Appendix K2:
Treasury Management Strategy – mid-year review

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review Report
2021/22
English and Welsh authorities

1. Background

1.1 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2020/21, all local authorities have been required to prepare a Capital Strategy which is to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

1.2 Treasury management

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

The second main function of the treasury management service is 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 operations. This management of longer term cash 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.

Accordingly, treasury management is defined as:

"The management of the local authority'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."

2. 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 Policy Statement 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 the full Council of an annual Treasury Management Strategy Statement - 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 Policy and Resources Committee:

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

- 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 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.
- An Economic update

Executive Summary

- The strategies set out in the Treasury Management Strategy approved by the Policy and resources committee on February the 8th 2021 remain in place and no breaches of strategy in relation to debt or investments have taken place.
- This mid-year update would like to clarify the position regarding the borrowing strategy (item 3.4) of the 21-22 Treasury management Strategy. While the council operates two pools of debt (General Fund and the Housing Revenue account) with each fund servicing the interest costs of a proportionate share of debt, for the purposes of compliance with the prudential indicators and for the policy of borrowing in advance of need the capital financing requirement the council will use is the combined capital financing requirement of the two pools. This does not conflict with the need to ensure the affordability of debt for each pool and is consistent with the Prudential Code.
- In the period to the 31st September 2021 £100m of PWLB borrowing has been taken to support the HRA. This was based on a need identified within the HRA capital expenditure plans and affordability is documented in the HRA 30 year business plan.
- Investment performance throughout the same period has been well above the benchmark. We have averaged a return of 0.22% against a benchmark of -0.08%. This benchmark is the rate at which banks will lend to one another and due to ultra-low interest rates and strong credit conditions this rate is negative at the moment.

3. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

3.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget

Capital Expenditure by Service	2021/22 As shown in TMSS £m	2021/22 at 30/09/2021 £m	2022/23 Projection £m	2023/24 Projection £m
General Fund	348,413	315,294	143,260	122,570
HRA	98662	71,597	73,567	42,108
Total capital **expenditure**	447,074	386,891	216,827	164,678

There has been a substantial revision (£61m) in the budgeted for capital expenditure after the approval of the TMSS relating to reprofiling of expenditure. This is due to various changes in the programme principal amongst them £30m related to reprofiling of loans to ODH and ULF Sage and significant reprofiling of HRA programmes to future years (£25m). The current projection is (33K) than the estimate included within the TMSS

3.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2021/22 As shown in TMSS	2021/22 Revised Budget £m	2022/23 Projection £m
Total capital expenditure	**447,074**	**386,891**	**216,827**
Financed by:			
Capital receipts	**9,631**	**14,107**	**6,292**
Capital grants	**214,384**	**170,828**	**92,158**
Capital reserves	**32,239**	**28,290**	**25,383**
Revenue	**12,033**	**17,555**	**4,967**
Total funding	**268,287**	**230,780**	**128,800**
Borrowing requirement	**178,787**	**156,111**	**88,027**

3.3 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 Indicator – Capital Financing Requirement

We are on target to achieve the original forecast Capital Financing Requirement (*or explain any significant changes*).

Prudential Indicator – the Operational Boundary for external debt

	2020/21 Actual £000s	2021/22 projection as shown in TMSS £000s	2022/23 Projection* £000s
Prudential Indicator – Capital Financing Requirement			
CFR – non housing	502,208	504,819	611,430
CFR – housing	234,458	262,768	270,347
Total CFR	736,666	767,587	881,777
Net movement in CFR	**136,778**	**141,439**	**145,111**
Prudential Indicator – the Operational Boundary for external debt			
Borrowing	492,561	536,707	647,598
Other long-term liabilities**	13,698	13,834	13,461
Total debt (year-end position)	**505,184**	**550,501****	**661,059***
TMSS Operational boundary	**652,703**	**858,408****	**858,408****
Debt headroom	**147,519**	**307,907**	**197,349**

**Revised since 21-22 TMSS, ** From 21-22 TMSS*
**** On balance sheet PFI schemes and finance leases etc.*

3.4 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.

** The management of transferred debt should be excluded from net borrowing.*

	2020/21 Actual £000s	Current Position At 31st September £000s	2022/23 Projection £000s
Borrowing	492,561	584,080	584,080
Other long term liabilities*	13,698	14,319	13,946
Treasury Investments	-153,900	-228,230	-100,000
Net debt	352,359	370,169	498,026
CFR* (year end position)	736,666	892,777	881,777

**Includes on balance sheet PFI schemes and finance leases etc.*

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

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 Members. 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.

Authorised limit for external debt	**2020/21 Original Indicator As per TMSS £000s**	**2021/22 Projection**
Borrowing	739,242	944,574
Other long term liabilities*	20,601	18,088
Total	759,843	962,662

Both the current and year-end projected borrowing are well within the authorised debt limits.

4. Investment Portfolio 2021/22

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. 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 31st March 2023, investment returns are expected to remain low.

The Council held £228.30m of investments as at 31 September 2021 and the investment portfolio yield for the first 6 months of the year is 0.22% against the 7-day LIBID of -0.08% (benchmark).

The Executive Director of Resources confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2020/21.

