Cabinet Meeting on Wednesday 18 November 2020

Half Yearly Treasury Management Report for the Period Ended 30 September 2020

Mike Sutherland, Cabinet Member for Finance and Corporate Matters said,

"The UK economy continues to face an uncertain environment in 2020/21, with Brexit negotiations and the impacts of the continuing Covid-19 pandemic. The County Council adheres to its Treasury Management Policy of using internal cash balances instead of borrowing money. This has delivered significant savings for taxpayers, as the infrastructure to deliver more skilled, better-paid jobs is being funded at a lower cost."

Report Summary:

1. This report provides a summary of the Council's borrowing and investment activities during the first six months of the year.

2. An analysis of the first half-year activities is set out in the report, but the key points to note are that;
   - the Treasury Management Panel, chaired by the County Treasurer and comprising other senior finance officers, met regularly to consider treasury matters;
   - all transactions were undertaken by authorised officers and within the limits approved;
   - all investments were to counterparties on the approved counterparty list and fully met the requirements of the relevant regulations; and
   - the Council operated within the limits and Prudential Indicators set out in the Council's Treasury Management Practices and Annual Treasury Management Strategy, with the exception of the Upper Limit for variable rate interest exposure, the reasons for which will be addressed in this report.

3. The Council maintained a cautious approach to investments. The policy of using cash instead of borrowing continues to generate significant savings, helping reduce the average interest the Council pays on its debt.

4. Overall, the report demonstrates that the Council's borrowing and investment activities are being undertaken prudently and in line with agreed strategies in a very challenging environment.

Local Members Interest If report is relevant to ALL Members, type 'N/A' into table and delete what is not required	
Insert Members Name	Insert Electoral Division

CABINET – 18 NOVEMBER 2020

Treasury Management Report for the half-year ended 30 September 2020

Recommendation of the Cabinet Member for Finance and Corporate Matters

1. That Cabinet note the treasury management activities for the half-year ended 30 September 2020.
2. That Cabinet note the Prudential Indicators detailed in **Appendix 2** and approve the increase to the Upper Limit of variable rate interest exposure as detailed in **paragraph 42** of this report.

Report of the County Treasurer

Reasons for Recommendations:

3. At their meeting on 18 January 2012, Cabinet adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code).

4. Treasury risk management at the County Council is conducted within the framework of the revised 2017 Edition of the CIPFA Code. This requires the County Council to approve a treasury management strategy before the start of each financial year and, as a minimum, provide a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

5. This report provides a summary of the County Council's treasury management activities for the first half of 2020/21, in the context of the strategy for the year, which was agreed by Cabinet on 29 January 2020. It considers both the borrowing and investment decisions taken within the specified period in the light of the interest rates and economic conditions prevailing at the time.

External Context

6. The spread of the coronavirus pandemic dominated during the period, as countries around the world tried to contain transmission of the virus while easing lockdown measures and getting their populations and economies working again. UK 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' offer. 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 tried to pass the Internal Market Bill, potentially breaking international law.

7. UK GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (April-June) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July. In addition, the headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year on year in August, further below the Bank of England's 2% target. 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.

8. On an international setting, the US economy contracted at an annualised rate of 31.7% in Q2 2020 (April-June). 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.

9. 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 recouped 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.

10. The economic context in which the Council operates remains volatile and uncertain and the measured approach the authority takes with its activity in the financial markets reflects this.

<u>Borrowing strategy update</u>

11. The Treasury Management Strategy Report for 2020/21 outlined the long-term borrowing strategy for the year. This was to:

    "use its internal resources in lieu of borrowing"

12. In accordance with this, cash has continued to be used in lieu of borrowing and the Council did not require new, or replacement loans, to be taken out in the first half of the year.

