Appendix 1

Mid Year Monitoring Report 2020/21
Treasury Management and Prudential Indicators: 1 April 2020 to 30 September 2020

1. Introduction

1.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government in Scotland Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made as yet during 2020/21).
- Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services; and the treasury activity with regard to the CIPFA Code of Practice for Treasury Management in Local Authorities.
- Statutory Instrument (SSI) 123 2016, set out statutory arrangements for local authority borrowing and lending and the requirement to maintain a loans fund and replace the statutory arrangements set out in Schedule 3 of the Local Government (Scotland) Act 1975 (Schedule 3).

1.2 The regulatory framework of treasury management requires that the Council receive a mid year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously. This report meets that requirement and also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators. The treasury strategy and prudential indicators were previously reported to Council on 4 March 2020. The current position is shown (where appropriate) and revisions to the 2020/21 estimate are provided where required.

1.3 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities require to prepare a Capital Strategy which provides 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; and
- the implications for future financial sustainability

The Council's Capital Strategy was reported to and agreed by Council on 4 March 2020.

1.4 This report sets out:

- Key changes to the Council's capital activity (the prudential indicators);
- An economic update for the first part of the 2020/21 financial year;
- The actual and proposed treasury management activity (borrowing and investment); and
- The risk approach to treasury management (the treasury management indicators).

2. Key Prudential Indicators

2.1 This part of the report is structured to update:

- The Council's capital expenditure plans and how these plans are being financed;
- The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow;
- Compliance with the limits in place for borrowing activity; and
- Policy on the statutory repayment of loans fund advances

2.2 **Capital Expenditure** – Table A shows the current position and revised estimates for capital expenditure for 2020/21 only.

Table A:

£000	**2020/21 Original Estimate**	**Current Position**	**2020/21 Projected Outturn**
General Services	67,437	16,150	49,602
HRA	60,006	23,494	48,300
Capital Expenditure	**127,442**	**39,644**	**97,902**
Financed by:			
Capital receipts	14,218	87	5,719
Capital grants	26,115	10,435	26,935
Revenue / other	7,574	0	7,810
Net financing need for the year	**79,535**	**29,122**	**57,438**

2.2.1 The movement in the level of anticipated capital expenditure is mainly due to the inclusion of additional slippage following the year end; a reduction in anticipated capital receipts; an increase in spend related to external funding offset by slippage levels identified to date (more significant in the current year due to Covid-19). The anticipated spends and resources are regularly reported to Members through budgetary control reports.

2.3 **Impact of changes in Capital Expenditure Plans** – Table B shows the CFR, which is the underlying external need to borrow for a capital purpose while Table C shows the expected debt position over the period.

Table B:

£000	2020/21 Original Estimate	2020/21 Projected Outturn
Opening CFR (1 April 2020)	**626,832**	**600,739**
New Borrowing	69,830	50,330
LTL repayment in year	(3,099)	(3,097)
Closing CFR (31/3/21)	**693,564**	**647,972**
movement in CFR	**66,731**	**47,233**
Net financing need for the year (Table A)	79,535	57,438
Loan repayments in year - excluding LTL (PPP)	(9,705)	(7,108)
New Borrowing - Movement in CFR (from previous year)	**69,830**	**50,330**

Table C:

£000	2020/21 Original Estimate	Current Position	2020/21 Projected Outturn
External Debt			
Estimated/Actual Debt at 1 April 2020	517,855	489,772	509,677
Maturing Debt	(221,628)	(143,230)	(221,628)
Movement in Borrowing			
New Borrowing - Maturing Debt	221,628	143,230	221,628
Borrowing adjustment in relation to over borrowing at year end	0	0	(8,880)
New Borrowing – CFR (Table B)	70,342	0	50,330
Debt at 31 March (1)	**588,193**	**458,002**	**551,127**
Long Term Liabilities (LTL) at 1 April	100,002	99,942	99,942
LTL repayment in year (Table B)	(3,611)	(1,803)	(3,605)
LTL at 31 March (2)	**96,391**	**98,140**	**96,377**
Actual Debt at 31 March (1) + (2)	**684,585**	**556,142**	**647,644**
CFR from Table B	**693,564**	**n/a**	**647,972**
Under/(Over) Borrowing	**8,979**	**n/a**	**508**

2.3.1 The external debt figures included within Table C now includes both short term and long term debt. This is due to the current strategy of using short term borrowing to fund long term capital investment enabling the Council to take advantage of lower interest rates. The reduction in the estimated external debt for 2020/21 is due to a reduction in the net capital financing need for the year.

