Report to:	**Audit and Standards Committee**
Date:	**8 March 2021**
Title:	**Treasury Management**
Report of:	**Chief Finance Officer**
Ward(s):	**All**
Purpose of report:	**To present details of recent Treasury Management activity.**
Officer recommendation(s):	**To note and recommend that Cabinet accepts that Treasury Management Activity for the period 1 January to 28 February 2021 has been in accordance to 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 January to 28 February 2021 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 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
249221	Kirklees Council	17 Feb 21	26 Mar 21	37	5,000,000	0.01	*
*UK Government body and therefore not subject to credit rating							

2.3 Fixed Term Deposits which have matured in the reporting period.

Ref	Counterparty	Date From	Date To	Days	Principal £	Int Rate %	Long-term Rating
248920	Telford and Wrekin Council	16 Sep 20	18 Jan 21	124	3,000,000	0.08	*
249020	RB Maidenhead & Windsor	30 Nov 20	19 Jan 21	50	5,000,000	0.03	*
249121	Debt Management Office	15 Jan 21	5 Feb 21	21	8,000,000	0.01	*
					16,000,000		
*UK Government body and therefore not subject to credit rating							

2.4 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 January to 28 February 2021 was 0.06%, below the average bank base rate for the period of 0.10%.

2.5 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 £3.081m generating interest of approximately £0.6k..

	Balance at 28 Feb. 2021 £'000	Average balance £'000	Current interest rate %
Santander Business Reserve Account	5,000	5,000	0.08
Lloyds Bank Corporate Account	345	2,016	0.00
Lloyds Bank Call Account	10	2,227	0.01

2.6 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 28 Feb. 2021 £'000	Average balance £'000	Average return %
Goldman Sachs Sterling Liquid Reserves Fund	£5,000	6,982	0.00
Deutsche Managed Sterling Fund	£5,501	7,922	0.00

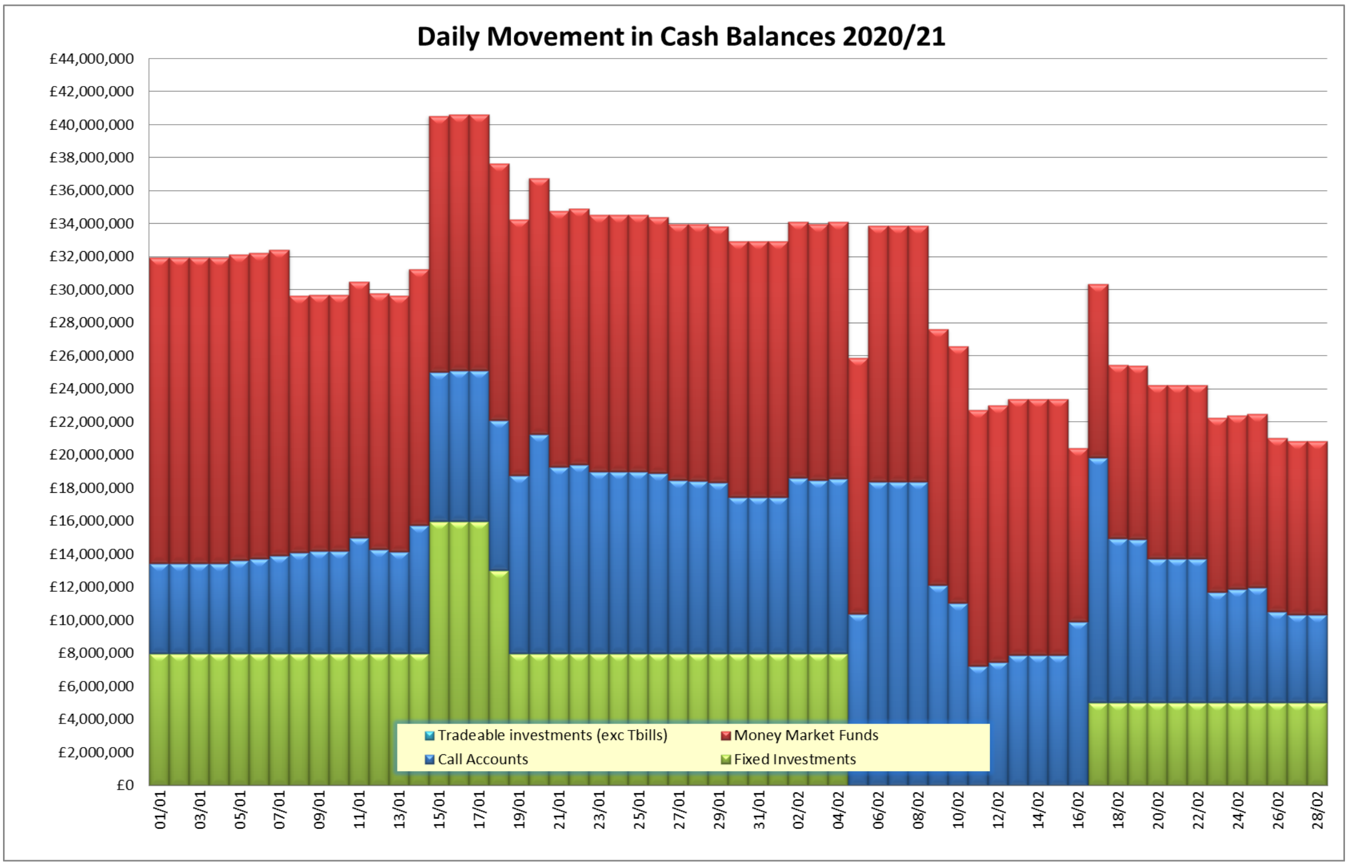
2.7 Treasury Bills (T-Bills)
There were no Treasury Bills held as at 28 February 2021, and there was no activity in the period.

