Aberdeenshire COUNCIL

Business Services

BUSINESS SERVICES COMMITTEE – 11 NOVEMBER 2021

REVIEW OF THE PERFORMANCE OF THE TREASURY MANAGEMENT FUNCTION AND INVESTMENTS FOR THE PERIOD TO 30 SEPTEMBER 2021

1. Reason for Report

1.1 This report details performance in relation to the treasury management and investment activity for the period to 30 September 2021. It also documents compliance and monitoring in relation to the Treasury Management Strategy Statement and Prudential Indicators for the period 1 April 2021 to 30 September 2021.

2. Recommendations

The Committee is recommended to:

2.1 Note that Investment Income is currently below the budget position as shown in paragraph 4.3;

2.2 Note that there has been no restructuring of Finance as detailed in paragraph 4.4;

2.3 Note the new PWLB borrowing of £50 million as detailed in paragraph 4.5;

2.4 Note the Treasury Management Activities as detailed in Appendix A;

2.5 Note compliance with the Treasury Management Indicators and the review of the performance of the Treasury Management Function to 30 September 2021 as detailed in Appendix B; and

2.6 Agree that a further report be provided after the end of the financial year on the outturn review of the performance of the Treasury Management function for the period 1 April 2021 to 31 March 2022.

3. Purpose and Decision Making Route

3.1 The Code of Practice for Treasury Management by Local Authorities issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), which forms part of the Council's Financial Regulations, states that the performance of the treasury management function should be reviewed at least twice per annum. Reports are now prepared covering operational performance on this basis.

3.2 The Treasury Management Strategy Statement and Prudential Indicators which underpin treasury management activity are approved annually by the Business Services Committee. The Strategy Statement incorporates the Investment Policy and Long-Term Borrowing Strategy.

4 Discussion

4.1 **Summary:** Treasury management, over the past 6 months has been challenging due to the constraints of the Medium-term Financial Strategy (MTFS) and a sustained period of low investment rates. To mitigate this the Treasury Management function have taken advantage of higher cash balances and through active cash flow management has allowed for investment of funds over a longer term to maximise returns available. The Performance Indicators in **Appendix B**, shows that the average cost of raising and servicing borrowing as a percentage of amounts owed to the Loans Fund from Council services, is forecast to reduce. This is a result of maturing borrowing being actively replaced with borrowing at lower level interest rates.

4.2 **Bank rate:** The Bank rate was 0.10% at the start of financial year 2021/22 and has remained unchanged during this reporting period.

4.3 **Investment Income**: The revenue budget assumes investment income of £60,000 in 2021/22 and the return for quarters 1 and 2 is detailed in **Table A** below. Investment income is under budget due to lower than anticipated interest rates.

Table A: Return of Treasury Management Investment Income

	Budget	**Q1**	**Q2**
	£000s	**£000s**	**£000s**
Interest Earned	60	6	18
Average Cash Balances	60,000	33,876	80,391
Annualised % Return	**0.10%**	**0.07%**	**0.09%**

4.4 **Repayments/Restructuring:** There has been no repayment or restructuring of debt undertaken during the reporting period. This option is reviewed on a weekly basis by the Treasury Management function and although borrowing rates are still at historically low levels, there can be additional costs associated with the breaking of existing borrowing contract which restricts restructuring opportunities.

4.5 **New Borrowing:** An opportunity arose in July 2021 to secure £50 million PWLB borrowing at historically low rates, this allowed for a reduction in the Council's exposure to short term borrowing and the replacement of a maturing loan. **Appendix A section 1 refers**.

4.6 Details of both treasury management and other investment activities undertaken during this reporting period are highlighted in **Appendix A**.

4.7 During the reporting period there were no instances of the Treasury Management Strategy Statement being in breach of counterparty limits per the permitted Investments Schedule, or breaching the prudential indicators relating to fixed and variable borrowing. See **Appendix B**.

4.8 **Economic Outlook**

The Global Economy has reopened after the worst period of the COVID-19 pandemic. After successful vaccination roll outs lockdowns across the globe have been lifted with businesses trying to recover.

