Agenda Item No. 11

THE VALE OF GLAMORGAN COUNCIL

CORPORATE PERFORMANCE AND RESOURCES SCRUTINY COMMITTEE: 16TH DECEMBER, 2020

REFERENCE FROM CABINET: 30TH NOVEMBER, 2020

“C399 TREASURY MANAGEMENT MID-YEAR REPORT 2020/21 (EL/PR) (SCRUTINY – CORPORATE PERFORMANCE AND RESOURCES) -

The Leader presented the report, the purpose of which was to provide a mid-year report on the Authority's Treasury Management operations for the period 1st April 2020 to 30th September 2020.

The interim report provided an update on the Authority's Treasury Management operations for the period 1st April to 30th September 2020. All activities were in accordance with the Authority's approved strategy on Treasury Management. Total external borrowing as at 30th September 2020 was £151.140m at an average rate of 4.679%. No new external borrowing was undertaken during the first 6 months of 2020/21. The Council invested with the Debt Management Deposit Facility, Local Authorities and Money Market Funds. Total investments as at 30th September 2020 stood at £100.500m at an average rate of 0.562%.

The Authority ensured that the Prudential Code was complied with, which had been developed by CIPFA as a professional code of practice. To demonstrate the Council had fulfilled these objectives, the Code set out prudential indicators that should be used and the factors that must be taken into account. The Council fully complied with these prudential indicators during the first 6 months of 2020/21.

Following the Debt Management Office (DMO) announcement on the 25th September 2020 that they would be offering negative terms on deposits, the Authority started utilising a broader range of investment tools reducing its use of DMO deposits and investing in Money Market Funds and making deposits with Lloyds Bank PLC, in line with the options available in the 2020/21 Treasury Management and Investment Strategy. The Treasury Management team also requested an increase in the financial limit for investments with UK institutions and Banks from £5m to£10m to facilitate increased use of these tools and this was approved using Emergency Powers on the 28th September 2020.

As a result of the Coronavirus pandemic both the UK's Sovereign and the Authority's banker's Lloyds Bank PLC have had their long-term credit ratings reduced during this reporting period. The reduction of the Sovereign rating to "Aa3 from Aa2" meant that the UK was still judged to be of high quality and subject to very low credit risk. Lloyds Bank PLC had had its credit rating reduced to "A1 from Aa3" and was now judged to be upper medium grade and subject to low credit risk. The revised rating still met the Authority's minimum credit rating criteria for investment. The Authority's Treasury advisers, Link Asset Services, had reduced the advised maximum maturity period for investments with Lloyds from 12 months to 6 months following this downgrading.

Historically the Authority had used the 3-month London Interbank Bid Rate (LIBID) to calculate interest to be charged on internal borrowing. This rate would cease to exist from 2021 and therefore interest on internal borrowing from 2020/21 onwards would be calculated using the Sterling Overnight Interest Average Rate (SONIA).

External Borrowing rates of interest from the Public Works Loan Board was currently under review following a consultation with local authorities. The Authority intended to refrain from any external borrowing until the outcome of the consultation was determined. This position would be kept under review by the Section 151 Officer.

This was a matter for Executive decision.

Cabinet, having considered the report and all the issues and implications contained therein

RESOLVED –

(1) T H A T the Treasury Management mid-year report for the period 1st April 2020 to 30th September 2020 be accepted.

(2) T H A T the latest Treasury Management indicators be agreed.

(3) T H A T the report be referred to the next Corporate Performance and Resources Scrutiny Committee for consideration.

(4) T H A T the use of Money Market Funds and Lloyds Bank Instant Access Accounts as investment tools be noted.

(5) T H A T the changes to the investment limits be noted and agreed.

(6) T H A T the report be referred to Council for approval.

<u>Reasons for decisions</u>

(1) To present the Treasury Management mid-year report as required by the CIPFA Treasury Management in the Public Services: Code of Practice.

(2) To present an update of the Treasury Management indicators which are included in the Treasury Management Strategy.

