

Appendix 3 - Treasury Management Update Report - Q1 2020/21

Introduction

The Authority has 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 Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2020/21 was approved at a full Council meeting on 24 February 2020. The Authority has borrowed and 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 Authority's treasury management strategy.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

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 Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24 February 2020.

External Context (provided by the Council's treasury management advisor, Arlingclose)

Economic background: The UK's exit from the European Union took a back seat during the first quarter of 2020/21 as the global economic impact from coronavirus took centre stage. Part of the measures taken to stop the spread of the pandemic included the government implementing a nationwide lockdown in late March which effectively shut down almost the entire UK economy. These measures continued throughout most of the quarter with only some easing of restrictions at the end of May and into June.

Bank Rate was maintained at 0.1% despite some speculation that the Bank of England's Monetary Policy Committee (MPC) might cut further and some MPC members also suggesting that negative rates are part of the Bank's policy tools. In June the Bank increased the asset purchase scheme by £100 billion, taking the recent round of QE to £300bn and total QE to £745 billion.

At the same time, the government also implemented a range of fiscal stimulus measures totalling over £300 billion which had been announced in March and designed to dampen the effect of the pandemic on the labour market.

GDP growth contracted by 2.2% in Q1 (Jan-Mar) 2020 pushing the annual growth rate down to -1.6%. The lockdown only came into force on 23rd March, and the markets are braced for a dire set of growth data for Q2. In April UK GDP fell 20.4% month-on-month. On the back of the 5.8% month-on-month fall in March, this means economic output fell by 25% compared to its pre-coronavirus peak in February 2020.

The headline rate of UK Consumer Price Inflation fell to 1.2% y/y in May, further below the Bank of England's 2% target.

In the three months to June, labour market data remained largely unchanged on the previous quarter. This is likely due to the government's furlough scheme as more than a quarter of the UK workforce was estimated to be supported by it. The ILO unemployment rate remained unchanged at 3.9% while the

employment rate fell to 76.4%. However, employers will have to contribute towards furlough payments from August and the scheme is due to stop at the end of October; unemployment is expected to rise as a result.

The US economy contracted at an annualised rate of 5.0% in Q1 2020. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% while the US government announced a \$2 trillion fiscal stimulus package. Relations between the US and China, which had briefly improved when Phase 1 of the trade agreement was signed in January, deteriorated over the quarter.

With little room to move on interest rates, the European Central Bank maintained interest rates at 0% and the rate on the deposit facility (which banks may use to make overnight deposits with the Eurosystem) at -0.5% and announced a further huge, open-ended commitment to buy €600bn of bonds under its Pandemic Emergency Purchase Programme (PEPP) which can be reinvested out to 2022. This lifted the ECB's total bond buying support package to €1.35trillion.

Financial markets: After selling off sharply in March, equity markets started recovering in April and while still down on their pre-crisis levels, the Dow Jones and FTSE 100 and 250 have made up around half of the losses. Measures implemented by central banks and governments continue to maintain some degree of general investor confidence, however volatility remains.

Ultra-low interest rates and the flight to quality continued to keep gilts yields low over the period with the yield on some short-dated government bonds turning negative. The 5-year UK benchmark gilt yield dropped from 0.18% at the beginning of April 2020 to -0.06% on 30th June. The 10-year benchmark gilt yield fell from 0.31% to 0.14% over the same period, and the 20-year from 0.69% to 0.52%. 1-month, 3-month and 12-month bid rates averaged 0.04%, 0.28% and 0.44% respectively over the quarter.

Over the quarter (April-June), the yield on 2-year US treasuries fell from 0.24% to 0.20% while that on yield on 10-year treasuries fell from 0.63% to 0.61%. German bund yields remain negative.

Credit review: After rising sharply in late March, credit default swap spreads slowly eased over the quarter but remained above their pre-crisis levels.

Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and also non-UK banks from early April onwards. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as downgrading Close Brothers' long-term rating to A-. Network Rail Infrastructure and LCR Finance's long-term ratings were downgraded from AA to AA-. HSBC Bank and HSBC UK Bank were the exceptions however, with Fitch upgrading their long-term ratings to AA-.

