Finance and Performance Sub Committee – 14th December 2020

Treasury Management Report to 30 September 2020 – Quarter 2

Purpose of report

The purpose of this report is to note the current position for Treasury Management for the period to 30 September 2020 in financial year 2020/21.

Attachment(s)

Appendix 1: Q2 2020/21 Economic Summary – Link Group
Appendix 2: Prudential and Treasury Management Indicators as at 30 September 2020

1. Introduction

1.1 The Treasury Management Strategy for 2020/21 was approved as part of the Medium Term Financial Strategy (MTFS) in March 2020. It is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2017.

1.2 An amendment to the Treasury Management Strategy for 2020/21 was approved by Full Council on 13 May 2020 to provide a delegation to the Chief Finance Officer (or their nominee), following consultation with the Chairmen of the Finance and Performance Sub Committee and the Governance and Audit Committee to temporarily increase the HM Treasury (Debt Management Office) counterparty limit from £10m to unlimited if required due to exceptional circumstances.

1.3 The CIPFA Code of Practice recommends that Members be informed of treasury management activities at least twice a year; this report therefore embraces best practice.

1.4 This report provides:

- A summary of the economic conditions affecting the council's investment strategy
- Details of investments made during the year
- A summary of the council's current investment portfolio

1.5 The council's investment priorities are:

- Security of capital invested
- Liquidity of capital invested
- Return on investment

2. Economic Background

2.1 Commentary on the economic background is provided by the Council's treasury advisor, Link Group and detailed at Appendix 1.

2.2 **UK Economic Summary**

2.3 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 left Bank Rate unchanged at its meeting on 6th August (and the subsequent September 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. No increase in Bank Rate is expected until at least after 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

2.4 The gradual pace of recovery is therefore 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.

2.5 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 is one area that has already seen huge growth.

2.6 A summary of the economic position of other World economies during Quarter 2 2020/21 which has been provided by the Council’s treasury advisor, Link Group, is set out in Appendix 1.

2.7 **Interest Rates**

2.8 The Council’s treasury advisor, Link Group, provided the following forecast on 11th August 2020.

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

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

2.9 The forecast shows that no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023.

2.10 **Gilt Yields and PWLB Rates**

2.11 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 heightened expectations that the US could have been heading for a recession in 2020, and a general background 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; 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. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years.

2.12 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.

2.13 Gilt yields had therefore already been on a falling trend during the last year up until the coronavirus crisis hit western economies. Since then, we have seen gilt yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies and moved cash into safe haven assets i.e. government bonds. However, major western central banks started massive quantitative easing purchases of government bonds which has acted to maintain downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Equity markets have enjoyed a rebound since the lows of March as confidence has started to return among investors that the worst is over and recovery is now on the way.

2.14 HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then at least partially reversed for some forms of borrowing on 11 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 spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins.

2.15 Although published after the end of Quarter 2 (which this paper focuses on), it should be noted that the result of this consultation was published in November 2020 and the Government confirmed that the interest rate of PWLB lending will be dropped by 100bps from 26th November 2020 (subject to a number of conditions). This will be covered in the Quarter 3 update to this sub committee.

