Public Document Pack

County Council
Wednesday 24 November 2021
10.00 am The McMillan Theatre, Bridgwater, TA6 4PZ

SUPPLEMENT TO THE AGENDA

To: The Members of the County Council

We are now able to enclose the following information which was unavailable when the agenda was published:

Item 8	Report of the Leader and Cabinet (Pages 3 - 24) To consider the report.

Published on 18 November 2021

Democratic Services, B3, County Hall, Taunton, TA1 4DY

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Decision Report - Cabinet Decision
Forward Plan Reference: FP/21/08/09
Decision Date - 15/11/21

Treasury Management Mid-Year Report 2021-22

Cabinet Member(s): Cllr Mandy Chilcott - Cabinet Member for Resources
Local Member(s) and Division: All
Lead Officer: Jason Vaughan, Director of Finance
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1. Summary / Background

1.1. This report is for information only. It gives a summarised account of Treasury Management activity and outturn for the first half of the year and ensures Somerset County Council (SCC) is embracing Best Practice in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) recommendations.

Gross investment balances stood at £324m on 30th September yielding an average rate of return of 0.53% as at that date. This figure includes approximately £58.28m of cash managed on behalf of the Local Enterprise Partnership (LEP), £6.54m of Earmarked Funds held on behalf of other decision-making bodies (e.g Somerset Rivers Authority, Somerset Waste Partnership, £31.6m held as a payment in advance for the NHS Clinical Commissioning Group (CCG) and £8.14m of other external bodies (e.g. Exmoor National Park (ENP), and South West Councils (SWC)).

During the six months, gross investment balances averaged £313.45m (£211.93m net of funds held for others), yielding 0.55% for the period including Pooled Funds. The cash return (net of Pooled Funds) of 0.20% was 0.13% higher than the average 12-month LIBID rate (a benchmark rate at which Banks will lend to each other).

Income of £858,967 (£819,539 net of that apportioned to the LEP and external bodies) has been earnt in the period, against anticipated income of £756,867. This is £62,672 more than anticipated.

The cost of carry associated with long term borrowing compared to temporary investment returns means that a passive borrowing strategy, borrowing funds as they are required has been the most appropriate. No new borrowing has been taken during the period, and due to timing of spending, and changes to the Capital Plan, it is not currently envisaged that any will be taken in the second half of the year. At the mid-year point nearly £547,000 of budgeted new borrowing costs have not been incurred.

All Treasury activities undertaken have been in full compliance with relevant legislation, codes, strategies, policies, and practices.

2. Recommendations

2.1. **That the Cabinet endorses the Treasury Management Mid-Year Report for 2021-22 and recommends it is received and endorsed by Full Council at the next sitting of Full Council.**

3. Reasons for recommendations

3.1 The Local Government Act 2003 requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services. The Code requires Full Council to receive as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close. This is the mid-year review for 2021-22.

4. Other options considered

4.1. Not applicable.

5. Links to County Vision, Business Plan and Medium-Term Financial Strategy

5.1. Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver the Somerset County Plan.

6. Consultations and co-production

6.1. None

7. Financial and Risk Implications

7.1. There are no specific risks associated with this outturn report. The risks associated with Treasury Management are dealt with in the Annual Treasury Management Strategy, Annual Investment Strategy, and Treasury Management Practice documents.

8. Legal and HR Implications

8.1. None.

9. Other Implications

9.1. Equalities Implications

None.

9.2. Community Safety Implications

None.

9.3. Sustainability Implications

None.

9.4. Health and Safety Implications

None.

9.5. Health and Wellbeing Implications

None.

9.6. Social Value

Not applicable

10. Scrutiny comments / recommendations:

10.1. The Audit Committee is the nominated body to provide scrutiny for Treasury Management.

11. Background

11.1. Economic Background

The economic recovery from the coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period, over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.

The Bank of England (BoE) Monetary Policy Committee (MPC) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions.

