Northumberland County Council

AUDIT COMMITTEE

25 NOVEMBER 2020

Treasury Management Mid-Year Review Report for Period 1 April to 30 September 2020

Report of Chris Hand, Executive Director of Finance and Section 151 Officer

Cabinet Member: Nicholas Oliver, Portfolio Holder for Corporate Services and Cabinet Secretary

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1. Purpose of the Report

This report provides a mid-year review of the activities of the Treasury Management function for the period 1 April to 30 September 2020, and, performance against the Treasury Management Strategy Statement (TMSS) 2020-21 - as approved by the County Council on 19 February 2020. The report provides a review of borrowing and investment performance for the period set in the context of the general economic conditions prevailing so far during the year. It also reviews specific Treasury Management prudential indicators defined by the (CIPFA) Treasury Management Code of Practice and CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code), and approved by Council in the TMSS.

2. Recommendations

It is recommended that Members:

- **Receive the report and note the performance of the Treasury Management function from 1 April to 30 September 2020.**
- **Present the report to County Council for information.**

3. Link to the Corporate Plan

This report supports the "We want to be efficient, open and work for everyone" priority included in the Council's Corporate Plan 2018-21.

4. Key Issues

The Local Government Act 2003 (the Act) and supporting regulations require the Council to produce a mid-year review of treasury management activities and actual performance against prudential and treasury indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

The report provides a review of the Treasury Management activities for the six-month period from 1 April to 30 September 2020 and sets out performance against the Treasury Management Strategy Statement for 2020-21.

TREASURY MANAGEMENT MID-YEAR REVIEW REPORT FOR THE PERIOD 1 APRIL TO 30 SEPTEMBER 2020

1. INTRODUCTION

1.1. Background

This Treasury Management mid-year report provides a review of the activities of the Treasury Management function for the period 1 April to 30 September 2020 and performance against the Treasury Management Strategy Statement (TMSS) for 2020-21. Its production and submission to full Council is a requirement of the CIPFA Code of Practice on Treasury Management.

Treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The Council operates a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, with a main aim of providing sufficient liquidity, ahead of the achievement of the best possible investment returns.

The second main function of the treasury management service is to arrange the funding of the Council's capital programme. The capital programme provides a guide to the borrowing need of the Council, and there needs to be longer term cash flow planning to ensure capital spending requirements can be met. The management of longer-term cash may involve arranging long or short-term loans, utilising longer term cash flow surpluses and, occasionally, debt restructuring to meet Council risk or cost objective.

1.2. Statutory and Regulatory Requirements

The Local Government Act 2003 (the Act) and supporting Regulations requires the Council to produce a mid-year review of treasury management activities and the actual performance against prudential and treasury indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore, important as it provides details of the performance of the treasury management activities and highlights compliance with the Council's policies previously approved by Members.

1.3. Basis and Content of Treasury Management Mid-Year Review Report for 2020-21

The report covers:

- Overview of the Treasury Management Strategy for the financial year 2020-21;

- Economic conditions and interest rates for period 1 April to 30 September 2020;
- Overview of the treasury position at 30 September 2020;
- Borrowing activity;
- Investment activity; and,
- Treasury management limits and prudential indicators position.

2. BACKGROUND - TREASURY MANAGEMENT STRATEGY FOR 2020-21

2.1. Overview of the 2020-21 Strategy

The expectation for interest rates within the Treasury Management Strategy Statement for 2020-21 – which was written and based on information at November 2019 - was for UK Bank Rate (often referred to as the Base Rate) to remain low at 0.75% with an increase to 1.00% around the final quarter of 2020-21. Longer term borrowing rates were also forecast to gently rise during the year, in line with increasing bond yields.

The forecasts were however predicated on an assumption that there would be no break-up of the Eurozone or EU, (apart from the departure of the UK), within the forecasting time period, despite the major challenges that were looming; and, that there were no major disputes in international relations, especially between the US and China / North Korea and Iran, which would have a major impact on international trade and world GDP growth.

