Oldham Council

Report to Cabinet

Treasury Management Mid-Year Review Report 2020/21

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Reason for Decision

This report advises Cabinet of the performance of the Treasury Management function of the Council for the first half of 2020/21 and provides a comparison of performance against the 2020/21 Treasury Management Strategy and Prudential Indicators.

Executive Summary

The Council is required to consider the performance of the Treasury Management function in order to comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). This report therefore sets out the key Treasury Management issues for Members' information and review and outlines:

- An economic update for the first six months of 2020/21;
- 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 2020/21;
- A review of the Council's borrowing strategy for 2020/21;
- Why there has been no debt rescheduling undertaken during 2020/21; and
- A review of compliance with Treasury and Prudential Limits for 2020/21.

Members will be aware that one of the roles of the Audit Committee is to scrutinize all Treasury Management reports before approval. Therefore, a version of this report was presented to the Audit Committee on 3 November 2020 to enable it to have the opportunity to review and scrutinise the 2020/21 Treasury Management Mid-Year Review report prior to its presentation to Cabinet.

Recommendation

That Cabinet approves and commends to Council the:

a) Treasury Management activity for the first half of the financial year 2020/21 and the projected outturn position

b) Amendments to both Authorised Limit and Operational Boundary for external debt as set out in the table at Section 2.4.5 of the report.

c) Amendments to the Capital Financing Requirement (CFR) as set out in the table at section 2.4.5

Cabinet **16 November 2020**

Treasury Management Strategy Mid-Year Review Report 2020/21

1 Background

1.1 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 is to ensure this cash flow is adequately planned, with surplus monies being invested with low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.2 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.

1.3 As a consequence, treasury management is defined as:

"The management of the local authority's 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."

1.4 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. Within these new codes as from 2019/20, all local authorities have been required to prepare a Capital Strategy which is to provide the following:

a) a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;

b) an overview of how the associated risk is managed;

c) the implications for future financial sustainability.

1.5 The Council has traditionally prepared a Capital Strategy, but the requirements of the Prudential and Treasury Management Codes required a revised format and content to ensure alignment with both Codes. A report incorporating the new requirements was presented to the 2020/21 Budget Cabinet and Budget Council meetings.

2 Current Position

2.1 Requirements of the Treasury Management Code of Practice

2.1.1 Treasury Management reports must be prepared in accordance with the requirements of the CIPFA Code of Practice on Treasury Management (revised 2017).

2.1.2 The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

c) 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** (this report**)** and an Annual Report (stewardship report) covering activities during the previous year.

d) 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. In Oldham, this responsibility is delegated to the Director of Finance.

e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. In Oldham, the delegated body is the Audit Committee.

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

- An economic update for the first six months of 2020/21;
- 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 2020/21;
- A review of the Council's borrowing strategy for 2020/21;
- Why there has been no debt rescheduling undertaken during 2020/21; and
- A review of the compliance with Treasury and Prudential Limits for 2020/21;

2.2 Economic Update for the First Six Months of the Financial Year

The United Kingdom (UK)

2.2.1 As expected, the Bank of England's Monetary Policy Committee (MPC) kept Bank Rate unchanged on 6 August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in Gross Domestic Product (GDP) in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.
- The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.
- It forecast that there would be excess demand in the economy by Q3 2022 causing Consumer Price Inflation (CPI) to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

2.2.2 It also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including Quantitative Easing (QE) and the use of forward guidance.

2.2.3 The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

2.2.4 In conclusion, this would indicate that the Bank need take no further action as the economy was recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. The challenges are clear from the way in which second waves of the virus are now impacting many countries including Britain.

2.2.5 However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused.

2.2.6 In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. The Chancellor announced in late September a second six- month package (from 1^{t} November) of Government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours.

2.2.7 There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid-September.

2.2.8 Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

2.2.9 There will be however, some longer-term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

2.2.10 One key addition to the Bank's forward guidance was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate

2.2.11 The Financial Policy Committee (FPC) report on 6 August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

<u>United States of America (USA)</u>

2.2.12 The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again.

2.2.13 However, growth will be dampened by continuing outbreaks of the virus in some States leading to fresh localised restrictions. At its end of August meeting, the Federal Reserve (Fed) tweaked its inflation target from 2% to maintaining an average of 2% over an unspecified time period i.e.following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time.

2.2.14 This change is aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade so financial markets took note that higher levels of inflation are likely to be in the pipeline and long term bond yields duly rose after the meeting.

