Appendix 1 - Treasury Management Update Q1 2021/22

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 report provides an additional update.

1.2. The Authority's treasury management strategy for 2021/22 was approved at a full Council meeting on 1 March 2021. 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 1 March 2021.

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

Economic background

2.1. Economic resurgence from coronavirus pandemic continued to dominate the first quarter of the financial year. In the biggest inoculation programme the country has ever undertaken, over 44 million people in the UK had received their first dose of a COVID-19 vaccine with 32 million also having a second dose.

2.2. The Bank of England (BoE) held Bank Rate at 0.10% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its June 2021 policy announcement, the BoE expected the economy to experience a temporary period of strong GDP growth and above-target CPI inflation, after which growth and inflation is expected to fall back.

2.3. There were, however, two-sided risks around this central path, and it is possible that near-term upward pressure on prices could prove somewhat larger than expected. The Bank's Monetary Policy Committee does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

2.4. Government initiatives continued to support the economy over the quarter, following the range of measures announced by the Chancellor in the 2021 Budget, which included extending the furlough (Coronavirus Job Retention) scheme until September 2021.

2.5. The latest labour market data showed that in the three months to April 2021 the unemployment rate fell to 4.7%, although it is likely that labour market slack has remained higher than implied by this measure. Some individuals stopped looking for work during the pandemic and were therefore recorded as inactive. There is uncertainty around how many of these individuals will resume their search for a job, and when.

2.6. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 5.6% for the three months February to April 2021. The seemingly high growth partly reflected a base effect from a decline in average pay in the spring of last year, associated with the reduced pay of employees on the furlough scheme.

2.7. Annual CPI inflation rose to 2.1% in May on the back of base effects in spring 2020 and partly due to higher energy and commodity prices and supply-side bottlenecks. The BoE expects inflation to exceed 3% for a temporary period. The ONS' preferred measure of CPIH which includes owner-occupied housing was also 2.1% year/year, marginally higher than expectations.

2.8. The reimposition of restrictions on activity in the first quarter of calendar 2021 year resulted in GDP falling 1.6% in Q1. GDP growth was strong in April at 2.3% with the partial easing of restrictions on non-essential retail and outdoor hospitality. Housing market activity remained strong, aided by the extension of the stamp duty threshold and an increase in mortgage approvals for house purchases.

2.9. The US economy rebounded by 4.3% in Q4 2020 (Oct-Dec) and then an even stronger 6.4% in Q1 as the recovery continued to be fuelled by $5 trillion worth of pandemic stimulus packages. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period. The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

Financial Markets

2.10. Ongoing monetary and fiscal stimulus together with improving economic growth prospects and successful vaccine rollout programmes continued to boost equity markets over the period. The Dow Jones reached a record high during the period while the UK-focused FTSE 250 index was back above pre-pandemic levels and the more internationally focused FTSE 100 had recouped around three-quarters of 2020 losses.

2.11. Inflation worries continued during the period but declines in bond yields between April and June suggest bond markets may be expecting any general price increases to be less severe, or more transitory, than was previously thought.

2.12. The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.32% by the end of June 2021. Over the same period the 10-year gilt yield fell from 0.80% to 0.71%, despite jumping to 0.90% in May. The 20-year yield declined from 1.31% to 1.21%. The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.

Credit Review

2.13. Credit default swap spreads were relatively flat over the period and remain only slightly above their pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, and Santander UK remained an outlier compared to the other ringfenced/retail banks.

2.14. There were only a small number of credit rating actions over the period which included upwardly revised outlooks for several UK and European banks from negative to stable by S&P. Notably, Barclays and Nationwide were revised by S&P from stable to positive. In addition to the S&P revised outlooks, Fitch also revised their outlook for the United Kingdom from negative to stable towards the end of the period.

2.15. The successful vaccine rollout programme is credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted from the pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose 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 2021, the Authority had net borrowing of £555.9m 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	31.03.21 Actual** £m
General Fund CFR	505.5
HRA CFR	332.3
**Total CFR ** **	**837.8**
Less: *Other debt liabilities	(28.2)
Borrowing CFR – comprised of:	**809.6**
- External borrowing	555.9
- Internal borrowing	253.7

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

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 30th June 2021 and the change over the quarter is shown in Table 2 on the following page.

