Oldham Council

Report to Council

Treasury Management Mid-Year Review Report 2021/22

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Reason for Decision

This report advises Council of the performance of the Treasury Management function of the Council for the first half of 2021/22 and provides a comparison of performance against the 2021/22 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 2021/22;
- 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;
- Why there has been no debt rescheduling undertaken during 2021/22; and
- A review of compliance with Treasury and Prudential Limits for 2021/22.

Members will be aware that one of the roles of the Audit Committee is to scrutinise all Treasury Management reports before approval. Therefore, a version of this report was presented to the Audit Committee on 2 November 2021 to enable it to have the opportunity to review and scrutinise the 2021/22 Treasury Management Mid-Year Review report prior to its presentation to Cabinet. The Committee was content to commend the report to Cabinet. The report was considered by Cabinet at its meeting of 15 November 2021. Cabinet was content to commend the report to Council.

Recommendation

That Council approves the:

a) Treasury Management activity for the first half of the financial year 2021/22 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

Treasury Management Strategy Mid-Year Review Report 2021/22

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 2020/21, 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 2021/22 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 2021/22;
- 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;
- Why there has been no debt rescheduling undertaken during 2021/22; and
- A review of the compliance with Treasury and Prudential Limits for 2021/22;

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

<u>The United Kingdom (UK)</u>

2.2.1 At the meeting of The Monetary Policy Committee (MPC) on 24 September 2021 the MPC voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

2.2.2 There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, the Governor was indicating the potential danger 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.

2.2.3 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, indicating, the MPC had been prepared to look through a temporary spike in inflation.

2.2.4 Therefore, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices,

particularly the increases in gas and electricity prices in October and due again April 2022, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement. This suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year.

2.2.5 This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

2.2.6 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 as furlough ended at the end of September. At the MPC's meeting in February 2022 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 2022 meeting when it would have data up until February 2022. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

2.2.7 The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

- Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
- Raising Bank Rate to 0.50% before starting on reducing its holdings.
- Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

European Union (EU)

2.2.8 The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle.

2.2.9 Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the European Central Bank (ECB) is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

German General Election

2.2.10 With the Christian Democratic Union of Germany (CDU)/ Christian Social Union (CSU) and Social Democratic Party (SDP) both having won around 24-26% of the vote in the September 2021 General Election, the composition of Germany's coalition Government has only just been agreed. The new SDP-led coalition will probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition Government is likely to be small. Now that Angela Merkel has stood down as Chancellor, there will be a hole in overall EU leadership which will be difficult to fill.

China

2.2.11 After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year. This enabled China to recover all the initial contraction. During

2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth.

2.2.12 At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns, which will also depress economic growth.

2.2.13 There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

Japan

2.2.14 During 2021, Japan has had a difficult year in combating the Covid-19 pandemic. However, after a slow start, many more of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4.

2.2.15 The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon and inflation was negative in July 2021. New Prime Minister Kishida having recently won a General Election, has promised a large fiscal stimulus package.

World Growth

2.2.16 World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022.

2.2.17 It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

Supply Shortages

2.2.18 The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. There have been major queues of ships unable to unload their goods at ports in New York, California, and China.

2.2.19 Such issues have led to misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries.

2.2.20 Many western countries are also having difficulty in filling job vacancies. It is expected that these issues will be gradually reduce, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

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 2021 to March 2024 together with Public Works Loan Board (PWLB) Rates which are presented at certainty rates (gilt yields plus 80 basis points (bps)).

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

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 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

2.3.3 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 2023/24 and a third one to 0.75% in quarter 4 of 2023/24.

Significant Risks to the Forecasts

2.3.4 There are significant risks to forecasts and these are set out below:

- Covid-19 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 Government implements an austerity programme that supresses GDP growth.
- The MPC tightens monetary policy too early, by raising Bank Rate or unwinding quantitative easing (QE).
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets, for example in the US, become increasingly judged as being over-valued and susceptible to major price corrections.
- Central Banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- Geo-political risks are widespread.

