was earned on cash investments during 2020-21. The decrease on the comparative figure for 2019-20 of £1.93m is due to the reduction of base rate to 0.1%, and expectations that it could drop further, or even go negative. When compared with average cash rates for the year, the ex-Pooled Funds yield of 0.46% was 0.39% above the average 6-month LIBID rate, and 0.29% more than the average 12-month LIBID rate, on a portfolio with an average duration of less than 5-months.

Pooled Funds. During 2020-21, SCC increased investment into Pooled Funds by £25m, to £40m. £15m was maintained in the CCLA Property Fund, whilst £15m was invested in the Royal London Investment Grade Short-Dated Credit Fund (RLAM), and a further £10m into the M&G Strategic Corporate Bond Fund (M&G). To 31st March the £40m investment (average £18.9m) in Pooled Funds delivered an average net income yield of 3.50%.

Yield (including Pooled Funds). Interest of £1.67m was earned on total investments during 2020-21. When compared to the average risk-free deposit rate of approximately 0.01% offered by the Government Debt Management Office (DMO) throughout the year, the benefit of the SCC investment strategy across the average SCC investment balance of £239m for the year was just over £1.66m (£1.32m in 2019-20).

Security and liquidity have been achieved with the income return of 0.70% achieved for the year, being 0.53% above the average 12-month LIBID rate.

During the year, two further dividends have been received from Kaupthing, Singer & Friedlander, £17,535.38 on 1st April 2020 and £13,409.41 on 17th December 2020. A further dividend has been declared and will be paid in April or May 2021.

In total, as at 31st March 2021 £23,349,613.41 had been recovered. More detail of the current position is in **appendix G**.

12.4 Temporary borrowing

Temporary borrowing has not been necessary at all during 2020-21.

12.5 Long term borrowing

The borrowing strategy for 2020-21 recognised that borrowing of up to £113m (including externalising current internal borrowing) may have been necessary. As the differential between investment earnings and debt costs remained negative during 2020-21, a passive borrowing strategy, borrowing funds as they were required, was pursued. With capital spending less than anticipated, no new borrowing was undertaken.

During 2020-21, there were no scheduled debt maturities. The debt portfolio therefore remained at £324.55m during the year. All details of long-term borrowing rates and any activity during the year can be found in **appendix F**.

12.6 Cash managed on behalf of others

During 2020-21 SCC provided treasury management services to the Police and Crime Commissioner for Avon and Somerset. As from 1st April 2020, a new contract had been signed, for Treasury Management services to be supplied to the Police, by SCC, on an ongoing basis. Funds continue to be lent on a segregated basis, with PCC funds lent in its own name.

SCC continues to manage cash on behalf of other not-for-profit organisations including Exmoor National Park Authority (ENPA), and South West Councils (SWRC) via service level agreements and the Comfund vehicle. These balances were just over £7.2m at year-end.

In addition, during 2020-21, SCC was retained to manage the Local Enterprise Partnership (LEP) Growth Deal Grant on behalf of the other Enterprise Partners. Grants of £25.6m, £12.8m, and £17.7m were received during the year and added to the £15.77m already held, and an average balance in excess of £44m was managed.

All treasury management activities, including a fee for the management of the LEP money, brought in income of nearly £133k during the year.

12.7 Investments

The Council holds significant investment balances, details shown by balance, type, source, and return achieved, is shown in tables 3-5 above. During the year, investment balances ranged between £162.3m and £284.8m, averaging £239m, up £25m from the previous year.

Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero. Deposit rates with the Debt Management Account Deposit Facility (DMADF) have continued to fall and are now largely around zero.

Given the risk and low returns from short-term bank investments, and the limited spread and duration of bank counterparties on the approved Arlingclose list, the Council has further diversified into more secure and higher yielding asset classes as shown in table 4 above. An increase of £88m to £130m was lent to other Local Authorities, improving both security and yield, as longer-term deposits were able to be made.

Strategic Pooled Funds investment increased by £25m. These 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.

When measuring the cash investment performance of its treasury management activities both in terms of its security and the yield achieved in relationship to benchmark interest rates, objectives have been met. The credit risk target of A(6) has been bettered at AA-(4.43), and the weighted cash investment return of 0.46% was 0.39% better than the average 6-Month LIBID rate for the financial year. A more detailed commentary on activity and analysis of performance for the year can be found in **appendix G**.

