

Agenda Item No:	7	
Committee:	Cabinet	
Date:	8 December 2021	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2021/22	

1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2021/22.

2 Key issues

- The Treasury Management Mid-Year Review 2021/22 as considered by Audit & Risk Management Committee on 29 November 2021 is attached.
- The report highlights all the key activities carried out within the Treasury Management function during the first six months of 2021/22. All activities have been conducted in accordance with the approved strategy and policies.
- Prudential indicators for the Capital Financing Requirement (CFR) and the capital position have been revised.

3 Recommendation

It is recommended that Members note the report.

Agenda Item No:	9	
Committee:	Audit and Risk Management Committee	
Date:	29 November 2021	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2021/22	

1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2021/22 and to provide members with an update on matters pertinent to future updates to the Council's Treasury Management Strategy.

2 Key issues

- The Council has operated within its Treasury Management Strategy Statement (TMSS), Annual Investment Strategy, treasury limits and prudential indicators set by Council for the first six months of 2021/22.
- Forecasts for Bank Rate now includes five increases, one in December 2021 to 0.25%, rising incrementally to 1.25% by Q1 2025.
- PWLB certainty rates are forecast to rise steadily over the next three-and-a-half years.
- The Prudential indicators for the Operational Boundary and Authorised Limit have been adjusted reflecting the anticipated need for external borrowing to support the Council's Commercial and Investment Strategy.
- Due to the Council's long term debt portfolio (£7.8m at 31/03/21) currently attracting excessive premiums for early redemption of debt, as has been the case since 2007, it is not financially advantageous for the Council to comply with the Gross Borrowing and Capital Financing Prudential Indicator in 2021/22.
- No new external borrowing has been taken out to date in 2021/22. The current Medium Term Financial Strategy assumes that some external borrowing will be required over the three-and-a-half-year period to 31 March 2024.
- Investment income received for the first six months of 2021/22 is £21k. This is in line with the original estimate of £40k for the whole year.
- Property Funds formed part of the Council's Annual Investment Strategy approved in February 2021 as an instrument to increase investment returns from surplus cash balances. There has been a delay in accessing Property Funds whilst the impact of COVID-19 is fully understood and other commercial property acquisitions are considered, with a corresponding reduction in budgeted income this year of around £150k.

3 Recommendations

It is recommended that Members note the report.

Wards Affected	All
Portfolio Holder(s)	Cllr Chris Boden, Leader and Portfolio Holder, Finance
Report Originator(s)	Peter Catchpole, Chief Finance Officer and Corporate Director Mark Saunders, Chief Accountant
Contact Officer(s)	Peter Catchpole, Chief Finance Officer and Corporate Director Mark Saunders, Chief Accountant
Background Paper (s)	Link Asset Services template Council Report - 23 February 2021 - General Fund Budget 2021/22 and Capital Programme 2021-24 Cabinet Report – 15 July 2021 - Capital Programme Update

Report:

1 Context

- 1.1 The Council's responsibilities in relation to Treasury Management are defined as part of the Local Government Act 2003 ('the Act'). The Act requires the Council to have regard to the Treasury Management Code published by the Chartered Institute of Public Finance and Accountancy, (CIPFA). CIPFA updated the Treasury Management Code in December 2017 and this report has been prepared with reference to the requirements set out in the updated Code.
- 1.2 Additionally, there is a statutory requirement for the Council to comply with the Prudential Code which is also published by CIPFA and was also updated in December 2017. There is a close interaction between the Treasury Management Code and the Prudential Code. The Prudential Code establishes a framework for the Council to self-regulate the affordability, prudence and sustainability of its capital expenditure and borrowing plans whilst the Treasury Management Code is concerned with how the Council uses its Treasury Management function to progress the future plans developed with reference to the Prudential Code.
- 1.3 Reductions in central government funding for local government and declining returns on deposits invested with financial institutions has led some local authorities to explore other avenues for generating investment returns, including investment in non-financial assets. Local authority spending on commercial property takes place in the context of the prudential framework, made up of both powers and duties created by legislation and a set of statutory codes and guidance to which authorities must have regard. In particular, there is a recognition that all authorities need to ensure they can clearly identify the strategic considerations underpinning their investment strategies and effective governance frameworks are in place to protect and preserve each authority's long-term financial sustainability. Specifically, from 2019/20, all local authorities have been required to approve a Capital Strategy which is intended 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.