Against this backdrop, the proposed strategy for 2020-21 was to continue to operate with an under-borrowing position - i.e. use investments in lieu of external borrowing – and to meet the remaining external borrowing requirement for the year (estimated at that time at £225.000 million net of maturing loans) primarily from medium to longer term borrowing, but with the caveat that shorter term/temporary borrowing may also be considered, particularly if the anticipated rate increases did not materialise as quickly as projected.

£40.000 million of the 2020-21 borrowing requirement was secured in the last quarter of the 2019-20 financial year, as rates dropped to historic lows - reducing the estimated new in-year requirement to £185.000 million.

2.2. Compliance

The Executive Director of Finance confirms that, throughout the period, all treasury activities have been conducted within the parameters and limits of the TMSS 2020-21, alongside best practice suggested by the CIPFA Treasury Management Code and Central Government.

3. ECONOMIC CONDITIONS AND INTEREST RATES FOR PERIOD 1 APRIL TO 30 SEPTEMBER 2020

3.1. Economy - At 26 October 2020

The extraordinary impact of the coronavirus pandemic and shutdown measures to contain it have plunged the global economy into a severe contraction. According to the latest International Monetary Fund (IMF) forecasts (October 2020), global growth is

projected to shrink by 4.40% in 2020. This would represent the deepest recession since the Second World War.

Economic activity among advanced economies has so far been hit the hardest (projected to fall 5.8% during 2020), as domestic demand and supply, trade, and finance have been severely disrupted. However, emerging market and developing economies (EMDEs) have also been impacted and are expected to shrink by 3.3% in 2020 - their first contraction as a group in at least sixty years.

UK Growth

The UK was officially in a recession following two consecutive quarters of negative growth in Quarters 1 and 2 of 2020.

As global coronavirus cases rose, social distancing measures were imposed forcing the closure of shops, businesses and schools from the end of March until the beginning of July. This led to the UK economy falling by more than a fifth in Quarter 2 2020. Whilst some of this fall has since been recovered, the latest IMF figures (published on 29 October 2020) forecast the UK will see a 10.40% fall in GDP in 2020, followed by growth of 5.70% in 2021.

Bond/Gilt Yields and PWLB Rates

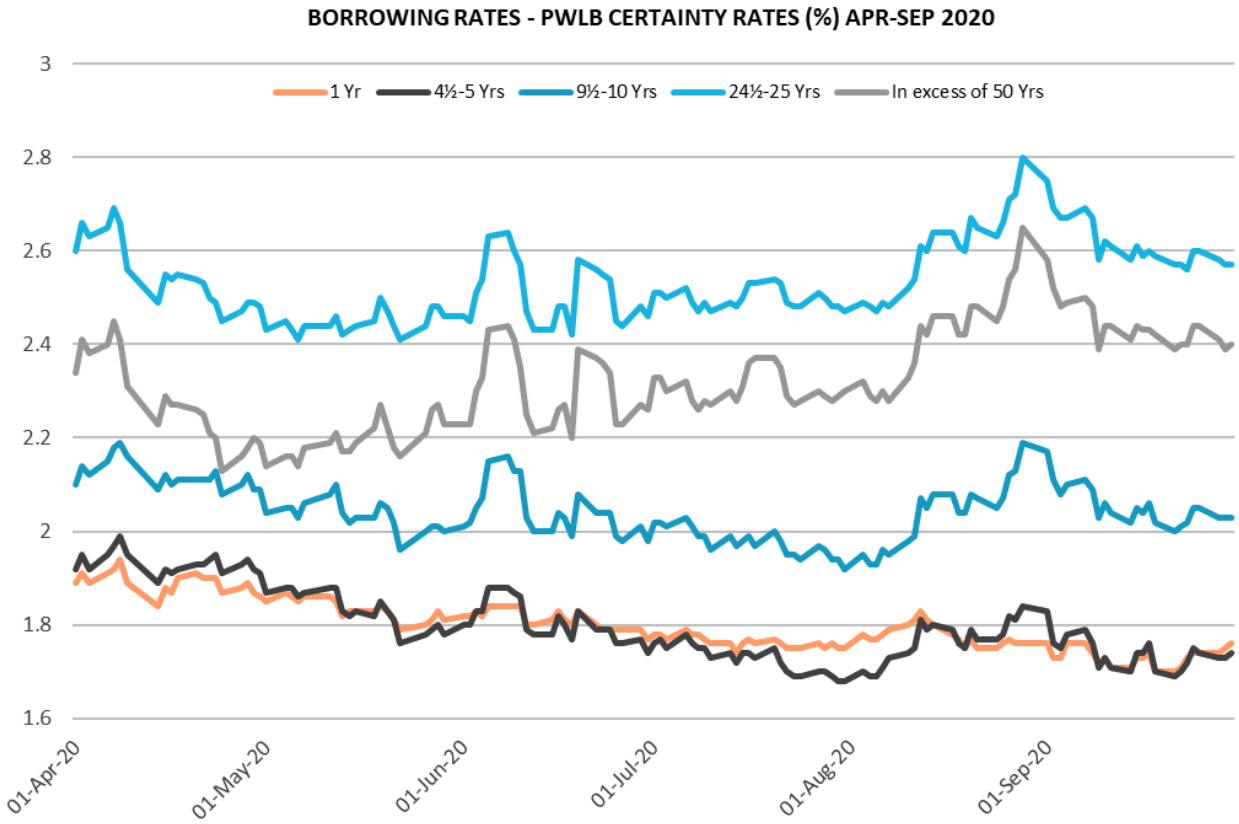
There has been much speculation recently that we are currently in a bond market bubble – where bonds are trading above their true worth (fuelled by a belief that no matter how high prices go, someone is likely to pay an even higher price), and that, eventually, this must come to an end. However, given the context that there are heightened expectations the US could be heading for a recession, and a general background of a downturn in world economic growth (fuelled by fears around the impact of the trade war between the US and China) together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. Over the last year we have seen many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has at times been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter term yields. In the past, this has been a precursor to a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

