

CABINET

DATE	9 December 2020
REPORT OF	Councillor Shreeve, Portfolio Holder for Finance and Resources
RESPONSIBLE OFFICER	Sharon Wroot, Director of Resources and Governance
SUBJECT	Treasury Management Mid-Year Report 2020/21
STATUS	Open
FORWARD PLAN REF NO.	CB 12/20/05

CONTRIBUTION TO OUR AIMS

Effective treasury management provides support towards the achievement of all Council Plan aims and objectives. Treasury management is an integral part of the Council's finances providing for cash flow management and financing of capital schemes.

EXECUTIVE SUMMARY

The report contains details of treasury management arrangements, activity and performance during the first six months of 2020/21.

The Council's high-level policies for borrowing and investments are:

- The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.
- The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

RECOMMENDATIONS

That Cabinet considers the content of the report and makes any recommendations to Council as necessary in respect of treasury management activity during 2020/21.

REASONS FOR DECISION

The Council's treasury management activity is guided by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. We therefore report after Quarter 2 and year end.

1. BACKGROUND AND ISSUES

1.1. CIPFA has defined treasury management as:

The management of the organisation's borrowing, investments and 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.

1.2. The proposed Treasury Management Strategy Statement (TMSS) for 2020/21 was developed in consultation with our treasury management advisors, Link Asset Services Ltd. This statement also incorporates the Investment Strategy.

1.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

1.4 The Council has nominated Audit & Governance Committee to be responsible for ensuring effective scrutiny of treasury management arrangements.

1.5 The key issues covered in the attached appendix include: -

- Management of the impact of the Covid-19 crisis on balances, access to financing and the interest rate environment.
- Political factors (Brexit, trade tensions) added volatility to interest rate and risk environments.
- Completion of the first long-term loan with Nomura Bank/The Pension Protection Fund at sub-PWLB rates in the sector.
- Compliance with Limits and Indicators set within the Treasury Management Strategy

1.6 Following consideration by Cabinet, this report will be submitted to full Council

2. RISKS AND OPPORTUNITIES

2.1 No Treasury activity is without risk. Specific risks include, but are not limited to, Counterparty Credit Risk (the risk of an investment not being repaid), liquidity risk (the risk that the Authority does not have its funds in the right place, at the right time and in the right amount to make it's payments as they fall due), interest rate risk (the risk that future rate movements have a revenue implication for the Authority) and reputational risk (see Section 4 below).

2.2 The attached Appendix records our approach toward mitigating these risks during 2020/21.

2.3 Treasury is an Authority-wide function and its equalities implications are the

same as for the Council itself.

2.4 As large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result equality issues are an increasingly important and heavily scrutinised part of their overall business.

2.5 General Data Protection Regulation 2018 – Relationships with external providers covered by the Treasury management Practices are governed by and operated in accordance with the act.

3. OTHER OPTIONS CONSIDERED

3.1 These were set out on Page 28 of the Treasury Management Strategy Statement.

4. REPUTATION AND COMMUNICATIONS CONSIDERATIONS

4.1 As you would expect, with large sums of public money involved, any treasury activity carries a high degree of reputational risk. Any losses have not just financial but also significant, ongoing resource implications for the Council and so Treasury retains a high degree of oversight from Senior Officers and Members.

5. FINANCIAL CONSIDERATIONS

5.1 As set out in the Appendix.

6. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

Treasury is an Authority-wide function and its climate change, environmental and sustainability implications are the same as for the Council itself.

The Authority will have regard to the environmental activities of its Counterparties (where reported) but:-

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result climate change considerations are an increasingly important and heavily-scrutinised part of their overall business.
- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

7. CONSULTATION WITH SCRUTINY

This Report was presented to Audit & Governance Committee on 12 November 2020

8. LEGAL IMPLICATIONS

8.1 There are no direct legal implications arising from the recommendations in this report which are not covered in the body of the report. The Council has complied with its statutory obligations arising from the Local Government Act,

the Local Government Finance Act and all relevant CIPFA guidance.

