ITEM NO	

REPORT TO EXECUTIVE

DATE	**8th December 2020**
PORTFOLIO	**Resources and Performance Management**
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2020/21 Treasury Management Mid-Year Report

PURPOSE

1. To report treasury management activity for the first half year of 2020/21 covering the period 1 April to 30 September 2020.

RECOMMENDATION

2. The Executive is requested to;

   - Note the treasury management activities undertaken during the period 1 April to 30 September 2020, and;

   Recommend that Full Council;

   - Endorse the mid-year update on Treasury Management Strategy for 2020/21 in compliance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.

   - Approve the revised Counterparty list and investment limits for Local Authority and Money Market Funds as set out in Appendix 2 to this report.

REASONS FOR RECOMMENDATION

3. - To inform members of the treasury management activity in the first half of 2020/21 and to fulfil statutory and regulatory requirements.

SUMMARY OF KEY POINTS

4. **Background**

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The first main function of treasury management operations is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is to ensure the funding of the Council's capital plans. These 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 commitments. This management of longer term cash may involve arranging long or short term loans, or using cash flow surpluses, and, on occasions, any current debt may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

> "The management of the Council'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."

The monitoring requirements for treasury were set out in the report which included both the Treasury Management Strategy for 2020/21 and the Prudential and Treasury Indicators for 2020/21 – 2022/23, approved by Full Council on 26 February 2020.

5. **Introduction**

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Strategy which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by Full Council of an annual Treasury Management Strategy - including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. 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.
5. 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 Scrutiny Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first six months of 2020/21;
- A review of the Treasury Management Strategy and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and 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.

6. **Economic Update (Provided by Link Asset Services)**

- As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August 2020. It also kept unchanged the level of quantitative easing at £745bn. Its 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 7½% 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.

- It 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.
- The MPC expected the £300bn of quantitative easing 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.
- In conclusion, this would indicate that the Bank could now just sit on its hands as the economy was 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 way in which second waves of the virus are now impacting many countries including Britain, 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. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous 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 1st 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.

- 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 to 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 shown up how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.
- 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 level of inflation is going to be persistently above target if it takes no action to raise Bank Rate
- The Financial Policy Committee (FPC) report on 6th 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%.

7. **<u>Interest Rate Forecast (Provided by Link Asset Services)</u>**

The Council's treasury advisor, Link Group, provided the following forecasts on 11th August 2020 (PWLB rates are certainty rates, gilt yields plus 180bps):

Link Group Interest Rate View 11.8.20	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
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	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	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	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	2.40	2.40	2.40	2.50	2.50	2.50	2.50

The Chancellor announced in his Spending Review on the 25th November 2020 that the 1% increase in PWLB rates that took place in October 2019 would be reversed following the outcome of the Government's consultation process. This took effect from 9am on the 26th November 2020 when the PWLB rates at certainty rate would become gilt yields plus 80bps. The Council's treasury advisor, Link Group, will update their forecasts shown in the table above shortly to take this change into account.

The coronavirus outbreak has done huge economic damage to the UK and economies 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 meeting on 6th August (and the subsequent September meeting), 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 quantitative easing 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 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

8. Treasury Management Strategy update

The Treasury Management Strategy (TMS) for 2020/21, which includes the Annual Investment Strategy, was approved by this Council on 26 February 2020. The council has since made a proposal to make a treasury investment of £4m with Burnley College in the next calendar year. This has been updated in the Counterpary list in appendix 2 to this report.

9. The Council's Capital Position

The table below shows the financing of the Original Capital Budget approved by Full Council on the 26 February 2020 and the latest Revised Capital Budget. The decrease is due to a combination of in year budget monitoring adjustments and reprofiling of capital expenditure into future years.

Capital	2020/21 Original Estimate £'000	2020/21 Revised Estimate £'000
Total Budget	**19,468**	**16,908**
Financed by:		
Capital receipts	2,020	2,516
Capital grants	9,484	6,571
Revenue	1,326	1,395
Total financing	**12,830**	**10,482**
Borrowing need	**6,638**	**6,426**

10. Investment Portfolio 2020/2120

As shown by the interest rate forecasts in section 7, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. 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 31st March 2023, investment returns are expected to remain low.

The average daily level of funds deposited during the financial year to date is £30.1m, compared with £17.3m for the same period in 2019/20. The actual value of funds deposited on the 30 September was £23.1m. These funds have been available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The fund balances include the COVID-19 government grant of £26.5m received in April to support small businesses and retail, hospitality and leisure businesses which has been held in the councils HSBC deposit account and distributed to businesses over the 6 month period.

There were 5 investments carried forward from 2019/20 totalling £18.1m, of which £12.1m was in call accounts with our bank HSBC, £4m was in fixed term deposits with Bank of Scotland, and £2m was in a fixed term deposit with Suffolk County Council.
There have been 3 new investments made during the period 1 April to 30 September 2020 totalling £8m, as well as a daily average of £21.7m being invested with HSBC's deposit account. Again, this includes the COVID-19 government grant to support small businesses and retail, hospitality and leisure businesses which has been distributed during the first 6 months of the year.The table below shows the amount deposited, and the rate of return against the market benchmark.

