POLICY & RESOURCES COMMITTEE	Agenda Item 97 Brighton & Hove City Council

Subject:		**Treasury Management Strategy Statement 2020/21 - Mid Year Review**		
Date of Meeting:		**3 December 2020**		
Report of:		**Executive Director for Finance & Resources**		
Contact Officer:	**Name:**	**James Hengeveld** **Haley Woollard**	**Tel:**	**Tel: 01273 291242** **Tel: 01273 291246**
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Ward(s) affected:		**All**		

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2020/21 Treasury Management Strategy Statement (TMSS), practices and schedules were approved by Policy & Resources Committee on 13 February 2020 and full Council on 27 February 2020.

1.2 The TMSS sets out the role of Treasury Management, whilst the practices and schedules set out the annual targets and methods by which these targets will be met. The TMSS includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash funds.

1.3 It is recommended good and proper practice that Members receive half yearly reports and review and endorse treasury management actions during the year. The purpose of this report is to advise of the action taken in the first half of 2020/21.

2. RECOMMENDATIONS:

That the Policy & Resources Committee:

2.1 Notes the key actions taken during the first half of 2020/21 to meet the TMSS and the investment strategy as set out in this report.

2.2 Notes the reported compliance with the AIS for the period under review.

2.3 Notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised borrowing limit and operational boundary have not been exceeded.

3. CONTEXT/ BACKGROUND INFORMATION

Economic Background

3.1. The council's treasury advisors, Link Asset Services (LAS) provide their assessment of the UK and global economic landscapes, and their interest rate forecast. This is included at Appendix 2.

3.2. The first half of 2020/21 was focussed on the Covid-19 pandemic. The UK GDP fell by nearly 22% in the first half of 2020, which was one of the largest falls of any developed nation. The Bank of England (BofE) provided some monetary stimulus in the form of reducing the Official Base Rate twice in March (first to 0.25%, and then to 0.10%), as well as extending quantitative easing (QE) by £300bn with a further £150bn announced in October's Monetary Policy Committee (MPC) meeting.

3.3. There has been much speculation as to whether the BofE will resort to using negative rates to help stimulate the economy; in October, the MPC started work to explore the practicalities and implications of negative interest rates. LAS' central interest rate forecast is for the bank rate to remain at 0.10% until 2023/24.

Treasury Management Strategy

3.4. A summary of the action taken in the 6 months to September 2020 is provided in Appendix 1 to this report and further information on borrowing and investment performance is shown in the September 2020 Treasury Management statistics at Appendix 2. The main points are:

- The council has not entered into any new borrowing during the period;
- The highest risk indicator during the period was 0.008% which is well below the maximum benchmark of 0.050%;
- The return on investments by the in-house treasury team has exceeded the target benchmark rates;
- The two borrowing limits approved by full Council have not been exceeded.

3.5 Treasury management activity for the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Apr 2020 to 30 Sep 2020			
	Fixed deposits	Money market funds & Notice Accounts	Total	
Up to 1 week	-	£314.7m	£314.7m	83.8%
Between 1 week & 1 month	-	-	-	0%
Between 1 month & 3 months	£3.0m	-	£3.0m	0.8%
Over 3 months	£58.0m	–	£58.0m	15.4%
	£61.0m	**£314.7m**	**£375.7m**	**100.0%**

Summary of Treasury Activity April 2020 to September 2020

3.6 The following table summarises the treasury activity in the half year to September 2019 compared to the corresponding period in the previous year:

April to September	2019/20	2020/21
Long-term borrowing raised (General Fund)	(£7.5m)	(£0.0m)
Long-term borrowing raised (HRA)	(£2.5m)	(£0.0m)
Long-term borrowing repaid (i360)	£0.5m	£0.5m
Long-term borrowing repaid (General Fund)	£0.3m	£0.3m
Long-term borrowing repaid (HRA)	£0.4m	£0.4m

Short-term borrowing (raised)/repaid	£8.0m	(£1.5m)
Investments made	£372.3m	£375.7m
Investments maturing	(£378.1m)	(£382.7m)

3.7 Due to uncertainties around the impact of COVID on expenditure and lost income in the first quarter of 2020/21, the council has maintained a much higher level of liquidity than it normally would to ensure cash is available when it's required.

3.8 As at TBM7, an underspend of £0.753m has been reported within the Financing Costs Budget. This underspend is as a result of a reduced minimum revenue provision due to a reduced need to borrow within the 2019/20 and 2020/21 capital programmes. This has been partly offset by a pressure on investment interest caused by the reduction of investment rates due to the Bank of England reducing the official Base Rate to 0.10% in March 2020.

