REPORT TO:	AUDIT AND GOVERNANCE COMMITTEE
DATE:	20 SEPTEMBER 2021
SUBJECT:	TREASURY MANAGEMENT AND CAPITAL STRATEGY UPDATE – QUARTER 1 2021/22
KEY DECISION:	N/A
PORTFOLIO HOLDER:	COUNCILLOR JONATHAN NOBLE
REPORT AUTHOR:	CHIEF FINANCE OFFICER
WARD(S) AFFECTED:	N/A
EXEMPT REPORT?	NO

SUMMARY

The Council fully complies with the Chartered Institute of Public Finance and Accountancy Code of Practice on Treasury Management (2017). This report sets out the Treasury Management and relevant capital strategy activities of the Council for the period 1 April to 30 June 2021.

In terms of investment returns, the Council is expecting to achieve a total of £914,000 for 2021/22 comprising £893,000 gross distribution income from property fund holdings (i.e. before deduction of management fees) and £21,000 from cash investments. This compares to the total gross annual budget of £1,016,000.

The Council is generally keeping cash investments short term up to a maximum of twelve months. As the financial climate changes, who we invest with and the amount invested, is under constant scrutiny, taking into account risk at any particular moment in time.

RECOMMENDATIONS

That members note the Treasury Management and Capital Strategy update position as at 30 June 2021.

REASONS FOR RECOMMENDATIONS

To effectively manage Treasury risk and protect Council capital.

OTHER OPTIONS CONSIDERED

There are no alternative recommendations.

REPORT

Reason for Report

To report the Council's Treasury Management Performance in 2021/22 and in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2017 and generally accepted best practice.

1. Introduction

1.1 The CIPFA Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (annual, mid-year and/or quarterly reports). This report, therefore ensures this Council is implementing best practice in accordance with the Code.

1.2 This report sets out Treasury Management and relevant capital strategy performance up to 30 June 2021, and looks ahead to the remainder of the year.

1.3 The Treasury Management Strategy Statement (TMSS) for 2021/22, approved by Full Council on 1 March 2021, incorporates the Council's Annual Investment Strategy, which outlines the Council's investment priorities ranked in order of importance: **security of capital, liquidity and yield.**

1.4 The Council always aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep the majority of investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using its advisors' (Link Asset Services) suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

1.5 The Treasury Management Strategy Statement (TMSS) sets Prudential and Treasury Indicators which are relevant for the purposes of setting an integrated Treasury Management Strategy and are a requirement of the CIPFA Code of Practice in Treasury Management.

2. Economic Background UK.

2.1 **UK.** The 24 June Monetary Policy Committee (MPC) meeting voted unanimously to keep Bank Rate unchanged at 0.10%. They voted by a majority of 8-1 to continue unchanged the existing programme of UK government bond purchases of £875bn which is due to end by the end of this year. The MPC noted the developing upside risks in the UK to both activity and inflation. It said that the news on activity "had predominately been to the upside" and that Bank staff had "revised up their expectations for 2021 Q2 GDP growth to 5.5% from 4.25%." For the first time, the policy statement noted that there are "increasing signs of recruitment difficulties for some businesses" and the minutes said, "it was possible that the near-term upward pressure on prices could prove somewhat larger than expected." Indeed, by saying that inflation "is likely to exceed 3% for a temporary period" the MPC admitted the Governor will have to write to the Chancellor later in the year explaining why inflation is more than 1% above the 2% target. However, the key point is that the MPC still appears willing to ride out the inevitable spike in inflation over the next six months as it thinks it will be short lived and caused by one-off reopening price rises and supply shortages relative to demand-boosted by consumers having built up savings of around £145bn during lockdown. These spikes will drop out of the Consumer Price Index (CPI) calculation over the next twelve months. In addition, the bank is undertaking a review of its stated policy to raise Bank Rate first before unwinding quantitative easing (QE) purchases of gilts. Indeed, it appears to be likely that the Bank could unwind QE first before raising Bank Rate as it sees QE as a very useful quick acting weapon to use to combat any sudden dysfunction in financial markets, as happened in March 2020. However, it is currently nearly maxed out on the total level of QE. Money markets are currently expecting Bank Rate to start rising in mid-2022 but they are probably being too heavily influenced by looking across the Atlantic where inflationary pressure are much stronger and building up further under a major boost from huge Federal government stimulus packages. Overall, there could be only a minimal increase in Bank Rate in 2023 or possibly no increases before 2024.

