APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

1. INTRODUCTION AND BACKGROUND

The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2009 was adopted by this Council in February 2010 and this Council fully com/plies with its requirements. The Code was revised in 2011 and further revised in 2017.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the Council of an annual treasury management strategy report (including the annual investment strategy report) for the year ahead, a mid year review and an annual review report of the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions, which in this Council is the Chief Officer Resources.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specified named body which in this Council is the Corporate Overview Scrutiny Committee.

Treasury management in this context is defined as:

> *"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "*

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the mid-year review report of treasury management activities, for the financial year 2020/21.

2. THIS TREASURY MANAGEMENT MID YEAR REVIEW REPORT COVERS

- Economic Background during the period
- Interest Rate Forecast
- Treasury Advisors
- The Council's treasury position as at 30 September 2020;
- Borrowing and investment rates for the first half of 2020/21;
- Mid-year review of the borrowing strategy 2020/21;
- Borrowing outturn for the first half of 2020/21;
- Debt rescheduling for the first half of 2020/21;

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

- Compliance with treasury limits and Prudential Indicators for the first half of 2020/21;
- Mid-year review of the investment strategy for 2020/21;
- Investment outturn for the first half of 2020/21;
- Other treasury management issues.

3. ECONOMIC BACKGROUND DURING PERIOD

As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

1. The fall in GDP in the first half of 2020 was revised from 28% to 23%. This is one of the largest falls in output of any developed nation.
2. The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.
3. It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022

It also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including QE.

In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six month package from 1st November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid September.

Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

There will be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

The Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses

Blaenau Gwent

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

4. INTEREST RATE FORECASTS

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Group Interest Rate View 11.8.20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

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 first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September meeting), although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **UK** - second nationwide wave of virus infections requiring a national lockdown
- **UK / EU trade negotiations** – if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for “weaker” countries. In addition, the EU recently agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **US – the Presidential election in 2020:** this could have repercussions for the US economy and trade relations.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **UK -** stronger than currently expected recovery in UK economy.
- **Post-Brexit** – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

5. TREASURY ADVISORS

The Council uses external treasury management advisors. The Council recognises that responsibility for Treasury Management decisions remains with the Authority at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The Council retendered for the provision of Treasury Management advisory services as a result of the existing contract expiring on 30th April 2017. This resulted in the appointment of Link Asset Services for a period of two years until 20th April 2019, with an option to extend for a further two years, this option has been exercised by the Chief Officer Resources and Link have been appointed to the 30th April 2021.

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

6. TREASURY POSITION AS AT 30 SEPTEMBER 2020

The Council's debt and investment position at the beginning of the year and the end of the half year was as follows:

This illustrates that the total debt outstanding as at 30 September 2020 was £144.2 million, comprising of long term debt of £97.9 million and short term debt of £46.2 million.

	31March 2020 Principal	Average Rate/ Return	30Sept 2020 Principal	Average Rate/ Return	Increase/ (Decrease) in Borrowing
	£000		£000		£000
Fixed Rate Funding:					
- PWLB	79,430	4.71%	76,996	4.05%	(2,430)
- Market Loans	14,000	1.67%	17,000	1.38%	3,000
Variable Rate Funding:					
- Market (LOBO *)	4,000	4.5%	4,000	4.50%	0
Total Long Term Debt	***97,430***	***4.10%***	***97,996***	***3.63%***	***566***
Short Term Loans(<365 days)	60,699	0.86%	46,199	0.58%	(14,500)
Total Debt	**158,129**	**2.86%**	***144,195***	***2.68%***	***(13,934)***
Investments:					
- Short Term	0		5,100		5,100
Total Investments	***0***		***5,100***		***5,100***

** LOBO – Lenders Option Borrowers Option. This loan has a fixed rate for the first two years of 3.85%. The remaining period of the loan (which we are now in) has a rate of 4.5%, but the lender can increase this rate at six month intervals.*

7. BORROWING AND INVESTMENT RATES IN 2020/21

The following table displays a selection of interest rates prevailing as at 1st April 2020 and 30th September 2020.

