Agenda item 12

Cabinet – 9 December 2020

Treasury Management Mid Year Position Statement 2020/21

Portfolio: Councillor Bird, Leader of the Council

Related portfolios: N/A

Service: Finance

Wards: All

Key decision: No

Forward plan: Yes

1. Aim

1.1 The council is required through regulations issued under the Local Government Act 2003 to produce a mid year position statement reviewing treasury management activities and prudential and treasury indicator performance. The Treasury Management mid year position statement at Appendix A provides Cabinet with these details, and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

2. Summary

2.1. This report sets out the council's 2020/21mid yearposition statement for treasury management activities (Appendix A) and a summary of performance against set targets (Appendix B).

2.2. Despite difficult market conditions with low interest rates the net position for capital financing is expected tomatch the 2020/21 budget.There are currently assumptions that pressures for dividend income, temporary interest costs in relation to pension payments and an element of Minimum Revenue Provision (MRP) costs are funded by reserves.

3. Recommendations

3.1 To note and forward to Council, for consideration and noting (and in line with the requirements of the Treasury Management Code of Practice (2017)), the mid-year position statement for treasury management activities 2020/21 including prudential and local indicators (Appendix A).

3.2 That Cabinet note and forward to Council, for consideration and approvalto utilise Link Asset Services to provide a Treasury Management training session via Microsoft Teams for all Members (Appendix A).

4. Report detail - know

Context

4.1 Each year the Council operates a balanced budget, which broadly means cash raised during the year will meet its expenditure. Part of the treasury management service is to ensure this cash flow is adequately planned, with surplus monies being invested in line with the Treasury Management Policy Statement – approved by Council in February 2020.

Another function of the treasury management service is the funding of the Council's capital programme. This function highlights any potential borrowing requirement which may involve arranging long or short term loans, or using longer term cash flow surpluses.

The following key points of interest have been extracted from the report at Appendix A:

- The mid year position statement meets the requirement of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

- The banking environment has continued to be one of low interest returns with some improved confidence in counter party risk. The base rate remained static at 0.10% for the period 1 April until 30 September 2020.

- Despite this situation the authority has continued to identify appropriate new areas of investment opportunity that has led to a significant impact on average investment performance which has decreased from 1.50% in 2019/20 to 1.08% in 2020/21. An underachievement of investment income is expected to be approximately £400k as a result of the average rate achieved across all investments being lower than budgeted for in the 2020/21 budget setting exercise.

- Savings are forecast to be made on interest payable costs totalling approximately £400k to offset the pressures identified above for investment income. These savings are as a result of utilising the Council's cash balances rather than borrow as budgeted for capital expenditure, given the historical low base rate.

Council Corporate Plan priorities

4.2 Sound financial management of the council's cash balances supports the delivery of council priorities within council's available resources.

Risk management

4.3 Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. It is recognised that the management of risk is as important as maximisation of performance and it is essential that the council has the right balance of risk and reward when making investment decisions. This is supported by treasury management policies which seek to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council.

4.4 Brexit continues to provide uncertainty for interest rates and within the financial markets and is expected to continue for the foreseeable future. The Council has responded to this risk by reviewing counterparties for investments to minimise the risk to any one counter party or class of counter party, and entering into fixed term investment deposits where possible that mature after the transitional period in January 2021 to minimise interest rate risk.

4.5 The impact of Covid-19 on the Council's cashflow is being managed by keeping cash in at call and notice accounts rather than longer fixed term investments, enabling the Council to ensure there is sufficient levels of cash available at all times to meet demand. As set out in section 4.1 above by holding cash in more liquid forms and the reduction in interest rates has had a corresponding impact on investment returns.

Financial implications

4.6 Treasury management activity forms part of the council's financial framework and supports delivery of the medium term financial strategy. The review of treasury management performance and activity is reviewed through both the treasury management annual report and the mid-year performance review report.

The proposed treasury management training session detailed within the report would incur a small one-off fee of £1,500, if supported, and this can be contained within the overall existing Treasury Management budget.

Legal implications

4.7 The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original treasury management code in 1992 and further revisions to the Code in 2002, 2010 and 2017.

