PART 1	ITEM NO.

REPORT OF THE LEAD MEMBER FOR FINANCE AND SUPPORT SERVICES

TO COUNCIL ON 18 NOVEMBER 2020

TITLE: TREASURY MANAGEMENT STRATEGY MID YEAR REVIEW 2019/20

RECOMMENDATIONS:

It is recommended that the City Mayor and Members note the contents of the report and approve the update to the prudential indicators

EXECUTIVE SUMMARY:
This report provides a progress report on the treasury management strategy for 2020/21 and updates the prudential indicators. City Mayor and Members will be requested to approve the update to the prudential indicators

BACKGROUND DOCUMENTS:
Various working papers in the Finance division including:

- Treasury management strategy 2020/21 reported to council on 26 February 2020
- Treasury management practices TMPs 1 to 12 and supporting schedules
- Treasury management in the public services, code of practice and cross-sectoral guidance notes (CIPFA), “CIPFA Code”
- Treasury management in the public services, guidance notes for local authorities including police authorities and fire authorities (CIPFA), “CIPFA guidance”

KEY DECISION: ~~YES /~~ NO

DETAILS: overleaf

1. BACKGROUND

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

1.2 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 longer-term cash flow planning to ensure the Council can meet its capital spending schedule. 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.

1.3 Treasury management is defined as:

> "The management of the local authority's 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

2.1 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:

- 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 way 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 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.

- 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.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to the Overview and scrutiny board.

2.2 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 part 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 budget report, 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 compliance with Treasury and Prudential Limits for 2020/21.

3. ECONOMIC UPDATE

3.1 During the first half of 2020 GDP fell by 21.8%, the bank of England monetary policy committee forecast peak unemployment in quarter 4 2020.

3.2 CPI inflation is expected to rise above the 2% target in quarter 3 2022. A new phrase was used in the Bank of England 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". This may indicate, that even if inflation rises to 2% in 2022, the MPC will not raise the Bank Rate until they can clearly see that the level of inflation is going to be persistently above target if it takes no action to raise Bank Rate

3.3 Overall, the economy is expected to return to pre-covid levels over a longer timescale, with the recovery adversely affected by the continuing impact of COVID 19.

4. INTEREST RATE FORECAST

Table 1 Link Asset Services interest rate forecast:

Link Group Interest Rate View 11.8.20	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	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
6 Month LIBID	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
12 Month LIBID	0.20	0.20	0.20	0.20	0.20	0.20	0.20	-	-	-	-
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

4.1 The Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, the level at which it remains

5. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

5.1 The Treasury Management Strategy Statement (TMSS) for 2020/21 was approved by the council on 26 February 2020. The council's Annual Investment Strategy, which is incorporated into the TMSS, outlines the council's investment priorities as *security of capital* and *liquidity*. The council also aims to achieve the optimum return (*yield*) in investments, commensurate with the proper levels of security and liquidity.

5.2 In the current economic climate, it is considered appropriate to keep a significant proportion of investments short term (less than 1 year) and only invest with high credit rated financial institutions or those guaranteed by the UK government, using Link Asset Services' suggested creditworthiness approach.

5.3 During April, May and June the counterparty limits were temporarily raised from £15m to £25m, after consultation with the lead member for Finance and Support Services, in order to manage the cashflow impact of money received by the council mainly relating to Covid19. This included £47.4m business grants funding to be distributed to local business, £8.9m emergency COVID 19 funding from the government and the accelerated payment of section 31 grants £11.4m.

5.4 During the first half of 2020/21 the council had not taken out any long-term borrowing. However, as the capital financing requirement for 2020/21 is forecast to rise by £44.7m, the option to use long term borrowing to finance this expenditure to minimise the council's interest rate risk exposure will be kept under review.

5.5 Investments and borrowing during the first six months of the year have been in line with the strategy, but with revised counterparty limits. Currently the target is to hold £25m - £35m in callable investments in order to provide the necessary liquidity for the council's cash flow.

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

6. THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

Table 2 Prudential Indicator for Capital Expenditure £m for 2020/21

	Original estimate	Current position	Revised estimate
Capital expenditure	160.4	37.6	125.5

6.1 Table 2 shows the revised estimates for capital expenditure since the capital programme was agreed in February 2020. The increase in forecast spend is due to schemes being reprofiled from the 2019/20 capital programme.

Table 3 Changes to the Financing of the Capital Programme 2020/21 £m

	Original estimate	Revised estimate
Grants	74.6	41.9
Borrowing requirement	85.8	83.6
Total	160.4	125.5

6.2 Table 3 shows the funding of the capital expenditure plans. The borrowing requirement 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).