2.3.2 The CFR is calculated on a year end position based on the Council’s balance sheet and therefore the current position is not shown. The CFR has reduced from the original estimate due to the forecast level of capital expenditure in 2020/21 being less than budgeted. The Strategic Lead - Resources can report that the Council is currently on target to meet the 2020/21 revised estimates for both indicators.

2.3.3 Table C highlights that the borrowing of the Council is forecasting a minimal under-borrowed position against the CFR at 31 March 2021.

2.4 **Compliance with the limits in place for borrowing activity** – A key control over the treasury activity is a prudential indicator to ensure that over the medium term, gross borrowing will only be for a capital purpose.

Gross 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 next two financial years. This allows some flexibility for limited early borrowing for future years.

The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. The revised indicator is detailed in Table D and is illustrated by comparing the estimated gross debt as at 31 March 2021 with the CFR as at 31 March 2023. The Strategic Lead - Resources reports that no difficulties are envisaged for the current year in complying with this prudential indicator.

Table D:

£000	2020/21 Original Estimate	2020/21 Projected Outturn
CFR at 31 March 2020		
2019/20 Estimate/Actual (From Table B above)	**626,832**	**600,739**
Estimated movement in CFR		
2020/21 (From Table B above)	66,731	47,233
2021/22	32,497	67,412
2022/23	44,521	44,521
Anticipated CFR at 31 March 2023	**770,582**	**759,905**
Gross Debt at 31 March 2021 (From C above)	**684,585**	**647,464**

2.4.1 The Operational Boundary is detailed in Table E below and is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Table E:

£000	2020/21 Original Estimate	Current Position	2020/21 Projected Outturn
External Debt	753,043	556,142	712,210

2.4.2 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which is detailed in Table F and 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.

Table F:

£000	**2020/21 Original Estimate**	**Current Position**	**2020/21 Projected Outturn**
External Debt	831,501	556,142	776,957

3. Economic Outlook (November 2020)

3.1 The mid-year update normally covers to September is reported to Members in October, in 2020/21 this has been postponed primarily due to covid-19 and therefore the economic update reflects the outlook as at November 2020.

UK

3.2 The Bank of England most recently voted unanimously to keep interest rates on hold at 0.1%. In addition, they have decided to increase their quantitative easing programme by an additional £150bn, which will start in January 2021. The central bank expects GDP to not fully recover until after Q3 2022, which was their initial forecast. The inflation rate is forecasted to end at 0.6% this year and unemployment is expected to end at 6.3% this year.

3.3 The UK economy grew by 15.5% in the three months to September 2020, the most on record and compared with market consensus of 15.8%, as restrictions on movement eased across June, July, August and September. Considering September only however, output expanded by 1.1% month on month the fifth consecutive month of expansion even though new lockdown measures were introduced. The year on year figure fell by 9.6% for Q3 of 2020, compared to the previous period’s 21.5% contraction.

3.4 The annual inflation rate in the United Kingdom creeped upwards to 0.7% in October of 2020 from 0.5% in September, slightly outperforming market expectations of 0.6%. This is the highest reading in three months, led mainly by a rebounds in the prices of clothing, food and furnishings.