9. HUMAN RESOURCES IMPLICATIONS

9.1 There are no immediate HR implications arising from the recommendations contained in this report.

10. WARD IMPLICATIONS

10.1 All wards indirectly affected.

11. BACKGROUND PAPERS

11.1 CIPFA Treasury Management Code and Guidance Notes

12. CONTACT OFFICER(S)

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COUNCILLOR S. SHREEVE
PORTFOLIO HOLDER FOR FINANCE AND RESOURCES

Half-Year Treasury Monitoring Report 2020/21



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Key Messages:

All investment and borrowing transactions were in line with the Approved 2020-21 treasury Strategy.

There are no proposed policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Whilst our central case is interest rates will remain low for some time this still has some uncertainty attached over the next few years and the implications for both investment income and borrowing cost will be closely monitored.

This report covers Treasury and it's related financial transactions. A Capital Strategy is reported separately covering non-treasury related investments

Director of Finance Overview

The Council operates a balanced budget, which broadly means cash raised during the year will meet its non-capital expenditure, however there will always be timing differences in how funds are received and expenses settled. A key element of treasury management is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, whilst retaining adequate liquidity before considering optimising investment return.

Our 2020-21 Investment Strategy is tailored to allow the Council to manage its risks in this order and stood up well to the exceptional pressures seen in the first half of the year as a result of the Coronavirus Pandemic. The first few weeks focussed heavily on ensuring the Authority maintained access to sufficient liquidity to support services immediate payment needs. As central Government support programme funds began to flow in, measures were taken to ensure the safety of those extraordinary funds whilst at the same time providing access on a daily basis to allow monies to be quickly dispersed to the intended recipients in the community. In total over £1Bn of aggregated investment transactions were managed by the team without incident.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending plans. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives. During the period the Authority completed the first loan transaction with Nomura Bank and The Pension Protection Fund, securing the funding well below the comparable PWLB rate.

Sharon Wroot, Director of Finance
October 2020

Key Messages:

No Treasury activity is without risk. These risks include, but are not limited to, Credit Risk, Liquidity Risk, Interest Rate Risk, Inflation Risk and Reputational Risk.

The Council uses in-house knowledge, advisors (Link Asset Services), treasury management software (Treasury Live) and the CIPFA Treasury Management Code to manage these risks.

Scrutiny of Treasury activity is undertaken by Audit Committee and reported twice-yearly to Full Council.

From 31 October 2020 the treasury function will focus solely on NELC cash management and risk mitigation following a review of Shared Service arrangements with North Lincolnshire Council.

Introduction and External Context

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) to provide a review of treasury management activities and the actual prudential and treasury indicators for 2020/21. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

This mid-year report covers the following:

- An economic update for the first half of the 2020/21 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2020/21;
- A review of the Council's borrowing strategy for 2020/21;
- A review of any debt rescheduling undertaken during 2020/21;
- A review of compliance with Treasury and Prudential Limits for 2020/21.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the mid-year position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the above treasury management report by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during 2019/20 in order to support members' scrutiny role.

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. This report covers treasury activity and the associated monitoring and control of risk.

As part of a continuous review the Shared Service arrangement with North Lincolnshire Council provided by the Treasury function will cease with effect from 31 October. Service provision for NELC will continue as previously with additional focus on risk management.

Key Messages:

The Council has taken a cautious approach to investing, but is also fully appreciative that the external risk environment is very much shaped by developments in the progression of both the Covid-19 pandemic and Brexit trade deal negotiations, with US election outcomes a further factor.

Whilst during 2019-20 there were limited expectations of rate rises to come the impact of Covid-19 on the economic environment during March 2020 changed the outlook entirely. As of September 2020 our advisors, Link Asset Services are not forecasting a Bank Rate before March 2023.