The Council's budgeted investment return for 2020/21 is £750,000, and performance for the year to date is in line with budget.

5. Borrowing

The Council's capital financing requirement (CFR) for 2022/23 is estimated at £881.777m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

Due to the increase in PWLB margins over gilt yields in October 2019, and the subsequent consultation on these margins by HM Treasury - which ended on 31st July 2020 - the Authority has refrained from undertaking new long-term PWLB borrowing for the present and has met its requirements for additional borrowing by using short-term borrowing until such time as new PWLB margins are finally determined. In addition, the effect of coronavirus on the capital programme objectives are being assessed. Therefore, our borrowing strategy will be reviewed and then revised in order to achieve optimum value and risk exposure in the long-term.

It is anticipated that further borrowing will be undertaken during this financial year.

The table below shows a summary of the treasury management activity over the six-month period from 01/04/2021 to 30/09/2021

LBB Portfolio Summary		Amount £'000s	Ave Interest Rate %
Investments	- as at 1 April 2021	155,980	0.11%
	- matured in period	(471,500)	
	- arranged in period	543,750	
	- as at 30 Sept 2021	**228,230**	0.22%
Debt	- as at 1 April 2021	484.080	3.13%
	- matured/repaid in period	0	
	- arranged in period	100,000	
	- as at 30 Sept 2021	**584,080**	2.91%

TREASURY MANAGEMENT INDICATORS

The Council measures its exposures to treasury management risks using the following indicators. Council is asked to note the following indicators as at 30 September 2021

Security: Average credit rating

To measure the security of its portfolio, the Council compares the historic risk of default of its investments against a maximum target rate.

As an example, based on historic data, a AAA (least risk) rated investment has 0% chance of default within 1 year and a 0.05% chance of default within 3 years. A BBB+ (most risk) rated investment has a 0.22% chance of default within 1 year and a 1.21% chance of default within 3 years. There have been no default events associated with any counterparties the Council has utilised within its investment portfolio since 2009 at the time of the Icelandic banking collapse. All funds and accrued interest held at that time were subsequently reclaimed via the administration process.
Using the criteria above, the Council's overall portfolio at 30 September 2021 had a 0.024% risk of default, ie, a very small, but not nil, probability.

	Limit	Actual	Met?
Historic risk of default	0.25% (max)	0.024%	✓

5.1 Debt Rescheduling

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.

Appendix 1 Economics and interest rates

ECONOMIC REVIEW APRIL – SEPTEMBER 2021

- **UK** 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; only one MPC member voted to stop these purchases now to leave total purchases £45bn short of the total target.
- The MPC was more upbeat in its new 2-3 year forecasts so whereas they had expected unemployment to peak at 5.4% in quarter 3, 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.)
- The MPC forecast that there would be excess demand in the economy by quarter 3 2022 causing CPI inflation to rise above the 2% target in quarter 3 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.
- The Covid-19 outbreak has resulted in 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 Monetary Policy Committee 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.

One key addition to **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 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%.

Interest rate forecasts

The Council's treasury advisor, Link Group, has provided the following forecasts (PWLB rates are certainty rates)

Link Group Interest Rate View			10.8.21								
	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25	0.50
3 month ave 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 ave 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 ave earnings	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.70
5 yr PWLB	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.50	1.50
10 yr PWLB	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00
25 yr PWLB	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.40	2.50
50 yr PWLB	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.30

Additional notes by Link on this forecast table:

LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months

Gilt yields and PWLB rates

As the interest forecast table for PWLB certainty rates, (gilts plus 180bps), above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2021/22.

The balance of risks to the UK: -

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

- 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.

Downside risks to current forecasts for UK gilt yields and PWLB rates include: -

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, resulting in further national lockdowns or severe regional restrictions.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Bank of England** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU agreed a €750bn fiscal support package which has still to be disbursed. These actions will help shield weaker economic regions in the near-term. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.

- Weak capitalisation of some **European banks**, which could be undermined further depending on the extent of credit losses resulting from the pandemic.

- **German minority government & general election in September 2021.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, because of the rise in popularity of the anti-immigration AfD party. Subsequently, the CDU has done badly in state elections, but the SPD has done even worse. Angela Merkel has stepped down from being the CDU party leader but remains as Chancellor until the general election in 2021. Her appointed successor has not attracted wide support from voters and the result of the general election could well lead to some form of coalition government, though there could be a question as to whether the CDU will be part of it which, in turn, could then raise an issue over the tenure of her successor. This then leaves a question mark over who the major guiding hand and driver of EU unity will be.

- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile and, therein, impact market confidence/economic prospects and lead to increasing safe-haven flows.

- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe-haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- Vaccinations are even more successful than expected and eradicate hesitancy around a full return to normal life, which leads into a stronger than currently expected recovery in UK and/or other major developed economies.

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- Longer term treasury yields rise strongly and pull gilt yields up higher than forecast.

APPENDIX 2: Investing

The levels shown below use the traditional market method for calculating LIBID rates – ie LIBOR – 0.125%. Given the ultra-low LIBOR levels through the first half of 2021/22 this produces negative rates at the short end of the money market yield curve.

Investment performance year to date as at 30th September 2021

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	-0.08%	0.22%	£380,279