2.2.15 The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The Federal Open Market Committee's (FOMC) updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least the end of 2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

European Union (EU)

2.2.16 The economy was recovering well towards the end of Q2 after a sharp drop in Gross Domestic product (GDP), (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism.

2.2.17 The fiscal support package, eventually agreed by the European Union (EU) after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The European Central Bank (ECB) has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.

China

2.2.18 After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending.

2.2.19 After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

Japan

2.2.20 There are some concerns that a second wave of the virus is gaining momentum and could dampen economic recovery from its contraction of 8.5% in GDP. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus.

2.2.21 It is also making little progress on fundamental reform of the economy. The resignation of Prime Minister Abe is not expected to result in any significant change in economic policy.

World Growth

2.2.22 Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

2.3 **Interest Rate Forecast**

2.3.1 The Council's treasury advisor, the Link Group, has provided the following forecast of interest rates over the period from December 2020 to March 2023 together with Public Works Loan Board (PWLB) Rates which are presented at certainty rates (gilt yields plus 180bps).

Link Group Interest Rate View 11.8.20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

2.3.2 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6 August (and the subsequent September meeting), although some forecasters had suggested that a cut into negative territory could happen.

2.3.3 However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary.

2.3.4 As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31 March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

<u>Gilt Yields / PWLB Rates</u>

2.3.5 There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020.

2.3.6 In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields.

2.3.7 While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc.

2.3.8 The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields (up to 10 years) turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession.

2.3.9 The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

2.3.10 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the initial phases of the health crisis in March, we have seen these yields fall sharply to unprecedented lows as major western central banks took rapid action to deal with excessive stress in financial markets, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds.

2.3.11 Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. At the close of the day on 30 September, all gilt yields from 1 to 6 years were in negative territory, while even 25-year yields were at only 0.76% and 50 year at 0.60%.

2.3.12 From the Local Authority borrowing perspective, HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019/20 without any prior warning. The first took place on 9 October 2019, adding an additional 1% margin over gilts to all PWLB period rates.

2.3.13 That increase was then at least partially reversed for some forms of borrowing on 11 March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased infrastructure expenditure.

2.3.14 It also announced that there would be a PWLB consultation with Local Authorities on possibly further amending these margins; this was to end on 4 June, but that date was subsequently put back to 31 July.

2.3.15 It is clear HM Treasury will no longer allow Local Authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

2.3.16 Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

2.3.17 It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation; however, the timing of such a change is currently unknown, although it would be likely to be within the current financial year.

2.3.18 As the interest forecast table for PWLB certainty rates (gilts plus 180bps), above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

The Balance of Risks to the UK

2.3.19 The overall balance of risks to economic growth in the UK is probably relatively even but is subject to major uncertainty due to the virus.

2.3.20 There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations.

2.3.21 However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

Downside risks to current forecasts for UK gilt yields and Public Works Loan Board (PWLB) rates

2.3.22 There are a number of downside risks to current forecasts for UK gilt yields and PWLB rates as follows:

- **UK** - second nationwide wave of virus infections requiring a national lockdown
- **UK / EU trade negotiations –** if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **A resurgence of the Eurozone sovereign debt crisis.** The European Central Bank (ECB) has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for “weaker” countries. In addition, the EU recently agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to Gross Domestic Product (GDP) and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- **Weak capitalisation of some European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel’s CDU party was left in a vulnerable minority position dependent on the support of the SPD party. The CDU has done badly in subsequent state elections, but the SPD has fared worse.. Angela Merkel has stepped down from being the CDU party leader, but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who the major guiding hand and driver of EU unity will be when she steps down.
- **Other minority EU governments**. Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Geopolitical risks**, for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.
- US – the Presidential election in 2020: this could have repercussions for the US economy and SINO-US trade relations.

Upside risks to current forecasts for UK gilt yields and PWLB rates

2.3.23 Upside risks to current forecasts of UK gilt yields and PWLB rates include:

- **UK -** stronger than currently expected recovery in UK economy.
- **Post-Brexit** – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

2.4 Treasury Management Strategy Statement and Annual Investment Strategy Update

2.4.1 The Treasury Management Strategy Statement (TMSS) for 2020/21 was approved at the Council meeting on 26 February 2020. The underlying TMSS approved previously now requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out in the next sections of this report.

