

## Report of the Director of Finance & IT to the meeting of Governance and Audit to be held on 25 November 2021

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**Subject:**

Treasury Management Mid-Year Review up to 30 September 2021

**Summary statement:**

This report shows the Council's Treasury Mid-Year Review up to 30 September 2021.

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**Portfolio:**  
Leader of the Council and Corporate

**Overview & Scrutiny Area:**  
Corporate

# Treasury Management Review up to 30<sup>th</sup> September 2021

## Background

### 1.1 Treasury management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

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 borrowing need of the Council, essentially the longer term cash flow planning 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, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

“The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

### 1.2 Introduction

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-Year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Governance and Audit Committee.

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

- An economic update for the first half of the 2021/22 financial year.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy.
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators.
- A review of the Council's investment portfolio for 2021/22.
- A review of the Council's borrowing strategy for 2021/22.
- A review of any debt rescheduling undertaken during 2021/22.
- A review of compliance with Treasury and Prudential Limits for 2021/22.

## 2. Economics and interest rates

### 2.1 Economics update

- The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.
- There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.
- So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.
- Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

- The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
  1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
  2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
  3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
  4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.
- **COVID-19 vaccines.** These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.
- **US.** See comments below on US treasury yields.
- **EU.** The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.
- **German general election.** With the CDU/CSU and SPD both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SPD-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.
- **China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

- **Japan.** 2021 has been a patchy year in combating Covid. However, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.
- **World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of **world globalisation** and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.
- **Supply shortages.** The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. In September there were major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

## 2.2 Interest rate forecasts

The Council's treasury advisor, Link Group, provided the following forecasts on 29<sup>th</sup> September 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View		29.9.21								
	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	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave eamings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave eamings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave eamings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

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 0.10%, it left Bank Rate unchanged at its subsequent meetings.

### Forecasts for Bank Rate

Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons: -

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
- Will supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- 1.6 million people came off furlough at the end of September; how many of these will not have jobs and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that there could be further nasty surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.

In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon - in line with what the new news is.

It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

### **Forecasts for PWLB rates and gilt and treasury yields**

As the interest forecast table for PWLB certainty rates on the previous page shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the “taper tantrums” in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

### **Gilt and treasury yields**

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic party's determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American families plan over the next decade which are caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy had already been growing strongly during 2021.

3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
4. And the Fed was still providing monetary stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of “substantial further progress towards the goal of reaching full employment”. However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK. As an average since 2011, there has been a 75% correlation between movements in 10-year treasury yields and 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

There are also possible DOWNSIDE RISKS from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to keep an eye on.

#### **The balance of risks to medium to long term PWLB rates: -**

- There is a balance of upside risks to forecasts for medium to long term PWLB rates.

#### **A new era – a fundamental shift in central bank monetary policy**

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on ‘achieving broad and inclusive “maximum” employment in its entirety’ in the US before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep

under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.

- The Bank of England has also amended its target for monetary policy so that inflation should be ‘sustainably over 2%’ and the ECB now has a similar policy.
- For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

## 2.3 Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement, (TMSS), for 2021/22 was approved by this Council on 25 March 2021 (Governance & Audit Committee). There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

## 2.4 The Council’s Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council’s capital expenditure plans.
- How these plans are being financed.
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow.
- Compliance with the limits in place for borrowing activity.

### 2.4.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget. The revised estimate is based on increased scrutiny of the schemes and budget profiles within the capital programme that took place at Quarter 1.

Capital Expenditure by Service	2021/22 Original Estimate £m	Current Position 30 Sept 2021 £m	2021/22 Revised Q2 Estimate £m
<b>Total capital expenditure</b>	254.9	37.0	139.4

## 2.4.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

<b>Capital Expenditure</b>	<b>2021/22 Original Estimate £m</b>	<b>2021/22 Revised Q2 Estimate £m</b>
<b>Total capital expenditure</b>	<b>254.9</b>	<b>139.4</b>
<b>Financed by:</b>		
<b>Capital receipts</b>	4.0	1.9
<b>Capital grants</b>	125.0	68.0
<b>Capital reserves</b>	3.9	2.1
<b>Revenue</b>	1.0	1.0
<b>Total financing</b>	<b>133.9</b>	<b>73.0</b>
<b>Borrowing requirement</b>	<b>121.0</b>	<b>66.4</b>

Projected changes to the Capital Programme have resulted in a reduced new borrowing requirement of £66.4m.

