Report To:	**Audit and Standards Committee**
Date:	**16 November 2020**
Report Title:	**Treasury Management**
Report of:	**Chief Finance Officer**
Ward(s):	**All**
Purpose of report:	**To present details of recent Treasury Management activity.**
Officer Recommendations:	**To note and recommend that Cabinet accepts that Treasury Management Activity for the period 1 September to 31 October 2020 has been in accordance with the approved Treasury Strategies.**
Reasons for recommendations:	**Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code) and this has to be reported to Full Council.**
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1. Introduction

1.1 The Council's approved Treasury Strategy Statement requires the Audit and Standards Committee to review details of Treasury Strategy transactions against the criteria set out in the Strategy and make observations to Cabinet as appropriate.

1.2 The Treasury Strategy Statement also requires the Audit and Standards Committee to review a formal summary report detailing the recent Treasury Management activity before it is considered by Council, in accordance with best practice and guidance issued by the Chartered Institute of Public Finance and Accountancy.

2. Treasury Management Activity

2.1 The timetable for reporting Treasury Management activity in 2020/21 is shown in the table below. This takes into account the timescale for the publication of each Committee agenda and is on the basis that it is preferable to report on activity for complete months. Any extraordinary activity taking place between the close of the reporting period and the date of the Audit and Standards Committee meeting will be reported verbally at that meeting.

Meeting date	Reporting period for transactions
6 July 2020	1 March to 30 June 2020 (*meeting cancelled*)

14 September 2020	1 April to 31 August 2020 (*revised reporting period*)
16 November 2020	1 September to 31 October 2020
18 January 2021	1 November to 31 December 2020
8 March 2021	1 January to 28 February 2021

2.2 Fixed Term Deposits pending maturity

The following table shows the fixed term deposits held between 1 September and 31 October 2020 and identifies the long-term credit rating of counterparties at the date of investment. It is important to note that credit ratings are only one of the criteria that are taken into account when determining whether a potential counterparty is suitable. All of the deposits met the necessary criteria the minimum rating required for deposits made after 1 April 2018 is long term A- (Fitch).

Ref	Counterparty	Date From	Date To	Days	Principal £	Int Rate %	Long-term Rating
248920	Telford & Wrekin Council	16 Sep 20	18 Jan 21	124	3,000,000	0.08	*
*UK Government body and therefore not subject to credit rating							

2.3 Fixed Term Deposits which have matured in the reporting period

The table below shows the fixed term deposits which have matured since 1 September 2020, in maturity date order. It is important to note that the table includes sums reinvested and that in total the Council's investments have not increased by £16.0m over this period.

Ref	Counterparty	Date From	Date To	Days	Principal £	Int. Rate %	Long-term rating
248720	Debt Management Office	1 Sep 20	8 Sep 20	7	8,000,000	0.01%	*
248820	Debt Management Office	9 Sep 20	16 Sep 20	7	8,000,000	0.01%	*
	Total				16,000,000		
	*UK Government body and therefore not subject to credit rating						

At no stage did the total amount held by any counterparty exceed the approved limit set out in the Investment Strategy. The average rate of interest earned on deposits held in the period 1 September to 31 October 2020 was 0.03%, below the average bank base rate for the period of 0.10%.

2.4 Use of Deposit accounts

In addition to the fixed term deposits, the Council has made use of the following interest bearing accounts in the period covered by this report, with the average amount held being £3.392m generating interest of approximately £1.2k

	Balance at 31 Oct. 2020 £'000	Average balance £'000	Current interest rate %
Santander Business Reserve Account	£5,000	£5,000	0.12
Lloyds Bank Corporate Account	£ 730	£1,848	0.00
Lloyds Bank Call Account	£3,300	£3,329	0.05

2.5 Use of Money Market Funds

Details of the amounts held in the two Money Market Fund (MMF) accounts used by the Council are shown below. The approved Investment Strategy allows a maximum investment of £10m in each fund, and at no time was this limit exceeded.

	Balance at 31 Oct ‘19 £’000	Average balance £’000	Average return %
Goldman Sachs Sterling Liquid Reserves Fund	£3,000	4,916	0.16
Deutsche Managed Sterling Fund	£3,001	4,200	0.19

2.6 Treasury Bills (T-Bills)

There were no Treasury Bills held at 31 October 2020, and there was no activity in the period.

