Cheltenham Borough Council
Council – 6th December 2021
Treasury Mid-Term Report 2021/22

Accountable member	**Cabinet Member for Finance, Councillor Peter Jeffries**
Accountable officer	**Executive Director Finance and Assets (Section 151 Officer), Paul Jones**
Accountable scrutiny	**Treasury Management Panel**
Ward(s) affected	**All**
Key Decision	**Yes**
Executive summary	The Treasury Management Strategy for 2021/22 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the council to approve treasury management semi-annual and annual reports.
Recommendations	The Treasury Management Panel considered this report on the 15th[th] November 2021 and have recommended this on to Council **:** **1. Note the contents of the summary report of the treasury management activity during the first six months of 2021/22.**

Financial implications	All financial implications are detailed throughout the report **Contact officer: Andrew Sherbourne, andrew.sherbourne@publicagroup.uk, 01242 264337**
Legal implications	The Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) requires the authority to approve a Treasury Management Strategy before the start of each financial year and to keep it updated throughout the year. The report fulfils the authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code. **Contact officer: Shirin Wotherspoon, shirin.wotherspoon@tewkesbury.gov.uk, 01684 272696**
HR implications (including learning and organisational development)	None arising directly from this report **Contact officer: Julie McCarthy, julie.mccarthy@cheltenham.gov.uk. 01242 264355**
Key risks	As noted in Appendix 1
Corporate and community plan Implications	The purpose of the report is to improve corporate governance, a key objective for the Council
Environmental and climate change implications	The Council does have some exposure to investments in a pooled fund which has shares with oil and gas companies. This is detailed in section 5.6 of the report. However, there will be a need to review the investment in the future in relation to the climate emergency, for which this council has signed up to.

1. Background

1.1 In February 2011 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice (*the CIPFA Code) which requires members to approve the treasury management semi-annual and annual reports.

1.2 The Council's treasury management strategy for 2021/22 was approved at a meeting on 22nd March 2021. The Council 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. The successful identification, monitoring and control of risk remain central to the council's treasury management strategy.

1.3 This report covers the treasury management activity and performance of the Council for the period 1 April to 30 September 2021.

2. Economic Background

2.1 The economic recovery from the coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period, over 48 million people in the UK had received their first dose of a Covid-19 vaccine and almost 45 million their second dose.

2.2 The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of Consumer Price Inflation (CPI) is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee (MPC) meeting ended with policy rates unchanged, the tone was more hawkish.

2.3 Government initiatives continued to support the economy over the quarter but came to an end on 30 September 2021, with businesses required to either take back the 1.6 million plus workers on the furlough scheme or make them redundant. The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to bases effect from a decline in average pay in the spring of last year associated with the furlough scheme.

2.4 The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

2.5 The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

3. Financial Markets

3.1 Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

3.2 Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more temporary, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a lack of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, leading to higher prices.

3.3 Credit default swap spreads were constantly flat over the most of period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back.

3.4 Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on the Council's counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

3.5 The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

3.6 At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the Council's counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended from 36 days to 100 days.

4. Treasury Management Summary position 1/4/2021 to 30/9/2021

4.1 On the 31st March 2021, the Council had net borrowing of £156.932m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.21 Actual £m
General Fund CFR	104.687
HRA CFR	73.421
Total CFR	**178.108**
Less: Usable reserves	20.200
Less: Working capital	0.976
Net borrowing	**156.932**

4.2 Lower official interest rates have reduced the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk. The treasury management position as at 31 March 2021 and the mid-year change is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.21 Balance £m	Movement £m	30.9.21 Balance £m	30.9.21 Rate %
Long-term borrowing Short-term borrowing	115.220 58.500	4.919 (21.500)	120.139 37.000	3.16 0.07
Total borrowing	**173.720**	**(16.581)**	**157.139**	**2.44**
Long-term investments Short-term investments Cash and cash equivalents	8.633 1.215 6.940	0.387 (0.290) (2.830)	9.020 0.925 4.110	2.55 2.10 0.06
Total investments	**16.788**	**(2.733)**	**14.055**	**2.53**
Net borrowing	**156.932**	**(13.848)**	**143.084**	

4.3 The Council pursued its strategy in funding the £39m capital asset purchase made in August 2019, plus other capital assets funded from borrowing, with the use of temporary borrowing and then either take long term borrowing or use future capital receipts to repay it. Currently interest rates for this borrowing is 0.05% to 0.15%, which is much cheaper than had we fixed 5 year borrowing from the PWLB, back in 2019.

4.4 As at 31st March 2021 the Council held loans of £173.720m and has reduced the amount of temporary borrowing by using cash investments which were earning very little interest. The balance as can be seen in Table 3 below shows a reduced figure of £157.139m as at 30th September 2021. The weighted average interest rate on these loans is 2.44% up from 2.20% in March 2021. Borrowing costs are expected to be £63,000 lower than forecasted with the budget at the end of the 2021/22 financial year.

