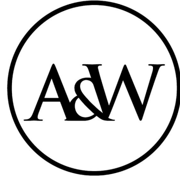

ADUR & WORTHING
COUNCILS

Joint Governance Committee
24 November, 2020

Joint Strategic Committee
1 December, 2020

Key Decision : No
Ward(s) Affected: All

MID YEAR REVIEW OF TREASURY MANAGEMENT 2020-21, ADUR DISTRICT COUNCIL AND WORTHING BOROUGH COUNCIL

REPORT BY THE DIRECTOR FOR DIGITAL AND RESOURCES

EXECUTIVE SUMMARY

1. PURPOSE

1.1 This report asks Members to note the Treasury Management mid-year performance for Adur and Worthing Councils at the 30 September 2020, as required by regulations issued under the Local Government Act 2003.

2. RECOMMENDATIONS

2.1 (i) The Joint Governance Committee is recommended to note this report and refer any comments or suggestions to the Joint Strategic Committee meeting on the 1st December 2020.

(ii) The Joint Governance Committee is asked to note that the Chief Executive used his urgency powers to approve changes to the investment limits for April to June (approved by JSC on 9th June 2020) in order to manage the significant funds provided by the Government to be distributed as Business Grants.

2.2 The Joint Strategic Committee is recommended to note this report and the changes to the investment limits which the Committee approved on 9th June 2020.

3. CONTEXT

3.1 This report summarises the treasury management activities and portfolio for both Adur and Worthing Councils for the half year to 30 September 2020.

3.2 This is one of 3 treasury management reports that are required to be presented during the financial year (see Para. 4.1.3).

3.3 **Capital Strategy**

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. All local authorities are required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out our Capital Strategy was approved by the full Councils on 16th July 2020 (Adur) and 14th July 2020 (Worthing).

3.4 **Treasury Management**

The Councils operate balanced budgets, which broadly means cash raised during the year will meet their cash expenditure. Part of the treasury management operation is to 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.

Covid 19 has had a significant impact on our cash flows during the year to date and this will continue to be the case over the next few months, necessitating continuous review and updating of the forecasts:

- there has been a large reduction in income from several areas including car parking, Business Rates and sales, fees and charges
- there have been significant additional costs incurred in order to support the local community and to continue to operate services
- Government grants are being received in large tranches, for example to be paid out to local businesses, which makes managing the funds particularly complex
- uncertainty around the extent to which our loss of income and additional costs will be reimbursed means that funds need to be kept liquid, reducing the opportunity to place longer term investments
- the substantial reduction in interest rates and concerns over risk require extensive research around the available investments and counterparties.

The second main function of the treasury management service is the funding of the Councils’ capital plans. These capital plans provide a guide to the borrowing need of the Councils, essentially the longer term cash flow planning to ensure the Councils can meet their 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 borrowing, 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.”

3.5 The Councils’ Treasury Management Strategy and Annual Investment Strategy place the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Councils’ priorities set out in Platforms for our Places.

4. ISSUES FOR CONSIDERATION

4.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised 2017).

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 Councils’ treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Councils will seek to achieve those policies and objectives.

3. Receipt by the full Councils 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 Councils 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 Councils of the role of scrutiny of treasury management strategy and policies to a specific named body. For these Councils the delegated bodies are the Joint Governance Committee and the Joint Strategic Committee.

4.2 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 half of the 2020/21 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Councils' capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Councils' investment portfolios for 2020/21;
- A review of the Councils' borrowing strategy for 2020/21;
- A review of any debt rescheduling undertaken during 2020/21;
- A review of compliance with Treasury and Prudential Limits for 2020/21

5. THE ECONOMY AND INTEREST RATES

*The following commentary has been supplied by **Link Treasury Services Ltd**, the professional consultants for the Councils' shared treasury management services provider. The context is significant as it describes the backdrop against which treasury management activity has been undertaken during the year.*

5.1 Economics update

5.1.1 **UK.** 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.

5.1.2 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.

5.1.3 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.

5.1.4 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%.

5.1.5 **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.

5.1.6 **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.

5.1.7 **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.

5.1.8 **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.

5.1.9 **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.

5.2 Interest rate forecasts

5.2.1 The Council's treasury advisor, Link Group, provided the following forecasts on 11th August 2020 (PWLB rates are certainty rates, gilt yields plus 180bps):

Link Group Interest Rate View 11.8.20										
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After 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 6th August (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. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

5.2.2 **Gilt yields / PWLB rates**. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. In addition, there were 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. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

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 30th September, 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%.