Introduction and External Context

2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. Since then, the whole world has changed as a result of the coronavirus outbreak. The overall growth rate in quarter 1 was -2.2%, -1.7% y/y. However, the main fall in growth did not occur until April when it came in at -24.5% y/y after the closedown of whole sections of the economy. What is uncertain, however, is the extent of the damage that will have been done to businesses by the end of the lockdown period, how consumer confidence and behaviour may be impacted afterwards, whether there could be a second wave of the outbreak and how soon a vaccine will be created.

Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but more K-shaped where some sectors see a sharp recovery in June through to August and others do not/are more heavily impacted by second wave restrictions. The last quarter of 2020 are now likely to show no growth as consumers remain cautious in spending. 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.

Uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. The most likely outcome is expected to be a slim deal on trade in order to minimise as much disruption as possible. However, nothing is guaranteed and the uncertainty is likely to prevail until the deadline date which will act as a drag on recovery.

After the Monetary Policy Committee left Bank Rate unchanged at 0.75% in January 2020, the onset of the coronavirus epidemic in March forced it into making two emergency cuts in Bank Rate first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE). It is not currently thought likely that the MPC would go as far as to cut Bank Rate into negative territory, although they have said all policy measures will be considered.

This authority does not have sufficient cash balances to be able to place deposits for more than around six months so as to earn higher rates from longer deposits. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Key Messages:

The Treasury Management Strategy Statement, (TMSS), for 2020/21 was approved by this Council on 20 February 2020. No changes are considered necessary at the mid-year point despite the uncertainty seen as a result of the Covid-19 pandemic.

The Authority has an increasing CFR over the next four years due to the capital programme, and with reduced investments will therefore need to borrow up to £44m over the next few years. An additional £21m will be required to replace maturing loans.

Since the 2008 financial crisis the Authority has adopted a cautious approach whereby investments are framed by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

Local Context

The Treasury Management Strategy Statement, (TMSS), for 2020/21 was approved by this Council on 20 February 2020.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council must ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator does still allow the Council some flexibility to borrow in advance of its immediate capital needs in 2020/21 should it desire.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator and we are on target to achieve the original forecast.

	31 March 2020 Principal	Rate/ Return	Average Life yrs		30 September 2020 Principal	Rate/ Return	Average Life yrs
Total debt	£146.7m	3.25%	28.1		£152.1	3.26%	28.7
Capital Financing Requirement (CFR)	£171.8m				£171.8m		
Over / (under) borrowing	(£25.1m)				(19.7m)		
Total investments	£32.8m	0.13%	0.01		£34.8	0.02	0.03
Net debt	£114.9m				£117.2m		

The overall level of investment balances held has remained steady in recent years, as the Authority used internal borrowing to both defer more expensive long-term borrowing and reduce its credit risk exposure. However, this rose toward the end of 2019-20 and remained above usual levels throughout the first half of 2020-21 as the Authority sought liquidity to assist with its response to the uncertainty created by the Covid-10 pandemic. 6

Key Messages:

When undertaking new borrowing the Council will review both the source and tenure of loans it seeks to take.

At 30/09/2020 the Authority held £152m of loans, (up £24m on 2019) as a result of funding previous years' capital programmes.

The Council's current borrowing portfolio is predominantly of a long-term and fixed nature. Whilst this provides certainty of cost it can restrict flexibility to restructure debts as plans and finances change.

No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Borrowing Strategy

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this such borrowing proves prudent.

	2020/21 Original Estimate £m	Current Position 30.9.2020 £m	2020/21 Revised Estimate £m
Borrowing	183.1	152.1	180.2
Other Long Term liabilities	0.0	0.0	0.0
Total debt	183.1	152.1	180.2
CFR (year end position)	210.3		206.4

The structure of our debt portfolio as at 30.9.2020 is shown below

Type of Loan	Amount	% of Portfolio
PWLB Fixed	£74.9m	49%
LOBO	£21.0m	14%
Market Fixed	£40.0m	25%
Short-term Fixed	£16.0m	11%
Variable Rate	£0.2m	1%
Total	£152.1m	

Key Messages:

Affordability and the “cost of carry” remained strong influences on the Authority’s borrowing strategy. As short-term interest rates are likely to remain, at least over the forthcoming two years, lower than long-term rates, the Authority determined it was largely more cost effective in the short-term to use its own funds to defer borrowing.

