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Cyngor Bwrdeistref Sirol MERTHYR TUDFUL
MERTHYR TYDFIL County Borough Council

FULL COUNCIL REPORT

Date Written	9th February 2021
Report Author	Adele Lewis
Service Area	Accountancy
Exempt/Non Exempt	Non Exempt
Committee Date	24th February 2021

To: Mayor, Ladies and Gentlemen

Treasury Management Half Year Review Report 2020/21

1.0 SUMMARY OF THE REPORT

1.1 The Treasury Reports outline the Council's performance for the first six months of 2020/21 in respect of:

- The management of the organisation's cash flows, its banking, money market and capital market transactions.
- The effective control of the risks associated with those activities.
- The pursuit of optimum performance consistent with those risks.

2.0 RECOMMENDATIONS that

2.1 The Treasury Management Half Year Review Report for 2020/21 be received.

3.0 INTRODUCTION AND BACKGROUND

3.1 The Treasury Management Half Year Review Report 2020/21 is attached at Appendix A, for Members' attention. This Report is a requirement of the Chartered Institute for Public Finance and Accountancy's Code of Practice on Treasury Management.

3.2 The Council employs Arlingclose as its Treasury Management consultant to give specialist advice on all Treasury Management matters including borrowing and investment requirements. This advice has been followed in producing the Annual Treasury Report.

4.0 FINANCIAL IMPLICATION(S)

4.1 Financial information and performance is included within the body of the report.

5.0 INTEGRATED IMPACT ASSESSMENT

	Positive Impacts	Negative Impacts	Not Applicable
1. Merthyr Tydfil Well-being Objectives	4 of 4	0 of 4	0 of 4
2. Sustainable Development Principles - How have you considered the five ways of working: • Long term • Prevention • Integration • Collaboration • Involvement	5 of 5	0 of 5	0 of 5
3. Protected Characteristics *(including Welsh Language)*	0 of 10	0 of 10	10 of 10
4. Biodiversity	0 of 1	0 of 1	1 of 1
Summary: The main positive impacts are that the Treasury Management Policy and Annual Investment strategy supports the Council to achieve its Well-being Objectives through its Treasury Management Activities.			

ELLIS COOPER ***CHIEF EXECUTIVE***	***COUNCILLOR ANDREW BARRY*** ***CABINET MEMBER FOR GOVERNANCE AND CORPORATE SERVICES***

BACKGROUND PAPERS		
Title of Document(s)	**Document(s) Date**	**Document Location**
Prudential Indicators – Council Tax 2020/21	Council 4th March 2020	Accountancy/Intranet Committee Agendas and Minutes
Treasury Management Policy and Annual Investment Strategy 2020/21 (Included within Medium Term Financial Plan Report 2020-21 to 2023-24)	Council 4th March 2020	Accountancy/Intranet Committee Agendas and Minutes
Treasury Management 2020/21 Working Papers	April 2020 to September 2020	Accountancy
Does the report contain any issue that may impact the Council's Constitution?		**No**

Consultation has been undertaken with the Corporate Management Team in respect of each proposal(s) and recommendation(s) set out in this report.

Appendix A

MERTHYR TYDFIL COUNTY BOROUGH COUNCIL

TREASURY MANAGEMENT HALF YEAR REVIEW REPORT 2020/21

1.0 Introduction and background

1.1 In March 2010 the Authority adopted he Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

1.2 The Authority's treasury management strategy for 2020/21 was approved at full Council on 4th March 2020.The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested sums and the revenue effect of changing interest rates. The successful identification, monitoring and control of risks remain central to the Authority's treasury management strategy.

1.3 The 2017 Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with Cipfa's requirement, was approved by full Council on 4th March 2020.

