Havering
LONDON BOROUGH

Audit Committee	**27th October 2020**
Subject Heading:	**Treasury Management Mid Year Report 2020-21**
Cabinet Member:	**Councillor Roger Ramsey** **Cabinet Member for Finance & Property**
SLT Lead:	**Jane West** **(Chief Operating Officer)**
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Policy context:	**The code of practice on treasury management 2017 requires that Council be provided with a Mid-year report on treasury activities**
Financial summary:	**There are no direct Financial implications from the report**
Is this a Key Decision?	**NO**
When should this matter be reviewed?	**Bi-Annually**
Reviewing OSC:	**Overview and Scrutiny Board**

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[]
Places making Havering	[]
Opportunities making Havering	[]
Connections making Havering	[]

SUMMARY

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code ("TM Code") require authorities to report on treasury management activities to Full Council at least twice per year (Treasury Management Strategy Statement and Annual TM report during the year).

The Authority's Treasury Management Strategy Statement (TMSS) for 2020-21 was approved at the Cabinet meeting on 12th February 2020 and at Full Council on 26th February 2020.

The Authority has 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. This report covers activity on treasury managed investments and borrowings and the associated monitoring and control of risk.

The key highlights of the Mid-Year report are as follows:

- At the end of June 2020, investment portfolio return was 1.02% outperforming the LINK benchmarking Group average of 0.64% and the authority's budgeted rate of return of 0.80% against a backdrop of falling 3 month LIBOR.
- PWLB consultation: The Government is concerned Authorities have used cheap PWLB debt to buy very significant amounts of commercial property for rental income, which reduces the availability of PWLB finance for core local authority activities. The Government is revising the terms of PWLB lending to ensure that local authorities continues to invest in housing, infrastructure and public services. The Government has already cut the interest rates for investment in social housing by one percentage point. The final outcome of the consultation will be known before the end of the financial year.
- There was no breach of the Authority's prudential indicators and treasury indicators.

RECOMMENDATIONS

- To note the treasury management activities to the end of September 2020 are detailed in the report.

REPORT DETAIL

Background

1.0 Treasury management

1.1 The authority operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.2 The other main function of authority's treasury management operation is to help fund its capital plans. These capital plans provide a guide to the borrowing need of the authority, essentially the longer term cash flow planning required to meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.0 Introduction

2.1 This report has been written in accordance with the requirements of the CIPFA TM Code.

2.2 This is the Mid-Year Review Report required by the TM Code and covers the following:

- an economic update for the first part of the 2020/21 financial year.
- Treasury Management Summary to September 2020.
- a review of the authority's borrowing strategy for 2020/21
- a review of the authority's investment portfolio for 2020/21; and
- a review of compliance with Treasury and Prudential Limits for 2020/21.

3.0 Economics and interest rates

3.1 Economics update

The Bank of England (BoE) latest GDP forecast assumes a V shaped economic recovery scenario albeit with a slightly longer return to the pre-pandemic peak. The MPC left its interest rate on hold at 0.1 per cent and its target on asset purchases at £745bn thereby helping to preserve liquidity in financial markets and keeping interest rates low.

GDP growth in 2021 will oscillate between 4% and 8% depending on the outcome of EU trade talks and success at eradicating the pandemic. CPI inflation is expected to remain within the BoE target rate of 2%.

3.2 Interest rate forecasts

The authority's treasury advisor, Link Asset Services (LAS), has provided the following updated forecast shown at **Appendix A**:

4.0 Treasury Management Summary

4.1 The mid year treasury management position is shown in table 1 below.

Table 1: Treasury Management Summary as at 30th September 2020

	01.04.20	Movement	30.09.20	Weighted Average Rate
Investments				
Fixed Deposit	137.800	-37.800	100.000	0.69
Money Market Funds	29.850	-26.950	2.900	0.89
Call Account	47.000	-32.000	15.000	0.36
Unrated Covered Bond	3.000		3.000	4.00
Total investments	**217.650**	**-96.750**	**120.900**	**0.74**
Loans				
PWLB	228.234		228.234	**3.36**
Banks (LOBO)	7.000		7.000	**3.61**
Temporary Borrowing	30.351	-25.000	5.351	**0.61**
Total Loans	**265.585**	**-25.000**	**240.585**	**3.31**

4.2 The Authority's investments as at 30th September 2020 were £120.9m – consisting of £95m with local authorities, £25.9m with UK banks.

4.3 Appendix B shows the breakdown of the authority's investments.

5.0 Borrowing Strategy

5.1 Detail

The short term strategy involves using the authority's cash balances and borrowing short-term from other local authorities to fund the estimated £220m 2020/21 borrowing requirement in the capital programme. As long term borrowing rates are far higher than short term borrowing rates this creates immediate revenue saving. Moreover the outcome of the Government PWLB consultation is due this financial year and there is an expectation that PWLB spreads will reduce and may even reverse the 1% increase that was unexpectedly applied last year – locking into long term debt now could result in the authority paying too much interest over the lifetime of the loan

This strategy is not without risk and officers have evaluated those risks:

1) Short term rates could increase; as stated in the aforementioned economic update there is little prospect of bank rate increasing and nor do we see liquidity tightening in the short term given the current level of monetary and fiscal expansion.
2) Inter local authority market falls away. Presently the sector has abundant cash balances augmented by Covid 19 support grants. However it is likely that these grants will diminish during the year and the supply of loans from this market could reduce. The ability to borrow from other sources, slippage or cuts to capital programmes in the sector mitigate against that risk. Moreover, this authority has a large cash balance it can draw upon before it ventures into the short term borrowing market for capital purposes.
3) Gilt yields increase: The gilt yield, influences the fixed rate, at the time long-term borrowing is locked down and the effect on revenue is felt for decades to come. The gilt yield is influenced by the markets view on inflation and growth. As stated in the economic update the outlook on both these factors remain subdued. Officers and LAS are monitoring these rates and the outlook on them very closely and if that view changes then a decision to draw down long term debt may be made.
4) PWLB will not reduce spreads before long-term borrowing is required: This is subject to a) market conditions, and b) a robust framework which fulfils their objectives. There is no guarantee that the PWLB will reduce their rates anytime soon. However the view is that the government is keen for authorities to fund their core programmes, Housing projects and regeneration schemes to help promote economic growth at a time when there is considerable surplus capacity in the economy and an elevated unemployment rate.
5) PWLB access is restricted, other long term investors will not be there to fulfil the need: Officers are looking at alternatives to the PWLB and the market of lenders to authorities is continuing to expand and offering pricing terms that are competitive with the PWLB. The options available

are; Public bonds, Bond Agency issue and private placement. The authority's credit quality is key to what terms lenders are prepared to offer and an increase in the short term borrowing ratio could result in a lower rating. Officers and LAS are monitoring this and other metrics and the authority's credit rating remains strong in this sector and capable of securing competitive terms to equivalent PWLB fixed rate loans with the added feature of being able to defer drawdown to match the borrowing requirement.

The PWLB have reversed the 1% increase in spread that was imposed last year on HRA loans. The authority will seek to draw down this debt once the HRA borrowing profile has been established.

5.2 Debt Rescheduling

The possibility of debt rescheduling is regularly discussed with our treasury adviser. However opportunities have been almost non-existent in the current economic climate.

5.3 LOBO's

The Authority holds a £7m LOBO loan with Danske Bank that has the option to propose an increase in the interest rate at set dates, while the Authority has the option to either accept the new rate or to repay the loan at no additional cost. LAS stated there is a low probability that the lender will propose an increased rate in the foreseeable future.

6.0 Budgeted Income and Return

6.1 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 2 below:

Table 2: 2020-21 Treasury Investment Performance to 30th September 2020

Period	Benchmark Return 3 month LIBOR (Average Quarterly Rate)	Budgeted Rate of Return %	Actual Rate of Return %	Average Investment Interest earned to Period end £m
Quarter 1	0.387	0.80	1.00	0.390
Quarter 2	0.075	0.80	1.01	0.334
Average / Total				0.724

6.2 The authority outperformed its benchmark in Q1 and Q2. This was achieved by locking into longer term deposits to mitigate the impact of a falling 3 month LIBOR. This strategy has achieved a better return for 2020-21 investment income.

6.3 It is expected that the average 3 month LIBOR will drop further and as maturing deposits are replaced with new investments at lower rates any excess interest in year may be eroded before the end of the financial year.

6.4 The deferral of long term borrowing has meant investment balances are running lower than planned and with short term interest rates falling during the year it may be challenging to meet the treasury investment income budget in 2020/21 but this will be more than offset by the savings on the interest payable budget.

7.0 Current Investment Opportunities

7.1 The Authority is occasionally made aware of long term investment opportunities by other oneSource Authorities, brokers or investment advisers. By extending the number of regulated brokerage firms it provided more competition and resulted in deals being agreed that best meets the authority's requirements.

7.2 Cabinet on the 12th February 2020 approved changes to the Treasury Management Strategy Statement (TMSS) which facilitate investment in a wider range of products.

8.0 Changes in risk appetite

8.1 The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to members' attention in treasury management update reports.

9.0 Compliance with Prudential and Treasury Indicators

9.1 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. The Authority's approved 2020/21 Treasury and Prudential Indicators (affordability limits) were included and approved by Full Council as part of the TMSS 26th February 2020.

9.2 During the half year, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority TMSS and in compliance with the authority's Treasury Management Practices. An update on indicators and limits are reported in **Appendix C** of this report.

IMPLICATIONS AND RISKS

Financial implications and risks:

Year toate treasury activity is in accordance with the Authority's approved TMSS. There has been no breach in the Authority's treasury indicators and prudential indicators set out in the TMSS.

It is expected that the authority's net interest costs will be within budget in 2020/21 and any new borrowing undertaken for the capital programme for remainder of 2020/21 will be in accordance with the Authority's treasury limits and prudential indicators. The impacts of the treasury management strategy are incorporated and managed within the medium term financial strategy of the council.

Legal implications and risks:

The Statutory guidance on treasury management provides as follows:

"For treasury management and other financial investments local authorities should continue to prioritise SECURITY, LIQUIDITY and YIELD in that order of importance."

Members must be sure that they understand the content of the Strategy and this Report and the risks involved as they are tasked with overseeing the use of significant sums of public money.

Otherwise there are no legal implications in noting the content of this Report.

Human Resources implications and risks:

There are no HR implications from this report

Equalities Implications and Risks:

The Public Sector Equality Duty (PSED) under section 149 of the Equality Act 2010 requires the Council, when exercising its functions, to have due regard to:

(i) The need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;
(ii) The need to advance equality of opportunity between persons who share protected characteristics and those who do not, and;
(iii) Foster good relations between those who have protected characteristics and those who do not.

The Council is committed to all of the above in the provision, procurement and commissioning of its services, and the employment of its workforce.

Health and Wellbeing Implications and Risks:

The Council is committed to improving the quality of life and wellbeing for all Havering employee's and residents in respect of socio-economics and health determinants. There are no direct implications to the Council's workforce and residents health and wellbeing as a result of this report.

BACKGROUND PAPERS

None

Audit Committee, 27th October 2020