The Bank of England Bank Rate fell to 0.10% in late March 2020 in response to the crisis and has remained there since. Investment rates continue to suffer, with returns only slightly above 0%. Forecasters predict that the Monetary Policy Committee (MPC) may have to raise Bank rate earlier than anticipated to keep inflation under control. Inflation has recently risen above the MPC's target rate of 2%, as predicted due to the low base figures from last year but with recent energy price rises and supply chain shortages across the country the rate may remain higher than the MPC have forecast and be above target rate longer than anticipated.

The Council's treasury advisors, Link Services, have provided a more detailed economic outlook and this can be found in **Appendix C**.

4.9 **UK Banks**: During the reporting period the ratings of UK institutions have remained relatively unchanged. UK banks are more highly capitalised than before the banking crisis and impaired lending is at the lowest rates since 2010. The outlook for all banks in recent times has changed from negative to stable to reflect the current economic climate as the economy starts to pick up pace. Lockdowns have been lifted after successful vaccination programmes start to ease the COVID pandemic. Future changes to ratings will depend on the UK sovereign rating which is also currently on stable outlook. Events will continue to be monitored on a continuous basis.

Government backed UK Banks: Monitoring of Government Backed Banks continues. The Treasury Advisors recommendation is for investments up to a maximum of 12 months. The Government has resumed its process to return Royal Bank of Scotland to private ownership through managed tranches reducing is share from 62.4% to 54.7% in May 2021, with a further 15% reduction planned over the next 12 months and a completed exit strategy by 2024.

4.10 **Clydesdale Bank:** The Council currently has its banking services with the Virgin Money, the brand name now used by the former Clydesdale Bank.

Recent results have shown that Virgin Money Group has returned to profitability with rating agencies upgrading their outlook. Clydesdale Bank is now back on the treasury advisors' list of acceptable financial institutions for investment. As with other UK Banks their long and short-term outlooks moved from a negative to stable outlook.

4.11 Following credit rating downgrades of the Clydesdale Bank in the past, the maximum investment period was reduced to Instant Access Accounts and this practice continues.

5 Council Priorities, Implications and Risks

5.1 This report supports all six of the Council's Strategic Priorities by delivering the underlying principle of responsible, long term financial planning.

5.2 The table below shows whether risks and implications apply if the recommendations are agreed.

Subject	Yes	No	N/A
Financial		X	
Staffing		X	
Equalities and Fairer Duty Scotland			X
Children and Young People's Rights and Wellbeing			X
Climate Change and Sustainability			X
Health and Wellbeing			X
Town Centre First			X

5.3 An integrated impact assessment is not required because the recommended actions do not have a differential impact on people with protected characteristics.

5.4 There are no staffing or financial implications, however it should be noted that proactive investment and debt management has been essential in the management of this budget.

5.5 The following Risk has been identified as relevant to this matter on a Strategic Level: Balancing the Books (*Directorate Risk Registers*). The mitigation actions are set out in this report.

6 Scheme of Governance

6.1 The Head of Finance and Monitoring Officer within Business Services have been consulted in the preparation of this report and had no comments to make.

6.2 The Committee can consider this item in terms of Section C.2.7 of the List of Committee Powers in Part 2A of the Scheme of Governance as it relates to the monitoring of the Treasury Management Strategy.

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Director of Business Services

Report prepared by Bruce Lawrence – Treasury Management Officer
Date 1 October 2021

List of Appendices:

Appendix A - Treasury management and other investment activities
Appendix B - Compliance and Performance
Appendix C - Economic Outlook

Appendix A

Treasury management and other investment activities

1. New Borrowing

An opportunity arose to take new long term borrowing at historically low rates. New loans raised during the reporting period in line with the approved MTFS are detailed below. Capital requirements continued to be funded by a mix of internal borrowing, long term borrowing and short term temporary borrowing.