Table 4 Capital Financing Requirement (CFR) £m 2020/21

	Original estimate	Revised estimate
Capital financing requirement	889.3	709.2
Annual change in CFR	203.4	44.7

6.3 The reduction in the forecast capital financing requirement is due to the postponement by one year of the implementation of IFRS 16 due to the COVID 19 pandemic. As a result, several leases will not be recognised on the council's balance sheet until 2021/22.

Table 5 Debt forecast £m

	Original estimate	Current position	Revised estimate
Borrowing	505.0	404.3	490.3
Other long-term liabilities	329.7	175.9	173.3
Total debt (yearend position)	834.7	580.2	663.6

6.4 Long term liabilities reduce as PFI schemes payments are made and as transferred debt (from the breakup of Greater Manchester Council) is repaid. By the end of the year a further 6 months of payments will have been made, this will reduce the balance nearer to the revised estimate. The reduction in the forecast is due to the postponement of the implementation of IFRS 16.

6.5 A key control applied to treasury activity is a prudential indicator to ensure that, over the medium term, debt will only be for a capital purpose, so no borrowing to invest. 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. As the total debt at the end of the year is forecast to be £663.6m and the forecast CFR is £709.2m this control has been complied with.

6.6 This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need if it is considered that this would be advantageous.

Table 6 Prudential Indicators Operational Boundary £m 2020/21

	Original estimate	Revised estimate
Borrowing	628.1	617.0
Other long-term liabilities	359.8	203.3
Total debt (yearend position)	987.9	820.3

6.7 The Operational Boundary for External Debt is based on the probable external debt during the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It acts as an early warning indicator to ensure the authorised limit is not breached. Similarly, to the authorised limit it also provides scope for the Council to borrow in advance of need. The prudential indicators have been updated to reflect changes to the underlying need to borrow due to the changes in the forecast borrowing requirement. In addition, for other long-term liabilities, the limit has reduced as the revised estimate reflects the delay in the implementation of the new accounting standard IFRS 16 . More details on IFRS 16 are detailed in section 9.

6.8 The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

6.9 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 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. The Authorised Limit is adjusted to reflect changes to the council's capital programme and the delay in the implementation of IFRS 16.

Table 7 Prudential indicator - authorised limit for external debt £m

	Original estimate	Current position	Revised estimate
Borrowing	685.4	404.3	657.0
Other long-term liabilities	389.8	175.9	233.3
Total debt (yearend position)	1,075.2	580.2	890.3

6.10 Appendix 2 details the prudential and treasury indicators for the next 4 years.

7. INVESTMENT PORTFOLIO 2020/21

7.1 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 4, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.10% Bank Rate.

7.2 The Council held £27.939m of investments as at 30 September 2020 (£65.290m at 31 March 2020) and the investment portfolio yield for the first 6 months of the year is 0.24% against current bank rate of 0.10%. The level of investments varies throughout the year, for example some investments held in March matured in April to enable a payment to be made to the pension fund in April.

7.3 The Chief Finance Officer confirms that the revised approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2020/21.

7.4 The Council's budgeted investment return for 2020/21 is £0.409m, and performance for the year to date is below this at £0.068m. However, whist reduced interest rates have affected the council's investment income, there has been a saving on the council's temporary borrowing budget with a budget for the year of £1.686m against costs of £0.342m for the year to date.

7.5 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function. It provides sufficient creditworthy counterparties for the council's investments.

7.6 There has been no change in the council's risk appetite for investments.

8. BORROWING

8.1 The Council's capital financing requirement (CFR) for 2020/21 is forecast to be £709.2m. 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. Table 5 shows the Council's current debt level of £404.3m and the yearend forecast of £490.3m.

8.2 The option to use long term borrowing to finance this expenditure to minimise the council's interest rate risk exposure will be kept under review. This will include an assessment of the different sources of funding available to the council.

