Appendix 1 - Treasury Management Outturn Report Q3 2020/21

1. Introduction

1.1. 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. This quarterly report provides an additional update.

1.2. The Authority's treasury management strategy for 2020/21 was approved at a meeting of full Council 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.

1.3. 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.

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

Economic background

2.1. Some good news came during the quarter ending 31st December as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK Medicines and Healthcare products Regulatory Agency (MHRA) provided authorisation for emergency supply of two COVID-19 vaccines in December and the rollout to individuals in the highest priority groups began in earnest.

2.2. A Brexit trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline. Having been agreed with the European Union (EU) on Christmas Eve, the Brexit trade deal was voted through the House of Commons by 521 votes to 73 and then written into law after passing through the House of Lords and given royal assent.

2.3. The Bank of England (BoE) maintained Bank Rate at 0.1% during the quarter but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its December interest rate announcement, the BoE noted that plans to roll out COVID-19 vaccines would reduce some of the downside risks to the economic outlook but that recent rises in the number of infections is likely to lead to weaker GDP growth than had been predicted in its November Monetary Policy Report.

2.4. 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 the government would have provided taxpayer support to jobs for over a year.

2.5. GDP growth rebounded by 16.0% (upwardly revised from first estimate of 15.5%) in Q3 2020 (Jul-Sep) according to the Office for National Statistics (ONS), pulling the annual growth rate up to -8.6% from -20.8% in Q2. Construction rose by a huge 41% over the quarter, services output was up almost 15% as was production output. However, recent monthly estimates of GDP have shown growth is slowing and only a 1.1% monthly rise was managed in September.

2.6. The headline rate of UK Consumer Price Inflation (CPI) rose to 0.3% year/year in November, below expectations (0.6%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 0.6% year/year (0.8% expected). 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.

2.7. In the three months to October, labour market data showed the unemployment rate increased from 4.3% to 4.9% while wages rose 2.7% for total pay in nominal terms (2.8% for regular pay) and was up 1.9% in real terms (2.1% for regular pay). The employment rate fell to 75.2% from 75.8%. Unemployment is expected to increase strongly once the various government job support schemes come to an end, with the BoE predicting unemployment could peak at almost 8% in the second quarter of 2021.

2.8. The US economy rebounded at an annualised rate of 33.4% in Q3 2020 (Jul-Sep), fuelled by more than $3 trillion in pandemic relief. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25%.

2.9. The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

Financial Markets

2.10. Equity markets continued to rise, and the Dow Jones beat its pre-crisis peak on the back of continued outperformance by a small number of technology stocks. The FTSE indices continued to perform well, with the more internationally focused FTSE 100 getting back to around 60% of its pre-March level while the more UK-focused FTSE 250 was closer to 80% of its previous peak over the same period.

2.11. Ultra-low interest rates prevailed through the quarter. Gilt yields remained low but volatile over the period with the yield on some short-dated UK government bonds continuing to remain negative. The 5-year UK benchmark gilt yield started the October–December period at -0.07% and ended at -0.09% (with much volatility in between). The 10-year gilt yield fell from 0.23% to 0.19% over the same period but peaked at 0.40% in November during a volatile quarter. The 20-year fell from 0.76% to 0.69%. 1-month, 3-month and 12-month SONIA bid rates averaged -0.01%, 0.06% and 0.07% respectively over the three months.

2.12. At the end of December, the yield on 2-year US treasuries was around 0.12% while for 10-year treasuries the yield was 0.92%. German bund yields remain negative across most maturities.

Credit Review

2.13. After rising in late October/early November, credit default swap 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. At the end of the period Barclays Bank Plc was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The ringfenced banks were trading between 33 and 36bps.

2.14. During the period Moody's downgraded the UK sovereign rating to Aa3 with a Stable outlook which then impacted a number of other UK institutions, banks and local government. These included Cornwall Council and Guildford BC which were downgraded to Aa3. Transport for London, Aberdeen CC, Lancashire CC, Lloyds Bank and HSBC Bank downgraded to A1 and Warrington BC was downgraded to A2.