Borrowing short-term from other local authorities provides a useful source of funding below current long-term rates and with the ability to exit loans within a reasonable timeframe.

Importantly however, whilst the above represents the default strategy, there always remains a risk of higher rates in the future. As such, the Authority completed one longer-term loan during the period.

Borrowing Strategy (continued)

- During 2020-21, the Council has maintained an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council’s reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.
- The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt. As a result a new loan of £20m over 30 years was arranged and drawn just after year end in April 2020. Due to the increase in PWLB margins this loan was arranged with Nomura International Bank and funded by The Pension Protection Fund. Additional short-term loans were obtained from the Local Authority lending market (see P10 for details).
- It is anticipated that further borrowing will be undertaken during this financial year.
- Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks :
 - where there was a significant perceived risk of a sharp FALL in long and short term rates, (e.g. due to a marked increased risk of recession or risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
 - if it had been felt that there was a significant risk of a sharp RISE in long and short term rates, perhaps arising from an acceleration in the start date or rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the future.

Key Messages:

The Authority's traditional source of long-term borrowing is the Public Works Loan Board (part of HM Treasury).

The rate at which the Authority can borrow is determined by the Gilt Market (the Government's own primary source of borrowing) and fluctuates with market conditions. On top of this 'base rate' PWLB apply a margin. In October 2019 this margin was more than doubled, meaning the PWLB was no longer the best value for money option for borrowing. NELC therefore opened discussion with several alternative lenders, finally completing a £20m loan with Nomura Bank/The Pension Protection Fund in April 2020.

Borrowing Strategy (continued)

PWLB rates are based on gilt (UK Government bonds) yields with H.M.Treasury determining a specified margin to add to gilt yields. Yields had already been on a falling trend during the year up when the coronavirus crisis hit western economies. Since then, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies and moved cash into safe haven assets i.e. government bonds. However, major western central banks started massive quantitative easing purchases of government bonds and this has acted to maintain downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance, in "normal" times would have caused bond yields to rise sharply. At the close of the day on 28th August, all gilt yields from 1 to 4 years were in negative territory, while even 25-year yields were at only 0.97% and 50 year at 0.82%.

In October 2019 HM Treasury imposed a change in the margin over gilt yields for PWLB rates without any prior signal, adding an additional 1% margin over gilts to all PWLB rates. HM Treasury later announced that there would be a consultation with local authorities on possibly further amending these margins; this ended on 31 July. The signal is that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream. NELC believes that its Capital plans as they currently stand will allow it to maintain full access to PWLB and should margins be significantly reduced it is likely that new long-term borrowing will be taken in the second half of the year to take advantage of the current accommodative interest rate environment. At the same time, NELC now has proven access to alternate lenders should the need arise (see P10) which mitigates some of the risk in PWLB being increasing proactive in managing demand and potential precluding some activity going forward.

Borrowing in advance of need

The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Key Messages:

The effect of Covid-19 and the resultant tightening of short-term liquidity markets from mid-March led to a sharp rise in rates available. During that month Local Authorities borrowed £3.1Bn (the largest amount ever in a single month) from PWLB on minimum terms of 1 year. We managed to avoid the need to resort to such measures and although rates later reduced dramatically as central Government support packages re-introduced liquidity, the short-term nature of our two loans contained cost of carry to a reasonable level considering the urgent liquidity need these loans were designed to satisfy.