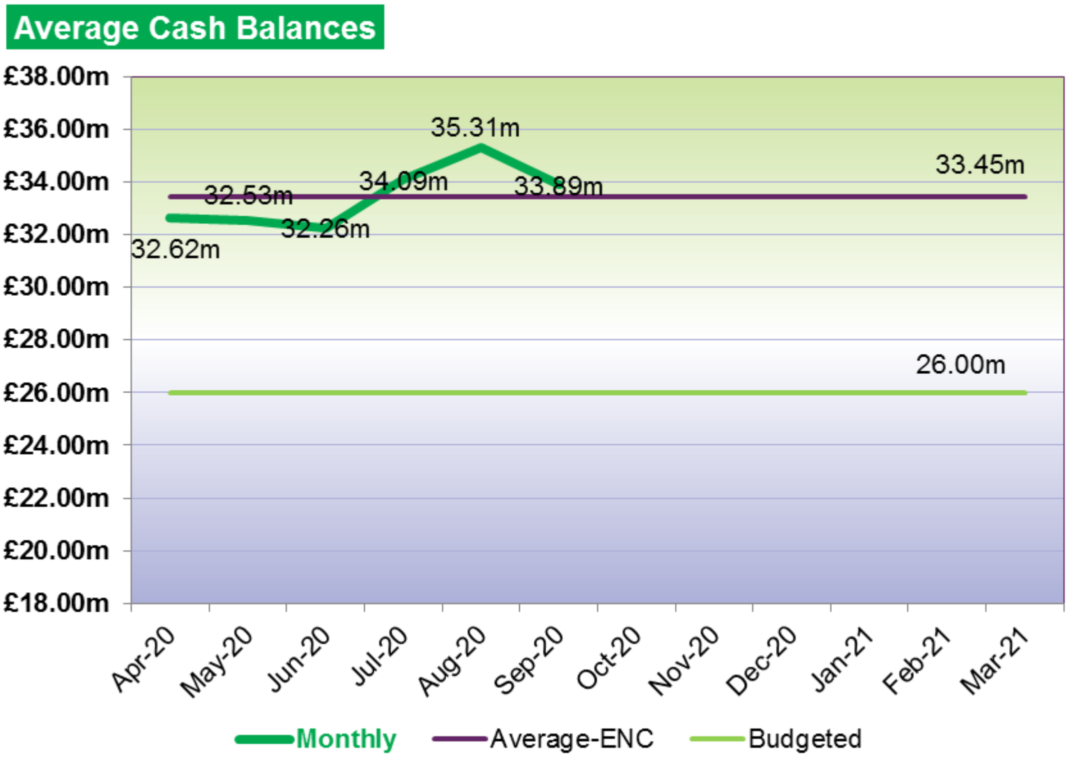
3. Annual Investment Strategy

3.1 The Treasury Management Strategy Statement (TMSS) for 2020/21, which includes the Annual Investment Strategy, was approved by the Council on 2 March 2020. It sets out the Council's investment priorities as being:

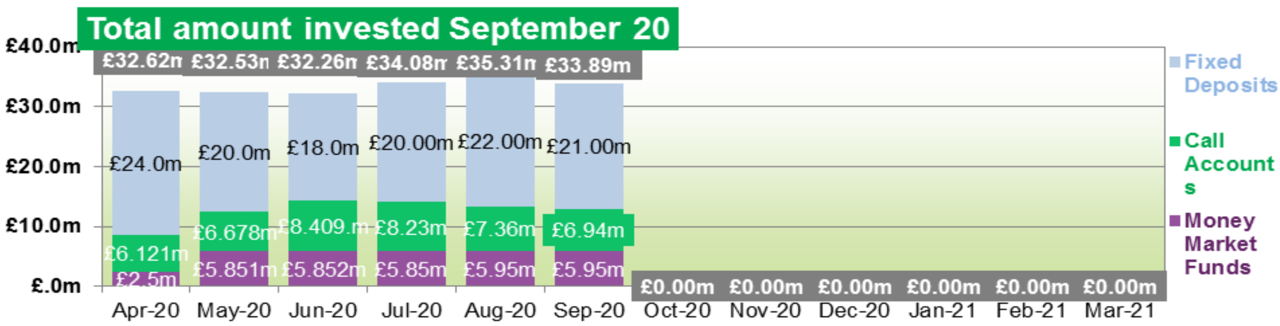
- Security of capital;
- Liquidity; and
- Yield.

3.2 The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. 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.

3.3 The average level of funds available for investment purposes during the quarter was £33.45m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The average level of funds available for investment at 30 September 2020 was significantly over the budget of £26m due to a step change in the level of cash balances held by the council on a temporary basis due to unprecedented levels of support for businesses and individuals during the coronavirus pandemic from Central Government which has been administered by Local Authorities.



3.4 The chart below demonstrates the change in investment by type up to 30 September 2020. Call accounts and Money Market Funds (MMF) are very short term, liquid investments. They are generally overnight deposits or short term notice accounts where the balance invested can be withdrawn immediately. Withdrawals from short term notice accounts attract a penalty if the required period of notice is not given and the council avoids withdrawing funds from these accounts without giving sufficient notice. Fixed term deposits are investments with a longer duration, where cash is invested for a contractually agreed period with no opportunity to withdraw cash prior to the maturity date of the deposit.

