Report of:	Meeting	Date
Councillor Michael Vincent, Resources Portfolio Holder and Clare James, Corporate Director Resources	Council	28 October 2021

Treasury Management Activity April to September 2021

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 2021/22, covering the six month period from April to September 2021.

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 2021/22 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 2021/22 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 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

5. Key issues and proposals

5.1 Economic update

(This economic update is extracted from an update provided by the Council's Treasury Advisors, Link Group, issued on 8 September 2021.)

5.1.1 The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn.

5.1.2 While that was all very much unchanged from previous MPC decisions over the last year, there was a major shift from indicating no expected tightening any time soon to now flagging up that interest rate increases were now on the horizon. There was disagreement among MPC members, some of whom felt that the forward guidance that the MPC won't tighten policy until inflation "is achieving the 2% inflation target sustainably", had already been met.

5.1.3 The MPC was more upbeat in its new 2-3 year forecasts so whereas they had expected unemployment to peak at 5.4% in Q3, the MPC now thought that the peak had already passed. (It is to be noted though, that the recent spread of the Delta variant has damaged growth over the last couple of months and has set back recovery to the pre-pandemic level of economic activity till probably late 2021.)

5.1.4 The MPC has concluded its review of its monetary policy and it will start to tighten monetary policy by:

1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
2. Raising Bank Rate to 0.50% (1.50% previously), before starting on reducing its holdings.
3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.

5.1.5 Inflation is currently expected to peak at over 4% during 2021. The key issue then is whether this is just going to be transitory inflation or whether it will morph into inflation which will exceed the MPC's 2% target on an ongoing basis. In his press conference, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that “the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures.” In other words, the MPC is worried that labour shortages will push up wage growth by more than it expects and that, as a result, CPI inflation will stay above the 2% target for longer. This then raises an interesting question as to whether the million or so workers who left the UK during the pandemic, will come back to the UK and help to relieve wage inflation pressures. We also have an unknown as to how trade with the EU will evolve once the pandemic distortions have dissipated now that the UK no longer has tariff free access to EU markets.

5.1.6 At the current time, the MPC’s forecasts are showing inflation close to, but just below, its 2% target in 2 to 3 years’ time. The initial surge in inflation in 2021 and 2022 is due to a combination of base effects, one off energy price increases and a release of pent-up demand, particularly from consumers who have accumulated massive savings during the pandemic, hitting supply constraints. However, these effects will gradually subside or fall out of the calculation of inflation. The issue for the MPC will, therefore, turn into a question of when the elimination of spare capacity in the economy takes over as being the main driver to push inflation upwards and this could then mean that the MPC will not start tightening policy until 2023.

5.1.7 One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on ‘achieving broad and inclusive “maximum” employment in its entirety’ in the US before consideration would be given to increasing rates. Although there are nuances between the monetary policy of all three banks, the overall common ground is allowing the inflation target to be symmetrical so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time. For local authorities, this means that interest rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

5.1.8 In the EU the slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2.2% which is likely to continue into Q3, though some countries more dependent on tourism may struggle. There is little sign that underlying inflationary pressures are building to cause the ECB any concern.

5.1.9 In China, after a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. Policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2021. However, the pace of economic growth will fall back after this initial surge of recovery from the pandemic. China is also now struggling to contain the spread of the Delta variant through sharp local lockdowns which will damage economic growth. There are also questions as to how effective Chinese vaccines are proving.

5.1.10 Globally further progress on vaccine roll outs, continued policy support, and the re-opening of most major economies should mean that global GDP growth in 2021 will grow at its fastest rate since 1973. The spread of the Delta variant poses the greatest risk to this view, particularly in large parts of the emerging world where vaccination coverage is typically lower than in advanced economies. Continued strong recovery will be accompanied by higher inflation. While most of the arithmetic and commodity price effects boosting inflation in recent months are behind us, goods shortages will last well into 2022 as order backlogs are worked through and inventories are replenished. What's more there is mounting evidence that rapid re-opening of economies generates labour shortages, which could exert further upward pressure on firms' costs. So, global inflation is unlikely to drop back until next year.