## 2.4.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table over shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so the underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR. The reduced borrowing requirement has reduced the CFR estimate.

The table over also shows the expected debt position over the period, which is termed the Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed.

	<b>2021/22 Original Estimate £m</b>	<b>2021/22 Revised Estimate £m</b>
<b>Prudential Indicator – Capital Financing Requirement</b>		
Total CFR	845	741
<b>Net movement in CFR</b>		<b>-104</b>
<b>Prudential Indicator – the Operational Boundary for external debt</b>		
Borrowing	707	707
Other long term liabilities*	143	143
<b>Total debt (year-end position)</b>	<b>850</b>	<b>850</b>

\* On balance sheet PFI schemes and finance leases etc.

#### 2.4.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	<b>2021/22 Original Estimate £m</b>	<b>Current Position 30 Sept 2021 £m</b>	<b>2021/22 Revised Estimate £m</b>
Borrowing	422.9	344.2	354.0
Other long term liabilities	143.0	143.0	143.0
<b>Total debt</b>	<b>565.9</b>	<b>487.2</b>	<b>497.0</b>
<b>CFR (year-end position)</b>	<b>845.0</b>		<b>741.0</b>

The Director of Finance & IT reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

<b>Authorised limit for external debt</b>	<b>2021/22 Original Indicator</b>	<b>2021/22 Revised Indicator</b>
Borrowing	709.0	709.0
Other long term liabilities	143.0	143.0
<b>Total</b>	<b>852.0</b>	<b>852.0</b>

## 2.4.5 Borrowing

The Council's capital financing requirement (CFR) for 2021/22 is expected to be below the original forecast of £845m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council has current long term borrowings of £477m and has utilised cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that any upside risk to gilt yields prevails.

The capital programme is being kept under regular review due to the effects of coronavirus and shortages of materials and labour. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

£5.5m of loans are due to mature in January 2021 with an average rate of interest of 9.25%. To date no new borrowing has been undertaken this year. Based on current capital spend forecasts it is anticipated that borrowing will be undertaken during this financial year.

### **PWLB maturity certainty rates (gilts plus 80bps) year to date to 30<sup>th</sup> September 2021**

Gilt yields and PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September.

The 50 year PWLB target certainty rate for new long-term borrowing started 2021/22 at 1.90%, rose to 2.00% in May, fell to 1.70% in August and returned to 2.00% at the end of September after the MPC meeting of 23<sup>rd</sup> September.

- The current PWLB rates are set as margins over gilt yields as follows: -.
  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

## 2.4.6 Debt Rescheduling

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

## **2.4.7 Compliance with Treasury and Prudential Limits**

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30<sup>th</sup> September 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22. The Director of Finance & IT reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

## **2.5 Annual investment strategy**

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions.

As shown by the interest rate forecasts in section 2, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before the second half of 2023, investment returns are expected to remain low.