The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

The latest labour market data showed that in the three months to August 2021 the unemployment rate fell to 4.5%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 7.2% and 6.0% respectively over the period. However, part of the robust growth figures is due to a base effect from a decline in average pay in the spring of last year associated with the furlough scheme.

Annual CPI inflation rose to 3.2% in August, exceeding expectations of 2.9%, with the largest upward contribution coming from restaurants and hotels. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year-on-year, marginally higher than expectations for 2.7%.

The easing of restrictions boosted activity in the second quarter of the calendar year, helping push GDP up by 5.5% quarter-on-quarter. Household consumption was the largest contributor.

Within the sector breakdown, production contributed 1.0%, construction 3.8% and services 6.5%, taking all of these close to their pre-pandemic levels.

The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more transitory, that was previously thought. However, an increase in gas prices in the UK and EU, and supply issues have led to higher prices.

The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30th September. Over the same period the 10-year gilt yield fell from 0.80% to 0.71% before rising to 1.03% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.37%.

Gilt yields have a direct correlation to Public Works Loan Board (PWLB) rates. The gradual fall from the beginning of the year turned into a sudden rise in PWLB borrowing rates at the end of September, and can be seen in Tables 2 and 3 in Appendix A.

London Interbank Bid (LIBID) rates based on the Intercontinental Exchange London Interbank Offered Rate (LIBOR) fixings show that there was hardly any movement from April until the middle of September, with most periods up to 6 months spending the entire 6-months in negative territory. The 12-month figure hovered between 0.04% and 0.06% for most of the period but shot up to 0.25% in the last week of September, as the case for an interest rate rise was being increasingly considered.

The 1-month, 3-month, 6-month, and 12-month LIBID rates averaged -0.07%, -0.05%, 0.02%, and 0.07% respectively over the period, and ended the period at -0.08%, -0.04, 0.05%, and 0.25% respectively.

Rates from banks to Local Authorities have generally followed LIBID rates, but with Arlingclose advice stating a maximum duration of 35-days with banks, this avenue of lending has been very restricted.

Lending rates between Local Authorities have remained suppressed, as supply has outstripped demand, with many Authorities still holding large balances from Government Covid support grants.

The effect that economic conditions had on money market rates during the period, can be seen in Table 1, Appendix A.

11.2. Debt Management

The Council’s need to borrow for capital purposes is determined by the capital programme. Council Members are aware of the major projects identified by the 4-year capital medium-term financial plan (MTFP) where the capital strategy forecast £152m of expenditure during

2021/22. £54m was identified for highways maintenance, major engineering, and traffic management; £41m for Local Enterprise Partnership and Economic Development projects; £36m for the delivery of schools' basic need; and £21m for other programmes. Much of this was to be funded by a combination of grant, contributions, and capital receipts. Although timings of capital expenditure may not be totally predictable, it was envisaged that potentially, borrowing of up to £55m may have been necessary.

The level of internal borrowing stood at £48.2m as at the 31st March 2021. With changes to the capital plan, and slippage, capital spend to be funded by borrowing in 2021/22 is now predicted to be £28.2m. This indicates a likely balance of internal borrowing by March 2022, of £76.4m

The cash flow of the Council has been less volatile and unpredictable than during the previous year. More funding for Covid-19 has been received, although reduced levels from 2019/20, and a further £17.7 m of Local Enterprise Partnership (LEP) money was received in May. With the extra cash and a slowing of capital expenditure, there has been no need for additional external borrowing to fund the Capital Programme to date.

The cost of carry associated with long term borrowing compared to temporary investment returns (borrowing costs largely stable, investment returns plummeting) means that a passive borrowing strategy, borrowing funds as they are required has been most appropriate. The benefits of this strategy have been monitored and weighed against the risk of shorter-term rates rising more quickly than expected. No new borrowing has been taken during the period, and due to extra income, timing of spending, and changes to the Capital Plan, it is not currently envisaged that any will need to be taken in the second half of the year.