5.2 Interest Rates Forecast

5.2.1 The Council's treasury advisor, Link Group, provided the following forecasts on 10 August 2021 (PWLB rates are certainty rates):

Link Group Interest Rate View – 10/08/2021	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25	0.50
3 Month average earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30	0.50
6 Month average earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.50	0.50
12 Month average earning	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.70
5yr PWLB Rate	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.50	1.50
10yr PWLB Rate	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00
25yr PWLB Rate	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.40	2.50
50yr PWLB Rate	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.30

5.2.2 The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank

Rate unchanged at its subsequent meetings, although some forecasters had suggested that a cut into negative territory could have happened prior to more recent months when strong recovery started kicking in. However, the minutes of the MPC in February 2021 made it clear that commercial banks could not implement negative rates within six months; by that time the economy would be expected to be recovering strongly and so there would be no requirement for negative rates. As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 1 of 2023/24 and another increase to 0.50% in quarter 4 of 23/24, as an indication that the Bank of England will be starting monetary tightening during this year.

5.3 The balance of risks to the UK

5.3.1 The overall balance of risks to economic growth in the UK is now to the upside though there are still residual risks from Covid variants - both domestically and their potential effects worldwide, and from various shortages.

5.3.2 There is relatively little domestic risk of increases in Bank Rate exceeding 0.50% in the next two to three years and, therefore, in shorter-term PWLB rates.

5.4 Treasury Management Strategy Statement and Annual Investment Strategy Update

5.4.1 The Treasury Management Strategy Statement (TMSS), for 2021/22 was approved by this Council on 22 April 2021.

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 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, LGIM, 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 or 20% of the investment balance per individual counterparty or 25% per whole counterparty group whichever is higher. During the first six months of 2021/22 this facility was not used.

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 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 £11,652 compared to an annual budget of £70,000. 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. As a result, the forecast will be adjusted down to reflect a more realistic target.

5.4.9 The equated investments for the first half of 2021/22 are detailed in the following table indicating that investments earned an average return of 0.10% which means that we have performed better than the benchmark LIBID (London Interbank Bid Rate) 7-day average of 0.08%. As referred to above, negative rates are common on investments of up to 12 months and whilst we have avoided using these, it has meant that at times we have deposited funds in zero interest earning accounts in order to maintain security and liquidity of funds.

	Equated Investment Principle	**Interest Due**	**Rate of Return**	**Benchmark Return**	**Number of days invested**
Santander 35 Day Corp. Notice	£3,172,600	£9,518	0.30%	0.08%	183
Qatar 3 month	£1,602,740	£3,686	0.23%	0.08%	105
Qatar 3 month	£427,400	£1,154	0.27%	0.08%	78
Qatar 6 month	£1,405,480	£5,903	0.42%	0.08%	92
Handelsbanken I.A. Account	£3,008,220	£0	0.00%	0.08%	183
Bank of Scotland (Call Acc)	£1,007,750	£101	0.01%	0.08%	183
Nat West - Liquid Select	£1,733,200	£173	0.01%	0.08%	183
LGIM	£2,569,040	£0	0.00%	0.08%	183
Insight	£2,834,250	£0	0.00%	0.08%	183
Prime Rate	£3,008,220	£300	0.01%	0.08%	183
TOTAL	**£20,768,900**	**£20,835**	**0.10%**	**0.08%**	**-**

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 2021/22 capital programme was agreed as part of the 2021/22 budget process.

	2021/22 Original Estimate £	**Movements**		**Current Position as at 30/09/21 £**
		2020/21 Slippage £	**Portfolio Holder Decisions £**	
Total Capital Expenditure	2,742,622	4,869,885	8,483,298	16,095,805

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 nil additional borrowing requirement. Just under 79% of planned expenditure is funded by grants and contributions; with around 21% being funded from a combination of capital receipts and revenue contributions/utilisation of reserves.

	2021/22 Original Estimate £	**Current Position as at 30/09/21 £**
Total Expenditure	**2,742,622**	**16,095,805**
Financed by:		
Capital Receipts	0	24,242
Capital Grants and Contributions	2,349,127	12,794,627
Revenue/reserves	393,495	3,276,936
Total Financing		
Borrowing Requirement	**2,742,622**	**16,095,805**

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	**2021/22 Original Estimate £m**	**2021/22 Mid-Year Estimate £m**
Capital Financing Requirement:		
Total CFR	**11,069**	**11,069**
Operational Boundary for external debt:		
Debt	13,452	13,452
Other long term liabilities	50	50
Total Operational Boundary	**13,502**	**13,502**

5.5.4 The CFR has been updated and has seen minor adjustments, based upon the 2020/21 outturn position. Planned capital expenditure for 2021/22 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 2021/22 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 2021/22 is set at £20.1m; this limit is still sufficient for the council.

5.6 Borrowing

5.6.1 The council's capital financing requirement (CFR) for 2021/22 is £11.1m. 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 2021/22 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 2021/22.

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 2021.

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 2021, the council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021. 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