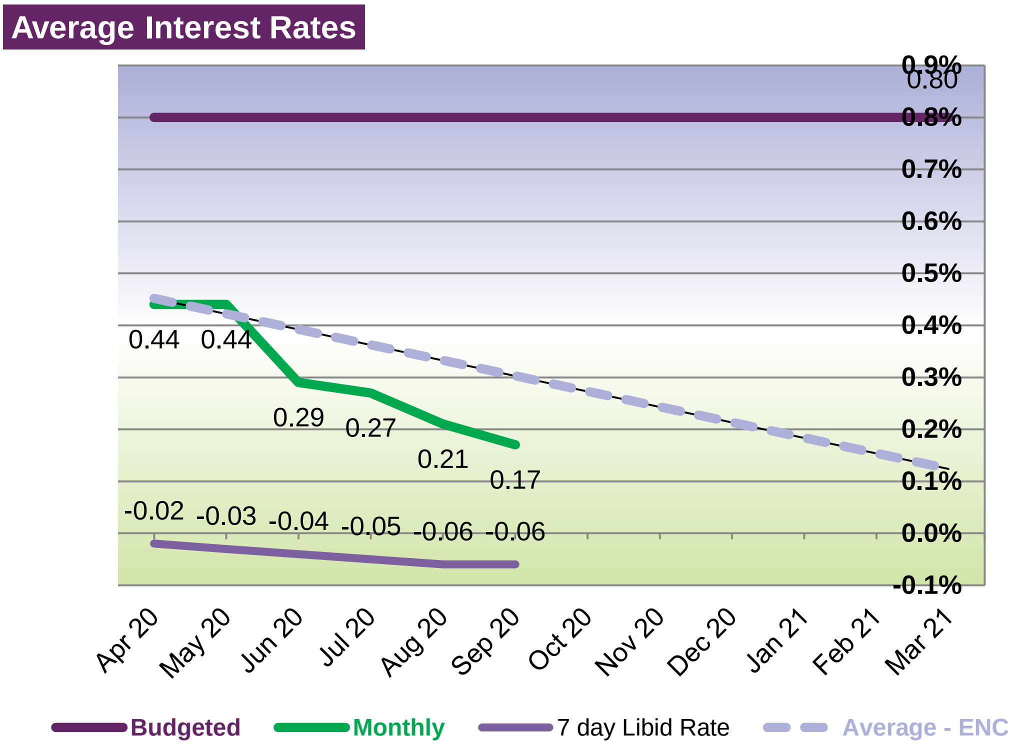


4. Investment Performance at 30 September 2020

4.1 The table below summarises the Council's portfolio of investments as at 30 September 2020:

Counterparty / Lender	Amount	Rate %	Maturity Date
Call Accounts			
Santander UK (95 Day notice)	£1,500,000	0.45	
Santander UK (180 Day notice)	£1,500,000	0.55	
Goldman Sach's (180 Day notice)	£3,000,000	0.65	
Barclays Bank Current Account	£940,876	0.00	
Money Market Funds			
Prime Rate Sterling Liquidity Fund	£2,952,454	0.08	
Deutsche Bank Sterling Fund	£3,000,000	0.00	
Fixed Term Deposits			
Lloyds Bank	£3,000,000	0.10	05/10/2020
Blaenau Gwent County Borough Council	£3,000,000	0.05	30/11/2020
Bournemouth, Christchurch and Poole Council	£3,000,000	0.04	05/01/2021
Leeds City Council	£3,000,000	0.08	19/02/2021
Monmouthshire County Council	£3,000,000	0.10	15/03/2021
Glasgow City Council	£3,000,000	0.15	15/06/2021
Slough Borough Council	£3,000,000	0.15	15/06/2021
	£33,893,330		

4.2 The average return on the Council's portfolio for the period to 30 September 2020 is 0.30%. This is 0.33 percentage points above the average 7 day London Interbank Bid Rate (LIBID) of -0.03% but significantly below the budgeted rate of 0.8%. The performance to date is shown below:



4.3 The forecast investment return for 2020/21 is set out below. The estimated outturn is based on the current forecast that Bank Rate will remain at the historic low of 0.10% for the duration of the 2020/21 financial year. Although the average return on the Council's portfolio for the period to 30 September 2020 is 0.30%, maturing investments will have to be re-invested at much lower rates of return due to profound changes in the market as a result of the reduction in Bank Rate.

Investment Return Budget vs. Estimated Outturn			
	Budget	**Estimated Outturn**	**(Surplus)/Deficit**
	£	**£**	**£**
Investment income	£150,000	£75,000	£75,000

4.4 The Council continues to make use of its surplus monies, meaning there has been no requirement to undertake any external borrowing in the quarter ended 30 September 2020. Consequently, no interest payable has been incurred during this period.

4.5 Work has been ongoing during 2020/21 to set up access to a Money Market Fund trading portal. Access to the portal will widen the amount of counterparties available to the Council. This will assist in managing both counterparty risk and liquidity risk.

5. Compliance with Prudential Indicators

5.1 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.

5.2 During the quarter ended 30 September 2020, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 2.

6. Temporary increase in Debt Management Office (DMO) limit

6.1 The delegation to temporarily increase the counterparty limit with the DMO (as outlined in paragraph 1.2) was used on 17th August 2020.

6.2 Every effort was made to place funds with other counterparties but ultimately this was unsuccessful due to the market being saturated with funds as a result of the unprecedented cash flow from Central Government for COVID-19 support grants.

6.3 The counterparty limit with the DMO was increased by £2m from £10m to £12m for two days. The balance with the DMO was therefore returned to the £10m limit on 19th August 2020.

6.4 As per the delegation within the TMSS, this temporary increase was actioned by the Chief Finance Officer following consultation with the Chair of the Finance and Performance Sub Committee and the Chair of the Governance and Audit Committee.