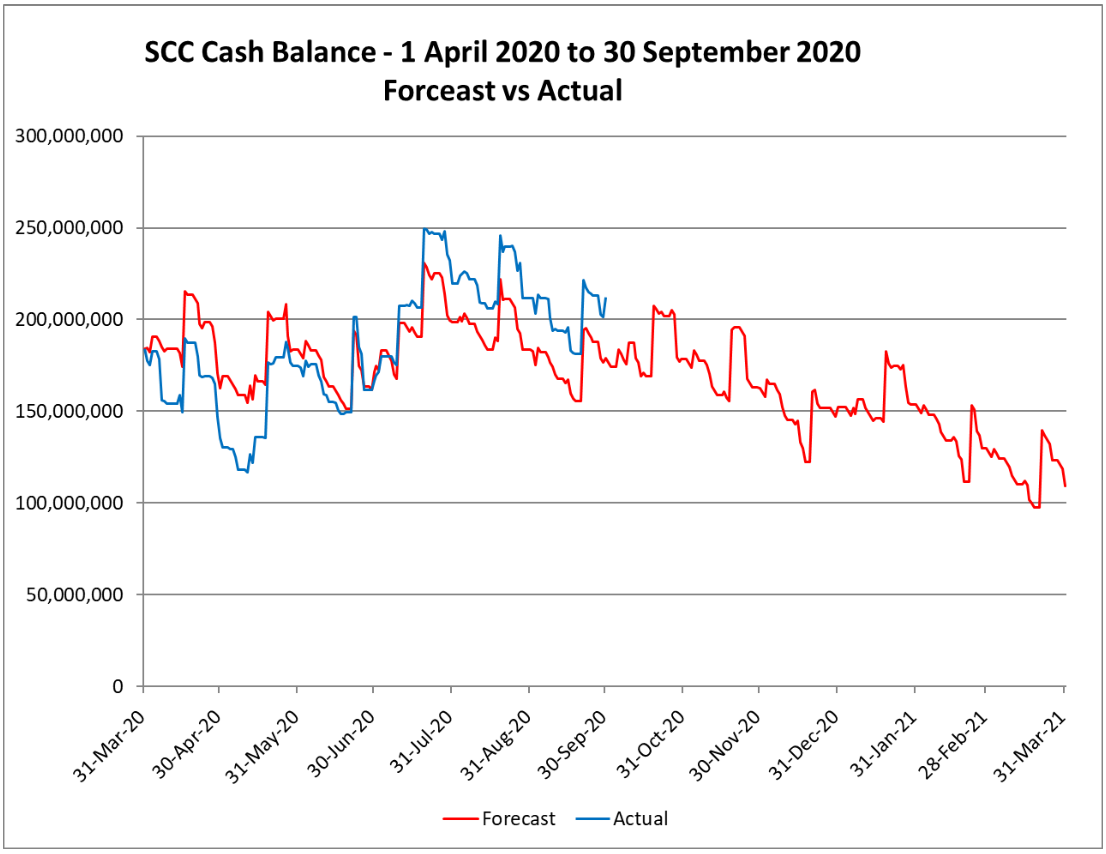
13. The strategy of using cash instead of borrowing has relied on two main factors; the Bank Rate (set by the Bank of England) remaining low, and cash balances being sufficient to meet the Council's day to day requirements.

14. The Bank of England (BoE) has maintained Bank Rate at 0.1% since 19 March 2020 and held its Quantitative Easing (QE) programme at £745 billion. The potential use of negative interest rates has not been ruled in or out by BoE policymakers.

15. In terms of the future, Arlingclose, the Council's treasury advisor, expects Bank Rate to remain at the current 0.1% level and additional monetary loosening most likely to occur 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.