S&P also acted on a range of UK and European banks, affirming their ratings but revising their outlook downwards due to the economic consequences of COVID-19. Moody's downgraded the long-term rating of Nationwide BS from Aa3 to A1 and S&P downgraded the long- and short-term ratings of HSBC Bank PLC and HSBC UK Bank PLC to A+ and A-1 respectively

In May, Fitch and S&P downgraded TfL's long-term rating to A+ from AA- after the 95% reduction in tube and train fares which make up 47% of TfL's revenue. However, the UK government agreed to a £1.6 billion support package which will help ease some of the stress TfL faces.

As the extent of the losses that banks and building societies will suffer due to the impact from the coronavirus epidemic remains uncertain but is expected to be substantial, in early June following Arlingclose's stress testing of the institutions on the counterparty list using bail-in analysis, a number of UK banks and building societies were suspended from the counterparty list for unsecured deposits. Although much better capitalised than before the 2007-09 financial crisis, under the current economic

circumstances these entities were suspended for reasons of prudence. For those remaining on the list, the duration advice remains up to 35 days.

Local Context

On 30th June 2020, the Authority had net borrowing of £526.4m and £100.1m of investments. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

Type of Liability	30.06.20 Actual £m
General Fund CFR	449.2
HRA CFR	274.3
Total CFR **	723.5
Less: *Other debt liabilities	-28.2
Borrowing CFR - comprised of:	695.3
- External borrowing	526.4
- Internal borrowing	168.9

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

** CFR figures are as at 31.03.20 these are calculated annually in the annual Statement of Accounts

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position on 30th June 2020 and the change from last quarter is shown in Table 2 below.

Table 2: Treasury Management Summary

Type of Borrowing / Investment	31.03.20 Balance (£m)	Movement (£m)	30.06.20 Balance (£m)	30.06.20 Rate (%)
Long-term borrowing	506.7	(0.3)	506.4	3.34
Short-term borrowing	25.0	(5.0)	20.0	0.95
Total borrowing	531.7	(5.3)	526.4	3.25
Long-term investments	0.0	0.0	0.0	0.00
Short-term investments	15.0	25.0	40.0	0.95
Cash and cash equivalents	77.3	(17.2)	60.1	0.06
Total investments	92.3	7.8	100.1	0.42
Net borrowing	439.4		426.4	

Borrowing Update

On 9th 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 before these options can be accessed.

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: the value of this discount is 1% below the rate at which the authority usually borrows from the PWLB). £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% was 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 deadline was extended to the 31st July 2020 with implementation of the new lending terms expected in the latter part of this calendar year. The Authority submitted a response, it also participated in a working group to form a joint response with other London boroughs through the Society of London Treasurers.

Municipal Bonds Agency (MBA): The MBA has revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency issued its first bond in March 2020 on behalf of Lancashire County Council.

If the Authority were to consider future borrowing through the MBA, it would first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and be satisfied with them.

Borrowing strategy

At 30th June 2020, the Authority held £526.4m of loans, (a decrease of £5.3m from 31st March 2020), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th June are summarised in Table 3 below.

Table 3: Borrowing Position

Type of Borrowing	31.03.20 Balance (£m)	Net Movement (£m)	30.06.20 Balance (£m)	30.06.20 Weighted Average Rate (%)	30.06.20 Weighted Average Maturity (Years)
Public Works Loan Board	381.7	(0.3)	381.4	2.89	25.37
Banks (LOBO)	125.0	0.0	125.0	4.72	39.94
Banks (fixed-term)	0.0	0.0	0.0	0.00	0
Local authorities (long-term)	0.0	0.0	0.0	0.00	0
Local authorities (short-term)	25.0	(5.0)	20.0	0.95	0.50
Total borrowing	531.7	(5.3)	526.4	3.25	27.89

The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

The Authority had undertaken £150m of additional long term borrowing toward the latter part of 2019/20 from the PWLB. The duration and interest rates on these long term loans averaged 23 years and 1.72% respectively. This borrowing was taken to fund the Council's growing underlying need to borrow from the capital programme, in conjunction with considerations around interest rates. As COVID 19 has adversely impacted the delivery of the capital programme and in keeping with the Authority's borrowing objectives, no new borrowing was undertaken in the period, while existing loans were allowed to mature without replacement.