2.4.2 A decrease is required to both the overall Authorised Limit (the "affordable borrowing limit" required by Section 3 of the Local Government Act 2003 above which the Council does not have the power to borrow) and Operational Boundary (the expected borrowing position of the Council during the year) for external debt. This indicator is made up of external borrowing and other long-term liabilities, Private Finance Initiatives (PFI) and Finance Leases. The revision to the limits aligns to the reduction in the Capital Financing Requirement as outlined at paragraph 2.4.4 and 2.4.5 below.

2.4.3 The Council has the following PFI and Public Private Partnership (PPP) Schemes each contributing to the Other Long-Term Liabilities element of the Authorised Limit and the Operational Boundary, thus making them both higher than if the Council was not required to present PFI schemes in this way:

- Gallery Oldham and Library
- Sheltered Housing (PFI2)
- Radclyffe and Failsworth Secondary Schools
- Chadderton Health & Well Being Centre
- Street Lighting
- Housing (PFI4)
- Blessed John Henry Newman RC College (Building Schools for the Future)

2.4.4 It will be necessary to reduce the Capital Financing Requirement (CFR) by £62.455m. Whilst approved capital expenditure/ funding carry forwards from 2019/20 caused an initial increase, this is more than offset by estimated re-phasing and re-alignment and other anticipated adjustments in the 2020/21 capital programme resulting in the reduced CFR.

2.4.5 Members are therefore requested to approve the key changes to the 2020/21 prudential indicators as set out in the table below which show the original and recommended revised figures:

Prudential Indicator 2020/21	Original £'000	Recommended Revised Prudential Indicator £'000
Authorised Limit	601,500	529,500
Operational Boundary	574,500	509,500
Capital Financing Requirement	567,242	504,787

2.5 The Council's Capital Position (Prudential Indicators)

2.5.1 This section of the report presents the Council's capital expenditure plans and their financing, the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow together with compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

2.5.2 The table below shows the anticipated half year position and the revised budget for capital expenditure. It therefore highlights the changes that have taken place and are forecast since the capital programme was agreed at the Council meeting on 26 February 2020.

Capital Expenditure by Service	2020/21 Original Estimate £'000	2020/21 Revised Estimate £'000
Corporate Services	6,010	20,757
Children's Services	15,590	9,982
Community Services & Adult Social Care	3,400	125
People & Place	108,308	48,080
Reform	346	2,010
Funds for Emerging Priorities	3,440	301
HRA	5,538	4,952
Commercial Activities / Non Financial Investments	5,000	3,740
Closing balance	**147,632**	**89,947**

2.5.3 The above table shows an anticipated decrease in the capital programme of £57.685m at month 6 compared to the February 2020 position, with current forecast spend of £89.947m. During the summer months the Council undertook the Annual Review of the Capital Programme in line with practice of recent years. The review identified a requirement for significant re-profiling across a number of schemes. Most of the re- phasing moved significant expenditure (£53.437m) from 2020/21 into the later years of the capital programme. The budget variations largely relate to re-profiling in the People and Place and Children's Services directorates. The major re-phasing within People and Place relates to key elements of the Creating a Better Place programme. Children's Services has identified re-phasing of the Schools Capital Programme, mainly due to planning related issues.

Changes to the Financing of the Capital Programme

2.5.4 The table below draws together the main strategy elements of the capital expenditure plans (above) highlighting the original supported (£48.562m) and unsupported elements i.e. requiring borrowing (£99.070m), and the expected financing (revised position) arrangements of this capital expenditure. The borrowing need 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.

2.5.5 The overall net reduction in the capital programme has resulted in a change in the mix of funding sources required in 2020/21; a decrease in all financing types reducing the forecast borrowing need by £44.604m from £99.070m to £54.466m.

Capital Expenditure	2020/21 Original Estimate £'000	2020/21 Forecast Position £'000
General Fund Services	137,0944	81,255
Housing Revenue Account	5,538	4,952
Commercial Activities and Non-Financial Investments	5,000	3,740
Total Expenditure	**147,632**	**89,947**
Financed by:		
Capital receipts	(9,306)	(9,847)
Capital grants – Ringfenced	(11,209)	(5,478)
Capital grants – Un-ringfenced	(22,504)	(14,838)
Other Resources	(5)	(344)
Revenue	0	(22)
HRA Revenue	(5,538)	(4,952)
Total Financing	**(48,562)**	**(35,481)**
Borrowing Need	**99,070**	**54,466**

Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

2.5.6 The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. As previously mentioned in paragraph 2.4.4 the CFR needs to decrease by £62.455m. It also shows the expected debt position over the period (the Operational Boundary). This indicator has decrease to reflect the revisions to the forecast year end position of the capital programme.