5.2.3 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 9th 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 11th 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 4th June, but that date was subsequently put back to 31st July. 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).

Following the changes on 11th March 2020 in margins over gilt yields, the current situation is as follows: -

PWLB Standard Rate is gilt plus 200 basis points (G+200bps)

PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)

PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)

PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)

Local Infrastructure Rate is gilt plus 60bps (G+60bps)

It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation; however, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

As the interest forecast table for PWLB certainty rates, (gilts plus 180bps), above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

5.3 **Economic risks**

5.3.1 **The balance of risks to the UK**

- 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.

5.3.2 **Downside risks to current forecasts for UK gilt yields and PWLB rates include:**

- **UK** - second nationwide wave of virus infections requiring a national lockdown

- **UK / EU** trade negotiations – if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.
- **UK** - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**. The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU recently agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments**. Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.
- **US – the Presidential election in 2020**: this could have repercussions for the US economy and SINO-US trade relations.

5.3.3 **Upside risks to current forecasts for UK gilt yields and PWLB rates**

- **UK** - stronger than currently expected recovery in UK economy.
- **Post-Brexit –** if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.
- **The Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

6. TREASURY MANAGEMENT STRATEGY STATEMENT and ANNUAL INVESTMENT STRATEGY UPDATE

6.1 The Treasury Management Strategy Statement (TMSS) for 2020/21 was noted by the Joint Governance Committee on the 28th January 2020 and approved by Adur Council on 20th February 2020 and by Worthing Council on 18th February 2020.

6.2 Use of Chief Executive's Urgency Powers

6.2.1 As approved by JSC on 9th June 2020, the Chief Executive used his urgency powers to amend the counterparty investment limits from 1 April 2020 to 30 June 2020 to enable the Councils to manage the significant funding received from the Government to distribute as Business Grants. The duty to distribute the funds as quickly as possible necessitated that the funds were kept liquid and they could not be placed in fixed term investments.

6.2.2 For Worthing Borough Council the investment limit was increased from £3m per counterparty to £6.5m per counterparty, with an overall total for money market funds of £26m. The limit for Lloyds Bank was increased to £7m.

6.2.3 For Adur District Council the investment limit was increased from £3m to £5m per counterparty with an overall total for money market funds of £20m. The limit for Lloyds Bank was increased to £6m.

6.2.4 The Treasury Management Strategy Statement counterparty limits now apply.

7. THE COUNCILS' CAPITAL POSITION (PRUDENTIAL INDICATORS)

This part of the report is structured to update:

- The Councils' capital expenditure plans
- How these plans are being financed
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow
- Compliance with the limits in place for borrowing activity

7.1 Prudential Indicator for Capital Expenditure

These tables show the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Adur District Council

	2020/21 Original Estimate	Actual at 30 Sept 2020	2020/21 Revised Estimate
	£m	£m	£m
HRA	16.768	1.575	10.564
Non HRA	10.200	2.367	16.675
Commercial property	37.020	0.000	23.488
Total capital expenditure	63.988	3.942	50.727

The change in the Adur revised capital expenditure estimate is due mainly to reprofiling caused by Covid-19 and £8.95m of grant funding from the Local Enterprise Partnership to assist the delivery of key strategic housing sites.

Worthing Borough Council

	2020/21 Original Estimate	Actual at 30 Sept 2020	2020/21 Revised Estimate
	£m	£m	£m
Non HRA	21.470	2.662	19.944
Commercial property	47.999	4.793	47.428
Total capital expenditure	69.469	7.455	67.372

There have been various changes to the Worthing capital expenditure programme, which have been detailed in regular reports and are partly due to Covid-19. Changes include grant funding of £4.5m from the Local Enterprise Partnership for the development of Decoy Farm and re-profiled spend of £3.5m for refurbishment of the High Street multi-storey car park.

7.2 **Changes to the Financing of the Capital Programme**

The tables below draw 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.