The Balance of Risks to the UK Economy

2.3.5 The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid-19 and its variants, both domestically and their potential effects worldwide.

Forecast for Bank Rate

2.3.6 Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so it 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.

2.3.7 Three increases in Bank Rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons:

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which actions to take.
- Some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit.
- Rising gas and electricity prices in October 2021 and April 2022 and increase in other prices caused by supply shortages and increases in taxation next April 2022, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers have around £200bn of excess savings left over from the pandemic for which the timing of spending is unclear.
- Approximately 1.6 million people came off furlough at the end of September 2021. It is unclear how many of those no longer have a permanent job and will, therefore, be available to fill labour shortages in many sectors of the economy. So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- The recent Omicron development in the Covid-19 pandemic, on top of the flu season this winter, could depress economic activity.

2.3.8 In summary, with the high level of uncertainty prevailing on several different fronts. It is likely that these forecasts will need to be revised again soon.

2.3.9 It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid-19 crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency 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 normality.

2.3.10 In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB Rates and Gilt Yields

2.3.11 As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

2.3.12 There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors:

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the US Federal Reserve (FED) take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will Central Banks implement their new average or sustainable level inflation monetary policies?
- How well will Central Banks manage the withdrawal of QE purchases of their national bonds?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

2.3.13 The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming and that there are no major changes in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Gilt and Treasury Yields

2.3.14 Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic Party's determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid-19 pandemic was what unsettled financial markets.

2.3.15 This was in addition to the $900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American Families Plan over the next decade which is currently caught up in Democrat / Republican debates. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when:

- A fast vaccination programme has enabled a rapid opening up of the economy.
- The economy had already been growing strongly during 2021.
- It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to impact on inflationary pressures more in the US than in other countries.
- The FED was still providing monetary stimulus through monthly QE purchases.

2.3.16 These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the FED to take much earlier action to start tapering monthly QE purchases and/or increasing the FED rate from near zero, despite their stated policy being to target average inflation.

2.3.17 It is notable that some FED members have moved forward their expectation of when the first increases in the FED rate will occur in recent FED meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation.

2.3.18 A run of strong monthly jobs growth figures could be enough to meet the threshold set by the FED of "substantial further progress towards the goal of reaching full employment". However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries.

2.3.19 However, during June 2021 and July 2021, longer term yields fell sharply. Even the large non-farm payroll increases in the first week of August 2021 seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the FED is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK.

2.3.20 As an average since 2011, there has been a 75% correlation between movements in 10-year treasury yields and 10-year gilt yields. This is a significant upward risk exposure to forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

2.3.21 There is also a possible downside risk from the huge sums of cash that the UK population has saved during the pandemic. When savings accounts earn little interest, it is likely that some of this cash could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down.

Balance of Upside Risks to Medium to Long Term PWLB Rates

2.3.22 One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the FED, the Bank of England, and the European Central Bank (ECB), to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate.

2.3.23 There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US before consideration would be given to increasing rates.

2.3.24 The FED in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.

2.3.25 The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.

2.3.26 For Local Authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

2.3.27 Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.

2.3.28 Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

2.4 Treasury Management Strategy Statement and Annual Investment Strategy Update

2.4.1 The Treasury Management Strategy Statement (TMSS) for 2021/22 was approved at the Council meeting on 4 March 2021. 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 £30.889m. Whilst approved capital expenditure / funding carry forwards from 2020/21 caused an initial increase, this is more than offset by estimated re-phasing and re-alignment and other anticipated adjustments in the 2021/22 capital programme resulting in the reduced CFR.

2.4.5 Cabinet is therefore requested to approve the key changes to the 2021/22 prudential indicators as set out in the table below which show the original and recommended revised figures:

Prudential Indicator 2021/22	Original £'000	Recommended Revised Prudential Indicator £'000
Authorised Limit	541,500	519,500
Operational Boundary	516,500	499,500
Capital Financing Requirement	525,647	494,758

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 4 March 2021.