Table 2: Treasury Management Summary

Type of Borrowing / Investment	31.3.21 Balance (£m)	Movement (£m)	30.6.21 Balance (£m)	30.6.21 Rate (%)
Long-term borrowing	496.9	(1.7)	495.2	3.27
Short-term borrowing	59.0	15.0	74.0	0.15
Total borrowing	**555.9**	**13.3**	**569.2**	**2.86**
Long-term investments	0.0	0.0	0.0	0.00
Short-term investments	5.0	(5.0)	0.0	0.00
Cash and cash equivalents	12.0	2.7	14.7	0.01
Total investments	**17.0**	**(2.3)**	**14.7**	**0.01**
Net borrowing	**538.9**	**15.6**	**554.5**	

4. Borrowing Update

4.1. Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

4.2. 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.

4.3. The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB.

Municipal Bonds Agency (MBA)

4.4. The MBA is working to deliver a new short-term loan solution, available in the first instance to principal local authorities in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25 million. Importantly, local authorities will borrow in their own name and will not cross guarantee any other authorities.

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.

UK Infrastructure Bank

4.6. In his March 2021 budget, the Chancellor confirmed that a UK Infrastructure Bank will be set up with £4bn in lending earmarked for local authorities from the summer of 2021. The availability of this lending to local authorities is due to commence in summer 2021 for which there is expected to be a bidding process. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

Borrowing strategy during the period

4.7. At 30th June 2021, the Authority held £569.2m of loans (an increase of £13.3m compared to 31st March 2021) as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th June 2021 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.21 Balance £m	Net Movement £m	30.06.21 Balance £m	30.06.21 Weighted Average Rate %	30.06.21 Weighted Average Maturity (years)
Public Works Loan Board	371.9	(1.7)	370.2	2.77	27.26
Banks (LOBO)	125.0	0.0	125.0	4.72	38.94
Local authorities (short-term)	59.0	15.0	74.0	0.15	0.52
Total borrowing	**555.9**	**13.3**	**569.2**	**2.86**	**26.35**

4.8. 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.

4.9. No new long-term borrowing was undertaken in the quarter, while £1.7m of existing loans matured. In line with the approved Treasury Management Strategy, new long term borrowing is anticipated to be raised over the remaining course of the 2021/22 financial year.

4.10. With short-term interest rates remaining much lower than long-term rates and with surplus of liquidity continuing to feature in the local authority to local authority market, the Authority considered it to be more cost effective in the near term to use short-term loans to satisfy liquidity requirements during the quarter. The net movement in temporary short-term loans is shown in Table 3 above.

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

4.12. Any borrowing which is taken prior to capital expenditure taking place, and reducing the extent of the Authority'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

4.13. 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 year.

5. <u>Treasury Investment Activity</u>

5.1. 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 £14.7 and £50.1 million due to timing differences between income and expenditure. The investment position is shown in table 4 on the following page.

Table 4: Treasury Investment Position

Investments	31.03.21	Net	30.06.21	30.06.21	30.06.21

	Balance £m	Movement £m	Balance £m	Rate of Return %	Weighted Average Maturity (Days)
Money Market Funds	0.0	14.7	14.7	0.01	1
UK Government:					
- Local Authorities	5.0	(5.0)	0.0	0.00	0
- Debt Management Office	12.0	(12.0)	0.0	0.00	0
Total investments	**17.0**	**(2.3)**	**14.7**	**0.01**	**1**

5.2. 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.

5.3. Ultra-low short-dated cash rates which have been a feature since March 2020 when Bank Rate was cut to 0.10% have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.

5.4. Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also largely around zero.

5.5. 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
31.03.2021	**3.91**	**AA-**	**0%**	**8**	**0.28%**
31.06.2021	**4.87**	**A+**	**100%**	**1**	**0.01%**
Similar Local Authorities	**4.70**	**A+**	**73%**	**23**	**0.11%**
All Local Authorities	**4.64**	**A+**	**67%**	**12**	**0.11%**

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

5.6. 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

5.7. Treasury investments generated an average rate of return of 0.01% in the first quarter of the financial year. The Authority's treasury investment income for the year is likely to be less than the budget forecast due to a lower than anticipated average rate of return.

5.8. Borrowing costs for 2021/22 are forecast in line with budget at Q1 at £24.8m (£16.2m HRA, £8.6m 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.

