MID-YEAR TREASURY MANAGEMENT STRATEGY REVIEW 2020/21

1 Original Strategy for 2020/21

1.1 The Treasury Management Strategy for 2020/21 was approved by Executive Board on 12th March 2020.

The broad strategy continued the approach of looking to minimise borrowing costs, in the context of the Council's long-term debt being considerably lower than its accumulated Capital Financing Requirement, with the difference covered by the use of short-term borrowing and any available balances. This approach had generated savings on interest costs over the last few years.

At the time, it was expected that interest rates could increase slowly, so it was noted that it might be possible, and appropriate, to take out more long-term borrowing.

1.2 The Original 2020/21 Investment Limits were set by reference to amount, duration and credit rating – and distinguished between Unsecured Deposits, which would be subject to greater risk of credit loss, and Secured Deposits, in which there was less risk. The limits set were largely comparable to those applying in previous years.

2 Economic Review 2020/21

2.1 The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news, it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

2.2 During the period, The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion.

2.3 GDP growth contracted by a massive 19.8% in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains, this still only makes up half of the lost output.

2.4 In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and were down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the BoE has forecast unemployment could hit a peak of between 8% and 9%.

2.5 Arlingclose, our Treasury Management Advisors, expect Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future, most likely through further financial asset purchases. While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

3 Treasury Performance to date

3.1 Thus far, cash balances have ranged between £40M and £110M, being significantly higher than in previous years as a result of grants received in advance from central government. These investment levels have also been supported by short-term borrowing (at rates averaging around 0.8%). No further long-term borrowing has been taken, while short-term borrowing levels have fluctuated, currently standing at slightly lower levels than the start of the year.

3.2 Investments have continued to be made with a limited range of banks, building societies and Money Market Funds, along with other local authorities and the Government’s Debt Management Office (DMO), earning interest at exceptionally low levels. Interest rates have fallen significantly to date this year, following the Bank of England Bank Rate cuts in March 2020, bringing the average interest earned on investment balances to around 0.17% in the first half of the year. It is likely that investment returns will remain exceptionally low in the second half of the year.

4 Investment and Borrowing Strategy for the rest of the year

4.1 Both the CIPFA Code and government guidance require that funds be invested prudently, and with regard to security and liquidity, before seeking the optimum rate of return or yield. The Council’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.

4.2 The Council’s Investment Criteria allow investment in a range of other organisations and structures, but as there are limited opportunities for straightforward trading in Secured Deposits, and as priority is given to maintaining liquidity, short-dated and simpler options are mainly used. Investments are made in: fixed term deposits and instant access accounts with banks and building societies; instant access Money Market Funds; and fixed term deposits with local authorities and the UK Government’s Debt Management Office. It is expected that these will continue to be the main investment options taken up across the remainder of the year.

4.3 In the light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Authority kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.

4.4 On 25th September the ‘less than 2 week’ deposit rates on the UK Government’s Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3 week deposits and 0.01% for longer maturities.

4.5 The Council continues to hold higher than usual cash levels. With interest rates being extremely low, including short term deposit rates with the DMADF being below 0%, it is proposed to make an amendment to the Investment Counterparty Limits approved by Executive Board on 12th March 2020, to allow the Council to further diversify its investments and attempt to maintain principal amounts invested, in a low interest rate environment. It is proposed to amend Investment Counterparty Limits as follows:

Other Investment Limits	Cash Limit
Money market funds	£30M in total (was £20M in total)

It is proposed that all other Investment Counterparty Limits remain as approved in March 2020 by Executive Board.

4.6 The Council's key 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. The flexibility to renegotiate loans, should long-term plans change is a further, secondary objective.

4.7 It is proposed that the Borrowing Strategy remain unchanged, with the Council looking to take new borrowing as determined by cash flow requirements and by reference to movements in actual and projected long-term interest rates.

5 Risk Management

5.1 The Council's main objective for the management of its investments is to give priority to the security and liquidity of its funds before seeking the best rate of return. Therefore, most surplus cash is held in short-term investments with government bodies, and with highly rated banks and pooled funds. In addition, the Council can hold investments that entail a slightly higher level of risk, but such risks are mitigated by limiting the amount and duration of exposure.

5.2 The Council's main objective for the management of its debt is to ensure its long-term affordability. The largest part of its loans is from the PWLB at long-term fixed rates of interest.

5.3 Another significant element of the Council's long-term debt is £18M of loans from banks and other institutions. £13M worth are "lender's option, borrower's option" (LOBO) loans, under which the Lender can, at pre-determined times, exercise an Option to increase the rate payable on the debt, and the Borrower has the Option to either accept the proposed increase or repay the whole loan.

These loans have interest rates fixed at levels that were relatively low when they began, but if the Lender Option is exercised, the Borrower has to deal with whatever interest rates turn out to be at that later date. This exposes the Council to some risk of rising long-term interest rates, but that is mitigated by the fact that £5M of this debt (forming a large part of the lowest interest rate elements) can only be "called" once in every five years. Current projected future interest rates suggest LOBOs are unlikely to be called in the next 5 years.

5.4 A combination of short duration investments and long duration debt exposes the Council to the risk of falling investment income during periods of low interest rates. However, the risk of low investment returns is viewed as lower priority compared to the benefits of optimising the security and liquidity of investments, and the savings made on borrowing costs. Also, though the Council has no long term investments, at this stage, it is hedged against the investment return risk by its short term debt holdings.

6 Indicators

6.1 The originally approved Indicators were set at cautious levels and can remain unchanged.