Procurement Implications/Social Value

4.8 None directly relating to this report.

Property implications

4.9 None directly relating to this report.

Health and wellbeing implications

4.10 None directly relating to this report.

Staffing implications

4.11 None directly relating to this report.

Reducing Inequalities

4.12 None directly relating to this report.

Consultation

4.13 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the S151 Officer, Head of Finance (Deputy S151 Officer) and Deputy Head of Finance (Corporate).

5. Decide

5.1 In line with the Treasury Management Code of Practice (2017) there are a number of reports that are required to be produced and reported publicly each year. The Treasury Management Mid Year Position Statement forms one of these requirements and as such is being reported to Cabinet for noting and forwarding onto Council for consideration.

6. Respond

6.1 This report is not seeking approval of a decision, in line with the Treasury Management Code of Practice (2017) it is required to be reported for noting and forwarding to Council for consideration.

7. Review

7.1 In line with Treasury Management Code of Practice (2017) this is a backward looking document looking at performance over the first six months of the current financial year and a further report on performance will be provided each year in line with the requirements of the Code.

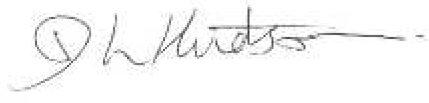
Background papers

Various financial working papers

Corporate Budget Plan and Treasury Management and Investment Strategy 2020/21(including Treasury Management Policy Statement) – Council 27/02/20

Author

Richard Walley
Finance Manager – Technical Accounting and Treasury Management
☎ 650708
✉ richard.walley@walsall.gov.uk



Deborah Hindson
Interim Executive Director

09 December 2020

Councillor Bird
Leader of the Council

09 December 2020

Appendix A

Treasury Management Mid Year Review

Table 1 shows borrowing and investments held at 31 March 2020 and 30 September 2020. The table shows that net borrowing during this period have remained the same.

The forecast borrowing position for the year end shows an approximate £14m reduction in overall borrowing levels linked predominantly due to the repayment of loan maturities for loans taken out to meet the cash flow requirements for the upfront pension payment made in April 2020.

The investment balance for the period to 30 September 2020 has increased by approximately £36m; this is in line with the budgeted assumptions for the year which included a plan to ensure that cash balances were maintained at an appropriate and robust level in line with expected cashflows projected for the year. This is also linked to the cashflow profile for local authorities where a large proportion of income is normally received at the start of the year (with upfront payment of grants / council tax / business rates etc), with corresponding expenditure normally being spread across the year.

The forecast investment position for the year end shows that investment balances are expected to decrease as we approach 31 March 2021 and payments on capital schemes are made and less income is profiled to be raised, and therefore collected, during the period.

Table 1

Borrowing	31-Mar-20	30-Sep-20	Change in year	Forecast Position 31-Mar-21	Forecast Change 31-Mar-20 to 31-Mar-21
	£m	£m	£m	£m	£m
PWLB	195.571	195.571	0.000	195.571	0.000
Private Loans	95.000	95.000	0.000	95.000	0.000
Other Loans	71.040	71.040	0.000	56.731	(14.309)
Total Borrowing	**361.611**	**361.611**	**0.000**	**347.302**	**(14.309)**

Investments	31-Mar-20	30-Sep-20	Change in year	Forecast Position 31-Mar-21	Forecast Change 31-Mar-20 to 31-Mar-21
	£m	£m	£m	£m	£m
At-call	46.485	55.725	9.240	33.840	(12.645)
Short term	124.000	158.000	34.000	117.500	(6.500)
Long term	14.000	7.000	(7.000)	12.000	(2.000)
Property funds	30.000	30.000	0.000	30.000	0.000

Total Investments	**214.485**	**250.725**	**36.240**	**193.340**	**(21.145)**

Net Position (Borrowing less Investment)	**147.126**	**110.886**	**(36.240)**	**153.962**	**6.836**

Capital Financing

Table 2 below shows the midyear revenue outturn forecast for treasury management capital financing. The net forecast overspend of £5.723m has currently been assumed to be funded from reserves. This is in the main attributable to the non delivery of investment income as a result of the impact low interest rates and Covid-19 and in line with a review of the Minimum Revenue Provision (MRP) that was undertaken during 2015/16 the charge for 2020/21 is £2.181m over budget with corresponding releases from reserves.

Other notable variances include an underachievement of investment income following a number of changes to the Bank of England base rate during 2020 and the associated difficulties in the financial markets following Covid-19, offset by a transfer from reserves for interest costs incurred as a result of temporary borrowing to finance the upfront payment to the West Midlands Pension Fund. This payment was made to secure budgetary savings over three years commencing 2020/21.

