

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2020/21

1 Background

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 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

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (last revised in 2017) was adopted by this Council on 20th February 2012.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which 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 Executive, Resources and Contracts PDS Committee.

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 part of the 2020/21 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- 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 2012021;
- A review of compliance with Treasury and Prudential Limits for 2020/21.

Key Changes to the Treasury and Capital Strategies

There are no key changes proposed in this Mid-Year review report.

3 Economic update (provided by Link Asset Services)

- As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:
 - The fall in **GDP** in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.
 - The peak in the **unemployment rate** was revised down from 9% in Q2 to 7½% by Q4 2020.
 - It 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, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.
- It also squashed any idea of using **negative interest rates**, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be “less effective as a tool to stimulate the economy” at this time when banks are worried about future loan losses. It also has “other instruments available”, including QE and the use of forward guidance.
- The MPC expected the £300bn of **quantitative easing** purchases announced between its March and June meetings to continue until the “turn of the year”. This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.
- In conclusion, this would indicate that the Bank could now just sit on its hands as the economy was recovering better than expected. However, the MPC acknowledged that the “medium-term projections were a less informative guide than usual” and the minutes had multiple references to **downside risks**, which were judged to persist both in the short and medium term. One has only to look at the way in which second waves of the virus are now impacting many countries including Britain, to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six month package from 1st November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid September.
- Overall, **the pace of recovery** is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.
- There will be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or

possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

- One key addition to **the Bank's forward guidance** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate
- The **Financial Policy Committee** (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its 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%.
- **US.** The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by continuing outbreaks of the virus in some states leading to fresh localised restrictions. At its end of August meeting, the Fed tweaked **its inflation target** from 2% to maintaining an average of 2% over an unspecified time period i.e. following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time. This change is aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade so financial markets took note that higher levels of inflation are likely to be in the pipeline; long term bond yields duly rose after the meeting. The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.
- **EU.** The economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The ECB has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.
- **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

- **Japan.** There are some concerns that a second wave of the virus is gaining momentum and could dampen economic recovery from its contraction of 8.5% in GDP. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. The resignation of Prime Minister Abe is not expected to result in any significant change in economic policy.
- **World growth.** Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2020/21 was approved by this Council on 24th February 2020. No revisions were proposed in the Annual Report 2019/20 reported to Council on 12th October 2020 or in the Mid-Year Review report.

5 Investment Portfolio

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 which is consistent with the Council's risk appetite. As shown by forecasts in section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.10% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

Details of the Council's investment activity during the first six months of 2020/21 are provided in sections 3.2.2 to 3.4.5 of the covering report and lists of current investments are provided in Appendices 2 (in maturity date order) and 3 (by counterparty). The Council held £373.3m of investments as at 30th September 2020 (£366.7m as at 30th June 2020).

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

The Council's budget for interest on investments in 2020/21 is £3.591m. As a result of higher levels of balances available for investment, a surplus of £750k is currently projected for the 2020/21 financial year.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

6 Borrowing

The Council's estimated capital financing requirement (CFR) for 2020/21 is £9.6m. The 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 Council does not currently borrow to finance its capital expenditure and has, in recent years, only had to borrow short-term (for cashflow purposes) on very few occasions.

No borrowing is currently anticipated during this financial year, but it is possible that some may be required in future years.

Prudential and Treasury Indicators – Mid-Year Review 2020/21

The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2019/20 were approved by Council in February 2019 and this Annex sets out the actual performance against those indicators in the first six months, updating them where necessary. Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the full Council in February 2002 and the revised 2011 Code was initially adopted by full Council in February 2012.

Prudential Indicators for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the Capital Programme for 2020/21 was agreed in February 2019. The decrease in the latest estimate for 2020/21 is mainly the result of slippage in expenditure originally planned for 2020/21 into future years, as highlighted in previous reports to the Executive and to PDS Committees.