3.9 The following table summarises how the day-to-day cash flows in the half-year have been funded compared to the same period in the previous year:

April to September	2019/20	2020/21
Net cash flow (shortage)/surplus	**(£5.3m)**	**(£7.3m)**
Represented by:		
Increase/(reduction) in long-term borrowing	£8.1m	(£1.2m)
Increase/(reduction) in short-term borrowing*	(£8.0m)	£1.5m
Reduction/(increase) in investments	£5.8m	£7.0m
Reduction/(increase) in bank balance	(£0.6m)	(£0.0m)

*including South Downs National Park external investments

Investment Strategy

3.10 A summary of investments made by the in-house team and outstanding as at 30 September 2020 in the table below shows that investments continue to be held in good quality, short term instruments.

'AAA' rated money market funds	£44.79m	31.8%
'AA' rated institutions	£64.50m	45.8%
'A' rated institutions	£31.50m	22.4%
Total	**£140.79m**	**100.0%**
Period – less than one week	£46.79m	33.2%
Period – between one week and one month	£10.50m	7.5%
Period – between one month and three months	£3.50m	2.5%
Period – between three months and 1 year	£60.00m	42.6%
Period – 1 year +	£20.00m	14.2%
Total	**£140.79m**	**100.0%**

Risk

3.11 As part of the investment strategy for 2020/21 the Council agreed a maximum risk benchmark of 0.050% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures the risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.008% and 0.003% between April 2020 and September 2020. It should be remembered however that the benchmark is an ‘average risk of default’ measure and does not constitute an expectation of loss against a particular investment. The actual risk indicator is much lower for the first half of 2020/21 as a result of the decision to increase highly liquid AAA rated balances within the first half of the year.

3.12 In July 2019, Internal Audit undertook an audit of the treasury management function. The audit concluded that “reasonable assurance” is provided on the effectiveness of the control framework operating and mitigating risks for treasury management. One medium and two low recommendations were provided; all recommendations have been actioned.

Creditworthiness of Counterparties

3.13 The credit rating agencies changed their outlook on many UK banks from stable to negative outlook during the quarter ended 30th June 2020 due to upcoming risks to banks’ earnings and asset quality during the economic downturn caused by the pandemic, but the ratings agencies affirmed the majority of the ratings (that is, removed the negative outlook and did not change the credit rating). This was due to continuing strong credit profiles of UK banks. During Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into the next quarters ahead, more information will emerge on actual levels of credit losses. This has the potential to cause rating agencies to revisit their initial rating adjustments which could be negative or positive, although it should also be borne in mind that UK banks went into this pandemic with strong balance sheets.

3.14 All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on negative watch, but with a small number of actual downgrades.

3.15 Link have conducted some stress testing on the Link credit methodology. This stress testing would result in no change to the council’s current counterparty list.

Compliance with the Annual Investment Strategy

3.16 During the reporting period, the information in this report provides assurance that the Annual Investment Strategy has been complied with in full.

Investment Rates

3.17 While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank of England and the Government have provided financial markets and businesses with access to credit, either directly or through commercial banks. In addition, the Government has provided grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on. This has caused investment rates for lending between local authorities to fall significantly as supply of cash is much higher than the demand for borrowing.

3.18 Money market funds (MMFs), yields have continued to drift lower. Some fund managers have suggested that they might resort to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is very large values of cash invested at the very short end of the market. This has seen several market operators offer nil or negative rates for very short-term maturities.

Investment Performance

3.19 The council's investment portfolio achieved an average rate of 0.76% over the first six months of the year. This is against a benchmark rate of -0.06% for the same period. The benchmark rate is the 7 Day LIBID: the rate at which UK banks are willing to pay for borrowing for a 7-day period. The Investment portfolio has therefore outperformed the benchmark by 0.82%. This is because a number of local authority lending deals were entered into before the pandemic with higher yields that have not matured in the first 6 months.

3.20 The current forecast estimates that the average investment rate earned over the full year will be 0.65% as investments mature and are replaced by those earning a lower interest rate.

Borrowing Strategy

3.21 The council operates separate debt portfolios for the General Fund and the HRA following in introduction of HRA Self-Financing in 2012.