Table 8 graph showing the movement in PWLB certainty rates since the start of the current financial year

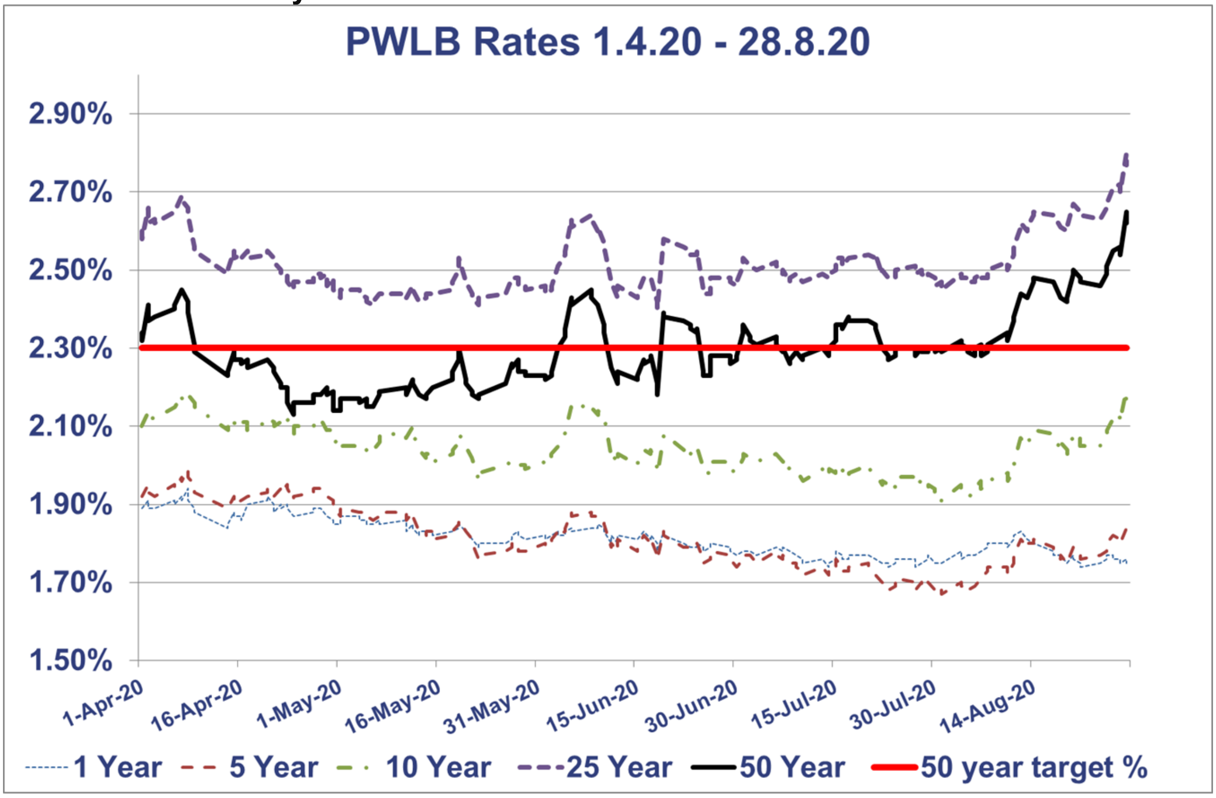

Table 9 table showing the movement in PWLB certainty rates since the start of the current financial year

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.74%	1.67%	1.91%	2.40%	2.13%
Date	14/07/2020	30/07/2020	31/07/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/2020	08/04/2020	08/04/2020	28/08/2020	28/08/2020
Average	1.81%	1.81%	2.04%	2.52%	2.30%

8.3 PWLB rates have varied within a relatively narrow range between April and July but the rates on longer term borrowing have risen during August.

8.4 No debt rescheduling has been undertaken to date in the current financial year.

9. OTHER

IFRS16 accounting standard

9.1 This accounting standard will come into effect from 1 April 2021 and be implemented in the 2021/22 financial accounts. It specifies the principles for recognition, measurement, presentation and disclosure of leases as a response to concerns about the lack of transparency in information. For any leases the council has entered or enters into as a lessee, the assets and liabilities arising with a term of more than 12 months are to be recognised in the financial statements unless they are of low value (less than £5k).

9.2 The impact on the council is likely to be the recognition of additional assets on the balance sheet leading to a significant increase in the CFR, due to the expected level of leases the council has entered into of this nature. The prudential indicators table in appendix 2 reflects an initial estimate based on information readily available. An exercise to review all the council's lease contracts is due to take place over the next year.

Changes in risk appetite

9.3 The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports. There has been no change in the council's risk appetite for investments.

10. CONCLUSION AND RECOMMENDATIONS

10.1 The council has not taken any new long term borrowing so far in this financial year. The option to use long term borrowing to finance capital expenditure to minimise the council's interest rate risk exposure will be kept under review. The council has continued to manage a portfolio of short-term borrowing to take advantage of the low interest rates currently available in the market.

