Appendix A

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review 2021/22

Report of Chief Finance Officer

1. Background

Capital Strategy

In December 2017 CIPFA (Chartered Institute of Public Finance and Accountancy) issued revised Prudential and Treasury Management codes. As from 2020/21, all local authorities will be required to prepare a Capital Strategy which is intended to provide:

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

A report setting out our Capital Strategy was taken to Council on 24 February 2021.

Treasury Management

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

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

Accordingly, treasury management is defined as:

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

2. Introduction

This report has been written in accordance with the requirements of CIPFA's Code of Practice for Treasury Management.

The primary requirements of the Code are as follows:

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

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

(iii) Receipt by full council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year Review Report and an Annual Report, covering activities during the previous year.

(iv) 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.

(v) Delegation by the council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Budget and Performance Panel.

This mid-year report covers the following:

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

3. Economics update (provided by Link Asset Services)

MPC meeting 24.9.21

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

- *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, it was flagging up a 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. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.*

- *So, 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 next April, 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. 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.*

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

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

4. Interest Rate Forecast

The Council's treasury advisor, Link Asset Services, provided the following forecast on 29 September 2021:

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

The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

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

5. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy (TMS) for 2021/22, which includes the Annual Investment Strategy was approved by the Council on 24 February 2021. There are no policy changes to the TMS; the details in this report update the position in light of the updated economic position and budgetary changes already approved.

6. Investment Portfolio

In accordance with the CIPFA Treasury Management Code of Practice the Council's investment priorities are set out as being:

- Security of capital
- Liquidity
- Yield

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

As shown by forecasts in section 4, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10 in March 2020. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before the second half of 2023, investment returns are expected to remain low.

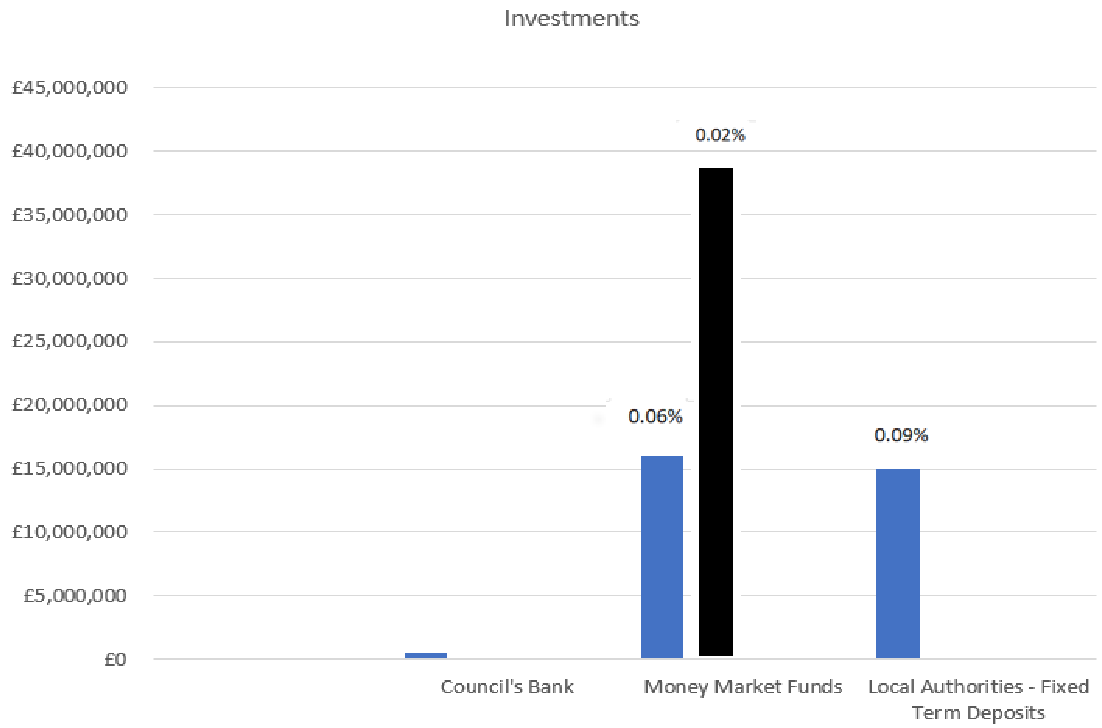
The average level of funds available for investment purposes over the six month period was **£38.3M**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept and business rate related payments, the receipt of grants and progress on the Capital Programme.

In terms of performance against external benchmarks, the return on investments compared to the 7 day LIBID and bank rates at the end of the period is as follows. This is viewed as reasonable performance, given the need to prioritise security of investments, and liquidity (i.e. making sure that the Council's cashflow meets its needs):

Base Rate	0.10%
7 day LIBID	-0.08%
Lancaster City Council investments	0.02%

Investment Balances – quarter ended 30 September 2021

At the start of the year investments totalled £31M rising to £39M by 30 September. Fixed term investments with local authorities fell to £0 whilst Money Market Fund balances were £39M.



