Appendix A

HARLOW COUNCIL
TREASURY MANAGEMENT STRATEGY
MID-YEAR REVIEW 2021/22

Summary of the Report

1. This report provides an update on economic conditions impacting on the Council and focuses on major issues affecting borrowing and Investments.

2. A full commentary is provided within this report by the Council's treasury management advisors, Arlingclose Ltd.

3. At all times the Council will take steps to protect its investment portfolio by placing Security (the reduction of risk in order to protect the return of capital sums) and liquidity (being able to have immediate access to a reasonable amount of funds so that cash flow obligations may be met) above yield (i.e. the interest paid on investments).

4. In setting the Council's strategy for 2022/23, a full report will be presented to Cabinet and Council in January / February 2022. This will be in conjunction with the 2022/23 budget proposals and Capital Strategy.

5. The Treasury Management Strategy for 2021/22 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (The CIPFA Code) which requires the Council to approve Treasury management half-year and annual reports.

6. The Council is supported by treasury management advisors, Arlingclose ltd., in decision making.

Background

7. The Council's Treasury Management Strategy Statement for 2021/22 was approved at a meeting of Council on 28 January 2021. The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

8. The Council operates within the framework of CIPFA's 'Prudential Code for Capital Finance in Local Authorities' (Prudential Code) the 'Treasury Management Code of Practice' and the Ministry of Housing Communities and Local Government (MHCLG) Investment Guidance.

9. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 28 January 2021.

External Context: Based upon commentary provided by the Council's Treasury Management advisors, Arlingclose Ltd. (October 2021)

10. **Economic background:** The economic recovery from the coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.

11. The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

12. Government initiatives continued to support the economy over the quarter but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.

13. **Credit review:** The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

Local Context

14. On 31st March 2021, the Council had net investments of £12.1m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.21 Actual £m
General Fund CFR	71.756
HRA CFR	196.269
Total CFR	268.025
Less: *Other debt liabilities	(-)1,513
External borrowing	(-)214.837
Internal borrowing	51,675
Less: Usable reserves	(-)78.730
Less: Working capital	14.952
Net investments	(-)12.103

* finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

15. Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk.

16. The treasury management position on 30th September 2021 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.21 Balance £m	Movement £m	30.9.21 Balance £m	30.9.21 Rate %
Long-term borrowing	211.837		211.837	3.492%
Short-term borrowing	3.000	(-)3.000	-	0.070%
Total borrowing	**214.837**	**(-)3.000**	**211.837**	
Long-term investments	(-)4.000	-	(-)4.000	1.909%
Short-term investments	-	-	-	-
Cash and cash equivalents		-		0.031%
Total investments	**(-)12.171**	**(-)6.708**	**(-)18.879**	
Net Borrowing	**202.666**	**(-)9.708**	**192.958**	

Borrowing Update

17. Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

18. The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB

Borrowing Strategy during the period

19. At 30 September 2021 the Council held £211.837m of loans, a decrease of £3m to 31 March 2021, as part of its strategy for funding previous years' capital programmes. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.21 Balance £m	Net Movement £m	30.9.21 Balance £m	30.9.21 Weighted Average Rate %	30.9.21 Weighted Average Maturity (years)
Public Works Loan Board	211.837		211.837	3.492	15.08
Local authorities (short-term)	3.000	(-)3.000	-	-	-
Total borrowing	**214.837**	**(-)3.000**	**211.837**		

20. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds

are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

21. In keeping with these objectives, no new borrowing was undertaken, while £3m of existing loans were allowed to mature without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

Treasury Investment Activity

22. The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six month period, the Council's investment balances ranged between £14.7m and £33.7m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.21 Balance £m	Net movement £m	30.9.21 Balance £m	30.9.21 Income Return %
Banks & building societies (unsecured)	1.495	0.404	1.899	0.050
Money Market funds	6.675	6.305	12.980	0.013
Other Pooled funds				
Cash Plus funds	2.000	0.000	2.000	0.173
Property funds (CCLA)	2.000	0.000	2.000	3.645
Total Investments	12.170	6.709	18.879	

23. Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

24. In furtherance of these objectives, and given the increasing risk and falling returns from short-term unsecured bank investments, the Council is not routinely placing unsecured deposits with individual banks and building societies preferring instead to spread risk in Money Market Funds, a Cash Plus Fund and a Property Fund. It has found local authority investment to be a secure means of investment.

25. Ultra-low short-dated cash rates which have been a feature since March 2020 when Bank Rate was cut to 0.1% have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees.

26. Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also largely around zero.

Non-Treasury Investments

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

Service Investments: Loans

28. The Council lends money to its subsidiary and a local business to support local public services and stimulate local economic growth.

29. HTS (Property and Environment) Ltd is a wholly owned subsidiary of Harlow Council which began trading on 1 February 2017. The Council provided a start-up loan to the business of £1.209m repayable over sixty two months and approved on 21 July 2016. The balance outstanding as at 31 March 2021 was £0.234m.

30. In addition £0.670m was loaned to HTS on 15 February 21 for the purchase of vehicles and plant and machinery. The balance outstanding at 31 March 2021 for principal and interest was £0.525m.

31. As part of a property scheme the Council also loaned HTS £1.011m for the purchase of five houses. A balance of £0.957m for principal and interest was outstanding at 31 March 2021. Interest is charged at 4% over 40 years. This scheme also involved an equity share investment of £0.450m by the Council.

32. Harlow Property Limited was provided with two loans to support its developments within the Harlow Enterprise Zone, approved on 23 January 2014. The advances made were £1m on 15 March 2016 and a further £1.5m on 3 March 2017. Interest accrues on these loans. The total outstanding as at 31 March 2021 was £3.074m with security held against the increase in the property values.

33. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The Council considers that this loss should be zero because (1) the Council is the sole shareholder of HTS, (2) HPL loans are a charged secured against property which considerably exceeds the value of the loan.

Commercial Investments: Property

34. The Ministry of Housing, Communities and Local Government (MHCLG) defines property to be an investment if it is held primarily or partially to generate a profit.

35. The Council has historically held nine commercial and residential properties with the intention of making a profit that will be spent on local public services. These include a Golf Club, and three other properties with a total value of £1.419m. Annual income from all of these assets is about £125,000.

Loan Commitments and Financial Guarantees

36. Although not strictly counted as investments, since no money has changed hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

37. In 1987 and 1992 the Council agreed to undertake joint liability with a number of other local authorities to guarantee loans of £66.3m and £17.3m to Home Housing Association (previously called North Housing Association) in support of their private initiative for the provision of housing in Harlow and surrounding authorities. The guarantee is for a 50-year period ending 2037. The Council's proportion of the total liability is £4.5m. The Council considers that the probability of the guarantee being called upon is low.

Compliance

38. The Deputy Chief Executive and Director of Finance (S151 Officer), reports that all treasury management activities undertaken during the first six months of 2021/22 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

Revisions to CIPFA Codes

39. In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

40. In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Council.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the Council's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
- New indicator for net income from commercial and service investments to the budgeted net revenue stream.
- Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the Council's full debt maturity profile.
- Excluding investment income from the definition of financing costs.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making

Arlingclose's Economic Outlook for the remainder of 2021/22 (based on the October 2021 interest rate forecast)

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

41. Arlingclose expects Bank Rate to rise in Q2 2022. We believe this is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure.

42. Investors have priced in multiple rises in Bank Rate to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.

43. The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

44. While Q2 UK GDP expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.

45. Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

46. The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.