Report Title:	**Treasury Management Mid-Year Review 2021/22**
Contains Confidential or Exempt Information	No - Part I
Cabinet Member:	Councillor Hilton, Cabinet Member for Finance and Ascot
Meeting and Date:	Audit and Governance Committee – 21 October 2021
Responsible Officer(s):	Adele Taylor, Executive Director of Resources (s151 Officer)
Wards affected:	All

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Royal Borough of Windsor & Maidenhead

REPORT SUMMARY

1. The purpose of this report is to:

   a) Update Members on the delivery of the Treasury Management Strategy approved by Council on 23rd February 2021 and allow for any changes to be made depending on market conditions;

   b) This report forms part of the monitoring of the treasury management function as recommended in the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code of Practice which requires that the Council receives a report on its treasury management activity at least twice a year;

   Specifically this report includes:

   i. a review of the Council's borrowing strategy in 2021/22;

   ii. a review of the Council's financial investment portfolio for 2021/22 as at 30th September 2021;

   iii. a review of compliance with the Council's Treasury and Prudential limits for the first 6 months of 2021/22; and

   iv. an economic update for the financial year is included as Appendix A.

1. DETAILS OF RECOMMENDATION(S)

RECOMMENDATION:

That the Audit and Governance Committee notes and approves the mid-year Treasury Management Mid-Year Review Report 2021/22.

2. REASON(S) FOR RECOMMENDATION(S) AND OPTIONS CONSIDERED

2.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management mid-year and annual reports.

2.2 The Council's treasury management strategy for 2021/22 was approved at the Council meeting on 23rd February 2021. When borrowing and investing money the Council is exposed to financial risks including the loss of invested funds and the revenue impact of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

3. KEY IMPLICATIONS

3.1 A successful treasury management approach will ensure the security of the Council's assets whilst meeting the liquidity requirements of the Council.

Table 1: Key Implications

Outcome	Unmet	Met	Exceeded	Significantly Exceeded	2021/22 Actual
No. of days that counterpart limits are exceeded	>0	<=0	N/A	N/A	0
No of days that the operational boundary for long-term debt is exceeded	>0	<=0	N/A	N/A	0

4. FINANCIAL DETAILS / VALUE FOR MONEY

MID-YEAR REVIEW OF TREASURY MANAGEMENT ACTIVITY

4.1 The treasury management position on 30th September 2021 and the change during the year to this date is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.21 Balance £m	Movement £m	30.9.21 Balance £m	30.9.21 Average Interest Rate
Long-term borrowing	57.0	4.3	61.3	4.40%
Short-term borrowing	134.2	(34.3)	99.9	0.05%
Total borrowing	**191.2**	**(30.0)**	**161.2**	
Long-term investments	1.3	0.0	1.3	4.35%
Short-term investments	8.9	(4.1)	4.8	0.60%
Cash and cash equivalents	13.7	(10.5)	3.2	0.01%
Total investments	**23.9**	**(14.6)**	**9.3**	
Net borrowing	**167.3**	**(15.4)**	**151.9**	

BORROWING UPDATE

4.2 Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

4.3 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

4.4 Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. Further changes to the CIPFA Prudential Code expected in December 2021 may prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.

4.5 The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to take advantage of the reduction in the PWLB borrowing rate.

4.6 Revised PWLB Guidance

HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26th November 2020 is allowable even for an 'investment asset primarily for yield'.

- Capital plans should be submitted by local authorities via a DELTA return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.

- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.

- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.

- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

4.7 Changes to PWLB Terms and Conditions from 8th September 2021

The settlement time for a PWLB loan has been extended from two working days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.

4.8 Municipal Bonds Agency (MBA)

The MBA is working to deliver a new short-term loan solution, available in the first instance to principal local authorities in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25 million. Importantly, local authorities will borrow in their own name and will not cross guarantee any other authorities.

4.9 If the Authority intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

4.10 UK Infrastructure Bank

£4bn has been earmarked for lending to local authorities by the UK Infrastructure Bank which is wholly owned and backed by HM Treasury. The availability of this lending to local authorities, for which there will be a bidding process, is yet to commence. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

BORROWING STRATEGY

4.11 At 30th September 2021 the Authority's total borrowing was £161.2m, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.21 Balance £m	Net Movement £m	31.9.21 Balance £m	31.9.21 Weighted Average Rate %
Public Works Loan Board	44	(1)	43	4.9
Banks (LOBO)	13	0	13	4.2
Local authorities (long-term)	0	5	5	0.6
Local authorities (short-term)	114	(38)	76	0.1
Funds held on behalf of LEP	21	3	24	0.1
Total borrowing	**192**	**(31)**	**161**	

4.12 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

4.13 With short-term interest rates remaining much lower than long-term rates and with surplus of liquidity continuing to feature in the LA to LA market during the period, the Authority considered it to be more cost effective in the near term to take out most of the new borrowing it required as short-term loans.