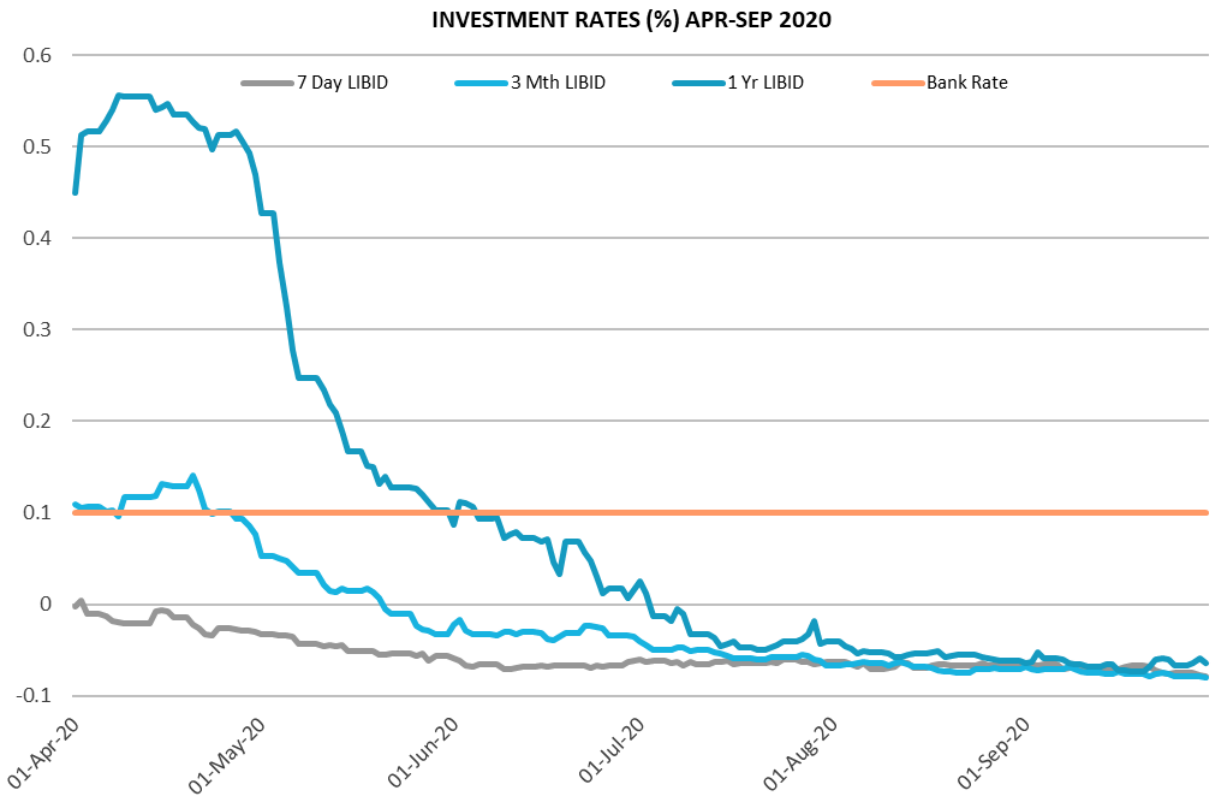
Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the initial phases of the health crisis in March, these yields have fall sharply to unprecedented lows as major western central banks took rapid action to deal with excessive stress in financial markets, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on

