East Devon District Council
Mid-Year Treasury Management Review
2020/21

1. Background

1.1 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2020/21, all local authorities have been required to prepare a Capital Strategy that is to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

1.2 Treasury management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

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 operations. 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.

Accordingly, treasury management is defined as:

> "The management of the local authority'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."

2. Introduction

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).
The primary requirements of the Code are as follows:

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

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

3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during 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.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Cabinet:

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the 2020/21 financial year;

- 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;

Recommendations

Cabinet is asked to recommend the following to the full Council:

- **To note the report, the treasury activity, investment values and performance for the period 1 April 2020 to 30 September 2020.**

3. Economics and interest rates

3.1 Economics update

See the Treasury Management Strategy Statement (Minimum Revenue Provision Policy Statement and Annual Investment Strategy) 2021/22 for the latest economic update.

3.2 Interest rate forecasts

See the Treasury Management Strategy Statement (Minimum Revenue Provision Policy Statement and Annual Investment Strategy) 2021/22 for the latest interest rate forecasts.

4. Investment Portfolio 2020/21

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return that is consistent with the Council's risk appetite.

As shown by the interest rate forecasts referred to in 3.2 above, it is now impossible to earn the level of interest rates commonly seen in previous decades, as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the UK Government's Debt Management Account Deposit Facility, (DMADF), are offering negative rates of return in some shorter time periods. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31 March 2023, investment returns are expected to remain low.

4.1 Negative investment rates

While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds, (MMFs), yields have continued to drift lower. Some managers have suggested that they might resort to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a glut of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short-term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions.

Inter-local authority lending and borrowing rates have also declined, due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

4.2 Creditworthiness.

Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during the quarter ended 30 June 2020, 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. However, during Q1 and Q2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions. As we move into the next quarters ahead, more information will emerge on *actual* levels of credit losses. (Quarterly performance is normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that UK banks went into this pandemic with strong balance sheets. Indeed, the Financial Policy Committee (FPC) report on 6 August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". They stated that in their assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on negative watch, but with a small number of actual downgrades.

4.3 Investment Counterparty criteria

In general, the current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function; however, one of the four money market funds that the Council has been using, Amundi, decided to close in October 2020. One or two new money market accounts may be opened to replace this, particularly as the volume of cash for investment has increased during the Covid 19 pandemic. It is requested that the time limit for investing in Building Societies is extended from 6 months to 9 months.

4.4 Internal Investments

The Council held £31.75m of internally managed investments as at 30 September 2020, (£19.5m at 31 March 2020) and the investment portfolio yield for the first 6 months of the year was 0.135% net, after fees were deducted, against a benchmark, (7 Day LIBID), of -0.06 %. *A full list of internal and external investments held as at 30 September 2020 is included in the Appendix at section 7.*

4.5 External Investments

The Council held £30.039m of externally managed investments as at 30 September 2020, (£29.604m at 31 March 2020), divided between two fund managers. The distribution yield for the first 6 months of the year was 0.62% net, after fees were deducted, against a benchmark, (7 Day LIBID), of -0.06%. *A full list of internal and external investments held as at 30 September 2020 is in the Appendix at section 7.*

The Strategic Lead Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2020/21.

4.6 Return on Investments compared to Budget

The Council's budgeted investment return for the first six months of 2020/21 for the above internal and externally managed investments and the actual performance was as follows:

	6 months to 30.9.20 Budget	**6 months to 30.9.20 Actual**	**Performance above or (below) budget**
	£	**£**	**£**
Net Return from Internal Investments	81,870	38,923	(42,947)
Net Return from External Investments (cash funds)	79,565	95,869	16,304
Net Return External Investments (property funds)	152,000	0	(152,000)
	313,435	**134,792**	**(178,643)**

When setting the budget prior to the beginning of the year, the Council had planned to switch part of the money held in external treasury investments, from cash funds to property funds. In so doing, the intention was to increase yield whilst maintaining appropriate levels of security and liquidity.

However, due to the unfolding pandemic crisis, the Council did not proceed with moving part of its external investments into property funds. The hitherto mentioned effect on interest rates had a detrimental effect on the return from all our usual forms of treasury investment, although as we had not carried out the planned disinvestment from our external cash fund investments, more interest was received than expected from this source because of the higher principal amount held.

4.7 Approved limits

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2020.