	2020/21 Original Estimate £'000	2020/21 Revised Estimate £'000
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	567,242	504,787
CFR – housing	0	0
Total CFR	**567,242**	**504,787**
Net movement in CFR		**(62,455)**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	350,000	284,500
Other long-term liabilities	224,500	225,000
Total debt 31 March	**574,500**	**509,500**

Limits to Borrowing Activity

2.5.7 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.

2.5.8 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 2020/21 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.

2.5.9 The CFR calculation is shown in the table below and the Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator as there is £83.160m headroom between total debt and the CFR.

	2020/21 Original Estimate £'000	2020/21 Revised Estimate £'000
Gross borrowing	237,599	198,624
Plus: other long- term liabilities*	224,425	223,003
Total Debt	**462,024**	**421,627**
CFR* (year-end position)	567,247	504,787
Headroom	**105,218**	**83,160**

* - Includes on balance sheet PFI schemes and finance leases

2.5.10 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. Presented in the table below is the original and the revised Authorised Limit.

Authorised limit for external debt	2020/21 Original Indicator £'000	2020/21 Revised Indicator £'000
Borrowing	372,000	299,500
Other long-term liabilities*	229,500	230,000
Total	**601,500**	**529,500**

* - Includes on balance sheet PFI schemes and finance leases.

2.5.11 The table above shows a reduction in the Authorised Limit of £72m due to the reduction in the capital programme and the associated financing.

2.6 **Annual Investment Strategy**

2.6.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. The current economic climate as detailed in 2.3, 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, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

2.6.2 As shown by the interest rate forecasts at 2.3, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31 March 2023, investment returns are expected to remain low.

Negative Investment Rates

2.6.3 While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks.

2.6.4 In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

2.6.5 As for money market funds (MMFs), yields have continued to drift lower. Some managers have suggested that they might resort to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a large amount of money at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short-term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions.

2.6.6 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties in accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

Creditworthiness

2.6.7 Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during the quarter ended 30 June 2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks.

2.6.8 However, during Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into the next quarters ahead, more information will emerge on actual levels of credit losses. (Quarterly performance is normally announced in the second half of the month following the end of the quarter). This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year.

2.6.9 These adjustments could be negative or positive, although it should also be borne in mind that UK banks went into this pandemic with strong balance sheets. Indeed, the Financial Policy Committee (FPC) report on 6 August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". They stated that in their assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

2.6.10 All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on negative watch, but with a small number of actual downgrades.

2.6.11 Oldham Council Treasury Advisors, The Link Group have conducted stress testing on the credit methodology they use to the base list of counterparties they suggest to clients, these test the affect a 1 notch downgrade to all Long-Term Ratings from all agencies. Under such a scenario, only NatWest Markets Plc (non-ring-fenced entity), Leeds, Skipton and Yorkshire Building Societies would be removed from the list currently in use.

Investment Counterparty criteria

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

CDS Prices

2.6.13 Although CDS prices, (these are market indicators of credit risk), for UK banks spiked upwards at the end of March / early April due to the liquidity crisis throughout financial markets, CDS prices have returned to more average levels since then, although they are still elevated compared to end-February. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

Investment Balances

2.6.14 The Council held £81.890m of investments, including property funds as at 30 September 2020 (£118.120m at 31 March 2020). A full list of investments as at 30 September is included at Appendix 1. A summary of investments by type is included in the table below.

2.6.15 The Council ensures enough funds are kept in either instant access accounts and/ or on-call accounts to meet its short-term liquidity requirements. As at 30 September the Council held £46.390m in Money Market Funds and £2.500m in Notice Accounts of a 35-day notice period.

