AGENDA ITEM 11

Treasury Management Update Report

AUDIT COMMITTEE MEETING DATE 2021/22 13 October 2021	CLASSIFICATION: Open
WARD(S) AFFECTED All Wards	
Ian Williams, Group Director Finance and Corporate Resources	

1. INTRODUCTION AND PURPOSE

1.1 The report, at Appendix 1, introduces the treasury management outturn report and the actual prudential indicators for 2020/21 for the Audit Committee setting out the background for treasury management activity over the previous financial year and confirming compliance with treasury limits and prudential indicators.

1.2 The report, at Appendix 2, provides a quarterly update on treasury management activity for the period June 2021 to August 2021 of 2021/22.

2. RECOMMENDATION(S)

The Audit Committee is recommended to:

- There are no immediate recommendations arising from this report as the purpose is to update the Audit Committee on the past events.

3. BACKGROUND

3.1 Policy Context

Treasury management and ensuring that the function is governed effectively means that it is essential for those charged with governance to review the operations of treasury management on a regular basis. This report sets out the prior year's outturn and forms part of the regular reporting cycle for the Audit Committee along with the second of the in-year updates for the current financial year covering the period from June 2021 to August 2021.

3.2 Equality Impact Assessment

There are no equality impact issues arising from this report.

3.3 Sustainability

There are no sustainability issues arising from this report.

3.4 Consultations

No consultations are required in respect of this report.

3.5 Risk Assessment

There are no risks arising from this report as it reports on past events. Clearly though the treasury management function is a significant area of potential risk for the Council if the function were not properly carried out and monitored by those charged with responsibility for oversight. Regular reporting on treasury management ensures that the Committee is kept informed.

4. COMMENTS OF THE GROUP DIRECTOR OF FINANCE AND CORPORATE RESOURCES

4.1 There are no direct financial consequences arising from this report as it reflects past performance through 2020/21 and for the period from June 2021 to August 2021. The information contained in this report will assist members of this Committee in monitoring the treasury management activities and enable better understanding of such operations. The Committee is requested to note this report.

5. COMMENTS OF THE DIRECTOR OF LEGAL

5.1 The Accounts and Audit Regulations 2015 place obligations on the Council to ensure that its financial management is adequate and effective and that it has a sound system of internal control which includes arrangements for management of risk. In addition, the Council within its Annual Treasury Management Strategy has agreed to comply with the CIPFA Code of Practice on Treasury Management. This report demonstrates that Treasury Management is meeting these requirements and adapting to changes as they arise.

5.2 There are no immediate legal implications arising from the report.

6. BACKGROUND PAPERS

6.1 The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice a year (mid-year and at year end).

6.2 The Authority's Treasury Management Strategy for 2020/21 was approved by full Council on 15th January 2020 which can be accessed on the Council website:

http://mginternet.hackney.gov.uk/documents/s68240/FINAL%20-%20Treasury%20Management%20Strategy%202020_21%201.pdf

6.3 The Authority's Treasury Management Strategy for 2021/22 was approved by full Council on 22nd February 2021.

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APPENDIX 1: Annual Treasury Management Outturn Report 2020/21

1. External Context

1.1 **Economic background:** The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut the Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime. Some good news came in December 2020 as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK vaccine rollout started in earnest; over 31 million people had received their first dose by 31st March.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

Inflation has remained low over the 12 month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation (CPI) fell to 0.4% year/year in February, below expectations (0.8%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 0.7% year/year (1.0% expected). After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower pace than the 41.7% rise in the prior quarter. When released, figures for Q1 (Jan-Mar) 2021 are expected to show a decline given the national lockdown.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

1.2 **Financial markets:** FinancialMonetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

1.3 **Credit background:** After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, albeit Santander UK is still an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The other ringfenced banks were trading around 33 and 34bps while Nationwide Building Society was 43bps.