Capital Expenditure by Service	2021/22 Original Estimate £'000	2021/22 Revised Estimate £'000
Corporate Services	5,320	3,765
Children's Services	6,110	15,403
Communities & Reform	637	36
Community Health & Social Care	3,409	2,005
HRA	3,412	785
People & Place	65,671	29,934
Funds for Emerging Priorities	1,442	1,115
Closing balance	**86,002**	**53,043**

2.5.3 The above table shows an anticipated decrease in the capital programme of £32.959m at month 6 compared to the March 2021 position, with current forecast spend of £53.043m. 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 (£32.959m) from 2021/22. Some expenditure has been realigned into the later years of the capital programme. However, following the review, the overall capital programme has reduced by £24.858 (most of which would have been funded by Prudential Borrowing) therefore producing an associated revenue financing saving. The budget variations largely relate to re-profiling in the People and Place Directorate capital programme.

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 (£43.131m) and unsupported elements i.e., requiring borrowing (£42.871m), 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 2021/22; a decrease in all financing types reducing the forecast borrowing need by £17.777m from £42.871m to £25.094m.

Capital Expenditure	2021/22 Original Estimate £'000	2021/22 Forecast Position £'000
Total Capital Expenditure	86,002	53,043
Financed by:		
Capital receipts	(3,999)	(5,533)
Capital grants – Ringfenced	(24,210)	(9,242)
Capital grants – Un-ringfenced	(11,459)	(11,718)
Other Resources	(51)	(671)
Revenue	0	0
HRA Revenue	(3,412)	(785)
Total Financing	**(43,131)**	**(27,949)**
Borrowing Need	**42,871**	**25,094**

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 £30.889m. It also shows the expected debt position over the period (the Operational Boundary). This indicator has decreased to reflect the revisions to the forecast year end position of the capital programme.

	2021/22 Original Estimate £'000	2021/22 Revised Estimate £'000
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	525,647	494,758
CFR – housing	0	0
Total CFR	**525,647**	**494,758**
Net movement in CFR		**(30,889)**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	301,500	284,500
Other long-term liabilities	215,000	215,000
Total debt 31 March	**516,500**	**499,500**

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 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.

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 £112.806m headroom between total debt and the CFR.

	2021/22 Original Estimate £'000	2021/22 Revised Estimate £'000
Gross borrowing	197,593	168,374
Plus: other long- term liabilities*	213,729	213,578
Total Debt	**411,322**	**381,952**
CFR* (year-end position)	525,647	494,758
Headroom	**114,325**	**112,806**

* - 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	2021/22 Original Indicator £'000	2021/22 Revised Indicator £'000
Borrowing	321,500	299,500
Other long-term liabilities*	220,000	220,000
Total	**541,500**	**519,500**

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

2.5.11 The table above shows a reduction in the Authorised Limit of £22m due to the reduction in the capital programme and the associated financing.

2.6 **Annual Investment Strategy**

2.6.1 The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Council on 4 March 2021. In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity.

2.6.2 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 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.

2.6.3 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. All short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020 until the MPC meeting on 24 September 2021 when 6 and 12 month rates rose in anticipation of Bank Rate going up in 2022. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before mid-2023, investment returns are expected to remain low.

Creditworthiness

2.6.4 Significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

Investment Counterparty criteria

2.6.5 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 banks (including those from the UK) spiked at the outset of the pandemic in 2020, they have subsequently returned to near pre-pandemic levels. 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 £103.699m of investments, including property funds as at 30 September 2021 (£83.540m at 31 March 2021). 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 £34.200m in Money Market Funds and £24.500m in Notice Accounts of a 35-day notice period. Rates on Notice Accounts are currently quite high compared to previous years therefore higher balances are currently invested in notice accounts.