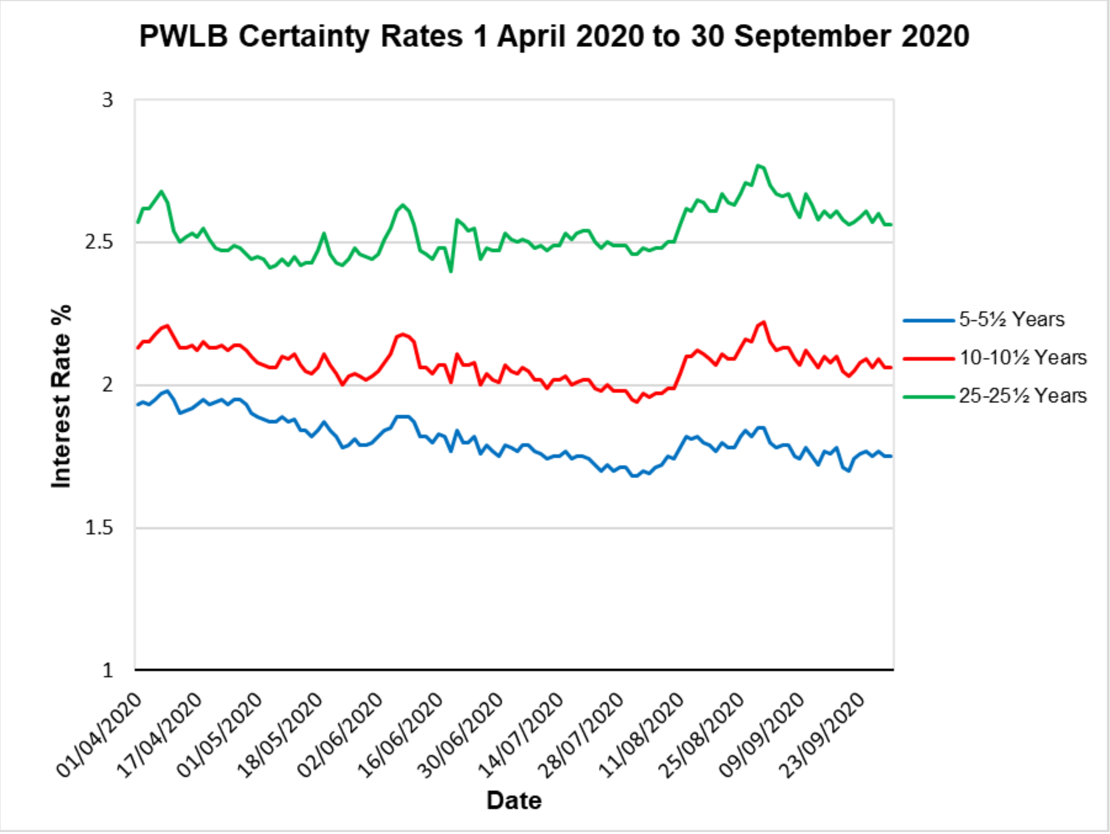
16. Current low interest rates mean that the strategy of using cash remains important and represents a cheap way of financing the capital programme. Overall, the short-term interest rate environment now and for future forecasts both still support the borrowing strategy adopted in 2020/21.

17. Secondly, cash balances have been sufficient to allow day to day cash management in the first half of the year. The following graph shows total actual cash balances for the first half of the year (in blue) against those forecast for the full year (in red).



18. Whilst it can be seen that the actual cash balance that the Council holds reflects the trendline of the forecast, the balance held is higher than expected. This reflects the remaining balance of Covid-19 grant as yet unspent by the council and additional income received by the authority in the first half of the year.

19. Cashfow forecasts indicate the Council will have sufficient balances to fund its debt for 2020/21, without the need to take out further long-term loans. When loans are taken-up these are mainly sourced from the Public Works Loan Board (PWLB), whose loan interest rates reflect changes in Gilt yields in the UK Government bond market. The following chart shows three typical loan periods where rates have been adjusted to reflect the “certainty-rate” reduction of 0.20% which is available to all local authorities who register with the Government.



20. Gilt yields are very sensitive to the risk appetite of international investors and the current low yields reflect the uncertain global financial environment. Ultra-low interest rates and the ‘flight to quality’ have 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.