2.2 **Current Situation.** Covid-19 vaccines have been a game changer which have enormously boosted confidence that life in the UK could largely return to normal during the second half of 2021 after a third wave of the virus threatened to overwhelm hospitals in Q1 this year. 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 UK has made fast progress, giving both jabs to over half of the population and one jab to well over two thirds. This programme should be completed in the second half of the year. The big question is whether mutations of the virus could develop which render the 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.

2.3 **Brexit.** The final agreement on 24 December 2020 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

2.4 **USA.** Since the Democrats won the elections in November 2020 and gained control of both Congress and the Senate, they have passed a $1.9trn (8.8% of GDP) stimulus package in March 2021 on top of the $900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly to hit the target of giving a first jab to over half of the population within the President's first 100 days, will promote a rapid easing of restrictions and strong economic recovery during 2021.

3. Interest Rate Forecast

3.1 The Council's treasury advisor (Link Asset Services) has provided the following forecast:

Table 1 Interest Rate View

Link Group Interest Rate View 10.5.21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.40	0.40
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.50	0.50
5 yr PWLB	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50
10 yr PWLB	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00	2.00	2.00
25 yr PWLB	2.20	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.40

3.2 The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool of further action becomes necessary. As shown in the forecast above, no increase in Bank Rate is expected within the forecast horizon ending 31 March 2024 as economic recovery is expected only to be gradual.

4. Investment Income

4.1 Longer term investment rates were on an upward curve for most of 2019/20 until the two emergency base rate cuts on 11 and 19 March 2020, the first to 0.25% and subsequently to 0.10%. The base rate is likely to remain at 0.10% for the foreseeable future.

4.2 The Council budgeted to receive £1,016,000 in gross investment income in 2021/22 comprising £977,000 from Property Funds (including £215,000 of management fees), and £39,000 from cash investments.

4.3 At 30 June 2021, total investment income is estimated to be £914,000 comprising £893,000 from Property Funds and £21,000 from cash investments.

4.4 In 2021/22, cumulatively to 30 June 2021, the Council achieved an average gross revenue return (before deduction of management fees) of 4.44% from the Property Funds (3.37% after fees).

4.5 Treasury (cash) investments achieved an average rate of 0.10% to 30 June 2021. This rate includes returns on investments placed on call with HSBC and CCLA; these rates being lower than investments placed for 3 months or more.

4.6 The average interest rates achieved so far in 2020/21 on the Council's cash investments are shown in Table 2 below. The table shows that overall performance generally compares favourably to the benchmark rates.

Table 2 – Benchmarked rates of return

Benchmark	Benchmark Return	Council Performance
3 month	-0.04%	0.16%
12 month	0.04%	N/A

4.7 Table 3 details the cash investments held by the Council at 30 June 2021. Investments are made in line with both Link's creditworthiness guidance and the duration limits applied to each colour banding.

Table 3 – Counterparty list and Investments held at 30 June 2021

Institutions with Cash held	Amount £'000	Duration	Rate	Most recent Link Asset Services Colour Rating
HSBC	9,715	Call	0.01%	Orange (12 months)
CCLA	3,000	Call	0.03%	Yellow 5 Years
Santander	3,000	95 day notice	0.40%	Red – 6 months
Barclays	3,000	95 day notice	0.15%	Red – 6 months
LLoyds	3,000	95 day notice	0.05%	Red – 6 months
BoS	2,000	175day notice	0.06%	Red – 6 months
Total	**23,715**			

4.8 The Council's Treasury Management Strategy states investments are limited with any one institution to no more than £3m invested per institution, and £5m per counterparty group. On 56 working days from 1 April 2021, residual balances in excess of the £5m limit were deposited in the Council's current bank account (HSBC) for cash flow reasons (in accordance with para 7.3 of the Treasury Management Strategy).

4.9 The average level of funds available for investment from 1 April to 30 June 2021 was £21.509m. Of this, an average of £10.509m was available on a temporary basis, the level dependent on the timing of precept and business rate pool payments, receipt of grants and capital programme spend.

5. Capital Strategy and Property Fund Valuation

5.1 Detailed below are the Property Fund investments held by the Council, the valuation date for all funds being 30 June 2021.

Table 4 – Property Fund Holdings as at 30 June 2021

Financial Institution	Purchase Cost £'000	Net Asset Value at 31 March 2021 £'000	Net Asset Value at 30 June 2021 £'000	In-year Gain /(Loss) £'000
Black Rock UK Property Fund	4,500	4,403	4,491	88
Schroder UK Real Estate Fund	4,250	4,255	4,351	96
Threadneedle Property Unit Trust	4,239	3,830	3,947	117
M&G UK Property Fund	4,000	3,478	3,605	127
AEW	4,000	3,526	3,724	198
Total	**20,989**	**19,492**	**20,118**	**626**

5.2 The difference between purchase price, (i.e. the amount invested) and net asset value reflects premiums paid or discount received against the Funds' "Net Asset Value" at the settlement date together with the movement in fund valuations since acquisition. Fair values have increased slightly during quarter 1, overall by 3.21% since 31 March 2021, as a result of the gradual recovery from the ongoing pandemic, subsequent deep recession and ongoing economic uncertainties.