6. Compliance

6.1. 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.

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

Table 6: Debt Limits

	Q1 Maximum £m	**30.06.21 Actual £m**	**2020/21 Operational Boundary £m**	**2020/21 Authorised Limit £m**	**Complied?**
Borrowing	569.2	569.2	1,157.4	1,207.4	Yes
PFI and Finance Leases	28.2	28.2	28.2	31.0	Yes
Total debt	**597.4**	**597.4**	**1,185.6**	**1,238.4**	**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 during quarter.

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.

	30.06.21 Actual	2021/22 Target	Complied?
Portfolio average credit score	4.87 (A+)	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.

	30.06.21 Actual	2021/22 Target	Complied?
Total cash available within 3 months	14.7	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	30.06.21 Actual	2021/22 Target	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.35m	£2m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.35m	£2m	Yes

6.8. 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

6.9. 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:

	30.06.21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	14.67%	50%	0%	Yes
12 months and within 24 months	5.92%	40%	0%	Yes
24 months and within 5 years	1.96%	40%	0%	Yes
5 years and within 10 years	3.95%	40%	0%	Yes
10 years and within 20 years	14.38%	40%	0%	Yes
20 years and within 30 years	8.78%	40%	0%	Yes
30 years and with 40 years	25.74%	50%	0%	Yes
40 years and within 50 years	24.60%	50%	0%	Yes
50 years and above	0.00%	40%	0%	Yes

6.10. 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.

6.11. The Authority 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 lower interest rates, and corresponding revenue savings. Short term borrowing exposes the Authority to refinancing risk: the risk that 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.

Short term borrowing	**Limit**	**30.06.21**	**Complied?**
Upper limit on short-term borrowing from other local authorities as a percentage of total borrowing	30%	13%	Yes

Principal Sums Invested for Periods Longer than a year

6.12. 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:

	2021/22	**2022/23**	**2023/24**
Actual principal invested beyond year end	Nil	Nil	Nil
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	Yes	Yes	Yes

7. <u>Other: CIPFA Consultations</u>

7.1. In February 2021, CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes.

7.2. However, from feedback documents the following changes are likely:

Prudential Code:

- Clarification and definitions to define commercial activity and investment, and that an authority must not borrow to invest for the primary purpose of commercial return.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- Proportionality will be included as an objective; new indicators for net income from commercial and service investments to net revenue stream.
- A specific objective around commercial investment with the intention of embedding good practice across authorities.

Treasury Management Code

- Inclusion of the liability benchmark as a mandatory treasury indicator.
- Implementation of a treasury management knowledge and skills framework.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.

8. <u>Outlook for the remainder of 2021/22</u>

8.1. The medium-term global economic outlook has continued to improve with the rollout of vaccination programmes. The UK has continued to benefit from its initial rapid vaccine rollout and has shifted focus onto second vaccinations to increase protection to counter a third wave of Covid variant. The opening up of the UK economy in Q2/Q3 will continue to prompt a sharp increase in GDP.

8.2. While downside risks seem to have fallen somewhat after recent trends in GDP and labour, the upside risks remain relatively balanced with the MPC reiterating its commitment not to tighten policy until there is clear evidence that the recovery is eliminating spare capacity in the economy. Arlingclose expects Bank Rate to remain at the current 0.10% level. The risk of movement in Bank Rate in the short term is low.

8.3. Inflation has moved above the Bank of England's 2% target. Alongside the increase in commodity prices, the MPC has acknowledged the prospect of a sharper upturn in inflation, with the potential CPI could rise above 3% in the coming months. However, the nature of the commodity price rise and the base effect easing, this is likely a more transitory effect.

8.4. Gilt yields could continue to increase in the short term but will begin to plateau and reduce once the market's expectation of rises in Bank Rate and inflation fears subside. Longer term yields may face upward pressure towards the end of Arlingclose's forecast period as the economy moves back to a sustained footing and policy expectations start to strengthen.

8.5. Downside risks remain – the damage from the pandemic will have lasting effects and there is the risk of further virus mutations due to the uneven global rollout of vaccines. Downside risks also arise from potential future vaccine shortages as the global demand for vaccines increases.

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Official Bank Rate													
Upside risk	0.15	0.15	0.15	0.15	0.30	0.30	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	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20