21. On 9 October 2019, HM Treasury, the government department responsible for the PWLB, increased the margin they charge over gilt yields from 80bps to 180bps for certainty rate loans, thus making PWLB loans much more expensive. The government reasoned that the cost of borrowing had fallen to record lows and some local authorities have substantially increased their use of PWLB borrowing. This new shift in policy was aimed to restore PWLB lending rates to ‘normal’ levels and act as a disincentive for some authorities using it to borrow for commercial investment. A consultation has been carried out by government in respect of this policy which ended on 31 July 2020 and the response is due later this year.

22. The Council's current external loans portfolio includes £51m Lender Option Borrower Option (LOBO) loans. LOBO loans are long term loans where the lender has the option to increase the interest rate at pre-determined intervals; if the lender exercises its option to change the rate, the borrower's option is triggered. The borrower must either accept the revised rate or they can repay the loan without penalty. LOBO loans were initially taken out by the Council when their rates compared favourably to PWLB rates.

23. The following table shows the interest rates incurred on the Council's debt portfolio for 2019/20 and for this half year, including an adjustment reflecting the use of cash.

	2019/20 Full Year %	**2020/21 Half Year %**
Weighted average rate of interest for external loans	4.64	4.64
Adjusted for the use of cash	4.18	3.98

24. The average rate on external loans remains the same as last year, as only a minimal amount of PWLB loans have been repaid. When the utilisation of cash reserves is taken into account, the rate falls considerably. This illustrates that the Council's policy of using cash instead of borrowing is of real benefit and it continues to generate significant savings, helping reduce the average interest paid on debt. It is estimated that the Council has saved £1.142 million in interest payments in the first half of the financial year, by using internal cash instead of borrowing. The reason that this saving is currently so high, is that the average borrowing rate is high in comparison to the interest received should the cash have been invested.

25. A graph illustrating the maturity profile of the long-term loans at 30 September 2020 is provided at **Appendix 3**.

Loan restructuring

26. Movements in interest rates over time may provide opportunities to restructure the loan portfolio in one of two ways:

- to replace existing loans with new loans at a lower rate (known as loan rescheduling); or
- repay loans early, without replacing the loans. This would increase the use of cash.

27. The Treasury Strategy for 2020/21 approved loan rescheduling where this re-balances risk and approved repayment of loans with no replacement, where deemed appropriate.

28. A combination of factors has meant that PWLB loan restructuring has not been financially viable so far in 2020/21:

- Low gilt yields mean that a large penalty would be payable; and

- Government policy, whereby a margin is applied to the early repayment of a PWLB loan, increases the penalty payable.

Investment Strategy update

29. The Council holds invested cash, representing income received in advance of expenditure plus balances and reserves held. As shown in the chart at **paragraph 17**, the Council's investment balances during the year have ranged between £117 million and £249 million, due to timing differences between income and expenditure. This increased level of cash reflects additional funding received by the council during the first half of the year. This includes the second tranche of Covid-19 monies, additional Local Enterprise Partnership funding for the 'Getting Building' scheme and Local Growth Fund grant for the 'Etruria Valley' project. This money is in effect income received ahead of expenditure and totals £57.6 million.

30. The Annual Investment Strategy (AIS) forms part of the Treasury Management Strategy and sets out those parties the Council will lend its money to. The AIS details the requirements of government guidance and the CIPFA Code; both documents require the Council to invest its funds prudently and to have regard to the following two prime risk issues over return:
    - The security of capital.
    - The liquidity of investments.

31. The resulting strategy adopted was characterised by:
    - the use of selected counterparties (high level of security);
    - the use of diversified sterling "AAA" money market funds (high level of security and liquidity);
    - a maximum duration of 12 months (high level of security); and
    - the use of same day liquidity accounts (high level of liquidity).

32. The Council has the ability to place unlimited funds with the UK Government, including Local Authorities (LAs) although investment in LAs have been limited to £5 million per counterparty to ensure investment diversification by the Treasury Management Panel.

