Committee and Date	Item
Audit Committee 10 December 2020 Cabinet 14 December 2020 Council 17 December 2020	Public

TREASURY STRATEGY 2020/21 – MID YEAR REVIEW

Responsible Officer James Walton
e-mail: james.walton@shropshire.gov.uk Tel: (01743) 258915

1. Summary

1.1 This mid year Treasury Strategy report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management 2017 and covers the following:-

- An economic update for the first six months of 2020/21
- A review of the Treasury Strategy 2020/21 and Annual Investment Strategy
- A review of the Council's investment portfolio for 2020/21
- A review of the Council's borrowing strategy for 2020/21
- A review of any debt rescheduling undertaken
- A review of compliance with Treasury and Prudential limits for 2020/21

1.2 The key points to note are:-

- The internal treasury team achieved a return of 0.62% on the Council's cash balances outperforming the benchmark by 0.68%. This amounts to additional income of £603,800 for the first six months of the year which is included within the Council's projected outturn position.

- In the first six months all treasury management activities have been in accordance with the approved limits and prudential indicators set out in the Council's Treasury Strategy.

- On 11 March 2020, the Government partially reversed the additional 1% margin over gilts it set in October 2019, to all PWLB rates for certain types of borrowing e.g. Infrastructure projects.

- The Government announced that there would be a consultation with local authorities on possibly further amending these margins. The consultation ended 31 July. The Council submitted its response in line with this deadline and is awaiting a response of the outcome from Government later this year.

2. Recommendations

2.1 Members are asked to accept the position as set out in the report.

2.2 Members note that any changes required to the Treasury Strategy including the Annual Investment Strategy or prudential and treasury indicators as a result of decisions made by the Capital Investment Board will be reported to Council for approval.

REPORT

3. Risk Assessment and Opportunities Appraisal

3.1 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.2 There are no direct environmental, equalities or climate change consequences arising from this report.

3.3 Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

4.1 The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in the year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions results in increased or reduced income for the Council.

4.2 The six month performance is above benchmark and has delivered additional income of £603,800 which will be reflected in the Period 6 Revenue Monitor.

4.3 The Council currently has £162m held in investments as detailed in Appendix A and borrowing of £304m at fixed interest rates.

5. Climate Change Appraisal

5.1 The Council's Financial Strategy includes proposals to deliver a reduced carbon footprint for the Council therefore the Treasury Team is working with the Council in order to achieve this. There are no climate change impacts arising from this report.

6. Background

6.1 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.

6.2 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 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.

6.3 The Council defines its treasury management activities as “the management of the authority’s borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with the activities, and the pursuit of optimum performance consistent with those risks”. The report informs Members of the treasury activities of the Council for the first six months of the financial year.

6.4 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities are required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out the Council’s Capital Strategy was taken to full Council in February 2020.

6.5 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 2017.

7. Economic update

7.1 UK Economy – As expected, the Bank of England’s Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in GDP in the first half of 2020 was revised from -28% to -23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.
- The peak in the unemployment rate was revised down from 9% in Q2 to 7.5% by Q4 2020.
- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022. Nevertheless, even if the MPC were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

7.2 The MPC also decided against any idea of using negative interest rates, at least in the next six months or so. The MPC suggested that while negative rates can work in some circumstances, it would be less effective as a tool to stimulate the economy at this time when banks are worried about future loan losses. It also has other instruments available, including QE and the use of forward guidance.

7.3 The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the turn of the year. This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

7.4 In conclusion, this would indicate that the Bank now expected the economy to recover better than expected. However, the MPC acknowledged that the medium-term projections were a less informative guide than usual and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. One has only to look at the way in which second waves of the virus are now impacting many countries including the UK, to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused.

7.5 In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous furlough scheme through to the end of October is another development that could cause the Bank of England (BoE) to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six-month package from 1 November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid-September. However, the furlough scheme has been revisited and the decision has been made to extend it until the end of March 2021.

7.6 Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

7.7 There will be some painful longer-term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

7.8 One key addition to the BoE forward guidance was a new phrase in the policy statement, namely that it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate.

7.9 In the US, the incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by continuing outbreaks of the virus in some states leading to fresh localised restrictions. At its end of August meeting, the Fed revised its inflation target from 2% to maintaining an average of 2% over an unspecified time period i.e.following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time. This change is aimed to provide more stimulus for economic growth and higher levels of employment. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting.

7.10 The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The Federal Open Market Committee's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

7.11 The Eurozone economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The ECB has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.