The overall rate paid on loans remained unchanged for the PWLB portfolio of £159.05m, at 4.59%. The average Market Loan rate at 30th September (LOBOs + Barclays, total £165.5m) was also the same as at 31st March, at 4.74%. The combined average rate was 4.66% on £324.55m.

As there has been no change to the PWLB portfolio during the period, the average weighted maturity as at 30th September had decreased by six months to 22.7 years. The average duration of all Market Loans dropped to 30.5 years from 31.

11.3. Investment Activity

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Security of capital remained the Council's main investment objective. This was achieved by following the counterparty policy as set out in the Annual Investment Strategy, and by the approval method set out in the Treasury Management Practices. Counterparties having approval for use during the period are listed in **Table 1** below. Those used during the first half of the year are denoted with a star. Fewer Banks have been used during this period and there has been a 100%+ increase in the use of Local Authorities compared to the same period last year.

Table.1 - Approved Counterparties

Bank or Building Society		**Bank or Building Society**	
Australia & NZ Bank	*	Standard Chartered Bank	*
Bank of Scotland		Handelsbanken Plc	*
Bank of Montreal		Toronto-Dominion Bank	
Bank of Nova Scotia		United Overseas Bank	
Barclays Bank Plc			
Canadian Imperial Bank of Commerce		**Sterling CNAV Money Market Funds**	
Close Brothers Ltd		Goldman Sachs MMF	
Commonwealth Bank of Australia		Deutsche MMF	
DBS Bank Ltd	*	Invesco Aim MMF	*
DZ Bank		Federated Prime MMF	*
Goldman Sachs International Bank		JP Morgan MMF	
HSBC Bank	*	Insight MMF	
Landesbank Hessen-Thuringen		Aberdeen Standard MMF	*
Lloyds Bank		LGIM MMF	
National Australia Bank		SSGA MMF	*
National Westminster	*	Aviva MMF	*
Nationwide BS	*		
Nordea Bank		**Other Counterparties**	
OP Corporate Bank		Other Local Authorities	* (26)

Oversea-Chinese Banking Corporation		Debt Management Office	*
Rabobank		CCLA Property Fund	*
Royal Bank of Scotland		RLAM Credit Fund	*
Santander UK	*	M&G Corporate Bond Fund	*

SCC has continuously monitored counterparties, and all ratings of proposed counterparties have been subject to verification on the day, immediately prior to investment. Other indicators considered have been:

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions i.e. bail-in.
- Share Price
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.

Counterparty Update

Over the period, Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

Fitch also revised the outlooks for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable from negative. The rating agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

At the end of the period Arlingclose had completed a full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended UK counterparties was extended to 100 days.

As ever, the institutions and durations on the Council's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

11.4. Liquidity

In keeping with guidance from the Ministry of Housing, Communities, and Local Government (MHCLG) (now the Department for Levelling-Up, Housing and Communities) the Council maintained a sufficient level of liquidity through the use of call accounts, Money Market Funds, and short-term deposits.

88 cash deposits totalling more than £564m (106 totalling £516m 2019-20) were made during the first half of the year. SCC did not need to borrow short-term money during the first half of 2020-21.

SCC, in managing an average of approximately £101.5m of money held on behalf of external bodies, has needed to retain more liquidity than normal, as forecasting and timing of Capital, Covid, and LEP spending has been beyond its' control. Whilst a proportion of the portfolio had been lent to other Local Authorities for up to a year to protect against a rate downturn, rates for reinvesting with Local Authorities when loans mature have been below 0.10%, even for a year. A lot of this cash is now in bank notice accounts. As well as improving liquidity, they offer a higher rate than most available deposits, and most are linked to short-term market rates, so will benefit from an instant pick-up if as seems likely, rates increase.