5. Borrowing

5.1 External Borrowing

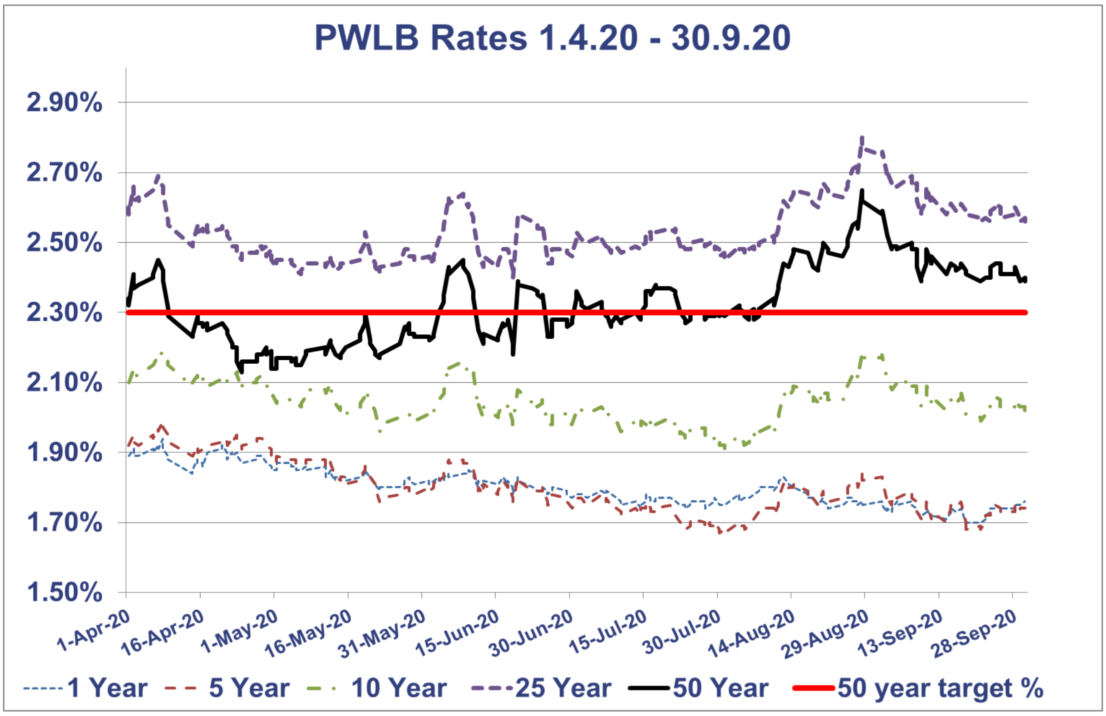
The Capital Financing Requirement (CFR) denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive, the Council may borrow from the PWLB or the market, (external borrowing) or from internal balances on a temporary basis, (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Details on the current and projected CFR may be found in the Treasury Management Strategy Statement (Minimum Revenue Provision Policy Statement and Annual Investment Strategy) 2020/21.

The total amount of external (PWLB) debt outstanding at 30 September 2020 was £90,746m, of which £84,670m related to the HRA, £3.427m related to Non-HRA and £2.649m related to borrowings to provide loans to third parties. There was no borrowing to finance commercial investment.

No external borrowing has been undertaken during this financial year, so far. It is anticipated that further external borrowing may take place by the end of the financial year for specific items in the Capital Programme. However, either timings are not certain, depend on decisions of the Council or have been financed temporarily in the meantime from internal resources. In addition, further external borrowing may take place to re-finance an HRA self-finance loan that is due to mature at the end of the financial year.

5.2 PWLB Rates

The Public Works Loan Board **(PWLB)** is a statutory body operating within the United Kingdom Debt Management Office. PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments. The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.70%	1.67%	1.91%	2.40%	2.13%
Date	18/09/2020	30/07/2020	31/07/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/2020	08/04/2020	08/04/2020	28/08/2020	28/08/2020
Average	1.80%	1.80%	2.04%	2.54%	2.33%

6. Debt Rescheduling

No debt rescheduling has been undertaken to date in the current financial year.

7. Appendix

List of investments held at as at 30 September 2020

Fund	**£000**
External investments	
Payden and Rygel	15,527,791
Royal London Asset Management	14,511,367
Internal investments	
Banks	
Bank of Scotland - Call Account	2,000,000
Lloyds Bank plc - Fixed Rate Deposit	1,000,000
Money Market Funds	
Amundi	3,000,000
CCLA Public Sector Deposit Fund	3,000,000
Goldman Sachs	3,000,000
Morgan Stanley	3,000,000
Fixed Rate Deposits – Building Societies	
National Counties Building Society	2,000,000
Newcastle Building Society	2,000,000
Nottingham Building Society	2,000,000
Principality Building Society	1,700,000
Progressive Building Society	2,000,000
West Bromwich Building Society	3,000,000
Fixed Rate Deposits – Other Local Authorities	
Thurrock Borough Council	3,000,000
Fixed Rate Deposits – Debt Management Office of UK Government	1,050,000
	61,789,158