Credit rating actions to the period ending September 2020 have been covered in previous outturn reports. Subsequent credit developments include Moody's downgrading the UK sovereign rating to Aa3 with a stable outlook which then impacted a number of other UK institutions, banks and local government. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

The vaccine approval and subsequent rollout programme are both credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

2 The Borrowing Requirement and Debt Management

2.1 The Council currently had one £2m LEEF (London Energy Efficient Fund) loan from the European Investment Bank to fund housing regeneration. This loan is below market rate and was taken out in July 2014.

2.2 The LEEF loan is an EIP (Equal Instalment of Principle) loan where each payment includes an equal amount in respect of loan principle throughout the duration of the loan. Therefore the interest due with each payment reduces as the principle is eroded, and so the total amount reduces with each instalment. Consequently, part of the loan is short term in duration, the amount which will be paid via instalments within one year with the remainder of loan maturing beyond 1 year (long term).

2.3 In addition, the Authority had £74.6m in long term external borrowing to finance part of the borrowing requirement within the Housing Revenue Account associated with the delivery of the housing capital programme, particularly in respect of regeneration.

Table 1: Capital Financing Requirement (CFR) & Total External Debt

	Balance as at 31/03/20 £'000	**New Borrowing £'000**	**Debt Maturing £'000**	**Debt Repaid £'000**	**Balance as at 31/03/21 £'000**	**Average Rate %**
CFR	493,014				493,014	
Short Term Borrowing*	45,400	-	-	45,000	400	1.9%
Long Term Borrowing	80,700	-	-	4,500	76,200	1.9%
TOTAL BORROWING	**126,100**	**-**	**-**	**49,500**	**76,600**	
Other Long Term Liabilities	12,528	-	-	882	11,646	
TOTAL EXTERNAL DEBT	**138,628**	-	-	50,382	**88,246**	

2.4 The Council's underlying need to borrow, as measured by the Capital Financing Requirement (CFR), as at 31/03/2021 was provisionally (whilst accounts remain open and unaudited, but no expectation of change) £503m.

2.5 External Borrowing – During the year no new external borrowing was accessed by the council.

3. Investment Activity

3.1 MHCLG's Investment Guidance requires local authorities to focus on security and liquidity, rather than yield.

3.2 Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its

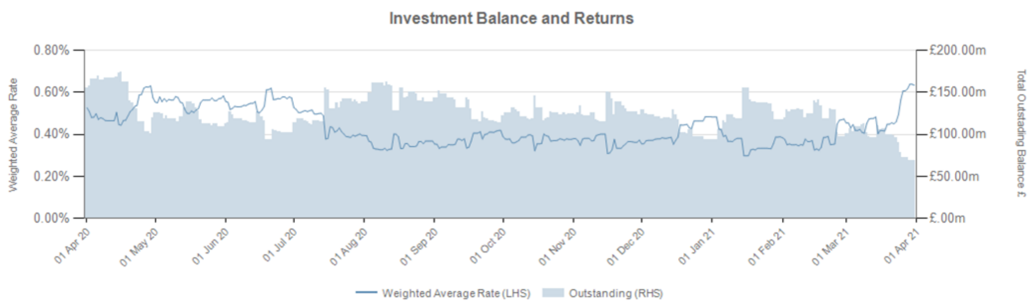
Treasury Management Strategy Statement for 2020/21 Investments during the year included:

- Deposits with other Local Authorities
- Investments in AAA-rated Constant Net Asset Value Money Market Funds
- Investments in AAA-rated Variable Net Asset Value Cash Enhanced Money Market Funds
- Call accounts, deposits and
- Housing Associations

Table 2: Investment Balances

Investments	Balance as at 31/03/20 £'000	Average Rate %	Balance as at 31/03/21 £'000	Average Rate %
Short Term Investments	28,429		18,543	
Long Term Investments	3,700		200	
Housing Associations	15,000		15,000	
Investments in VNAV MMF's (Money Market Funds)	13,000		13,000	
Investments in CNAV MMF's (Money Market Funds)	19,250		22,700	
TOTAL INVESTMENTS	**79,379**	**0.74**	**69,443**	**0.7**

3.3 The Council's investment balance reduced by £10m to £69m at the end of the financial year with weighted average rate (investment return) of 0.7%. The Council is forecasting a further downward trend in cash balances as the Council progresses on a number of major capital schemes requiring forward funding. The movement of cash balances (thick grey block) and yield (thin blue line) throughout the year is represented in the graph below:



3.4 Credit Risk- Counterparty credit quality was assessed and monitored with reference to credit ratings; credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price. The minimum long-term counterparty credit rating determined for the 2020/21 treasury strategy was A- across rating agencies Fitch, S&P and Moody's.