Capital Expenditure by Portfolio	2020/21 Original Estimate £m	2020/21 Revised Estimate £m
Children, Education & Families	13.6	14.8
Adult Care & Health	2.3	0.1
Environment & Community Services	11.6	12.3
Renewal Recreation & Housing	26.5	20.7
Executive, Resources & Contracts	5.3	4.7
Estimated slippage/new schemes	-15.0	-15.0
Total	44.3	37.6

Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure.

Capital Expenditure	2020/21 Original Estimate £m	2020/21 Revised Estimate £m
Supported	44.3	37.6
Unsupported	-	-
Total spend	44.3	37.6
Financed by:		
Capital receipts	9.2	1.2
Capital grants/contributions	26.8	25.7
General Fund	-	-
Internal Borrowing	-	-
Revenue contributions	8.3	10.7
Total financing	44.3	37.6
Borrowing need	-	-

Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

It is a statutory duty for the Council to determine and keep under review the “Affordable Borrowing Limits”, which comprise external / internal borrowing and other long-term liabilities, mainly finance leases. The Council’s approved Treasury and Capital Prudential Indicators (affordability limits) are outlined in the approved TMSS. The table below shows the expected “worst case” debt position over the period. This is termed the Operational Boundary. Bromley has an operational “borrowing” limit (Operational Boundary) of £30m, although in practice, this limit is never in danger of being breached.

The Authorised Limit, which represents the limit beyond which borrowing is prohibited, is another of the prudential indicators and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003 and, for Bromley, this figure has been set at £60m.

The table also shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. The Council’s capital financing requirement (CFR) as at 1st April 2020 was £9.5m. 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 Council’s CFR relates to liabilities arising from finance leases entered into in recent years in respect of various items of plant and equipment. The Council currently has no external borrowing as such.

Prudential Indicators	2020/21 Original Estimate £m	2020/21 Revised Estimate £m
CFR	0.4	8.9
Debt – Operational Boundary		
Borrowing	10.0	10.0
Other long-term liabilities	20.0	20.0
Total Operational Boundary	30.0	30.0
Debt – Authorised Boundary		
Borrowing	30.0	30.0
Other long-term liabilities	30.0	30.0
Total Operational Boundary	60.0	60.0

Other Prudential Indicators

Other indicators designed to control overall borrowing and exposures to interest rate movements are included in the summary table below, which will require the approval of full Council.

Prudential and Treasury Indicators - Summary

	2020/21	2020/21
	Original Estimate	Revised Estimate
Total Capital Expenditure	£44.3m	£37.6m
Ratio of financing costs to net revenue stream	0.0%	0.0%
Net borrowing requirement (net investments for Bromley)		
brought forward 1 April	£272.6m	£336.1m
carried forward 31 March	£251.8m	£328.3m
in year borrowing requirement (reduction in net investments for Bromley)	-£20.8m	-£7.8m
Estimated CFR as at 31 March (finance lease liability) (NB. Actual CFR as at 31 March 2020 (finance lease liability) = £9.6m)	£0.4m	£8.9m
Annual change in Cap. Financing Requirement	-£0.3m	-£0.6m
Incremental impact of capital investment decisions	£ p	£ p
Increase in council tax (band D) per annum	-	-

TREASURY MANAGEMENT INDICATORS	2020/21 Original Estimate	2020/21 Revised Estimate
Authorised Limit for external debt -		
Borrowing	£30.0m	£30.0m
other long term liabilities	£30.0m	£30.0m
TOTAL	£60.0m	£60.0m
Operational Boundary for external debt -		
borrowing	£10.0m	£10.0m
other long term liabilities	£20.0m	£20.0m
TOTAL	£30.0m	£30.0m
Upper limit for fixed interest rate exposure	100%	100%
Upper limit for variable rate exposure	20%	20%
Upper limit for total principal sums invested beyond year-end dates	£170.0m	£170.0m