Date	Amount	Rate of Interest	Term
	£'s	%	Years
19/07/2021	25,000,000	1.73%	49.50
19/07/2021	25,000,000	1.72%	50.00
	50,000,000	**1.72%**	**49.00**

2. Loan Repayment

No loans were repaid during the six months to 30 September 2021.

3. Counterparties and Balances

Counterparty	Investment Status	Balance as at 30/09/21 £'s
Fixed Term Deposits		
Santander	Up to 365 days	20,000,000
Standard Chartered Bank	Up to 365 days	20,000,000
Total Fixed Term Deposits		**40,000,000**
Call Accounts		
Clydesdale Bank	Up to 365 days	23,650,000
Svenska Handelsbanken	Up to 365 days	15,000,000
Total Call Accounts		**38,650,000**
Total Investments		**78,650,000**

4. Other Investment Activity

Name	Principal Balance as at 31 March 2021	Investment Return - YTD		Principal Balance as at 30 September 2021
	£'s	**£'s**		**£'s**
Call Accounts	39,950,000	13,112		38,650,000
Money Market Funds	0	164		0
Fixed Term Deposits	0	10,453		40,000,000
	39,950,000	**23,729**		**78,650,000**
Trust Funds: Heritable Property	0	0		0
Trust Funds: Government Stocks	222,259	2,145		226,349
Trust Funds Shareholdings: Investment Trusts	824,325	1,428		1,035,300
Trust Funds Shareholdings: Unit Trusts	3,423,976	31,364		3,597,718
Trust Funds Shareholdings: Others	80,941	0		87,431
Investment in Loans Fund	3,029,092	1,202		3,029,092
	7,580,593	**36,139**		**7,975,890**
Common Good Funds: Heritable Property	1,907,934	0		4,310,863
Common Good Funds: Government Stocks	0	0		0
Common Good Funds Shareholdings: Unit Trusts	13,743	272		14,093
Investment in Loans Fund	1,573,799	759		1,573,799
	3,495,476	**1,031**		**5,898,755**
Adhoc loans incl. existing long-term debtors	10,588,271	98,403		10,547,635
Support for Aberdeenshire Business Scheme	55,747	329		40,597
	10,644,018	**98,732**		**10,588,232**
Investment Land and Buildings	**1,326,100**	0		1,309,765
Total	**62,996,187**	**159,631**		**104,422,642**

Appendix B

A. Compliance and Performance

1. Treasury Management Performance

(i) "Average cost of servicing Loans Fund advances in year"

Purpose: - The Loans Fund interest and expenses rates indicate the cost of raising and servicing the Council's borrowings as a percentage of amounts owing to the Loans Fund by the Council's services.

	2020/21 Actual	2021/22 Budget	2021/22 Forecast
Loans Fund Interest Rate	2.63%	2.71%	2.63%
Loans Fund Expenses Rate	0.03%	0.04%	0.03%
Total Rate	**2.66%**	**2.75%**	**2.66%**

The Loans Fund interest rate reflects rates applicable to the whole debt portfolio of the Council. Much of the Council's debt was borrowed in times when interest rates were much higher than at present.

(ii) "Average interest rate of longer-term borrowing (i.e. for one year or more) raised in-year": -

Purpose: - Indicates whether the Council is achieving value for money in its borrowings.

	2020/21 Actual	2021/22 Budget	2021/22 Forecast
Average interest rate of longer-term borrowing	0.00%	2.50%	1.72%

(iii) "Average maturity of long-term borrowing raised in year"

Purpose: - Indicates whether the Council's borrowing strategy is appropriate to the prevailing interest rate environment. In times of low interest rates, it is desirable to borrow for long periods at fixed interest rates to guard against the risk that rates might increase. Conversely, in times of high interest rates, it can be desirable to borrow over shorter periods if rates are expected to fall.

	2020/21 Actual	2021/22 YTD
New borrowing	0.00 years	49.75 years
Debt rescheduling	n/a	n/a
Average	0.00 years	49.75 years

2. Compliance with Treasury Strategy

***(i) "Selection of counterparties for lending of surplus money in the Council Loans Fund"*: -**

Lending has been to the counterparties listed below. This complies with the conditions for lending included in the Investment Policy.