Counterparties	Date of Investment	Investment Made £m	Return	Benchmark
Santander (95 Day Notice)	05/08/2020	4.0	0.60%	0.11%
HSBC (31 Day Notice)	12/08/2020	2.0	0.25%	-0.02%
Close Brothers (6 month Fixed)	11/09/2020-11/03/2021	2.0	0.45%	0.21%

The Council has an approved list of counterparties which governs treasury management investment activity. This list is a restricted list taking into consideration the credit rating of the institution concerned and there are also limits on the amount which can be invested with any particular institution from a particular sector e.g. building society, bank etc. and also any group of institutions within an overall banking group. As part of the daily operations of the treasury management dealings, in consultation with guidance from Link Asset Services and the money market brokers, decisions are taken by the Head of Finance & Property Services, temporarily suspending/revising operations with individual counterparties. The latest deposit counterparties list was approved by the Full Council on 26 February 2020. During the year the maximum limit for investments with HSBC was increased from £25m to £50m to allow for the unexpected level of government support grants for the coronavirus outbreak.

It is proposed that the council increases the maximum investment limit with Local Authorities from £2m to £8m, with a maximum limit of £6m per LA, and to increase the maximum investment with Money Market Funds from £2m to £8m (with a limit of £2m per MMF). This will allow more diversity in the investment of council funds and will also provide greater opportunity to take advantage of higher interest rates on offer for short term investments during the ongoing pandemic and current economic climate.

The table below shows the maximum amount invested with any of the counterparties at any one time during the period April 2020 to 30 September 2020 against the maximum limits approved in the 2020/21 Treasury Management Strategy.

Counterparties	Maximum Limits £m	Highest level of Investment 2020/21 (£m)
HSBC	50.0	40.3
Bank of Scotland	4.0	4.0
Santander	4.0	4.0
Suffolk County Council	2.0	2.0
Close Brothers	2.0	2.0

11. **<u>Property Funds</u>**

The council made 2 investments totalling £2m in property funds in 2018/19 for the purpose of increasing and diversifying our risk in investment income receivable and to help alleviate future revenue budget pressures. Dividends received in the 3 month period April to June 2020 amounted to £14,523, earning an average yield of 2.9%,compared to £16,756 received for the same period in 2019/20.

In March, CCLA reported that they would expect to pay between 70% and 75% of the historic distributions this year with the final quarter for 2020/21 being higher.
Hermes reported collection rates of around 60% three weeks into the first quarter of 2020/21. The actual amount received in dividends in the first quarter of 2020/21 was equal to 86.7% of the amount received for the same period in 2019/20, with CCLA being 89.1% and Hermes 83.3%, which were better than anticipated.

12. **<u>Borrowing</u>**

The Council's capital financing requirement (CFR) for 2020/21 is £43.782m. The CFR denotes the Council's underlying need to borrow for capital purposes. Below is a summary of the Councils' external indebtedness, as at 1 April 2020, and as at 30 September 2020.

Borrowing	1 Apr 20 £'000	30 Sept 20 £'000	Change Apr – Sept £'000
Public Works Loan Board	37,663	36,663	(1,000)
Temporary Market Loans	16	16	-
Total	**37,679**	**36,679**	**(1,000)**

PWLB Loans – There was one loan of £1m repaid during the period 1 April to 30 Septemebr 2020.

Temporary Market Loans – There has been no movement in temporary market loans during the period 1 April 2020 to 30 September 2020.

13. **<u>Debt Rescheduling</u>**

There have been no debt rescheduling opportunities in the current economic climate and consequent structure of interest rates. Therefore, no debt rescheduling was undertaken during the first six months of 2020/21.

14. **Compliance with Treasury & Prudential Limits**
It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy.

During the financial year to date the Council's treasury management activities operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy in compliance with the Council's Treasury Management Practices.

An extract of the Prudential and Treasury Indicators are shown in Appendix 1.

15. **Interest Payable on External Borrowing / Interest Receivable**
Provision is made in the revenue budget to meet the net interest payable on external borrowing. The figure in the original budget for 2020/21 was set at £1,134,193.

This budget has been revised up to £1,160,904 due to new PWLB borrowing for capital expenditure increasing the amount of interest to be repaid.

The total interest receivable on temporary deposits for the period 1 April 2020 to 30 September 2020 amounted to £24,336. an additional £14,523 was received in dividends on Property Funds for the period 1 April 2020 to 30 June 2020. The budget for the year for interest and dividend receipts was set at £180k. This has been revised down to £100k due to the reduction in base rate interest to 0.10% at the beginning of the year.

FINANCIAL IMPLICATIONS AND BUDGET PROVISION

16. None arising as a direct result of this report.

POLICY IMPLICATIONS

17. Compliance with the revised CIPFA Code of Practice on Treasury Management.

DETAILS OF CONSULTATION

18. None.

BACKGROUND PAPERS

19. None.

FURTHER INFORMATION	
PLEASE CONTACT:	**Howard Hamilton-Smith – Head of Finance and Property**