### **Creditworthiness.**

Significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

### **Investment Counterparty criteria**

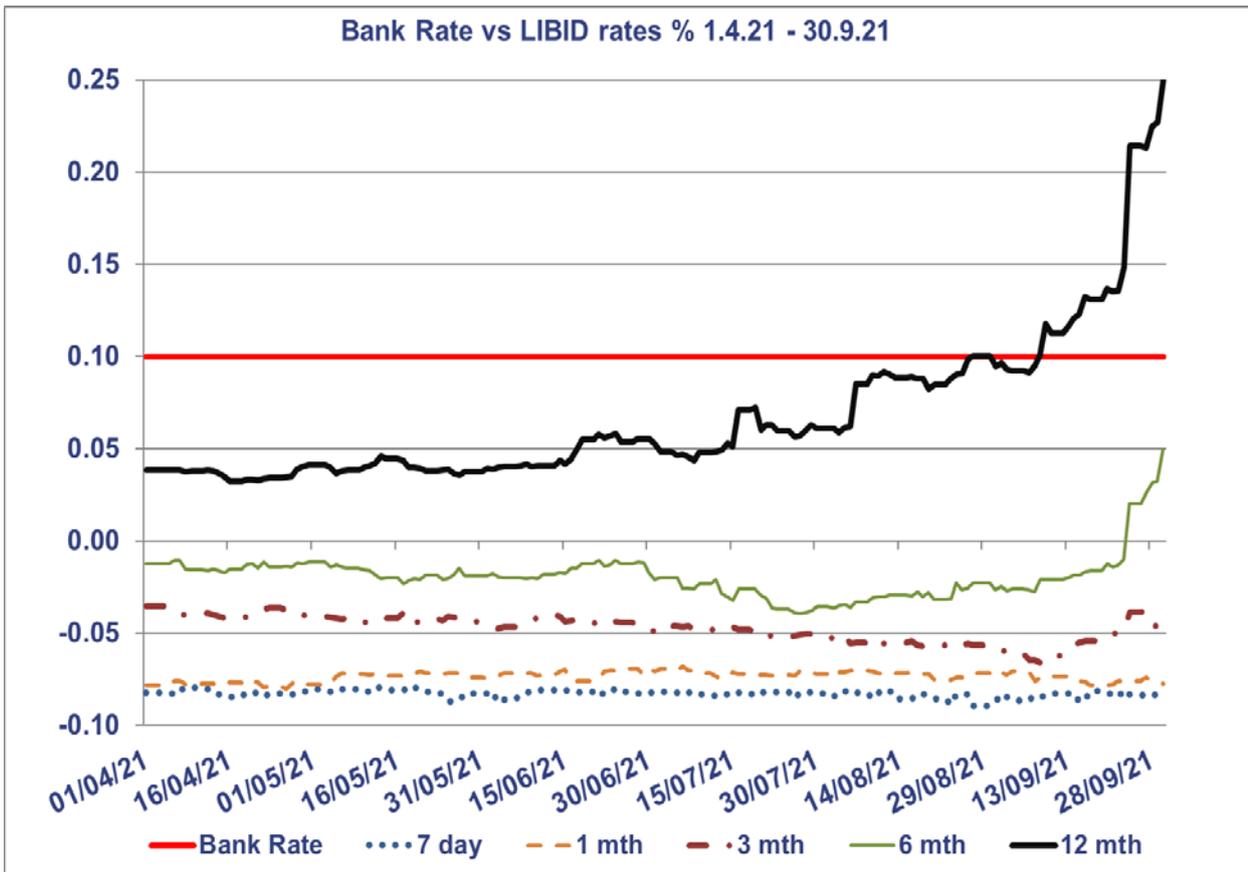
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function

### **Investment balances**

The Council held £158.9m of investments as at 30<sup>th</sup> September 2021 (£133.3m at 31<sup>st</sup> March 2021) and the investment portfolio yield for the first 6 months of the year is 0.08% against a benchmark of -0.07%.

### **Investment rates during period ended 30<sup>th</sup> September 2021**

As highlighted earlier in this report, the levels shown below use the traditional market method for calculating LIBID rates – i.e., LIBOR – 0.125%. Given the ultra-low LIBOR levels this year, this produces negative rates across some periods.



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
<b>High</b>	0.10	-0.08	-0.07	-0.04	0.05	0.25
<b>High Date</b>	01/04/2021	09/04/2021	06/07/2021	01/04/2021	30/09/2021	30/09/2021
<b>Low</b>	0.10	-0.09	-0.08	-0.07	-0.04	0.03
<b>Low Date</b>	01/04/2021	27/08/2021	26/04/2021	08/09/2021	27/07/2021	16/04/2021
<b>Average</b>	0.10	-0.08	-0.07	-0.05	-0.02	0.07
<b>Spread</b>	0.00	0.01	0.01	0.03	0.09	0.22

As illustrated, the Council outperformed the benchmark by 0.154 bps. The Council's budgeted investment return for the year to date is expected to be below budget.

### Approved limits

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the period ended 30<sup>th</sup> September 2021.

## 2.6 Other areas for consideration

### 2.6.1 None

## 3. Other Issues

New source of borrowing.

A new potential source of borrowing is now available for Local Authorities the UK Infrastructure Bank. The Bank lends to Councils for Infrastructure and climate change schemes with a value of over £5million at a rate of gilts plus 60bp.

With this in mind the Council wishes to add the UK Infrastructure Bank to its list of approved sources of borrowing.

## 4. Financial and Resources Appraisal

4.1 The financial implications are set out in section 2 of this report.

## 5. Risk Management and Governance Issues

5.1 The principal risks associated with treasury management are:

Risk: Loss of investments as a result of failure of counterparties.