7.12 In China, after a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

8. Economic Forecast

8.1 The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts are shown below:

Link Group Interest Rate View 11.8.20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

8.2. 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 to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting on 6th August, 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 within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

8.3. Link's central assumption is that there will be some form of agreement on a reasonable form of Brexit trade deal but the coronavirus outbreak could affect the timing of reaching a deal.

8.4. The overall balance of risks to economic growth in the UK is probably relatively even but is subject to major uncertainty due to the virus. There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

8.5. Long term PWLB rates are expected to rise to 2.4% in September 2021 before increasing to reach 2.5% by June 2022.

9. Treasury Strategy update

9.1 The Treasury Management Strategy (TMS) for 2020/21 was approved by Full Council on 27 February 2020. This Treasury Strategy does not require updating as there are no policy changes or any changes required to the prudential and treasury indicators previously approved. The details in this report update the position in the light of the updated economic position.

10. Annual Investment Strategy

10.1 The Council's Annual Investment Strategy, which is incorporated in the TMS, outlines the Council's investment priorities as the security and liquidity of its capital. As shown by forecasts in section 8.1, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.10% bank rate.

10.2 The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, plus the ongoing issues surrounding the global pandemic, prompts a low risk and short-term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

10.3 The Council aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (up to 1 year), and only invest with highly credit rated financial institutions using Link's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link. The Treasury Team continue to take a prudent approach keeping investments short term and with the most highly credit rated organisations.

10.3 In the first six months of 2020/21 the internal treasury team outperformed its benchmark by 0.68%. The investment return was 0.62% compared to the benchmark of -0.06%. This amounts to additional income of £603,800 during the first six months which is included within the Council's projected outturn position.

10.4 A full list of investments held as at 30 September 2020, compared to Link's counterparty list, and changes to Fitch, Moody's and Standard & Poor's credit ratings are shown in **Appendix A**. None of the approved limits within the Annual Investment Strategy were breached during the first six months of 2020/21 and have not been previously breached. Officers continue to monitor the credit ratings of institutions on a daily basis. Delegated authority has been put in place to make any amendments to the approved lending list.

10.5 As illustrated in the economic background section above, investment rates available in the market have decreased significantly due to the bank rate decrease to 0.10% in March 2020. The average level of funds available for investment purposes in the first six months of 2020/21 was £180 million.

10.6 The Council's interest receivable/payable budgets are currently projecting a surplus of £2.5 million as reported in the monthly revenue monitoring reports due to no long-term borrowing being undertaken, changes to the Minimum Revenue Provision (MRP) calculation previously approved by Council and investment returns achieved being higher than anticipated.

11. Borrowing

11.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Prudential Indicators (affordability limits) are outlined in the TMS. A list of the approved limits is shown in **Appendix B**. The schedule at **Appendix C** details the Prudential Borrowing approved and utilised to date.

11.2 Officers can confirm that the Prudential Indicators were not breached during the first six months of 2020/21 and have not been previously breached.

11.3 No new external borrowing has currently been undertaken to date in 2020/21, although discussions are currently being held at the Capital Investment Board where outline business cases are being considered. The schemes being considered are already within the current authorised borrowing limits in place. In the event the authorised borrowing limits need to be amended, this will be reported to Council for approval. The table below illustrates the low and high points across different maturity bands for borrowing rates for the first six months of the financial year.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.70%	1.67%	1.91%	2.40%	2.13%
Date	18/09/2020	30/07/2020	31/07/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/2020	08/04/2020	08/04/2020	28/08/2020	28/08/2020
Average	1.80%	1.80%	2.04%	2.54%	2.33%

11.4 HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019-20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB rates. That increase was then at least partially reversed for some forms of borrowing on 11th March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased infrastructure expenditure.

11.5 Government also announced that there would be a consultation with local authorities on possibly further amending these margins; this was to end on 4th June, but that date was subsequently put back to 31st July. The Council responded prior to the deadline and is awaiting a response from the Government. It is not clear as to whether HM Treasury will allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

12. Debt Rescheduling

12.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. During the first six months of the year no debt rescheduling was undertaken.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Council, 27 February 2020, Treasury Strategy 2020/21 Council, 27 February 2020, Capital Strategy 20/21 – 24/25 Council, 20 September 2018, Revised Minimum Revenue Provision Statement 2018/19
Cabinet Member: David Minnery, Portfolio Holder for Finance
Local Member N/A
Appendices A. Investment Report as at 30th September 2020 B. Prudential Limits C. Prudential Borrowing Schedule