

**SUBJECT: MID-YEAR TREASURY REPORT 2020/21**

**MEETING: Audit Committee**

**DATE: 26th November 2020**

**DIVISION/WARDS AFFECTED: Whole Authority**

## **1 PURPOSE**

- 1.1 To provide an interim mid-year update on treasury management activity for the first 6 months of 2020/21 in accordance with best practice and the requirements of the Authority's Treasury Management Strategy Statement for 2020/21.

## **2 RECOMMENDATIONS**

- 2.1 That Members review the treasury management activities in the first half of 2020/21 using this report and discuss with officers any changes to the process that should be considered for incorporation into the 2021/22 Treasury Management Strategy Statement which will be considered at the January Audit Committee.

## **3 KEY ISSUES**

- 3.1 In March 2005 the Authority 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 Authority to approve treasury management semi-annual and annual reports to allow scrutiny of the treasury management process. The Cipfa Code requires the Authority to have regard to the security & liquidity of its investments before seeking additional returns.
- 3.2 The Authority's treasury management strategy for 2020/21 was approved at Council on the 5th March 2020. The Authority has since borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.
- 3.3 The Treasury Management Code which was revised in 2017/18 now covers non-treasury investments as well as treasury investments requiring Authorities to show how they provide due diligence on these investments in the same way as it does for treasury investments (see Section 8). Given the current economic circumstances the Authority has not increased its holding of non-treasury investments in the first half of 2020/21.
- 3.4 The first six months of 2020/21 has seen significant economic uncertainty both with the spread of the coronavirus pandemic and its impact on global economies, and in respect of Brexit with agreements between the UK and EU on a trade deal looking difficult.
- 3.5 Despite gilt yields remaining extremely low, the continued large margin on Public Works Loan Board (PWLB) borrowing has resulted in long term borrowing remaining less attractive.
- 3.6 With short-term interest rates remaining much lower than long-term rates and temporary investments

earning Bank Rate or even lower, the Authority considered it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead.

- 3.7 The current economic environment is unprecedented and very much represents the bottom of the treasury cost curve for an Authority like Monmouthshire who is a net borrower. Despite this, it is very difficult to currently justify locking into longer term borrowing to provide additional certainty to long term treasury costs and budgets. The continued margin on PWLB borrowing in particular is a significant barrier to this in an environment where the cost of carry is so substantial.
- 3.8 At the 31<sup>st</sup> March 2020 the Authority had a borrowing CFR (Capital Financing Requirement) of £187.0m and gross external borrowing of £186.9m. As detailed in table 2, gross borrowing reduced considerably by £22.2m to £164.7m in the six months to the 30<sup>th</sup> September 2020 but net borrowing only fell by £8.2m due to an overall reduction in investments. This can be explained by the extraordinary circumstances at the end of March 2020 where the Authority was responding to the initial outbreak of the Coronavirus pandemic and held large balances of both temporary borrowing and the front loading of grant funding from Welsh Government. As the year has progressed both of these balances have naturally reduced as the financial response has developed and stabilised.
- 3.9 The Authority continues to hold a minimum of £10m of investments to meet the requirements of a professional client under the Mifid II regulations (Markets in financial instruments directive).
- 3.10 £3m of the Authority's investments are held in externally managed strategic pooled multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. As at 30<sup>th</sup> September these funds generated an average total return of -2.72% (-5.31% at 31<sup>st</sup> March), comprising a 4.03% (4.29% at 31<sup>st</sup> March) income return which is used to support services in year, and -6.75% (-9.48% at 31<sup>st</sup> March) of unrealised capital loss.
- 3.11 As shown in section 9, the Authority is forecasting a saving against budget of £22,000 for 2020/21 in the areas of interest payable and interest receivable against a total net budget of £3.8m.
- 3.12 As reported in section 10, the Authority complied with the Cipfa code of practice on treasury management and the 2019/20 Treasury management strategy, during the year.
- 3.13 The ongoing coronavirus pandemic will continue to have a significant financial impact on the Authority and consequently its treasury management activity for the remainder of the 2020/21 financial year. At the time of writing it is felt that the existing Treasury Strategy approved for the 2020/21 financial year provides the required flexibility both in terms of investment and borrowing approach to respond the challenges faced.