2.15. 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.

3. Local Context

3.1. On 31st March 2020, the Authority had net borrowing of £531.7m arising from its revenue and capital income and expenditure. 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	31.03.20 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	531.7
- Internal borrowing	163.6

* 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

3.2. Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Authority continued to pursue its long standing strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk.

3.3. The treasury management position on 31st December 2020 and the change over the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.03.20		31.12.20	31.12.20

Type of Borrowing / Investment	Balance (£m)	Movement (£m)	Balance (£m)	Rate (%)
Long-term borrowing	506.7	(9.3)	497.4	3.26
Short-term borrowing	25.0	5.0	30.0	0.43
Total borrowing	**531.7**	**(4.3)**	**527.4**	**3.10**
Long-term investments	0.0	0.0	0.0	0.00
Short-term investments	15.0	10.0	25.0	0.99
Cash and cash equivalents	77.3	(67.3)	10.0	0.01
Total investments	**92.3**	**(57.3)**	**35.0**	**0.71**
Net borrowing	**439.4**		**492.4**	

4. Borrowing Update

4.1. 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.

4.2. 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 Officer. The PWLB can now also restrict local authorities from borrowing in unusual or large amounts.

4.3. 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.

Municipal Bonds Agency (MBA)

4.4. The MBA 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 has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor.

4.5. If the Authority were to consider future borrowing through the MBA, it would first ensure that it had thoroughly scrutinised the legal terms and conditions of the arrangement and taken proper advice on these.

Borrowing Strategy during the period

4.6. At 31st December 2020, the Authority held £527.4m of loans, a decrease of £4.3m compared to 31st March 2020), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st December are summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.20 Balance £m	Net Movement £m	31.12.20 Balance £m	31.12.20 Weighted Average Rate %	31.12.20 Weighted Average Maturity (years)
Public Works Loan Board	381.7	(9.3)	372.4	2.77	27.71
Banks (LOBO)	125.0	0.0	125.0	4.72	39.43
Local authorities (short-term)	25.0	5.0	30.0	0.43	0.57
Total borrowing	**531.7**	**(4.3)**	**527.4**	**3.10**	**28.94**

4.7. 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.

4.8. With short-term interest rates remaining much lower than long-term rates and temporary investments earning Bank Rate or lower, the Authority considered it to be more cost effective in the near term to use internal resources or short-term loans instead. The net movement in temporary / short-term loans is shown in table 3 above.

4.9. The Council has a significant capital programme which extends into the foreseeable future. A large proportion of this will be financed by borrowing, which the Council will have to undertake in coming years. The Council's treasury advisor, Arlingclose undertakes a weekly 'cost of carry' analysis which informs the Council on whether it is financially beneficial to undertake borrowing now or delay this for set time periods based on PWLB interest rate forecasts.

4.10. Any borrowing which is taken prior to capital expenditure taking place, and reducing the extent of the Council's internal borrowing, would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing, creating an immediate cost for revenue budgets. The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing is maintained.

LOBO Loans

4.11. 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 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. No banks exercised their option during the quarter.

5. Treasury Investment Activity

5.1. The Authority received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. The funds received were temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds and disbursed by the end of December.

5.2. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £35.0 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	31.12.20 Balance £m	31.12.20 Rate of Return %	31.12.20 Weighted Average Maturity (Days)
Banks & building societies (unsecured)	0.0	0.0	0.0	0.00	0
Money Market Funds	0.0	10.0	10.0	0.01	1
UK Government:					
- Local Authorities	15.0	10.0	25.0	0.99	67
- Debt Management Office	77.3	(77.3)	0.0	0.00	0
Total investments	**92.3**	**(57.3)**	**35.0**	**0.71**	**49**

5.3. 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.

