Report of the Director:
Governance and Partnerships

Agenda Item No: 5
Meeting: 14 December 2021

NORTH LINCOLNSHIRE COUNCIL

COUNCIL

TREASURY MANAGEMENT MID-YEAR REPORT 2021/22

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1. This report provides an overview of the Council's treasury performance during the first six months of 2021/22 and sets out national factors that affect the Council's Treasury activity.

1.2. The key points are that the Council's:

- Investment returns remain at near zero due to the impact of the Covid 19 pandemic. The Council has continued to take a cautious approach to investing.
- Borrowing remains comfortably within the control levels set and no new borrowing was undertaken.
- Treasury activity was compliant with the Prudential Indicators set for the financial year.

2. BACKGROUND INFORMATION

2.1 This report fulfils the Authority's legal obligation under the Local Government Act to have regard to both the CIPFA Code and the department for Levelling Up, Housing and Communities (DLUHC), previously the Ministry of Housing, Communities & Local Government (MHCLG) Investment Guidance. The CIPFA Code requires that Council receive a report at the start of the financial year, mid-year and year end. The Audit Committee also receive regular updates regarding treasury activity, providing assurance on the effectiveness of the Council's treasury management arrangements.

2.2 The CIPFA Code sets out the following objectives for treasury management:

"It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield risk, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy."

2.3 Council agreed the Treasury Management Strategy Statement (TMSS) for 2021/22 in February 2021.

3. OPTIONS FOR CONSIDERATION

3.1 This is a report on past performance for Council to consider the mid-year performance and treasury management activity. Full details of the mid-year review are attached in appendix 1.

4. ANALYSIS OF OPTIONS

4.1 The key messages are:

- Interest rates remain near all-time lows at 0.10%. The bank rate is not expected to increase quickly, a forecast rise to 0.25% in June 2022 with a further increase to 0.75% in the final quarter of 2023/24. As a result, there is opportunity for reducing our average cost of borrowing.

- The Council aims to achieve optimum return on its investments in accordance with its priorities of security, liquidity and risk appetite.

- The Council's investment balances during the first six months of the year were £48.9m and as such is always in a position to meet its liabilities, while managing risks associated with carrying cash balances.

- The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

- It is anticipated that further borrowing will not be required during this financial year.

5. RESOURCE IMPLICATIONS (FINANCIAL, STAFFING, PROPERTY, IT)

5.1 Not applicable

6. OTHER IMPLICATIONS (STATUTORY, ENVIRONMENTAL, DIVERSITY, SECTION 17 - CRIME AND DISORDER, RISK AND OTHER)

6.1 Risk and external factors are considered in the monitoring report.

7. OUTCOMES OF INTEGRATED IMPACT ASSESSMENT (IF APPLICABLE)

7.1. Not applicable.

8. OUTCOMES OF CONSULTATION AND CONFLICTS OF INTERESTS DECLARED

8.1 Not applicable.

9. RECOMMENDATIONS

9.1 That Council receives and notes the treasury management mid-year report 2021/22.

DIRECTOR: GOVERNANCE AND PARTNERSHIPS

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Background Papers used in the preparation of this report

Council
2021-22 Treasury Management Strategy
2021-22 Capital Programme

CIPFA Publications
Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2017 Edition)
The Prudential Code for Capital Finance in Local Authorities (2017 Edition)

Legislation and Central Government Guidance
Local Government Act 2003
The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
MHCLG

Appendix 1

Mid-Year Review 2021/22
Treasury Management

North Lincolnshire Council

www.northlincs.gov.uk

1. Background

1.1 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

1.2 Treasury management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations 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.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can 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.

Accordingly, treasury management is defined as:

> "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. Introduction

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Audit Committee:

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2021/22 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

3. Economics and interest rates

3.1 Economics update

MPC meeting 24.9.21

- The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing.

- A potential danger was highlighted that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.

- At MPC meeting, there was a concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth. This could lead to inflation rising to 4% before reducing again to the 2% MPC target.

- Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

- The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
    1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
    2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
    3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
    4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.

3.2 Interest rate forecasts

The Council's treasury advisor, Link Group, provided the following forecasts on 29th September 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View 29.9.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

The COVID-19 outbreak has had economic impact both in the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 23/24 and a third one to 0.75% in quarter 4 of 23/24.

Significant risks to the forecasts

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The MPC tightens monetary policy at the wrong time.