Table 3: Credit Score Analysis

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating
31/03/2020	5.0	A+	5.9	A
30/06/2020	4.9	A+	6.5	A
30/09/2020	4.7	A+	6.0	A
31/12/2020	4.7	A+	6.3	A
31/03/2021	5.3	A+	6.1	A

Scoring: - Aim = AA- or higher credit rating, with a score of 4 or lower, to reflect current investment approach with main focus on security
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 27

3.5 Liquidity - In keeping with the MHCLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds/overnight deposits/call accounts.

3.6 Yield - The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate changed from 0.25% to 0.1% in March 2020.

4. Compliance

4.1 The Council can confirm that it has complied with its Prudential Indicators for 2020/21, which were approved on 15th January 2020 as part of the Council's Treasury Management Strategy Statement.

4.2 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2020/21. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

4.3 The Authority can confirm that during 2020/21 it complied with its Treasury Management Policy Statement and Treasury Management Practices. However, the Audit Committee will be aware that the 2020/21 accounts at this point remain open and unaudited. There is therefore the possibility that changes to the numbers could occur but this is not expected.

5. Prudential Indicators

5.1 Capital Financing Requirement (CFR)

The Council's cumulative maximum external borrowing requirements for 2018/19 to 2021/22 are shown in the table below.

	31/03/19 Actual £'000	31/03/20 Actual £'000	31/03/21 Estimated outturn £'000	31/03/22 Estimated £'000
Gross CFR	484,185	493,014	503,314	478,718
Less: Other Long Term Liabilities	13,349	12,528	11,646	10,697
Borrowing CFR	**470,836**	**480,486**	**491,669**	**468,021**
Less: Existing Profile of Borrowing	84,841	126,008	76,536	75,000
Gross Borrowing Requirement/Internal Borrowing	**385,995**	**354,478**	**415,133**	**393,021**
Usable Reserves	324,598	276,176	270,000	250,000
Net Borrowing Requirement/(Investment Capacity)	**61,397**	**78,302**	**145,133**	**143,021**

In the Prudential Code Amendment (November 2012), it states that the Chief Finance Officer should make arrangements for monitoring with respect to gross debt and the capital financing requirement such that any deviation is reported to him/her, since any such deviation may be significant and should lead to further investigation and action as appropriate.

	2018/19	**2019/20**	**2020/21**	**2021/22**
	Actual	**Actual**	**Estimate**	**Estimate**
	£'000	**£'000**	**£'000**	**£'000**
Gross Debt	98,190	138,536	88,182	85,697
CFR	484,185	493,014	503,314	478,718
Borrowed in excess of CFR? (Y/N)	N	N	N	N

5.2 Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

- The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.

- The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

- The Group Director of Finance and Corporate Resources confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year.

	Operational Boundary (Approved) as at 31/03/21 £'000	**Authorised Limit (Approved) as at 31/03/21 £'000**	**Actual External Debt as at 31/03/21 £'000**
Borrowing	502,000	532,000	76,536
Other Long-term Liabilities	20,000	20,000	11,646
Total	**522,000**	**552,000**	**88,182**

(b) Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on Council tax and in the case of the HRA, housing rent levels.

	2019/20 Actual £000	**2020/21 Estimate £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**
Capital Expenditure					
Housing	122,120	91,414	114,000	293,000	251,000
Non-Housing	108,346	110,715	83,000	147,000	113,000
Total spend	**230,466**	**202,129**	**197,000**	**440,000**	**364,000**

Current capital expenditure financing is as per the table below. However further review of the capital programme will be happening during 2021/22 financial year meaning configuration of numbers below are likely to change. The Prudential borrowing line below relates primarily to regeneration schemes.