5.4. Continued downward pressure on short-dated cash rate brought net returns on money market funds (MMFs) close to zero even after some managers had temporarily lowered their fees. At this stage, although close to nil, negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain slight positive net yields, but the possibility of negative rates cannot be ruled out.

5.5. Deposit rates with the Debt Management Office (DMO) have continued to fall and are now largely below zero. Funds invested for 3 weeks earn -0.03% rising to -0.01% for a deposit 4 months or more. The rate was 0% for up to 3-week deposits.

5.6. The return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.1% in March, are now at or very close to zero. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.

5.7. 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	**3.40**	**AA**	**0%**	**56**	**0.23%**
31.12.2020	**4.47**	**AA-**	**29%**	**49**	**0.71%**
Similar Local Authorities	**4.89**	**A+**	**66%**	**41**	**0.15%**
All Local Authorities	**4.56**	**A+**	**63%**	**17**	**0.00%**

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

Non-Treasury Investments

5.8. 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 the Ministry of Housing, Communities and Local Government (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

Treasury Performance

5.9. Treasury Investments generated an average rate of return of 0.73% in the first two quarters of the year. The Council's treasury investment income for the year is forecast in line with budget of £136.5k.

5.10. Borrowing costs for 2020/21 are forecast in line with budget at Q2, at £20.4m (£16.4m HRA, £4.0m General Fund). In prior years, these budgets have underspent due to a number of factors, including: the current lower interest rate environment reducing interest costs for the Council, and delays in the capital programme's delivery. Should slippage in the Council's capital programme occur, it will reduce the borrowing requirement, and reduce this forecast.

Estimates for income 2020/21

5.11. 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.

5.12. Investment income in the Authority's 2020/21 budget was set against a very different economic backdrop. Bank Rate, which was 0.75% until February 2020, now stands at 0.1%. In light of these changes, interest earned from short-dated money market investments will be significantly lower.

6. Compliance

6.1. The Director of Finance reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

6.2. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

Table 6: Debt Limits

	Q3 Maximum	31.12.2020 Actual	2020/21 Operational Boundary	2020/21 Authorised Limit	Complied? Yes/No
Borrowing	531.7	527.4	929.6	979.6	Yes
PFI and Finance Leases	28.2	28.2	28.1	30.9	Yes
Total debt	**559.9**	**555.6**	**957.7**	**1,010.5**	**Yes**

6.3. 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 well below this limit at all points in the first half of the year.

Treasury Management Indicators

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

Security

6.5. 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.

	31.12.20 Actual	2020/21 Target	Complied?
Portfolio average credit score	4.47 (AA-)	7.0 (A-)	Yes

Liquidity

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

	31.12.20 Actual	2020/21 Target	Complied?
Total cash available within 3 months	23.3	10.0	Yes

Interest Rate Exposures

6.7. 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:

Interest rate risk indicator	31.12.20 Actual	2020/21 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	0.3	£1m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	-0.3	£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

6.8. 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:

	31.12.20 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	8.44%	50%	0%	Yes
12 months and within 24 months	1.41%	40%	0%	Yes
24 months and within 5 years	6.14%	40%	0%	Yes
5 years and within 10 years	4.27%	40%	0%	Yes
10 years and within 20 years	15.95%	40%	0%	Yes
20 years and within 30 years	9.48%	40%	0%	Yes
30 years and with 40 years	24.93%	50%	0%	Yes
40 years and within 50 years	29.39%	50%	0%	Yes
50 years and above	0%	40%	0%	Yes

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.

Principal Sums Invested for Periods Longer than a year

6.9. 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:

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	Nil	Nil	Nil
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	Yes	Yes	Yes

7. Outlook for the remainder of 2020/21

7.1. The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.

7.2. Restrictive measures and further lockdowns are likely to continue in the UK and Europe until most of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.

7.3. Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages. The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.

7.4. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.

7.5. Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term 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, the deployment of vaccines or if the UK leaves the EU without a deal.

7.6. 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.

7.7. Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.

7.8. Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period comes to an end.

	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 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	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50