Report of:	Meeting	Date
Councillor Alan Vincent, Resources Portfolio Holder and Clare James, Corporate Director Resources	Council	12 November 2020

Treasury Management Activity April 2020 to September 2020

1. Purpose of report

1.1 To report on the overall position and activities in respect of Treasury Management for the first half of the financial year 2020/21, covering the six month period from April 2020 to September 2020.

2. Outcomes

2.1 An informed Council who have an understanding of Treasury Management activity, in line with the approved Treasury Management Policy and Strategy Statements and Treasury Management Practices.

3. Recommendation

3.1 That the Mid-year Review Report on Treasury Management Activity for the first half of the 2020/21 financial year be noted, in line with requirements of CIPFA's 'Treasury Management in the Public Services: Code of Practice (revised 2017)'.

4. Background

4.1 Treasury Management

4.1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA), has set out a clear definition of treasury management activities: "The management of the organisation's borrowing, 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."

4.1.2 The council operates a balanced budget, which broadly means cash raised during the year will fund cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, making sure that there is adequate liquidity cover before considering optimisation of investment returns.

4.1.3 Another function of the treasury management service is the funding of the council's capital plans. The capital plans provide a guide to the borrowing need of the council, essentially the longer term cash flow planning, to ensure the council can meet its capital spending operations. This management of longer term cash flow may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

4.1.4 This report has been written in accordance with the requirements of the CIPFA's 'Treasury Management in the Public Services: Code of Practice (revised 2017)' (the Code). The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy, Capital Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year Review Report and an Annual Report, covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. For this Council the Finance Director is responsible for treasury management.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Overview and Scrutiny Committee.

4.1.5 As recommended by the Code, this mid-year report covers the following:

- An economic update for the first half of the 2020/21 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and related prudential indicators;

- A review of the Council's investment portfolio for 2020/21;
- A review of the Council's borrowing strategy for 2020/21;
- A review of any debt rescheduling undertaken during 2020/21;
- A review of compliance with Treasury and Prudential Limits for 2020/21.

5. Key issues and proposals

5.1 Economic update

This economic update has been provided by the Council's Treasury Advisors, Link Group, issued on 7 October 2020.

5.1.1 As expected, the Bank of England's Monetary Policy Committee (MPC) kept Bank Rate unchanged on 6 August (and subsequently 16 September). It also kept unchanged the level of quantitative easing (QE) at £745bn. It's forecasts were optimistic in terms of three areas:

- The fall in GDP in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.
- The peak in the unemployment rate was revised down from 9% in Q2 to 7.5% by Q4 2020.
- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022 (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

5.1.2 The MPC also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available" including QE and the use of forward guidance.

5.1.3 The MPC still expects the £300bn of QE purchases announced between its March and June meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

5.1.4 In conclusion, this would indicate that the Bank can now just 'sit on its hands' as the economy is recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references

to downside risks, which were judged to persist both in the short and medium term. One has only to look at the potential for a second wave of the virus to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused.

5.1.5 In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down in the furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six month package from 1 November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid-September.

5.1.6 Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE. There will be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

5.1.7 One key addition to the Bank's forward guidance 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 that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate.

5.1.8 The Financial Policy Committee (FPC) report on 6 August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise

under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

5.1.9 In the USA, incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by continuing outbreaks of the virus in some states leading to fresh localised restrictions.

5.1.10 In the Eurozone (EZ), the economy was recovering well towards the end of Q2 after a sharp drop in GDP. However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The European Central Bank (ECB) has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more QE purchases of bonds in the absence of sufficient fiscal support.

5.2 Interest Rates Forecast

5.2.1 The council's treasury advisor, Link Group, has provided the following forecasts on 11 August 2020 (PWLB rates are certainty rates):

Link Group Interest Rate View - 11.08.20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month average earnings	0.05	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 Month average earnings	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 Month average earning	0.15	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

5.2.2 The coronavirus outbreak has done huge economic damage to the UK and around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting on 6 August, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it

clear that he currently thinks that such a move would do more damage than good and that more QE is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31 March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

5.3 The balance of risks to the UK

5.3.1 The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty owing to the virus.

5.3.2 There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields (and so PWLB rates), in the UK.

5.4 Treasury Management Strategy Statement and Annual Investment Strategy Update

5.4.1 The Treasury Management Strategy Statement (TMSS) for 2020/21, which includes the Annual Investment Strategy (AIS), was approved by this Council on 17 September 2020. This was slightly later than is normal owing to Covid-19; the documents had been reviewed by Cabinet on 25 March 2020 and were recommended to Council for approval. However, a number of Council meetings were then cancelled. In accordance with the CIPFA's Treasury Management Code of Practice, it sets out the council's investment priorities as being:

1. Security of capital;
2. Liquidity;
3. Yield.

The council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the council's risk appetite. In the current economic climate it is considered appropriate to keep investments short-term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach.

