Renfrewshire Council

To: **Finance Resources and Customer Services Policy Board**

On: **10 November 2021**

Report by: **Director of Finance and Resources**

Heading: **Treasury Management Mid-Year Review 2021-2022**

1. Summary

1.1 This mid-year report has been prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services Code of Practice. The report covers the following:

- an economic update for the first half of the 2021-2022 financial year;
- a review of the Treasury Management Strategy Statement 2021-2022, incorporating the annual investment strategy;
- a review of the Council's investment portfolio for 2021-2022;
- a review of the Council's borrowing strategy for 2021-2022; and
- a review of compliance with treasury management indicators for 2021-2022.

2. Recommendations

It is recommended that Members:

2.1 note the treasury management activity for the period 1 April 2021 to 15 October 2021;

2.2 agree to revise the treasury management strategy to allow the Council to mitigate foreign exchange rate risk intrinsic in a construction contract as outlined in section 8 below.

3. Economic update

3.1 In September the Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures

3.2 The September MPC's minutes indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices, are likely to lead to faster and higher inflation expectations and underlying wage growth. This would in turn increase the risk that price pressures would prove more persistent next year than previously expected. To emphasise its concern about inflationary pressures, the MPC chose to reaffirm its commitment to the 2% inflation target in its statement. This suggested that the MPC was now willing to prioritise bringing inflation down next year. This is a reversal of its priorities since August and a change from earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Previously the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy may get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer. Financial markets are now beginning to price in an increase in the Bank rate later in 2021 or early in 2022.

3.3 **COVID-19 vaccines** have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is potential for increased demand for services in hard hit sectors like restaurants, travel and hotels. The risk is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

3.4 **Supply shortages**. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports worldwide. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping.

Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also experiencing difficulties in filling job vacancies. It is expected that these issues will gradually ease, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves

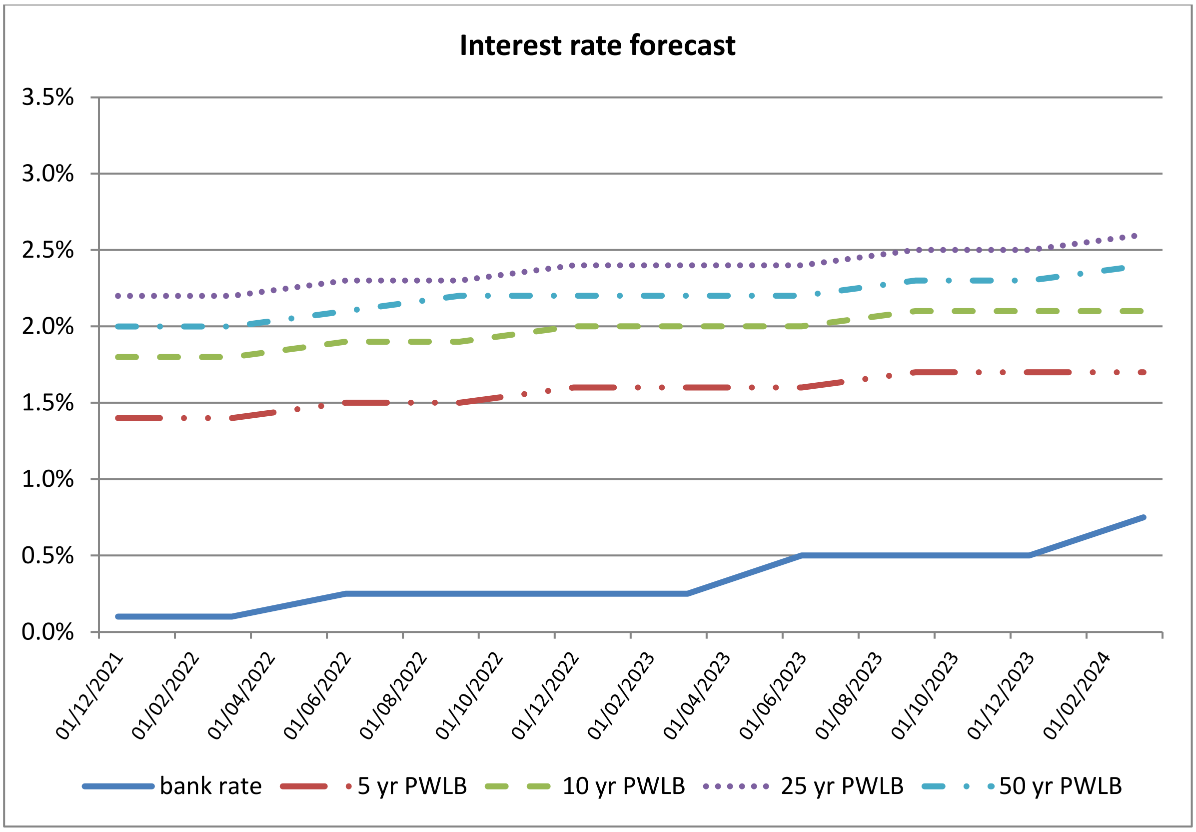
3.5 **Credit background:** Although the credit rating agencies changed their outlook on many UK banks from stable to negative due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis started in March 2020. In the main, where they did change, any alterations were limited. However, as economies are beginning to reopen, there have been some instances of previous lowering of ratings being reversed and it should also be borne in mind that UK banks went into this pandemic with strong balance sheets.

