

Report

Council

Part 1

Date: 26 January 2021

Subject **Report on Treasury Management for the period to 30 September 2020**

Purpose This report is to inform the Council of treasury activities undertaken during the period to 30 September 2020 and confirms that all treasury and prudential indicators have been adhered to in the first half of the financial year.

Author Head of Finance / Assistant Head of Finance

Ward All

Summary In line with the agreed Treasury Management Strategy, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows. Current forecasts indicate that in the future, temporary borrowing will continue to be required to fund normal day-to-day cash flow activities and longer-term borrowing will increase to fund new commitments in the current capital programme as well as the impact of reduced capacity for 'internal borrowing'.

During the first half of the financial year the Council's net borrowing decreased by £17.1m from £166.3m at 31 March 2020 to £149.2m at 30 September 2020.

All borrowing and investments undertaken during the first half of the year was expected and within the Council's agreed limits

Proposal To note and approve the report on treasury management activities for 2020/21 were in line with the agreed Treasury Management Strategy 2020/21. Note the comments from Audit Committee on the report.

Action by Head of Finance / Assistant Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance

Signed

Background

1. In June 2009 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Authority to approve a treasury management annual report after the end of each financial year.
2. Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation to have regard to the CIPFA Code.
3. The Authority has borrowed substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.
4. The 2020/21 Treasury Management Strategy was approved by the Council as part of the Capital Strategy in February 2020 and can be viewed via the following link

<https://democracy.newport.gov.uk/documents/s17728/06%20Council%20Report%20Capital%20Strategy%20and%20Treasury%20Strategy%202020.pdf?LLL=0>

5. This report presents the following information:
 - details of capital financing, borrowing, debt rescheduling and investment transactions
 - reports on the risk implications of treasury decisions and transactions
 - details the half year monitoring position on treasury management transactions in
 - confirms compliance with treasury limits set and Prudential code

BORROWING STRATEGY / ACTIVITY

Short and Long Term Borrowing

1. Whilst the Council has significant long-term borrowing requirements, the Council's current strategy of funding capital expenditure is through reducing investments ('internal borrowing') rather than undertaking new borrowing where it can i.e. we defer taking out new long term borrowing and fund capital expenditure from the Council's own cash resources – which it has because of its 'cash-backed' reserves and, to a lesser extent, day to day positive cash-flows, for as long as we can. The Council may undertake borrowing early if, there is the need for future borrowing and it feels it can minimise risk of future interest rate rises while providing value for money, this will be in line with advice from our treasury advisors.

By using this strategy the Council can also minimise cash holding at a time when counterparty risk remains relatively high, especially with the current economic implications during Covid-19. The interest rates achievable on the Council's investments are also significantly lower than the current rates payable on long-term borrowing and this remains the main reason for our current 'internally borrowed' strategy.

At 31 March 2020, the level of internal borrowing was about £87m, mainly in relation to the Council's level of cash backed reserves. At current rates, this saves about £2.6m in interest costs annually compared to physically borrowing this level of cash. As the Council spends its reserves over the medium to long term (PFI reserves, Capital reserves, Invest to Save reserves in particular), then the

internal borrowing will have to be replaced with actual external borrowing and this interest cost will be incurred.

2. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.
3. As shown in Appendix B, as at 30 September 2020 the level of borrowing has decreased by £17.1m to £149.2m. This decrease is in relation to the short term borrowing the Council undertook at the end of March to support the cash flow of providing grants to businesses in response to the Covid-19 pandemic. This was reimbursed by Welsh Government and subsequently the borrowing was repaid in June 2020.

The level of investments has increased by £15.7m to £28.8, (including £18.2m held on very short-term periods), meaning a decrease in net borrowing of £32.7m during the first half of financial year to £121.1m. Therefore, no new long-term borrowing was required to be taken out in the first half of the financial year. However, it is anticipated that the Council will need to undertake additional borrowing on a short term basis for the remainder of the year in order to cover normal day to day cash flow activity. With current estimates there is the potential that a small amount of additional long-term borrowing will be required in this financial year. This includes small amount of new long term borrowing from Salix of £0.6m which is interest free and linked to specific energy efficiency projects.