Investment Type	Total at 30 September 2021 £'000
Property	15,000
Commercial Paper	4,999
Fixed (Term Deposits) Bank / Building Society	25,000
Fixed (Term Deposits) Local Authorities / Public Bodies	0
Notice Accounts	24,500
Money Market Fund	34,200
Total	**103,699**

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 2021/22.

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	(0.08%)	0.010%
1 month	(0.07%)	0.747%
3 months	(0.05%)	0.137%
6 months	(0.02%)	0.215%
Average Return first 6 months		**0.125%**

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 (4.15%). 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 2020 mainly to valuer caution rather than any significant increase in pressure to sell properties, however valuations since then have continued to increase and are now slightly higher than the level of the original investment.

2.7 Borrowing

2.7.1 It is proposed in this report that the Council's CFR for 2021/22 is revised to £494.758m 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 £381.952m and will have utilised £112.806m 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 The capital programme is being kept under regular review due to the effects of the Covid-19 pandemic and shortages of materials and labour. The borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

2.7.4 At this point it is not anticipated that borrowing will be undertaken during this financial year.

2.7.5 The Council applied in September 2021 for the PWLB 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 2021 to 31 October 2022.

2.7.6 Current PWLB certainty rates are set out in the following table and show for a selection of maturity periods over the first half of 2021/22, 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 2021 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	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/21	08/07/21	05/08/21	17/08/21	10/08/21
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/21	28/09/21	28/09/21	13/05/21	13/05/21
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

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 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22 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

International Financial Reporting Standard (IFRS) 16 – Leases

2.10.1 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, the Financial Reporting Advisory Board (FRAB), announced the deferral of International Financial Reporting Standard 16 (IFRS 16) implementation to 2022/23.

2.10.2 Previously, leases were split into finance leases and operating leases however, from 1 April 2022 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 was charged to the 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.

Code Consultation

2.10.3 In April 2021, CIPFA consulted on the principles to support the changes to the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (Treasury Management Code) to which the Council provided a response. On 21 September 2021, CIPFA issued stage 2 of the consultation process and provided an amended draft of the two revised Codes for further consultation. The consultation closed on 16 November 2021 and the Council submitted a response. Members should note that if the proposed changes to the Treasury Management Code is approved there will be a significant change to the Council's Treasury Management Practices (an internal document that covers the process, approvals and governance of the Treasury Management operations of the Council). Members will be updated when the consultations have been completed and the revised Codes are issued with any significant changes brought to their attention.

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 Council approves the recommendations in the Treasury Management Mid-Year Review Report.

5 Consultation

5.1 Consultation has taken place with Link Asset Services (the Council's Treasury Management Advisors), and senior officers. The report was presented to the Audit Committee on 2 November 2021 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 and the Committee was content to commend the report to Cabinet. At its meeting on 15 November 2021, Cabinet approved the report and commended it to Council.

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 FCL-13-21

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
Contact No: 0161 770 6608 / 4424