2.8 Secured Investments
There were no Secured Investments as at 28 February 2021.

2.9 Tradeable Investments
There were no Tradeable Investments as at 28 February 2021, 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 January to 28 February 2021. 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 28 February 2021, except for the balance held with Lloyds Bank, which exceeded the £5m limit for 17 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 Investment returns expectations - Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

4.4 The overall balance of risks to economic growth in the UK is now probably more to the upside but is subject to major uncertainty due to the virus - both domestically and its potential effects worldwide. 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 anytime soon 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, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

Negative investment rates

4.5 While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in February 2021 stated that financial institutions would not be ready to implement negative rates for six months, some deposit accounts were offering negative rates for shorter periods prior to this latest announcement. 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 cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

4.6 As for money market funds (MMFs), yields have fallen near to zero. Some managers have resorted 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 surfeit of money swilling around at the very short end of the market.

4.7 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 January to 28 February 2021 – excess funds of between £1m and £8m.

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

Interest Rate Forecast

5.2 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 9.2.21. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	8.2.21												
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.90	0.90	0.90	0.90	1.00	1.00	1.10	1.10	1.10	1.20	1.20	1.20	1.20
10 yr PWLB	1.30	1.30	1.30	1.30	1.40	1.40	1.50	1.50	1.50	1.60	1.60	1.60	1.60
25 yr PWLB	1.90	1.90	1.90	1.90	2.00	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.20
50 yr PWLB	1.70	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00	2.00	2.00

5.3 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 subsequently left Bank Rate unchanged at its subsequent meetings, including its last meeting on 4th February 2021, although some forecasters had suggested that a cut into negative territory could happen. However, at that last meeting, we were informed that financial institutions were not prepared for implementing negative rates. The Monetary Policy Committee (MPC), therefore, requested that the Prudential Regulation Authority require financial institutions to prepare for such implementation if, at any time in the future, the MPC may wish to use that as a new monetary policy tool. The MPC made it clear that this did not in any way imply that they were about to use this tool in the near future. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as it is unlikely that inflation will rise sustainably above 2% during this period so as to warrant increasing Bank Rate.

Gilt yields / PWLB rates

5.4 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. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc.

5.5 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 was that bond prices were elevated as investors would have been 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.

5.6 As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as government bond yields of major countries around the world are expected to rise little during this time in an environment where central bank rates are also expected to remain low for some years; this is the result of a change of inflation targeting policy of central banks to one based on average inflation over a number of years. 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 2020 when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

5.7 **Investment and borrowing rates**

- **Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.
- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to six years were negative during most of the first half of 2020/21; they jumped up after the Monetary Policy Report of 4th February 2021. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps, but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The new margins over gilt yields are 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)

- **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are near to historic lows. The Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Although short-term interest rates are cheapest, longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable.

- While this authority will not be able to avoid borrowing to finance new capital expenditure, or to replace maturing debt, there will be a *cost of carry*, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances.

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 28 February 2021, 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**	**28 February 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%	0.06%	
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	n/a	
Ratio of financing costs to net revenue stream (CS 8.1.1):			

Treasury Prudential Indicators	2020/21 Estimate Indicator	28 February Actual Indicator	RAG Status/Reason
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 (LHIC) -** 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 31 January 2021, there had been no draw down 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 31 January 2021, £65 of the working capital facility had been drawn down to cover administrative expenses.

7.2 **Aspiration Homes LLP (AH)** - 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 31 January 2021, £1,663,660 had been drawn down for the purchase of Grays School, Newhaven and dwellings at Oakfield, Plumpton Green.

A working capital facility loan of £100,000 has been agreed, at an interest rate of 2% above Base Rate. As at 31 January 2021, £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 and a detailed economic commentary on developments during period ended 28 February 2021 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.