## 4 EXTERNAL CONTEXT

- 4.1 **Economic background:** 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.
- 4.2 The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes

that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

- 4.3 Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the 'Eat Out to Help Out' (EOHO) offer.
- 4.4 GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. 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.
- 4.5 The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme. The Office for National Statistics' preferred measure of CPIH which includes owner-occupied housing was 0.5% y/y.
- 4.6 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 was 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 when the furlough scheme eventually ends. On the back of this, the BoE has forecast unemployment could hit a peak of between 8% and 9%.
- 4.7 The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is 'moderately' above the 2% average target, particularly given it has been below target for most of the last decade.
- 4.8 The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.
- 4.9 **Financial markets:** Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.
- 4.10 Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.23% respectively over the period.
- 4.11 At the end of September, the yield on 2-year US treasuries was around 0.13% while that on 10-year treasuries was 0.69%. German bund yields remain negative across most maturities.
- 4.12 **Credit review:** Credit default swap spreads eased over most of the period but then started to tick up again through September. In the UK, the spreads between ringfenced and non-ringfenced entities remains, except for retail bank Santander UK whose CDS spread remained elevated and the highest of those we monitor at 85bps while Standard Chartered was the lowest at 41bps. The ringfenced banks are currently trading between 45 and 50bps.

4.13 After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned a AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

4.14 There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31<sup>st</sup> December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

## 5 LOCAL CONTEXT

5.1 On 31<sup>st</sup> March 2020, the Authority had net investments of £27.6m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

**Table 1: Balance Sheet Summary (Start of year)**

	<b>31.3.20 Actual £m</b>
General Fund capital financing requirement	189.5
Less: *Other debt liabilities	(2.4)
<b>Borrowing capital financing requirement</b>	<b>187.0</b>
External borrowing	(186.9)
Internal borrowing	0.1
Less: Usable reserves	(18.5)
Less: Working capital	(9.3)
<b>Investments at 31<sup>st</sup> March 2020</b>	<b>(27.6)</b>

\* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

5.2 Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk.

5.3 The treasury management position on 30<sup>th</sup> September 2020 and the change over the six months is shown in Table 2 below.

**Table 2: Treasury Management Summary**

	<b>31.3.20</b>	<b>31.3.20</b>	<b>Net</b>	<b>30.09.20</b>	<b>30.09.20</b>
	<b>Balance</b>	<b>Rate</b>	<b>Movement</b>	<b>Balance</b>	<b>Rate</b>
	<b>£m</b>	<b>%</b>	<b>£m</b>	<b>£m</b>	<b>%</b>
Long-term borrowing	93.2	3.5	(0.5)	92.7	3.5
Short-term borrowing	93.7	1.0	(21.7)	72.0	0.3
<b>Total borrowing</b>	<b>186.9</b>	<b>2.2</b>	<b>(22.2)</b>	<b>164.7</b>	<b>2.1</b>
Long-term investments	0.0	N/A	0.0	0.0	N/A
Short-term investments	(3.0)	0.52	0.0	(3.0)	0.03
Pooled Funds	(2.7)	4.29	(0.1)	(2.8)	4.03
Cash and cash equivalents	(21.9)	Included in ST above	14.2	(7.8)	Included in ST above
<b>Total investments</b>	<b>(27.6)</b>	<b>0.9</b>	<b>14.0</b>	<b>(13.6)</b>	<b>0.4</b>
<b>Net Borrowing</b>	<b>159.3</b>		<b>(8.2)</b>	<b>151.1</b>	

5.4 At the 31<sup>st</sup> March 2020 the Authority had a borrowing CFR (Capital Financing Requirement) of £187.0m and gross external borrowing of £186.9m. As detailed above, gross borrowing reduced considerably by £22.2m to £164.7m in the six months to the 30<sup>th</sup> September 2020 but net borrowing only fell by £8.2m due to an overall reduction in investments. This can be explained by the extraordinary circumstances at the end of March 2020 where the Authority was responding to the initial outbreak of the Coronavirus pandemic and held large balances of both temporary borrowing and the front loading of grant funding from Welsh Government. As the year has progressed both of these balances have naturally reduced as the financial response has developed and stabilised.

## **6 BORROWING UPDATE**

6.1 On 9<sup>th</sup> October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders and lead times and volumes of borrowing required can prove to be significant barriers.

6.2 The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields. £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% has been made available to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

6.3 The consultation titled "Future Lending Terms" allows stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to allow authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

6.4 The consultation closed on 31<sup>st</sup> July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year or early next year.

6.5 Municipal Bonds Agency (MBA): The MBA revised its standard loan terms and framework

agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor.

6.6 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.