4. In regards to LOBOs, no loans were called during the period. All £30m outstanding is subject to potential change of interest rates by the lender (which would automatically trigger a right to the Council to repay these loans) prior to the end of this financial year. Should a change of interest rate be requested, then it will be considered in detail and a decision on how we proceed will be made in conjunction with our treasury advisors.
5. Audit Committee requested that its previous comments on limits placed on future borrowing were reflected in the upcoming Capital Strategy. This will be prepared over the next couple of months in line with the Medium Term Financial Plan and approved at Council alongside the budget report.

INVESTMENTS ACTIVITY / POSITION

6. The Council's strategies in this area of Treasury Management are (i) to be a short term and relatively low value investor, consistent with the pursuit of an 'internal borrowing strategy' and (ii) investment priorities should follow the priorities of security, liquidity and yield, in that order.

Included within the investment figure of £28.2m on the 30 September 2020, is £18.2m held on very short-term. Due to the pandemic the Authority kept more cash available at very short notice than is normal to cover any unexpected calls on cash flow. Currently there is not much demand for very short term borrowing within the market place, and in September rates on deposits below 14 days with the Debt Management Account Deposit Facility (DMADF) dropped below zero percent. The Authority has its investment with LA of £20m with an average rate of 0.3%. But it is anticipated that investments will reduce during 2020/21 until we reach the balance of £10m, which will be invested for compliance with MiFIDII.

7. All investments are currently placed on a temporary basis and are placed in high security institutions, in line with our other strategy in this area, dealing with our investing priorities of (i) security (ii) liquidity and (iii) yield, in that order. At the 30 September 2020 £20m was placed with various local authorities. The maximum maturity date of any of these investments held was 14 October 2020.
8. January 2018 saw the implementation in the UK of the second Markets in Financial Instruments Directive (MiFID II), where firms will be obliged to treat all local authorities as retail clients unless

they opt up to professional client status and meet certain criteria. These criteria include holding a minimum of £10m investment balance and employing knowledgeable and experienced staff to carry out investment transactions. It is anticipated that our investment balances will remain at or above the minimum £10m.

9. To retain its classification as 'professional clients', the Council currently invests its funds over short-term, low-risk instruments such as other local authorities and central government and because of the low risk nature of these – income from these are also very low. As part of the 2020/21 Medium Term Financial Plan and the Capital and Treasury Management Strategy it was approved that the Council could undertake larger, long-term investments in riskier financial instruments such as pooled funds, and other instruments. Essentially, investments in stock market and property funds to generate additional interest receivable income. However, due to Covid 19, investment in approved Property Funds was suspended. Due to the financial risk and the impact the ongoing pandemic could have on the economic global market, the Council will not be pursuing this strategy in 2020/21.
10. The Authority is currently undertaking the process of applying to be able to invest in Money Market Funds. This will enable the Authority to invest in short term funds if required, which has a higher rate of return but which is still deemed low risk due to its very short term nature. The use of these funds is already approved within the Council's Treasury Management Strategy.
11. The Council does not hold any long-term (more than 364 days) treasury investments as at 30 September 2020.

IMPACT OF COVID-19 PANDEMIC

12. Since the early days of the pandemic the Council has been monitoring the impact on cash flow closely. As highlighted within the borrowing figures, the Council undertook some additional borrowing at the end of the 2019/20 financial year to enable the delivery of business grants prior to the cash being received by WG, this was subsequently reimbursed and the borrowing repaid. In addition to the business grants, the Council has seen an increase in covid related expenditure, a reduction in income across services, and a decrease in the collection of Council Tax and Non-Domestic Rates (NDR) and the Council has also implemented the NDR Relief Scheme for retail, leisure and hospitality businesses who receive 100% relief.
13. All of the above would have had a significant impact on cash flow, however aside from the beginning of the year when the additional short-term borrowing was required, WG have mitigated the impact by reimbursing increased expenditure through the hardship fund and through loss of income claims. WG have also repaid the business grants in a timely manner, and front-loaded a significant portion of the Revenue Support Grant payments to the Council into April, as well as providing a grant to support the cash flow of the 100% rate reliefs. Up to this point this has certainly assisted with cash flow and the Council has not required to undertake additional borrowing in the first half of the year.
14. As we continue through the remainder of the financial year and continue to see a reduction in Council Tax and NDR income, we anticipate that we will require to undertake some borrowing, but this is not substantially different to where we were expecting to be at this stage of the year and is in line with the limits set by Council in the capital strategy.