	01/04/2020	30/09/2020
Bank Base Rate	0.10%	0.10%
7 day LIBID	0.01%	-0.07%
PWLB 10 year Maturity	1.47%	1.47%
PWLB 15 year maturity	1.78%	1.78%
PWLB 25 year maturity	2.03%	2.76%

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

8. MID YEAR REVIEW OF THE BORROWING STRATEGY FOR 2020/21

The Treasury Management Strategy Statement for 2020/21 was approved by Council in March 2020. The Borrowing Strategy adopted as part of this was as follows:

To utilise the Authority's overdraft facility:
To fund unexpected daily cash deficits;
To fund temporary cash shortfalls where there are no other sources of funding available within the marketplace.

To borrow over the short term:
To fund temporary cash shortfalls;
To maintain a suitably balanced maturity profile; to make short term savings required in order to meet budgetary constraints;
In anticipation of securing longer term loans at more attractive rates.

To borrow over the long term:
To reduce the Authority's average cost of borrowing;
To maintain a stable, longer term portfolio;
To maximise the potential for future debt rescheduling.

If appropriate to avoid all new external borrowing:
To maximise savings in the short term;
To run down temporary investment levels;
To minimise exposure to interest rate and credit risk.

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer term stability of the debt portfolio. With short term interest rates generally much lower than long term rates, it can be cost effective in the short term to either use internal resources, or to borrow short term loans instead.

However, due to the current climate and the PWLB rates reducing to record lows, the Authority has been able to borrow in recent months into the longer term at affordable rates. This has allowed the Authority to be able to reduce long term borrowing costs and reduce overall treasury risk. The benefits of short term borrowing will be monitored regularly against the potential for securing advantageous longer term rates when the opportunity arises.

Borrowings undertaken during the period (see section 9 below) have been done so in accordance with this strategy and in the current economic climate it is considered that the approved strategy is still fit for purpose and therefore no revisions are proposed.

Blaenau Gwent

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

9. BORROWING OUTTURN FOR THE FIRST HALF OF 2020/21

Long Term Borrowing
Definition
Long term borrowing relates to debt taken out for a period of greater than one year. It is taken out for periods of 1 year up to 50 years. This borrowing is required to finance capital expenditure undertaken in the year that is funded through:

- Borrowing approvals from Welsh Government, known as un-hypothecated supported borrowing (USB), for which revenue support for the borrowing costs is provided through the revenue support grant;
- Prudential borrowing, for which borrowing costs are funded through revenue savings.

Total outstanding as at 30th September 2020
The total long term debt outstanding as at 30th September 2020 was £97.9 million. This is made up of debt taken from the Public Works Loan Board (PWLB), from other local authorities (through the market place), and from the market (LOBO). This debt is due to be repaid within the following years:

Maturing Within	£000s
1YR	232
1-2YRS	5,697
2-3YRS	10,919
3-4YRS	8,764
4-5YRS	14,051
5-6YRS	1,876
6-10YRS	23,438
10-15YRS	5,962
15+ YRS	27,057
Total	**97,996**

New borrowings for the First Half of 2020/21
Due to advantageous interest rates, during the first half of 2020/21, the Authority entered into long term borrowing of £ 9 million.

Short Term Borrowing
Definition
Short term borrowing relates to debt taken out for a period of less than one year i.e. it will all be fully repaid within a year. These short term loans are taken out to manage the Authority's short term cash flow i.e. to fund deficits in cash flow on a daily basis pending receipt of income from grants or other sources, or pending the taking out of longer term debt to fund capital expenditure whilst we wait for advantageous longer term borrowing opportunities. Current short term borrowing rates are very low and are forecast to stay at these levels for the medium term. The Authority is therefore taking advantage of such rates and is borrowing short term to fund its capital expenditure and maturing debt until such time the market indicates that long term rates are more advantageous.

Blaenau Gwent

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

Total outstanding as at 30th September 2020

The total short term debt outstanding as at 30th September 2020 was £46.2 million. This is made up of debt taken from other local authorities through the market place.

New borrowings for the First Half Year of 2020/21

Appendix A lists the short term loan activity during for the first half year and shows that over the period a total of £60.7 million loans were brought forward from the previous year and £48.0 million of new short term loans were raised. A total of £62.5 million of these loans were repaid during the first half year, leaving a balance outstanding as at 30th September 2020 of £46.2million.

The following table gives a summary which shows that the average rate of interest paid was in line with the benchmark.