### 6.7 **Borrowing Strategy during the period**

6.8 At 30<sup>th</sup> September 2020 the Authority held £164.7m of loans, (a decrease of £22.2m from 31<sup>st</sup> March 2020), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30<sup>th</sup> September are summarised in Table 3 below.

**Table 3: Borrowing Position**

	<b>31.3.20</b>	<b>Net Movement</b>	<b>30.09.20</b>	<b>30.09.20</b>	<b>30.09.20</b>
	<b>Balance</b>		<b>Balance</b>	<b>Weighted Average</b>	<b>Weighted Average</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>Rate %</b>	<b>Maturity (years)</b>
Public Works Loan Board	89.1	(14.2)	74.9	3.6	17.8
Banks (LOBO)	13.6	0.0	13.6	4.8	21.3
Welsh Government Interest Free	5.2	0.0	5.2	0.0	3.8
Local authorities/Other	78.9	(8.0)	70.9	0.2	0.3
<b>Total borrowing</b>	<b>186.9</b>	<b>(22.2)</b>	<b>164.7</b>	<b>2.1</b>	<b>10.1</b>

6.9 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.

6.10 In keeping with these objectives, no new long term borrowing was undertaken, while existing loans maturing were replaced with rolling temporary / short terms loans, or internal resources. With short-term interest rates remaining much lower than long-term rates and temporary investments earning Bank Rate or lower, the Authority considers it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans. When the results of the PWLB consultation are known this approach will be reassessed.

6.11 PWLB funding margins have lurched quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields plus 0.80%. The Authority will continue to evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

6.12 LOBO loans: The Authority continues to hold £13.6m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority 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 quarter.

## 7 **INVESTMENT UPDATE**

7.1 From the start of April 2020 onwards, the Authority has received Welsh Government funding to support small and medium businesses during the coronavirus pandemic through grant schemes.

£26.0m was received, temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds. £24.3m was disbursed by the end of September.

- 7.2 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £10.0m and £27.6m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

**Table 4: Treasury Investments**

	<b>31.3.20 Balance £m</b>	<b>Net Movement £m</b>	<b>30.09.20 Balance £m</b>	<b>31.03.20 Capital Return %</b>	<b>30.09.20 Income Return %</b>
Banks & building societies (unsecured)	(2.0)	0.0	(2.0)	N/A	0.03%
Government (incl. local authorities)	(10.9)	7.9	(3.0)		
Money Market Funds	(12.0)	6.2	(5.9)		
Multi asset pooled funds	(2.2)	(0.2)	(2.4)	-6.99%	3.45%
Property pooled funds	(0.4)	0.0	(0.4)	-6.72%	4.14%
<b>Total investments</b>	<b>(27.6)</b>	<b>14.0</b>	<b>(13.6)</b>		

- 7.3 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.
- 7.4 Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.
- 7.5 On 25<sup>th</sup> September the overnight, 1- and 2-week deposit rates on 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.
- 7.6 The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.1%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.
- 7.7 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/or Money Market Funds to manage both credit and liquidity risks.
- 7.8 The progression of risk and return metrics are shown in the quarterly investment benchmarking in Table 5 below.

**Table 5: Investment benchmarking**

	<b>Credit Score</b>	<b>Credit Rating</b>	<b>Bail-in Exposure</b>	<b>Weighted Average Maturity (days)</b>	<b>Rate of Return %</b>
31.03.2020	AA-	4.01	64%	2	0.74