2.0 External Context

2.1 Appendix 1 outlines an Economic Summary for the first six months of the 2020/21 financial year.

3.0 Local Context

3.1 On 31st March 2020, the Authority had net borrowing of £97m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table1 Balance Sheet Summary

Description	31st March 2020 £'000
General Fund CFR	104,060
Less: *Other debt liabilities	(58)
Borrowing CFR	**104,002**
External borrowing	(110,251)
Internal (over) **borrowing**	**(6,249)**
Less: Usable reserves	**(15,788)**
Less:Working capital	**9,173**
Net (borrowing/investments)	**(12,864)**

3.2 The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

3.3 The Treasury management position as at 30th September 2020 and the change during the year is shown in Table 2 below

Table 2 Treasury Management Summary

Description	31st March 2020 £'000	2020/21 Movement £'000	30th September 2020 £'000	Rate/ Return %
Long term borrowing	56,207	(227)	55,980	6.27
Short term borrowing	54,044	(6,836)	47,208	0.61
Total Borrowing	**110,251**	**(7,063)**	**103,188**	**3.68**
Long term investments	10	0	10	0.00
Short term investments	12,854	(2,097)	10,757	0.14
Total Investments	**12,864**	**(2,097)**	**10,767**	**0.14**
Net Borrowing	**97,387**	**(4,966)**	**92,421**	**4.09**

4.0 Borrowing Update

4.1 On 9th October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

4.2 The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included:

- £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

- Authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield without impeding their ability to pursue their core policy objectives of service delivery, housing, and regeneration. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

4.4 The consultation closed on 31st July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year or early next year.

5.0 Borrowing Strategy during the period

5.1 At 30th September 2020, the Authority held £103m loans, a decrease of £7m to the 31st March 2020 position, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in Table 3 below:

Table 3 Borrowing Position

Description	31st March 2020 £'000	2020/21 Movement £'000	30th September 2020 £'000	Rate/ Return %
Public Works Loan Board	45,761	(638)	45,123	7.07
Banks (Lender's Option Borrower's Option Loans)	12,000	0	12,000	4.50
Banks (fixed-term)	0	0	0	0.00
Local authorities (short-term)	50,500	(6,500)	44,000	0.16
Other	1,990	75	2,065	0.00
Total Borrowing	**110,251**	**(7,063)**	**103,188**	**3.68**

5.2 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

5.3 In keeping with these objectives, no new long term borrowing was undertaken, while £637k of existing loans were allowed to mature without replacement to the 30th

September 2020. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.4 With short-term interest rates remaining much lower than long-term rates, the Authority considered it to be more cost effective in the near term to use short-term loans instead.

5.5 The Authority continues to hold £12m of LOBO (Lender's Options Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the period.

6.0 Treasury Investment Activity

6.1 The Authority received Welsh government funding to support small and medium businesses during the coronavirus pandemic through grant schemes £19.946 million was received and was temporarily invested on short-term basis.

6.2 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year the Authority's investment balances ranged between £10 million and £36 million due to the timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4 Investment Position

Description	31st March 2020 £'000	2020/21 Movement £'000	30th September 2020 £'000	Rate/ Return %
Banks	2,854	(2,097)	757	0.00
Building Societies	0	0	0	0.00
Government (inc local authorities)	10,000	0	10,000	0.15
Other	10	0	10	0.00
Total investments	**12,864**	**(2,097)**	**10,767**	**0.14**

6.3 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.4 On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities.

7.0 Non Treasury Investments

7.1 The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government’s (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority has an investment (Gellideg Housing Co-operative) made for service purposes which is currently valued at £408,000 (as at 31st March 2020), the terms of the investment are that it is cost neutral for the Authority. A full Council report on the Gellideg Housing Co-operative project was reported on the 25th February 2015. The Council also participates in the Empty Homes and Vibrant and Viable Places Loans schemes funded by the Welsh Government.

8.0 Treasury Performance

8.1 The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget as shown in Table 5 below.

Table 5 Performance

Description	**Estimate £'000**	**Outturn to 30th September 2020 £'000**
Public Works Loan Board Loans	3,215	1,187
Lender's Option Borrower's Option Loans	541	209
Short Term Borrowing	581	157
Short Term Investments	(111)	(28)
Total Borrowing	**4,226**	**1,525**

The estimate detailed above is the full year position, the outturn is the position to 30th September 2020.