12.8 Prudential indicators

The Council can confirm that it has complied with its Prudential Indicators for 2020-21. Indicators that were set for 2020-21, and the year-end position for each are set out in **appendix H**.

12.9 Non-financial assets, regulatory changes, and risk management

Some Local Authorities have continued to invest in non-financial assets, with the primary aim of generating profit. Others have entered into very long-term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects. Some recent 'non-financial investments' by other Local Authorities are highlighted in **appendix B.**

During the year, the Treasury conducted a consultation on changes to the Public Works Loan Board, which it said would attempt to "focus PWLB loans on service delivery, housing, and regeneration, and ensure that this money is not diverted into financial investments that serve no direct policy purpose".

The conclusion was to ban access to PWLB funds for Authorities that chose to invest in 'investments primarily for yield'. It also reduced PWLB rates to their previous levels in November 2020, i.e. 1% over Gilts from 2% over Gilts.

Furthermore, a consultation was launched on proposed changes to the CIPFA Treasury Management and Prudential Codes. The outcome will be revealed later in 2021 for full implementation in the 2022-23 strategy.

MiFID II

The Council continues to meet the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. As a result, the Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

Risk Management, Governance, and Compliance

During the year, all Council treasury management policies, practices, and activities remained compliant with all relevant statutes and guidance, namely the MHCLG investment guidance issued under the Local Government Act 2003, the CIPFA Code of Practice for Treasury Management, and the CIPFA Prudential Code.

The MHCLG's Guidance on Investments reiterates security and liquidity as the primary objectives of a prudent investment policy. All investments were compliant with guidance issued by the MHCLG, with the investment strategy agreed, and activities conducted within the procedures contained in the TMPs.

As required by the CIPFA TM Code, a mid-year review was presented to Full Council in November 2020.

Officers from the Treasury Management team reported debt and investment positions and performance via comprehensive reports at monthly meetings with the Director of Finance and/or the Strategic Manager (Pensions Management).

All recent audits conducted by the South West Audit Partnership (SWAP) have received a 'Comprehensive' Audit Opinion, the highest rating for its management of risk.

An Internal Audit was conducted by SWAP during Autumn 2020, reporting in November 2020. It awarded the best possible outcome, as quoted below.

> "SWAP conducted a Treasury Management review as part of the 2019/20 Internal Audit Plan and provided a Substantial assurance opinion. Since then, the COVID-19 pandemic has required the Investments team to move to a fully electronic review and authorisation processes.
> This additional Substantial assurance opinion has been given on the basis that the amended processes are operating effectively.
>
> A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited".

Arlingclose have been retained Treasury Advisors throughout the period.

During the year Treasury staff have continued to attend (virtual) courses and seminars provided through the CIPFA Treasury Management Network (TMN), its advisors, Arlingclose, and other ad hoc events.

13. Background papers

Treasury Management Strategy Statement 2020-21 and appendices. These were approved by Full Council at the meeting on 19th February 2020. The full papers can be found under the 10th February 2020 Cabinet meeting at:

http://democracy.somerset.gov.uk/documents/s14325/Treasury%20Management%20Report.pdf

http://democracy.somerset.gov.uk/documents/s14327/Treasury%20Management%20App%20A%202020-21.pdf

http://democracy.somerset.gov.uk/documents/s14328/Treasury%20Management%20App%20B%202020-21%20v2.pdf

http://democracy.somerset.gov.uk/documents/s14329/Treasury%20Management%20App%20C%202020-21.pdf

http://democracy.somerset.gov.uk/documents/s14326/Treasury%20Management%20TMPs%20V6%20January%202020.pdf

Note: For sight of individual background papers please contact the report author.

Report Sign-Off

		Signed-off
Legal Implications	Honor Clarke	30/06/21
Governance	Scott Wooldridge	03/06/21
Corporate Finance	Jason Vaughan	19/05/21
Human Resources	Chris Squire	28/05/2021
Property	Paula Hewitt / Oliver Woodhams	NA
Procurement / ICT	Simon Clifford	NA
Senior Manager	Stephen Morton	17/05/21
Commissioning Development	Sunita Mills / Ryszard Rusinek	NA
Renewal Board		NA
Local Member		NA
Cabinet Member	Cllr Mandy Chilcott - Cabinet Member for Resources	04/06/21
Opposition Spokesperson	Cllr Liz Leyshon	01/07/21
Scrutiny Chair	Cllr Anna Groskop - Place Scrutiny	01/07/21