

# Treasury Management Strategy Statement and Annual Investment Strategy

## Mid-year Review Report 2021/22

### 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 20<sup>th</sup> 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 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 2021/22 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 2021/22
- A review of the Council's borrowing strategy for 2021/22
- A review of any debt rescheduling undertaken during 2021/22
- A review of compliance with Treasury and Prudential Limits for 2021/22.

### **3 Key Changes to the Treasury and Capital Strategies**

A proposed amendment to the Strategy is outlined in paragraphs 3.38 to 3.40 of the covering report.

### **4 Economic update (provided by Link Asset Services)**

- The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; only one MPC member voted to stop these purchases now to leave total purchases £45bn short of the total target.
- While that was all very much unchanged from previous MPC decisions over the last year, there was a major shift from indicating no expected tightening any time soon to now flagging up that interest rate increases were now on the horizon. There was disagreement among MPC members, some of whom felt that the forward guidance that the MPC won't tighten policy until inflation "is achieving the 2% inflation target sustainably", had already been met. Although other MPC members did not agree with them, they did all agree that "some modest tightening of monetary policy over the forecast period was likely to be necessary to be consistent with meeting the inflation target sustainably in the medium term".
- The MPC was more upbeat in its new 2–3-year forecasts so whereas they had expected unemployment to peak at 5.4% in Q3, the MPC now thought that the peak had already passed (It is to be noted though, that the recent spread of the Delta variant has damaged growth over the last couple of months and has set back recovery to the pre-pandemic level of economic activity till probably late 2021).
- We have been waiting for the MPC to conclude a review of its monetary policy as to whether it should raise Bank Rate first before reducing its balance sheet (quantitative easing) holdings of bonds. This review has now been completed so we learnt that it will start to tighten monetary policy by:
  1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances"
  2. Raising Bank Rate to 0.50% (1.50% previously), before starting on reducing its holdings.
  3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
  4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.
- What the MPC did not give us was any indication on when it would start raising Bank Rate. Inflation is currently expected to peak at over 4% during 2021. The key issue then is

whether this is just going to be transitory inflation or whether it will morph into inflation which will exceed the MPC's 2% target on an ongoing basis. In his press conference, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it's worried that labour shortages will push up wage growth by more than it expects and that, as a result, CPI inflation will stay above the 2% target for longer. Which then raises an interesting question as to whether the million or so workers who left the UK during the pandemic, will come back to the UK and help to relieve wage inflation pressures. We also have an unknown as to how trade with the EU will evolve once the pandemic distortions have dissipated now that the UK no longer has tariff free access to EU markets.

- At the current time, the MPC's forecasts are showing inflation close to, but just below, its 2% target in 2 to 3 years' time. The initial surge in inflation in 2021 and 2022 is due to a combination of base effects, one off energy price increases and a release of pent-up demand, particularly from consumers who have accumulated massive savings during the pandemic, hitting supply constraints. However, these effects will gradually subside or fall out of the calculation of inflation. The issue for the MPC will, therefore, turn into a question of when the elimination of spare capacity in the economy takes over as being the main driver to push inflation upwards and this could then mean that the MPC will not start tightening policy until 2023. Remember, the MPC has sets its policy as being wanting to see inflation coming in sustainably over 2% to counteract periods when inflation was below 2%. While financial markets have been pricing in a hike in Bank Rate to 0.25% by mid-2022, and to 0.50% by the end of 2022, they appear to be getting ahead of themselves. The first increase to 0.25% is more likely to come later; our forecast shows the first increase in Q1 of 23/24 and the second to 0.50% in Q4 of 23/24. The second increase would then open the way for the Bank to cease reinvesting maturing bonds sometime during 2024.

### **Gilt and treasury yields**

Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic party's determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American families plan over the next decade which are caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when:

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy had already been growing strongly during 2021.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
4. And the Fed was still providing monetary stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. In addition, more recently, shortages

of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of “substantial further progress towards the goal of reaching full employment”. However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK. As an average since 2011, there has been a 75% correlation between movements in 10-year treasury yields and 10-year gilt yields. This is a significant upward risk exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

There are also possible downside risks from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to keep an eye on.

### **A new era – a fundamental shift in central bank monetary policy**

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. 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. Although there are nuances between the monetary policy of all three banks, the overall common ground is allowing the inflation target to be symmetrical so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time. For local authorities, this means that interest 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. 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. 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.

### **Globally, our views on economies are as follows:**

- **EU.** The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2.2% which is likely to continue into Q3, though some countries more dependent on tourism may struggle. There is little sign that underlying inflationary pressures are building to cause the ECB any concern.