Capital Financing	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Prudential Borrowing	38,933	71,339	56,000	334,000	231,000
S106/CIL	7,590	8,661	12,000	4,000	0
Capital receipts	104,655	44,975	38,000	11,000	42,000
Grants	25,879	27,724	39,000	22,000	23,000
Reserves/ Discretionary	-	4,813	4,000	4,000	3,000
RCCO	53,409	44,618	48,000	65,000	65,000
Total Financing	**230,466**	**202,129**	**197,000**	**440,000**	**364,000**

The above table shows that the capital expenditure plans of the Authority could not be funded entirely from sources other than borrowing.

(c) Ratio of Financing Costs to Net Revenue Stream

- This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs.
- The ratio is based on costs net of investment income.
- The 20/21 number here is provisional whilst the accounts remain open, and 2021/22 to 2023/24 numbers will be updated again in this financial year prior to year-end.

Ratio of Financing Costs to Net Revenue Stream	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Non-HRA	1.0%	0.8%	1.0%	1.1%	1.2%
HRA	30%	32%	32%	32%	32%

(d) **Adoption of the CIPFA Treasury Management Code**

This indicator demonstrates that the Authority adopted the principles of best practice via approval of the CIPFA Treasury Management Code

Appendix 2 – Treasury Management Update Report

Treasury Management Activities from June 2021 to August 2021

1. Economic Highlights

1.1 **Growth:** First estimates for the second Quarter of 2021 suggest that GDP increased in all three months leading to an overall 4.8% Q-o-Q increase. The largest contributor to this growth in GDP was household consumption likely due to the gradual easing of lockdown restrictions over the period. There were also increases in every other main component of GDP except for trade.

1.2 **Inflation:** CPI rate 2.0% year-on-year for July 2021 (June 2021 2.5%). The headline July CPI rate was lower than expected, thanks to downward contributions from 9 of the 12 main divisions. The largest downward contribution from recreation and culture (data processing equipment). These were partially offset from an upward contribution from transport. We continue to believe that retailers' ability to pass higher costs onto consumers in a sustained manner is limited, so while the CPI rate may continue to rise in the coming months, we expect this will moderate towards year end as base effects strengthen.

1.3 **Labour Market:** The Labour Force Data for the three months to June 2021 showed some change to the previous quarter's readings. The estimated employment rate increased by 0.3 percentage points on the quarter to 75.1% while the unemployment rate declined by 0.2 percentage points on the quarter to 4.7%.

1.4 **Monetary Policy Committee:** At its meeting on 4th August 2021, the MPC voted unanimously to maintain the Bank Rate at 0.1% and the stock of sterling non-financial investment-grade corporate bond purchases at £20 billion. The Committee voted by a majority of 7-1 for the Bank of England to continue with the existing programme of UK government bond purchases, maintaining the target stock at £875 billion. This leaves the total target stock of asset purchases at £895 billion.

2. Borrowing & Debt Activity

2.1 The Authority currently has £75.1m in external borrowing. This is made up as a single LEEF loan of £1.8m from the European Investment Bank to fund housing regeneration and £73.3m borrowed from Public Work Loan Board for housing capital programme, particularly in respect of housing regeneration.

3. Investment Policy and Activity

3.1 The Council held average cash balances of £75 million during the reported period, compared to an average £127 million for the same period last financial year.

Movement in Investment Balances 01/06/21 to 31/08/21

	Balance as at 01/06/2021 £'000	Average Rate of Interest %	Balance as at 31/08/2021 £'000	Average Rate of Interest %
Short Term Investments	18,551	-	18,545	-
Long Term Investments	200	-	200	-
Housing Associations	15,000	-	15,000	-
Investments in VNAV MMF's (Money Market Funds)	13,000	-	13,000	-
Investments in CNAV MMF's (Money Market Funds)	58,049	-	19,100	-
	104,800	**0.8**	**65,845**	**0.5**

3.2 Due to the volatility of available creditworthy counterparties, longer and short term investments have been placed in highly rated UK Government institutions, thus ensuring creditworthiness of investments.

