Crawley Borough Council

Report to Overview and Scrutiny Commission
22 November 2021

Report to Cabinet
24 November 2021

Treasury Management Mid-Year Review 2021/2022

Report of the Head of Corporate Finance, **FIN/538**

---

1. Purpose

1.1 This report provides an update on the Council's Treasury Management Strategy for the two first quarters of 2021/2022.

2. Recommendations

2.1 To the Overview and Scrutiny Commission:

That the Commission consider the report and decide what comments, if any, it wishes to submit to the Cabinet.

2.2 To the Cabinet

That the Cabinet is recommended to note the report and the treasury activity for the first two quarters of 2021/2022

3. Reasons for the Recommendations

3.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy, annual and mid-year reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

4. Interest rate forecasts

4.1 The Council's treasury advisor, Arlingclose Limited, has provided the following forecast:

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

5. Annual Investment Strategy

5.1 The Treasury Management Strategy for 2021/22, which includes the Annual Investment Strategy, was approved by this Council on 24 February 2021. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield; and
- Ethical investment policy

6. Compliance with Treasury and Prudential Limits

6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy.

6.2 During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 2.

7. Investment Portfolio 2021/22

7.1 The Council has received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. This was received and temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds.

7.2 The Council held £124.366m of investments as at 30 September 2021 (£109.094m at 31 March 2021). Summary table below:

INVESTMENT PORTFOLIO	Actual 31 March 2021 £000	Net Movement £000	Actual 30 September 2022 £000	30 September 2021 Income Return %	31 September 2021 Weighted Average Maturity Days
Treasury investments					
Banks & building societies (unsecured)	494	172	666	0	1
Government (incl. local authorities)	92,000	10,700	102,700	0.51	184
Money Market Funds	16,600	4,400	21,000	0.01	1
TOTAL TREASURY INVESTMENTS	109,094	15,272	124,366	0.41	152

A full list of investments held as at 30th September 2021 is in appendix 2.

7.3 The Head of Corporate Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.

7.4 Investment performance for the financial year to date as at 30 September 2021:

Investments managed in-house	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2021 30.09.2021	4.57 4.56	A+ A+	12% 17%	154 152	0.43 0.41
Similar Las **All LAs**	**4.66** **4.69**	**A+** **A+**	**69%** **69%**	**32** **10**	**0.08** **0.08**

In the strategy set at the start of the year, the Council projected that there would not be a rise in interest rates. At the time, base rate was 0.1% and the expectation is that it will remain at this level for the rest of the year, though zero or negative rates cannot be ruled out.

Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also largely around zero.

The Council has not invested at negative rates so far, though some rates in the market are negative. It has been difficult to invest and in some cases investments have been made at 0%. The average rate on the Council's investments is 0.41% for the first half of the year - mostly down to investments that were taken out before the rate cuts. As these mature, the average rate will fall.

8. Non-Treasury Investments

8.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

8.2 The Council held £21.3m of such investments in:

- Directly owned property (£20.9m – see Appendix 2)
- Loan to The Hawth (£0.4m)

9. Borrowing

9.1 The Council borrowed £260.325m in March 2012 for HRA self-financing. The average borrowing rate is 3.19%. There has been no requirement for further borrowing in 2021/2022.

10. Implications

10.1 The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these. There are no other legal implications arising in this report.

10.2 The financial implications are addressed throughout this report.

10.3 Risks are highlighted throughout this report, but Appendix 3 addresses the risk to security, liquidity and yield of the Council's investment strategy.

11. Background Papers

Treasury Management Strategy for 2021/2022 – Cabinet, 3 February 2021 [report FIN/517 refers]
Quarterly Budget Monitoring 2021/2022 Quarter 2 – Cabinet, 24 November 2021 [report FIN/535 refers]
Budget and Council Tax for 2020/21 - Cabinet, 25 November 2020 [report FIN/508 refers]
"Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes", 2017 Edition - Chartered Institute of Public Finance and Accountancy
"The Prudential Code for Capital Finance in Local Authorities", 2017 Edition - Chartered Institute of Public Finance and Accountancy
DCLG Guidance on Local Government Investments (Second Edition)

Report author and contact officer: Carey Manger, Finance Business Partner (01293 438021)

External Context APPENDIX 1

Economic background: The economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

Government initiatives continued to support the economy over the quarter but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.

The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to a base effect from a decline in average pay in the spring of last year associated with the furlough scheme.

Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.

The easing of restrictions boosted activity in the second quarter of calendar year, helping push GDP up by 5.5% q/q (final estimate vs 4.8% q/q initial estimate). Household consumption was the largest contributor. Within the sector breakdown production contributed 1.0% q/q, construction 3.8% q/q and services 6.5% q/q, taking all of these close to their pre-pandemic levels.

The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

Financial markets: Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more transitory, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, lead to higher prices.

The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30th September. Over the same period the 10-year gilt yield fell from 0.80% to 0.71% before rising to 1.03% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.37%.

The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.

Credit review: Credit default swap spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back. The gap in spreads between UK ringfenced and non-ringfenced entities continued to narrow, but Santander UK remained an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 53bps and Lloyds Banks Plc the lowest at 32bps. The other ringfenced banks were trading between 37-39bps and Nationwide Building Society was 39bps.

Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

Fitch also revised the outlooks for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable from negative. The rating agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days.