4 Interest rate forecasts

4.1 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings. However as shown in the forecast graph below (provided by the Council's treasury advisers), one increase in Bank Rate from 0.10% to 0.25% to help counter inflationary pressures has now been included in quarter 2 of 2022/23.

4.2 Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons:

- There are potential grounds for viewing the economic recovery as levelling off as we move into the autumn.
- Rising gas and electricity prices and increases in other prices caused by supply shortages and increases in taxation next April, may deflate consumer spending power
- However, estimates suggest consumers could have excess savings left over from the pandemic which may be spent – the timing of this is uncertain
- There is a risk that there could be further Covid variants which, on top of the flu season this winter, which could depress economic activity
- The consequences of the ending of the furlough scheme at the end of September remain uncertain



4.3 In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon. It should also be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. The MPC could decide to remove this emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

4.4 From the Council's perspective, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

5 Review of the Treasury Management Strategy Statement 2021-2022 (incorporating annual investment strategy) as at 15 October 2021

5.1 The Treasury Management Strategy Statement for 2021-2022 was approved by Council on 4 March 2021. The Council's annual investment strategy, which is incorporated in the Treasury Management Strategy Statement, sets out the Council's investment priorities as follows:

- the security of capital and
- the liquidity of its investments.

5.2 The Council also aims to achieve the optimum returns on its investments commensurate with the proper levels of security and liquidity. Investments and borrowing during the first six months of the year have been in line with the strategy and there have been no changes to the policies set out in the Treasury Management Strategy Statement 2021-2022. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions. The details in this report update the position in light of the updated economic position and budgetary changes already approved.

6 Review of borrowing and investments over the period 1 April 2021 to 15 October 2020

6.1 The Council's net borrowing position as at 15 October 2021 is shown in Appendix 1.

6.2 During the period 1 April 2021 to 15 October 2021 the Council's total external borrowings have decreased very slightly to £220.04 million, due to the scheduled repayments of PWLB debt.

6.3 During this period, temporary investments have increased from £187.70 million to £261.7 million. The increase in investments reflects:

- the re-profiling of elements of the current capital programme due to the pause in construction activity during and following the coronavirus lockdown period;
- the "front-loading" (that is, more income being received in the early part of the year) of revenue support grant income; and additional funding in relation to Covid costs.

6.4 The Director of Finance and Resources confirms that, during the period 1 April 2021 to 15 October 2021, the approved limits set out within the annual investment strategy sections of the Treasury Management Strategy Statement 2021-2022 were complied with. The Council only invested with institutions listed in the Council's approved lending list. Similarly, only permitted investment vehicles were used, mainly fixed term deposits with other local authorities, the UK governments deposit facility (DMADF), call accounts and money market funds.