NON-TREASURY INVESTMENTS

15. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government's (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held such investments in:

- directly owned property such as office and commercial units of £10.8m
- loans to local businesses and landlords £4.4m
- shareholding in subsidiaries £0.3m

These investments generated £0.7m of investment income for the Authority after taking account of direct costs. The outbreak of Covid-19 has impacted global financial markets and as at the valuation date of 31st March 2020, less weight can be attached to previous market evidence to inform opinions of value. There is an unprecedented set of circumstances on which to base a judgement. Valuations were therefore reported on the basis of ‘material valuation uncertainty’ as per the RICS Red Book Global.

OTHER MID YEAR TREASURY MATTERS

Economic background and Counter Party Update

16. Appendix A outlines the underlying economic environment during the first half of the financial year, as provided by the Council’s Treasury Management Advisors Arlingclose.
17. As discussed previously in this report the Council does not have any long-term treasury investments, and the investments that it currently undertakes is mainly with other local authorities which are deemed very secure, therefore the risk is currently ‘low’. At the end of September 2020 there have been no changes to the names on the counterparty list, but our Treasury Management Advisors now advise that where strategies permit, bank deposits should only be made for periods up to 35 days. The long-term rating of Santander UK, the Council’s bankers, remains at A+; above the Council’s minimum level of A-.

Compliance with Prudential Indicators approved by Council

18. The Authority measures and manages its exposures to treasury management risks using various indicators which can be found in Appendix B. The Authority has complied with the Prudential Indicators for 2020/21, set in February 2020 as part of the Treasury Management Strategy. Details of treasury-related Prudential Indicators can be found in Appendix B.

PWLB future lending terms

19. Members will be aware that the PWLB increased interest rates on loans in the autumn of 2019 following concerns about the level of Local Government debt, in particular for commercial activities.

A consultation was held this year, closing on 31st July 2020, on the proposed changes in their lending criteria, which Newport City Council responded to. It contained proposals to allow authorities that are not involved in “debt for yield” activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances. The announcement of the new lending terms is expected at the end of this calendar year or early next year.

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High but depending on	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor money	Members, Head of Finance, Treasury

	investment value		market movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds available for investment will also alleviate the risk.	staff, based on advice from treasury advisors
Interest Rates moving adversely against expectations	Low	Low	Future expectations for higher short term rates are subdued. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Governments that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to Council for approval. Thus the Council is required to approve the report or not.

Preferred Option and Why

To note and approve the report on treasury management activities for 2020/21 were in line with the agreed Treasury Management Strategy 2020/21.

Comments of Chief Financial Officer

Decisions made on treasury matters will be made with a view to comply with the Treasury Management Strategy, Prudential Indicators, taking advice, where needed, from our Treasury Advisers.

Comments of Monitoring Officer

There are no legal implications. The in year and annual treasury management report is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's investment Strategy.

Comments of Head of People and Business Change

There are no direct HR implications associated with the report.

The Council is required to approve a treasury management annual report at the end of each financial year. The Well-being of Future Generations Act requires public bodies to balance short-term needs with the needs to safeguard the ability to meet long-term needs. As stated in this report, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows but current forecasts indicate that in future temporary borrowing will continue to be required and longer-term borrowing will increase to fund the capital programme. This annual report fits in with the well-being goal of a Prosperous Wales.

Comments of Cabinet Member

Leader of the Council Cabinet Member for Economic Growth and Investment presented the papers to Cabinet for approval to be taken to Council.

Local issues

N/A

Scrutiny Committees

N/A

Equalities Impact Assessment and the Equalities Act 2010

The Equality Act 2010 contains a Public Sector Equality Duty which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better informed decision-making and policy development and services that are more effective for users. In exercising its functions, the Council must have due regard to the need to: eliminate unlawful discrimination, harassment, victimisation and other conduct that is prohibited by the Act; advance equality of opportunity between persons who share a protected characteristic and those who do not; and foster good relations between persons who share a protected characteristic and those who do not. The Act is not overly prescriptive about the approach a public authority should take to ensure due regard, although it does set out that due regard to advancing equality involves: removing or minimising disadvantages suffered by people due to their protected characteristics; taking steps to meet the needs of people from protected groups where these differ from the need of other people; and encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.