The Council's Capital Strategy for 2021/22 was approved by Full Council on the 23 February 2021.

- 1.4 The Council recognises that there is an ongoing consultation relating to changes to both the Prudential Code and the Treasury Management Code with new versions of both documents due to be published in December 2021. Whilst CIPFA has recently announced that full implementation of the updated codes will not be required until the 2023/24 financial year, the impact of changes to both documents will be considered when determining the Council's Treasury Management Strategy Statement and Capital Strategy for 2022/23 which are due to be approved in February 2022.

Treasury Management

- 1.5 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."
- 1.6 The Council complies with the requirements of CIPFA's Code of Practice on Treasury Management (revised 2017).

- 1.7 The primary requirements of the Code applicable to the 2021/22 financial year 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 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 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 (including Mid-year Review Report) to a specific named body. For this Council the delegated body is the Audit and Risk Management Committee.
- 1.8 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 2021/22 taking account of expert analysis provided by the Council's Treasury Management Advisors, Link Asset Services;
 - a review of the Treasury Management Strategy Statement and Annual Investment Strategy;
 - the Council's capital plans;
 - a review of the Council's investment portfolio for 2021/22;
 - a report of the Council's borrowing strategy for 2021/22;
 - a report of debt rescheduling during 2021/22;
 - a review of compliance with Treasury and Prudential Limits for 2021/22.

2 Economic Update

MPC meeting 04.11.21

- 2.1 The Monetary Policy Committee (MPC) voted 7-2 to leave Bank Rate unchanged at 0.10% with two members voting for an increase to 0.25% 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 by a vote of 6-3.
- 2.2 After the Governor and other MPC members had made speeches prior to the MPC meeting in which they stressed concerns over inflation, (the Bank is now forecasting inflation to reach 5% in April when the next round of capped gas prices will go up), thus reinforcing the strong message from the September MPC meeting, financial markets had confidently built in an expectation that Bank Rate would go up from 0.10% to 0.25% at this meeting. However, these were not messages that the MPC would definitely increase Bank Rate at the first upcoming MPC meeting as no MPC member can commit the MPC to make that decision ahead of their discussions at the time. The MPC did comment, however, that Bank Rate would have to go up in the short term. It is, therefore, relatively evenly balanced as to whether Bank rate will be increased in

December, February or May. Much will depend on how the statistical releases for the labour market after the end of furlough on 30th September 2021 turn out.

- 2.3 Information available at the December MPC meeting will be helpful in forming a picture but not conclusive, so this could cause a delay until the February meeting. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would, therefore, need to wait until the May meeting (although it also meets in March) when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation expected around that time. If the statistics show the labour market coping well during the next six months, then it is likely there will be two increases in these three meetings.
- 2.4 Over the next year the MPC will be doing a delicate balancing act of weighing combating inflation being higher for longer against growth being held back by significant headwinds. Those headwinds are due to supply shortages (pushing prices up and holding back production directly), labour shortages, surging fuel prices and tax increases. However, those headwinds could potentially be offset – at least partially - by consumers spending at least part of the £160bn+ of “excess savings” accumulated during the pandemic. However, it is also possible that more affluent people may be content to hold onto elevated savings and investments and, therefore, not support the economic recovery to the extent that the MPC may forecast.
- 2.5 The latest forecasts by the Bank showed inflation under-shooting the 3 years ahead 2% target (1.95%), based on market expectations of Bank Rate hitting 1% in 2022. This implies that rates don't need to rise to market expectations of 1.0% by the end of next year.
- 2.6 It is worth recalling that the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement after the MPC meeting in September yet at its August meeting it had emphasised a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was ‘sustainably over 2%’. On balance, once this winter is over and world demand for gas reduces - so that gas prices and electricity prices fall back - and once supply shortages of other goods are addressed, the MPC is forecasting that inflation would return to just under the 2% target.
- 2.7 The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
 1. Raising Bank Rate as “the active instrument in most circumstances”.
 2. Raising Bank Rate to 0.50% 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.
- 2.8 COVID-19 vaccines. These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread. There is also a potential for the winter flu season combined with Covid to overwhelm NHS hospitals so the UK is not entirely in the clear yet.
- 2.9 World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal

of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those observed in prior decades.