(3) To present this report to the Corporate Performance and Resources Scrutiny Committee.

(4) To ensure Members are aware of current Treasury Management practices.

(5) To ensure Members are aware of changes to the Treasury Management strategy.

(6) To comply with the Treasury Management Strategy."

Attached as Appendix – Report to Cabinet: 30th November, 2020

Agenda Item: 13

Meeting of:	**Cabinet**
Date of Meeting:	**Monday, 30 November 2020**
Relevant Scrutiny Committee:	Corporate Performance and Resources
Report Title:	Treasury Management Mid - Year Report 2020/21
Purpose of Report:	To provide a mid-year report on the Authority's Treasury Management operations for the period 1st April 2020 to 30th September 2020.
Report Owner:	Executive Leader and Cabinet Member for Performance and Resources
Responsible Officer:	Carys Lord, Head of Finance / Section 151 Officer
Elected Member and Officer Consultation:	None
Policy Framework:	This report needs to be referred to Council for approval.

Executive Summary:

- This interim report provides an update on the Authority's Treasury Management operations for the period 1st April to 30th September 2020. All activities were in accordance with the Authority's approved strategy on Treasury Management. Total external borrowing as at 30th September 2020 was £151.140m at an average rate of 4.679%. No new external borrowing was undertaken during the first 6 months of 2020/21. The Council invested with the Debt Management Deposit Facility, Local Authorities and Money Market Funds. Total investments as at 30th September 2020 stood at £100.500m at an average rate of 0.562%.
- The Authority must ensure that the Prudential Code is complied with, which has been developed by CIPFA as a professional code of practice. To demonstrate the Council has fulfilled these objectives, the Code sets out prudential indicators that should be used and the factors that must be taken into account. The Council fully complied with these prudential indicators during the first 6 months of 2020/21.
- Following the Debt Management Office (DMO) announcement on the 25th September 2020 that they would be offering negative terms on deposits, the Authority has started utilising a broader range of investment tools reducing its use of DMO deposits and investing in Money Market Funds and making deposits with Lloyds Bank PLC, in line with the options available in the 2020/21 Treasury Management and Investment Strategy. The Treasury Management team also requested an increase in the financial limit for investments with UK institutions and Banks from £5m to

£10m to facilitate increased use of these tools and this was approved using Emergency Powers on the 28th September 2020.

- As a result of the Coronavirus pandemic both the UK's Sovereign and the Authority's banker's Lloyds Bank PLC have had their long term credit ratings reduced during this reporting period. The reduction of the Sovereign rating to "Aa3 from Aa2" means that the UK is still judged to be of high quality and subject to very low credit risk. Lloyds Bank PLC has had its credit rating reduced to "A1 from Aa3" and is now judged to be upper medium grade and subject to low credit risk. This revised rating still meets the Authority's minimum credit rating criteria for investment. The Authority's Treasury advisers, Link Asset Services, have reduced the advised maximum maturity period for investments with Lloyds from 12 months to 6 months following this downgrading.
- Historically the Authority has used the 3 month London Interbank Bid Rate (LIBID) to calculate interest to be charged on internal borrowing. This rate will cease to exist from 2021 and therefore interest on internal borrowing from 2020/21 onwards will be calculated using the Sterling Overnight Interest Average Rate (SONIA).
- External Borrowing rates of interest from the Public Works Loan Board is currently under review following a consultation with local authorities. The Authority intends to refrain from any external borrowing until the outcome of the consultation is determined. This position will be kept under review by the Section 151 Officer.

Recommendations

1. That the Treasury Management mid-year report for the period 1st April 2020 to 30th September 2020 be considered.
2. That the latest Treasury Management indicators be considered.
3. That the report be forwarded to the next Corporate Performance & Resources Scrutiny Committee for consideration.
4. That Cabinet notes the use of Money Market Funds and Lloyds Bank Instant Access Accounts as investment tools.
5. That the changes to the investment limits be noted.
6. That the report be forwarded to Council for approval.