Investment Type	Total at 30 September 2020 £'000
Property	15,000
Fixed (Term Deposits) Bank / Building Society	5,000
Fixed (Term Deposits) LA's / Public Bodies	13,000
Notice Accounts	2,500
Money Market Fund	46,390
Total	**81,890**

2.6.16 The Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2020/21.

2.6.17 The Council's investment strategy looks to achieve a return on its investment of London Interbank Bid Rate (LIBID) plus a 5% mark up. The Council will maintain sufficient cash reserves to give it its necessary liquidity and may place investments up to 10 years if the cash flow forecast allows and the credit rating criteria is met. Performance against this benchmark was as follows:

Benchmark	Benchmark Return LIBID +5%	Council Performance
7 days	(0.06%)	0.24%
1 month	(0.02%)	0.64%
3 months	0.12%	0.85%
6 months	0.21%	0.89%
Average Return first 6 months		**0.60%**

2.6.18 The Council's performance on its cash investments exceeded its target on all benchmarks as can be seen in the table above.

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

Property Fund

2.6.20 In the first six months of the year the Councils investment within the Churches, Charities and Local Authorities (CCLA) property fund has generated a return of (4.45%). Given the impact Covid-19 has had on investment returns this fund has continued to perform better than expected and rental collection by the fund remains high which should result in continuing to receive better than expected dividends.

2.6.21 Due to the huge market uncertainty surrounding Covid-19 and Brexit, the property fund had seen a decline in the value up until the end of August mainly to valuer caution rather than any significant increase in pressure to sell properties, however valuations for September have started to increase. In contrast, occupier trends were strong, and dividends received stay at a similar rate.

2.7 Borrowing

2.7.1 It is proposed in this report that the Council's CFR for 2020/21 is revised to £504.787m and this 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.

2.7.2 The table within paragraph 2.5.9 shows the Council has expected year end borrowings of £421.627m and will have utilised £83.160m of cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

2.7.3 Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR), new external short-term borrowing of £20m was undertaken in the first two months of the financial year. The table below shows the new borrowing.

Loan Ref	Amount £'000	Start Date	Maturity Date	Term Days	Rate %
West Midlands Combined Authority	10,000	27/04/20	27/07/20	91	0.72%
North of Tyne Combined Authority	10,000	04/05/20	04/11/20	184	0.80%

2.7.4 Due to the increase in PWLB margins over gilt yields in October 2019, and the subsequent consultation on these margins by HM Treasury - which ended on 31 July 2020 - the Authority has refrained from undertaking new long-term PWLB borrowing for the present and has met its requirements for additional borrowing by using short-term borrowing, as detailed above, until such time as new PWLB margins are finally determined.

2.7.5 In addition, the effect of coronavirus on the capital programme objectives is being assessed. Therefore, the borrowing strategy will be reviewed and then revised in order to achieve optimum value and risk exposure in the long-term.

2.7.6 It is anticipated that further borrowing may be undertaken during this financial year.

2.7.7 The Council applied in September 2020 for the certainty rate reduction. This entitles the Council to receive a 20-basis point rate reduction on the prevailing rate of PWLB on any borrowing undertaken from 1 November 2020 to 31 October 2021.

2.7.8 Current PWLB certainty rates are set out in the following table and show for a selection of maturity periods over the first half of 2020/21, the range (high and low points) in rates and the average rates over the period. In addition, Appendix 2 tracks the movement in the PWLB certainty rate over the period April to September 2020 across the same range of loan terms as is used in the table below.

Maturity Rates	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.70%	1.67%	1.91%	2.40%	2.13%
Date	18/09/20	30/07/20	31/07/20	18/06/20	24/04/20
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/20	08/04/20	08/04/20	28/08/20	28/08/20
Average	1.80%	1.80%	2.04%	2.54%	2.33%

2.8 **Debt Rescheduling**

2.8.1 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

2.9 **Compliance with Treasury and Prudential Indicators**

2.9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2020, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2020 and continues to manage its treasury affairs in a prudent manner. The Director of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

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

2.10 Other Key Issues

Claim against Barclay Bank

2.10.1 The Council is currently involved in legal action against Barclays Bank with regards to certain Lender Option Borrower Option (LOBO) transactions. This is based on the Bank's involvement in manipulation of the LIBOR benchmark rate and the subsequent impact on the Council's financial position. This matter is on-going.

Municipal Bond Agency

2.10.2 The UK Municipal Bonds Agency (UKMBA) in which the Council is a shareholder has finally issued its first ever bond. In February 2020, the UKMBA issued a £350-300m 5-year SONIA linked Floating Rate Note (FRN) for Lancashire County Council. A further bond between the UKMBA and Lancashire County Council was agreed in August 2020. The second bond was a £250m issue with a 40-year maturity, 80bps lower than the equivalent rate from the Public Works Loan Board. Work is ongoing, to issue the UKMBA's first proportionally guaranteed bond, that is likely to involve a number of Local Authorities. The pooled bond is expected to be a £250m 10-year fixed rate bond. Oldham Council officers will continue to monitor bond issuance by UKMBA. If there is a long-term borrowing requirement then UKMBA will be appraised against the PWLB to ensure best value for money is achieved. Further updates on the UKMBA's bonds issues will be included in future treasury management reports.