4.14 The total of short-term borrowing is currently lower than at the end of the previous financial year due to timing differences in its cashflows, with income received in advance of expenditure used in place of taking out new borrowing.

4.15 Although the majority of new borrowing required during the period has been obtained as short-term loans to take advantage of cheaper borrowing rates, in line with advice from its treasury management advisors the Authority decided to increase its level of long-term borrowing by £20m to reduce some of its exposure to future interest rate rises. It has decided to obtain this financing from the LA market as this is currently the cheapest source of long-term funding available to the Authority for the length of loans required. £5m of this funding was received during the period, with a further £10m so far arranged to be received in October.

4.16 The Council continues to hold £13m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either

accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the period.

TREASURY INVESTMENT ACTIVITY

4.17 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the period, the Authority's investment balances ranged between £8.1m and £47.9m due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury Investment Position

	31.3.21 Balance £m	Net Movement £m	31.9.21 Balance £m	31.9.21 Income Return %
Banks	**3.2**	**(2.5)**	**0.7**	**0**
Money Market Funds	**10.5**	**(8)**	**2.5**	**0.01**
Loans to Associates	**10.2**	**(4.1)**	**6.1**	**1.38**
Total investments	**23.9**	**(14.6)**	**9.3**	

4.18 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

4.19 Very low short-dated cash rates which have been a feature since March 2020 when Bank Rate was cut to 0.1% have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee cuts or waivers should result in MMF net yields having a floor of zero, but the possibility cannot be ruled out.

4.20 Deposit rates with the Debt Management Account Deposit Facility (DMADF) have continued to fall and are also largely around zero.

4.21 The Authority maintains low levels of investments seeking to keep balances of cash and cash equivalents as low as possible while maintaining a sufficient balance to cover its working capital requirements.

NON-TREASURY INVESTMENTS

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. As at 30/09/2021 the Council held £94.8m of such investments in investment properties. These investments generated £1.427m of investment income for the Authority during the period after taking account of direct costs, representing a rate of return of 1.5%.

COMPLIANCE

4.22 The Executive Director of Resources (S151 Officer) reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

4.23 The performance against debt and counterparty limits is shown in Tables 5 and 6 below.

Table 5: Debt Limits

	2021/22 Maximum	31.9.21 Actual	2021/22 Operational Boundary	2021/22 Authorised Limit	Complied?
Borrowing	£200m	£161m	£266m	£291m	Yes

Table 6: Counterparty Limits

	2021/22 Actual	2021/22 Target	Complied?
No. of days that counterpart limits are exceeded	0	0	Yes

4.24 The Authority's interest rate exposure limit is set to control its exposure to interest rate rises by limiting the amount of short-term borrowing that it holds. The Authority complied with this limit as shown in Table 7 below:

Table 7: Interest Rate Risk Indicator

	30.9.21 Actual	2021/22 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.98m	£2.25m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.07m	£2.80m	Yes

4.25 The maturity structure of borrowing indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing and compliance against these are shown in Table 8 below:

Table 8: Maturity Structure of Borrowing

	30.9.21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	**62%**	**80%**	**0%**	**Yes**
12 months and within 24 months	**5%**	**80%**	**0%**	**Yes**
24 months and within 5 years	**3%**	**100%**	**0%**	**Yes**
5 years and within 10 years	**0%**	**100%**	**0%**	**Yes**
10 years and above	**30%**	**100%**	**0%**	**Yes**

4.26 Table 9 shows the Authority's compliance with its limits for the amount of principal invested beyond year end. The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments.

Table 9: Principal sums invested beyond year end

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£1.3m	£0m	£0m
Limit on principal invested beyond year end	£25m	£25m	£25m
Complied?	Yes	Yes	Yes

OTHER

4.27 **CIPFA consultations:** 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.

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

Prudential Code

- 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 and (b) 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).

- New indicator for net income from commercial and service investments to the budgeted net revenue stream.

Treasury Management Code

- 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.

- Implementation of a treasury management knowledge and skills framework.

- Incorporating Environmental Social & Governance issues as a consideration within TMP 1 Risk Management.