Table A: Interest Receivable Realised from Counterparties

Counterparty	**2021/22 YTD**
	£s
Aberdeen Sterling Liquidity MMF	92
Clydesdale Bank PLC	11,057
Federated Investors Sterling MMF	73
Santander	8,000
Standard Chartered Bank	2,453
Svenska Handelsbanken	2,054
Total Interest Receivable	**23,729**

The conditions contained in the Investment Policy relating to the counterparties in Table A are that all counterparties are UK or EU domiciled and are checked weekly to the Council's Treasury Advisors suggested counterparty list.

(ii) *"Investment of the fund balances of trusts and common good funds"*

Investments held by trusts and common good funds administered by the Council complied with the Investment Policy in the period 1 April 2021 to 30 September 2021.

(iii) *"Restriction of amount lent to any one borrower at any one time to £30M".*

There was no instance of the amount being breached during the reporting period. The review of lending is checked and maintained on a daily basis on the balance of advances to counterparties database maintained by the treasury function.

(iv) *"Restriction of temporary borrowing to 40% of the total capital debt outstanding at the time of borrowing"*

	Actual 2020/21	**YTD 2021/22**
Maximum Temporary Borrowing to Debt Outstanding	19.61%	18.61%

(v) ***"The minimum average life to maturity of all long-term borrowing will be at least 5 years"***

	Actual 2020/21	**YTD 2021/22**
Minimum Average Life to Maturity	28.32 years	28.76 years

(vi) ***"No more than the greater of 25% of all temporary borrowing or £30M will be taken from any one lender at any one"***

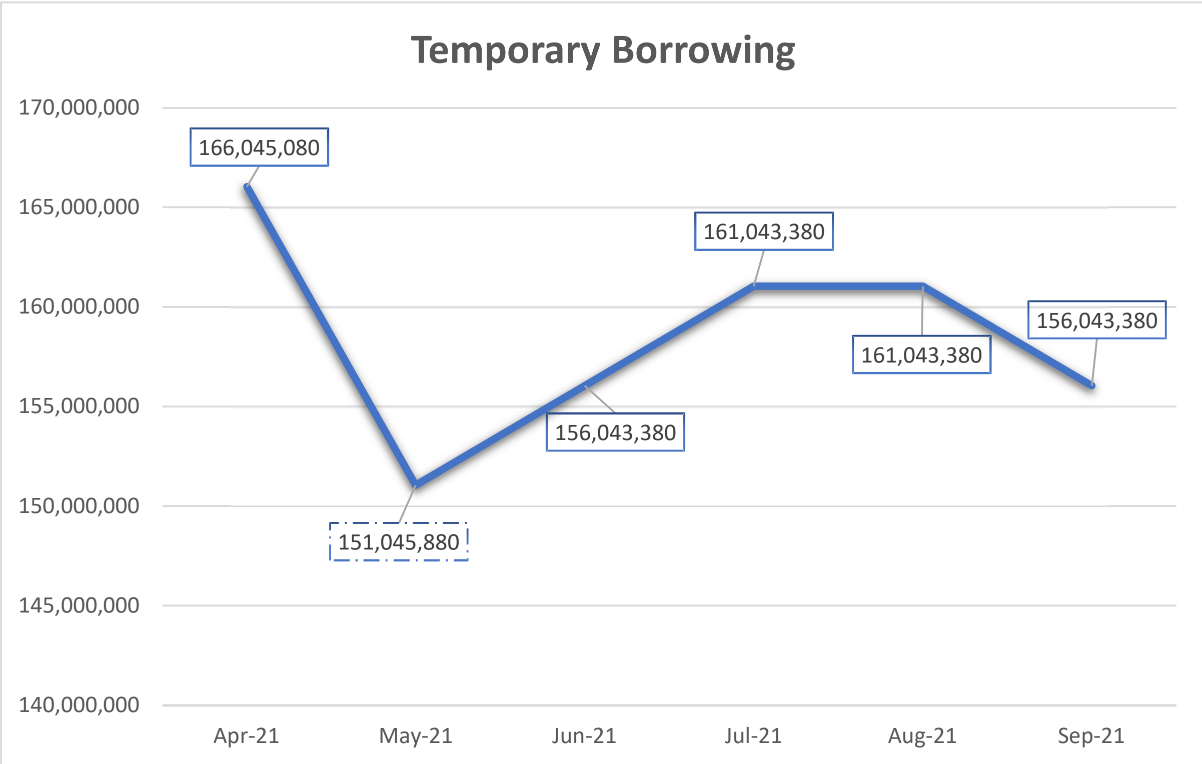
	Actual 2020/21	**YTD 2021/22**
	£'s	**£'s**
Maximum Outstanding with 1 lender	20,000,000	20,000,000*

