Appendix 3

Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2020/21

1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management stipulates that the Chief Finance Officer should set out in advance the Treasury Management Strategy for the forthcoming financial year, and subsequently report the treasury management activities during that year.

1.2 The primary requirements of the Code are as follows:

(a) forecast the likely activity for the forthcoming year (in the Annual Treasury Management Strategy Report);
(b) a mid-year review report; and,
(c) review actual activity for the preceding year, including a summary of performance.

1.3 This section of the document contains the required mid-year review report for 2020/21. 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 first six months of 2020/21;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy for 2020/21;
- A review of the Authority's investment portfolio for 2020/21;
- A review of the Authority's borrowing strategy for 2020/21; and,
- A review of compliance with Treasury and Prudential Limits for 2020/21 (detailed in Reference to appendix 2).

Economic Performance and Outlook Summary

2.1 Economic performance has been driven by Covid-19 and the continued fallout for this worldwide pandemic. The Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10% and has remained at this level since. The Bank of England has committed to quantitative easing (QE) of £745bn. The fall in GDP in the first half of 2020 was revised from 28% to 23% and then subsequently to (21.8%), one of the largest falls in output in any developed nation. Peak unemployment has been revised down from 9% in Q2 to 7.5% by Q4 2020. It is currently 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.

2.2 Any possibility of negative rates has been reduced in at the least the next six months of so, negative interest rates will be less effective when other methods are available.

Interest Rate Forecast

3.1 Link Asset services currently forecast Bank of England base rate to remain unchanged for the immediate future. The sentiment driven by continued weighing of the Coronavirus pandemic.

Table 1: Link Asset Services BoE base rate forecast

Month	Dec-20	Dec-21	Dec-22
BBR Rate	0.10%	0.10%	0.10%

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 6 August 2020 (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

Bond Yields and Increase in the cost of borrowing from the PWLB

4.1 Conditions for low bond yields are driven by the growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields.

4.2 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the initial phases of the health crisis in March, we have seen these yields fall sharply to unprecedented lows as major western central banks took rapid action to deal with excessive stress in financial markets, and started massive quantitative easing purchases of government bonds: this also acted to put 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 30 September 2020, all gilt yields from 1 to 6 years were in negative territory, while even 25-year yields were at only 0.76% and 50 year at 0.60%.

4.3 From the local authority borrowing perspective, HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019-20 without any prior warning. The first took place on 9 October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then at least partially reversed for some forms of borrowing on 11 March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was to end on 4 June 2020, but that date was subsequently put back to 31 July 2020. It is clear HM Treasury will no longer

allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

4.4 North Tyneside Council has previously relied on the PWLB as its main source of long-term funding; it now must consider alternative sources of borrowing as necessary. At the current time, this area is still currently developing. The market has seen financial institutions entering the long-term borrowing market and make borrowing products available; however, this remains suitable for larger capital drawdowns in and around £50m+. Therefore, whilst this has limited appeal to North Tyneside Council, we continue to watch this space for future developments.

4.5 The MBA have, since the last mid-year update, undertaken two bond issuances with Lancashire County Council (LCC). The first bond issuance undertaken in February 2020. A £350m inaugural five-year floating rate bond which is linked to SONIA was successfully issued. The second issuance was a £250m ultralong maturity (40 year) fixed rate bond. As noted by the bond denominations bond issuances are particularly useful for raising large amounts of capital, and whilst the return of bond issuances is a favourable development for Local Authorities the application in particular to North Tyneside Council is limited. Nonetheless, the development of UK Local Authority bond market will be watched closely.

4.6 A detailed interest rate and PWLB rate forecast is available as a background paper to this report**.**

Balance of Risk to the UK

5.1 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. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

A background paper ‘Risks to UK Economy’ is available detailing upside and downside risk to the UK economy as detailed by Link, our treasury advisors.

Annual Investment Strategy

6.1 The Treasury Management Strategy Statement (TMSS) for 2020/21, which includes the Annual Investment Strategy, was approved by the 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.

6.2 The 20 February 2020 Council approved TMSS sets out the Council’s investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

6.3 The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions.

6.4 The approved limits within the Annual Investment Strategy were not breached during the period to 30 September 2020.

6.5 During the six months of the financial year, Treasury Management activities have predominantly been to manage the large surplus cash balances which has been generated by the front loading of government grants in response to Covid-19 as well as borrowing the Authority undertook in March 2020 which was to reduce the liquidity risk as Covid-19 took priority across the world.

Table 2: Investment performance at 30 September 2020

Investments	30/09/2020 £m	Average rate of Return %	Interest Earned period to 30/09/2020
Debt Management Office	20.000	0.02%*	£3,100
Other Local Authority	40.500	0.59%	£69,723
Bank Deposits	5.000	0.05%	£623

***** *Average rate for DMO investments since 01 Apr 2020*

6.6 As shown by the interest rate forecasts in background paper 'LINK Interest rate forecasts', 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 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.

6.7 Short-term cash investment rates remain at all-time lows and an opportunity has been taken to maximise investment returns by investing longer and locking in investment returns by undertaking forward dated transactions. As a result, the Authority has locked in £0.159m in interest income to be received by year end.

Borrowing

7.1 The Authority's total capital financing requirement (CFR) including PFI for 2020/21 is £635.200m. The CFR denotes the Authority's underlying need to borrow for capital purposes. If the CFR is positive the Authority 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. The summary table provided below provides the borrowing position as at 30 September 2020. Total external debt including PFI's is £568.166m.

7.2 There was net increase in borrowing during the quarter ended 30 September 2020.

Table 3: Total External Debt 30 September 2020

Principal £m	
	External Borrowing
358.443	Public Works Loan Board (PWLB)
20.000	Lender Option Borrower Option (LOBO)
45.300	Other Local Authorities
423.743	**Total**
	Other External Debt
113.899	PFI & Finance Lease (as at 01 Apr 20)
568.166	**Total External Debt**
	Split of External Borrowing
263.506	Housing Revenue Account
180.237	General Fund
443.743	**Total**

7.3 Following introduction of self-financing for the Housing Revenue Account, from 1 April 2012, loans were split between General Fund and Housing. However, decisions on borrowing for both General Fund and Housing will continue to be made within the overall Treasury Management Strategy and will be reported jointly.

7.4 The difference between the CFR and external borrowing is known as internal borrowing. The level of internal borrowing is determined within the Treasury Management Strategy, by a number of factors including market conditions for investments and the level of the Authority's reserves and balances.

7.5 The Authority's borrowing strategy has been to borrow short term due to the relatively low interest rate levels. Short term temporary borrowing remains pertinent to the strategy due to the ongoing PWLB consultation.

Debt Rescheduling

8.1 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields

which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

Compliance with Treasury and Prudential Limits

9.1 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2020, the Authority has operated within the treasury and prudential indicators set out in the Authority's Treasury Management Strategy Statement for 2020. All treasury management operations have also been conducted in full compliance with the Authority's Treasury Management Practices.