Reasons for Recommendations

1. To present the Treasury Management mid-year report as required by the CIPFA Treasury Management in the Public Services: Code of Practice.
2. To present an update of the Treasury Management indicators which are included in the Treasury Management Strategy.
3. To present this report to the Corporate Performance & Resources Scrutiny Committee.
4. To ensure members are aware of current Treasury Management practices.
5. To ensure members are aware of changes to the Treasury Management strategy.
6. To comply with the Treasury Management Strategy

1. Background

Capital Strategy

1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities have been required to prepare a Capital Strategy which is to provide the following: -

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed; and
- The implications for future financial sustainability.

1.2 The Council's Capital Strategy was approved by Council on 26th February 2020, min 710 refers.

Treasury Management

1.3 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.4 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:
"The management of the local authority's borrowing, 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."

2. Key Issues for Consideration

2.1 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).

2.2 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 Corporate Resources & Performance Scrutiny Committee.

2.3 This mid-year report covers the following:

- An economic update for the first part of the 2020/21 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy for 2020/21;
- A review of the Council's capital expenditure and prudential indicators;
- A review of the Council's investment portfolio for 2020/21;
- A review of the Council's borrowing strategy for 2020/21;
- A review of any debt rescheduling undertaken during 2020/21; and
- A review of compliance with Treasury and Prudential Limits for 2020/21.

Economic Review

UK Economic Review

2.4 The fall in Gross Domestic Product (GDP) in the first half of 2020 was revised from originally -28% to -21.8%. 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 as a result of the COVID-19 pandemic.

2.5 The Bank of England's Monetary Policy Committee (MPC) Bank Rate remained unchanged on 6th August 2020. It also kept unchanged the level of quantitative easing at £745bn.

2.6 The forecast peak in the unemployment rate in the UK was revised down from 9% in Q2 to 7½% by Q4 2020.

2.7 The MPC forecast is that there will be excess demand in the economy by Q3 2022 causing Consumer Price Index (CPI) inflation to rise above the 2% target in Q3 2022.

2.8 The MPC squashed any idea of using negative bank base rates, at least in the next six months to 12 months. 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 quantitative easing and the use of forward guidance.

2.9 The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the turn of the calendar 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.

2.10 Indications suggest that 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. The way in which second waves of the virus are now impacting many countries including Britain, illustrates these challenges.

2.11 In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery.

2.12 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 after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending. The uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. 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 quantitative easing.

2.13 There will be some painful longer term adjustments e.g. use of 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 highlighted how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

2.14 One key addition to the Bank's 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 the level of inflation is going to be persistently above target if it takes no action to raise Bank Rate.

2.15 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%.

USA Economic Review

2.16 The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by continuing outbreaks of the virus in some states leading to fresh localised restrictions

2.17 At its end of August meeting, the Federal Bank tweaked its inflation target from 2% to maintaining an average of 2% over an unspecified time period. This change is aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary trap like Japan.

2.18 The Federal Open Market Committee's updated economic and rate projections in mid-September showed that officials expect to leave the federal funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Federal Bank has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

Eurozone Economic Review

2.19 The Eurozone economy was recovering well towards the end of Q2 2020 after a sharp drop in GDP. However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries.

2.20 The European Central Bank has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.

China Economic Review

2.21 After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in Q2 2020 and has enabled it to recover all of the contraction in Q1 2020. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

Japan Economic Review

2.22 There are some concerns that a second wave of the virus is gaining momentum and could dampen economic recovery from its contraction of 8.5% in GDP. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

World Growth

2.23 Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Interest Rate Forecasts

2.24 The Council's Treasury Advisor, Link Asset Services, has provided the following forecasts on the 11th August 2020, Public Works Loan Board (PWLB) rates are certainty rates, gilt yields plus 180 basis points.