3 Interest Rate Forecast

- 3.1 The Council's treasury advisor, Link Group, provided the following forecasts on 8th November 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View 8.11.21														
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.10	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.50	0.60	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	1.80	1.90	1.90	2.00	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.40
25 yr PWLB	2.10	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70
50 yr PWLB	1.90	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50

- 3.2 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 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.
- 3.3 As shown in the forecast table above, the forecast for Bank Rate now includes five increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.
- 3.4 Gilt Yields / PWLB Rates - as the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US. However, there is likely to be exceptional volatility and unpredictability in gilt yields. PWLB rates and interest rates will both be kept under review by officers to inform the Council's strategy.
- 3.5 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.
- 3.6 For local authorities, this means that investment interest rates and very short term PWLB 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.

4 Treasury Management Strategy Statement and Annual Investment Strategy Update

- 4.1 The Treasury Management Strategy Statement (TMSS) for 2021/22 was approved by Council on 23 February 2021. There are no policy changes to the TMSS.
- 4.2 The Prudential indicators for the Operational Boundary and Authorised Limit have been adjusted reflecting the anticipated external borrowing need to support the Council's Commercial and Investment Strategy (see paragraph 5.3 below).

5 The Council's Capital Position

5.1 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 limits in place for borrowing activity.

5.2 At its meeting on 15 July 2021 the Cabinet approved revised estimates for the 2021/22 capital programme and the financing of that programme. The revised estimate addresses amendments to the programme since February, including re-profiling schemes from 2020/21 and a re-assessment of resources available in the period 2021-24.

5.3 The capital programme reflects the Council's decision to allocate a maximum of £25 million to take forward schemes in accordance with the Council's Commercial and Investment Strategy. Members will be aware that the Investment Board approved the first purchase of an Investment Property in March 2021. Originally, £10 million of borrowing to fund the Commercial and Investment Strategy was allocated to the 2021/22 financial year. This has been reduced in light of the purchase which took place in March 2021 after the 2021/22 budget had been approved.

5.4 The table below compares the revised estimates with the original capital programme which was incorporated into the 2021/22 Treasury Management Strategy Statement (TMSS).

Capital Programme	2021/22 Original Estimate £000	2021/22 Revised Estimate £000
Capital Programme (Excluding Commercial and Investment Strategy Schemes)	17,970	21,447
Commercial and Investment Strategy Schemes	10,000	6,302
Forecast Expenditure	27,970	27,749
Financed by:		
Capital Grants	14,449	16,327
Section 106's & Contributions	108	159
Capital Receipts	265	265
Capital Reserves	508	563
Total Financing	15,330	17,314
Borrowing Requirement	12,640	10,435

5.5 The table below shows the anticipated CFR at 31 March 2022, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period; this is termed the Operational Boundary. The revised estimated CFR is in line with the original forecast.

Prudential Indicators	2021/22 Original Estimate £000	2021/22 Revised Estimate £000
Capital Financing Requirement as at 31 March 2022	15,409	15,409
External Debt / Operational Boundary		
Borrowing	12,000	12,000
Other Long Term Liabilities Finance Leases	1,000	1,000
Commercial Activities/ Non Financial Investments	25,000	21,302
Total Debt 31 March	38,000	34,302

- 5.6 The Council has made provision to repay all 'borrowing' liabilities through increased Minimum Revenue Provision (MRP) in the General Fund revenue budget.
- 5.7 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the 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. The policy permits borrowing in advance of need where it is prudent to do so. Members should note that the current limits and estimates set out below have been determined with reference to the existing capital programme.