3.22 The General Fund has been carrying an internal borrowing position (i.e. where the General Fund borrows cash from its own reserves) since 2008 as a response to the financial crisis. In response to a combination of expectation of increasing interest rate forecasts, the reduction of certain reserves and historically low PWLB borrowing rates, the General Fund has entered into planned borrowing of £27.5m from the PWLB to reduce the internal borrowing position over the last three years. The most recent of this borrowing was undertaken in August 2019, where a £7.5m loan was undertaken for a period of 50 years at a historical low rate of 1.67%. Additionally, £10m of PWLB borrowing was undertaken by the General Fund in March 2019 as part of a debt restructure to replace RBS loans.

3.23 In the current climate the rates that can be earned on investing reserves are historically low. Additionally, the council's Treasury Advisors, Link Asset Services, forecast that interest rates will remain at current levels for the next 3 years. Additionally, an increase in PWLB margins over gilt yields in October 2019, and the subsequent consultation on these margins by HM Treasury (which ended on 31st July 2020) has meant the Authority has refrained from undertaking new long-term PWLB borrowing for the present. Consequently, officers are reviewing the levels of under-borrowing that the council's reserves can support to reduce our investment portfolio further and reduce the need for undertaking new long-term borrowing in the short term. This may result in the council utilising short term borrowing to support its cash flow. This policy will require ongoing monitoring.

3.24 The Housing Revenue Account (HRA) carries a fully funded borrowing position (i.e. the HRA does not borrow from its own reserves, but instead undertakes borrowing for its entire borrowing requirement). Over the last three years, the HRA has entered into a total of £24.0m of external borrowing and £4.5m of borrowing from the General Fund to support the HRA Capital Programme. Of the £24.0m of external borrowing, £2.5m was undertaken in August 2019, where a for a period of 50 years at a historical low rate of 1.67%. A further loan of £7.5m was undertaken in March 2020 for a period of 50 years at an interest rate of 1.54%. This loan was to support the HRA Capital Programme and to externalise a portion of the existing loan from the General Fund. Additionally, £16m of PWLB borrowing was undertaken by the HRA in March 2019 as part of a debt restructure to replace RBS loans.

3.25 The treasury team, along with the council's treasury advisors, monitor interest rates and will seek to externalise the remainder of the HRA's borrowing from the General Fund at a time which would be optimal for both the HRA and the General Fund. The treasury team are exploring alternative borrowing sources such as forward market borrowing for future capital investment plans.

3.26 A summary of the council's debt portfolio is summarised in Appendix 1.

Treasury Advisors

3.27 In April 2020, a 4-year contract for treasury advisory services was awarded to Link Asset Services (LAS) via an approved framework. This contract was procured in a joint arrangement with East Sussex County Council, and the exercise provided an annual contract saving for the council.

3.28 The council recognises that responsibility for decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report sets out action taken in the 6 months to September 2020. Treasury management actions have been carried out within the parameters of the AIS, TMSS and Prudential Indicators. Therefore, no alternative options have been considered.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted over the content of this report. No other consultation was undertaken.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as "best and proper practice" under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year's performance. This report fulfils that requirement.

7. FINANCIAL & OTHER IMPLICATIONS:

<u>Financial Implications:</u>

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraph 3.8.

Finance Officer Consulted: James Hengeveld Date: 16/11/20

<u>Legal Implications:</u>

7.2 The TMSS is approved and associated actions carried out under powers given to the council by Part 1 of the Local Government Act 2003, which includes the power for a local authority to invest for the purposes of the prudent management of its financial affairs (section 12).

7.3 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003/3146 require local authorities to have regard to the CIPFA Code of Practice referred to in paragraph1.3 above when carrying out their functions under Part 1 of the 2003 Act.

7.4 The council's policy and the actions outlined in the report are considered to comply with the council's obligations under the Act and wit the afore-mentioned Code.

Lawyer Consulted: Elizabeth Culbert Date: 24/11/20

<u>Equalities Implications:</u>

7.5 There are no direct implications arising from this report

<u>Sustainability Implications:</u>

7.6 There are no direct implications arising from this report

<u>Brexit Implications:</u>

7.7 Appendix 2 includes commentary on the potential impact of the current Brexit negotiations on interest rates.

<u>Any Other Significant Implications:</u>

7.8 There are no direct implications arising from this report

SUPPORTING DOCUMENTATION

Appendices:

1. A summary of the action taken in the period April 2020 to September 2020
2. The Economy & Interest Rates – Link Asset Services

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations.
2. The Treasury Management Strategy Statement, Treasury Management Practices and associated schedules 2020/21 (including the Annual Investment Strategy 2020) approved by Policy , Resources & Growth Committee on 13 February 2020 and full Council on 27 February 2020.
3. Papers held within Finance, Finance & Resources Directorate.
4. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2011.