Appendix 3

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

2022 / 23

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Owner: Strategic Finance

North Tyneside Council

Table of Contents

Foreword

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 2021/22. 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 2021/22;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy for 2021/22;
- A review of the Authority's investment portfolio for 2021/22;
- A review of the Authority's borrowing strategy for 2021/22; and,
- A review of compliance with Treasury and Prudential Limits for 2021/22 (detailed in Reference to appendix 2).

Economic Performance and Outlook Summary

2.1 Economic performance continues to be driven by Covid-19 and the continued fallout for this worldwide pandemic. The Bank of England took emergency action in March 2020 to cut Bank Rate to first 0.25%, and then to 0.10% and has remained at this level since.
The easing of restrictions in Q2 of 2021 have led to significant inflationary pressure resulting in the first potential reaction from the Bank of England use monetary policy tools to manage inflation.

2.2 Inflation remains the hot topic over the MTFP, inflation recently rose above the 2% target to 3.1% in September.
The increases in energy prices, pent-up demand post COVID as well as labour shortages have all contributed to the sharp rise in inflation.
Markets have factored in the first rate rise since the start of the pandemic, however the Bank of England remain cautious with the tone from the MPC to await for sufficient data

Interest Rate Forecast

3.1 Link Asset services currently forecast Bank of England base rate to increase from the current 0.10% during Q2 of 2022.

Table 1: Link Asset Services BoE base rate forecast

Month	Dec-21	Dec-22	Dec-23
BBR Rate	0.10%	0.25%	0.50%

3.2 The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.
As indicated in table 1, one increase in Bank Rate from 0.10% to 0.25% has now been included in 2022, a second increase to 0.50% in 2023 and a third one to 0.75% in 2024.

3.3 Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%.

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

4.1 One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Federal Reserve (Fed), the Bank of England and the European Central Bank (ECB), to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target, and the target rate could not be exceeded. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US before consideration would be given to increasing rates.

4.2 The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.

4.3 The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.

4.4 For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

4.5 Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.

4.6 Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

4.7 North Tyneside Council has previously borrowed only from the PWLB as its main source of long-term funding; the changing market means the Authority should 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.

Balance of Risk to the UK

5.1 The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

5.2 There is a balance of upside risks to forecasts for medium to long term PWLB rates.

Annual Investment Strategy

6.1 The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Council on 18 February 2021. 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 18 February 2021 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 2021.

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 2021

Investments	30/09/2021 £m	Average rate of Return %	Interest Earned period to 30/09/2021
Debt Management Office	40.000	0.01%	£1,609
Other Local Authority	25.000	0.10%	£76,605
Bank Deposits	5.000	0.01%	£249
Cash at Bank	2.258	0.00%	£0

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.

Borrowing

7.1 The Authority's total capital financing requirement (CFR) including PFI for 2021/22 is £617.417. 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 2021. Total external debt including PFI's is £512.109m.

7.2 There was net decrease in borrowing during the quarter ended 30 September 2021.

Table 3: Total External Debt 30 September 2021

Principal £m	
	External Borrowing
377.443	Public Works Loan Board (PWLB)
20.000	Lender Option Borrower Option (LOBO)
5.000	Other Local Authorities
402.443	**Total**
	Other External Debt
109.666	PFI & Finance Lease (as at 01 Apr 21)
512.109	**Total External Debt**
	Split of External Borrowing
244.672	Housing Revenue Account
157.771	General Fund
402.443	**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 2021, the Authority has operated within the treasury and prudential indicators set out in the Authority's Treasury Management Strategy Statement for 2021/22. All treasury management operations have also been conducted in full compliance with the Authority's Treasury Management Practices.