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and therefore a balanced portfolio of short- and long-term borrowing is maintained, as demonstrated in table 3 above.

LOBO loans: The Authority continues to hold £125m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. The Council has a policy to repay any LOBO loans where the options is exercised, however it acknowledges that this is unlikely given the low interest rate environment. No banks have, so far this year, exercised their options.

Treasury Investment Activity

The Authority has administered in excess of £50m of central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. This has caused cash balances to be in excess of what would usually be anticipated to be held. All such funds were temporarily invested with the Debt Management Office part of HM Treasury on an overnight basis so they were available each business day for disbursement.

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the period, the Authority's investment balances ranged between £99.0 and £166.6 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

Investments	31.03.20 Balance £m	Net Movement £m	30.06.20 Balance £m	30.06.20 Rate of Return %	30.06.20 Weighted Average Maturity Days
Banks & building societies (unsecured)	0.0	0.0	0.0	0.00	0.0
Money Market Funds	0.0	23.9	23.9	0.14	1.0
UK Government:					
- Local Authorities	15.0	25.0	40.0	0.95	182.6
- Debt Management Office	77.3	-41.1	36.2	0.01	1.0
Total investments	92.3	7.8	100.1	0.42	73.6

Both the CIPFA Code and government guidance require the Authority 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 Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The table below shows counterparty credit quality as measured by credit ratings for the period. The table also shows the percentage of the in-house investment portfolio exposed to bail-in risk. Bail-in is the response to the government bail-outs in the global financial crisis, when a number of banks failed and received government bail-outs in 2008. Under bail-in, unsecured deposits made with certain financial institutions would be at risk, should the institution fail, and investors would lose a portion of their invested funds. The below table shows a snapshot at a point in time, and movements in the figures do not reflect changes in policy or strategy but are indicative of the Council's cashflows on that particular date.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking - Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (Days)	Rate of Return
31.03.2020	3.4	AA	0%	56	0.23%
30.06.2020	3.7	AA-	24%	74	0.42%
Similar Local Authorities	4.24	AA-	70%	79	0.80%
All Local Authorities	4.10	AA-	59%	18	0.97%

Scoring:

AAA = highest credit quality = 1

D = lowest credit quality = 26

Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

In a relatively short period since the onset of the COVID-19 pandemic in March and the ensuing enforced lockdown in many jurisdictions, the global economic fallout has been sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, business and individuals.

In 2020/21 the Authority expects to receive lower income from its cash and short-dated money market investments and from its externally managed funds than it did in 2019/20 and earlier years

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. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government's (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Council lends money to third parties such as its subsidiaries, local businesses, local charities, local residents and its employees to support local public services and stimulate local economic growth. These are often treated as capital expenditure and included within the Council's capital programme. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, it will be ensured that any new loans made will remain proportionate to the size of the organisation. The Council also holds properties which are classified as 'investment properties' in the Council's statement of accounts. These properties are all within the local area, and the revenue stream associated with these (net of the costs of maintaining the properties) forms a modest part of the Council's annual budget, therefore contributing to the resources available to the Council to spend on local public services.

Table 6: Balances as at 31.03.2020 of non-treasury investments were as follows:

	31.03.2020				
	Balance	Loss Allowance	Balance	Weighted Average Rate of return	Net Total Revenue
	£m	£m	£m	%	£m
Subsidiaries	16.9	-0.3	16.6	0.0	0.0
Local Businesses	4.7	-0.7	4.0	5.2	0.2
Local Charities	47.9	-43.5	4.3	3.0	0.1
Local Residents	0.1	0.0	0.1	4.0	0.0
Employees	0.1	0.0	0.1	0.0	0.0
Commercial Properties*	88.6	0.0	88.6	6.2	5.5
Total borrowing	158.3	-44.6	113.7		5.9

*for commercial properties this is the revenue generated from the properties less directly associated costs

The largest balance above relates to historic Alexandra Palace debts (shown under local charities). A large provision has been created, however the debt has not been written off. The loans to local business include the opportunity investment fund, and a loan to a business who operates some of Haringey's leisure facilities.