5.4.2 TMSS Update

There are no policy changes to the TMSS; the details in this report update the position in light of the updated economic position and budgetary changes already approved.

5.4.3 AIS Update - Investment Portfolio

In accordance with the Code, it is the council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the council's risk appetite. As shown by the forecasts in section 5.2, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates up to 12 months are either negative or barely above zero now that Bank Rate is at 0.10%. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31 March 2023, investment returns are expected to remain low.

5.4.4 The council has continued to invest any surplus balances with the council's Bank, NatWest on-call deposit facility, Money Market Funds (MMF) with Prime Rate Capital Management, Deutsche, LGIM and Insight, the Bank of Scotland (Overnight/Call account and 95 day notice facility), Handelsbanken (Instant Access account and 35 day notice facility) Santander (35 day corporate notice facility) and Qatar National bank (1 month and a 3 month fixed notice facility).

5.4.5 Our current policies and practices allow us to invest up to £6m with any one institution. It was agreed by full Council that this position should be relaxed over the first quarter of 2020/21 or until the pandemic position alters owing to the significant sums being deposited with us by central government. We are in the process of increasing the number of accounts available to us to deposit funds with. The £6m cap was increased to £12m during this unusual period for use in limited circumstances only until the aforementioned capacity is increased. During the first six months of 2020/21 this facility was used between the 1 April and 3 April.

5.4.6 Within the council's current Annual Investment Strategy, the Investment Policy criteria are based on Link Asset Services creditworthiness service and it is meeting the requirement of the treasury management function. The council, to date, has adopted a very cautious approach and regularly monitors organisations with which investments are held to ensure they meet the Investment Policy criteria.

5.4.7 AIS Update - Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

5.4.8 Interest receivable on investments for the first half of the year was £40,499 compared to an annual budget of £150,000. The level of interest received is expected to reduce through the second part of the year. This is a result of a number of factors including the low level of interest rates available and the amount of funds available for investment diminishing as a result of the Covid-19 business grants being paid out,

capital expenditure and reduced levels of Council Tax income in the last quarter of the year.

5.4.9 The equated investments for the first half of 2020/21 are detailed in the following table indicating that investments earned an average return of 0.44% against a benchmark LIBID (London Interbank Bid Rate) 7-day average of 0.41%.

	Equated Investment Principle	Interest Due	Rate of Return	Benchmark Return
NatWest Liquidity Account	1,463,215	2,287	0.30%	0.41%
Handelsbanken IA Account	789,041	1,389	0.35%	0.41%
Bank of Scotland Call Account	274,466	137	0.05%	0.41%
Handelsbanken 35 Day Notice Account	1,430,137	6,238	0.10%	0.41%
Santander 35 Day Corp Notice	690,411	3,935	0.57%	0.41%
Qatar 1 month	1,504,110	4,216	0.60%	0.41%
Qatar 3 month	73,973	703	0.95%	0.41%
LGIM	3,008,220	6,162	0.35%	0.41%
Insight	1,046,575	1,721	0.21%	0.41%
Deutsche	2,317,809	3,967	0.28%	0.41%
Prime Rate	3,008,220	6,278	0.37%	0.41%
Bank of Scotland 95 Day Notice	315,068	3,466	1.10%	0.41%
Total	**15,921,245**	**40,499**	**0.44%**	**0.41%**

5.5 The Council's Capital Position (Prudential Indicators)

5.5.1 Prudential Indicator for Capital Expenditure

The following table shows the updated budget position for capital expenditure and the changes since the 2020/21 capital programme was agreed as part of the 2020/21 budget process.

	2020/21 Original Estimate £	Movements		Current Position as at 30/09/20 £
		2019/20 Slippage £	Portfolio Holder Decisions £	
Total Capital Expenditure	3,367,386	3,576,855	4,846,959	11,791,200

5.5.2 Changes to the Financing of the Capital Programme

The table below shows how the capital expenditure (as set out in paragraph 5.4.1) will be financed, with any shortfall of resources resulting in a need to borrow. The current planned expenditure is fully funded resulting in a £0 borrowing requirement. Just under 70% of planned expenditure is funded by grants and contributions; with around 30% being funded from a combination of capital receipts and revenue contributions/utilisation of reserves.