30.09.2020	AA-	4.29	72%	10	0.86
<b>Similar LAs</b>	AA-	4.05	44%	177	0.40
<b>All LAs</b>	AA-	4.16	64%	18	0.90

- 7.9 **Externally Managed Pooled Funds:** £3m of the Authority's investments are held in externally managed strategic pooled multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. As at 30<sup>th</sup> September these funds generated an average total return of -2.72% (-5.31% at 31<sup>st</sup> March), comprising a 4.03% (4.29% at 31<sup>st</sup> March) income return which is used to support services in year, and -6.75% (-9.48% at 31<sup>st</sup> March) of unrealised capital loss.
- 7.10 In a relatively short period since the onset of the COVID-19 pandemic in March and the ensuing enforced lockdown in many jurisdictions, the global economic fallout has been sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, business and individuals.
- 7.11 The Authority is invested in multi-asset and property funds. The falls in the capital values of the underlying assets, in particular bonds and equities were reflected in the 31<sup>st</sup> March 2020 fund valuations with funds registering negative capital returns over a 12-month period. Since March there has been improvement in market sentiment which is reflected in a modest increase in capital values of the funds in the Authority's portfolio. Market values at 31<sup>st</sup> March and 30<sup>th</sup> September 2020 are as shown in Table 4, above.
- 7.12 Similar to many other property funds, dealing (i.e. buying or selling units) in the CCLA Local Authorities Property Fund was suspended by the fund in March 2020. The relative infrequency of property transactions in March as the pandemic intensified meant that it was not possible for valuers to be confident that their valuations correctly reflected prevailing conditions. To avoid material risk of disadvantage to buyers, sellers and holders of units in the property fund, the management company was obliged to suspend transactions until the required level of certainty is re-established. The dealing suspension was lifted in September 2020. There has also been a change to redemption terms for the CCLA Local Authorities Property Fund; from September 2020 investors are required to give at least 90 calendar days' notice for redemptions.
- 7.13 Because the Authority's externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.
- 7.14 In 2020/21 the Authority expects to receive significantly lower income from its cash and short-dated money market investments and from its externally managed funds than it did in 2019/20 and earlier years. Dividends and income paid will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact, the fund's sectoral asset allocation, securities held/bought/sold and, in the case of equities, the enforced or voluntary dividend cuts or deferral.

## 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 Ministry of



Housing, Communities and Local Government's (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 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.

8.3 The Authority held a book value of £31.0m of such non-financial asset investments at the 31<sup>st</sup> March 2020 (£34.0m as at 31<sup>st</sup> March 2019) with the reduction in value of these assets very much reflecting the ongoing uncertain economic environment. These are:

- Oak Grove Solar Farm £4.6m Net book value (£6.7m as at 31<sup>st</sup> March 2019)
- Castlegate Business Park & service loan £7.5m Net book value (£7.65m as at 31<sup>st</sup> March 2019)
- Newport Leisure Park & service loan £18.9m Net book value (£21.0m as at 31<sup>st</sup> March 2019)

8.4 The rest of the Authority's Investment Properties have been held for over a decade and are retained purely for income or capital gain, and are valued as at 31<sup>st</sup> March 2020 as:

- Agricultural Properties £29.6m Net book value
- Industrial Properties and Retail Units £2.8m Net book value

8.5 These investments are budgeted to generate approximately £1.22m of investment income for the Authority after taking account of direct costs and contributes to supporting the Authority's ongoing revenue budget. COVID-19 has impacted the Council as it will have every Council with both additional costs and significant income losses. We have entered into rental deferral agreements with a number of tenants to give them the best chances of surviving the downturn and to protect jobs that would otherwise be lost. Beyond amounts recovered from Welsh Government COVID-19 Hardship Funds, we remain hopeful that we will recover in full the majority of any remaining shortfall in the next financial year as tenants return to trading.

## 9 TREASURY PERFORMANCE

9.1 The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

**Table 6: Performance**

	<b>Forecast 2020/21 £'000</b>	<b>Budget 2020/21 £'000</b>	<b>Over/(under) Spend</b>
PWLB	2,710	2,849	(139)
Market loans	653	653	(0)
Short term loans	542	544	(2)
<b>Total interest payable on borrowing</b>	<b>3,905</b>	<b>4,046</b>	<b>(141)</b>
Invested cash	4	(56)	60
Pooled Funds	(74)	(134)	60
Finance lease income	(62)	(62)	0
<b>Total interest from Investments</b>	<b>(133)</b>	<b>(252)</b>	<b>119</b>
<b>Net Over/(Under)spend</b>	<b>3,772</b>	<b>3,794</b>	<b>(22)</b>

9.2 **Estimates for income for 2020/21 and beyond:**

9.3 The corporate world is still adjusting to the economic shock, with probably more to come, and it is still too early to tell which companies will withstand the economic damage in the short- to medium-term or which will choose to conserve cash in very difficult economic conditions simply to survive.

9.4 Investment income in the Authority's 2020/21 was set against a very different economic backdrop. Bank Rate, which was 0.75% in January/February 2020, now stands at 0.1%. Interest earned from short-dated money market investments will be significantly lower. In relation to income from the Authority's externally managed strategic funds, dividends and income distributions will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact, the fund's sectoral asset allocation, securities held/bought/sold and, in the case of equities, the enforced or voluntary dividend cuts or deferral.

9.5 Further to this the Authority will be reviewing its expectations for investment income in 2021/22 as part of ongoing budget process.

**10 COMPLIANCE**

10.1 The Section 151 officer reports that all treasury management activities undertaken during the first six months of the year have complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated below.