11.5. Yield

With base rate anchored at 0.10%, (with the potential for negative rates), and with duration for deposits with banks limited to 35-days for all but the last few days of the period, it has been a challenge to pick up any rates at all.

Money Market Funds (MMFs) were not yielding enough to cover their fees, with many not paying a dividend at all. Others paid a nominal 0.01% out of their management fees.

In order to place deposits for longer maturities, and to pick up a better yield, more deposits had been placed with UK Local Authorities. This too has become more difficult, as the deluge of money from Central Government has increased liquidity and reduced the number of Local

Authorities looking to borrow money. At times there have been no Local Authorities looking to borrow money, and this has kept rates suppressed.

Comfund

As at 30th September Comfund investment stood at £205m averaging just under £182m for the year-to-date (£144m and £140m respectively for 2019/20). The Comfund vehicle, which consists mainly of SCC Capital, Revenue Reserves, and money held on behalf of the Local Enterprise Partnership (LEP), has an average return for the year-to-date of 0.27%, and has outperformed the benchmark by 0.17% as base rate has averaged 0.10% for the period. The weighted average maturity of the Comfund was approximately 3 months. This is lower than the 4.8 months for this time last year due to Arlingclose advice. The return of 0.27% is 25 basis points above the 6-month LIBID average of 0.02 and 0.20% above the 12-month LIBID average of 0.07%.

A total of over £244k (£204k net of that paid to the LEP and external bodies) has been earned in Comfund interest in the first six months of the year (£556k gross 2019-20). Comfund administration charges and other Treasury Management fees brought in approximately £72k of income in the period.

Revenue

Revenue interest has contributed a further £24.5k of income, with an average revenue balance (general monthly working capital) of just under £72.8m (£61.8m 2019-20), and an average return of 0.07%, 15 basis points above the average 1-month LIBID rate of -0.08% and 0.12% above the 3-month LIBID rate of -0.05%.

Pooled Funds

The decision to invest further into Pooled Funds was driven by 2 key factors. Firstly, by diversifying away from unsecured Bank deposits, it would help to mitigate the increased risk posed by unsecured bank bail-in, and secondly, to mitigate the risk of negative returns (real negative returns, or inflation adjusted returns) posed by the low interest rate environment.

As at 31st March 2021 held £40m in Pooled Funds. £15m was in the CCLA (Churches, Charities, Local Authorities) Property Fund, £15m in the Royal London Investment Grade Short-Dated Credit Fund (RLAM), and a further £10m in the M&G Strategic Corporate Bond Fund (M&G). A further £5m was invested in the M&G Fund in July.

CCLA Property Fund: This Fund is an actively managed, diversified portfolio of UK Commercial Property with a stated investment objective "to provide investors with a high level of income and long-term capital appreciation".

As at 30th September 2021 the Net Asset Value of the SCC holding was £15,062,756 and a Bid Price (value at which investment could be sold) of £14,829,221. The value of the fund has steadily increased from June 2020 In the meantime, the average Property Fund yield of circa 3.67% net, was circa 3.47% above average cash yields, and has so far yielded income of £264,000 for the year to date.

RLAM: This Fund is an actively managed, diversified Investment Grade Short-Dated Credit Fund. £15m has been invested, As at 30th September 2021 the Bid value (value at which investment could be sold) of the SCC holding was £14,881,539. Income of £164k has been received, and at period-end it was yielding 2.19%.

M&G: This Fund is an actively managed, diversified Strategic Corporate Bond Fund. £10m had been invested in March 2021, and a further £5m added in July. As at 30th September 2021 the Bid value (value at which investment could be sold) of the SCC holding was £14,793,650, and at period-end it was yielding 2.51%.

The combined yield of all 3 Pooled Funds as at 30th September was 2.92%.