government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply.

3.2. Actual Interest Rates 1 April to 30 September 2020

The following graphs show interest rate movements over the period, for various terms of borrowing and investment:





3.3. Forecast Interest Rates

The Council's treasury advisor, Link Asset Services, current interest rates forecast (dated 11 August 2020) is shown below:

	Quarter 3 2020-21 (Q/E Dec 2020)	Quarter 4 2020-21 (Q/E Mar 2021)	Quarter 1 2021-22 (Q/E Jun 2021)	Quarter 2 2021-22 (Q/E Sep 2021)
Bank Rate	0.10%	0.10%	0.10%	0.10%
5 year PWLB	1.90%	2.00%	2.00%	2.00%
10 year PWLB	2.10%	2.10%	2.10%	2.10%
25 year PWLB	2.50%	2.50%	2.50%	2.60%
50 year PWLB	2.30%	2.30%	2.30%	2.40%

This was accompanied with the following comments:

"We do not think that the MPC will increase Bank Rate during the current and next two financial years as we expect the economy to take a prolonged period to recover momentum after the Covid crisis.

Forecasts for average investment earnings beyond the three year time horizon will be heavily dependent on economic and political developments.

The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more "risky" assets i.e. equities, or the "safe haven" of government bonds. The overall longer run trend is for gilt yields

and PWLB rates to rise, albeit gently, although there are likely to also be periods of sharp volatility from time to time.

Our forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU, (apart from the departure of the UK), within our forecasting time 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."

4. THE PORTFOLIO POSITION AT 30 SEPTEMBER 2020

4.1. Current Borrowing

The Council's debt at the beginning of the year and at 30 September 2020 is shown below:

TABLE 1: BORROWING	Total Principal 1 Apr 2020 £m	Weighted Average Rate %	Total Principal 30 Sep 2020 £m	Weighted Average Rate %
Public Works Loan Board Loans	468.344	2.65	464.080	2.65
LOBOs	176.500	3.95	176.500	3.95
Market / Local Authority (>1yr)*	170.100	2.35	137.100	2.68
Market / Local Authority (<1yr)*	10.000	1.15	10.000	1.15
Salix	0.037	0.00	0.030	0.00
TOTAL EXTERNAL BORROWING	**824.981**	**2.85**	**787.710**	**2.93**

* Note: above figures are based on the term of loans at their inception and exclude PFI borrowing.

4.2. Current Investments

The table below summarises the investment position at 30 September 2020:

TABLE 2: INVESTMENTS	Total Outstanding 1 Apr 2020 £m	Weighted Average Rate %	Total Outstanding 30 Sep 2020 £m	Weighted Average Rate %
Fixed Term Investments – Long Term (>1yr)*	33.250	3.24	33.250	3.24
Fixed Term Investments – Short Term (<1yr)*	72.000	0.93	23.000	0.29
Money Market Funds and Call Accounts	85.800	0.47	119.802	0.16
TOTAL INVESTMENTS (excl. Cash)	**191.050**	**1.13**	**176.052**	**0.76**

* Note: above figures are based on the term of investments at their inception

5. BORROWING ACTIVITY 2020-21

Given the dramatic downturn in the economy, the accompanying fall in interest rates and the expectation of these rates remaining low for a prolonged period of time, a decision was taken early in the new financial year to shift the emphasis for meeting the year's external borrowing requirement to shorter, rather than longer, term loan facilities.

