TEES VALLEY COMBINED AUTHORITY | TEES VALLEY MAYOR

AGENDA ITEM 11

REPORT TO THE TEES VALLEY COMBINED AUTHORITY CABINET

2nd JULY 2021

REPORT OF GROUP DIRECTOR OF FINANCE AND RESOURCES

TREASURY MANAGEMENT OUTTURN REPORT 2020/21

SUMMARY

This report informs Members of the 2020/21 performance against the treasury management and prudential indicators set in the Treasury Management Strategy approved by the Authority in March 2020.

RECOMMENDATIONS

It is recommended that Cabinet note the contents of the report.

INTRODUCTION

1. The Authority adopted the 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.

2. The Authority's treasury management strategy for 2020/21 was approved at Cabinet meeting on 13th March 2020. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Authority's treasury management strategy.

3. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by Cabinet covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was also approved by full Cabinet at the 13th March 2020 meeting.

DETAIL

External Context

4. The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

5. The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

6. Inflation has remained low over the 12-month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation (CPI) fell to 0.4% year/year in February, below expectations (0.8%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 0.7% year/year (1.0% expected).

7. After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower pace than the 41.7% rise in the prior quarter. When released, figures for Q1 (Jan-Mar) 2021 are expected to show a decline given the national lockdown.

8. After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. The US recovery has been fuelled by three major pandemic relief stimulus packages totalling over $5 trillion. The Federal Reserve cut its main interest rate to between 0% and 0.25% in March 2020 in response to the pandemic and it has remained at the same level since.

9. The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

10. Monetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

11. Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

12. The 5-year UK benchmark gilt yield began the financial year at 0.18% before declining to -0.03% at the end of 2020 and then rising strongly to 0.39% by the end of the financial year. Over the same period the 10-year gilt yield fell from 0.31% to 0.19% before rising to 0.84%. The 20-year declined slightly from 0.70% to 0.68% before increasing to 1.36%.

13. After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, albeit Santander UK is still an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The other ringfenced banks were trading around 33 and 34bps while Nationwide Building Society was 43bps.

14. Credit rating actions to the period ending September 2020 have been covered in previous outturn reports. Subsequent credit developments include Moody's downgrading the UK sovereign rating to Aa3 with a stable outlook which then impacted several other UK institutions, banks and local government. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

15. The vaccine approval and subsequent rollout programme are both credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose 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.

Local Context

16. The treasury management position on 31st March 2021 and the change during the year is shown in Table 1 below.

Table 1: Treasury Management Summary

	31.3.20 Balance £m	Movement £m	30.3.21 Balance £m
Long-term borrowing	30.00	(0.86)	29.14
Short-term borrowing	0.00	0.00	0.00
Total Borrowing	**30.00**	**(0.86)**	**29.14**
Long-term investments	0.00	0.00	0.00
Short-term investments	0.00	5.00	5.00
Cash and cash equivalents	62.65	34.25	96.9
Total Investments	**62.65**	**39.25**	**101.9**
Net Investments	**32.65**	**38.39**	**72.15**

17. During the year the Authority has not taken out any additional borrowing and all investment plan expenditure has been funded via Government grants or internal borrowing from cash reserves.

18. During the year the Authority has received large value grants in advance of expenditure which has resulted in the increase in cash balances. Investments that are due to mature within 90 days are classified as cash and cash equivalents.

Borrowing Update

19. In November 2020 the PWLB published its response to the consultation on 'Future Lending Terms'. From 26th November the margin on PWLB loans above gilt yields was reduced from 1.8% to 0.8% providing that the borrowing authority can confirm that it is not planning to purchase 'investment assets primarily for yield' in the current or next two financial years. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. As part of the borrowing process authorities will now be required to submit more detailed capital expenditure plans with confirmation of the purpose of capital expenditure from the Section 73. The PWLB can now also restrict local authorities from borrowing in unusual or large amounts.

20. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management. Misuse of PWLB

borrowing could result in the PWLB requesting that Authority unwinds problematic transactions, suspending access to the PWLB and repayment of loans with penalties.

21. Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders

Borrowing Strategy

22. At 31st March 2021 the Authority held £29m of loans as part of its strategy for funding the capital programmes within the Investment Plan, this was the first borrowing taken out by the Authority. Outstanding loans on 31st March 2021 are summarised in Table 2 below.