6.5 In accordance with CIPFA's Treasury Management in the Public Services Code of Practice, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

6.6 As shown by the interest rate forecasts in section 4.2, it is now impossible to earn the level of interest rates commonly seen in previous years as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020.

The MPC meeting on 24th September 2021 was the first occasion when 6 and 12 month rates have risen in anticipation of Bank Rate going up in 2022. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before mid-2023, investment returns are expected to remain low.

6.7 The table below shows the average interest rate achieved by the Council on its temporary investments during the period 1 April 2021 to 15 October 2021. The table also shows for comparison the benchmark comparator, which is the average 7-day LIBID rate (uncompounded). (The 7-day LIBID rate is the London Interbank Bid Rate, being the rate at which a bank is willing to borrow from other banks, for borrowings of a maturity of seven days.)

The LIBID benchmark is closely related to the LIBOR benchmark; both of which are being phased out from the end of 2021 following evidence in recent years of manipulation of these rates. Work is currently progressing on a comparable benchmark in terms of evaluating short term investment returns is SONIA – the Sterling Overnight Index Average – which is reflects bank and building societies actual overnight funding rates in Sterling and is administered by the Bank of England. In future reports the SONIA benchmark will be used; however both benchmarks are detailed in the table below.

Interest rates achieved on investments	Average value of investments	Actual rate of return	Benchmark return
Internally managed investments	£235.46m	0.118%	-0.084% (LIBID) 0.049% (SONIA)

6.8 Debt rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and it is not anticipated that this is likely to change over the short to medium term. However, in conjunction with the Council's treasury advisors, the service will remain alert to any opportunities which may arise.

7 Review of compliance with treasury management indicators for 2021-2022

7.1 During the period 1 April 2021 to 15 October 2021 the Council complied with the approved treasury management indicators as set out in the Treasury Management Strategy Statement 2021-2022. These indicators relate to:

- interest rate exposures: the upper limit on the proportion of investments which are exposed to fixed interest rates and the upper limit on the proportion of investments which are exposed to variable interest rates;
- the maturity structure of borrowing: the lower and upper limits on the proportion of investments which fall into each maturity band.

7.2 In addition to the treasury management indicators referred to at 7.1, there are two *prudential* indicators (as set out in the Prudential Framework for Capital Finance and Treasury Management Strategy Statement 2021-2022, approved by Council on 4 March 2021) which are of particular relevance to the Council's treasury management strategy:

- operational boundary for external debt;
- authorised limit for external debt.

7.3 During the period 1 April 2021 to 15 October 2021 the Council operated within the operational boundary for external debt, and within the authorised limit for external debt. These indicators, along with the Council's actual external debt, are shown in Appendix 2.

8 Exchange rate risk

8.1 The Council traditionally has no exposure to exchange rate risk and has therefore no provision with the current treasury management strategy (as agreed by Council on 4 March 2021) with regards the management and mitigation of this risk. The recent award of a construction contract includes an obligation to make payment of part of the costs incurred in Euros as opposed to Sterling; and therefore solely in relation to this contract the Council may require to mitigate the risk of exchange rate movements over the period of the contract.

8.2 It is therefore proposed to insert the following sections which outline the risk concerned, measures taken to mitigate this risk, and the mechanisms which may be used:

New section in TM strategy	*Proposed addition*
A3 (vi)	*Exchange rate risk* – the risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.
A4 (vi)	*Exchange rate risk* – The Council will closely monitor exchange rate movements and may utilise risk management tools or instruments available such as a forward contract or advance purchase of foreign currency to hold in an account until such time as required; always providing that these measures are used only for the prudent management of the

	Council's financial affairs and not for any speculative purpose.
A5 (xii)	*Forward foreign exchange contracts and options.* These are only utilised in order to manage specific known exchange rate risks and not for speculative purposes. A forward contract may be entered into in order to hedge against exchange rate risk where the amount and date of a payment in a foreign currency is known in advance. An option is a premium paid product which gives the right, but not the obligation, to purchase a pre agreed EUR amount, at a pre agreed rate and date.