Mitigation: Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties.

Risk: That the Council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or new borrowing (Liquidity risk).

Mitigation: Ensuring that a minimum proportion of investments are held in short term investments for cash flow purposes.

Risk: The level of investments and surplus cash is higher than needed to fund short term timing differences.

Mitigation: Cash flow forecasting and capital expenditure monitoring.

Risk: Increase in the net financing costs of the Council due to borrowing at high rates of interest.

Mitigation: Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking mostly long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

Risk: Higher interest rates increase borrowing making it more difficult to self-finance capital schemes. Debt servicing becomes less affordable and less sustainable and crowds out revenue spend.

Mitigation: To pause, delay or defer capital schemes. Also review opportunities to borrow in the future at current interest rates.

Risk: Return on non-treasury investments lower than expected.

Mitigation: Review and analysis of risk prior to undertaking non-treasury investments.

Risk: The Council's Minimum Revenue Policy charges an insufficient amount to the Revenue Estimates to repay debt.

Mitigation: Align the Minimum Revenue Policy to the service benefit derived from the Council's assets.

Risk: Associated with cash management, legal requirements and fraud.

Mitigation: These risks are managed through:

- Treasury Management Practices covering all aspects of Treasury management procedures including cash flow forecasting, documentation, monitoring, reporting and division of duties.
- All Treasury management procedures and transactions are subject to inspection by internal and external auditors. The Council also employs external financial advisors to provide information on market trends, credit rating alerts, lending criteria advice and investment opportunities.

Risk: Anticipated borrowing is lower than expected because the 2021-22 capital programme is underspent. This is explained in more detail below, together with the actions being taken to reduce these risks:

Mitigation: The Council is required to set a balanced budget for its revenue estimates; so in broad terms, income received will match expenditure over the 2021-22 financial year. The 2021-22 revenue estimates cause only temporary cash flow differences, for example when income is received in a different month to when the expenditure is incurred.

However, the 2021-22 capital budget will cause a cash flow shortfall in the long term, which generates a borrowing requirement. While some of the capital budget is funded immediately, mainly with Government grants, other elements are not funded initially, leading to the cash flow deficit that requires borrowing.

Managing borrowing is part of the Treasury Management role. To help in its management, the Treasury Strategy identifies the element within the capital budget that is not funded straightaway, to anticipate the Council's borrowing requirement.

However, when the capital budget is underspent, the Council has a lower borrowing requirement than anticipated. This risk is managed in practice because the Council only borrows when there is an actual cash flow shortage. The uncertainty around spend against the capital budget makes cash flow management more difficult. For example, it is less likely that the Council would take advantage of a short-term fall in interest rates, without more certainty around the timing of any borrowing need. Actions that have taken place to manage the risks relating to this uncertainty in the timing of capital spend are: Councillor and Officer challenge sessions on the capital budget; increased scrutiny of the capital forecasts in the quarterly monitoring, and the collection of additional documentation around the critical paths of individual schemes.

Risk: Coronavirus. The level of uncertainty in the future path of economic growth, unemployment, fiscal and monetary policy make it very difficult to accurately assess the impact on investments, capital spend and borrowing for the Council. The scale of impact will depend on the effects of the virus over the coming months and the depth of any recessionary impact.

Mitigation: Cash investments will be mainly held short term due to the uncertainties caused by the virus and we will continue to monitoring the situation and report any changes in the next Treasury report.

## **6. Legal Appraisal**

6.1 Any relevant legal considerations are set out in the report

## **7. Other Implications**

7.1 Equality & Diversity – no direct implications

7.2 Sustainability implications – no direct implications

7.3 Green house Gas Emissions Impact – no direct implications

7.4 Community safety implications – no direct implications

7.5 Human Rights Act – no direct implications

7.6 Trade Unions – no direct implications

7.7 Ward Implications – no direct implications

7.8 Implication for Corporate Parenting – no direct implications

7.9 Issues arising from Privacy Impact Assessment– no direct implications

## **8. Not for publications documents**

8.1 None

## **9. Options**

9.1 None

## **10. Recommendations**

10.1 That the details in paragraph 3 be noted by the Governance and Audit Committee and passed to Full Council on the 14 December for adoption.