8.2 The corporate world is still adjusting to the economic shock, with probably more to come, and it is still too early to tell which companies will withstand the economic damage in the short- to medium-term or which will choose to conserve cash in very difficult economic conditions simply to survive.

8.3 Investment income in the Authority's 2020/21 was set against a very different economic backdrop. Bank Rate, which was 0.75% in January/February 2020, now stands at 0.1%. Interest earned from short-dated money market investments will be significantly lower.

8.4 The Authority will be reviewing its expectations for investment income in 2020/21 and will likely make downward adjustments and will monitor and report on actual income received during the year.

9.0 Compliance Report

9.1 The Chief Finance Officer reports that all treasury management activities undertaken during the period complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy with the exception detailed in table 7 below.

Table 6 Debt limits

Description	2020/21 Maximum £'000	30.9.20 Actual £'000	2020/21 Operational Boundary £'000	2020/21 Authorised Limit £'000	Complied
Borrowing	105,496	102,858	140,770	154,672	✓

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cashflow, and this is not counted as a compliance failure.

Table 7 Investment Limits

Description	2020/21 Maximum £'000	30.9.20 Actual £'000	2020/21 Limit £'000	Complied
Banks and Building Societies	5,012	807	5,000	☒
UK Local Authorities	5,000	5,000	5,000	✓
UK Government	15,000	0	As required	✓

The Authority exceeded the £5 million pound investment limit for one organisation with the Authority's own Bank Account on one occasion due to a number of small credit/debit card payments being received in the Authority's bank account overnight.

10.0 **Treasury Management Indicators**

10.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

10.1.1 Interest Rate Exposures:

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one year revenue impact of a 1% rise in interest rates was:

Description	**30.9.20 Actual £'000**	**2020/21 Limit £'000**	**Complied**
Upper limit on one year revenue impact of a 1% rise in interest rates	256	437	✓

The Limit detailed above is the full year position, the outturn is the projected year end position at 30th September 2020.

10.1.2 Maturity structure of Borrowing:

This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Description	**30.9.20 Actual**	**Upper Limit**	**Lower Limit**	**Complied**
Under 12 months	57%	90%	0%	✓
12 months and within 24 months	3%	25%	0%	✓
24 months and within 5 years	8%	25%	0%	✓
5 years and within 10 years	9%	25%	0%	✓
10 years and above	23%	50%	0%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

10.1.3 Principal Sums invested for Periods longer than 364 days:

The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Description	2020/21	2021/22	2022/23
Principal Sums Invested for Periods Longer than 364 days	0	0	0
Complied	✓	✓	✓

11.0 Other

The implementation of the new IFRS 16 Leases accounting standard has been delayed until 2021/22.

12.0 Outlook for the remainder of 2020/21 (Data as at 4th October 2020)

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been supressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

Appendix 1

External Context (Data as at 4th October 2020)

Economic background

The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the 'Eat Out to Help Out' (EOHO) offer.

GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme. The Office for National Statistics' preferred measure of CPIH which includes owner-occupied housing was 0.5% y/y.

In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the BoE has forecast unemployment could hit a peak of between 8% and 9%.

The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is 'moderately' above the 2% average target, particularly given it has been below target for most of the last decade.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

Financial markets

Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.23% respectively over the period.

At the end of September, the yield on 2-year US treasuries was around 0.13% while that on 10-year treasuries was 0.69%. German bund yields remain negative across most maturities.

Credit review

Credit default swap spreads eased over most of the period but then started to tick up again through September. In the UK, the spreads between ringfenced and non-ringfenced entities remains, except for retail bank Santander UK whose CDS spread remained elevated and the highest of those we monitor at 85bps while Standard Chartered was the lowest at 41bps. The ringfenced banks are currently trading between 45 and 50bps.

After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned a AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.