A review of the capital programme in June 2020 also identified that a considerable proportion of the original budgeted capital expenditure for 2020-21 will not now be spent until later years (see 7.1 below). As a result, the anticipated net new borrowing requirement for the year has reduced to £115.000 million – down £70.000 million from the £185.000 million outlined in the original strategy (see paragraph 2.1 above).

To cover this requirement, nine 'forward deals' have since been agreed to borrow £75.000 million from other local authorities between December 2020 and February 2021 (when the borrowing is expected to be required). The weighted average term of the loans is 1.73 years and they have a combined average interest rate of 0.66%.

In addition to the above, it is estimated that a further £40.000 million of external borrowing will be required before the financial year end.

As shown in the above table, total external borrowing has decreased by £37.271 million, from £824.981 million at the start of year to £787.710 million at 30 September 2020 – this is due to maturing existing loans. However, taking into account the above forward arrangements, future maturities and further borrowing requirement of around £40.000 million, overall borrowing is projected to total around £845.438 million by 31 March 2021.

The reduced need to borrow, combined with the significantly lower than budgeted interest rates (*) are anticipated to generate an overall saving of around £2.623 million compared to the original interest payable budget for 2020-21 of £25.658 million.

[* The original estimate assumed long term borrowing averaging 2.95%, whereas the actual short-term borrowing is currently averaging around 0.66%].

6. INVESTMENT ACTIVITY 2020-21

The Council's investment policy (as set out in the Treasury Management Strategy Statement for 2020-21) is governed by the Communities and Local Government's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies (Moody's, Fitch Group and Standard and Poor's), supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

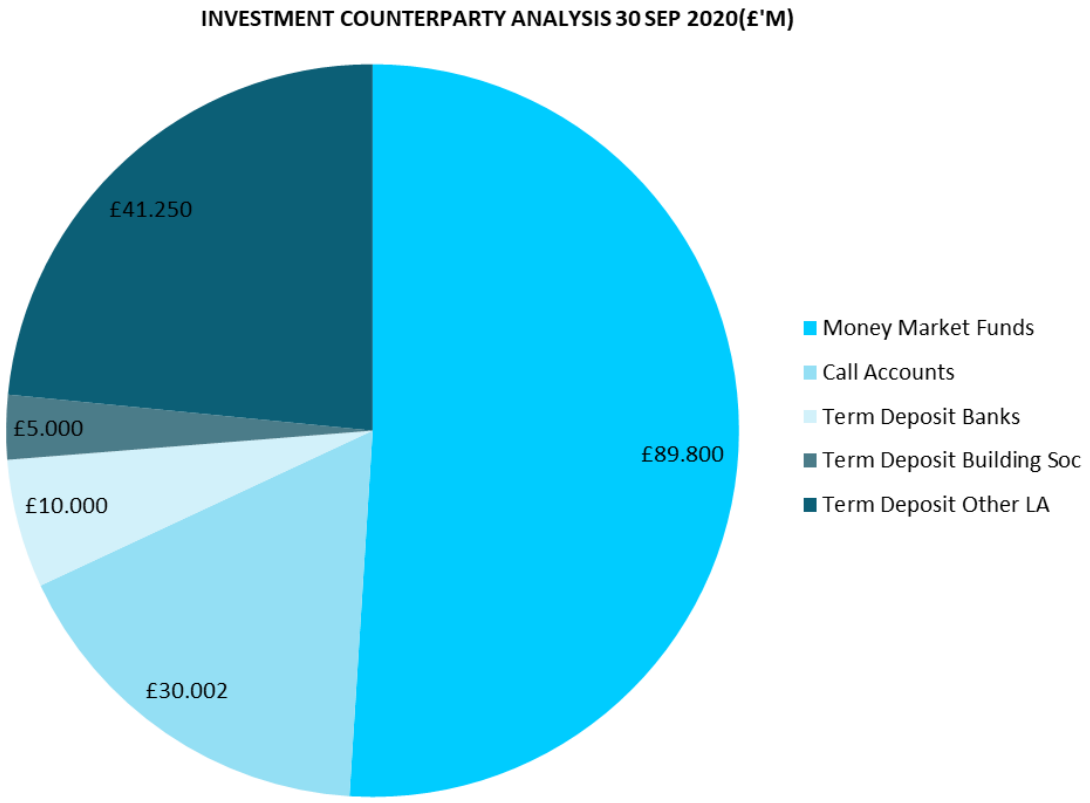
All investment activity during the year to date conformed to the approved strategy, and the Council had no liquidity difficulties.

