TEES VALLEY COMBINED AUTHORITY | TEES VALLEY MAYOR

AGENDA ITEM 7

REPORT TO THE TEES VALLEY COMBINED AUTHORITY CABINET

17th DECEMBER 2021

REPORT OF GROUP DIRECTOR OF FINANCE AND RESOURCES

TREASURY MANAGEMENT MID YEAR REVIEW 2021/22

SUMMARY

This report informs Members of the mid-year performance against the treasury management and prudential indicators set in the Treasury Management Strategy approved by the Authority in January 2021.

RECOMMENDATIONS

It is recommended that:-

1. Cabinet note the contents of the report.
2. Cabinet approve the revised Investment Limits set out in para 23

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 2021/22 was approved at Cabinet meeting on 29th January 2021. The Treasury Management indicators were then revised by Cabinet at the meeting of 2nd July 2021. The Authority has 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 29th January 2021 meeting.

DETAIL

External Context

4. The economic recovery from 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.

5. The Bank of England (BoE) 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.

6. The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. 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 8.3% and 6.3% 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.

7. Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.

8. The easing of restrictions boosted activity in the second quarter of calendar year, helping push GDP up by 5.5% q/q (final estimate vs 4.8% q/q initial estimate). Household consumption was the largest contributor. Within the sector breakdown production contributed 1.0% q/q, construction 3.8% q/q and services 6.5% q/q, taking all of these close to their pre-pandemic levels.

9. 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, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, lead to higher price.

10. 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%.

11. 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.

12. 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.

Local Context

13. The treasury management position on 30th September 2021 and the change in year is shown in Table 1 below.

Table 1: Treasury Management Summary

	31.3.21 Balance £m	**Movement £m**	**30.9.21 Balance £m**
Long-term borrowing	29.14	-0.44	28.70
Short-term borrowing	0.00	0.00	0
Total Borrowing	**29.14**	**-0.44**	**28.70**
Long-term investments	0.00	0.00	0.00
Short-term investments	5.00	-5.00	0.00
Cash and cash equivalents	96.90	-5.40	91.50
Total Investments	**101.90**	**-10.40**	**91.50**
Net Investments	**72.76**	**-9.96**	**62.80**

14. Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk.

Borrowing Update

15. Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 73 Officer. 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. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

16. At 30th September 2021 the Authority held £28.7m of loans, as part of its strategy for funding the capital programmes within the Investment Plan. This is expected to increase significantly during the year as borrowing is taken out to deliver projects approved by Cabinet previously. Outstanding loans on 30th September are summarised in Table 2 below.

Table 2: Borrowing Position

	31.3.21 Balance £m	**Net Movement £m**	**30.9.21 Balance £m**	**30.9.20 Weighted Average Rate %**	**30.9.20 Weighted Average Maturity (years)**
Public Works Loan Board	29.14	-0.44	28.70	2.67	23.33
Total borrowing	**29.14**	**-0.44**	**28.70**	**2.67**	**23.33**

17. 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.

18. 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. Having considered the appropriate duration and structure of the Authority's borrowing need based on realistic projections, the Authority took out no further borrowing during the period April to September 2021.

Treasury Investment Activity

19. 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 September is shown in table 3 below.

Table 3: Treasury Investment Position

Counterparty	**Amount**	**Start**	**Maturity**
	£	**Date**	**Date**
Redcar & Cleveland Council	10,000,000	15/04/2021	15/10/2021
West Dumbartonshire Council	3,000,000	28/04/2021	12/11/2021
Blackrock	15,000,000	07/12/2016	Instant Access
Aberdeen	15,000,000	06/10/2016	Instant Access
Federated	15,000,000	06/10/2016	Instant Access
Legal & General	15,000,000	06/10/2016	Instant Access
Insight	15,000,000	07/12/2016	Instant Access
DMO	3,500,000	17/09/2021	04/10/2021
TOTAL	**91,500,000**		

20. As a result of significant increases in the forecast cash position of the Authority in the short term the Investment Limits are to be revised. The below table sets out the new Investment Limits for approval, we have consulted with our Treasury Management advisors prior to setting these limits and these are deemed to be in line with normal Treasury Management levels.

	Cash limit
Any single organisation, except the UK Central Government	£15,000,000
UK Central Government	unlimited
Any group of organisations under the same ownership	£15,000,000
Any group of pooled funds under the same management	£37,500,000
Negotiable instruments held in a broker's nominee account	£37,500,000
Foreign countries	£15,000,000
Registered providers and registered social landlords	£37,500,000
Unsecured investments with building societies	£15,000,000
Loans to unrated corporates	£15,000,000
Money Market Funds	Unlimited
Real estate investment trusts	£37,500,000

21. 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.

22. 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 %
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
30.09.2020	4.15	AA-	81%	12	0.06
31.03.2021	4.63	AA+	75%	11	0.02
Similar LAs	4.12	AA-	60%	55	0.17
All LAs	4.16	AA-	64%	18	0.27

Non-Treasury Investments

23. 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.

24. 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.

25. As at the end of September 2021 also held £138.4m of such investments in;
    - loans to subsidiaries £125.2m
    - loans to constituent local authorities £8.8m
    - loans to local businesses £4.4m

Compliance

26. 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

Table 5: Debt Limits (£m)

	Maximum in Year	**30.9.21 Actual**	**2021/22 Operational Boundary**	**2021/22 Authorised Limit**	**Complied? Yes/No**
Borrowing	29.14	28.70	460.38	552.46	Yes

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

Table 6: Investment Limits

	Maximum in Year	**30.9.21 Actual**	**2021/22 Limit**	**Complied? Yes/No**
Any single organisation, except the UK Central Government	£15m	£13.5m	£15m per organisation	Yes
UK Central Government	£60.5m	£3.5m	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	£37.4m	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

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

29. 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

	30.9.21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	0%	25%	0%	Yes
12 months and within 24 months	0%	40%	0%	Yes
24 months and within 5 years	0%	60%	0%	Yes
5 years and within 10 years	0%	80%	0%	Yes
10 years and above	100%	100%	0%	Yes

30. 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. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 8: Long Term Investments

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£0	£0	£0
Limit on principal invested beyond year end	£15m	£10m	£5m
Complied?	Yes	Yes	Yes

Outlook for the remainder of 2021/22

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

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

32. 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.

33. 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.

34. 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.

35. 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.

36. 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.

37. Government bond yields increased sharply following the September FOMC 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..

38. The MPC appears to be playing both sides, but 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.

FINANCIAL IMPLICATIONS

39. None

LEGAL IMPLICATIONS

40. None

CONSULTATION & COMMUNICATION

41. None

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