20 Appendices

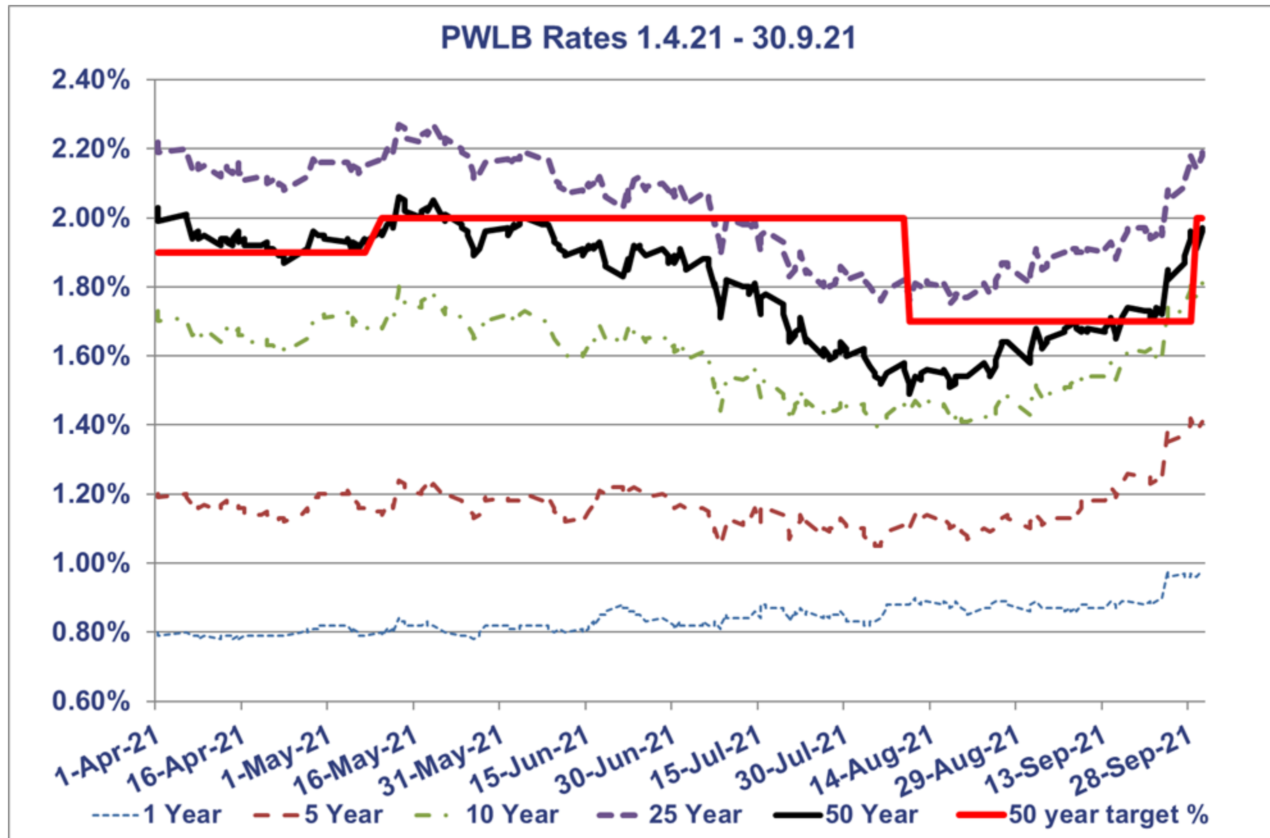
Appendix 1 Investments as at 30 September 2021
Appendix 2A PWLB Certainty Rate Variations 2021/22
Appendix 2B Comparison of Borrowing parameters to actual external borrowing - Table
Appendix 2C Comparison of Borrowing parameters to actual external borrowing - Graph

