West Northamptonshire Council

WEST NORTHAMPTONSHIRE COUNCIL CABINET

21 DECEMBER 2021

CABINET MEMBER WITH RESPONSIBILITY FOR FINANCE: COUNCILLOR MALCOLM LONGLEY

Report Title	**Treasury Management Update Quarter 2, 2021-22**
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1. Purpose of Report

1.1. The purpose of this report is to provide a Quarter 2 update position on the Council's Treasury Management Strategy.

2. Report Background

2.1 Capital Strategy

2.1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. These require all local authorities 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.
- the implications for future financial sustainability.

2.2 Treasury management

2.2.1 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.

2.2.2 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.

2.2.3 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."

3. Introduction

3.1. 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), which is in the process of being refreshed and updated by them.

3.2. The primary requirements of the Code are as follows:

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

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

3.2.3. 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, covering activities during the previous year.

3.2.4. 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.

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

- An economic update for the first half of the 2021/22 financial year.
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators.
- A review of the Council's investment portfolio for 2021/22.
- A review of the Council's borrowing strategy for 2021/22.
- A review of any debt rescheduling undertaken during 2021/22.
- A review of compliance with Treasury and Prudential Limits for 2021/22.

4. Recommendations

It is recommended that the Cabinet:

4.1.1 Note the report and the treasury activity for the first half of the 2021-22 financial year and forward it to full council for consideration.

5. Economics and interest rates

5.1 Economics update

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

5.1.2 There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate.

5.1.3 In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago. For example, the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.

5.1.4 So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected.

5.1.5 Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high of around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

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

5.1.7 The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
Raising Bank Rate to 0.50% before starting on reducing its holdings.
Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
Once Bank Rate had risen to at least 1%, it would start selling its holdings.

5.1.8 **COVID-19 vaccines**. These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread. Recent events with the emergence of the Omicron variant suggest that the future will be uncertain for some time to come.

5.1.9 **European Union.** The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

5.1.10 **World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of **world globalisation** and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

5.1.11 **Supply shortages**. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. Recently there were major queues of ships unable to unload their goods at ports in New York, California, and China. Such issues have led to misdistribution of shipping containers around the world and have contributed to a huge

increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

5.2 **Interest rate forecasts**

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

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

Additional notes by Link on this forecast table: -

- *LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.*
- *Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.*

5.2.2 The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left the Bank Rate unchanged at its subsequent meetings.
As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 23/24 and a third one to 0.75% in quarter 4 of 23/24.

5.2.3 **Significant risks to the forecasts:**

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that supresses GDP growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding QE.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.

- Major stock markets e.g. in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- Geo-political risks are widespread e.g., German general election in September 2021 produces an unstable coalition or minority government and a void in high-profile leadership in the EU when Angela Merkel steps down as Chancellor of Germany; on-going global power influence struggles between Russia/China/US.

  It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

6. Summary WNC Treasury Portfolio Position

6.1 The highlight for the treasury portfolio position for the period to September 2021 is the council is forecasting net borrowing position of £408m compared to the approved budget of £482m. The forecast for 2021/22 shows there will be a £10.4m improvement on the surplus cash available for investment. See table 1 below for more information.

6.2 The expected borrowing requirement to fund the capital programme is lower than expected during the year to date hence the overall forecast performance, in addition to the fact that some loan repayments were not reflected in the budget assumptions.

Table 1

	TREASURY PORTFOLIO 21-22				
	TMSS Approved Budget	Actual	Actual	Forecast out-turn	Forecast out-turn
		30-Sep-21	30-Sep-21	31-Mar-22	31-Mar-22
Treasury investments	**£000**	**£000**	**%**	**£000**	**%**
Total managed in house	77,547	76,453	89%	87,532	90%
Total managed externally	9,154	9,646	11%	9,641	10%
Total treasury investments	**86,700**	**86,099**	**100%**	**97,173**	**100%**
Third party loans	23,000	46,266		36,726	
Total external borrowing	**591,600**	**557,086**	**100%**	**542,433**	**100%**
Net treasury investments / (borrowing)	**(481,900)**	**(424,721)**		**(408,534)**	

6.3 During the year to date, the council has made £11.076m of loan repayments detailed below:

- Full principal repayment of a £5m of PWLB loan
- Full principal repayment of a £5m to Cornwall Council
- Various partial principal repayment totalling £1.076m for the half year period.

6.4 Third party loans are showing an adverse variance of £23.2m. The actuals reflect the position following the disaggregation work and is a full reflection of the agreed portfolio split. These loans are held by WNC, including associated PWLB loans that were used to fund them.

6.5 The forecast position on total external borrowing is £542m compared to the budget of £591.6m. The council is due to repay £25.7m of principal repayments by the end of this financial year. In addition, due to slippage on the capital programme, further borrowing requirements have been delayed.

