Appendix 1

Treasury Management Half Yearly Report – 2020/21

1. Background

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 security and liquidity initially before considering optimising investment return (yield).

Accordingly Treasury Management is defined as:

"The management of the local authority's 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."

The second main function of a treasury management service is the funding of an authority'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 occasions any debt previously drawn may be restructured to meet Council risk or cost objectives.

2. Introduction

In February 2010 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

The Council's treasury management strategy for 2020/21 was approved at a meeting on 19 February 2020. The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 19 February 2020.

This Half Yearly Report to members is intended to provide an update of the treasury management strategy and performance for the period April to September of this financial year. It has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the 2020/21 financial year to 30 September 2020;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy; and
- A review of the Council's investment portfolio for 2020/21.

3. Economic Update – as provided by the Council's Treasury Management Advisors, Arlingclose

The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

The Bank of England maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by Bank of England policymakers, but then a comment in the September Monetary Policy Committee meeting minutes that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the 'Eat Out to Help Out' offer.

GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year on year in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the 'Eat Out to Help Out' scheme.

In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the Bank of England has forecast unemployment could hit a peak of between 8% and 9%.

Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative.

There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for UK institutions there is the added complication of the end of the Brexit transition period on 31 December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

Outlook for the remainder of 2020/21

	Dec 20	Mar 21	Jun 21	Sep 21	Dec 21	Mar 22	Jun 22	Sep 22	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23
Official Bank Rate													
Upside Risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	**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**
Downside Risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been supressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (Quantitative Easing). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

4. Regulatory Updates – as provided by the Council's Treasury Management Advisors, Arlingclose

IFRS 16

The implementation of the new IFRS 16 Leases accounting standard has been delayed until 2021/22.

5. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy for 2020/21 was approved by Full Council on 19 February 2020. The Council's annual Investment Strategy, which is incorporated in the Treasury Management Strategy, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim 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, and only invest with highly credit rated financial institutions using the Arlingclose suggested creditworthiness matrices. Currently investments are only being made with UK financial institutions.

Investments during the first six months of the 2020/21 financial year have been in line with the strategy, and there have been no deviations from the strategy.

As outlined in Section 3 above, there is considerable uncertainty in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 19 February 2020 is still fit for purpose in the current economic climate.

6. Investment Portfolio 2020/21

In accordance with the CIPFA Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, 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. Given this environment, investment returns are likely to remain low.

The Council held investments of £7m as at 30 September 2020; £5m was placed in the Debt Management Account Deposit Facility (DMADF) with the DMO, £1m was held in the Public Sector Deposit Fund, and £1m was held in the Council's Lloyds Current Account for liquidity. In comparison only £4.5m was held as at 31 March 2020, entirely within the Council's Lloyds Current Account. Investments held have been with institutes with a credit rating of A+ or above. This is greater than the average portfolio credit rating target of A or above set in the Council's Treasury Management Strategy 2020/21.

Funds available for investment purposes during 2020/21 to date have varied between nil and £25m, mainly due to the central government funding received to support small and medium businesses during the coronavirus pandemic. Typically this variance is between nil and £10m. These fluctuations are due to cash inflows and outflows during each month. Large cash inflows include council tax and business rate direct debits and the Housing Benefit subsidy from the Department for Work and Pensions. Large cash outflows include payment of the precepts to Staffordshire County Council, the Fire Authority and the Police, payment of salaries and payment of business rates to Central Government and the Staffordshire Business Rate pool.

The investment portfolio yield for the first six months of the year is 0.13%, at 30 September 2019 this yield was 0.52%. The Council's budgeted investment return for 2020/21 is nil. As at the end of the first 2 quarters of 2020/21 £8,400 of interest has been earned.

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses.

On 25 September 2020 the overnight, 1 week and 2 week deposit rates on DMADF deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities. The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.1%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.

Heritable Bank

The original investment with Heritable Bank was £2.5m. Fifteen dividends have been received from administrators Ernst and Young representing a return of 98%, with the most recent payment of £99,932 being made in August 2015.

The bank's administrators confirmed the execution of a settled de-minimis payment from the parent company of Heritable Bank which will be paid to the Council in the event that the remaining 2% of the original investment is no longer contingent. At the time this equated to £9,411.35.

Following the conclusion of the administration, the Council actually received a final payment of £23,919.80 in July 2020, making the total amount of investment returned £2.492m

Estimates for income, 2020/21

The corporate world is still adjusting to the economic shock, with probably more to come, and it is still too early to tell which companies will withstand the economic damage in the short to medium-term or which will choose to conserve cash in very difficult economic conditions simply to survive.

Investment income in 2020/21 was set against a very different economic backdrop. Bank Rate, which was 0.75% in January/February 2020, now stands at 0.1%. Interest earned from short-dated money market investments will be significantly lower. In relation to income from the Council's externally managed strategic funds, dividends and income distributions will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact.

7. Borrowing Position 2020/21

The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. During the first six months of 2020/21 no borrowing has taken place, however it is envisaged that borrowing will be required to cover short-term cash flow deficits together with the capital programme.

With short-term interest rates remaining much lower than long-term rates, the Council consider it to be more cost effective in the near term to use internal resources or borrow on a short-term basis. This is also in line with advice provided by Arlingclose Ltd.

However, a need to borrow in order to fund the Council's capital programme was included within the Revenue and Capital Budgets, Council Tax and Strategies 2020/21 report presented to Council on 19 February 2020. The impact of borrowing is included in the Medium Term Financial Strategy pressures for 2020/21 and future years.

Borrowing Update

In October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields. £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% has been made available to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

The consultation titled "Future Lending Terms" allows stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to allow authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

The consultation closed on 31 July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year.

8. Prudential Indicators 2020/21

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2020/21 Treasury Management Strategy. Consequently, there is no intention to revise any of the indicators for the remainder of the year.

9. Compliance

The Executive Director (Resources and Support Services) reports that all treasury management activities undertaken during the year to date have complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

Annex A

Treasury Management – Glossary of Terms

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.

- **CPI** – a measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

- **DMADF** –is provided by the DMO as part of its cash management operations and in the context of a wider series of measures designed to support local authorities' cash management.

- **DMO** – The Debt Management Office is an Executive Agency of Her Majesty's Treasury responsible for debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

- **GDP** – Gross Domestic Product is the market value of all officially recognised final goods and services produced within a country in a given period of time.

- **Liquidity** – relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **MHCLG** – the Ministry of Housing, Communities and Local Government is the UK Government department for housing, communities and local government in England. Known previously as Department for Communities and Local Government (DCLG), it was renamed to add Housing to its title and changed to a ministry in January 2018.

- **PMI** – is an index of the prevailing direction of economic trends in the manufacturing and service sectors.

- **PWLB** – is a statutory body operating within the United Kingdom Debt Management Office. PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments.

- **Quantitative Easing** – a form of unconventional monetary policy in which a central bank purchases longer-term securities from the open market in order to increase the money supply and encourage lending and investment. Buying these securities adds new money to the economy, and also serves to lower interest rates by bidding up fixed-income securities. It also expands the central bank's balance sheet.