As identified above, the current policy is to use a significant proportion of available investment balances as 'internal borrowing' to support the financing of the Capital Financing Requirement (CFR).

Overall external investments (excluding cash) reduced during the first six months of the year from £191.050 million to £176.052 million. This is due to general cash flow movements - borrowing taken at the end of 2019-20 which increased the available cash to invest has been used to support 2020-21 capital expenditure; and, Covid-19 grant support received at the end of March 2020, which has since been paid to businesses and individuals.

Based on the forecast revised capital spend for the year, investment balances are anticipated to reduce to around £99.557 million by 31 March 2021 - due to the increased utilisation of investment balances to cover the Capital Financing Requirement (CFR) in lieu of borrowing externally.

An analysis of the mid-year investment balance (excluding cash) by counterparty is shown in the following chart:



The internally managed funds earned an overall average rate of return of 0.85% during the first 6 months of 2020-21. The returns achieved were maximised by the longer-term investments with other Local Authorities taken out a number of years earlier, and compare favourably against the average London Interbank Bid Rate (LIBID) benchmark indicators of:

- 7 Day – negative 0.06%
- 3 Month – negative 0.02%
- 1 Year – 0.11%

The Council's budgeted investment return for 2020-21 is £1.405 million (excluding interest on loans to thirds parties). Based on the current position and forecasts for the

remainder of the year, it is estimated that the actual interest earned will be around or slightly above this level. (Whilst interest rates have been lower than anticipated, this has been offset by a higher than estimated level of cash balances in the early part of year, mainly due to the Covid-19 grant support from Central Government).

The above figures are exclusive of interest received on loans from third parties, such as the facilities to Advance Northumberland and Northumbria Healthcare NHS Foundation Trust etc. These loans are made for policy/service reasons, and not day-to-day treasury undertakings in relation to the investment of cash flows, and therefore do not form part of this report.

7. PRUDENTIAL INDICATORS AND TREASURY LIMITS 2019-20

The Prudential Code was developed by CIPFA. The Code has a central role in capital finance decisions, including borrowing for capital investment. Its key objectives are to provide a framework for local authority finance that will ensure individual authorities' capital expenditure plans are affordable; all external borrowing is within prudent and sustainable levels; and, that treasury management decisions are taken in accordance with good professional practice.

Performance against the approved prudential indicators, as set out in the 2020-21 Treasury Management Strategy Statement, is outlined below. None of the indicators have been exceeded during the period 1 April 2020 to 30 September 2020.

7.1. Capital Expenditure

This table shows the original approved capital programme (as agreed as part of the Medium-Term Financial Plan), current expenditure and forecast outturn for the year:

Capital Expenditure	2020-21 Original Estimate £m	2020-21 Current Budget £m	Current Expenditure 30 Sept 2020 £m	2020-21 Forecast Outturn £m
Adult Services	2.224	2.630	0.244	1.814
Chief Executive	4.627	5.458	0.062	2.626
Children's Services	71.739	65.118	21.985	46.976
Corporate Finance	49.290	63.540	12.078	49.011
Human Resources & OD	18.041	15.929	3.425	20.051
Local Services	48.249	56.253	16.789	47.225
Regeneration, Commercial and Economy	40.766	40.990	3.463	14.423
TOTAL EXPENDITURE	**234.936**	**249.918**	**58.046**	**182.126**

7.2. Authorised Limit and Operational Boundary

The authorised limit - is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

The following table demonstrates that during 2020-21 the Council has maintained gross borrowing within its authorised limit and operational Boundary.