Treasury Investments

33. Approved investments stood at £212.054million on 30 September 2020 (£183.910million on 31 March 2020), these are analysed by type and term below:

Long-term local authority	**£m**	**Term**
Derby City Council	7.500	28/11/2030
Derby City Council	7.500	28/11/2031
Redcar and Cleveland Borough Council	7.500	29/11/2032
Redcar and Cleveland Borough Council	7.500	29/11/2033
Short-term UK Government		
Debt Management Office	10.000	14/10/2020
Banks and building societies		

Lloyds Bank Plc	8.024	Instant Access
Money Market Funds		
Aberdeen	36.000	Instant Access
Black Rock	35.950	Instant Access
Insight	36.000	Instant Access
Federated	31.000	Instant Access
State Street	20.080	Instant Access
Collective Investment Scheme		
Royal London Cash Plus Fund	5.000	3 day notice
TOTAL	**212.054**	

34. Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to its security and liquidity before seeking a rate of return. The Authority's main objective when investing money is to minimise the risk of incurring losses from defaults. In the light of the pandemic crisis, the likelihood of unexpected calls on cash flow and a further possibility of austerity measures, the Council has kept more cash available at very short notice. Liquid cash was diversified over several counterparties and Money Market Funds, to manage both credit and liquidity risks. With interest rates continuing to be ultra-low and many organisations holding onto cash there is currently very little value across the market for returns on investments. Rather than income returns from interest the authority has utilised cash to realise savings on additional borrowing costs as discussed in **paragraph 24**.

35. Given the current circumstances, the Council is principally utilising its MMF's (for daily liquidity) and Government held Debt Management Office Account (for periods longer than overnight). The only real opportunity to earn a return in the cash market at the moment, is by investing in the longer term (i.e. a number of years) with local authority borrowers, who are seeking to take advantage of the historically low interest rates when compared to the rates from the PWLB.

36. The following table shows the Council's investment returns in 2019/20 and 2020/21 to date.

	2019/20 Full Year	**2020/21 Half Year**
Average return on investments	1.46%	0.92%
7-day LIBID * (benchmark)	0.50%	-0.05%
Additional return generated	0.96%	0.97%
Adjusted without long-term local authority investments	0.67%	0.08%

** LIBID (London Interbank BID interest rate)*

37. Returns on investments have benefited from the four long-term local authority investments detailed in **paragraph 33**, as these were entered into at an average rate of 4%. The average return in 2020/21 has outperformed the

benchmark, although this is lower than the return achieved in 2019/20, for the reasons explained above.

38. A copy of the counterparty list as at 30 September 2020 is shown at **Appendix 4**.

Non-treasury investments

39. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. The revised Investment Guidance from MHCLG broadened this definition further to include loans and investments for service purposes.

40. The County Council currently has one non-treasury investment. This non-treasury investment made for service purposes is a 49% share in the company Entrust which provides education support services to schools. At 31 March 2020, the Council's share in Entrust had a nil value.

Compliance with Treasury Limits and Prudential Indicators

41. It can be certified that for the half year ended 30 September 2020:

(i) in accordance with Financial Regulations, the Treasury Management Panel chaired by the County Treasurer and comprising other senior finance officers, met regularly to consider treasury matters;

(ii) all treasury related transactions were undertaken by authorised officers and within the limits approved by the County Council; and

(iii) all investments were to counterparties on the Lending List current at the time and fully met the requirements of relevant legislation.

42. As previously discussed in this report the Council has a large cash holding for the financial year 2020/21. This fact has been regularly discussed by the Treasury Management Panel and arrangements made for the secure deposit of cash in line with the Annual Investment Strategy. The impact of this is that the variable interest rate prudential limit was exceeded. This indicator is calculated based on the highest expected cash balance in the year which, as a result of additional grant announced after the budget setting process, has been higher than forecast. In view of this the indicator is being revised from £183million to £255million.