Limits to Borrowing Activity	2021/22 Original Estimate £000	2021/22 Revised Estimate £000
Gross Borrowing (Excluding Commercial and Investment Strategy Schemes)	11,060	7,800
Plus Other Long Term Liabilities Finance Leases	106	106
Commercial Activities/ Non Financial Investments	10,000	10,000
Anticipated Gross Borrowing as at 31 March 2022	21,166	17,906
Anticipated Capital Financing Requirement as at 31 March 2022	15,409	15,409

- 5.8 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/2021) currently attracting excessive premiums (£2.570m at the time of writing this report) if it were prematurely repaid, it is not financially advantageous for the Council to fully comply with this prudential indicator. A similar issue applies to the fixed rate loan of £3.3m which the Council has with Barclays. This has been the case since the housing stock transfer in 2007 and has been acknowledged and approved by Council since then. In addition, the Council's external auditors have also acknowledged this situation and have not raised any issues with our strategy.
- 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 Members. It reflects the level for 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	2021/22 Original Estimate £000	2021/22 Revised Estimate £000
Debt	17,000	17,000
Plus Other Long Term Liabilities Finance Leases	1,000	1,000
Commercial Activities/ Non Financial Investments	25,000	21,302
Total Borrowing	43,000	39,302

- 5.10 The Corporate Director & Chief Finance Officer reports that no difficulties are envisaged for the current year in complying with the above prudential indicators.

6 Investment Portfolio

- 6.1 In accordance with the Treasury Management 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.
- 6.2 As set out in section 2, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020 until the MPC meeting on 24th September 2021 when 6 and 12 month rates rose in anticipation of Bank Rate going up in 2022.
- 6.3 The current forecasts shown in paragraph 3.1, includes a forecast for a first increase in Bank Rate in December 2021 though there is a high risk that it could be delayed until quarter 1 or 2 of 2022. Investment returns are expected to remain low for the remainder of this year.
- 6.4 The Council held investments of £34.5m as at 30th September 2021 (£24m at 31st March 2021). The investment portfolio yield for the first 6 months of the year is 0.11% (7 day LIBID uncompounded rate -0.08%).

- 6.5 It should be noted that the value of investments remains high due to the distorting impact on working capital of some of the mechanisms government introduced to mitigate the liquidity impact of the pandemic on local authorities. Typically, this involved local authorities receiving significant funds up-front before the cost of implementing policies to support local businesses could be accurately determined. The relevant government departments are still working through the various reconciliations which will result in the Council repaying funds received in excess of those required. Likewise, the Council received significant up-front grant funding in respect of capital schemes approved prior to the implementation of a new wave of restrictions in December 2020. Progress on these schemes is gathering pace and this result in the use of grants received in the coming months.
- 6.6 The Council has achieved investment income of £21k to 30th September 2021. The 2021/22 original estimate of £40k is projected to be achieved.
- 6.7 Property Funds formed part of the Council's Annual Investment Strategy approved in February 2021 as an instrument to increase investment returns from surplus cash balances. There has been a delay in accessing Property Funds whilst the impact of COVID-19 is fully understood and other commercial property acquisitions are considered, with a corresponding reduction in budgeted income this year of around £150k.
- 6.8 In line with the 2017 CIPFA Codes and guidance notes greater emphasis is placed on the enhanced importance of risk management. Should the Council decide to invest in a Property Fund(s) this increases the level of risk associated with the Council's treasury management activity as the value of investments can go down as well as up and the Council may get back less than they originally invested. During the previous five years property funds have generally generated better investment returns (through capital appreciation and income) than bank deposits, though past performance or future projections are not indicative of future returns. One of the main characteristics of investment in Property Funds, compared to bank deposits, is that the Council will need to be prepared to hold on to its investment for a longer period – typically at least five years – to benefit from capital appreciation in the underlying value of the investment. Officers are working with Link Asset Services to examine the opportunities and evaluate the risks associated with investing in this way.
- 6.9 The Corporate Director and Chief Finance Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.

7 Borrowing Strategy

- 7.1 The Council's estimated CFR for 2021/22 is £15.409m (including finance lease borrowing facilities). 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.
- 7.2 No new external borrowing has been undertaken during 2021/22 to date. The Council has utilised surplus cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that any upside risk to gilt yields prevails.
- 7.3 The current Medium Term Financial Strategy assumes that some external borrowing will be required over the three-and-a-half-year period to 31 March 2024. Assumptions about the level of external interest payable are included within the budget. Responsibility for deciding when to borrow externally, together with details of the amount to borrow and the term and type of any loan, rests with the Chief Finance Officer. The Chief Finance

Officer's decision will be informed by advice from the Council's treasury management advisors and information regarding the progress of schemes set out in the capital programme. Any borrowing decisions will be reported to Cabinet through the annual treasury management report.

8 Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken or is anticipated in the current financial year.