5. LEGAL IMPLICATIONS

5.1 In producing and reviewing this report the Council is meeting legal obligations to properly manage its funds.

6. RISK MANAGEMENT

6.1 **Table 8: Impact of risk and mitigation**

Risk	Level of uncontrolled risk	Controls	Level of controlled risk
That a counterparty defaults on repayment of a loan resulting in a loss of capital for the Council	MEDIUM	Loans are only made to counterparties on the approved lending list. The credit ratings of counterparties on the lending list are monitored regularly Counterparty limits reviewed and reduced to limit individual exposure.	LOW
That funds are invested in fixed-term deposits and are not available to meet the council's commitment to pay suppliers and payroll.	MEDIUM	A cashflow forecast is maintained and referred to when investment decisions are made to ensure that funds are available to meet the council's commitment to pay suppliers and payroll.	LOW

7. POTENTIAL IMPACTS

7.1 Equalities. None identified.

7.2 Climate change/sustainability. None identified.

7.3 Data Protection/GDPR. None identified.

8. CONSULTATION

8.1 This section is not applicable.

9. TIMETABLE FOR IMPLEMENTATION

This section is not applicable.

10. BACKGROUND DOCUMENTS

10.1 This report is supported by 1 Appendix:

- Appendix A – Economic Update

11. CONSULTATION (MANDATORY)

Name of consultee	**Post held**	**Date sent**	**Date returned**
Mandatory:	*Statutory Officers (or deputy)*		
Adele Taylor	Executive Director of Resources/S151 Officer	8/10/21	12/10/21
Emma Duncan	Deputy Director of Law and Strategy / Monitoring Officer	8/10/21	13/10/21
Deputies:			
Andrew Vallance	Head of Finance (Deputy S151 Officer)	Report Author	
Elaine Browne	Head of Law (Deputy Monitoring Officer)	8/10/21	
Karen Shepherd	Head of Governance (Deputy Monitoring Officer)	8/10/21	
Other consultees:			
Duncan Sharkey	Chief Executive	8/10/21	
Cllr Hilton	Cabinet Member for Finance and Ascot	12/10/21	13/12/21

REPORT HISTORY

Decision type:	**Urgency item?**	**To follow item?**
Key decision	No	No

Report Author: Andrew Vallance, Head of Finance

Arlingclose - Economic background

The economic recovery from the 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 million plus 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 base effects 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 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 the calendar year, helping push GDP up by 4.8% q/q. Household consumption was the largest contributor. Within the sector breakdown production contributed 0.5% q/q, construction 3.3% q/q and services 5.7% 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 a 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, leading 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 0.60% by 27th September. Over the same period the 10-year gilt yield fell from 0.80% to 0.71% before rising to 0.95% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.27%.

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

Credit review: Credit default swap spreads were flat over most of the 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 time of writing (28th September), Santander UK was trading the highest at 52bps and Lloyds Banks Plc the lowest at 32bps. The other ringfenced banks were trading between 36 and 38bps while 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.

Arlingclose's Outlook for the remainder of 2021/22

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Official Bank Rate													
Upside risk	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.10	0.10	0.10	0.10	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15

The medium-term global economic recovery has continued with the reopening of economies and most look set to grow at a decent pace. Recovery in world demand has been more highly concentrated in goods than in services. The UK has continued to benefit from its initial rapid vaccine rollout, which appears to have weakened the link between infections and hospitalisations.

The re-opening of the UK economy will result in improved GDP in Q3, the 'pingdemic' in June and July having restrained activity a little and exacerbated labour shortages. The more upbeat assessment is that GDP will return to its pre-Covid peak by the end of 2021 but will be predicated on the extent and speed with which households and businesses normalise their spending and activity during the remainder of the year.

Alongside the increase in commodity and energy prices, supply and transportation bottlenecks and the boost in prices from the lifting of restrictions, the MPC has acknowledged the potential of CPI rising to around 4% in Q4 2021.

There is uncertainty over the size and pace of change in the labour market as companies adjust their staffing levels and new hires to post-Covid demand and working arrangements. The number of furloughed jobs has declined and the scheme ends in September.

Arlingclose expects the Bank Rate to remain at the current 0.10% level. The risk of movement in Bank Rate in the immediate term is low although the risks over the MPC's 3-year horizon have increased and are leaning to the upside.

Gilt yields volatility is likely given the uncertainties over the economic outlook and central bank asset purchase programmes. Longer term yields may face upward pressure towards the end of our forecast period as the economy moves back to a sustained footing and policy expectations start to strengthen.

Downside risks remain – the risk of further virus mutations including the Delta variant could destabilise the recovery. Downside risks also arise from potential future vaccine shortages as the demand for vaccines increases.