The borrowing element of the tables increases the underlying indebtedness of the Councils by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Adur District Council

	2020/21 Original Estimate	2020/21 Revised Estimate
	£m	£m
Total Capital Expenditure	63.988	50.727
Financed by:		
Capital receipts	1.045	1.248
Capital Grants & contributions	2.317	10.666
HRA Major Repairs & Dev Reserves	6.313	5.540
GF Reserves & revenue contributions	0.110	0.091
Total financing	9.785	17.545
Borrowing requirement	54.203	33.182

Worthing Borough Council

	2020/21 Original Estimate	2020/21 Revised Estimate
	£m	£m
Total Capital Expenditure	69.469	67.372
Financed by:		
Capital receipts	4.056	2.117
Capital grants & contributions	7.290	7.972
Reserves & revenue contributions	2.764	0.399
Total financing	14.110	10.488
Borrowing requirement	55.359	56.884

7.3 **Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary**

The tables below show the CFR, which is the underlying external need to incur borrowing for a capital purpose. They also show the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator - Capital Financing Requirement
As explained above, the CFR forecasts change with the capital expenditure forecasts, to the extent that the expenditure is not funded.
Prudential Indicator - the Operational Boundary for external debt

Adur District Council

	2020/21 Original Estimate	Actual at 30 Sept 2020	2020/21 Revised Estimate
	£m	£m	£m
Prudential Indicator			
Capital Financing Requirement			
CFR - HRA	71.849	60.294	63.667
CFR – Non-HRA	158.443	107.005	134.311
Total CFR	230.292	167.299	197.978
Net movement in CFR	54.203	0.281	30.960
	Operational Boundary	**Actual Debt**	**Operational Boundary**
Borrowing	229.000	160.835	229.000
Other long term liabilities	1.000	0.000	1.000
Total debt	230.000	160.835	230.000

Worthing Borough Council

	2020/21 Original Estimate	Actual at 30 Sept 2020	2020/21 Revised Estimate
	£m	£m	£m
Prudential Indicator			
Capital Financing Requirement			
CFR - Non-HRA	188.892	135.094	183.954
Net movement in CFR	55.359	5.954	54.814
	Operational Boundary	**Actual Debt**	**Operational Boundary**
Borrowing re Worthing Homes	10.000	10.000	10.000
Borrowing re GB Met	5.000	5.000	5.000
Other Borrowing	179.000	112.898	179.000
Other long term liabilities	1.000	0.000	1.000
Total debt	195.000	127.898	195.000

7.4 Limits to Borrowing Activity: CFR and debt

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the next two financial years. This allows some flexibility for limited early borrowing for future years. The Councils have approved a policy for borrowing in advance of need which will

be adhered to if this proves prudent. The Chief Financial Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

Adur District Council

	2020/21 Original Estimate	Actual debt at 30 Sept 2020	2020/21 Revised Estimate
	£m	£m	£m
Borrowing	221.709	160.835	192.762
Other long term liabilities	0.000	0.000	0.000
Total debt	221.709	160.835	192.762
CFR	230.292	167.299	197.978

Worthing Borough Council

	2020/21 Original Estimate	Actual debt at 30 Sept 2020	2020/21 Revised Estimate
	£m	£m	£m
Borrowing	184.868	127.898	182.885
Other long term liabilities	0.000	0.000	0.000
Total debt	184.868	127.898	182.885
CFR	188.892	135.094	183.954

7.5 **Limits to Borrowing Activity: Authorised Limit and debt**

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, 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.

Adur District Council

	2020/21 Original Indicator	Actual debt at 30 Sept 2020	2020/21 Revised Indicator
Authorised Limit for external debt	£m	£m	£m
Borrowing	244.000	160.835	244.000
Other long term liabilities	1.000	0.000	1.000
Total	245.000	160.835	245.000

Worthing Borough Council

	2020/21 Original Indicator	Actual debt at 30 Sept 2020	2020/21 Revised Indicator
Authorised Limit for external debt	**£m**	**£m**	**£m**
Borrowing re Worthing Homes and GB Met	15.000	15.000	15.000
Other Borrowing	184.000	112.898	184.000
Other long term liabilities	1.000	0.000	1.000
Total	200.000	127.898	200.000

8 BORROWING

8.1 The Capital Financing Requirement (CFR) denotes the Councils' underlying need to borrow for capital purposes. If the CFR is positive the Councils 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. For both Adur and Worthing Councils capital expenditure in 2020/21 is funded from grants, capital receipts, contributions, reserves and revenue contributions as well as borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring.

8.2 Adur District Council's revised CFR forecast for 2020/21 is £197.978m. The relevant table in 7.4 shows the Council has borrowings of £160.835m at 30 September 2020.

