Appendix A

Treasury Management Update Report
As At 30th September 2020

Introduction

The Council has adopted 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.

The Council's treasury management strategy for 2020/21 was approved at the Full Council meeting on 19th February 2020. The Council has 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 remains central to the Council's treasury management strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was also approved by full Council on 19th February 2020.

External Context

Economic background: The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the 'Eat Out to Help Out' (EOHO) offer.

GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme. The Office for National Statistics' preferred measure of CPIH which includes owner-occupied housing was 0.5% y/y.

In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the BoE has forecast unemployment could hit a peak of between 8% and 9%.

The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is 'moderately' above the 2% average target, particularly given it has been below target for most of the last decade.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

Financial markets: Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.23% respectively over the period.

At the end of September, the yield on 2-year US treasuries was around 0.13% while that on 10-year treasuries was 0.69%. German bund yields remain negative across most maturities.

Credit review: Credit default swap spreads eased over most of the period but then started to tick up again through September. In the UK, the spreads between ringfenced and non-ringfenced entities remains, except for retail bank Santander UK whose CDS spread remained elevated and the highest of those we monitor at 85bps while Standard Chartered was the lowest at 41bps. The ringfenced banks are currently trading between 45 and 50bps.

After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned a AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

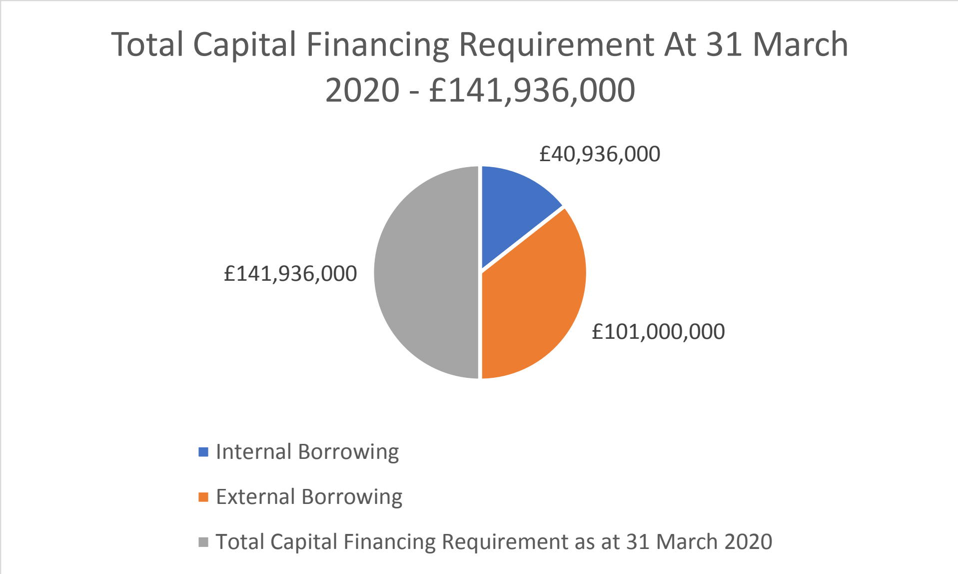
Local Context

On 31st March 2020, the Council had a net investment position of £28.7m 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

	31.03.20 Actual £'000
General Fund CFR	33,955
HRA CFR	107,981

	31.03.20 Actual £'000
Total CFR	**141,936**
External Borrowing	(101,000)
Less: Usable Reserves	(60,530)
Less: Working Capital	(9,160)
Net Investments	**(28,754)**



The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 30th September 2020 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.03.20 £000	**Movement £000**	**30.09.20 £000**
Long Term Borrowing	(75,500)	0	(75,500)
Short Term Borrowing	(25,500)	0	(25,500)
Total Borrowing	**(101,000)**	**0**	**(101,000)**
Long Term Investments	3	(3)	0
Short Term Investments	5,026	(30)	4,996
Cash and Cash Equivalents	28,691	(6,069)	22,622
Total Investments	**33,720**	**(6,102)**	**27,618**
Net Borrowing	**(67,280)**	**(6,102)**	**(73,382)**

Borrowing Update

On 9th October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields. The value of this discount is 1% below the rate at which the Council usually borrows from the PWLB). £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% has been made available to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

The consultation titled "Future Lending Terms" allows stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to allow authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

The consultation closed on 31st July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year or early next year.