	Authorised Limit for External Debt £m	Operational Boundary for External Debt £m	Actual 30 September 2020 £m
Borrowing	1,208.524	1,007.104	787.710
Other Long-Term Liabilities (PFI)	82.551	68.792	69.656
TOTAL EXTERNAL DEBT	**1,291.075**	**1,075.896**	**857.366**

7.3. Limits to Borrowing Activity

One of the key controls over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowing less investment) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of Capital Financing Requirement (CFR) [i.e. the underlying need to borrow] in the preceding year plus the estimates of any additional CFR for 2020-21 and the next two financial years.

CFR vs Borrowing	2020-21 Original Estimate £m	Position at 30 Sept 2020 £m	2020-21 Forecast Outturn £m
Borrowing	915.438	787.710	845.438
Other Long-Term Liabilities (PFI)	70.169	69.656	66.032
TOTAL EXTERNAL DEBT	**985.607**	**857.366**	**911.470**
CFR	**1,134.815**	**N/A**	**1,076.914**

The Executive Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this indicator.

The purpose of the following limit is to restrain the activity of the treasury function within certain limits; thereby managing risk; and, reducing the impact of any adverse movement in interest rates.

Interest Rate Exposure	Limit for 2020-21	Actual 30 Sep 2020
Fixed Rate Exposure	0% - 100%	89.88%
Variable Rate Exposure	0% - 50%	10.22%

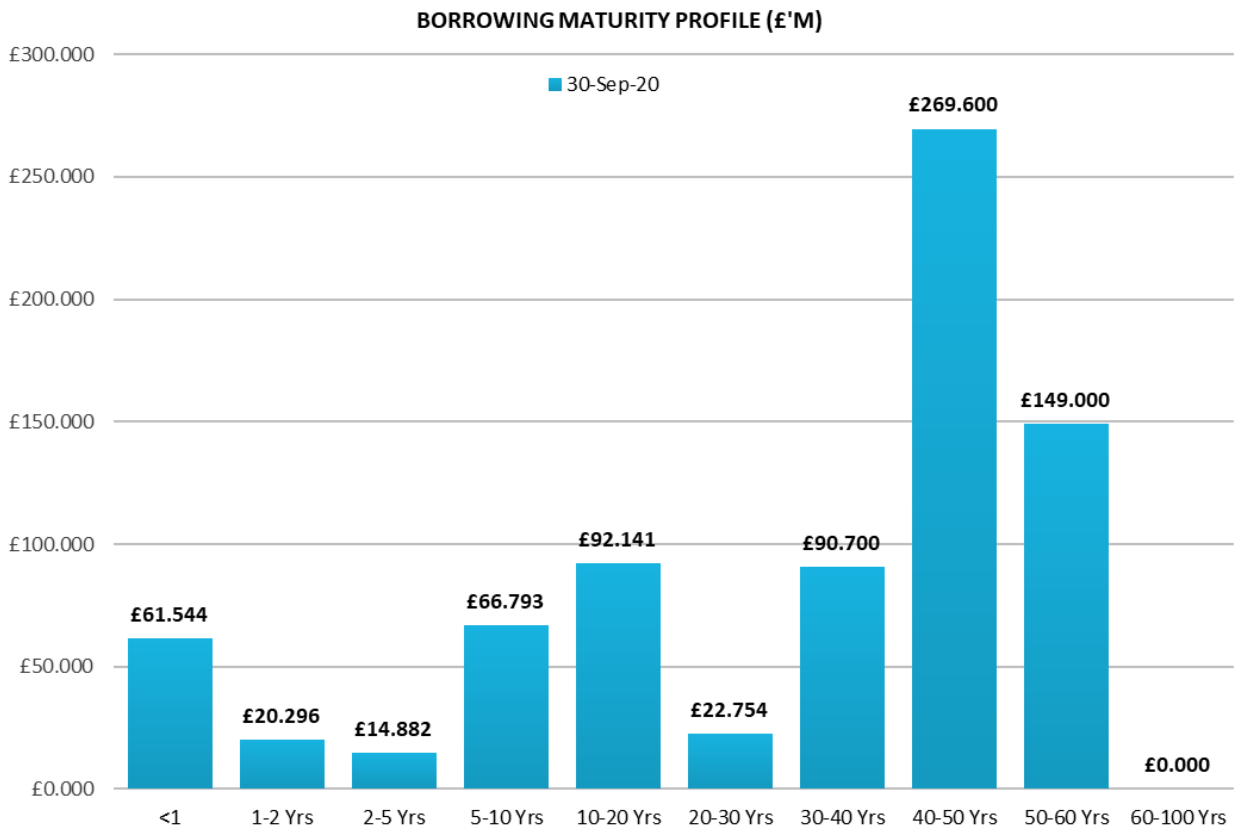
Lender option, borrower option loans (LOBOs) callable within 12 months are classed as variable; if the rate is fixed for a longer period they are classed as fixed. At 30 September 2020 the total of variable rate loans was £80.500 million and is within the set limit.