Appendix 1 Investments as at 30 September 2021

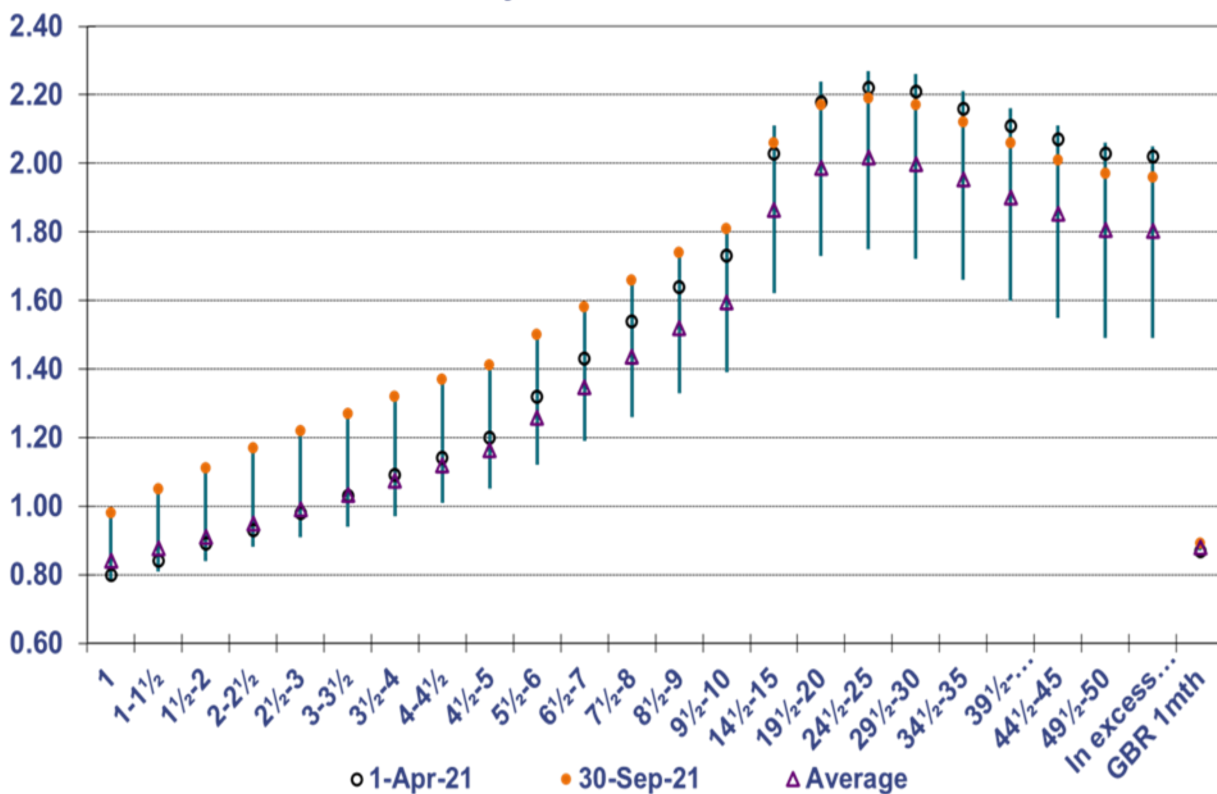
Investments	Type	30th September 2021 £'000	Interest Rate	Date of Investment	Date of Maturity
CCLA Property Fund	Property	15,000	4.15%	Prior Years	open
Total Property Fund		**15,000**			
Transport for London		4,999	0.12%	15-Sep-21	10-Nov-21
Commercial Paper		**4,999**			
Close Brothers Ltd	Fixed	5,000	0.25%	25/05/2021	25-Nov-21
Close Brothers Ltd	Fixed	5,000	0.25%	29/06/2021	29-Dec-21
Nationwide Building Society	Fixed	5,000	0.07%	01/07/2021	04-Jan-22
Goldman Sachs	Fixed	5,000	0.18%	02/08/2021	01-Feb-22
Nationwide Building Society	Fixed	5,000	0.07%	23/09/2021	23-Mar-22
Total Fixed Investments		**25,000**			
Santander	35 day call	2,500	0.30%	03-Jun-20	open
Santander	95 day call	2,500	0.40%	30-Apr-21	open
Bank of Scotland	95 day call	5,000	0.05%	26-Jul-21	open
Bank of Scotland	95 day call	5,000	0.05%	03-Aug-21	open
Santander	180 day call	5,000	0.38%	28-May-21	24-Nov-21
Barclays	O/night	4,500	0.01%	30-Sep-21	
Total Investments on call		**24,500**			
Invesco Sterling Liquidity	MMF	10,000	0.01%	23-Sep-21	
Aberdeen Sterling Liquidity	MMF	19,520	0.01%	30-Sep-21	
Federated Sterling Liquidity 3	MMF	14,680	0.01%	28-Sep-21	
Total MMF		**34,200**			
Total		**103,699**			