Link Group Interest Rate View 11.8.20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

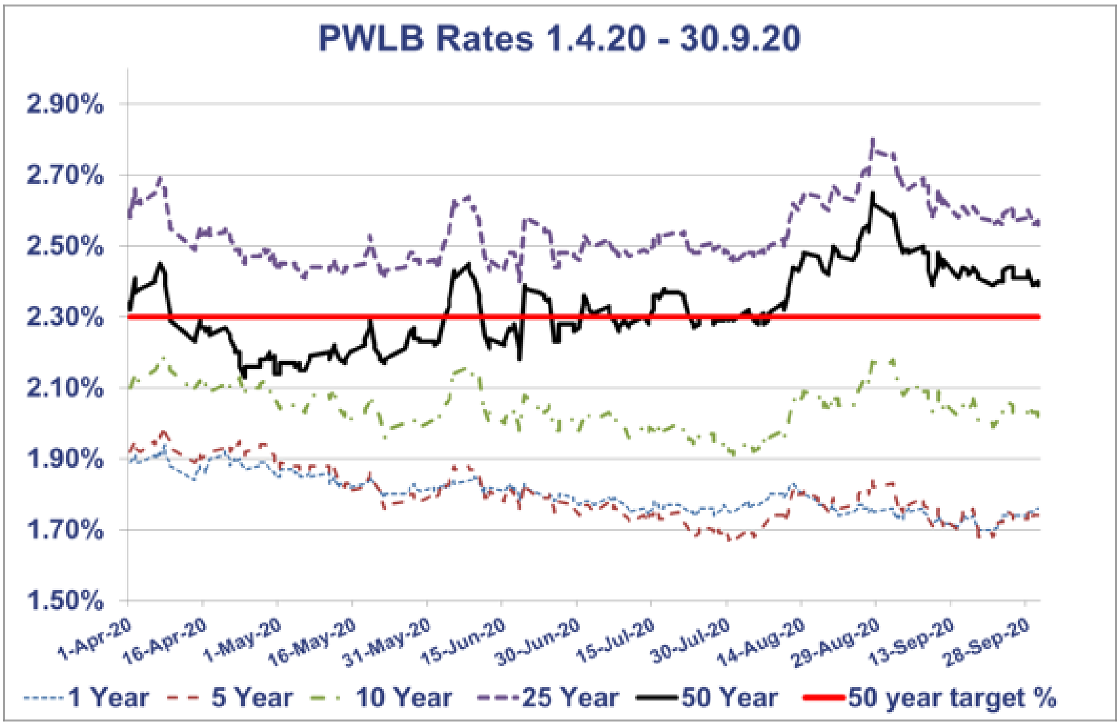
2.25 The coronavirus outbreak has done huge economic damage to the UK and economies around the world, as outlined above. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September meeting), although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

2.26 From the local authority borrowing perspective, HM Treasury imposed two changes of margins over gilt yields for Public Works Loan Board (PWLB) rates in 2019/20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then at least partially reversed for some forms of borrowing, namely the Housing Revenue Account (HRA) on 11th March 2020, but not for mainstream General Fund capital schemes. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was to end on 4th June 2020, but that date was subsequently put back to 31st July 2020. The outcome of the consultation is not yet known. It is clear HM Treasury will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

2.27 Following the changes on 11th March 2020 in margins over gilt yields, the current certainty rates are as follows:

PWLB Standard Rate is gilt plus 200 basis points (G+200bps)
PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
Local Infrastructure Rate is gilt plus 60bps (G+60bps)

2.28 The graph below sets out the PWLB interest rates between over the period of the report (April 2020 to September 2020).



2.29 As the interest forecast table for PWLB certainty rates above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

The Balance of Risks to the UK

2.30 The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus.

2.31 There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

Treasury Management Strategy 2020/21

2.32 Council approved the 2020/21 Treasury Management Strategy Statement (TMSS) at its meeting on 26th February 2020 minute no 713.

2.33 The Authority's investment strategy is to secure the best return on its investments whilst having regard to capital security within the parameters laid down.

2.34 In line with the Authority's existing borrowing strategy the revised estimate for new loans required to support the capital programme for 2020/21 is £9.570M (£3.393M supported). This sum will fluctuate dependent on the delivery of the capital programme. The net increase in the capital financing requirement after adjusting for Minimum Revenue Provision is £4.380m as set out in the table 2.37 below.