Borrowing Strategy (continued)

Borrowing – the following loans were taken during the period: -

Counterparty	Start Date	Maturity Date	Amount	Rate
East Sussex County Council*	02/04/2020	01/04/2021	£9,000,000	1.00%
Wychavon District Council*	01/04/2021	01/04/2022	£3,000,000	1.70%
Rugby Borough Council*	01/04/2021	01/04/2023	£3,000,000	1.70%
The Pension Protection Fund**	28/04/2020	28/04/2050	£20,000,000	1.98%
Lincolnshire County Council	30/04/2020	30/07/2020	£5,000,000	0.80%
West of England Combined Authority	05/05/2020	04/05/2021	£5,000,000	0.98%

*These loans were arranged using the Authority's accrued internal borrowing position to match prepayment of the Authority's Pension Fund contributions in return for which East Riding Pension Fund offered a discount of 4%.

**With an identified requirement for long-term borrowing to fund capital programmes, and wishing to take advantage of historically low rates, the Authority entered negotiations with Nomura International Bank to provide funds at sub-PWLB rates. In the first such transaction in the sector, NELC completed the transaction fixing a proportion of its long-term requirement for 30 years at below 2%. As part of the agreement the loan was transferred to the Government-backed Pension Protection Fund contemporaneously.

Key Messages:

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

All other things being equal we would expect to see balances fall each year by the amount of corporately funded capital expenditure less any new borrowing. However, during 2020-21 higher balances were maintained as a result of officers adding liquidity at the outset of the Covid-19 pandemic and subsequent Government support programmes.

Investment rates remained historically low during the period, even touching negative returns at points. This is expected to be the case for some time.

Total investment income was £0.008m compared to an annual budget expectation of £0.050m.

Investment Activity

The Authority has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. As part of its national response to the Coronavirus pandemic the UK Government provided large sums of additional cash resources to local authorities. Some of these funds supported additional burdens experienced by Authorities as a result of the pandemic and others were provided for Authorities to distribute targeted support to the private sector. Most significant among these funds was the BEIS Business Support Grant. The £35.5m received under this grant was segregated from the Council's own funds (and therefore Treasury Limits). At the period end £32.8m had been dispersed to qualifying local businesses.

During 2020/21 total investment balances ranged between £34.8m and £83.0 million. The average balance maintained was £56.3m with a weighted average maturity of 10 days. An average yield of 0.05% was achieved. This is in line with our targeted rate of 7-day LIBID (0.05%).

Investment Policy – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council in February 2020. Investment activity during the year conformed to the Investment Strategy for 2020/21 which aimed to reduce risk by;

- Setting value and term limits for counterparties based on Credit rating, available collateral and sector.
- Utilising data tools available via Treasury Live and Link Asset Services to monitor risk.
- Ensuring a minimum level of liquidity was maintained to allow payments to be made as they fell due

The Council aims to achieve an adequate return (yield) on its investments commensurate with robust levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs using our suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness - Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during this period and CDS prices, (market indicators of credit risk), for UK banks spiked upwards, due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks. NELC largely avoids direct bank exposure.

Key Messages:

Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A-); credit default swap prices, financial statements, and reports from quality financial news feeds.

The higher average balances were a result of a combination of an active strategy to maintain liquidity during the significant uncertainty around year-end due to Covid-19 crisis and subsequent central government assistance schemes.

Investment Activity

Investments	Balance on 31/03/2020 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 30/09/2020 £m	Avg Rate/Yield (%) and Avg Life (years)
UK Government:					
- DMADF	26.4	974.0	(979.2)	21.2	0.03% 10 days
- Treasury Bills	-	-	-	-	-
Bonds issued by Multilateral Development Banks	-	-	-	-	-
Direct Unsecured Investments (call accounts, deposits) with financial institutions					
- rated A- or higher	2.4	18.9	(19.0)	2.3	0.25% at Call
- rated below A-	-	-	-	-	-
Tradable Investments with Financial institutions Corporates (CDs) rated A- or higher	-	-	-	-	-
Money Market Funds	4.0	24.8	(17.4)	11.4	0.10% at Call
TOTAL INVESTMENTS	32.8	1,017.7	(1,015.6)	34.9	0.05% 10 days
Increase/ (Decrease) in Investments £m				2.1	

Given the increasing risk and continued low returns from short-term unsecured bank investments, but having no funds available for longer-term investment, the Authority is unable to simply diversify into more secure and/or higher yielding asset classes such as repurchase agreements or covered bonds which are secured on financial assets. Eliminating Credit Risk by running down balances whilst still maintaining adequate liquidity is therefore a key strand of operational activity.