10.2 The council has stayed within prudential limits in the review period.

10.3 The City Mayor and Members are requested to note the contents of the report and approve the changes to the prudential indicators detailed in appendix 2.

KEY COUNCIL POLICIES: Treasury management strategy; budget strategy.

EQUALITY IMPACT ASSESSMENT AND IMPLICATIONS: Not applicable

ASSESSMENT OF RISK:

The monitoring and control of risk underpins all treasury management activities. The main risks are of adverse or unforeseen fluctuations in interest rates and security of capital sums.

LEGAL IMPLICATIONS Supplied by: Tony Hatton, Principal Solicitor

The Treasury Management Strategy sets out the Council's policies for managing its investments which includes giving priority to security and liquidity.

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Act therefore requires the Council to set out its Treasury Management Strategy at the start of each new financial year and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Council is also required to "determine for the current financial year an amount of Minimum Revenue Provision (MRP) that it considers to be prudent." It is also required to submit a statement on the Council's policy for its annual MRP to the Council for approval before the start of the financial year to which the provision will relate.

The Treasury Management Strategy 2020/21was set out in a report to Council and approved by them on the 27 February 2020. This complied with the relevant requirements of the Local Government Act 2003 and the CIPFA Treasury Management Code. This further report to Council provides a progress report on the Treasury Management Strategy for 2020/21.

FINANCIAL IMPLICATIONS: This report has been prepared by the Finance division of the Service Reform service group. The costs of borrowing: minimum revenue provision, interest and debt management expenses, are borne by the corporate capital financing budget.

PROCUREMENT IMPLICATIONS provided by: Not applicable

HR IMPLICATIONS provided by: Not applicable

OTHER SERVICE GROUPS CONSULTED: Not applicable

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WARDS TO WHICH REPORT RELATES: None specifically.

APPENDIX 1
Glossary of Terms

Base rate – the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Capital financing requirement – reflects the local authority underlying need to borrow for a capital purpose.

Consolidated rate of interest (CRI) – is the average rate of interest for external borrowing during the year.

Fixed rate funding - a fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

Gilts - The loan instruments by which the government borrows. Interest rates will reflect the level of interest shown by investors when the government auctions gilts.

LOBO – “Lender offer, borrower option”, a financial instrument where the lender may choose to vary the interest rate at certain break points. Only if the lender chooses to vary the interest rate, the borrower has an option to terminate the arrangement at no penalty.

Market - The private sector financial institutions - banks, building societies etc.

Maturity profile - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the council vulnerable to current interest rates in that year.

Monetary Policy Committee (MPC) – the independent body which determines base rate.

PWLB - Public Works Loan Board. An institution managed by the government to provide loans to public bodies at rates which reflect the rates at which the government is able to sell gilts.

Variable rate funding - The rate of interest either continually moves reflecting interest rates of the day, or can be tied to specific dates during the loan period. Rates may change on a monthly, quarterly or annual basis.

Volatility - The degree to which the debt portfolio is affected by current interest rate movements. The more debt that matures in the year and needs replacing, and the more debt subject to variable interest rates, the greater the volatility.

Yield curve - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short term loans compared to long term loans. An inverted yield curve is the opposite of this.

APPENDIX 2

Table 10 Revised Prudential and Treasury Indicators £m

Prudential Indicators	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Capital Expenditure	81.5	125.5	65.9	20.0	20.0
Capital financing requirement (CFR)	663.5	709.2	878.6	854.2	828.3
Total debt	618.5	663.6	832.4	807.5	781.0
Annual Change in CFR					
Capital expenditure financing	47.0	83.6	51.1	20.0	20.0
Debt repayment provision MRP	-27.1	-37.9	-41.7	-44.4	-45.9
Total	19.9	45.7	9.5	-24.4	-25.9

Table 11 Operational boundary for external debt £m

Treasury Indicators	2019/20	2020/21	2021/22	2022/23	2023/24
Borrowing	598.6	617.0	603.2	587.3	570.3
Other long-term liabilities	208.5	183.3	355.4	346.9	338.0
Total	807.1	800.3	958.6	934.2	908.3

Table 12 Authorised limit for external debt £m

Treasury Indicators	2019/20	2020/21	2021/22	2022/23	2023/24
Borrowing	669.7	657.0	643.2	627.3	610.3
Other long-term liabilities	238.5	193.3	385.4	376.9	368.0
Total	908.2	850.3	1,028.6	1,004.2	978.3