Municipal Bonds Agency (MBA): The MBA revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor.

If the Council intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

Borrowing Strategy during the period

As at 30th September 2020 the Council held £101.00m of loans, which is no change from the reported position at 31 March 2020. Outstanding loans as at 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

Type of Borrowing	31 March 2020 £000	Movement £000	30 September 2020 £000

PWLB Fixed Rate Loans	71,000	0	71,000
PWLB Variable Rate Loans	5,000	0	5,000
Barclays Bank Fixed Rate Loan	3,000	0	3,000
Local Authority	22,000	0	22,000
Total	**101,000**	**0**	**101,000**

The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

The Council is currently reviewing its capital programme, including commercial, regeneration and housing, as part of its 2021/22 budget setting process and therefore may have plans to borrow for both the General Fund and Housing Revenue Account at a future point in time.

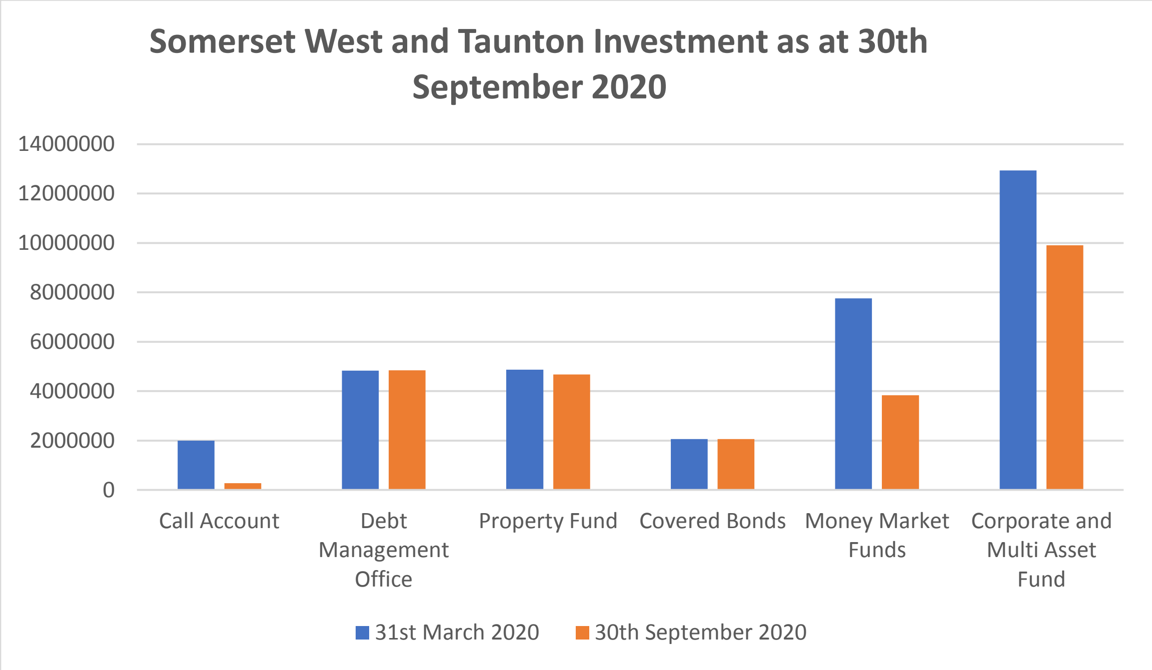
Treasury Investment Activity

On 1st April 2020 the Council received Central Government grant funding to support small and medium sized businesses during the coronavirus pandemic. Somerset West and Taunton Council received £46.626m was received at the beginning of the financial year and the decision was taken to deposit these funds overnight with the Debt Management Office in order that monies were available to cover the daily creditor runs that were undertaken at the time. As at 30th September 2020 £44.053m has been disbursed, with the remaining balance being invested in call accounts / money market funds.