Table 2

Service Description	Full Year Forecast	Annual Budget	Forecast Variance	Transfer (from) / to reserves	Net Forecast Variance
	£m	£m	£m	£m	£m
Interest Payable	11.643	11.568	0.075	(0.493)	(0.418)
Investment Returns	(2.424)	(5.876)	3.452	(3.049)	0.403
Allocation of interest on internal balances	0.122	0.122	0.000	0.000	0.000
Other Local Authority Debt	2.164	2.164	0.000	0.000	0.000
Treasury Management costs	0.035	0.020	0.015	0.000	0.015
Bank charges	0.086	0.086	0.000	0.000	0.000
Minimum Revenue Provision	11.802	9.621	2.181	(2.181)	0.000
Total	**23.428**	**17.705**	**5.723**	**(5.723)**	**0.000**

Economics update provided by the Council's external Treasury Management Partneras at September 2020

As expected, the Bank of England's Monetary Policy Committee (MPC) kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

The fall in GDP in the first half of 2020 was revised from 28% to 23%. This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.

The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.
It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

It also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including QE and the use of forward guidance.

The MPC still expects the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

In conclusion, this would indicate that the Bank can now just *sit on its hands* as the economy is recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. One has only to look at the potential for a second wave of the virus to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down in the furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE. Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. There will also be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

One key addition to forward guidance was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably”. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years’ time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate

The Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to “somewhat less than £80bn”. It stated that in its assessment “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.

Overall, it is expected that there has been a strong pickup in economic growth during the back-end of quarter 2 of 2020. However, that pace is likely to fade as the furlough scheme ending in October will lead to many job losses during the second half of the year. Consumers will also probably remain cautious in spending and this will dampen growth. Uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind.

Member Training

Treasury Management policies, strategy, full year and mid year reviews are scrutinised by Cabinet and Council,and members must be trained to better understand and challenge the long-term financial implications of matters reported within the Treasury Management Strategy.

Link Asset Services, the council’s treasury advisors,can offer independent Member training which is tailored to the Council’s specific needs, using the Council’s own strategic documents, financial statements, capital programme, balance sheet position and debt and investment portfolios, as appropriate.

It is therefore proposed that members consider the option for such training to be provided. If supported training would be delivered by the Council’s Client Relationship Manager, Richard Bason (Regional Director). Richard has been a treasury management consultant for over 20 years and previously worked in Local Government. He is a Fellow of the Chartered Institute of Public Finance and Accountancy.

The training will allow members to develop an enhanced awareness of their role within the Treasury Management function, understanding the changing regulatory and market environment and the challenges facing officers on a daily basis.

This proposed training provides a sound understanding through interactive discussion on the roles and responsibilities of members and officers relating to treasury management and covers:-

- The overarching strategic and governance frameworks relating to the Capital Strategy and Treasury Management activity

- The Treasury Management and Prudential Codes of Practice (revised December 2017)
- MHCLG Investment Guidance issued February 2018 and with effect from April 2018
- Risk Management
- The Financial Markets
- Interest Rate Forecasts
- Credit Ratings and Creditworthiness
- Investment Management
- Debt Management
- Non-Financial Investments e.g. Investment Property
- Scrutiny Focus – officers and members responsibilities

The training can be delivered via Microsoft Teams. It normally takes two hours to deliver and there is opportunity for interaction and to ask questions. Handouts will be provided if requested and the slides sent to members for review a week ahead of any training being delivered.

The relevant fee for the training service is a flat £1,500 (plus VAT) regardless of the number of members / officers that attend, therefore this allows the training offer to be extended to all members, if supported, at no extra cost.

Performance

The prudential and local indicators as at 30 September 2020 are shown in **Appendix B.**All indicators are currently being met with the exception of the following:

PRL1 - Capital Expenditure is forecasted to be £46.50m less than target, due to the re profiling of capital schemes from 2020/21 to future years.

PRL10 - Fixed Interest Rate Exposure is currently 98.64% against a target of 95%. This is due to a number of long term Lenders Option Borrowers Option (LOBO) loans changing from variable to fixed exposure. These loans will fluctuate between fixed and variable throughout the term of the loan as a result of call dates. This variance will be within target at year end.