International Financial Reporting Standard (IFRS) 16 – Leases

2.10.3 IFRS 16 is a new standard for lease accounting which should have come into force in January 2019. The changes apply to the accounting arrangements for lease agreements that organisations take out for property, plant and equipment (PPE). The standard for the public sector should have commenced from 1 April 2020. However, due to COVID-19 and the additional pressure Local Authorities are facing in these unprecedented times, on 20 March 2020, the Financial Reporting Advisory Board (FRAB), announced the deferral of International Financial Reporting Standard 16 (IFRS 16) implementation to 2021/22.

2.10.4 Previously, leases were split into finance leases and operating leases however, from 1 April 2021 they will now be accounted for as finance leases. Under the current regime, operating leases were not included in Balance Sheets as assets and expenditure were charged to Comprehensive Income and Expenditure Statement in the Council's accounts. Under IFRS 16 all leases must now be accounted for on the Balance Sheet. Work is currently ongoing to assess the full impact, but an estimate has been included in the Council's CFR so that the Council's prudential indicators are not adversely affect by the implementation of IFRS 16.

3 Options/Alternatives

3.1 In order that the Council complies with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management the Council has no option other than to consider and approve the contents of the report. Therefore, no options/alternatives have been presented.

4 Preferred Option

4.1 As stated above the preferred option is that the content of the report is approved.

5 Consultation

5.1 Consultation has taken place with Link Asset Services (the Councils Treasury Management Advisors), and senior officers. The report was presented to the Audit Committee for scrutiny prior to its consideration by Cabinet. All matters raised by Audit Committee Members were addressed at the meeting to the satisfaction of the Committee.

6 Financial Implications

6.1 All included within the report.

7 Legal Services Comments

7.1 None.

8 Co-operative Agenda

8.1 The Council ensures that any Treasury Management decisions comply as far as possible with the ethos of the Co-operative Council.

9 Human Resources Comments

9.1 None.

10 Risk Assessments

10.1 There are considerable risks to the security of the Authority's resources if appropriate treasury management strategies and policies are not adopted and followed. The Council has established good practice in relation to treasury management which has previously been acknowledged in both Internal and the External Auditors' reports presented to the Audit Committee.

11 IT Implications

11.1 None.

12 Property Implications

12.1 None.

13 Procurement Implications

13.1 None.

14 Environmental and Health & Safety Implications

14.1 None.

15 Equality, community cohesion and crime implications

15.1 None.

16 Equality Impact Assessment Completed?

16.1 No.

17 Key Decision

17.1 Yes

18 Key Decision Reference

18.1 FG -08-20

19 Background Papers

19.1 The following is a list of the background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents, which would disclose exempt or confidential information as defined by that Act.

File Ref:	Background papers are contained with Appendices 1, 2A, 2B & 2C
Officer Name:	Lee Walsh/Talei Whitmore
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20 Appendices