7. Equality and Diversity Implications

7.1 This report is for information. There are no equality and diversity implications arising from the content.

8. Privacy Implications

8.1 This report is for information. There are no privacy implications arising from the content.

9. Health Implications

9.1 This report is for information. There are no health implications arising from the content.

10. Legal Implications

10.1 This report is for information. There are no legal implications arising from the content.

11. Risk Management

11.1 The risks arising from treasury management activity are recorded in the Corporate Risk Register. The risks are subject to regular review and update.

12. Resource and Financial Implications

12.1 This report is for information. There are no financial implications arising from this report.

13. Constitutional Implications

13.1 This report does not require any amendment to the Council's Constitution.

14. Implications for our Customers

14.1 There are no implications for our customers arising directly from this report.

15. Corporate Outcomes

- ***Good Value for Money*** - *This report demonstrates that the council is ensuring it effectively manages its surplus cash to achieve good value for money for the council*

- ***Effective Management*** - *Treasury Management allows the council to manage its surplus cash balances to ensure the main principles (Security, Liquidity, and Yield) are maintained, contributing to effective management of the council*

16. Recommendations

16.1 Finance and Performance Sub Committee is recommended to:

(1) note the Treasury Management performance for the period to 30 September 2020 (Quarter 2) in the financial year 2020/21

(2) recommend to Full Council that the Treasury Management performance for the period to 30 September 2020 (Quarter 2) in financial year 2020/21 be noted

(Reason – In accordance with CIPFA guidance and best practice in Treasury Management)

<table>
<tr><td rowspan="2">Legal</td><td colspan="5">Power: Local Government Act 2003</td></tr>
<tr><td colspan="5">Other considerations: CIPFA Treasury Management in the Public Services: Code of Practice (2017); CIPFA Prudential Code for Capital Finance in Local Authorities (2017)</td></tr>
<tr><td colspan="6">Background Papers: Agendas, reports and minutes | East Northamptonshire Council
Treasury Management Strategy | East Northamptonshire Council</td></tr>
<tr><td colspan="6">Person Originating Report: Amy Eyles, Finance Manager, 01832 742087
aeyles@east-northamptonshire.gov.uk</td></tr>
<tr><td colspan="6">Date: 08/12/2020</td></tr>
<tr><td>CFO (Deputy) 09/12/20</td><td></td><td>MO (Deputy) 09/12/20</td><td></td><td>CX 09/12/20</td><td></td></tr>
</table>

Appendix 1

Quarter 2 2020/21 Economic Summary Provided by the Council's Treasury Advisor, Link Group

1. USA Economic Summary

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 tweaked 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 and to avoid the danger of getting caught in a deflationary "trap" like Japan. 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.

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 FOMC'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.

2. Eurozone Economic Summary

The 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.

3. China Economic Summary

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.

4. Japan Economic Summary

There are some concerns that a second wave of the virus is gaining momentum and could dampen economic recovery from its contraction of 8.5% in GDP. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. The resignation of Prime Minister Abe is not expected to result in any significant change in economic policy.

5. World Growth

Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Prudential and Treasury Management Indicators – as at 30 September 2020

1. Prudential Indicators

PRUDENTIAL INDICATORS	2020/21	31/03/20	30/09/20
	budget	actual	estimate
Capital Expenditure*	£2,444,000	£7,028,000	£3,043,291
Ratio of financing costs to net revenue stream	1.09%	0.00%	1.09%
Incremental impact of capital investment decisions (increase in council tax (band D charge) per annum)	£0.004	£0.008	£0.004
In year borrowing requirement	£537,000	£2,785,000	£3,322,000
CFR	£3,322,000	£2,785,000	£3,322,000
Annual change in Capital Financing Requirement	£537,000	£2,785,000	£537,000

***** *Capital expenditure for 2019/20 is shown as per the draft outturn position. This may be subject to change during the audit of the financial statements. If there is any change to the figure as a result of the audit this will be reported to the Finance and Performance Sub Committee in a future Treasury Management update report.*

2. Treasury Management Indicators

TREASURY MANAGEMENT INDICATORS	2020/21	31/03/20	30/09/20
	budget	actual	estimate
	£'000	£'000	£'000
Authorised Limit for external debt			
borrowing	5,000	5,000	5,000
other long term liabilities	0	0	0
TOTAL	5,000	5,000	5,000
Operational Boundary for external debt			
borrowing	3,750	3,000	3,750
other long term liabilities	0	0	0
TOTAL	3,750	3,000	3,750
Actual external debt	0	0	0
Investments	26,000	25,824	32,261
Net borrowing	(26,000)	(25,824)	(32,261)
Upper limit for principal sums invested over 365 days	3,000	3,000	3,000

3. Summary

The council is maintaining an affordable and sustainable capital programme in the medium term. At 30 September 2020 the council did not have any external debt and had not breached either the operational or authorised borrowing limits as set out in the 2020/21 Treasury Strategy.