10.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

**Table 7: Debt limits**

	<b>2020/21 Maximum during year £m</b>	<b>30.09.20 Actual £m</b>	<b>2020/21 Operational Boundary £m</b>	<b>2020/21 Authorised Limit £m</b>	<b>Complied? Yes/No</b>
Borrowing	195.8	164.7	210.8	230.0	Yes
PFI, Finance Leases & Other LT liabilities	2.4	2.4	3.9	5.4	Yes
<b>Total debt</b>	<b>198.2</b>	<b>167.1</b>	<b>214.7</b>	<b>235.4</b>	

10.3 Compliance with agreed Investment limits is shown below:

**Table 8: Investment limits**

	<b>2020/21 Maximum</b>	<b>2020/21 Limit</b>	<b>Complied? Yes</b>
Local Authorities per counterparty	£2m	£2m or 10%	Yes
Banks per counterparty, rating A- or above	£2m	£2m	Yes
Any group of pooled funds under the same management	£1m	£2m	Yes
Limit per non-UK country	£0m	£4m	Yes
Money Market Funds	£2m	£2m or 10%	Yes
Investments over 1 year	£0m	£6m	Yes

10.4 **Treasury Management Indicators**

10.5 The Authority measures and manages its exposures to treasury management risks using the following indicators.

10.6 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating and credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

**Table 9: Security**

	<b>30.09.20 Actual</b>	<b>2020/21 Target</b>	<b>Complied?</b>
Portfolio average credit	AA-/4.01	A-/5.0	Yes

10.7 **Maturity Structure of Borrowing:** This indicator is set to control the Authority’s exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

**Table 10: Maturity structure of borrowing**

	<b>30.09.20 Actual</b>	<b>Lower Limit</b>	<b>Upper Limit</b>	<b>Complied?</b>
Under 12 months	46%	0%	60%	Yes
12 months and within 24 months	2%	0%	20%	Yes
24 months and within 5 years	7%	0%	30%	Yes
5 years and within 10 years	9%	0%	30%	Yes
10 years and above	36%	0%	100%	Yes

10.8 **Principal Sums Invested for Periods Longer than a year:** 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. The limits on the long-term principal sum invested to final maturities beyond the period end were:

**Table 11: Invested beyond 1 Year**

	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>
Actual principal invested for 365 days & beyond year end	£0	£0	£0
Limit on principal invested for 365 days & beyond year end	£6m	£6m	£6m
Complied?	Yes	Yes	Yes

10.9 **Other issues**

10.10 **IFRS 16:** CIPFA/LASAAC has proposed deferring the implementation of the new IFRS 16 Leases accounting standard for a further year to 2021/22. Some preparatory work required to meet the requirements of the standard was initially carried out in December 2019 but was paused when notification of the deferral was made. Given the current pressures on the finance section and particularly those sections holding the majority of the Authorities leases (Transport, Schools & Estates) there is likely to be significant risk around completing the work necessary to meet the requirements of the new standard in time for 2020/21 accounts closure. The Authority will look to

engage with both CIPFA/LASAAC representatives and if necessary external auditors to explore any possible mitigations to this.

#### 10.11 Arlingclose's Outlook for the remainder of 2020/21

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
<b>Official Bank Rate</b>													
<b>Upside risk</b>	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
<b>Arlingclose Central Case</b>	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
<b>Downside risk</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

10.12 The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been suppressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

10.13 The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

10.14 However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

10.15 This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

10.16 Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

10.17 Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). 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.

10.18 Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

10.19 Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

## 11 REASONS

11.1 The Treasury Management Strategy for the Authority is underpinned by its adherence to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management, which includes the requirement that members are informed of Treasury Management

activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

## **12 OPTIONS APPRAISAL**

12.1 Not applicable.

## **13 EVALUATION CRITERIA**

13.1 Not applicable.

## **14 RESOURCE IMPLICATIONS**

14.1 There are no resource implications arising directly from this report.

## **15 WELLBEING OF FUTURE GENERATIONS (INCORPORATING EQUALITIES, SUSTAINABILITY, SAFEGUARDING AND CORPORATE PARENTING.**

15.1 There are no implications directly arising from the recommendations and decisions highlighted in this report.

## **16 CONSULTEES**

16.1 Chief Officer, Resources (Acting Section 151 officer)  
Arlingclose – Treasury Management Advisors to Monmouthshire CC

## **17 BACKGROUND PAPERS**

17.1 None

## **18 AUTHOR**

Jonathan S Davies – Finance Manager

## **19 CONTACT DETAILS**

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