As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

Detailed holdings at 30 September 2021 **APPENDIX 2**

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
UK BANKS									
Lloyds Bank plc	20		01/10/2021	1	0.000%	0.666	0.666	10.000	A-
CENTRAL GOVERNMENT									
DMADF Cash Account	2681	02/09/2021	05/10/2021	5	0.010%	2.700			
	2683	15/09/2021	19/10/2021	19	0.010%	5.000	7.700	unlimited	AA-
United Kingdom Gilts	2672	18/06/2021	31/01/2024	853	0.125%	5.000	5.000	unlimited	AA-
LOCAL AUTHORITIES									
Blackburn with Darwen BC	2643	13/09/2021	12/09/2022	347	0.200%	5.000	5.000	15.000	A+
Cambridgeshire CC	62	03/01/2020	04/01/2022	96	1.600%	3.000			
	2627	18/01/2021	17/01/2022	109	0.400%	2.000	5.000	15.000	A+
Cherwell District Council	2654	16/08/2021	16/08/2022	320	0.100%	5.000	5.000	15.000	A+
Cheshire West and Chester Council	2604	02/11/2020	01/11/2021	32	0.300%	5.000	5.000	15.000	A+
Derbyshire County Council	2605	29/10/2020	28/10/2021	28	0.250%	5.000	5.000	15.000	A+
Dumfries & Galloway Council	60	02/12/2019	02/12/2021	63	1.350%	5.000	5.000	15.000	A+
London Borough Of Hillingdon	2623	21/12/2020	20/12/2021	81	0.250%	5.000	5.000	15.000	A+
Kingston-Upon-Hull City Council	36	02/12/2013	02/12/2021	63	2.750%	5.000	5.000	15.000	A+
London Borough of Islington	2652	07/05/2021	06/05/2022	218	0.100%	5.000	5.000	15.000	A+
City of Liverpool	2651	21/06/2021	20/06/2022	263	0.150%	5.000	5.000	15.000	A+
Monmouthshire County Council	2644	23/06/2021	23/12/2021	84	0.100%	5.000	5.000	15.000	A+
North Lincolnshire Council	63	01/04/2021	01/04/2022	183	1.750%	3.000	3.000	15.000	A+
North Lanarkshire Council	2639	05/03/2021	06/12/2021	67	0.080%	2.000	2.000	15.000	A+
Redcar & Clevedon Borough Council	2626	02/12/2020	02/12/2021	63	0.300%	5.000	5.000	15.000	A+
Rotherham Metropolitan BC	2645	18/06/2021	16/06/2023	624	0.450%	5.000	5.000	15.000	A+
Slough Borough Council	2620	30/10/2020	29/10/2021	29	0.300%	2.000			
	2621	19/11/2020	19/11/2021	50	0.300%	3.000	5.000	15.000	A+
Surrey Heath Borough Council	2650	14/06/2021	14/12/2021	75	0.060%	3.000	3.000	15.000	A+
Uttlesford District Council	2641	14/09/2021	13/09/2022	348	0.200%	5.000	5.000	15.000	A+
Woking Borough Council	2619	19/10/2020	18/10/2021	18	0.300%	5.000	5.000	15.000	A+
Wyre Forest District Council	61	10/12/2019	10/12/2021	71	1.400%	2.000	2.000	15.000	A+
MONEY MARKET FUNDS									
Aberdeen Liquidity Fund	5		01/10/2021	1	0.010%	7.000	7.000	15.000	AAA
The Public Sector Deposit Fund	6		01/10/2021	1	0.023%	7.000	7.000	15.000	AAA
Federated Prime Rate Cash Man	1		01/10/2021	1	0.010%	7.000	7.000	15.000	AAA
				-----------			----------		
				152			124.366		
				-----------			----------		

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
INVESTMENT PROPERTIES									
Ashdown House							9.170		
Ask High Street							1.183		
Atlantic House							4.909		
Kingsgate Car Park*							5.636		

							20.898		

							145.264		
							----------		

* Lease surrendered without notice after 30 September. It will now by run as a Council owned car park after essential works are carried out.

Prudential and Treasury Indicators as at 30th September 2021 — APPENDIX 3

Treasury Indicators	2021/22 Strategy £'000	30 September Actual £'000
Authorised limit for external debt	276,325	270,325
Operational boundary for external debt	296,325	260,325
Investments *	44,330	124,366
* Capital expenditure was budgeted at £78.4m for 2021/22. £21.1m has been spent to 30 September. The revised estimate is £51.2m. See Quarter 2 Budget Monitoring for further details.		
Maturity structure of fixed rate borrowing - upper and lower limits:		
Under 12 months	0% - 10%	6%
12 months to 2 years	0% - 10%	4%
2 years to 5 years	0% - 20%	14%
5 years to 10 years	0% - 40%	31%
10 years to 20 years	0% - 55%	45%
20 years to 30 years	0% - 10%	0%
30 years to 40 years	0% - 10%	0%
40 years to 50 years	0% - 10%	0%

Weighted average life of investments	Avg. 0.70 years Max 1.20 years	0.42
Upper limit for principal sums invested over 364 days	50,000	5,000

Prudential Indicators	2021/22 Strategy £'000	Quarter 2 Forecast £'000
General Fund		
Capital expenditure	45,319	33,699
Capital Financing Requirement (CFR)	16,000	30,698
Annual change in CFR	16,000	30,698*
In year borrowing requirement	16,000	30,698
HRA		
Capital expenditure	33,070	17,522
Capital Financing Requirement (CFR)	260,325	240,627
Annual change in CFR	0	(19,698)*
In year borrowing requirement	0	0

***** includes the transfer of garages between the HRA and General Fund of £19,698,000.

APPENDIX 4

Revisions to CIPFA Codes

In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
  - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
  - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
  - Excluding investment income from the definition of financing costs.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making

MHCLG Improvements to the Capital Finance Framework: MHCLG published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that "while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk".

The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

A further consultation on these matters is expected soon.