2.35 Given the current and projected level of Council reserves, the current low interest environment with some counterparties offering negative interest rates and the potential risks associated with Brexit, it is likely that the sum required will now be internally borrowed during 2020/21. If there is a requirement to borrow externally from the PWLB, due to the increase in PWLB margins over gilt yields in October 2019, and the subsequent consultation on these margins by HM Treasury ending on 31st July 2020, the Authority will refrain from undertaking new long-term PWLB borrowing for the present until the new PWLB margins are finally determined.

2.36 The effect of coronavirus on the capital programme objectives are being assessed, therefore, the Authority's borrowing strategy will be reviewed and then revised in order to achieve optimum value and risk exposure in the long-term.

2.37 Council officers in conjunction with the treasury advisors continually monitor the prevailing interest rates and the market forecasts and adopt a pragmatic approach to changing circumstances in respect of its borrowing needs.

2.38 The Head of Finance (Section 151 Officer) is pleased to report that all Treasury Management activity undertaken during the period complied with the approved strategy, the CIPFA Code of Practice and the relevant legislative provisions.

2.39 Following the Debt Management Office (DMO) announcement on the 25th September 2020 that they would be offering negative terms on deposits, the Authority has started utilising a broader range of investment tools and have invested in Money Market Funds and have set up two instant access accounts with Lloyds Bank PLC. To reflect the changing investment market the Treasury Management Team submitted an Emergency Powers which was approved on 28th September 2020 and increased the financial limit of investment with UK institutions and Banks from £5m to £10m. This enabled the Council to increase its use of Money Market Funds up to £10m per institution and also increase deposits with Lloyds Bank up to £10m. The use of these investment limits are in accordance with advice from the Council's Investment Advisors Link Asset Management Ltd and will be kept under regular review by the Section 151 Officer.

2.40 With the exception of the Emergency Powers request outlined above, there are no other policy changes to the TMSS. The details in this report update the position in the light of the updated economic position and budgetary changes which were already approved.

2.41 In light of the Coronavirus pandemic a decision was taken by CIPFA to delay the introduction of the IFRS16 Leasing standard until April 2021 therefore the 2020/21 prudential indicators do not need to be revised for the additional financial liabilities brought onto the Council's balance sheet in light of the introduction of this standard as had previously been indicated. Work is ongoing to establish values for the lease liabilities in accordance with the standard and to agree an acceptable de minimus policy for low value leases with Audit Wales in accordance with the standard. Whilst it is not expected that the introduction of this standard will impact the bottom line of the Council's balance sheet the standard will attempt to quantify the additional debt that the Council commits to when it enters into leasing agreements which is set against a controllable asset for the period, for example leased properties such as Hen Goleg or Victoria School. A more detailed report will be presented to Audit Committee to outline the Council's approach to implementing the standard and the likely impact on the Council's accounts.

Prudential Indicators

2.42 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2020, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2020/21. The Head of Finance (Section 151 Officer), reports that no difficulties are envisaged for the current or future years in complying with these indicators.

2.43 This table shows a comparison of the original capital programme as agreed by Authority on the 26th February 2020 with the revised capital budget as proposed in a report elsewhere on this agenda

Capital Expenditure by Service	**2020/21 Original Estimate £m**	**2020/21 Revised Estimate £m**
Learning & Skills	71.022	57.249
Social Services	0.100	1.052
Environmental & Transport	9.608	19.629
Managing Director & Resources	4.785	9.499
City Deal	1.313	1.313
Housing Revenue Account	27.047	20.224
Total Capital Expenditure	**113.875**	**108.966**

Changes to the Financing of the Capital Programme

2.44 The table below shows the main sources of funding for the capital expenditure plans shown above, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Sources of Capital Financing	**2020/21 Original Estimate £m**	**2020/21 Revised Estimate £m**
Total Capital Expenditure	113.875	108.966
Financed by:		
GCF Grant	3.403	3.403
GF Reserves & Revenue	12.714	13.481
HRA Reserves & Revenue	5.665	14.840