Other Investments	Term	Maturity Date	Opening 1.4.21 £	Closing 3.09.21 £	Indicative Rate (YTD)	Current Fixed Rate	Interest to Date £
Call Accounts							
Natwest (Cash Manager Plus)			529,000	384,000		0.01%	35
Money Market Funds							
Blackrock Sterling Liquidity First Fund				6,000,000	0.01%		163
				6,000,000	0.00%		1
Blackrock Sterling Govt Insight				3,000,000	0.00%		0
Lancashire County Council			12,000,000	12,000,000	0.05%		3,008
LGIM				6,000,000	0.00%		0
Aberdeen Life Investments			4,000,000	6,000,000	0.01%		298
Fixed Term Deposits							
Central Bedfordshire Council	25 days	26/04/2020	5,000,000	0		0.10%	342
South Somerset Council	18 days	19/04/2021	5,000,000	0		0.10%	247
Birmingham City Council	48 days	19/05/2021	5,000,000	0		0.08%	526
Sub-total			**31,529,000**	**39,384,000**			**4,620**
						Budgeted income	**41,350**
							(36,730)

Investment Counterparty criteria

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

Approved Limits

The fact that the authority is currently holding a significant amount of funds due to be repaid to central government and the unpredictability of the amount and date of receipt of funding and income compensation payments arising from the Covid-19 pandemic, has created pressure on the investment headroom available within the approved Treasury Management Strategy. Many other authorities are in a similar position making it very difficult to source a counter party to lend to as markets are flooded with cash. This is also exacerbated by expenditure on the Capital Programme running significantly behind that anticipated. This has resulted in the £1m limit of funds held overnight in the Council's current account very occasionally being breached. In most instances the breach was less than £150k rising to £516k at maximum. Action has now been taken to re-commence deposits with the UK Debt Management Office, Debt Management Account Deposit Facility in the case of such emergencies.

7. Borrowing

The Council's capital financing requirement (CFR) for 2021/22 was forecast as £134.88M as set out at **Annex A.** The current forecast CFR at quarter 2 is, however, £105.13M as much of the expenditure funded by unsupported borrowing, most notably that in the Development Pool, is expected to slip. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council currently has borrowings of £61.04M. It intended to utilise £33.09M of cash flow funds in lieu of borrowing and take out new borrowing of £12M later in the financial year.

The capital programme is being kept under regular review due to the effects of coronavirus and the shortage of materials and labour. Therefore, our borrowing strategy will be reviewed and then revised in order to achieve optimum value and risk exposure in the long-term.

8. Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate 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.

9. Compliance with Treasury and Prudential Limits

During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy and in compliance with the Council's Treasury Management Practices.

It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. With the exception of the circumstances outlined in paragraph 6, during the half year ended 30th September 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021 and no difficulties are envisaged for the current or future years in complying with these indicators.

10. Other Issues

Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or to other types of investment instruments this change in risk appetite and policy should be brought to members' attention in treasury management update reports. There are no such changes to report.

ANNEX A

PRUDENTIAL INDICATORS - MID YEAR REVIEW

Prudential Indicator for Capital Expenditure

This table shows the current estimates for the General Fund and Housing Revenue Account capital programmes, compared to the original estimates.

Capital Expenditure by Service	2021/22 Original Estimate £m	 Quarter 2 Position £m
Communities and Environment	10.08	11.54
Economic Growth and Regeneration	2.54	4.05
Corporate Services	0.14	0.14
Development Pool	50.15	0.76
Total for General Fund	**62.91**	**16.49**
Council Housing (HRA)	**4.78**	**4.78**
Total Capital Expenditure	**67.69**	**21.27**

Changes to the Financing of the Capital Programmes

This table shows the changes in the financing of the capital programmes, and the level of borrowing required.

Capital Expenditure	2021/22 Original Estimate £m	 Quarter 2 Position £m
Total capital expenditure	**67.69**	**21.27**
Financed by:		
Capital receipts	0.64	0.64
Capital grants	19.57	7.17
Reserves	5.25	4.39
Revenue	0.00	0.00
Total Financing	**25.46**	**12.20**
Borrowing Requirement	**42.23**	**9.07**

Changes to the Capital Financing Requirement

The following table shows that the capital financing requirement (CFR) is £29.75M lower than the original estimate due to schemes in the Development Pool section of the capital programme not being delivered in year as spending officers anticipated.

Capital Financing Requirement	2021/22 Original Estimate £m	2021/22 Quarter 2 Position £m
General Fund	98.69	68.94
HRA	36.19	36.19
Total Capital Financing Requirement	**134.88**	**105.13**
Net movement in CFR	**39.01**	**-29.75**

Limits to Borrowing Activity

A key control over treasury management activity is to ensure that over the medium term, net borrowing (borrowings less investments) will only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total capital financing requirement.

External Debt v Borrowing Need (CFR)	2021/22 Original Estimate £m	2021/22 Quarter 2 Position £m
External Debt	102.09	61.08
Other long term liabilities	-1.04	-1.04
Expected Change in Other long term liabilities	0.00	0.00
Total Debt	**101.05**	**60.04**
Compared to current :		
Capital Financing Requirement	**134.88**	**105.13**
Operational Boundary:-		
Debt	**95.87**	**105.13**
Authorised Limit:-		
Debt	**112.00**	**112.00**

Definitions:

Operational Boundary

The limit beyond which external debt is not normally expected to exceed is known as the operational boundary.

Authorised Limit for External Debt

A further prudential indicator controls the overall level of borrowing. This is the authorised limit which represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, whilst not desired, could be afforded in the short term, but it is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements.