POLICY AND RESOURCES SCRUTINY COMMITTEE – 23RD FEBRUARY 2021

SUBJECT: **TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL INDICATORS QUARTER 3 MONITORING REPORT (1ST APRIL 2020 TO 31ST DECEMBER 2020)**

REPORT BY: **CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE SERVICES**

1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st April 2020 to 31st December 2020.

1.2 To review the Treasury Management Strategy for 2020/21 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

2.1 The Code of Practice on Treasury Management in the Public Services 2009, which was adopted by the Council on 12th October 2010, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate Committee on a quarterly basis.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The capital strategy for 2020/21 was submitted to Full Council on the 20th February 2020.

2.4 The Authority's Annual Treasury Strategy and Capital Financing Prudential Indicators for 2019/20 were also approved by Council on the 20th February 2020.

3. RECOMMENDATIONS

3.1 Members are asked to note the contents of this report.

4. REASONS FOR THE RECOMMENDATIONS

4.1 Compliance with the CIPFA "Code of Practice for Treasury Management in the Public Services".

5. THE REPORT

5.1 Treasury Management

5.1.1 Borrowing Activity

The current policy of internal borrowing is not sustainable in the long-term, but where prudent the policy of internal borrowing will be utilised. As at the 31st March 2020 the internal borrowing position was £85m.

The Annual Treasury Management Strategy was approved by Council in February 2020. As part of the strategy approval was given to borrow £32.3m in 2020/21 to part fund the General Fund capital programme if required. A further £52.0m was approved for the HRA to fund the WHQS and Affordable Housing capital programme. During the reported period no external borrowing has taken place and internal funds have been used. There was no further drawdown from the Salix Loan Facility during the reported period. Total Salix drawn down to date is £3.3m.

During the period covered by this report, PWLB loans to the value of £1.4m were repaid on maturity. Such loans had an average interest rate of 3.83%. £30k of the WRU Loan was also repaid. Total debt outstanding as at 31st December 2020 was £299.7m and comprised of £256.3m PWLB loans; £30m market loans (LOBOs); £10m Bank loan; £90k WRU loan; and a £3.3m Salix Energy Finance loan.

With respect to LOBO loans the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. A LOBO loan with a total value of £10m had a rate option reviewed during quarter one and quarter three, and the lender chose not to exercise the option. LOBO loans will be further reviewed again later in 2020/21 by lenders, with a total value of £20m that is exposed to variable interest rate movement. This represents 7.0% of the Authority's debt portfolio, which is exposed to interest rate risk. The Authority acknowledges there is an element of refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options.

5.1.2 Rescheduling

The Annual Strategy allows for the utilisation of debt rescheduling providing for both in year and future year savings and additional revenue resources. No rescheduling opportunities presented themselves during the period covered by this report.

5.1.3 Investments

During the reported period the Authority was holding £15.0m of long-term investments where the maturity date is greater than 365 days. These investments are in accordance with the approved Investment Strategy. The long-term investments comprise of covered bonds with banks; UK Gilts, and Local Authority Loans. The covered bonds are secured investments and collateralised against the counterparty's pool of assets.The value of short-term deposits as at 31st December 2020 was £96.9m.

The total investments held as at 31st December 2020 was £111.9m and had an average rate of return equating to 0.85% which is a significant improvement over placing deposits with the Debt Management Office (DMO) whose rates was negative during certain times of the reporting period. The rate of return is above the target rate, as detailed in the Annual Treasury Management Strategy report to Council, of 0.50%. During the reporting period, there was a significant drop in investment rates from our traditional counterparties. Under normal circumstances, the Authority would have made loans to other Local Authorities on a regular basis, however, due to all Local Authorities, receiving additional monies due to Covid-19, there was little demand, if any, for borrowing on the Inter-LA market. The rates from other counterparties were so low that it proved more beneficial to the Authority to maintain our cash surpluses to subsidise our capital programme and delay any borrowing during this time of uncertainty. Other Long-Term investments e.g. pooled funds that the Authority had approval to invest in were put on hold as equities fell and other funds suspended trading due to uncertainties in the market as a result of Covid-19.

The portfolio as at 31st December 2020 comprised of the following types of investments:

Counterparty	**Investment Product**	**Sector**	**£m**
Banks & Building Societies	Covered bonds	Financial	15.0
Banks	Instant Access	Financial	35.9
Money Market Fund	Cash Pooled Fund	Financial	40.0
UK Government	Gilts	UK Government	10.0
Local Authorities and Housing Associations	Fixed-term cash deposits	Local Government	11.0
Total Investments			**111.9**

5.1.4 Economic Outlook

The effect of Covid-19 has during this reporting period has had an unprecedented effect on the UK economy. This along with the Brexit negotiations have steered the UK through some of the most challenging economic times in its history.

Looking forward, there has been some positive news as Covid-19 vaccines have been given approval and are rapidly being rolled out across the UK. Also, a Brexit trade deal was agreed at the final hour on the 31st December 2020 deadline.

The headline rate of UK Consumer Price Inflation (CPI) rose to 0.3% year on year in November, below expectations (0.6%) and still well below the Bank of England's 2% target. The weaker-than-expected readings were due to falling prices for clothing as Black Friday deals started earlier than usual and for food and non-alcoholic drinks.

The Bank of England maintained Bank Rate to 0.1% in December 2020 and noted that plans to roll out Covid-19 vaccines would reduce some of the downside risks to the economic outlook.