S106	12.554	10.050
Welsh Government Grant / Grants	52.352	50.932
Capital Receipts (General & HRA) and Appropriations	3.717	6.690
Total Financing	90.405	99.361
Prudential Borrowing Requirement	**20.077**	**6.177**
Supported Borrowing Requirement	**3.393**	**3.393**

Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

2.45 The table below shows the CFR, which is the underlying external need for the Council to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary. The Authority is expected not to achieve the original CFR estimate for 2020/21 due primarily to a decrease in the estimated borrowing for the Housing Revenue Account (HRA).

	2020/21 Original Estimate £m	**2020/21 Revised Estimate £m**
Prudential Indicator – the Capital Financing Requirement		
CFR – Non Housing	122.002	123.800
CFR – HRA	94.737	79.680
Total CFR	216.739	203.480
Borrowing Requirement		9.570
Less Minimum Revenue Provision		(5.190)
Net movement in CFR		**4.380**
Prudential Indicator – the Operational Boundary for External Debt		
Borrowing	221.461	206.879
Other Long Term Liabilities	0	0
Total Debt (Year End Position)	**221.461**	**206.879**

Limits to Borrowing Activity

2.46 A key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. The figure shown below reflects the Council's current strategy as outlined in paragraph 2.27 of this report in respect of maximising internal borrowing.

	2020/21 Original Estimate £m	**2020/21 Revised Estimate £m**
External Net Borrowing	174.122	157.017
Other Long Term Liabilities	0	0
Total Debt	174.122	157.017
CFR (Year End Position)	**216.739**	**203.480**

No difficulties are envisaged for the current or future years in complying with this prudential indicator.

The Authorised Limit

2.47 The Authorised Limit represents that limit beyond which borrowing is prohibited, and this needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	**2020/21 Original Indicator £m**	**2020/21 Revised Indicator £m**
Borrowing	228.394	216.682
Other long term liabilities	0	0
Total	**228.394**	**216.682**

Interest Rate Exposure

2.48 This indicator is set to control the Authority's exposure to interest rate risk. The exposures to fixed and variable rate interest rates, expressed as an amount of net principal borrowed were:

	Limit (£m)	Actual (£m)	Met
Upper limit on fixed rate exposures	151.140	145.040	✓
Upper limit on variable rate exposures	0	0	✓

2.49 Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that either mature during the financial year or have a floating interest rate are classed as variable rate.

Maturity Structure of Borrowing

2.50 This indicator is set to control the Authority's exposure to refinancing risk. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The maturity structure of fixed rate borrowing as at 30th September 2020 was:

	Upper Limit	**Lower Limit**	**Actual**	**Met**
Under 12 months	20%	0%	0.92%	✓
12 months and within 24 months	20%	0%	5.21%	✓
24 months and within five years	30%	0%	16.17%	✓
Five years and within 10 years	40%	0%	15.25%	✓
10 years and above	100%	0%	62.45%	✓

Investments

2.51 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

2.52 The Authority has made the following investments for the period 1st April 2020 to 30th September 2020 as set out below:-

Investment Counterparty	**Opening Balance**	**Invested**	**Returned**	**Closing Balance**
	01/04/2020			**30/09/2020**
	£m	**£m**	**£m**	**£m**
UK Local Authorities	87.000	150.000	(139.500)	97.500
Debt Management Office	11.000	1,729.450	(1,740.450)	0.00
Money Market Funds (MMF)	0.000	3.000	0.000	3.000
Total	**98.000**	**1,882.450**	**(1,879.950)**	**100.500**

2.53 Interest, at an average rate of 0.562% and amounting to £277,263 has been received from these investments during the first 6 months of 2020/21.