- **China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. Policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2021. However, the pace of economic growth will fall back after this initial surge of recovery from the pandemic. China is also now struggling to contain the spread of the Delta variant through sharp local lockdowns which will damage economic growth. There are also questions as to how effective Chinese vaccines are proving.
- **Japan.** After declaring a second state of emergency on 7<sup>th</sup> January, which depressed growth in Q1 2021, the economy was expected to make a strong recovery to pre-pandemic GDP levels in the rest of the year as the slow roll out of vaccines eventually gathers momentum. However, the Delta variant has now raised questions as to whether lockdowns will be needed to contain it and to protect the health service from being overwhelmed.
- **World growth.** Further progress on vaccine rollouts, continued policy support, and the re-opening of most major economies should mean that global GDP growth in 2021 will grow at its fastest rate since 1973. The spread of the Delta variant poses the greatest risk to this view, particularly in large parts of the emerging world where vaccination coverage is typically lower than in advanced economies. Continued strong recovery will be accompanied by higher inflation. While most of the arithmetic and commodity price effects boosting inflation in recent months are behind us, goods shortages will last well into 2022 as order backlogs are worked through and inventories are replenished. What's more there is mounting evidence that rapid re-opening of economies generates labour shortages, which could exert further upward pressure on firms' costs. So, global inflation is unlikely to drop back until next year.

## **5 Treasury Management Strategy Statement and Annual Investment Strategy update**

The Treasury Management Strategy Statement (TMSS) for 2021/22 was approved by this Council on 1<sup>st</sup> March 2021. No revisions were proposed in the Annual Report 2020/21 reported to Council on 12<sup>th</sup> July 2021 or in the Mid-Year Review report.

## **6 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 2021/22 are provided in the covering report and lists of current investments are provided in Appendices 2 (in maturity date order) and 3 (by counterparty). The Council held £427.6m of investments as at 30<sup>th</sup> September 2021 (£373.3m as at 30<sup>th</sup> September 2020).

The Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.

The Council's budget for interest on investments in 2021/22 is £3.591m and the current projection is that the outturn will be in line with the budget.

### **Investment Counterparty criteria**

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

## **7 Borrowing**

The Council's estimated capital financing requirement (CFR) for 2021/22 is £8.4m. 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 2021/22

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 2021/22 were approved by Council in March 2021 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 2021/22 was agreed in February 2020. The decrease in the latest estimate for 2021/22 is mainly the result of slippage in expenditure originally planned for 2021/22 into future years, as highlighted in previous reports to the Executive and to PDS Committees.

Capital Expenditure by Portfolio	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Children, Education & Families	11.1	9.5
Adult Care & Health	0.6	0.1
Environment & Community Services	6.5	5.9
Renewal Recreation & Housing	21.1	37.0
Executive, Resources & Contracts	17.8	21.4
Estimated slippage/new schemes	-25.0	-40.0
<b>Total</b>	<b>32.1</b>	<b>33.9</b>

## 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	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Supported	32.1	33.9
Unsupported	-	-
<b>Total spend</b>	<b>32.1</b>	<b>33.9</b>
Financed by:		
Capital receipts	1.9	1.9
Capital grants/contributions	17.5	17.5
General Fund	-	-
Internal Borrowing	-	-
Revenue contributions	12.7	14.5
<b>Total financing</b>	<b>32.1</b>	<b>33.9</b>
<b>Borrowing need</b>	<b>-</b>	<b>-</b>

## 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 1<sup>st</sup> April 2021 was £8.4m. 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 & equipment and housing.

The Council currently has no external borrowing.

<b>Prudential Indicators</b>	<b>2021/22 Original Estimate £m</b>	<b>2021/22 Revised Estimate £m</b>
<b>CFR</b>	<b>8.4</b>	<b>25.7</b>
<b>Debt – Operational Boundary</b>		
Borrowing	10.0	10.0
Other long-term liabilities	20.0	20.0
<b>Total Operational Boundary</b>	<b>30.0</b>	<b>30.0</b>
<b>Debt – Authorised Boundary</b>		
Borrowing	30.0	30.0
Other long-term liabilities	30.0	30.0
<b>Total Operational Boundary</b>	<b>60.0</b>	<b>60.0</b>

### 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

	2021/22	2021/22
	Original Estimate	Revised Estimate
Total Capital Expenditure	£32.1m	£33.9m
Ratio of financing costs to net revenue stream	0.0%	0.0%
Net borrowing requirement (net investments for Bromley)		
brought forward 1 April	£251.8m	£380.1m
carried forward 31 March	£270m	£400m
in year borrowing requirement (reduction in net investments for Bromley)	-£18.2m	-£19.9m
Estimated CFR as at 31 March (finance lease liabilities)	£8.4m	£25.7m
Annual change in Cap. Financing Requirement	-£0.6m	£16.1m
Incremental impact of capital investment decisions	£ p	£ p
Increase in council tax (band D) per annum	-	-

TREASURY MANAGEMENT INDICATORS	2021/22	2021/22
	Original Estimate	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