<u>Combined</u>

Combined return for the period has been 0.55% on an average balance of £313.45m. This figure includes approximately £52.34m of cash managed on behalf of the Local Enterprise Partnership (LEP), £9.55m of Earmarked Funds held on behalf of other decision-making bodies, £31.6m held as a payment in advance for the CCG, and £7.9m of other external bodies (e.g. Exmoor National Park (ENP), and South West Councils (SWC)). Total investment income was nearly £859k (£819k net of external investors). This equates to a £843k benefit of investing over the risk-free option, the Government Debt Management Office (DMO), which is currently offering 0.01% for any period out to 6-months.

Budgeted income for the year to date was £757k, meaning an extra £62,672 (net of that paid to external bodies) has been earnt.

The combined gross return for the same period in 2019-20 was 0.82% on an average balance of £216.5, or approximately £893k in monetary terms.

Figures below highlight investment balances and returns over the period - **Table 2**, investment balances by type – **Table 3**, and a breakdown of investment balances by source – **Table 4**: -

Table.2 – Investment figures and returns for period

	Balance 31 March 2021 £m	**Rate of Return at 31 March 2021 %**	**Balance as at 30 Sept 2021 £m**	**Rate of Return at 30 Sept 2021 %**	**Average Balance April to Sept £m**	**Average Rate April to Sept %**
Short-Term Balances (Variable)	75.63	0.04	74.01	0.07	89.29	0.05
Comfund (Fixed)	160.00	0.39	205.00	0.20	181.84	0.27
Pooled Funds	40.00	2.87	45.00	2.77	42.30	2.78
Total Lending	**275.63**	**0.66**	**324.01**	**0.53**	**313.45**	**0.55**

Table.3 – Investment balances by type

	31 March 2021 £m	**30 Sept 2021 £m**	**Change £m**
Money Market Funds	25.63	19.01	-6.62
Bank Call Accounts	20.00	20.00	0.00
Bank Notice Accounts	40.00	95.00	+55.00
Time Deposits – Banks	20.00	45.00	+25.00
Time Deposits – LAs	130.00	100.00	-30.00
Pooled Funds	40.00	45.00	+5.00
Total Investments	**275.63**	**324.01**	**+48.38**

Table.4 – Breakdown of investment balances by source

	31 March 2021 £m	30 Sept 2021 £m	Change £m
ENPA / SWC (Daily cash)	0.04	0.19	+0.15
Organisations in the Comfund	7.22	7.95	+0.73
LEP	41.69	58.28	+16.59
Earmarked Funds held on behalf of other decision-making bodies	11.55	6.54	-5.01
CCG Prepayment	31.60	31.60	0.00
Total external	**92.10**	**104.56**	**+12.46**
SCC	183.53	219.45	+35.92
Total	**275.63**	**324.01**	**+48.38**

11.6. Icelandic Investments Update - Current and final position

Landsbanki & Glitnir
SCC has concluded any interest that it had with these two banks.

Kaupthing, Singer & Friedlander –
Two further dividends of £10,314.93 and £13,409.41 were received in April and August 2021, the latter being the final dividend. 87.03% of this claim has now been paid. The Administrators have now filed for dissolution of the Administration, concluding all interest in the bank.

In total, as at 30th September 2021 £23,373,337.77 of Icelandic deposits had been recovered. The shortfall of £1.63m from the original investment was written off back in 2008-09.

11.7. Compliance and Prudential Indicators

All treasury management activities undertaken during the first 6-months have complied fully with the CIPFA Code of Practice and the Councils approved Treasury Management Strategy.

SCC has continuously proactively assessed and implemented mitigation for the risks that have materialised in the new investment environment. Controls/procedures are constantly being assessed and introduced/adapted where needed and embedded into practices to further mitigate risks to SCC investment and borrowing portfolios.