2.7 Secured Investments

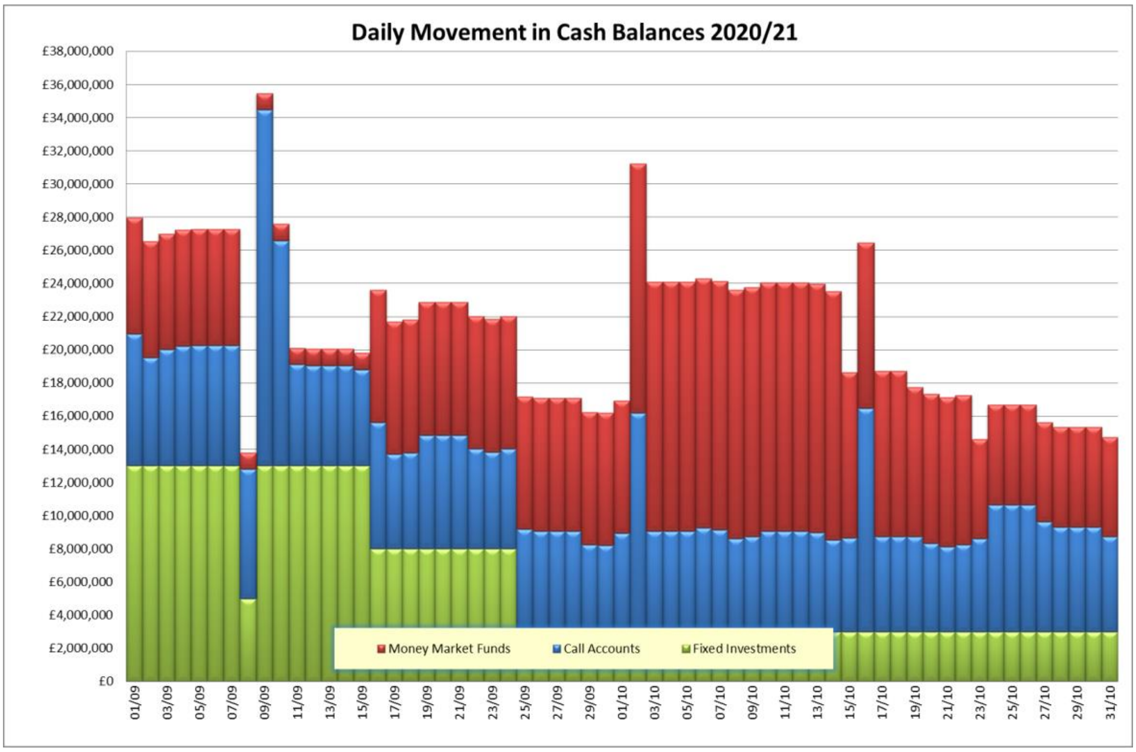
There were no Secured Investments at 31 October 2020.

2.8 Tradeable Investments

There were no Tradeable Investments at 31 October 2020, and there was no activity in the period.

3. Overall investment position

3.1 The chart below summarises the Council’s investment position over the period 1 September to 31 October 2020. It shows the total sums invested each day as Fixed Term deposits, amounts held in Deposit accounts and Money Market Funds.



4. Annual Investment Strategy

4.1 The Treasury Management Strategy Statement (TMSS) for 2020/21 which includes the Annual Investment strategy, was approved by the Full Council on Wednesday, 19th February. It sets out the Council's investment priorities as being:

- Security of Capital;
- Liquidity;
- Yield.

Approved limits within the Annual Investment Strategy were not breached during the period ending 31 October 2020, except for the balance held with Lloyds Bank, which exceeded the £5m limit for 9 days during the period.

4.2 Investment rates available in the market have continued at historically low levels. Investment funds are available on a temporary basis and arise mainly from the timing of the precept payments, receipts of grants and the progress of the capital programme.

4.3 As shown by the interest rate forecasts, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this risky environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2023, investment returns are expected to remain low.

Negative investment rates

4.4 While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short-term until those sums were able to be passed on.

4.5 As for money market funds (MMFs), yields have continued to drift lower. Some managers have suggested that they might resort to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a glut of money swilling around at the very short end of the market.

4.6 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

5. Borrowing

5.1 The current account with Lloyds Bank generally remained with credit limits throughout most of the period with the following exceptions:

Exceptions:

1 September 2020 to 31 October 2020 – excess funds of between £1m and £15m.

The Council's long term borrowing in the reporting period is £56.673m.

Interest Rate Forecast

5.2 The Council's treasury advisor, Link Group, provided the following forecasts on 11 August 2020:

Link Group Interest Rate View 11.8.20	Sep-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	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	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	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	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	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

The above table is based on PWLB certainty rates – gilt yields plus 180bps.