Key Messages:

Figuratively the Authority's risk profile remained fairly steady for most of the year, increasing only right at the end of Q4 reflecting the downgrade of the UK Sovereign Rating on the back of the Covid crisis.

As the Covid-19 crisis escalated in March 2020 and unsure of the cash flow impact to come the Authority lifted its min cash liquidity level from £10m to £20m. The majority of this extra money was placed with DMO/UK Government who still represented the 'safe haven' option regardless of Ratings Agency actions.

Investment Activity (contd.)

Credit Risk

Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating
31/03/2020	3.72	AA-
30/06/2020	3.17	AA
30/09/2020	3.09	AA

Scoring:

- Value weighted average reflects the credit quality of investments according to the size of the deposit
- Time weighted average reflects the credit quality of investments according to the maturity of the deposit
- AAA = highest credit quality = 1
- D = lowest credit quality = 26
- Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

As the Covid-19 crisis escalated in March 2020 and unsure of the cash flow impact to come the Authority lifted its min cash liquidity level from £10m to £20m. We sought to bolster our liquidity position via the short-term Local Authority market. As Authorities found themselves in similarly uncertain predicaments lenders in that market withdrew. This forced Authorities in need of cash to turn PWLB where minimum terms are 1 year but even so £3.1Bn was borrowed nationally in March alone. The highest month on record. Fortunately, we were able to leverage our good relationships with brokers to fulfil all our requirements short-term and even though rates spiked, the short tenures meant that this was the most efficient method of meeting a substantial short-term requirement.

Subsequent support programmes from Central Government and more robust income levels than expected have meant that we carried larger balances in 2020-21 but again the short-term nature of these later loans will allow the position to adjust organically over the remainder of the year.

Key Messages:

In an environment where direct unsecured bank deposits present increased risk but low return NELC has sought to avoid this imbalance by utilising UK Government based investments and diversified funds.

Ultimately we seek to minimise counterparty risk by limiting our cash levels whilst still maintaining adequate liquidity.

There were no operational breaches a TMSS limits during the period.

Investment Activity (contd.)

Benchmarking

- Comparisons are made to other Authorities using the Treasury Live database which looks at over £6Bn of local Authority investments. As at the outturn date this shows that other Authorities:-
 - Hold more cash than NELC. Average balance £78m (estimated) vs £35m at NELC
 - Invest for longer periods. 100 days on average vs only 12 days at NELC
 - Take more risk than us collectively.
 - Deliver higher return than us. 0.39% vs 0.01%
- Whilst the above shows the greater return generated by term premiums the Council is of the view that, in a post Bail-in environment elimination of credit risk through lower balances is worth lower overall return. NELC also recognises that this strategy needs to ensure it does not replace credit risk with liquidity risk and so a liquid balance at least £10m is maintained. As an example of how liquidity risk comes into play, the uncertainty around March/April as a consequence of the Covid-10 pandemic meant that access to liquid funds carried increased importance and so this minimum balance was raised in March 2020 in order to ensure the Authority retained access to liquidity during that unprecedented period.

Operational Breaches

- There were no breaches of limits set within the TMSS during the period.

Key Messages:

The Authority confirms compliance with its Prudential Indicators for 2020/21, which were set in February as part of the Authority's Treasury Management Strategy Statement.