Worthing Borough Council's revised CFR for 2020/21 is £183.954m. The relevant table in 7.4 shows the Council has borrowings of £127.898m at 30 September 2020.

8.3 Due to the overall financial position, the payments made on repayment loans and the underlying need to borrow for capital purposes, new external borrowing was undertaken as shown in the tables below. It is anticipated that further borrowing will be undertaken by both Councils during this financial year to fund capital expenditure and any debt refinancing needs. Due to the increase in PWLB margins over gilt yields in October 2019, and the subsequent consultation on these margins by HM Treasury - which ended on 31 July 2020 - the Councils have made use of short-term borrowing from other local authorities. When the new PWLB policy is issued our borrowing strategy will be reviewed and revised in order to achieve optimum value and risk exposure in the long-term.

Adur District Council – new loans

Lender	Principal	Type	Interest Rate	Maturity
Worthing Borough Council	£2.5m	Fixed interest rate	1.00%	30/06/2022
Rugby Borough Council	£2.0m	Fixed interest rate	1.70%	25/11/2022

Worthing Borough Council – new loans

Lender	Principal	Type	Interest Rate	Maturity
Gloucestershire County C	£5m	Fixed interest rate	1.00%	30/06/2022
Rugby Borough Council	£2m	Fixed interest rate	1.70%	25/11/2022

8.4 **PWLB maturity certainty rates (gilts plus 180bps) year to date**

PWLB rates varied within a relatively narrow range between April and July but the longer end of the curve rose during August. This increase came in two periods; the first in the second week of the month was on the back of hopes for fresh US stimulus. This saw investors switch monies out of government bonds and into equities. The second shift higher at the longer end of the curve came in the latter stages of the month as investors reacted to the announcement of the tweak to the Fed's inflation target. Despite moves further out in the yield curve, the short end remained anchored on the basis of no fundamental change to the interest rate outlook.

The 50-year PWLB target rate for new long-term borrowing was unchanged at 2.3%.

9.0 DEBT RESCHEDULING

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year for either Council.

10.0 COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

It is a statutory duty for the Councils to determine and keep under review the affordable borrowing limits. Due to the Covid-19 pandemic the Government made substantial payments to both Councils to distribute as Business Grants to local businesses. On April 1st 2020 Adur District Council received £17.64m and Worthing Borough Council received £26.13m. Additional funding was also received to provide relief to the local community, support the additional

costs that the Councils are incurring, and to compensate for the loss of income.

The Councils have been very successful in distributing the funds to support local businesses, However it was not possible to accept the grant funding and also adhere to the counterparty investment limits set out in the Treasury Management Strategy Statement whilst managing these short term funds. Consequently the Chief Executive used his urgency powers to approve changes to the investment limits for three months (April - June), which was approved by JSC on the 9th June 2020. The approval ended on the 30th June, but unfortunately the counterparty limits were still exceeded on the 1st July. All counterparty limits were met on the 2nd July and subsequently and there was no loss to either Council. These breaches have previously been reported to the Joint Governance Committee and Joint Strategic Committee.

The Chief Financial Officer reports that no difficulties are envisaged for the current or future years in complying with the indicators.

11.0 ANNUAL INVESTMENT STRATEGY

11.1 The Treasury Management Strategy Statement (TMSS) for 2020/21, which includes the Annual Investment Strategy, was approved by the Adur Council on 20 February 2020 and by Worthing Council on 18 February 2020. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Councils' investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Councils will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity and with the Councils' risk appetite. 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 high credit rated financial institutions. The shared Treasury Service uses information supplied by the Treasury advisers, Link, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

As shown by the interest rate forecasts in section 5.2, 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 31st March 2023, investment returns are expected to remain low.

This has had an impact on the income from our investment portfolios which has fallen substantially. Within the Medium Term Financial Strategy, the

impact of these rates has added to the financial pressure the Councils are under.

Negative investment rates

While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have suggested that they might resort to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a glut of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

11.2 **Creditworthiness**

Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during the quarter ended 30th June 2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks. However, during Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions.

As we move into the next quarters ahead, more information will emerge on actual levels of credit losses. (Quarterly performance is normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that UK banks went into this pandemic with strong balance sheets. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". They stated that in their

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%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on negative watch, but with a small number of actual downgrades.