5.3 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, 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.

5.4 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. 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 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 From the local authority borrowing perspective, 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 period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes. At the same time the Government announced in the Budget a programme of increased infrastructure expenditure.

5.6 It also announced that there would be a consultation with local authorities on possibly further amending these margins; the HM Treasury consultation was initially due to end on 4th June, but that date was subsequently put back to 31st July. To date, the outcomes of the consultation have yet to be announced but it is clear that HM Treasury will most likely no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the primary aim is to generate an income stream (assets for yield).

5.7 Following the changes on 11th March 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **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)

5.8 It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the HM Treasury consultation; however, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

5.9 As the interest forecast table for PWLB certainty rates, (gilts plus 180bps), above shows, there is likely 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. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

6 Compliance with Treasury and Prudential Limits

6.1 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 (affordability limits) are included in the approved TMSS. As at 31 October 2020, the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

Treasury Prudential Indicators	**2020/21 Estimate Indicator**	**31 October Actual Indicator**	**RAG Status/Reason**
Authorised limit for external debt (CS 4.2.3)	£117.7m	£117.7m	
Operational boundary for external debt (CS 4.2.3)	£127.7m	£127.7m	
Gross external debt (CS 4.2.2)	£137.0m	££56.6m	
Capital Financing Requirement (CS 2.3.4)	£136.9m	n/a	
Debt vs CFR under/(over) borrowing	-		
<u>Investments</u>			
Investment returns expectations	0.10%	0.03%	
Upper limit for principal sums invested for longer than 365 days			
Maturity structure of fixed rate borrowing - upper limits:			
Under 12 months	75%	75%	
12 months to 2 years	75%	75%	
2 years to 5 years	75%	75%	
5 years to 10 years	100%	100%	
10 years and above	100%	100%	
Capital expenditure (CS 2.1.4)	£11.9		
Ratio of financing costs to net revenue stream (CS 8.1.1):			
Proportion of Financing Costs to Net Revenue Stream (General Fund)	1.68%	1.68%	
Proportion of Financing Costs to Net Revenue Stream (HRA)	18.08%	18.08%	

Key: CS – 2020/21 Capital Strategy Appendix 1

7. Non-treasury investments

The non-treasury investment activity includes loans to Council-owned companies or the purchase of property assets for the purpose of income generation.

7.1 **Lewes Housing Investment Company** - a wholly owned subsidiary of the Council. Incorporated in July 2017, LHIC was set up to acquire, improve and let residential property at market rents. The 2020/21 Capital programme includes £2.5m as commercial loan funding to facilitate property purchases. At 30 September 2020, there had been no draw drawn of the loan facility.

A working capital facility loan of £100,000 has been agreed, at an interest rate of 2% above Base Rate. As at 30 September 2020, £602 of the working capital facility had been drawn down to cover administrative expenses.

7.2 **Aspiration Homes LLP** - a limited liability Partnership owned equally by Lewes District Council and Eastbourne Borough Council. Incorporated in June 2017, AH has been set up for the purpose of developing housing to be let at affordable rent. The Capital programme includes £17.5m as commercial loan funding to AH to facilitate property purchases. At 30 September 2020, £912,910 had been drawn down for the purchase of Grays School, Newhaven.

A working capital facility loan of £100,000 has been agreed, at an interest rate of 2% above Base Rate. As at 30 September 2020, £20,000 of the working capital facility had been drawn down.

8. Economic Background

8.1 As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August (and subsequently 16th September). A detailed economic commentary on developments during period ended 30th September 2020 is attached as **Appendix A**.

9. Financial Appraisal

9.1 All relevant implications are referred to in the above paragraphs.

10. Risk Management Implications

10.1 The risk management implication associated with this activity is explained in the approved Treasury Management Strategy. No additional implications have arisen during the period covered by this report.

11. Equality Analysis

11.1 This is a routine report for which detailed Equality Analysis is not required to be undertaken.

12. Legal Implications

12.1 There are no legal implications from this report.

13. Environmental sustainability implications

13.1 This report notes the treasury management performance of the Council. There are no anticipated environmental implications from this report that would affect the Council's sustainability policy. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the treasury activities and highlights compliance with the Council's policies previously approved by members.

14. Appendix

14.1 Appendix A - Detailed economic commentary.

15. Background Papers

15.1 Treasury Strategy Statements 2020/21.