## **11. Appendices**

Appendix 1 Prudential and Treasury Indicators as at 30 September 2021

Appendix 2 Borrowing Rates

Appendix 3 Approved Countries for Investment as at 30/09/21

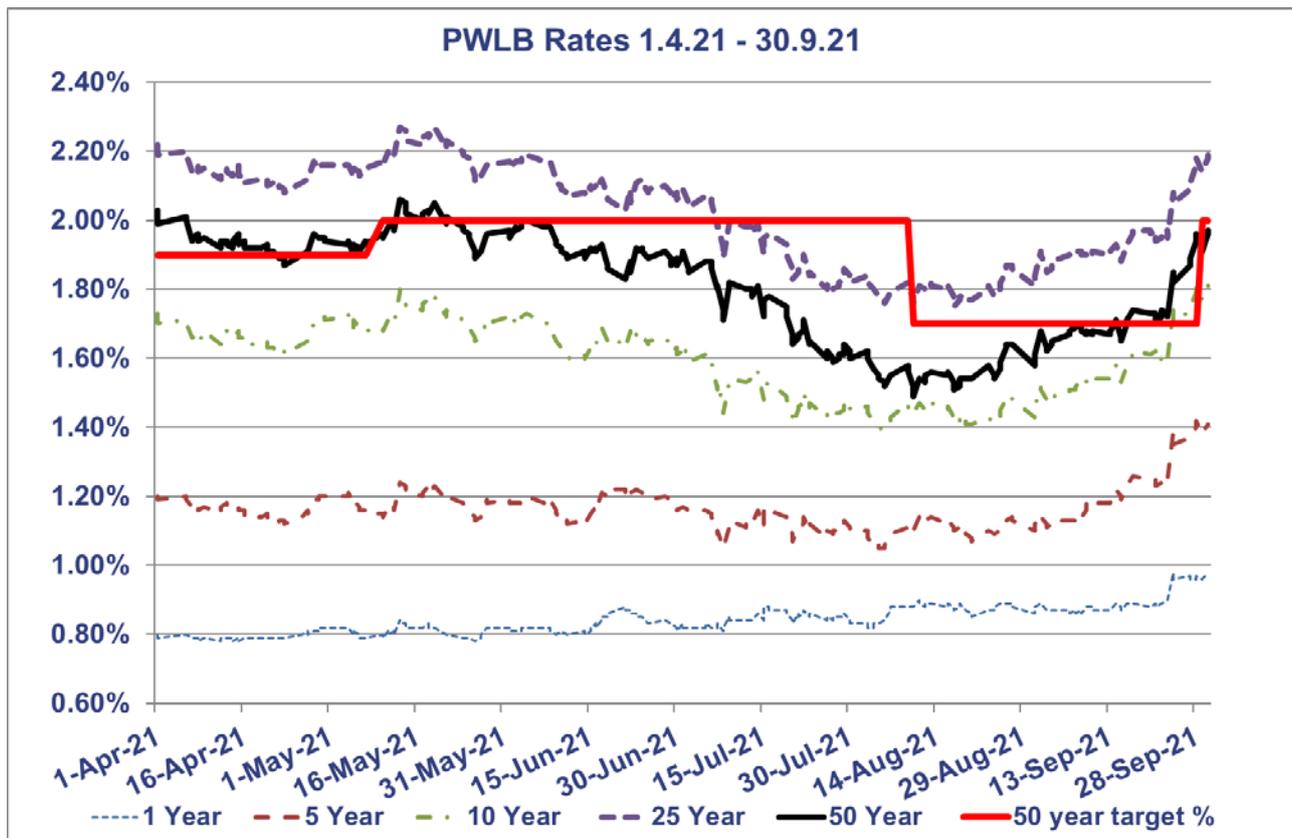
## APPENDIX 1: Prudential and Treasury Indicators as at 30<sup>th</sup> September 2021

<b>Treasury Indicators</b>	<b>2021/22 Budget £m</b>	<b>(Apr - Sept) Actual £m</b>
Authorised limit for external debt	£850m	£850m
Operational boundary for external debt	£852m	£852m
Gross external debt	£565.9m	£487.2m
Upper limit for principal sums invested over 365 days	£20m	£0m

<b>Maturity structure of fixed rate borrowing -</b>	<b>Upper Limit</b>	<b>(Apr-Sept) Actual</b>
Under 12 months	20%	2%
12 months to 2 years	20%	5%
2 years to 5 years	50%	7%
5 years to 10 years	75%	21%
10 years and above	90%	65%