SCC has complied with its Prudential Indicators for 2021-22. Those indicators agreed by Full Council and actual figures as at 30th September are included below:

	2021-22 £m	As at 30-09 £m
Authorised limit (borrowing only)	508	333
Operational boundary (borrowing only)	463	333

Maturity structure of borrowing

	Upper Limit	Lower Limit	As at 30-09-21
Under 12 months	50%	15%	27.5%
>12 months and within 24 months	25%	0%	0.0%
>24 months and within 5 years	25%	0%	15.0%
>5 years and within 10 years	20%	0%	3.3%
>10 years and within 20 years	20%	5%	10.8%
>20 years and within 30 years	20%	0%	6.0%
>30 years and within 40 years	45%	15%	37.4%
>40 years and within 50 years	15%	0%	0.0%
50 years and above	5%	0%	0.0%

	2021-22 £m	As at 30-09 £m
Prudential Limit for principal sums invested for periods longer than 365 days	75	50

Credit Risk Indicator

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk (in conjunction with Arlingclose) and will be calculated quarterly.

Credit risk indicator (Number to be below target)	**Target**	**Actual**
Portfolio average credit rating (score)	A (6)	A+ (4.65)

CIPFA no longer recommends setting upper limits on fixed and variable rate exposures, so these are no longer calculated for this paper.

11.8. Outlook for Quarters 3 & 4

Arlingclose expects Bank Rate to rise in Q2 2022. They believe this is driven as much by the Bank of England's desire to move away from emergency levels as by fears of inflationary pressure.

Investors have priced in multiple rises in Bank Rate, to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.

The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

While Q2 UK GDP expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.

Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increased in wages is possible given the pressures on businesses.

Government bond yields increased sharply following the September Federal Open Market Committee (FOMC – USA equivalent of our MPC) and MPC minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.

The MPC has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

Table 6 below shows a forecast for base rate to September 2024 and includes an assessment of the relative upside and downside risks.

Table 6 – Base Rate forecast to 2024

	Dec 21	Mar 22	Jun 22	Sep 22	Dec 22	Mar 23
Upside Risk	0.00	0.15	0.00	0.25	0.25	0.25
Base Rate	0.10	0.10	0.25	0.25	0.25	0.50
Downside Risk	0.00	0.00	0.15	0.15	0.15	0.40

	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sept 24
Upside Risk	0.25	0.25	0.25	0.25	0.25	0.25
Base Rate	0.50	0.50	0.50	0.50	0.50	0.50
Downside Risk	0.40	0.40	0.40	0.40	0.40	0.40

11.9. Changes to PWLB Terms and Conditions from 8th September 2021

The settlement time for a PWLB loan has been extended from two workings days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.

Revised PWLB Guidance

HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26th November 2020 is allowable even for an 'investment asset primarily for yield'.
- Capital plans should be submitted by local authorities via a DELTA return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.
- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

11.10. Revisions to CIPFA Codes

In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
    - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
    - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
    - Excluding investment income from the definition of financing costs.
- Incorporating Environmental Social Governance (ESG) issues as a consideration within TMP 1 Risk Management.

- Additional focus on the knowledge and skills of officers and elected members involved in decision making

11.12. Summary

In compliance with the requirements of the CIPFA Code of Practice this report provides Councillors with a summary report of the treasury management activity during the first six months of 2021-22. As indicated in this report all treasury activity was conducted within the benchmarks set as Prudential limits for prudent and sustainable capital plans, financing, and investment. A risk-averse approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

12. Background Papers

12.1. Treasury Management Strategy Statement and appendices.

Report Sign-Off

		Signed-off
Legal Implications	Honor Clarke	22/10/21
Governance	Scott Woodridge	27/10/21
Corporate Finance	Jason Vaughan	20/10/21
Human Resources / ICT	Chris Squire	1/11/21
Property	Paula Hewitt	01/11/21
Procurement	Claire Griffiths	04/11/21
Senior Manager	Stephen Morton	01/11/21
Commissioning Development	Sunita Mills	04/11/21
Local Member		N/A
Cabinet Member	Cllr Mandy Chilcott - Cabinet Member for Resources	27/10/21
Opposition Spokesperson	Cllr L Leyshon	01/11/21
Scrutiny Chair	Cllr Anna Groskop - Place Scrutiny	04/11/21

Appendix A

Money Market Data and PWLB Rates

The average low and high rates correspond to the rates during the financial year-to-date, rather than those in the tables below.