7. Borrowing and CFR

7.1 The Council's capital financing requirement (CFR) for 2021/22 has not been finalised as there is ongoing review of capital finance balances from the legacy entities that will feed into the overall position for the Council. The CFR denotes the Council's underlying need to borrow for capital purposes.

7.2 It is anticipated as this stage that no further borrowing will be undertaken during this financial year.

7.3 Table 2 below sets out the maturity profile of the Council's borrowing portfolio at the end of Q2.

Table 2

Term Remaining	Borrowing		Limits
	£m	%	%
Under 12 months	15.5	2.8%	80%
1-2 years	12.7	2.3%	50%
2-5 years	37.2	6.7%	50%
5-10 years	29.4	5.3%	50%
10-20 years	19.8	3.5%	100%
20-30 years	10.1	1.8%	100%
30-40 years	135.3	24.3%	100%
40-50 years	277.0	49.7%	100%
Over 50 years	20.0	3.6%	100%
TOTAL	**557.1**	**100%**	

7.4 Market LOBO loans are included in Table 3 above. In the current low interest rate environment, the likelihood of lenders exercising their option to increase the interest rates on these loans - and so triggering the Council's option to repayment at par - is considered very low to happen.

8. Borrowing Restructuring

8.1 Rescheduling opportunities have been limited in the current economic climate. No debt rescheduling has therefore been undertaken in the current financial year. Officers continue to monitor the position regularly.

9. Investments

9.1 The approved Treasury Management Strategy Statement (TMSS) for 2021/22, includes the Annual Investment Strategy. It sets out the Council's investment priorities as being:

- Security of Capital.
- Liquidity; and then
- Yield

9.2 The average level of funds available for investment purposes during the quarter was £112m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme. The Council held £76.4m core cash balances for investment purposes as at the end of Sept 2021. This is expected to increase to £87.5m by the end of the financial year.

10. Investment performance year to date as of 30th September 2021

10.1 As highlighted earlier in this report, the levels shown below use the traditional market method for calculating LIBID rates – i.e., LIBOR – 0.125%. Given the ultra-low LIBOR levels this year, this produces negative rates across some periods.

Table 4

Period	LIBID benchmark return	Council performance
6 months	-0.02%	0.14%

10.2 As illustrated, the Council outperformed the benchmark by 16 basis points. The Council's budgeted investment return for 2021/22 has used 20-21 figures and as such it is not appropriate to make comparison with figures, as will be illustrated in the comment further in report on treasury budget performance.

11. Treasury Management budget

11.1 As the budget for 21/22 were based on 20/21 figures the net financing costs will vary significantly to budget by £1.6m when compared to the forecast out-turn for 21/22. These are set out below:

Table 5

Treasury revenue budget	TMSS Budget Approved	Forecast -out-turn	Variance - favourable/(adverse)
	£'m	£'m	£'m
Net financing costs -	11.50	12.30	(0.80)
Interest receivable on investments	(1.9)	(1.1)	(0.80)
Total	**9.60**	**11.20**	**(1.60)**

11.2 The key explanation for variance to the budgets are:

11.2.1 **Within the net financing costs**-

- **NCC Minimum Revenue Provision (MRP) policy change**: £0.8m is due to the late technical change in the methodology of a predecessor authority's Minimum Revenue Provision policy during the closedown of the 2019/20 statement of accounts (and after the 2021-22 Budget was set).
- **Interest receivable on investments –** despite the better yield performance, compared to LIBID, highlighted earlier in the report, the overall investment income is down by £0.8m due to particularly low rates now offered for investments compared to the rate assumed when the budget was set.

12. Approved Limits

12.1 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2021.

13. Compliance with Treasury & Prudential limits

13.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22.

13.2 The Director of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

13.3 All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

14. Background Papers

None

Appendix A: Treasury and Prudential Indicators

Prudential Indicator	**2021/22 Indicator**	**2021/22 Q2**
Authorised limit for external debt *[Excluding PFI and Finance Lease Liabilities]*	----- £850.0m -----	
Operational boundary for external debt *[Excluding PFI and Finance Lease Liabilities]*	----- £800.0m -----	
Capital Financing Requirement (CFR) *[Excluding PFI and Finance Lease Liabilities]*	TBC	TBC
Ratio of financing costs to net revenue streams	1.6%	TBC
Upper limit of fixed interest rates based on net debt	*100%	16%
Upper limit of variable interest rates based on net debt	65%	-8.8%
Principal sums invested > 365 days *[Excluding third party loans]*	*£20m	£5.5m
Maturity structure of borrowing limits: -		
Under 12 months	Max. 80% Min. 0%	3%
12 months to 2 years	Max. 50% Min. 0%	2%
2 years to 5 years	Max. 50% Min. 0%	7%
5 years to 10 years	Max. 50% Min. 0%	4%
10 years and above	Max. 100% Min. 0%	83%

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