43. The latest position for Treasury Management Prudential Indicators is shown in **Appendix 2**.

Rob Salmon
County Treasurer

Background Documents

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2017)
2. Prudential Code for Capital Finance in Local Authorities (CIPFA) (2017)

3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)
5. Statutory Guidance on Minimum Revenue Provision – Issued under section 21 (1A) of the Local Government Act 2003 (2018)
6. Localism Act 2011 – Guidance on the General Power of Competence in sections 1 to 6.

Contact Details

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Appendix 1

Equalities Implications – There are no equalities implications arising from this report.

Legal Implications – There are no legal implications arising from this report.

Resource and Value for Money Implications – The resource and value for money implications are contained within the body of the report.

Risk Implications – Counterparty and interest rate risk arising as a result of Treasury Management activity have been considered in the body of this report.

Climate Change Implications – There are no climate change implications arising from this report.

Health Impact Assessment screening – There are no health impact assessment implications arising from this report.

Appendix 2

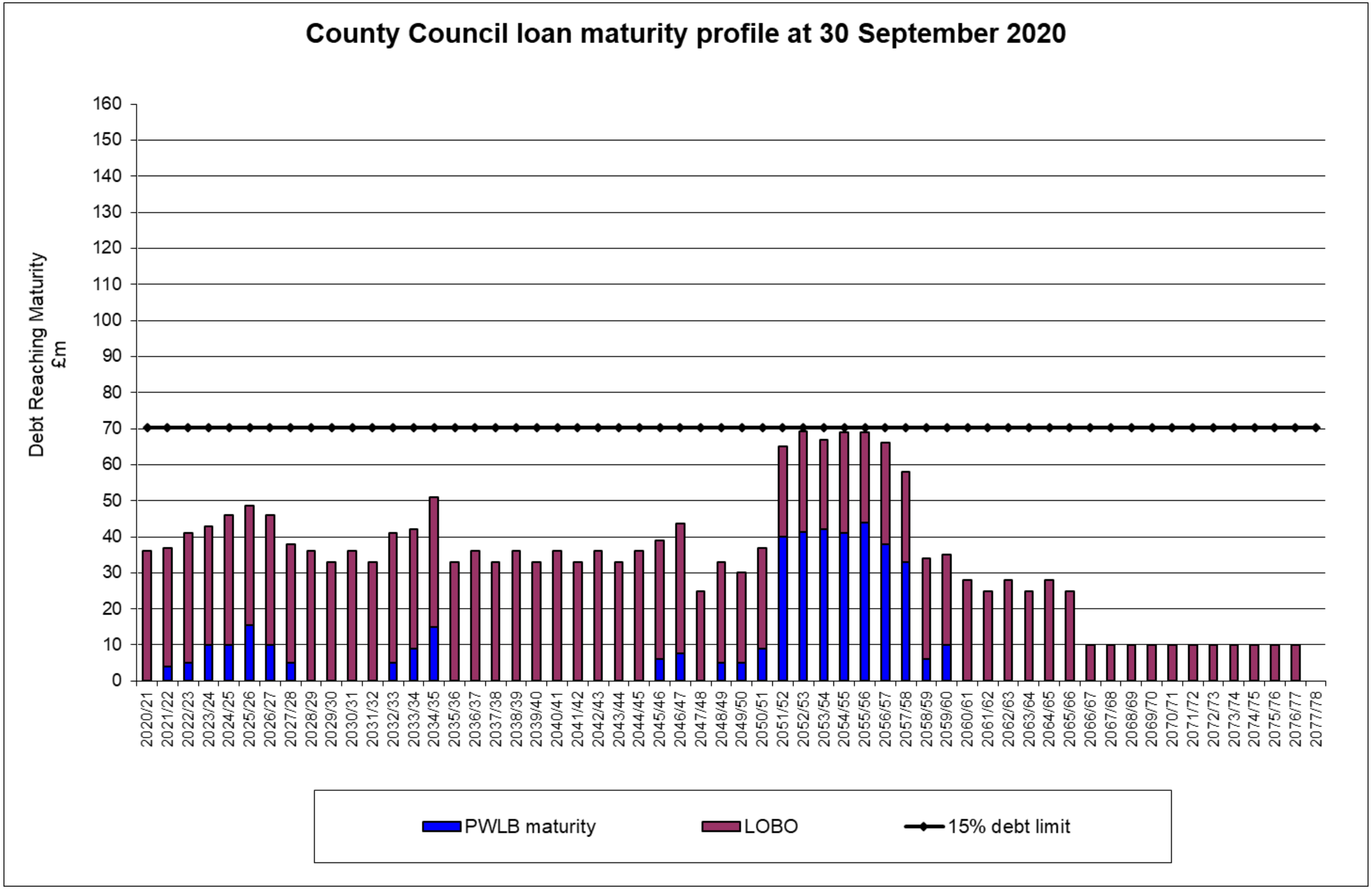
Staffordshire County Council

Cabinet
18 November 2020

Prudential Indicators for Treasury Management

Indicator	Estimated Limit 2020/21	Actual Position at 30/09/20
1. External Debt		
Authorised Limit for borrowing	£640m	£468m
Authorised Limit for other liabilities	£252m	£242m
TOTAL	**£892m**	**£710m**
Operational Boundary for borrowing	£518m	£468m
Operational Boundary for other liabilities	£252m	£242m
TOTAL	**£770m**	**£710m**
External Loans	**£468m**	£468m
The Authorised Limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the Capital Programme. *The Operational Boundary represents the County Treasurer's estimate of the day to day limit for treasury management activity based on the most likely i.e. prudent but not worst-case scenario.* *"Other liabilities" relate to PFI schemes which are recorded in the Council's accounts.*		
2. Interest Rate Exposures		
a. Upper Limit (Fixed)	£565m	£468m
b. Upper Limit (Variable)	(£255m)	(£212m)