6. Borrowing

6.1 At the start of the 2021/22 financial year, the Council's total long term borrowing was £16.449m. Total annual interest payments are estimated at £494,000.

6.2 No additional borrowing was undertaken during the three months to 30 June 2021, and officers continue to monitor opportunities to replace the internally invested sums with long term borrowing.

Table 5 - PWLB rates

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.12%	1.60%	2.03%	1.83%
Date	08/04/2021	22/04/2021	11/06/2021	21/06/2021	21/06/2021
High	0.88%	1.24%	1.80%	2.27%	2.06%
Date	21/06/2021	13/05/2021	13/05/2021	13/05/2021	13/05/2021
Average	0.81%	1.18%	1.68%	2.14%	1.94%
Spread	0.10%	0.12%	0.20%	0.24%	0.23%

7. Compliance with Treasury and Prudential Limits

7.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators are included in the approved TMSS.

7.2 During the quarter ended 30 June 2021, the Council has operated within the treasury and prudential indicators set out in the Council's TMSS and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in Appendix A.

8. Other

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

CONCLUSION

Treasury Management continues to require close attention given the current financial climate. Officers will continue to be vigilant and report any significant issues to this committee.

FINANCIAL IMPLICATIONS

The entire report.

LEGAL IMPLICATIONS

The General Power of Competence (GPOC) in the Localism Act 2011 allows Councils a broad freedom in their operations.

Councils have the general power to borrow under Section 1 of the Local Government Act 2003.

The power to invest is set out in the Local Government Act 2003, Section 12, which gives the Council the power to invest for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs.

The power that allows councils to spend for capital purposes is included in the Local Government Act 2003.

CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

None

EQUALITY AND SAFEGUARDING IMPLICATIONS

None

OTHER IMPLICATIONS

The Code of Practice sets out the framework for controlling the risks associated with treasury management decisions for borrowing and investing. Ultimately investment and borrowing decisions are made in accordance with the Council's Treasury Management Strategy. The overriding priority is that the security of a deposit takes precedence over a return on investment.

The Prudential and Treasury Indicators control the limits for investing and borrowing, to ensure that any borrowing is affordable and sustainable and long term borrowing is for capital purposes only.

There is a requirement to try and balance the risks and rewards from investing our available cash resources, as outlined within the Treasury Management Strategy 2021/22.

CONSULTATION

No consultation undertaken.

APPENDICES Appendices are listed below and attached to the back of the report: -	
APPENDIX A	Prudential and Treasury Indicators

BACKGROUND PAPERS Background papers used in the production of this report are listed below: -	
Document title	**Where the document can be viewed**
Treasury Mgmt. Strategy Statement 2021/22	*As part of the MTFS reported to Cabinet 24 February, approved by Full Council 1 March 2021.* *https://moderngov.boston.gov.uk/documents/b5223/Council%20Report%20-%202021-22%20Budget%20Report%20Medium%20Term%20Financial%20Strategy%20and%20Council%20Tax%2001st-Mar-202.pdf?T=9*

CHRONOLOGICAL HISTORY OF THIS REPORT	
A report on this item has not been previously considered by a Council body.	
REPORT APPROVAL	
Report author:	Steven Houchin, Chief Finance Officer, PSPS Ltd, steven.houchin@pspsl.co.uk
Signed off by:	Christine Marshall, S151 Officer, Christine.marshall@sholland.gov.uk
Approved for publication:	Cllr Noble

Appendix A – Prudential and Treasury Indicators

PRUDENTIAL/TREASURY INDICATOR	2021/22	2021/22	Notes
	Original Estimate	Projected Outturn	
	£'000	£'000	
Capital Expenditure	2,458	4,010	
Capital Financing Requirement as at 31 March	20,304	20,304	
Annual Change in Capital Financing Requirement	(65)	(65)	
In year Borrowing Requirement	0	0	
Ratio of financing costs to net revenue stream	*%*	*%*	
General Fund	*(4.70)*	*(4.70)*	
Authorised Limit for external debt			
Borrowing and other Long term liabilities	25,000	25,000	
Operational Boundary for external debt -			
Borrowing	22,000	22,000	
Gross External Debt	(16,449)	(16,449)	
Investments	12,588	12,588	
Net Borrowing	(3,861)	(3,861)	