Investment Counterparty criteria

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

Credit Default Swap prices

Credit Default Swaps (CDS) are credit derivative contracts that enable investors to swap credit risk on a company with another counterparty. They are market indicators of credit risk. Although CDS prices for UK banks spiked upwards at the end of March / early April due to the liquidity crisis throughout financial markets, CDS prices have returned to more average levels since then, although they are still elevated compared to end-February. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

11.3 **Investment balances**

The average level of funds available for investment purposes during the half year for Adur was £20.6m and for Worthing was £17.7m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt and payment of grants and progress on the capital programme.

11.4 **Investment performance – Adur District Council**

The investment portfolio yield for the first 6 months of the year is 0.43% p.a. against benchmark rates (supplied by Link) of 0.21% for 6 month deposits. This rate excludes the £3m investment in the Local Authorities’ Property Fund, which returned 3.7% p.a. over the 6 months. The portfolio is shown below. Adur District Council’s budgeted investment return for 2020/21 for both the General Fund and the HRA is £383k and the current forecast will result in an under achievement of about £205k, due to poor interest rates available in the market, the delay in the capital receipt from the sale of the Civic Centre site in Shoreham and the use of internal borrowing to fund capital projects. This strategy contributes to a saving in the interest payable budget which is currently expected to underspend by £181k by the year end.

Investment portfolio – Adur District Council

Counterparty	Issue Date	Maturity Date	Principal	Interest Rate	Long Term Rating
Birmingham City Council	15.04.20	05.02.21	£2,000,000	1.10%	AA-
CCLA MMF	n/a	n/a	£3,000,000	var	AAA
Close Brother Ltd	10.08.20	10.08.21	£1,000,000	0.80%	A-
Close Brothers Ltd	20.08.20	06.09.21	£1,000,000	0.80%	A-
Federated Investments MMF	n/a	n/a	£2,295,000	var	AAA
Handelsbanken call account	n/a	n/a	£3,000,000	var	AA-
Invesco MMF	n/a	n/a	£10,000	var	AAA
Leeds Building Society	24.06.20	05.01.21	£2,000,000	0.26%	A-
Lloyds Bank 95 day notice	22.07.20	n/a	£1,000,000	0.30%	A+
Local Authority Property Fund	25.04.17	n/a	£3,000,000	var	n/a
Nationwide Building Society	01.07.20	05.10.20	£1,000,000	0.17%	A
Santander UK	27.09.19	05.10.20	£1,000,000	1.00%	A
Santander UK	02.10.19	05.10.20	£1,000,000	1.00%	A
Boom Credit Union	06.03.15	n/a	£25,000	n/a	n/a
TOTAL			**£21,330,000**		

11.5 **Investment performance – Worthing Borough Council**

The investment portfolio yield for the first 6 months of the year is 0.37% p.a. against benchmark rates of 0.21% for 6 month deposits. This rate excludes the £1.5m investment in the Local Authorities' Property Fund, which returned 3.7% p.a. over the 6 months.

The Council has also made 2 loans which are treated as capital expenditure rather than treasury investments:

- £10m to Worthing Homes at 0.7% above the rate at which the funds were borrowed, generating £70k p.a. for the Council
- £5m to GB Met College at 2% above the rate at which funds were borrowed, generating £100k in 2020/21 for the Council.

Worthing's investment portfolio yield is lower than Adur's because Adur has been able to place more fixed term investments due to its higher average balance of funds. Worthing needs to retain more of its cash in short term investments, including Money Market Funds, because it collects a larger amount of Council Tax and Business Rates, most of which is held temporarily. The portfolio is shown below.

Worthing Borough Council's budgeted investment income for 2020/21, excluding the Worthing Homes and GB Met loans, is £169k and the current forecast will result in an under achievement of about £67k, due to poor interest rates available in the market and the use of internal borrowing to fund capital

projects. This strategy contributes to a saving in the interest payable budget which is currently expected to underspend by £291k by the year end.