Compliance with Prudential Indicators

Treasury Management Indicators

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

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2020/21	2021/22	2022/23
Upper limit on fixed interest rate exposure	£280m	£280m	£280m
Actual*	£163m	£198m (est)	£192m (est)
Upper limit on variable interest rate exposure	£70m	£70m	£70m
Actual*	£37m	£35m (est)	£35m (est)

*= Peak position for 2020/21

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 fixed rate borrowing were:

	Upper	Lower	Actual
Under 12 months	60%	0%	39%
12 months and within 24 months	30%	0%	1%
24 months and within 5 years	50%	0%	3%
5 years and within 10 years	50%	0%	9%
10 years and within 20 years	75%	0%	12%
20 years and within 30 years	75%	0%	12%
Over 30 years	90%	0%	24%

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. Note: LOBO option dates are included as potential repayment dates.

Key Messages:

For 2020-21 a minimum cash level of £10m (temporarily increased to £20m during the initial stages of the Covid-19 pandemic) was targeted and there were no breaches of this, or other Indicators.

Compliance with Prudential Indicators (contd.)

Principal Sums Invested for Periods Longer than 365 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 total principal sum invested to final maturities beyond the period end will be:

	2020/21	2021/22	2022/21
Limit on principal invested beyond year end	£21m	£21m	£21m
Actual	£0m	£0m	£0m

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual
Portfolio average credit rating	A	AA-

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	Target	Actual (Low)
Total cash available within 1 month	£10m	£32m*

*excludes Business Support Grant balances held during the period for the purpose of dispersal to local businesses.

Key Messages:

Borrowing remains comfortably below control levels as a result of continued internal borrowing support for the Capital Programme.

Borrowing levels were projected to be £182m at the end of 2020/21 when the TMSS was set in Feb 2020. The actual position as at 30.9.2020 was £152m. The difference was represented by cash and Reserves at the period end and was expected to be utilised to fund Capital Spend during the remainder of 2020/21 although the Covid-19 crisis may force some delay in planned spend.

Compliance with Prudential Indicators (contd.)

Other Prudential Indicators

The following prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst-case scenario for external debt.

Operational Boundary	2020/21 £m	2021/22 £m	2022/23 £m
Borrowing	£215m	£225m	£225m
Other long-term liabilities	£25m	£25m	£25m
Boundary for Total Debt	£240m	£250m	£250m

Authorised Limit for External Debt: The authorised limit is "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2020-21 the Council has maintained gross borrowing within its authorised limit.

Authorised Limit	2020/21 £m	2021/22 £m	2022/23 £m
Borrowing Limit	£250m	£250m	£250m
Other long-term liabilities	£30m	£30m	£30m
Total Debt Limit	£280m	£280m	£280m
Actual/projected Peak Debt levels	£165m	£192m (est)	£189m (est)

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition in February 2018.

Key Messages:

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

The Authority confirms compliance with its Capital Finance Prudential Indicators for 2020/21, which were set in February as part of the Authority's Treasury Management Strategy Statement.

Changes to the 2020/21 and later programmes may occur as these are rolled forward in the coming months.

Compliance with Capital Finance Prudential Indicators

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Authority's planned capital expenditure and financing as at 30 September 2020 may be summarised as follows.

Capital Expenditure and Financing	2020/21 Original £m	2020/21 Changes £m	2020/21 New Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Total Expenditure	74.8	-4.3	70.5	42.1	21.0
Capital Receipts	0.3	0.0	0.3	0.3	0.0
Government Grants	33.0	-2.6	30.4	17.9	15.3
Ring-fenced External Funding	0.8	0.0	0.8	0.0	0.0
Borrowing	40.7	-1.7	39.0	23.9	5.7
Total Financing	74.8	-4.3	70.5	42.1	21.0

Key Messages:

The percentage of the Council's income required to service its debt came in below projections due primarily to slippage in the capital programme and the effect of using short-term borrowing alongside alternate long-term lenders which came at lower than anticipated interest rates.

Compliance with Capital Finance Prudential Indicators (contd.)

Ratio of Financing Costs to Net Revenue Stream

This is a voluntary indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

	2020/21 Original Estimate %	2020/21 New Estimate %	2021/22 Estimate %	2022/23 Estimate %
Ratio of Financing Costs to Net Revenue Stream				
General Fund	7.5	7.2	8.5	8.7