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £34.01 million and £97.29 million due to timing differences between income and expenditure. The investment position as at 30th September 2020 is shown in table 4 below.

Table 4: Treasury Investment Position

Type of Investment	**31 March 2020 £000**	**Movement 2020 £000**	**30 September 2020 £000**
Call Accounts	1,993	(1,711)	282
Debt Management Office	4,834	16	4,850
Property Fund	4,876	(201)	4,675
Covered Bonds	2,062	0	2,062
Money Market Funds	7,765	(3,930)	3,835
Corporate and Multi Asset Funds	12,939	(1,025)	11,914
Total Investments	**34,469**	**(6,851)**	**27,618**



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 income.

Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.

On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities.

The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.1%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.

The table below shows counterparty credit quality as measured by credit ratings and the percentage of the in-house investment portfolio exposed to bail-in risk. This is an extract from Arlingclose's latest quarterly investment benchmarking.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Rate of Return %
31.03.2020	3.12	AA+	46%	2.05
30.06.2020	3.04	AA+	21%	-1.20
Similar LAs	4.10	AA-	59%	0.58
All LAs	4.10	AA-	59%	0.33

As at 30th September 2020 Somerset West and Taunton Council had £12.7m of its investments held externally in managed strategic pooled 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 generated an average total return of 4.16%, comprising of a 2.35% income return which is used to support services in year, and a 1.81% in respect of capital growth.

Because these 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 rates.

In 2020/21 the Council expects to receive significantly lower income from its cash and short-dated money market investments and from its externally managed funds than it did in 2019/20 and earlier years. Dividends and income paid will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact, the fund's sectoral asset allocation, securities held/bought/sold and, in the case of equities, the enforced or voluntary dividend cuts or deferral.

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Council holds £6.301m of such investments held as loans to local businesses, charities, partnerships and sports clubs as at 30th September 2020.

Treasury Performance

The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

Table 6: Performance

	Actual 30.09.20 £000	Budget 30.09.20 £000	Variance 30.09.20 £000
Interest Paid	1,249	1,480	(231)
Interest Received	(381)	(438)	(57)

The corporate world is still adjusting to the economic shock, with probably more to come, and it is still too early to tell which companies will withstand the economic damage in the short- to medium-term or which will choose to conserve cash in very difficult economic conditions simply to survive.

Investment income in the Council's 2020/21 was set against a very different economic backdrop. Bank Rate, which was 0.75% in January/February 2020, now stands at 0.1%. Interest earned from short-dated money market investments will be significantly lower. In relation to income from the Council's externally managed strategic funds, dividends and income distributions will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact, the fund's sectoral asset allocation, securities held/bought/sold and, in the case of equities, the enforced or voluntary dividend cuts or deferral.

The Council will continue to monitor its expectations for investment income in 2020/21 and any changes / variances will be reported as part of the overall financial monitoring exercise included within the budget monitoring reporting processes.

Compliance

The Assistant Director Finance and S151 Officer can report that all bar one of its treasury management activities undertaken during the period April – September 2020 complied with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

The exception was in regards to the investment limit in respect of any single organisation (except UK government). On occasions during the period of April – September 2020 the maximum balance held within two Money Market Funds exceeded the 2020/21 approved limit. Appropriate corrective action was taken to reduce the Council's exposure in these individual funds, therefore ensuring compliance was restored. Additional Money Market Funds are also now being utilised to manage the cash flow of the organisation in these current economic times.

Compliance with specific investment limits is demonstrated in table 7 below.