Investment Portfolio - Worthing Borough Council

Counterparty	Issue Date	Maturity Date	Principal	Interest Rate	Long Term Rating
Adur District Council	30.06.20	30.06.22	£2,500,000	1.00%	AA-
CCLA MMF	n/a	n/a	£1,920,000	var	AAA
Federated Investments MMF	n/a	n/a	£25,000	var	AAA
Handelsbanken call account	n/a	n/a	£3,000,000	var	AA-
Invesco MMF	n/a	n/a	£5,000	var	AAA
Leeds Building Society	24.06.20	05.01.21	£2,000,000	0.26%	A-
Nationwide Building Society	01.07.20	05.10.20	£2,000,000	0.17%	A
Local Authority Property Fund	27.04.17	n/a	£1,500,000	var	n/a
Boom Credit Union	Various	n/a	£50,000	n/a	n/a
TOTAL			**£13,000,000**		

Investment Performance – Approved Limits

The Chief Financial Officer confirms that the only breaches of the approved limits during the first six months of 2020/21 for Adur District Council or Worthing Borough Council within the Annual Investment Strategy were as described in section 10 above.

11.6 **Counterparty commitment to sustainability**

The Councils are committed to ethical investments and the use of counterparties which have appropriate sustainability, carbon reduction or ethical plans. There are links below to the plans or declarations of our current investment counterparties.

https://www.birmingham.gov.uk/info/20015/environment/2026/climate_emergency/3

https://www.ccla.co.uk/our-policies/climate-change-and-investment-policy

https://www.closebrothers.com/sustainability-and-environment

https://www.federatedinvestors.com/resources/resource-centers/responsible-investing-center.do?hint=class

https://www.handelsbanken.com/en/sustainability/climate-impact

https://www.invesco.com/corporate/about-us/esg/environmental-sustainability

https://www.leedsbuildingsociety.co.uk/knowledge-base/members/continuing-to-reduce-our-carbon-footprint/

https://www.lloydsbankinggroup.com/our-group/responsible-business/financing-a-green-future-together/reducing-our-own-environmental-footprint/

https://www.nationwide.co.uk/-/media/MainSite/documents/about/corporate-information/results-and-accounts/2019-2020/Responsible_Business%20Report_2019_Nationwide.pdf

https://www.santander.co.uk/assets/s3fs-public/documents/2019_santander_esg_supplement.pdf

12. ENGAGEMENT AND COMMUNICATION

12.1 The Adur and Worthing Councils' treasury management team provides treasury services to Mid Sussex District Council through a shared services arrangement (SSA). The SSA is provided under a Service Level Agreement that was renewed from 18th October 2019, and which defines the respective roles of the client and provider authorities for a period of three years.

12.2 Information and advice is supplied throughout the year by Link Treasury Services Ltd, the professional consultants for the Councils' shared treasury management service.

13. FINANCIAL IMPLICATIONS

13.1 This report has no quantifiable additional financial implications to those outlined above. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget.

14. LEGAL IMPLICATIONS

14.1 The presentation of the Half Year Report is required by regulations issued under the Local Government Act 2003 to review the treasury management activities, the actual prudential indicators and the treasury related indicators for 2020/21.

Background Papers

Joint Treasury Management Strategy Statement and Annual Investment Strategy Report 2020/21 to 2022/23 (Adur Council 20 February 2020 and Worthing Council 18 February 2020).

Annual Joint In-House Treasury Management Operations Report 1 April 2019 – 31 March 2020 (Adur Council 29 October 2020, Worthing Council 20 October 2020)

Link Treasury Services Ltd Half Year Report Template 2020/21

Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA)
The Prudential Code for Capital Finance in Local Authorities (CIPFA)

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SUSTAINABILITY & RISK ASSESSMENT

1. ECONOMIC

The treasury management function ensures that the Councils have sufficient liquidity to finance their day to day operations. Borrowing is arranged as required to fund the capital programmes. Available funds are invested according to the specified criteria to ensure security of the funds, liquidity and, after these considerations, to maximise the rate of return.

2. SOCIAL

2.1 Social Value

Matter considered and no issues identified.

2.2 Equality Issues

Matter considered and no issues identified.

2.3 Community Safety Issues (Section 17)

Matter considered and no issues identified.

2.4 Human Rights Issues

Matter considered and no issues identified.

3. ENVIRONMENTAL

Matter considered and no issues identified.

4. GOVERNANCE

4.1 The Councils' Treasury Management Strategy and Annual Investment Strategy places the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Council priorities.

4.2 The operation of the treasury management function is as approved by the Councils' Treasury Management Strategy and Annual Investment Strategy 2020/21 - 2022/23, submitted and approved before the commencement of the 2020/21 financial year.

4.3 In the current economic climate the security of investments is paramount, the management of which includes regular monitoring of the credit ratings and

other incidental information relating to credit worthiness of the Councils' investment counterparties.