PRL12 – Maturity Structure of Borrowing for debt between 5 and 10 years is not currently falling within range (currently 0.52% of debt compared to a lower limit of 5%) due to delays in undertaking borrowing to support prior year capital programmes, to help offset the reduction in investment returns.

The report also sets out a number of Local Indicators covering performance against targets for interest expense and investment income. There are a number of variances against target in 2020/21 due to the unforeseen impact that Covid-19 has had on interest rates following the base rate cut in March 2020.

L5 – Average interest rate of external debt outstanding excluding OLA. The target for this year includes borrowing for capital expenditure which was budgeted to be taken out at lower rates than our historical borrowing rates, resulting in a lower average rate across all of our borrowing. This borrowing will no longer be undertaken in 2020/21 and will be funded by utilising the Council's cash balances. Therefore whilst the target is not being met there are interest cost savings being made as a result of not borrowing and a reduction in interest rate and counterparty risks.

L9a, L9b, L9d, L10, L11a, L11b - The average interest rates (L10-11b) are currently below target due to the underachievement on At Call investments (L9a). This is due to the unforeseen impact of the Covid-19 crisis which has highly impacted investment rates since the base rate cuts in March 2020.

The targets that these prudential indicators are monitored against have been taken from the Treasury Management and Investment Strategy for 2020/21 Onwards, which was approved by Council in February 2020.

Appendix B

Prudential Indicators as at 30th September 2020

Prudential Indicator		Actual 2019/20 £m	Target 2020/21 £m	Forecast Position at 31-Mar-21 £m	Variance to target Numerical Variance	% Variance
PrI 1	**Capital Expenditure**	69.780	186.440	**139.940**	-46.50	-25%
This indicator is required to inform the council of capital spending plans it is the duty of a local authority to determine and keep under review the amount that it can afford to allocate to capital expenditure. Capital expenditure may be funded by grant, capital receipts and borrowing. The forecast variance to target for 2020/21 is due to re profiling of capital schemes.						
PrI 2	**Ratio of financing costs to net revenue stream**	**4.31%**	3.78%	**3.74%**	-0.03%	-1%
Financing costs - Divided by (Interest charged on loans Less Interest earned on investments)		**Budget requirement** (Revenue Support Grant + NNDR +Council Tax)			**The ratio of financing costs to net revenue stream (General Fund)** as a %	
PrI 3	**Estimates of the incremental impact of new capital investment decisions on Council Tax**	**£15.36**	£28.49	**£28.49**	0.00	0%
This is a notional amount indicating the amount of council tax band D that is affected by the capital programme in the budget report compared to existing approved commitments and current plans.						
PrI 4	**Capital Financing Requirement**	**381.564**	380.886	**380.886**	0.00	N/A
This represents the underlying level of borrowing needed to finance historic and future capital expenditure. It is updated at end of the financial year.						
PrI 5	**Authorised Limit for external debt**	**458.391**	472.173	**472.173**	0.00	0%
The council may not breach the limit it sets, so it is important to allow prudent room for uncertain cash flow movements and borrowing in advance of future need.						
PrI 6	**Operational Limit for external debt**	**416.719**	429.248	**429.248**	0.00	0%
This has been set at the level of the capital financing requirement less the CFR items relating PFI and finance leases.						

Prl 7	**Gross Borrowing exceeds capital financing requirement**	**No**	**No**	**No**	
The CFR represents the underlying level of borrowing needed to finance historic capital expenditure. Actual net borrowing should be lower than this because of strong positive cash flow and balances. It would be a cause for concern if net borrowing exceeded CFR.					
Prl 8	**Authority has adopted CIPFA Code of Practice for Treasury Management**	**Yes**	**Yes**	**Yes**	
To ensure that treasury management activity is carried out within best professional practice.					
Prl 9	**Total principle sums invested for longer than 364 days must not exceed**	**14.0**	**25.0**	**7.0**	
The council is at risk when lending temporarily surplus cash. The risk is limited by investing surplus cash in specified investments and by applying lending limits and high credit worthiness. These are kept under constant review.					

