MID-YEAR TREASURY MANAGEMENT STRATEGY REVIEW 2021/22

1 Original Strategy for 2021/22

1.1 The Treasury Management Strategy for 2021/22 was approved by Executive Board on 11th March 2021.

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 2021/22 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 2021/22

2.1 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

2.2 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.

2.3 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.

2.4 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.

2.5 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' preferred measure of CPIH, which includes owner-occupied housing, was 3.0% year/year, marginally higher than expectations for 2.7%.

2.6 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.

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

3 Treasury Performance to date

3.1 Thus far, cash balances have ranged between £50M and £85M, continuing to be 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 0.36%). No further long-term borrowing has been taken, while short-term borrowing levels have fluctuated, currently standing at levels lower than the start of the year.

Analysis of Debt Outstanding	31st March 2021 £m	30th September 2021 £m
Short-Term Debt	78.3	40.0
Longer-Term Debt:		
Public Works Loan Board (PWLB)	127.4	125.3
Market Loans	18.0	18.0
Other Market Debt	0.3	0.3
	145.7	143.6
Lancashire County Council (LCC) Debt	13.6	13.3
Debt re PFI Arrangements	61.6	60.7
Gross Borrowings	**299.2**	**257.6**
This was offset by investments of:	58.6	61.9
Net Borrowing (gross borrowing less investments)	**240.6**	**195.7**
Net Borrowing (if LCC and PFI debt are excluded)	**165.4**	**121.7**

3.2 Investments have continued to be made with a limited range of banks and Money Market Funds, along with other local authorities and the Government's Debt Management Office (DMO), earning exceptionally low levels of interest. Interest rates have remained historically low to date this year, with the average interest earned on investment balances being around 0.05% in the first half of the year. It is likely that investment returns will remain low in the second half of the year.

3.3 Decreased net interest costs have already been reported through corporate monitoring, reflecting lower interest rates achieved on short-term borrowings this year.

4 Investment and Borrowing Strategy for the rest of the year

Investment

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 continuing pandemic and the higher likelihood of unexpected calls on cash flow, the Authority continues to keep more cash available at very short notice. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.

4.4 It is proposed that there be no changes to the existing Investment Criteria and Investment Counterparty Limits.

Borrowing

4.5 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.

4.6 In keeping with these objectives, no new long term borrowing was undertaken in the first half of the year, while £38.3M of existing short term loans were allowed to mature without replacement. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

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.

5.5 The significant part of the debt portfolio - of around £40M in short-term loans from other local authorities - does raise interest rate risk issues. If the medium to long-term cost of debt were to move sharply upwards, it may be necessary to restructure the Council's debt quickly, and cope with an increased cost of borrowing. This issue is kept under review, with regular updates from Arlingclose.

6 Indicators

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

6.2 The Council has complied with the Limits and Indicators it has set, and expects to do so over the remainder of the year.

7 Codes of Practice – consultation and proposed changes

7.1 Earlier this year CIPFA consulted on the principles to support the changes to the Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (Treasury Management Code), as well as on the changes to the Prudential Code for Capital Finance in Local Authorities.

7.2 The final outcomes from these consultation exercises may result in changes to the Council's Treasury Management Strategy going forward.