Appendix 2

2A) PWLB Certainty Rate Variations 2021/22



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%



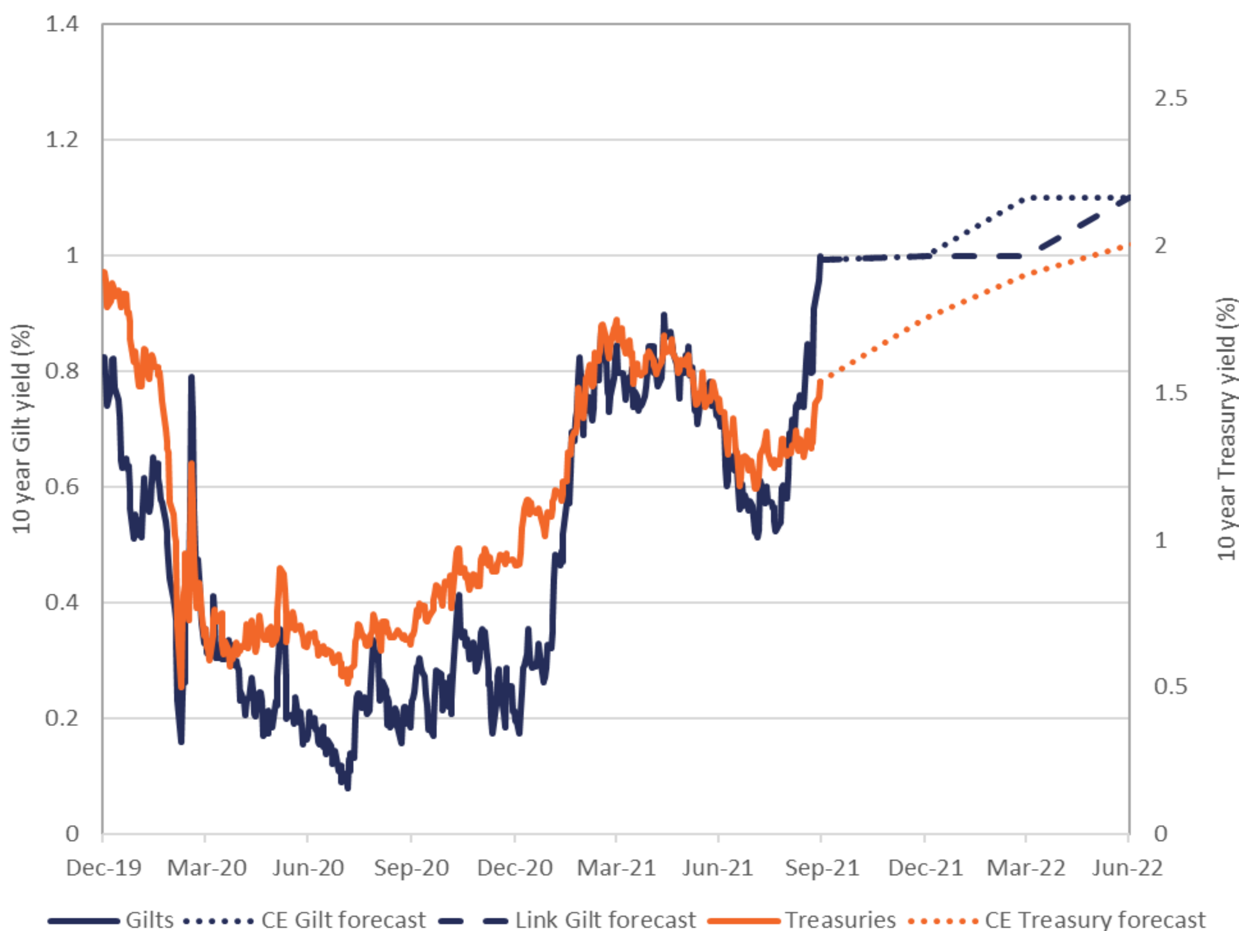
PWLB RATES. There was much speculation during the **second half of 2019** that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. 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. 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. The consequence of this has been **the gradual lowering of the overall level of interest rates and bond yields in financial markets.** Over the year prior to the coronavirus crisis, this resulted in many bond yields up to 10 years turning negative in the Eurozone. In addition, there was, at times, an inversion of bond yields in the US whereby 10 year yields fell below shorter-term yields. In the past, this has been a precursor of a recession.