Prudential Indicator continued		**Upper Limit**	**Lower Limit**	**Actual 2019/20**	**Forecast Position at 31-Mar-21**
Prl 10	Fixed Interest Rate Exposure	95.00%	40.00%	**95.20%**	**98.64%**
Prl 11	Variable Interest Rate Exposure	45.00%	0.00%	**4.80%**	**1.36%**
Prl12	***Maturity Structure of Borrowing***				
	Under 12 months	25.00%	0.00%	**6.51%**	**9.50%**
	12 months and within 24 months	25.00%	0.00%	**6.55%**	**21.17%**
	24 months and within 5 years	40.00%	0.00%	**31.69%**	**23.32%**
	5 years and within 10 years	50.00%	5.00%	**1.89%**	**0.52%**
	10 years and above	85.00%	30.00%	**53.36%**	**45.49%**

Local Indicators as at 30th September 2020

Local Indicators		Actual 2019/20	Target 2020/21	Forecast Position as at 31-Mar-21	Variance to target		Met
					Numerical Variance	% Variance	
L1	**Full compliance with prudential code**	**Yes**	Yes	**Yes**	-	-	Y
L2	**Average length of debt**	**19.05**	Lower Limit 15 years, Upper limit 25 years	**16.16**	-	-	Y
This is a maturity measure and ideally should relate to the average lifespan of assets.							
L3a	**Financing costs as a % of council tax requirement**	**6.06%**	20.00%	**7.19%**	-12.81%	-64.06%	Y
L3b	**Financing costs as a % of tax revenues**	**3.78%**	12.50%	**4.54%**	-7.96%	-63.64%	Y
These are a variation to PrI 3 excluding investment income and including MRP (amount set aside to repay debt costs). The target figure of 12.5% represents an upper limit of affordable net borrowing costs as a percentage of tax revenues for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favorable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.							
L4	**Net actual debt vs. operational debt**	**73.82%**	85.00%	**84.24%**	-0.76%	-0.89%	Y
This assists the monitoring of the authority's debt position.							
L5	**Average interest rate of external debt outstanding excluding OLA**	**3.74%**	3.35%	**3.37%**	0.02%	0.46%	N
L6	**Average interest rate of external debt outstanding including OLA**	**3.86%**	3.53%	**3.46%**	-0.07%	-2.09%	Y
The measure should be as low as possible. Other Local Authority debt (OLA) is managed on our behalf by Dudley council.							

L7	**Gearing effect of 1% increase in interest rate**	**3.92%**	5.00%	**3.50%**	**0.04%** **This would increase the average interest rate payable from 3.46% shown in L6 to 3.50%**		**Y**

This relates risk management principles to the monitoring of the TM strategy. It measures the effect of a change in interest rates and the effect it may have on the capital financing costs.

L8	**Average interest rate received on STI vs. At Call rate**	**n/a**	50.00%	**526.67%**	476.67%	953.33%	**Y**

The council aims to be gain interest on surplus funds higher than the 7 day LIBID rate. This measures performance in a changing economic context.

L9a	**AT call investments**	**0.63%**	0.60%	**0.15%**	-0.45%	-75.00%	**N**
L9b	**Short Term Investments**	**1.24%**	1.10%	**0.94%**	-0.16%	-14.55%	**N**
L9c	**Long Term Investments**	**1.65%**	1.65%	**1.68%**	0.03%	1.82%	**Y**
L9d	**Property Fund Investments**	**4.16%**	3.90%	**3.73%**	-0.17%	-4.25%	**N**
L10	**Average interest rate on all ST investments (ST and AT call)**	**1.11%**	1.04%	**0.56%**	-0.48%	-46.15%	**N**
L11a	**Average rate on all investments (ex. Property fund)**	**1.20%**	1.11%	**0.70%**	-0.41%	-36.70%	**N**
L11b	**Average rate on all investments (inc. property fund)**	**1.50%**	1.45%	**1.08%**	-0.37%	-25.52%	**N**

As L10, but includes investments longer than 364 days. The average interest rates (L10-11b) are currently below target due to the underachievement on At Call investments (L9a). This is due to the unforeseen impact of the Covid-19 crisis which has highly impacted investment rates since the base rate cuts in March 2020. Ongoing negotiations are being undertaken by the service to secure favourable rates when considering investment options, and through the review and identification of new and appropriate opportunities for investment.

L12	**% daily bank**	**100%**	99%	**100%**	1.00%	1.01%	**Y**

	balances within target range						
This measures how good our daily cash flow prediction is. A figure of 98% and above indicates a high level of accuracy.							