The balance of risks to the UK economy: -

There remains a number of risks to economic growth in the UK, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

Forecasts for Bank Rate
Bank Rate is not expected to increase quickly after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may need to be revised again as the economic situation evolves.

The Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to remove that last cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is historically both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields
As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to a number of economic factors.

Gilt and treasury yields

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. This volatility is likely to continue over the medium term but PWLB rates are most likely to increase slowly in line with the forecasts shown above.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement, (TMSS), for 2021/22 was approved by this Council on 25 February 2021.

- There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2021/22 Original Estimate £m	Current Position £m	2021/22 Revised Estimate £m
Total capital expenditure	49.26	14.406	55.68

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Total capital expenditure	49.260	55.68
Financed by:		
Capital receipts	10.500	10.500
Capital grants	24.008	28.336
Revenue	0.016	0.060
Total financing	34.524	38.836
Borrowing requirement	14.736	16.844

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

We are on target to achieve the original forecast Capital Financing Requirement.

Prudential Indicator – the Operational Boundary for external debt

	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR –	264.554	264.554
Total CFR	264.554	264.554
Net movement in CFR	0.000	0.000
Prudential Indicator – the Operational Boundary for external debt		
Borrowing	269.554	269.554
Other long-term liabilities	2.000	2.000
Total debt (year-end position)	**271.554**	**271.554**

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2021/22 Original Estimate £m	Current Position £m	2021/22 Revised Estimate £m
Borrowing	200.855	155.959	152.616
Other long term liabilities	0.000	0.000	0.00
Total debt	200.855	155.959	152.616
CFR (year end position)	264.554	264.554	264.554

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2021/22 Original Indicator £m	Current Position £m	2021/22 Revised Indicator £m
Borrowing	304.554	155.959	304.544
Other long term liabilities	5.000	0.000	5.000
Total	309.554	155.959	309.554

6. Borrowing

The Council's capital financing requirement (CFR) for 2021/22 is £264.554m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

It is anticipated that further borrowing will not be undertaken during this financial year.

7. Debt Rescheduling

No debt rescheduling has been undertaken to date in the current financial year.

8. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22. The Director Governance and Partnerships reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

9. Annual investment strategy

The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Council on 25 February 2021. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach.

As shown by the interest rate forecasts in section 3.2, interest rates are expected to remain close to zero.

Creditworthiness.

At the beginning of the Covid-19 pandemic there was a concern that many financial institutions would have their credit rating reduced. In the main, this did not happen.