Gilt yields had, therefore, already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020 which caused gilt yields to spike up. However, yields then fell sharply in response to major western central banks taking rapid policy action to deal with excessive stress in financial markets during March and starting massive quantitative easing driven purchases of government bonds: these actions also acted to put downward pressure on government bond yields at a time when there was a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply.

At the start of January 2021, all gilt yields from 1 to 8 years were negative: however, since then all gilt yields have become positive and rose sharply during the spring, especially in medium and longer-term periods, until starting a significant decline since May which was then sharply reversed in August / September. Repeated assurances by the Fed in the US, and by other major world central banks, that inflation would spike up after Covid restrictions were abolished, but would only be transitory, allayed investor fears until August / September when high inflation was again seen as a growing danger and both central banks in the US and UK gave indications that monetary policy tightening was now on the horizon. **There is considerable concern that the US Fed is taking a too relaxed view that inflation pressures in the US are purely transitory and that they will subside without the need for the Fed to take significant action to tighten monetary policy. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that rates will end up rising faster and further in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields.**

Correlation between 10 year US treasury yield and 10 year gilt yield

The Link Group forecasts have included a risk of a 75% correlation between movements in US treasury yields and gilt yields over 10 years since 2011. As US treasury yields are expected to rise faster and further than UK gilt yields, there is an upside risk to forecasts for gilt yields due to this correlation. The graph below shows actual movements in both 10 year yields and forecasts by Link (gilt only) and Capital Economics.



- Yields on 10 year Gilts and Treasuries initially both fell during the first quarter of 2020, as signs emerged that the COVID-19 virus would become a global pandemic which would lead to a sharp downturn in economic growth.
- The correlation between 10 year yields in the UK and the US lessened during the second half of 2020 when US yields displayed an increasing tendency to rise, whilst UK yields remained more range bound. This divergence was consistent with the relatively better economic performance registered by the US during the pandemic, which was aided by historically low US business inventory levels needing to be rebuilt.
- During late 2020 gilt yields rose significantly, reflecting optimism that the fast vaccine roll-out in the UK would support a strong economic recovery during 2021.
- During September 2021, treasury yields rose sharply in response to growing investor concerns around high inflation and indications from the Fed that tapering of quantitative easing purchases of treasuries are likely to occur in the near future. Gilts also rose sharply, as did investor concerns around a sharp increase in inflation in the UK which is now likely to go over 4%. In addition, the MPC meeting in September 2021 flagged up major concerns around the strength of inflation which may require Bank Rate to go up much faster than had previously been expected.

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

CAPITAL FINANCING REQUIREMENTS					
		Actual	Estimated	Estimated	Estimated
		2020/21	**2021/22**	**2022/23**	**2023/24**
CFR (including PFI and finance leases)		£'000	£'000	£'000	£'000
GFCFR		£491,714	£494,758	£540,858	£590,200
Total CFR		**£491,714**	**£494,758**	**£540,858**	**£590,200**
CFR (excluding PFI and finance leases)					
GFCFR		£268,347	£281,446	£336,454	£390,662
Total CFR		**£268,347**	**£281,446**	**£336,454**	**£390,662**
External Borrowing		**£172,843**	**£168,374**	**£238,374**	**£308,374**
Deferred Liabilities		**£224,405**	**£213,578**	**£204,404**	**£199,538**
Total Debt		**£397,248**	**£381,952**	**£442,778**	**£507,912**
Authorised Limit		£537,500	£519,500	£565,500	£624,000
Authorised Limit ex Deferred Liabilities		£313,095	£305,922	£361,096	£424,462
Operational Boundary		£512,500	£499,500	£545,500	£594,000
Operational Boundary ex Deferred Liabilities		£288,095	£285,922	£341,096	£394,462

2C) Comparison of borrowing parameters to actual external borrowing (Graph) – all in £000s