	2020/21 Original Estimate £	**Current Position as at 30/09/20 £**
Total Expenditure	**3,367,386**	**11,791,200**
Financed by:		
Capital Receipts	25,330	65,850
Capital Grants and Contributions	2,700,856	8,077,396
Revenue/reserves	641,200	3,647,954
Total Financing	**3,367,386**	**11,791,200**
Borrowing Requirement	**0**	**0**

5.5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicators	**2020/21 Original Estimate £m**	**2020/21 Mid-Year Estimate £m**
Capital Financing Requirement:		
Total CFR	**11,163**	**11,166**
Operational Boundary for external debt:		
Debt	13,452	13,452
Other long term liabilities	7	7
Total Operational Boundary	**13,459**	**13,459**

5.5.4 The CFR has been updated and has seen minor adjustments, based upon the 2019/20 outturn position. Planned capital expenditure for 2020/21 has been fully funded. The CFR requirement represents historical capital expenditure which has yet to be financed.

5.5.6 There has been no change to the prudential indicator setting out the operational boundary for external debt; we are currently operating below the operational boundary level of external debt. The operational boundary is based on probable external debt during the course of the year. It is not a limit but it acts as an early warning indicator to ensure that the Authorised Limit is not breached. If external debt levels are close to the operational boundary, they will be monitored closely to ensure that the Authorised Limit, which is the maximum level of external borrowing that the council can incur, is not exceeded.

5.5.7 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

5.5.8 The Corporate Director Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

5.5.9 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Council. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The approved Authorised Limit for 2020/21 is set at £20m; this limit is still sufficient for the council.

5.6 Borrowing

5.6.1 The council’s capital financing requirement (CFR) for 2020/21 is £11.2m. The CFR denotes the Council’s underlying need to borrow for capital purposes. This borrowing can be external, from the Public Works Loan Board (PWLB) or the market, or internal, from balances on a temporary basis. The 2020/21 budget assumed no additional long-term

borrowing and that capital schemes were to be funded by grants and contributions, capital receipts, revenue or reserves.

5.6.2 There were no short-term borrowing transactions (i.e. less than 365 days) during the first six months of 2020/21.

5.6.3 Interest payments in respect of short-term and long-term borrowing for the first half of the financial year are on target and total £34,415 compared to a budgeted figure of £68,830 for the full year. There is also an additional budget of £1,000 to cover interest payments in the latter part of the financial year in case there are any temporary borrowing requirements as income from Council Tax reduces during February and March.

5.6.4 The council incurs charges at 4% over the current base rate for net overdrawn balances with no annual arrangement fee. The council's net bank account position was not overdrawn during the period April to September 2020.

5.7 Debt Rescheduling

5.7.1 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year although it is reviewed at least annually.

5.7.2 The following table provides details of the council's outstanding long term borrowing:

Date	Source	Value (£)	Period (Yrs)	Rate (%)	Maturing
05/03/08	PWLB	552,000	30	4.48	September 2037
05/03/08	PWLB	1,000,000	50	4.41	September 2057
		1,552,000			

5.8 Compliance with Treasury and Prudential Limits

5.8.1 It is a statutory duty for the council to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2020, the council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2020. The Corporate Director Resources reports that no difficulties are envisaged for the current or future years in complying with these indicators.

5.8.2 All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

Financial and legal implications	
Finance	Considered in detail in the report above.
Legal	The approval of the recommendation will ensure that the CIPFA Code of Practice on Treasury Management and statutory requirements have been complied with.

Other risks/implications: checklist

If there are significant implications arising from this report on any issues marked with a ✓ below, the report author will have consulted with the appropriate specialist officers on those implications and addressed them in the body of the report. There are no significant implications arising directly from this report, for those issues marked with a x.

risks/implications	✓ / x
community safety	x
equality and diversity	x
sustainability	x
health and safety	x

risks/implications	✓ / x
asset management	x
climate change	x
ICT	x
data protection	x

Processing Personal Data

In addition to considering data protection along with the other risks/ implications, the report author will need to decide if a 'privacy impact assessment (PIA)' is also required. If the decision(s) recommended in this report will result in the collection and processing of personal data for the first time (i.e. purchase of a new system, a new working arrangement with a third party) a PIA will need to have been completed and signed off by Data Protection Officer before the decision is taken in compliance with the Data Protection Act 2018.

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List of background papers:		
name of document	date	where available for inspection
None		

List of appendices

None

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