Table 2: Borrowing Position

	31.3.20 Balance £m	**Net Movement £m**	**31.3.21 Balance £m**	**31.3.21 Weighted Average Rate %**	**31.3.21 Weighted Average Maturity (years)**
Public Works Loans Board	30.00	(0.86)	29.14	2.67	23.83
Total borrowing	**30.00**	**(0.86)**	**29.14**	**2.67**	**23.83**

23. 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.

24. The Authority has an increasing capital financing requirement due to the capital programme within the investment plan and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital.

Treasury Investment Activity

25. The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances fluctuated due to timing differences between income and expenditure. The investment position at the end of March 2021 is shown in table 3 below.

Table 3: Treasury Investment Position

Counterparty	Amount	Start	Maturity
	£	Date	Date
Natwest SIBA	1,900,000	n/a	Call Account
UK Government DMO	10,000,000	29-Mar-21	12-Apr-21
Blackrock	15,000,000	07-Dec-16	Money Market Fund
Aberdeen Standard	15,000,000	06-Oct-16	Money Market Fund
Federated	15,000,000	06-Oct-16	Money Market Fund
Legal & General	15,000,000	06-Oct-16	Money Market Fund
Insight	15,000,000	07-Dec-16	Money Market Fund
Redcar & Cleveland Council	10,000,000	02-Dec-20	15-Apr-21
Flintshire County Council	5,000,000	23-Mar-21	23-Aug-21
	101,900,000		

26. 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 treasury investments before seeking the optimum 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.

27. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 4 below.

Table 4: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2019	4.23	AA-	42%	52	0.79
30.06.2019	4.60	A+	100%	13	0.76
30.09.2019	4.75	A+	66%	82	0.69
31.12.2019	4.30	AA-	100%	18	0.76
31.03.2020	4.30	AA-	92%	11	0.50
31.03.2021	4.63	A+	75%	10	0.02
Similar LAs	4.62	A+	47%	67	0.61
All LAs	4.63	A+	63%	14	0.90

Non-Treasury Investments

28. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

29. The Authority can lend money to its subsidiaries, constituent Local Authorities and local businesses to support delivery of the Strategic Economic Plan and stimulate local economic growth. Loans are not issued by the Authority for purely financial return, they are provided if the proposal meets the priorities set out in the Investment Plan and related strategies. Loans may be given in order to comply with state aid regulations, or alternatively it may be that the applicant has the ability to repay the support via increased revenues as a result of the investment.

30. As at the end of March 2021 also held £95.8m of such investments in;
- loans to subsidiaries £82.7m
- loans to constituent local authorities £8.8m
- loans to local businesses £4.3m

Compliance

31. The Group Director of Finance and Resources reports that all treasury management activities undertaken during complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 5 below.

Table 5: Debt Limits

	Maximum in Year	31.3.21 Actual	2020/21 Operational Boundary	2020/21 Authorised Limit	Complied? Yes/No
Borrowing	£30m	£29.14m	£122.90m	£147.48m	Yes

32. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	Maximum in Year	31.3.21 Actual	2020/21 Limit	Complied? Yes/No
Any single organisation, except the UK Central Government	£10m	£10m	£15m per organisation	Yes
UK Central Government	£25m	£10m	Unlimited	Yes
Any group of organisations under the same ownership	£0	£0	£15m per organisation	Yes
Any group of pooled funds under the same management	£0	£0	£37.5m	Yes
Negotiable instruments held in a broker's nominee account	£0	£0	£37.5m	Yes

Foreign countries	£0	£0	£15m	Yes
Registered providers and registered social landlords	£0	£0	£37.5m	Yes
Unsecured investments with building societies	£0	£0	£15m	Yes
Loans to unrated corporates	£0	£0	£15m	Yes
Money Market Funds	£75m	£75m	£75m	Yes
Real estate investment trusts	£0	£0	£37.5m	Yes

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

34. 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 are set out in table 7 below.

Table 7: Borrowing Maturity

	31.3.21 Actual	**Upper Limit**	**Lower Limit**	**Complied?**
Under 12 months	0%	100%	0%	Yes
12 months and within 24 months	0%	100%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	100%	100%	0%	Yes

35. Principal Sums Invested for Periods Longer than a year: 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.

Table 8: Long Term Investments

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	£0	£0	£0
Limit on principal invested beyond year end	£15m	£10m	£5m
Complied?	Yes	Yes	Yes

FINANCIAL IMPLICATIONS

36. None

LEGAL IMPLICATIONS

37. None

CONSULTATION & COMMUNICATION

38. None

Name of Contact Officer: Gary Macdonald
Post Title: Group Director of Finance and Resources
Telephone Number: 01642 526527
Email Address: gary.macdonald@teesvalley-ca.gov.uk