2.54 As can be seen from the table above, the Authority had initially in the year invested mainly with UK local authorities and the Debt Management Office (DMO). The Council indicated in its investment strategy for 2020/21 that it intended to utilise a broader mix of investment tools to maximise return for the Council including Treasury Bills, Money Market Fund Deposits and deposits with Banks. Following the DMO's announcement on the 25th September 2020 that they would be offering negative terms on deposits, the Authority started utilising the Money Market Accounts and set up two Instant Access accounts with Lloyds Bank PLC.

2.55 This strategy is considered prudent considering the continuing pressures in the financial markets, the negative rates on offer from the DMO and other counterparties, the threat of bail in for fixed term investments with banks and the remaining uncertainty of Brexit. The Head of Finance (Section 151 Officer) will continue to have regard to the security and liquidity of the investments before seeking the highest rate of return or yield.

2.56 The Council will continue working with the treasury management adviser to consider other investment tools and keep the existing tools and counterparties under review to maximise return without otherwise compromising security.

Borrowing

2.57 The Council's estimated revised CFR for 2020/21 is £203.480m. 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).

2.58 The following table sets out the monies externally borrowed / repaid during the period.

Loan Type	**Opening Balance**	**Received**	**Repaid**	**Closing Balance**
	01/04/2020			**30/09/2020**
	£m	**£m**	**£m**	**£m**
PWLB	145.210	0	(0.670)	144.540
Other Long Term Loans	6.000	0	0	6.000
Temporary Loans	0.100	0	0	0.100
WG Loans	2.600	0	(2.100)	0.500
Total	**153.910**	**0**	**(2.770)**	**151.140**

- Loans borrowed from the PWLB are intended to assist local authorities in meeting their longer term borrowing requirements. The above loans are all at fixed rates of interest. The rate paid on each loan is largely dependent upon the original duration of the loan and date taken out. The loans taken out for the Housing Revenue Account Subsidy buyout were at a predetermined range of rates specified by HM Treasury.
- Other long term loans represent those non-PWLB loans that are repayable at least 1 year or more from the date they are advanced. The bulk of this debt is represented by two market loans of £2,000,000 and £4,000,000.
- Temporary loans represent those loans that are borrowed for a period of less than 1 year. They are borrowed on 7 day notice.
- Welsh Government (WG) Loan is made up of two interest free loans provided by WG, one of these was repaid during this financial year the other is expected to be repaid in December 2021.

2.59 External interest at an average rate of 4.679% and amounting to £3,586,448 has been paid on these loans during the first 6 months of 2020/21.

2.60 As outlined in paragraph 2.19 and 2.26 of this report Councils are currently awaiting the outcome of the PWLB consultation, given the current raised levels of PWLB borrowing rates. In light of this and the current low and in some cases negative returns in the investment market it is the advice of the Council's independent Treasury Management advisor Link Asset Management Ltd. that the Council should continue to maximise internal borrowing where possible. The Section 151 Officer will continue to liaise with Link Asset Management and will keep the position in respect of the Council's borrowing strategy and potential PWLB borrowing under review. As at the 30th September 2020 it is estimated that the Authority will have internally borrowed in excess of £46m at 31st March 2021 to finance the capital programme. If the outcome of the PWLB consultation is not known in 2020/21 this approach could require the Council's internal borrowing to increase by an additional £6m to £52.465m. This position will be kept under review by the Section 151 Officer, and advice sought from Link as required. An update shall be included in the Treasury Management and Investment Strategy 2021/22.

2.61 Historically interest on internal borrowing that is not supported by a revenue stream has been charged using the estimated average 3 month LIBID rate but as it is expected that this rate will cease to exist in 2021, it is proposed that interest will from 2020/21 onwards be calculated using the Sterling Overnight Interest Average rate (SONIA). The average rate calculated to the 30th September is 0.0532%.

2.62 SONIA rates were introduced in the March 1997 and was reformed by the Bank of England in 2018 to provide a benchmark that complies with the international best practice. The use of London Interbank Bid Rate (LIBID) will continue in the financial markets until it is phased out in 2021. However, Link Group Market Services, the Councils Treasury Management Advisors have stated that they would expect that most investors may well use the Term SONIA rates as their investment benchmarks, as these would reflect their own circumstances (cash flow, liquidity requirements, their own interest rate outlook etc.) as well as market expectations of policy rates as at the point of investment.