7.4. Maturity Structure of Borrowing

Measuring maturity structure of borrowing ensures a reasonable spread of maturing debt as a safety mechanism to ensure significant amounts of debt do not mature at a time when interest rates for refinancing the debt may be high.

Maturity Structure	Upper Limit for 2020-21	Actual 30 Sep 2020
Under 12 months	25%	8%
1 year - 2 years	40%	3%
2 years within 5 years	60%	2%
5 years within 10 years	80%	9%
10 years and above	100%	78%

The following graph shows maturity of loans by monetary value. LOBOs are shown as held to maturity. In the current climate it is not envisaged that loans would be called for repayment within the next 12 months, as rates are so low.



7.5. Investments for periods longer than 365 days

These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

	Limit 2020-2021 £m	Actual Highest £m	Actual 30 Sept 2020 £m

Principal sums invested > 364 days	120.000	33.250	33.250

Implications

Policy	The report provides a half-year review of the Treasury Management activities for 2020-21 and sets out performance against the Treasury Management Strategy Statement for 2020-21. It is consistent with "We want to be efficient, open and work for everyone" priority included in the Council's Corporate Plan 2018-21.
Finance and value for money	The financial implications of the 2020-21 investment and borrowing transactions have been taken into account within the revenue budget for 2020-21. Northumberland County Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Capita benchmarking clubs.
Legal	Under Section 1 of the Local Government Act 2003 (the Act) the Council may borrow money for any purpose relevant to its functions under any enactment, or for the purpose of the prudent management of its financial affairs. The Act and supporting regulations also require the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice (which were adopted by Northumberland County Council in February 2010).
Procurement	There are no direct procurement implications for the County Council.
Human Resources	There are no direct staffing implications for the County Council.
Property	There are no direct property implications for the County Council.
Equalities (Impact Assessment attached) Yes ☐ No ☐ N/A ☐	There are no direct equalities implications for the County Council.
Risk Assessment	The report highlights the principal financial risks within the Treasury Management function. The identification, monitoring and control of risk are the prime criteria by which the effectiveness of the County Council's Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the Council. The investment priority is security and liquidity rather than yield, which is a secondary aim.
Crime & Disorder	There are no Crime and Disorder implications for the County Council.
Customer Consideration	There are no Customer Considerations for the County Council.
Carbon reduction	There are no carbon reduction implications for the County Council.

Health & Wellbeing	There are no health and wellbeing implications for the County Council.
Wards	All divisions.

Background Papers:

Treasury Management Strategy Statement for 2020-21 – County Council 19 February 2020

CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance notes (revised 2011)

CIPFA Prudential Code for Capital Finance in Local Authorities

Guidance on Local Government Investments The Local Government Act 2003

Local Authorities (Capital Finance and Accounting) Regulations 2012 (S.I.2012/265)

Report sign off:

Authors must ensure that officers and members have agreed the content of the report:

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Deputy Monitoring Officer/Legal	Helen Lancaster
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