*See Lenders table below.

The table details the lending taken at any point in time in the monitoring period April to September 2021. The graph details the actual temporary borrowing totals at the end of each month for comparison purposes.

Lender	**£'s**
Angus Council	3,000,000
Bath & North East Somerset District Council	5,000,000
Bristol City Council	5,000,000
Cambridge City Council	10,000,000
City of Edinburgh Council	20,000,000
Cumbria County Council	5,000,000
Essex County Council	10,000,000
Gloucestershire County Council	5,000,000
London Borough of Sutton	10,000,000
Merseyside Fire & Rescue Service	2,000,000
Middlesbrough Teesside Pension Fund	20,000,000
Neath & Port Talbot County Borough Council	5,000,000
Nexus	5,000,000
North Somerset District Council	6,000,000
Oxfordshire County Council	15,000,000
Police & Crime Commissioner for Humberside	5,000,000
Police & Crime Commissioner of West Yorkshire	10,000,000
Sheffield City Council	5,000,000
South Lanarkshire Council	10,000,000
Warwickshire County Council	20,000,000
West of England Combined Authority	20,000,000
West Midlands Combined Authority	10,000,000
West Yorkshire Combined Authority	30,000,000
Wokingham Borough Council	20,000,000
Worcestershire County Council	5,000,000
TOTAL	**261,000,000**

The following graph highlights the temporary borrowing position at the end of each month in the monitoring period April to September 2021.



Appendix C - Economic Outlook

MPC meeting 24.9.21

- 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; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.
- There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, the Governor 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 was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.
- So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.
- Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

- The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
    1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
    2. Raising Bank Rate to 0.50% 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.

- COVID-19 vaccines. These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

- **US**. 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. 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 was happening at a time when: -

- A fast vaccination programme has enabled a rapid opening up of the economy.

- The economy has been growing strongly during 2021.

- It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.

- And the Fed was still providing stimulus through monthly QE purchases.

- These factors could cause an excess of demand in the economy which could then unleash strong inflationary pressures. This could then force the Fed to take much earlier action to start increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that in the September Fed meeting, Fed members again moved forward their expectation of when the first increases in the Fed rate will occur. In addition, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of stronger jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards maximum employment" for a first increase in the Fed rate.

- A further concern in financial markets is when will the Fed end QE purchases of treasuries and how will they gradually wind them down. These purchases are currently acting as a downward pressure on treasury yields. In his late August speech at the Jackson Hole conference, the Fed Chair implied that the central bank plans to start tapering its asset purchases before the end of this year. But the plan is conditional on continued improvement in the labour market, which the August employment report suggests is proceeding more slowly than the Fed anticipated. That may mean that any announcement of tapering is pushed back, possibly even into early 2022.

- As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases are likely to be faster and stronger than Bank Rate increases in the UK. Nonetheless, any upward pressure on treasury yields could put upward pressure on UK gilt yields too.

- 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.

- **EU**. The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

- German general election. With the CDU/CSU and SDP both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SDP-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.

- World growth. World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

- Supply shortages. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.