2.63 Internal Borrowing currently represents a far cheaper alternative to borrowing externally for the Council and is affordable given the current and projected level of reserves. The estimated total interest to be charged to revenue for internal borrowing for pooled loans for 2020/21 is £18,461.

2.64 When pooling the interest charges for external & internal borrowing, the average rate charged to the Council to deliver the capital programme is estimated to be 3.76%.

2.65 In addition the Council has previously internally borrowed for the Local Government Borrowing Initiative (LGBI) for 21st Century Schools, Affordable Housing & Highways initiatives. The interest to be charged for this element of the internal borrowing for 2020/21 is £370,590.

Debt Rescheduling

2.66 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

Changes in Risk Appetite

2.67 The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members’ attention in treasury management update reports.

Treasury Bills

2.68 The Authority has not placed any deposits with the UK Government in Treasury Bills as the returns have not been favourable and have gone negative during the accounting period under review.

Money Market Funds

2.69 The 2018 No.325 (W.61) Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 have been issued which have introduced some changes to the treatment of certain types of treasury management investments. Paragraph 9 of the regulations now makes clear that the following types of investment are not to be treated as being capital expenditure:

- A treasury investment involving the acquisition of loan capital, through a bond issued via grant or for financial assistance for a capital purpose will remain capital expenditure;
- An investment in a money market fund;
- An investment in the shares of a company to which Part 12 of the Corporation Tax Act 2010(1) (real estate investment trusts) applies; and
- The acquisition of shares in an investment scheme approved by the Treasury under section 11(1) of the Trustee Investments Act 1961(2) (local authority investment).

2.70 The Authority opened a Money Market Fund with Federated Hermes (UK) LLP and placed an initial deposit on the 30th September 2020. Federated has made a commitment to keep the rate it is paying on MMF deposits positive (even if the fund is paying a negative return) by waiving fees, whilst the Bank of England's rate remains positive

2.71 An emergency powers was approved on 28th September 2020 that increased the short term limit for UK institutions to £10m per institution therefore the Council can deposit sums of up to £10m with each money market fund.

2.72 An initial deposit was also placed with CCLA in the Public Sector Deposit Fund on 2nd November 2020.

2.73 Both funds are domiciled in the UK and their funds rated 'AAAmmf' (highest credit quality) by the Fitch credit rating agency. Funds to a maximum of £10m may be invested in each fund in accordance with the Council's revised counterparty limits.

2.74 As part of the agreement with Lloyds Bank, the Council is asked on an annual basis to sign a set off agreement which includes accounts that are in our overdraft agreement. The agreement gives the bank the right at any time and without notice to combine or consolidate all of these accounts with any of our liabilities and set off or transfer any credit balance towards setting off a liability. The accounts covered by this agreement are managed on a day to day basis by the Council so that the total balance of these accounts remains positive. However the Council does have a £2m overdraft facility so therefore this agreement currently has no impact on the Council's financial position. This does not include any stewardship accounts held on behalf of Social Services clients.

3. How do proposals evidence the Five Ways of Working and contribute to our Well-being Objectives?

3.1 The Treasury Management and Investment Strategy ensures that the financial plans of the Council are sustainable into the future and do not adversely impact on future generations.

3.2 The Treasury Management and Investment Strategy underpins the financial management of the Council and its ability to achieve its Well Being objectives as set out in the Corporate Plan.

4. Resources and Legal Considerations

Financial

4.1 Money is borrowed for capital purposes and interest is charges to revenue accounts

Employment

4.2 There are no direct employment issues relating to this report.

Legal (Including Equalities)

4.3 Compliance with the Local Government Act 2003 and CIFPA'S "Code of Practice for Treasury Management in the Public Services" is mandatory.

5. Background Papers

CIPFA's "Code of Practice for Treasury Management in the Public Service" (2017 Edition), "The Prudential Code" (2017 Edition) and WG guidance on local authority investments.