The Authority assesses the risk of loss before entering into and whilst holding service loans by weighing up the service outcomes any such loan could provide against the creditworthiness of the recipient. This is done on a case by case basis, given the low number of such arrangements. This forms part of the Council's capital programme, further details of which are in the Council's annual medium term financial strategy.

Budgeted Income and Outturn

The Council's treasury investment income for the year is forecast to be £137k which is in line with budget. Borrowing costs are forecast in line with budget at £20.4m (£16.4m HRA, £4.2m GF). Although, it is expected that the capital programme will lag forecast which will subsequently impact on the level of borrowing that the Council undertakes in the year.

Compliance

The Director of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	31.06.20	2020/21 Operational Boundary £m	2020/21 Authorised Limit £m	Complied
Borrowing	526.4	929.6	979.6	Yes
PFI and Finance Leases	28.1	28.1	30.9	Yes
Total Debt	554.5	957.7	1,010.5	Yes

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure, however Haringey's debt remained below this limit at all points during the quarter.

Table 8: Investment Limits

	Q1 Maximum	30.6.20 Actual	2020/21 Limit	Complied? Yes/No
Any single organisation, except the UK Government	£5m	£5m	£5m each	Yes
Any group of organisations under the same ownership	£5m	£5m	£5m per group	Yes
Any group of pooled funds under the same management	£5m	£5m	£5m per manager	Yes
Negotiable instruments held in a broker's nominee account	Nil	Nil	£5m per broker	Yes
Foreign countries	Nil	Nil	£5m per country	Yes
Registered providers and registered social landlords	Nil	Nil	£5m in total	Yes
Unsecured investments with building societies	Nil	Nil	£5m in total	Yes
Loans to unrated corporates	Nil	Nil	£5m in total	Yes
Money Market Funds	£25m	£23.9	£25m in total	Yes
Real Estate Investment Trusts	Nil	Nil	£5m in total	Yes

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Table 9: Investment Security Indicator

	30.06.20 Actual	2020/21 Target	Complied
Portfolio average credit	3.7 (AA-)	7.00 (A-)	Yes

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Table 10: Liquidity Risk Indicator

	30.06.20 Actual	2020/21 Target	Complied?
Total cash available within 3 months	£65.1m	£10.0m	Yes

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Table 11: Interest Rate Exposure Indicator

Interest rate risk indicator	30.06.20 Actual	2020/21 Target	Complied Yes/No
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	0.3m	£1m	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	-0.3m	£1m	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Table 12: Mature Structure Indicator

Maturity structure of borrowing	Lower Limit	Upper Limit	30.06.20
under 12 months	0	50%	15.4%
12 months & within 2 years	0	40%	7.5%
2 years & within 5 years	0	40%	15.8%
5 years & within 10 years	0	40%	4.7%
10 yrs & within 20 yrs	0	40%	15.5%
20 yrs & within 30 yrs	0	40%	8.5%
30 yrs & within 40 yrs	0	50%	15.5%
40 yrs & within 50 yrs	0	50%	17.0%
50 yrs & above	0	40%	0

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Total short term borrowing: the Council has used short term borrowing (under 1 year in duration) from other local authorities extensively in recent years, as an alternative to longer term borrowing from PWLB, due to the lower interest rates, and corresponding revenue savings. Short term borrowing exposes the Council to refinancing risk: the risk that interest rates rise quickly over a short period of time and are at significantly higher rates when loans mature, and new borrowing has to be raised. With this in mind, the Authority has set a limit on the total amount of short term local authority borrowing, as a proportion of all borrowing.

Table 13 -Short Term Borrowing Indicator

Short term borrowing	Limit	30.06.20 Actual	Complied?
Upper limit on short term borrowing from other local authorities as a percentage of total borrowing	30%	4%	Yes

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 14 - Amount Invested Over 365 Days

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	Nil	Nil	Nil
Limit on principal invested beyond year end	£10.0m	£10.0m	£10.0m
Complied?	Yes	Yes	Yes