4. Counterparty Update

4.1 Fitch has revised the United Kingdom's outlook to Stable from Negative and affirmed the short and long-term sovereign ratings. Arlingclose remains comfortable with their clients making investments of unlimited amounts for up to 50 years with the UK Government, including the Debt Management Account Deposit Facility, treasury bills and gilts.

4.2 Arlingclose advises against new lending to the Slough Borough Council for treasury management purposes while their legal power to enter into new agreements is unclear. There is no need to recall existing loans. We have currently no investments with Slough Borough Council.

4.3 Fitch has revised the outlook of Coventry Building Society, Yorkshire Building Society and Leeds Building Society to Stable from Negative. The long-term and short-term ratings have been affirmed. Arlingclose continues to advise clients not to make deposits with Coventry Building Society, Yorkshire Building Society and Leeds Building Society.

4.4 Whilst the ongoing investment strategy remained cautious counterparty credit quality remains strong, as can be demonstrated by the Credit Score Analysis summarised below:

5. Credit Score Analysis

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating Score	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating Score
30/06/2021	A+	5.4	A+	5.4
31/07/2021	A+	5.5	A-	6.6
31/08/2021	A+	5.4	A	6.2

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 27
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

5.1 The Council continues to utilise AAAmmf/Aaa/AAAm rated Money Market Funds for its very short, liquidity-related surplus balances. This type of investment vehicle has continued to provide very good security and liquidity, although yield suffers as a result.

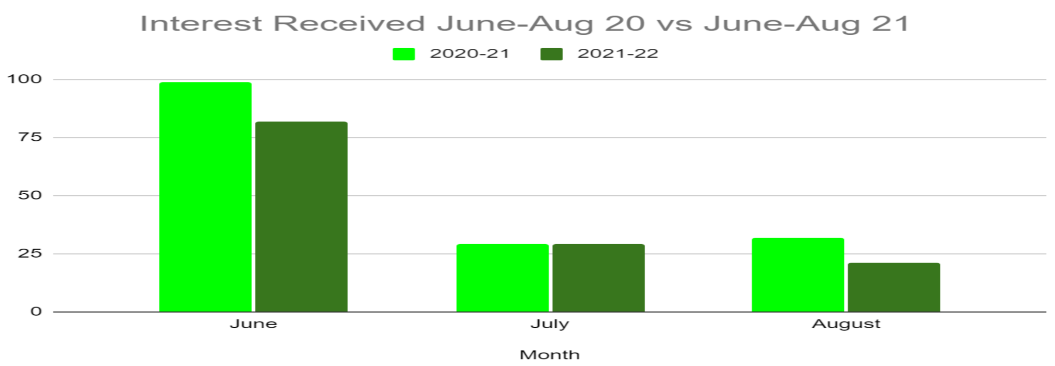
5.2 In light of legislative changes and bail-in risk for unsecured bank deposits, as set out in previous monitoring reports, the Council continues to invest in highly rated UK Government institutions, Building Society and Housing Associations. This investment vehicle offers a good level of security and increases diversification for the Council's portfolio whilst achieving a reasonable yield.

6. Comparison of Interest Earnings

6.1 The Council continues to adopt a fairly cautious strategy in terms of investment counterparties and periods. Due to the volatility of available creditworthy counterparties, longer term and short term investments have been placed in highly rated UK Government institution and Housing Associations, thus ensuring creditworthiness whilst increasing yield's through the duration of the deposits.

6.2 The graph below provides a comparison of interest earnings for June 2021 and August 2021 against the same period for 2020/21.

6.3 Average interest received for the period June 2021 to Aug 2021 was £44k compared to £53k for the same period last financial year. Less interest received this year is a clear indication of falling interest rates.



7. Movement in Investment Portfolio

7.1 Investment levels have decreased to £66 million at the end of Aug 2021 in comparison to the end of Aug 2020 last year of £139 million. It is anticipated that overall levels of investment balance will reduce as and when the capital programmes are delivered, although we need to maintain liquidity for day-to day operational purposes.