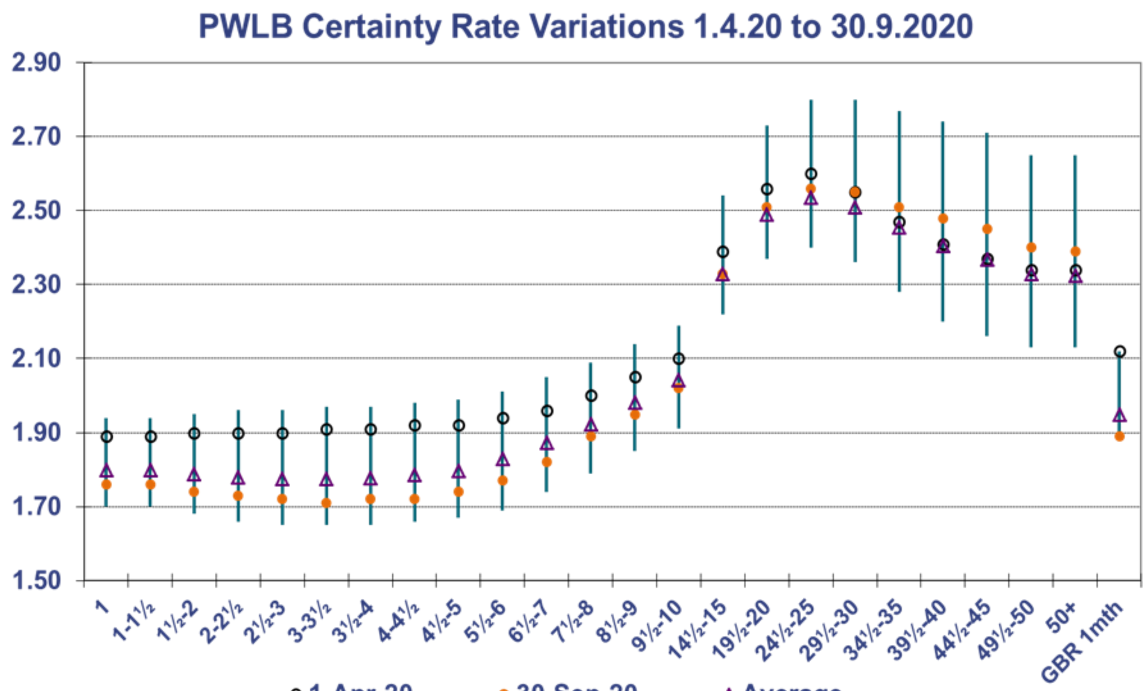
Appendix 1	Investments as at 30 September 2020
Appendix 2A	PWLB Certainty Rate Variations 2020/21
Appendix 2B	Comparison of Borrowing parameters to actual external borrowing - Table
Appendix 2C	Comparison of Borrowing parameters to actual external borrowing - Graph

Appendix 1 Investments as at 30 September 2020

Investments	Type	30th September 2020 £'000	Interest Rate	Date of Investment	Date of Maturity
CCLA Property Fund	Property	15,000	4.45%	Prior Years	open
Total Property Fund		**15,000**			
Slough Borough Council	Fixed	5,000	1.15%	06/04/2020	06/10/2020
Birmingham City Council	Fixed	3,000	1.05%	20/04/2020	20/10/2020
Thurrock Council	Fixed	2,500	0.58%	29/05/2020	30/11/2020
Thurrock Council	Fixed	2,500	0.58%	08/06/2020	08/12/2020
Santander UK Plc 180 Notice Ac	Fixed	5,000	0.70%	03/06/2020	30/11/2020
Total Fixed Investments		**18,000**			
Santander	35 day call	2,500	0.47%	03/06/2020	open
Total Investments on call		**2,500**			
Federated Sterling Liquidity 3	MMF	8,140	0.06%	30/09/2020	01/10/2020
Aberdeen Sterling Liquidity	MMF	18,250	0.09%	30/09/2020	01/10/2020
Invesco Sterling Liquidity	MMF	20,000	0.03%	01/09/2020	01/10/2020
Total MMF		**46,390**			
Total		**81,890**			

Appendix 2

2A) PWLB Certainty Rate Variations 2020/21



2B) Comparison of borrowing parameters to actual external borrowing (Table)

CAPITAL FINANCING REQUIREMENTS					
		Actual	Estimated	Estimated	Estimated
		2019/20	**2020/21**	**2021/22**	**2022/23**
CFR (including PFI and finance leases)		£'000	£'000	£'000	£'000
GFCFR		£472,376	£504,787	£553,364	£619,059
Total CFR		**£472,376**	**£504,787**	**£553,364**	**£619,059**
CFR (excluding PFI and finance leases)					
GFCFR		£238,657	£281,784	£340,052	£414,655
Total CFR		**£238,657**	**£281,784**	**£340,052**	**£414,655**
External Borrowing		**£167,843**	**£198,624**	**£223,624**	**£243,624**
Deferred Liabilities		**£233,719**	**£223,003**	**£213,312**	**£204,404**
Total Debt		**£401,562**	**£421,627**	**£436,936**	**£448,028**
Authorised Limit		£512,000	£529,500	£579,500	£643,000
Authorised Limit ex Deferred Liabilities		£278,281	£306,497	£366,188	£438,596
Operational Boundary		£495,000	£509,500	£559,500	£623,000
Operational Boundary ex Deferred Liabilities		£261,281	£286,497	£346,188	£418,596

2C) Comparison of borrowing parameters to actual external borrowing (Graph)