Table 7: Specific Investment Limits

	Maximum Exposure	2020/21 Limit	Complied
Any single organisation (except UK government)	£9.0m	£7m each	x
UK central government and UK local authorities	£51.5m	Unlimited	✓
Any group of organisations under the same ownership	£2.0m	£9m per Group	✓
Any group of pooled funds under the same management	£5.0m	£21m per Manager	✓
Negotiable instruments held in a broker's nominees account	£2.0m	£21m per Broker	✓
Foreign countries	Nil	£9m per Country	✓
Registered providers	Nil	£21m in Total	✓
Loans to unrated corporates	Nil	£9m in Total	✓
Money market funds	£27.0m	£42m in Total	✓
Real Estate Investment Trusts	Nil	£21m in Total	✓

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

Table 8: Debt Limits

	30.09.20 Actual £000	2020/21 Operational Boundary £000	2020/21 Authorised Limit £000	Complied
Borrowing	101,000	200,000	220,000	✓

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. However, the Council stayed well within this limit during the period.

Treasury Management Indicators

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

Security: The Council 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. Unrated investments are assigned a score based on their perceived risk.

	30.09.20 Actual	2020/21 Target	Complied
Portfolio average credit rating	AA+	A-	✓

Liquidity: The Council 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.

	30.09.20 Actual	2020/21 Target	Complied
Total cash available within 3 months	£27.6m	£21.0m	✓

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	30.9.20 Actual	2020/21 Limit	Complied
Upper limit on one-year revenue impact of a 1% rise in interest rates	(£0.050m)	(£0.075m)	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.050m	£0.075m	✓

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.09.20 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	25.25%	100%	0%	✓
1 year and within 2 years	9.90%	100%	0%	✓
24 months and within 5 years	17.82%	100%	0%	✓

	30.09.20 Actual	Upper Limit	Lower Limit	Complied
5 years and within 10 years	40.10%	100%	0%	✓
10 years and above	6.93%	100%	0%	✓

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.

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	£0m	£0m	£0m
Limit on principal invested beyond year end	£30m	£25m	£25m
Complied	✓	✓	✓

Other

IFRS 16: The implementation of the new IFRS 16 Leases accounting standard has been delayed until 2021/22.

Outlook for the remainder of 2019/20

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been supressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable, financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

Appendix B

Investments as at 30th September 2020

Borrower	**Amount £**	**Rate of Interest %**	**Date of Investment**	**Date of Maturity**
Debt Management Office	1,915,000	0.010	10/08/2020	09/11/2020
Debt Management Office	1,019,000	0.010	14/09/2020	14/12/2020
Debt Management Office	1,916,000	0.010	13/07/2020	12/10/2020
Leeds Building Society	1,031,350	1.565	24/04/2015	16/11/2020
Leeds Building Society	1,030,618	1.622	01/05/2018	16/11/2020
NatWest	281,876	0.000	N/A	On Demand
Aberdeen Standard Liquidity	500,000	Variable	N/A	On Demand
CCLA Investment Fund (Public Sector Deposit Fund)	1,000,000	Variable	N/A	On Demand
CCLA Local Authority Property Fund	4,674,916	Variable	N/A	On Demand
Columbia Threadneedle Strategic Bond Fund	2,039,216	Variable	N/A	On Demand
Investec Diversed Income Fund	2,661,157	Variable	N/A	On Demand
Payden and Rygel Sterling Reserve Fund	2,010,452	Variable	N/A	On Demand
Royal London Enhanced Cash Plus Fund (Class Y)	997,040	Variable	N/A	On Demand
Aberdeen Investments - Sterling Short Duration Cash Fund (K2)	1,040,028	Variable	N/A	On Demand
Schroder Income Maximser Fund	1,438,627	Variable	N/A	On Demand
Aviva Government Money Market Fund	2,235,000	Variable	N/A	On Demand
Federated	100,000	Variable	N/A	On Demand
Aegon Diversified Monthly Income Fund	1,727,753	Variable	N/A	On Demand
TOTAL	**27,618,033**			