Investment Counterparty criteria

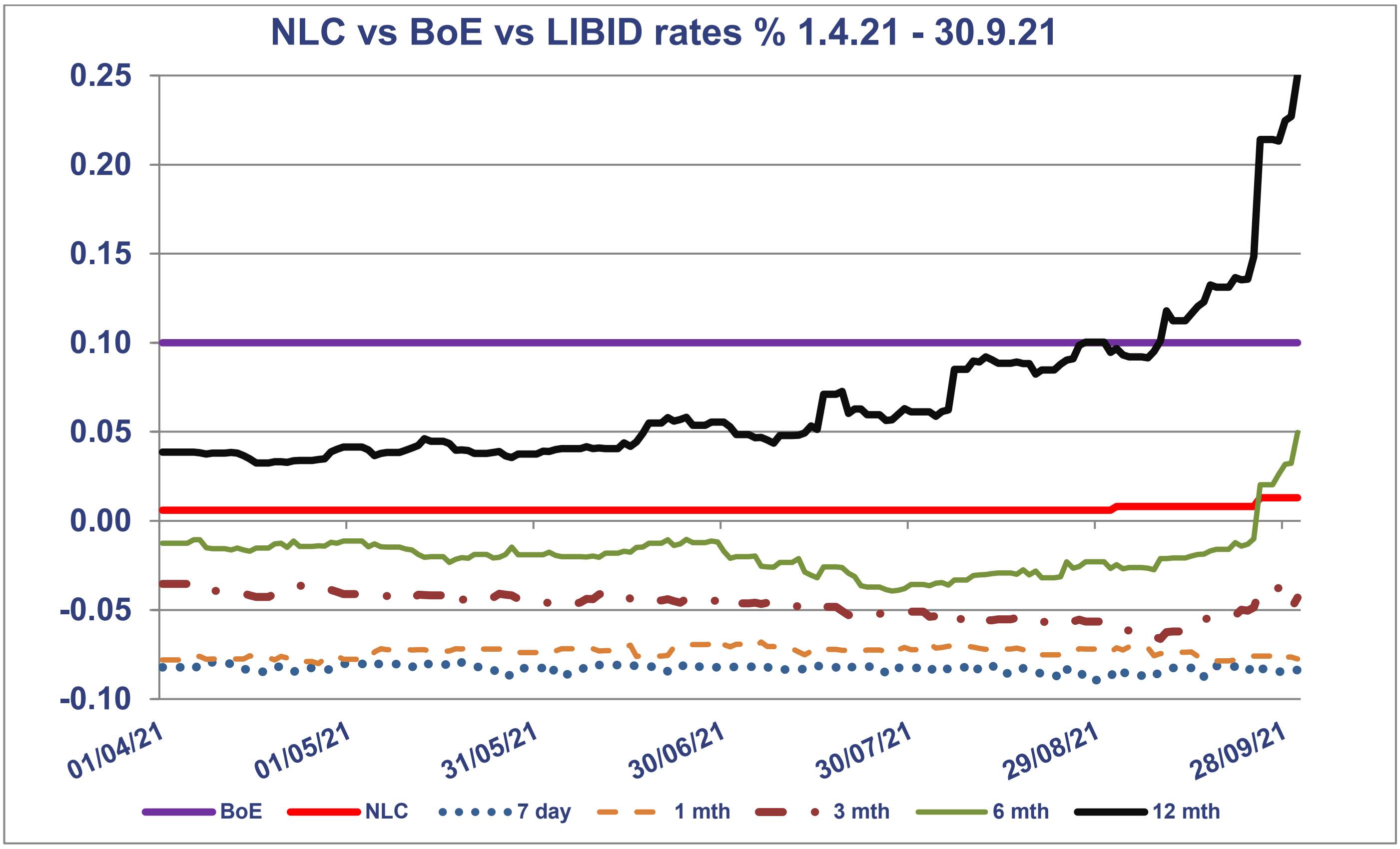
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

Investment balances

The average level of funds available for investment purposes during the first half of the year was **£48.9 m**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Investment rates during half year ended 30th September 2021

As highlighted earlier in this report, the levels shown below use the traditional market method for calculating LIBID rates – i.e., LIBOR – 0.125%. Given the ultra-low LIBOR levels this year, this produces negative rates across some periods.



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	-0.08	-0.07	-0.04	0.05	0.25
High Date	01/04/2021	09/04/2021	06/07/2021	01/04/2021	30/09/2021	30/09/2021
Low	0.10	-0.09	-0.08	-0.07	-0.04	0.03
Low Date	01/04/2021	27/08/2021	26/04/2021	08/09/2021	27/07/2021	16/04/2021
Average	0.10	-0.08	-0.07	-0.05	-0.02	0.07
Spread	0.00	0.01	0.01	0.03	0.09	0.22

Investment performance year to date as at 30th September 2021

Period	LIBID benchmark return	Council performance	Investment interest earned
7 day	**-0.08%**	0.013%	£153.41
1 month	**-0.07%**	0.008%	£376.71
3 month	**-0.05%**	0.006%	£866.10
6 month	**-0.02%**	0.006%	£1,597.44

As illustrated, the Council outperformed the benchmark by 0.026%.

Fund investments

- Money Market Funds (MMFs)
- DMO Deposits
- Interest earning call accounts

Investments As at 30 September 2021			
Type	**Counterparty**	**Rate**	**Principal O/S (£)**
Fixed	DMADF (Debt Management Account Deposit Facility)	0.010%	44,500,000.00
Call	Bank of Scotland plc	0.010%	3,000,000.00
Call	Barclays Bank plc	0.010%	3,555,310.69
MMF	BlackRock Institutional Sterling Liquidity	0.007%	3,000,000.00
MMF	Goldman Sachs MMF	0.000%	3,000,000.00
			57,055,310.69

Following BoE, Monetary Policy Committee (MPC) meeting in September 2021, there is now an expectation that interest rates will rise in next 2 quarters. The Council is exploring possible investment opportunities with improved returns. The outcome of this will be reported in the annual outturn report for 2021-22.

Approved limits

The approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2021.

10. Other

1. Barclays Approval Sequence

Due to system requirements of Barclays.net, the order of approvals in the workflow of payments above £50k has changed. This does not affect the controls in place for the approval of payments.