4.5 The Council took a 30 year £6m annuity loan from the PWLB at a rate of 1.85% to fund HRA capital expenditure which had occurred in 2021. This is part of the HRA capital programme which is scheduled to borrow significant funds over the next few financial years. The outstanding loans on 30th September 2021 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.21 Balance £m	2021/22 Movement £m	30.9.21 Balance £m	30.9.21 Rate %
Public Works Loan Board Banks (LOBO) Banks (fixed-term) Local authorities (short-term)	99.320 7.000 8.900 58.500	4.919 0 0 (21.500)	104.239 7.000 8.900 37.000	3.04 4.45 3.82 0.07
Total borrowing	**173.720**	**(16.581)**	**157.139**	**2.44**

4.6 Local authorities can borrow from the Public Works Loan Board (PWLB) provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to re-finance existing loans or externalise internal borrowing.

4.7 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, re-financing debt and treasury management. Competitive market alternatives are available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. Further changes to the CIPFA Prudential Code expected in December 2021 may prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB. Consultation is currently taking place on the proposed changes.

5. Investments

5.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six month period the council's investment balance ranged between £8.5m and £19.4m due to timing differences between income and expenditure. The levels are lower than in previous years due to using available cash to repay temporary debt. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.21 Balance £m	**Net Movement £m**	**30.9.21 Balance £m**	**30.9.21 Rate of Return %**
Money Market Funds/ Call Accounts	6.940	(2.829)	4.111	0.06
Pooled Funds	7.000	-	7.000	4.22
Other investments	2.848	0.097	2.945	2.12
Total Investments	**16.788**	**(2.732)**	**14.056**	**2.52**

5.2 Both the CIPFA Code and Government Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment.

5.3 Due to the impact of the payment of the Government's Covid-19 grants to businesses on cash flow, the Council kept cash available at very short notice to support daily cash flows, and then any excess cash was used to reduce the temporary borrowing. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks. Now that cash flow has stabilised, and the high possibility that interest rates will rise very shortly, opportunities to lend out longer (3 to 6 months) may arise soon, improving investment returns.

5.4 Investment income was budgeted to be £593,500 in the Council's 2021/22 budget set in February 2021. The Council has reviewed its expectations for investment income in 2021/22 and has assumed after looking at the returns over the first 6 months that the income could exceed budget by £64,000 by year end due to the Council's Pooled Funds achieving higher returns than estimated when the budget was set.

5.5 £7m of the Authority's investments are held in externally managed strategic pooled equity, multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds have generated an average total return of 4.22% for the first 6 months of this financial year which is used to support services in year. Because the Council's externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rate.

5.6 **Table 5: Pooled Funds**

FUND NAME	Initial Investment	1 April 2021 Fund Value	30th Sept 21 Fund Value	Dividends paid out in 2021/22 as at 30 Sept	Gain / (Loss) for 2021/22	Gain / (Loss) to Initial Principal
	£	£	£	£	£	£
CCLA Property Fund	3,000,000	2,754,920	2,947,076	43,881	192,156	(59,924)
Schroders Income Maximiser Fund *	2,000,000	1,457,039	1,500,434	58,212	43,395	(499,566)
CCLA Diversified Income Fund	2,000,000	1,977,147	2,090,142	16,719	112,995	90,142
Total	**7,000,000**	**6,189,106**	**6,537,652**	**118,812**	**348,546**	**(469,348)**

*The Schroders Income Maximiser Fund has purchased shares within the oil and gas industry, which accounts for 14% of the total amount of the fund. This equates to £280,000 of the original £2m invested into the fund by the council. The fund overall returns 5-6% annually. There is no plan at present to sell this investment, as the fund is valued over £499k below the initial investment. We will keep this under review.

6. ARLINGCLOSE'S ECONOMIC OUTLOOK FOR THE REMAINDER OF 2021/22

6.1 Table 6: Interest rate forecast

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Official Bank Rate													
Upside risk	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.10	0.10	0.10	0.10	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15

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

6.3 Investors have priced in multiple rises in Bank Rate to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.

6.4 The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

6.5 While Q2 UK Gross Domestic Product (GDP) expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of Government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.

6.6 Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

6.7 The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increased in wages is possible given the pressures on businesses.

6.8 Government bond yields increased sharply following the September Federal Open Market Committee (FOMC) and the Monetary Policy Committee (MPC) minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.

6.9 The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

7. COMPLIANCE

7.1 The Chief Finance Officer reports that all treasury management activities undertaken during the first six months of 2021/22 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy**.**

Table 7: Debt Limits

	30.9.21 Actual	2021/22 Operational Boundary	2021/22 Authorised Limit	Complied? Yes/No

	£m			
Total debt	**157.139**	***307.000***	**317.000**	Yes

Council approved on 22nd March 2020 the authorised borrowing limit and operational boundary limit are increased to the new levels as shown above in table 7.

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.