Government initiatives continued to support the economy as the furlough (Coronavirus Job Retention) scheme was extended once again to April 2021, supporting some 10 million jobs, and meaning that by then time the government would have provided taxpayer support to jobs for over a year. In the 3 months to November 2020 the unemployment rate increased to 5.0%, 1.2% higher than a year earlier. This is expected to increase strongly once the various government job support schemes come to an end.

GDP growth rebounded by 16.0% in Q3 2020 (Jul-Sep), pulling the annual growth rate up to 8.6% from -20.8% in Q2. However, recent monthly estimates of GDP have shown that growth is slowing and only a 1.0% increase in GDP was achieved in Q4 2020.

Globally, the US economy rebounded at an annualised rate of 33.4 in Q3 2020. The Federal Reserve maintained the Federal Funds rate at between 0% and 0.25%.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

Gilt yields remained low but volatile over the period with the yield on some short-dated UK Government bonds continuing to remain negative.

Arlingclose expects Bank Rate to remain at the current 0.10% level. The central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.

Table. Arlingclose Bank Rate Central Case.

	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
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Cas	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	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

5.1.5 Borrowing Update

In November 2020 the PWLB published its response to the consultation on ‘Future Lending Terms’. From 26th November the margin on PWLB loans above gilt yields was reduced from 1.8% to 0.8% providing that the borrowing authority can confirm that it is not planning to purchase ‘investment assets primarily for yield’ in the current or next two financial years. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. As part of the borrowing process authorities will now be required to submit more detailed capital expenditure plans with confirmation of the purpose of capital expenditure from the Section 151 / Section 95 Officer. The PWLB can now also restrict local authorities from borrowing in unusual or large amounts.

Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management. Misuse of PWLB borrowing could result in the PWLB requesting that Authority unwinds problematic transactions, suspending access to the PWLB and repayment of loans with penalties.

Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

The authority is not planning to purchase any investment assets primarily for yield within the next 3 years and so is able to take advantage of the reduction in the PWLB borrowing rate.

5.1.6 Counterparty Update

Credit Default Swap (CDS) spreads declined over the remaining period of the calendar year to broadly pre-pandemic levels and the gap in spreads between UK ringfenced and non-ringfenced entities remained. During the period Moody's downgraded the UK sovereign rating to Aa3 with a Stable outlook which then impacted several UK institutions, banks and local government.

While the approval of two coronavirus vaccines is a credit positive, there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. 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.

5.1.7 Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Such investments can comprise of property; shared ownership housing; loans to local businesses/ subsidiaries; and shareholdings. During the reported period the Authority did not hold any non-treasury related investments.

5.1.8 Welsh Regulations

In November 2019 the Welsh Government published new Statutory Guidance on Local Government Investments to be effective from the 2020/21 financial year. This involves a complete re-write along the lines of the guidance issued last year by the Ministry of Housing, Communities and Local Government (MHCLG) for local authorities in England.

The definition of investments is widened to include "all of the financial and non-financial assets a local authority has invested money into primarily or partially for the purpose of generating a surplus including investment property" providing it has been made using the power to invest contained in the Local Government Act 2003. In addition, loans to wholly owned companies or associates, to a joint venture, or to a third-party count as investments, irrespective of the purpose or legal power used.

5.2 Prudential Indicators

5.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 1 shows a projected CFR value of £420.4m as at 31st March 2021. The actual CFR as at 31st March 2020 was £391.9m. Due to the pandemic certain capital schemes have been delayed or the scheme extended which has resulted in a lower funding requirement than budgeted.

5.2.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management are shown in Appendix 1, and the Authority is currently operating within the approved limits.

5.2.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2 and currently show a projected reduction from the original budget as a consequence of deferred borrowing for the General Fund.

5.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows no change against the planned position.

6. ASSUMPTIONS

6.1 The details set out in the report are based on actuals that have occurred between 1st April 2020 and 31st December 2020 (period 9).

7. LINKS TO RELEVANT COUNCIL POLICIES

7.1 Treasury Management Strategy 2020/21 as agreed by Council on 20th February 2020.

7.2 Prudent financial management contributes to the following Well-being Goals within the Well-being of Future Generations Act (Wales) 2015:-

- A prosperous Wales.
- A resilient Wales.
- A healthier Wales.
- A more equal Wales.

- A Wales of cohesive communities.
- A Wales of vibrant culture and thriving Welsh Language.
- A globally responsible Wales.

8. WELL-BEING OF FUTURE GENERATIONS

8.1 The effective management of the Authority's borrowing and investments are key in ensuring that the Well-being Goals within the Well-being of Future Generations Act (Wales) 2015 are met.

9. EQUALITIES IMPLICATIONS

9.1 This report is for information purposes, so the Council's Equalities Impact Assessment (EqIA) process does not need to be applied.

10. FINANCIAL IMPLICATIONS

10.1 As detailed throughout the report.

11. PERSONNEL IMPLICATIONS

11.1 There are no personnel implications arising from this report.

12. CONSULTATIONS

12.1 There are no consultation responses that have not been reflected in this report.

13. STATUTORY POWER

13.1 Local Government Acts 1972 and 2003.

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Appendices:

Appendix 1 – Treasury Management Prudential Indicators – Prudence
Appendix 2 – Capital Finance Prudential Indicators – Affordability
Appendix 3 – Capital Expenditure and Funding