Table 1: Bank Rate, Money Market Rates (LIBID Rates based on Intercontinental Exchange LIBOR rates)

Date	Bank Rate	O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid
01/04/2021	0.10	-0.08	-0.08	-0.08	-0.04	-0.01	0.04	0.28
30/04/2021	0.10	-0.09	-0.08	-0.08	-0.04	-0.01	0.04	0.31
31/05/2021	0.10	-0.08	-0.08	-0.07	-0.04	-0.02	0.04	0.31
30/06/2021	0.10	-0.08	-0.08	-0.07	-0.05	-0.02	0.06	0.37
31/07/2021	0.10	-0.09	-0.08	-0.07	-0.05	-0.04	0.06	0.43
31/08/2021	0.10	-0.08	-0.09	-0.07	-0.06	-0.02	0.09	0.48
30/09/2021	0.10	-0.09	-0.08	-0.08	-0.04	0.05	0.25	0.72
Average	**0.10**	**-0.08**	**-0.08**	**-0.07**	**-0.05**	**0.02**	**0.07**	**0.40**
Maximum	**0.10**	**-0.08**	**-0.08**	**-0.07**	**-0.04**	**0.05**	**0.25**	**0.73**
Minimum	**0.10**	**-0.09**	**-0.09**	**-0.08**	**-0.07**	**-0.04**	**0.03**	**0.26**
Spread	**0.00**	**0.01**	**0.01**	**0.01**	**0.03**	**0.09**	**0.22**	**0.47**

Table 2: PWLB Borrowing Rates – Fixed Rate, Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2021	128/21	1.16	1.43	1.95	2.24	2.38	2.42
30/04/2021	167/21	1.16	1.43	1.93	2.20	2.32	2.36
31/05/2021	205/21	1.15	1.41	1.92	2.20	2.32	2.36
30/06/2021	249/21	1.15	1.39	1.83	2.11	2.23	2.26
31/07/2021	293/21	1.14	1.31	1.66	1.89	2.00	2.02
31/08/2021	335/21	1.18	1.34	1.68	1.91	2.02	2.04
30/09/2021	379/21	1.39	1.63	2.03	2.27	2.37	2.39
	Low	**1.09**	**1.26**	**1.60**	**1.83**	**1.94**	**1.95**
	Average	**1.17**	**1.39**	**1.81**	**2.07**	**2.19**	**2.22**
	High	**1.40**	**1.64**	**2.03**	**2.32**	**2.44**	**2.47**
	Spread	**0.31**	**0.38**	**0.43**	**0.49**	**0.50**	**0.52**

Table 3: PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2021	128/21	1.40	1.93	2.38	2.41	2.31	2.22
30/04/2021	167/21	1.40	1.91	2.32	2.34	2.24	2.13
31/05/2021	205/21	1.38	1.90	2.32	2.34	2.25	2.15
30/06/2021	249/21	1.36	1.81	2.23	2.25	2.16	2.07
31/07/2021	293/21	1.30	1.65	2.00	2.00	1.90	1.80
31/08/2021	335/21	1.32	1.66	2.02	2.01	1.90	1.80
30/09/2021	379/21	1.61	2.01	2.37	2.37	2.26	2.16
	Low	**1.25**	**1.59**	**1.93**	**1.92**	**1.80**	**1.69**
	Average	**1.36**	**1.80**	**2.19**	**2.20**	**2.10**	**2.00**
	High	**1.62**	**2.01**	**2.44**	**2.46**	**2.36**	**2.25**
	Spread	**0.37**	**0.42**	**0.51**	**0.54**	**0.56**	**0.56**

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