Children and Families (Wales) Measure

N/A

Wellbeing of Future Generations (Wales) Act 2015

This report is a backwards looking report of the treasury management activities of the Council. It shows that we followed the treasury management strategy and the compliance with prudential code and treasury management indicators. This links into the long-term objectives of the authorities and ensures that the councils activities are carried out in an affordable, prudent and sustainable manner.

Crime and Disorder Act 1998

Section 17(1) of the Crime and Disorder Act 1998 imposes a duty on the Local Authority to exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area.

Consultation

N/A

Background Papers

Report to Council February 2020: Capital Strategy and Treasury Strategy.

Dated: 26 January 2021

APPENDIX A

External Context

Economic background:

The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the 'Eat Out to Help Out' (EOHO) offer.

GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme. The Office for National Statistics' preferred measure of CPIH which includes owner-occupied housing was 0.5% y/y.

In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the BoE has forecast unemployment could hit a peak of between 8% and 9%.

The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is 'moderately' above the 2% average target, particularly given it has been below target for most of the last decade.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

Financial markets:

Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.23% respectively over the period.

At the end of September, the yield on 2-year US treasuries was around 0.13% while that on 10-year treasuries was 0.69%. German bund yields remain negative across most maturities.

Credit review:

Credit default swap spreads eased over most of the period but then started to tick up again through September. In the UK, the spreads between ringfenced and non-ringfenced entities remains, except for retail bank Santander UK whose CDS spread remained elevated and the highest of those we monitor at 85bps while Standard Chartered was the lowest at 41bps. The ringfenced banks are currently trading between 45 and 50bps.

After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned a AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

Appendix B

Local Context

On 31st March 2020, the Authority had net borrowing of £121.1m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.20 Actual £m
General Fund CFR	280
Less: *Other debt liabilities	43
Borrowing CFR	237
Less: Usable reserves	(87)
Less: Working capital inc. non-treasury investments	4
Net borrowing	154

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 30 September 2020 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.20 Balance £m	Movement £m	30.9.20 Balance £m	30.9.20 Rate %
Long-term borrowing	150.6	(1.4)	149.2	3.7
Short-term borrowing	-	-	-	-
Cash and cash equivalents	15.7	(15.7)	-	-
Total borrowing	166.3	(17.1)	149.2	3.7
Long-term investments	0	-	-	-
Short-term investments	0	(10.0)	(10.0)	0.1
Cash and cash equivalents	(12.5)	(5.7)	(18.2)	0.2
Total investments	(12.5)	(15.7)	(28.2)	0.3
Net borrowing	153.8	(32.7)	121.1	3.9

The table above shows significant movement in both the borrowing and investment levels of the Council, however overall the NET borrowing position for the Council has decreased by £32.7m.

Borrowing Update

On 9th October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction.

Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields (if the Authority has an HRA, then include: the value of this discount is 1% below the rate at which the authority usually borrows from the PWLB). £1.15bn of additional “infrastructure rate” funding at gilt yields plus 0.60% has been made available to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

The consultation titled “Future Lending Terms” allows stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to allow authorities that are not involved in “debt for yield” activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

The consultation closed on 31st July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year or early next year

Municipal Bonds Agency (MBA): The MBA revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor.

If the Authority intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

Borrowing Strategy during the year

At 30th September 2020 the Authority held £149.2m of loans, a decrease of £17.1m 31st March 2020, as part of its strategy for funding previous and current years’ capital programmes. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.20	Net Movement	30.9.20	30.9.20	30.9.20
	Balance	£m	Balance	Weighted Average Rate	Weighted Average Maturity
	£m		£m	%	(years)
Public Works Loan Board	105.7	(1.4)	104.3	3.8	19.3
Banks (LOBO)	30.0	-	30.0	4.4	33.7
Banks (fixed-term)	5.0	-	5.0	3.8	57.4
Local authorities (long-term)	-	-	-	-	-
Local authorities (short-term)	15.0	(15.0)	-	-	-
Other inc. WG loans	9.9	(0.0)	9.9	-	7.8
Accrued interest	0.7	(0.7)	-		
Total borrowing	166.3	(17.1)	149.2	3.7	22.7

The Authority’s chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority’s long-term plans change being a secondary objective.

In keeping with these objectives, no new borrowing was undertaken. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

With short-term interest rates remaining much lower than long-term rates and temporary investments earning Bank Rate or lower, the Authority considered it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead, as per our Treasury Management Strategy. The net movement in temporary / short-term loans is shown in table 3 above.

LOBO loans: The Authority continues to hold £30m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

Other Debt Activity

After £0.8m repayment of prior years' Private Finance Initiative and finance leases liabilities, total debt other than borrowing stood at £42.4m on 31st March 2020, taking total debt to £208.7m.

Treasury Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £28.1m and £65.8 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.20		30.09.20	30.09.20	30.09.20
	Balance	Movement	Balance	Income Return	Weighted average maturity
	£m	£m	£m	%	Years
Banks & building societies (unsecured)	-	8.2	8.2	0.14	-
Government (incl. local authorities)	12.5	7.5	20.0	0.31	-
Total investments	12.5	15.7	28.2	0.31	-

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.

On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities.

The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.1%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.

In the light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Authority kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and/or Money Market Funds to manage both credit and liquidity risks.

In the Treasury Management Strategy it was agreed that the Authority will move into higher risk/higher yield investments such as pooled funds. However, this has been delayed while the Authority reviewed its risk appetite. While an increased income target has been included in the 2020/21 budget, due to the current economic uncertainty surrounding Covid-19, the Authority has invested into secure institutions such as local authorities and Central Government.

In November 2019 the Welsh Government published new Statutory Guidance on Local Government Investments to be effective from the 2020/21 financial year. This involves a complete re-write along the lines of the guidance issued last year by the Ministry of Housing, Communities and Local Government (MHCLG) for local authorities in England.

The definition of investments is widened to include “all of the financial and non-financial assets a local authority has invested money into primarily or partially for the purpose of generating a surplus including investment property” providing it has been made using the power to invest contained in the Local Government Act 2003. In addition, loans to wholly-owned companies or associates, to a joint venture, or to a third party count as investments, irrespective of the purpose or legal power used.

Non-Treasury Investments

The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. For English and Welsh Authorities: This is replicated in the Investment Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held such investments in:

- directly owned property such as office and commercial units of £10.8m
- loans to local businesses and landlords £4.4m
- shareholding in subsidiaries £0.3m

These investments generated £0.7m of investment income for the Authority after taking account of direct costs in the first half of the year. As stated above, Covid is likely to have an impact on the income which is generated this financial year.

Compliance

The Head of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority’s approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 5 below.

Table 5: Debt Limits

	H1 Maximum	30.9.20 Actual	2020/20 Operational Boundary	2020/21 Authorised Limit	Complied? Yes/No
Borrowing	192.8	149.2	230	240	<input type="checkbox"/>
PFI and Finance Leases	42	42	43	43	<input type="checkbox"/>
Total debt	234.8	208.3	273	283	<input type="checkbox"/>

Table 6: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£2m per country
Registered providers and registered social landlords	£5m in total
Unsecured investments with building societies	£5m in total
Money market funds	£10m in total
Real estate investment trusts	£10m in total

Above table only shows limits where the Council have invested money in during the year, excluding the UK Central Government.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	Limit	Complied
Upper limit on one-year revenue impact of 1% <u>rise</u> in interest rates	£200,000	✓
Upper limit on one-year revenue impact of 1% <u>fall</u> in interest rates	£100,000	✓

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.19 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	1%	60%	0%	✓
12 months and within 24 months	3%	40%	0%	✓
24 months and within 5 years	20%	40%	0%	✓
5 years and within 10 years	7%	40%	0%	✓
10 years and within 20 years	19%	30%	0%	✓
20 years and within 30 years	15%	20%	0%	✓
30 years and within 40 years	20%	20%	0%	✓
40 years and within 50 years	8%	20%	0%	✓
50 years and above	7%	20%	0%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	10	10	10
Complied?	✓	✓	✓

Other

IFRS 16: CIPFA/LASAAC has proposed delaying the implementation of the new IFRS 16 Leases accounting standard for a further year to 2021/22.

Arlingclose's Outlook for the remainder of 2020/21

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been suppressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

The global central bank and government responses have been significant and are in many cases ongoing, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions. This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.