AUDIT, GOVERNANCE & STANDARDS COMMITTEE	15 November 2021

Treasury Management Mid-Year Review 2021/22

Final Decision-Maker	Audit, Governance & Standards Committee
Lead Head of Service	Ellie Dunnet – Head of Finance
Lead Officer and Report Author	John Owen – Finance Manager
Classification	Public
Wards affected	All

Executive Summary

This report sets out the activities of the Treasury Management Function for the first 6 months of the 2021/22 financial year in accordance with CIPFA's Code of Practice on Treasury Management in Local Authorities.

Purpose of Report

This report requires a decision from the Committee.

This report makes the following recommendations to this Committee:

1. That the position of the Treasury Management Strategy as at 30 September 2021 be noted;
2. That no amendments to the current procedures are necessary as a result of the review of activities in 2021/22.

Timetable	
Meeting	***Date***
Audit, Governance & Standards Committee	15 November 2021

Treasury Management Mid-Year Review 2021/22

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The Treasury Management Function ensures the safeguarding of Council finances and the liquidity of funds when liabilities become due to support the strategic plan objectives.	Head of Finance
Cross Cutting Objectives	The report recommendations support the achievements of all the cross-cutting objectives in the way stated above.	Head of Finance
Risk Management	Covered in the risk section of this report.	Head of Finance
Financial	This report relates to the financial activities of the council in respect of treasury management and specific financial implications are therefore detailed within the body of the report.	Section 151 Officer & Finance Team
Staffing	None	Head of Finance
Legal	Under Section 151 of the Local Government Act 1972 (LGA 1972) the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management. The legal implications are detailed within the body of the report which is compliant with statutory and legal regulations such as the CIPFA Code of Practice on Treasury Management in Local Authorities. Appropriate remedial action should be taken if at any time it appears likely that expenditure will exceed available resources. The S151 Officer has a personal duty under Section 114(3) of the Local Government Finance Act 1988 to report to the Council if it appears that the set budget will be exceeded. Having received a S114 report, members are obliged to take all reasonable practical measures to bring the budget back into balance.	Legal Team

Privacy and Data Protection	None	Policy and Information Team
Equalities	The recommendations do not propose a change in service therefore will not require an equalities impact assessment.	Equalities & Communities Officer
Public Health	None	Public Health Officer
Crime and Disorder	None	Head of Finance
Procurement	None	Head of Finance and Section 151 Officer
Biodiversity and Climate Change	There are no direct implications on biodiversity and climate change.	Biodiversity and Climate Change Manager

2. INTRODUCTION AND BACKGROUND

2.1 The Council 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.

2.2 The Authority's Treasury Management Strategy for 2021/22 was approved at Council on 24th February 2021. The Authority has 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 is therefore central to the Authority's treasury management strategy.

2.3 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit, Governance and Standards Committee.

2.4 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2021/22 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

2.5 <u>Economics Update</u>

- The Council's treasury advisors, Link Asset Services, have provided the Council with the following economic update for the first 6 months of 2021/22 (information is correct as of 06/10/2021).

- At a meeting on 24th September 2021, the Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

- There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.

- So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

- Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022 (however the markets are pricing in a rate rise for December 2021), but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

2.6 Interest Rates

- The Council's treasury advisor, Link Group, provided the following forecasts on 29th September 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View	29.9.21									
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

- As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 23/24 and a third one to 0.75% in quarter 4 of 23/24. As stated in 2.5, the bank rate is forecast to rise in quarter 1 which will in turn bring forward the expected increases.

- Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021.

- The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

- As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

- The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

- The Bank of England has amended its target for monetary policy so that inflation should be 'sustainably' over 2% so there will be a greater emphasis on other targets for monetary policy, before the consideration of increasing rates further.

2.7 <u>Treasury Management Strategy Statement and Annual Investment Strategy Update</u>

2.7..1 The Treasury Management Strategy Statement, (TMSS), for 2020/21 was approved by this Council on 24th February 2021 in accordance with the

CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

2.7..2 There are no policy changes required to the TMSS for 2021/22. The details in this report update the position of the treasury management function and the economic position.

2.8 Investment Portfolio

2.8..1 The council held investments totalling £16.16m at the start of the year, this has now risen to £45.19m as at 30th September 2021. The reason the investment balance is at this level is due to business and COVID grant funding from the Government and the lower than forecasted Capital spend. However, grants will soon be repaid to Government and the capital programme will accelerate over the next few months, which in turn will reduce this balance.

2.8..2 A full list of investments held at this time is shown in **Appendix A**. All investments are held in either short term notice accounts or money market funds, to be readily available to fund the Council's liabilities, including the capital programme.

2.8..3 Investment income to 30th September 2021 totals £21k against a budget of £50k with an average rate of 0.13%. As the interest rates in the table above show, rates are at historically low levels and as the Council's Treasury Management Strategy 2021/22 dictates that investments will be kept short term to meet liabilities, these are kept in low yielding short term instruments.

2.8..4 Due to the possible interest rate increase, investment rates for the 6 to 12 months have increased, which the Council will look to utilise if appropriate.

2.9 Debt Portfolio

2.9..1 The Council's capital financing requirement (CFR) for 2021/22 is £69.663m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). In practice, owing to slippage in the capital programme, it is unlikely that borrowing on this scale will be required in practice.

2.9..2 The Council has short term external borrowing of £9m from other local authorities. A list of these can also be found in Appendix A.

2.9..3 The Council has constantly reviewed long term rates to determine when would be the best time to lock into these rates fixed term rates. There had been no cause to do this as at 30th September 2021, however with the possibility of increasing rates the Council is looking to take on a small amount of PWLB borrowing. The aim is to cut back on short term funding and to lock in some certainty with rates which are currently around the 2% mark (as at writing this report). The intention is to replace short term borrowing with longer term certainty as the fixed term of short term loans expires.

2.10 Prudential and Treasury Indicators

2.10..1 It is a statutory duty for the Council to determine and keep under review 'Affordable Borrowing Limits.' During the first six months of financial year 2021/22, the Council has operated within the prudential and treasury indicators set out in the Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury indicators can be found in **Appendix B**.

2.10..2 The Director of Finance & Business Improvement confirms no indicator has been breached in the first half of 2021/22.

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3. AVAILABLE OPTIONS

3.1 The Audit, Governance and Standard Committee agrees that no amendments to the current procedures are necessary as a result of a review of activities of the first 6 months of 2021/22.

3.2 The Audit, Governance and Standard Committee proposes changes to the current procedures as the result of a review of activities with the first 6 months of 2021/22.

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4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

4.1 The Audit, Governance and Standard Committee agrees that no amendments to the current procedures are necessary as a result of a review of activities of the first 6 months of 2021/22 as there are no justifications to make any changes.

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5. RISK

5.1 Risks are highlighted for the treasury management function within the Treasury Management Strategy Statement 2021/22 report. This report is purely for information purposes and has no risk management implications.

6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

6.1 None

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7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

7.1 If Audit, Governance and Standards Committee agrees that no change in current procedures with Treasury management will be made, then there will be no further action.

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8. REPORT APPENDICES

8.1 The following documents are to be published with this report and form part of the report:

- Appendix A - Investments-Borrowing 30th September 2021
- Appendix B - Prudential and Treasury Indicators

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9. BACKGROUND PAPERS

9.1 None