The Council sets upper limits of fixed and variable borrowing and investments. The effect of setting these upper limits is to provide ranges within which the Council will manage its exposure to fixed and variable rates of interest. Negative figures are shown in brackets; these relate to the" high- point" of investments at a variable rate which are not offset by variable borrowings. The exposure to variable rate movements has been reduced by the use of cash in lieu of borrowing.		
3. Maturity Structure of Borrowing		
See Graph at **Appendix 3**		
This indicator relates to the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. The Council currently applies the practice of ensuring that no more than 15% of its total gross fixed rate loans mature in any one financial year. *Because this is a complex situation for the Council, involving PWLB loans, LOBO loans with uncertain call dates and the use of internal cash, specific indicators have not been set. Instead the Council will manage its exposures within the limits shown on the graph at **Appendix 3**. This graph shows all LOBO call options on a cumulative basis; in fact the actual pattern of repayment, although uncertain, will not be of this magnitude.*		
4. Total principal sums invested for periods longer than a year	£95m	£30m
Any investments made for over longer than a year will be in accordance with the County Council's limits on non-standard investments.		

Appendix 3



County Council loan maturity profile at 30 September 2020
Debt Reaching Maturity £m
160
150
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
2020/21
2021/22
2022/23
2023/24
2024/25
2025/26
2026/27
2027/28
2028/29
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2068/69
2069/70
2070/71
2071/72
2072/73
2073/74
2074/75
2075/76
2076/77
2077/78
PWLB maturity
LOBO
15% debt limit

Appendix 4

Approved Counterparty List - September 2020	
	Time Limit
Regulation Investments	
Debt Management Office	12 months
UK Government T-bills	6 months
UK Local Authority	12 months
Banks and Building Societies	
Barclays	35 days
Lloyds	35 days
HSBC	35 days
Nationwide	35 days
Santander	35 days
MMF	
Black Rock	same day
Insight	same day
Federated	same day
Aberdeen	same day
State Street (SSGA)	same day
Enhanced MMF	
Royal London Cash Plus	3 day notice