TO: GOVERNANCE AND AUDIT COMMITTEE
27 JANUARY 2021

TREASURY MANAGEMENT REPORT 2021/22 AND 2020/21 MID-YEAR REVIEW
(Director of Finance)

1 PURPOSE OF DECISION

1.1 The Council must operate a balanced budget, which broadly means cash raised during the year plus any use of reserves will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity before considering maximising investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the longer term cash flow planning needs to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

1.3 The Local Government Act 2003 requires a local authority to "have regard to" guidance issued by, or specified by, the Secretary of State. As such, the Council is required to have regard to the Prudential Code and the Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

1.4 The Code of Practice requires the Council's annual Treasury Management Strategy (and associated documents) to be examined and reviewed by a responsible body. An additional primary requirement of the code is for the receipt by Full Council of a Mid-Year Review of the Treasury Management activities of the authority.

1.5 This report seeks to achieve both these requirements of updating Members on progress in 2020/21 and to review the Treasury Management Report for 2021/22.

2 RECOMMENDATIONS

2.1 That the Committee consider and review the Mid-Year Review Report.

2.2 That the Committee agree that the Mid-Year Review Report be circulated to all Members of the Council.

2.3 That the Committee review the Treasury Management Report in Annex A for 2021/22 prior to its approval by Council.

3 REASONS FOR RECOMMENDATIONS

3.1 The reasons for the recommendations are set out in the report.

4 ALTERNATIVE OPTIONS CONSIDERED

4.1 The Code of Practice requires the Council's annual Treasury Strategy to be examined and reviewed by a responsible body and for that body to review progress of the Council's treasury management activities. The Governance and Audit Committee has been nominated by Council to be that body.

5 SUPPORTING INFORMATION

Mid-Year Review

5.1 This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first nine months of 2020/21
- A review of the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy
- The Council's capital expenditure
- A review of the Council's investment portfolio for 2020/21
- A review of compliance with Treasury and Prudential Limits for 2020/21

Economic Update

5.2 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 to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, 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 if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

5.3 There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers.

5.4 This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

5.5 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

5.6 There is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Treasury Management Strategy Statement Review

5.7 The Treasury Management Strategy Statement (TMSS) for 2020/21 was approved by the Council on 24th February 2020. There are no policy changes to the TMSS in 2020/21 and only one change is proposed to the strategy for 2021/22. This is to review the individual limits on Money Market Funds and increase this to £10m from its current level of £7m. The reasoning behind this is set out in detail in the attached Treasury Management Report for 2021/22

Review of Investment and Debt Portfolio 2020/21

5.8 The Council held £23.338m of investments as at 31 December 2020 and the investment portfolio yield for the first nine months of the year is 0.01% against a benchmark (Local Authority 7-Day Rate) of 0.0%.

Investment	Maturity	Amount (£'000)	Rate (%)
Money Market Funds			
Aberdeen	1 Day	6,997	0.01
Black Rock	1 Day	2,047	0.01
Federated	1 Day	1,989	0.01
Federated Cash Plus	2 Day	4,508	0.04
Goldman Sachs	1 Day	800	0.01
Deutsche	1 Day	6,997	0.01
Total Investments		**23,338**	

5.9 The 2020/21 interest budget assumed that an average interest rate of 0.5% would be earned on the Council's investment portfolio. However as interest rates have been cut to historic lows and with the negative rates being offered in the market this target will not be achieved. However cash balances are higher as a result in the interruption caused due to the pandemic and as such the investment budget should still be achieved this year.

5.10 As at 31 December 2020 the Council's debt portfolio was as follows

Short Term Market Loans

Counterparty	Amount £	Rate	Start Date	Maturity Date
Somerset	5,000,000	1.22%	01/04/2020	04/01/2021
	5,000,000			

PWLB Loans

PWLB	Amount	Rate	Start Date	Maturity Date
PWLB	10,000,000	2.60%	09/02/2017	31/03/2062
PWLB	10,000,000	2.60%	09/02/2017	31/03/2066
PWLB	10,000,000	2.42%	20/06/2017	31/03/2063
PWLB	10,000,000	2.41%	20/06/2017	31/03/2064
PWLB	20,000,000	1.85%	21/11/2017	21/11/2024
PWLB	10,000,000	2.50%	21/11/2017	21/11/2062
PWLB	10,000,000	2.14%	03/12/2018	03/12/2028
	80,000,000			

Compliance with Treasury and Prudential Limits for 2020/21

5.11 The Director of Finance can confirm that the approved limits within the Annual Investment Strategy were not breached during the first nine months of 2020/21 and no changes to these limits are proposed for the remaining 3 months.

Treasury Management Report 2021/22

5.12 The Council is required to have regard to the Prudential Code and Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). Under these requirements the Council must set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. At its meeting on 2 March 2011 Council nominated the Governance and Audit Committee as the responsible body to examine and assess the effectiveness of the treasury management strategy and policies and recommend them to Council.

5.13 The attached Treasury Management Report 2021/22 (Annex A) was approved by the Executive, as a part of the Council's overall budget proposals, on 15 December 2020 and outlines the Council's Prudential Indicators for 2021/22 to 2023/24 in addition to setting out the expected treasury strategy and operations for this period. The Executive requested that the Governance and Audit Committee review each of the key elements. Following this review the Treasury Management Report and associated documents will be presented to Council for approval on 24 February 2021.

6 ADVICE RECEIVED FROM STATUTORY AND OTHER OFFICERS

Borough Solicitor

6.1 None.

Director of Finance

6.2 The financial implications are contained within the report.

Equalities Impact Assessment

6.3 None.

Strategic Risk Management Issues

6.4 The Treasury Management Report deals directly with the strategic management of risk associated with the Council's treasury management activities

7 CONSULTATION

Principal Groups Consulted

7.1 The Overview & Scrutiny Commission was consulted on the budget proposals, including the Treasury Management Strategy, in December.

Background Papers

None

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