Implications of the Report

1. **Financial** – As described in the report. The Treasury Management Strategy Statement and treasury management indicators assist in providing assurance that the Council's treasury management activities and longer term plans are affordable, prudent and sustainable.

2. **HR & Organisational Development** – none

3. **Community Planning** – none

4. **Legal** – none

5. **Property/Assets** – none

6. **Information Technology** – none

7. **Equality & Human Rights** – Recommendations contained within this report have been assessed in relation to their impact on equalities and human rights. No negative impacts on equality groups or potential for infringement of individuals' human rights have been identified arising from the recommendations contained in the report because it is for noting only. If required following implementation, the actual impact of the recommendations and the mitigating actions will be reviewed and monitored, and the results of the assessment will be published on the Council's website.

8. **Health & Safety** – none

9. **Procurement** – none

10. **Risk** – The Treasury Management Strategy Statement and treasury management indicators provide a framework to take forward the Council's treasury activities in the context of the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. This mid-year review report demonstrates that the treasury management activities carried out during the period 1 April 2021 to 15 October 2021 have been consistent with the Treasury Management Strategy Statement 2021-2022 and have complied with the treasury management indicators set out in the Strategy Statement

11. **Privacy Impact** – none

12. **COSLA Policy position** – none

13. **Climate risk** - none

List of Background Papers
None

Author: Alastair MacArthur – 0141 618 7363

Appendix 1

Borrowing and investment position as at 15 October 2021

	balance at 01-Apr-21	new borrowing in 2021-2022	principal repayments	debt restructuring	net cash movements	balance at 15-Oct-21
Long term borrowings						
PWLB - fixed	202,130,616.12	-	(3,081.74)	-	-	202,127,534.38
PWLB - variable	-	-	-	-	-	-
Market loans	52,916,000.00	-	-	-	-	52,916,000.00
	255,046,616.12	-	(3,081.74)	-	-	255,043,534.38
Short term borrowings						
Temporary loans	-	-	-	-	-	-
	-	-	-	-	-	-
Total external borrowings	255,046,616.12	-	(3,081.74)	-	-	255,043,534.38
Investments						
Fixed term deposits	130,000,000.00	-	-	-	5,000,000.00	135,000,000.00
Notice accounts	5,000,000.00	-	-	-	-	5,000,000.00
Call accounts	8,000,000.00	-	-	-	-	8,000,000.00
UK Government DMADF	5,720,000.00	-	-	-	80,420,000.00	86,140,000.00
Ultra-Short Dated Bond Funds	-	-	-	-	5,000,000.00	5,000,000.00
Money market funds	39,000,000.00	-	-	-	(16,470,000.00)	22,530,000.00
Total investments	187,720,000.00	-	-	-	73,950,000.00	261,670,000.00
Net borrowing	67,326,616.12	-	(3,081.74)	-	73,950,000.00	(6,626465.62)

Appendix 2

Treasury Management Indicators as at 15 October 2021

	2021-2022 estimate	2021-2022 probable	2022-2023 estimate	2023-2024 estimate
Authorised limit for external debt	£480m	£412m	£606m	£685m
Operational boundary for external debt	£460m	£396m	£580m	£655m
Actual external debt at 15 October 2021	n/a	£329.48m	n/a	n/a
Upper limit for fixed interest rate exposure (borrowing) expressed as percentage of total net outstanding principal	100%	n/a	100%	100%
Upper limit for variable interest rate exposure (borrowing) expressed as percentage of total net outstanding principal	25%	n/a	25%	25%

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	new borrowing in 2021-2022		total of all borrowing	
	value	maturity structure	upper limit	actual at 15 Oct 2021
Maturity structure of fixed rate borrowing				
under 12 months	0	0%	15%	0.33%
12 months and within 24 months	0	0%	15%	0.73%
24 months and within 5 years	0	0%	45%	4.25%
5 years and within 10 years	0	0%	50%	0.01%
10 years and above	0	0%	100%	94.68%