	Total Value of Loans during the period	Average Loan	Interest paid during the period	Average Interest Rate	Benchmark Interest Rate *
Short Term borrowing	£108M	£2.5M	£159K	0.67%	1.00%

** Benchmark = 1.0% Budgeted interest rate for short term borrowings*

7. DEBT RESCHEDULING

No debt rescheduling was undertaken during the period.

8. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operates within the treasury limits and Prudential Indicators set out in the Treasury Strategy Statement 2020/21, approved by Council in July 2020.

Operational Boundary for external debt

The Council resolved that this limit be set at £166.5 million for 2020/21. The average level of borrowings to the 30th September 2020 was £144 million, this is well below the limit

The operational boundary can be exceeded on an occasional basis, and this is to be expected due to cash flow fluctuations. Sustained breaches however, would indicate that either the limit has been set too low, or that the Authority is breaching its prudential boundaries and that corrective action needs to be taken.

Blaenau Gwent

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

Monitoring of the operational boundary is undertaken on a daily basis and any such continual breaches would be investigated and a recommended course of action reported to Council.

Authorised Limit for external Debt
The Council resolved that this limit be set at £181 million for 2020/21. The Authorised Limit is set having regard to the operational boundary above.

The average level of borrowings for the first half year to the 30th September 2020 was £144 million, so well within the limit set.

The Authorised Limit must not be breached.

Maturity Structure of Fixed Rate Borrowing

The Council resolved the following limits for the maturity structure of fixed rate borrowings for 2020/21;

	Upper Limit	Lower Limit	Actual as at 30/09/ 2020
under 12 months	20%	0%	0.24%
12 months and within 24 months	20%	0%	5.81%
24 months and within 5 years	50%	0%	34.43%
5 years and within 10 years	75%	0%	25.83%
10 years and above	95%	5%	33.69%

The actual debt maturity profile at 30th September 2020 is well within the limits set.

Upper Limit on Variable Interest Exposure

Council resolved the upper limit on variable rate exposures for 2020/21 should be set at 30% of outstanding long term debt. This strategy limits the proportion of interest which is subject to variable rate terms and hence protects the Council against increased costs in times of rising interest rates.
The actual level of variable borrowings is £4 million (LOBO) which equates to 4% of the outstanding long term debt as at 30th September 2020, so is well within the limit set.

9. MID YEAR REVIEW OF INVESTMENT STRATEGY FOR 2020/21

The Annual Investment Strategy for 2020/21 adopted by Council in March 2020 was to maintain only temporary, short term investments and to make those investments in accordance with anticipated cash flow requirements (including the investing of sums borrowed at prevailing low interest rates in anticipation of capital spending). The Council's investment priorities are:

a. the security of capital;
b. The liquidity of its investments.

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APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21

The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to the security of its investments.

In order to ensure that the Authority's investments are secure and that risk is minimised an investment matrix is used to determine investment counterparties, which factors in Fitch and Moody's credit ratings, credit default swap (CDS) spread data, and credit rating agency comments.

Currently, the only approved investment counterparties available to the Authority are Barclays, the Authority's bank, Lloyds Bank, the Debt Management Account Deposit Facility (DMADF) and other local Authorities. The DMADF started offering negative interest rates from the 25th September 2020, so it is no longer viable to place cash in this facility. As a result the Aurthority has signed up to a Money Market fund in line with the counterparty list. Whilst interest rates receivable on these counterparties is low the security of the capital sum is high and there is no cost associated with placing cash there.

It is also proposed to revise the investment strategy for the second half of the year as the limit on the amount of money that can be hel in the Authority's bank is £6million, however it is proposed to increase this to £10 million

This strategy has been adhered to in determining the investments for the first half of 2020/21 outlined in section 11 below.

10. INVESTMENT OUTTURN FOR THE FIRST HALF OF 2020/21

Appendix B gives details of the investments made during the first half of the year, and the following table gives a summary, which shows the Authority's average rate of return was below the benchmark.

	Total Value of Investments during period	Average Investment	Investment Returns	Average Rate of Return	Benchmark Return *
Internally Managed	£242M	£2.9M	£3k	0.07%	-0.07%

** Benchmark = 7 day LIBID - 0.07%*

No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

11. OTHER TREASURY MANAGEMENT ISSUES

None to report

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2020/21