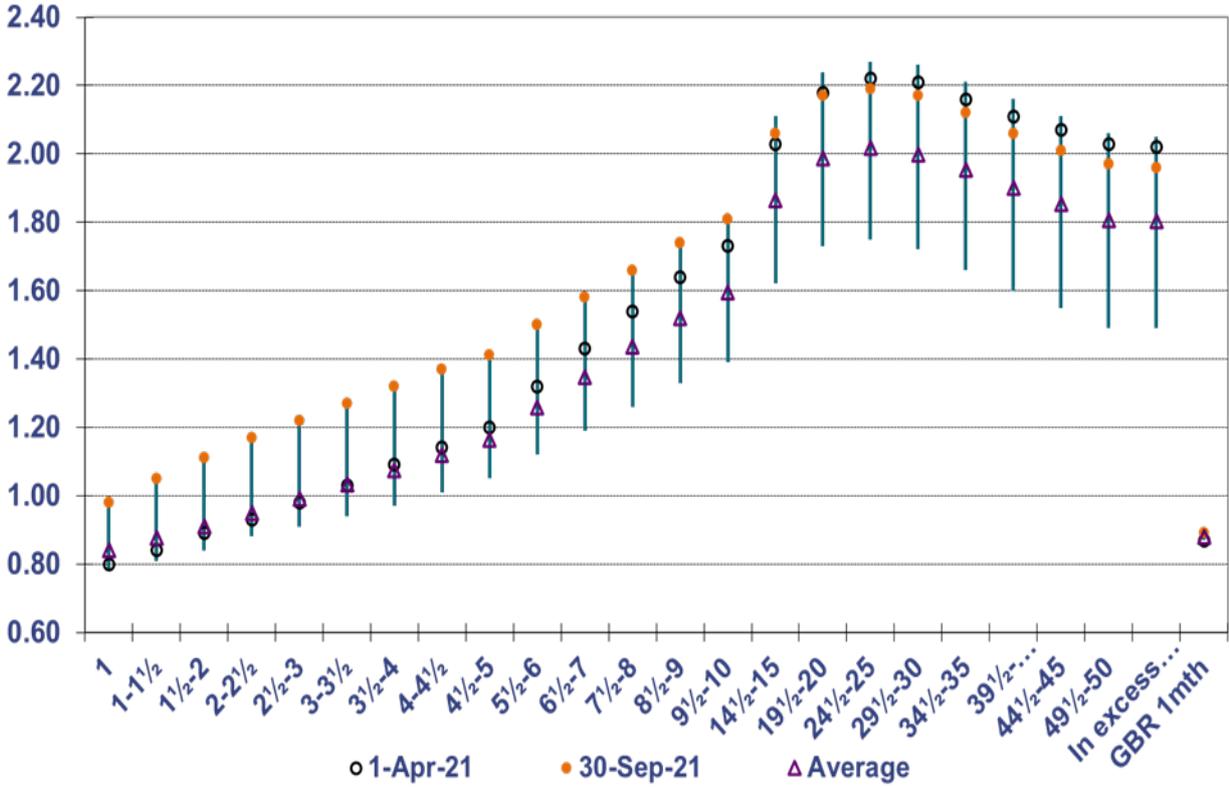
<b>Prudential Indicators</b>	<b>2020/21 Q2 Budget £m</b>	<b>2020/21 Revised Estimate £m</b>
Capital expenditure (Revised Q2 Budget)	£139.4m	£121.3m
Capital Financing Requirement (CFR)	£845.0	£741.0
Ratio of financing costs to net revenue stream	15.5%	14.7%

## APPENDIX 2: Borrowing rates



	1 Year	5 Year	10 Year	25 Year	50 Year
<b>Low</b>	0.78%	1.05%	1.39%	1.75%	1.49%
<b>Date</b>	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
<b>High</b>	0.98%	1.42%	1.81%	2.27%	2.06%
<b>Date</b>	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
<b>Average</b>	0.84%	1.16%	1.60%	2.02%	1.81%
<b>Spread</b>	0.20%	0.37%	0.42%	0.52%	0.57%

### PWLB Certainty Rate Variations 1.4.21 to 30.9.2021



## APPENDIX 3: Approved countries for investments as at 30th September 2021

### *Based on lowest available rating*

AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- France

AA-

- Belgium
- Hong Kong
- **U.K.**