Table 13 Graph of CFR, total debt, operational boundary and authorised limit

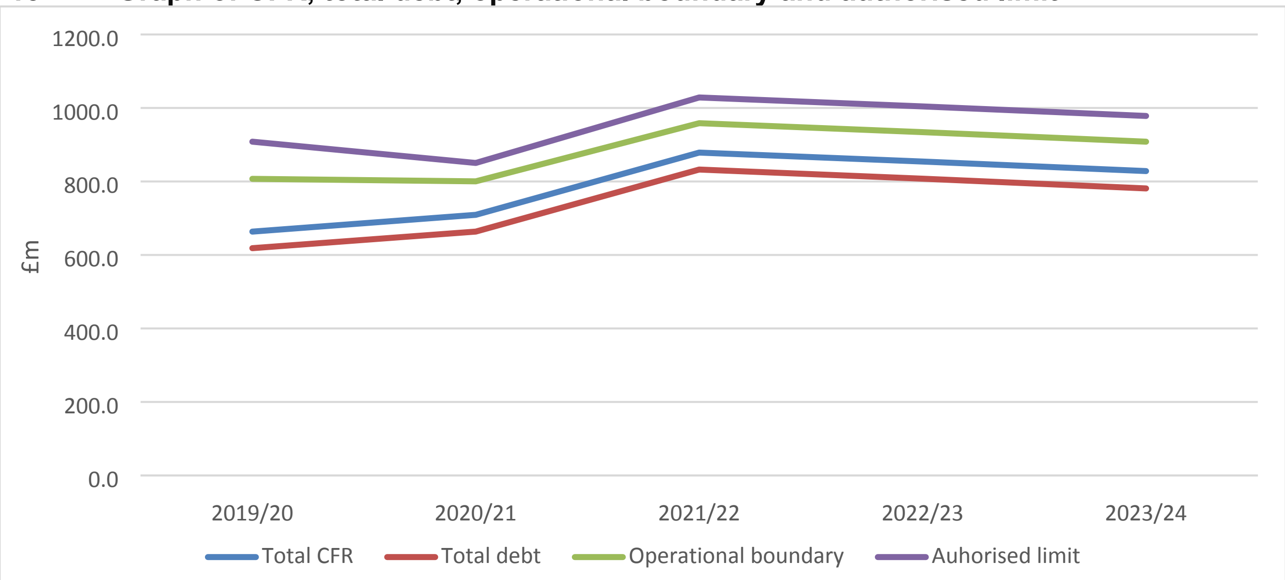

Table 14 Maturity structure for fixed rate borrowing estimated position at year end

	Upper Limit	Lower Limit	%	£M
Under 12 months	75%	0%	37%	247.0
12 and within 24 months	50%	0%	10%	63.2
24 months and within 5 years	50%	0%	15%	101.3
5 years and within 10 years	50%	0%	6%	39.3
10 years and above	100%	25%	32%	212.9

Table 15 Maturity structure for variable rate borrowing estimated position at year end
Table 16

	Upper Limit	Lower Limit	%	£M
Under 12 months	10%	0%	0%	0.0
12 and within 24 months	0%	0%	0%	0.0
24 months and within 5 years	0%	0%	0%	0.0
5 years and within 10 years	0%	0%	0%	0.0
10 years and above	0%	0%	0%	0.0

Table 17 Upper Limit for Investments beyond 365 days estimated position at year end

	2020/21	2021/22	2022/23	2023/24	Estimated position at year end
Upper Limit for Investments beyond 365 days	£40m	£40m	£40m	£40m	£0

The operational boundary limits for external debt reflect the estimate of the most likely, prudent, but not worst case, scenario without the additional headroom included within the authorised limit.

These indicators should be considered together. Whilst all the council's borrowing is fixed, the amount due to mature in the next 12 months looks high at £247.0m, this is partly explained because the figure includes £83m of LOBO loans that are callable in 2020/21, it is unlikely that LOBO loans will be called over the next few years as the LOBO interest rates already exceed current market rates and the option to change lies with the banks. The forecast £157.4m of temporary borrowing due for renewal within 12 months; is in-line with the council's current strategy.

Following the increase in the margin in the PWLB rates by an additional 1%, the differential is 1.82% between short term rates (0.2% for 1 year) and 10-year maturity PWLB rate (2.02%). Although the current strategy is to utilise very low short-term rates. With £157.4m of forecasted temporary borrowing, the additional call on the revenue budget of switching from temporary borrowing to a 10-year fix would be £2.9m per year.

For exceptional reasons only, such as a large-scale voluntary transfer of assets, the indicators may be temporarily flexed to allow repayment and rescheduling of borrowing.