3.5 The number of people in work in the UK fell by 164,000 on quarter to 32.51 million in the three months to September of 2020, compared to forecasts of a 148,000 fall. The unemployment rate in the UK increased to 4.8% in the three months to September of 2020, higher than 4.5% in the previous period and 3.9% a year earlier. It is the highest jobless rate since the last quarter of 2016, amid the coronavirus-hit. The number of people claiming for unemployment benefits in the United Kingdom fell by 29,800 to 2.6 million in September of 2020, following a revised 40,200 decrease in the previous month and beating market expectations of a 50,000 rise. Average weekly earnings (excluding bonuses) rose by 1.9% year on year in the three months to September compared to a 0.9% year on year rise in the three months to August, above market forecasts of a 1% year on year rise.

3.6 Having left the EU on the 31st of January 2020 and entered the transition period, attention will now focus on the success of the UK's attempt to negotiate a free trade treaty with the EU.

International update

3.7 The US economy expanded by an annualised 33.1% in Q3 2020, beating forecasts of a 31% surge. It is the biggest expansion ever, following a record 31.4% plunge in Q2, as the economy rebounds from the coronavirus pandemic. Meanwhile, the Federal Reserve voted to leave the federal funds rate unchanged once again in their November meeting. They also confirmed that rates will remain low until the labour market is sufficiently consistent with maximum employment.

3.8 In the Eurozone the latest reading pointed to neither growth nor contraction in manufacturing and services activity. The Eurozone economy shrank by 4.4% year on year in Q3 of 2020, easing from a record slump of 14.8% seen during Q2 and very close to market expectations of a 4.3% contraction.

3.9 At it's October meeting, the European Central Bank left it's key interest rates and COVID-19 stimulus package unchanged as they took a wait-and-see approach until more insightful projections are released in December, allowing for a more thorough assessment of the economic outlook. This means that they will continue with their pledge to buy up to €1.35 trillion worth of debt through June 2021 under their Pandemic Emergency Purchase Programme and maintain interest rates until inflation is sufficiently close to but below 2%.

4. Interest Rate Update

4.1 **Last year the** Public Works Loan Board (PWLB) increased interest rates as a result of significant high levels of borrowing by a number of English Councils. The UK Government recently ran a consultation on the future of the Public Works Loan Board (PWLB). As an outcome of this review HM Treasury has concluded their findings and published revised lending terms for the PWLBwith rates updated as follows:

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps); and
- PWLB Certainty Rate is gilt plus 80 basis points (G+80bps).

4.2 These new terms apply to all loans arranged from 26 November 2020. In addition, further reforms will also be implemented and guidance will be provided to support councils to determine if a proposed project is an appropriate use of PWLB loans. The government will monitor the implementation of these reforms to make sure that the new lending arrangements are working as intended. The new lending terms include:

- councils will be asked to submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB;
- the PWLB will ask the s95 Officer to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years. This restriction applies on a 'whole plan' basis – meaning that the PWLB will not lend to any council which plans to buy investment assets

primarily for yield anywhere in their capital plans, regardless of whether the transaction would notionally be financed from a source other than the PWLB; and

- when applying for a new loan, the local authority will be required to confirm that the plans they have submitted remain current and that the assurance that they do not intend to buy investment assets primarily for yield is still accurate.

3.11 The Council's treasury advisor, Link Asset Services, has provided the following interest rate forecast. As at November 2020 (following the recent announcement in changes to PWLB rates) :

Table G:

Link Group Interest Rate View 9.11.20							(The Capital Economics forecasts were done 1					
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20												
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60

3.12 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- UK - further waves of virus infections requiring further national lockdowns;
- 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. These actions will help shield weaker economic regions for the next year or so. However, risks remain around high levels of debt and the cost of covid; and
- Weak capitalisation of some European banks, which could be undermined further depending on extent of credit losses resultant of the pandemic.
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3.12 Upside risks to current forecasts for UK gilt yields and PWLB rates are as follows:

- 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; and
- 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.

4. Treasury Management Activity

4.1 This part of the report is structured to update:

- The Council's expected borrowing need and details of under/(over) borrowing;
- Debt rescheduling and new borrowing;
- Debt charges; and
- Investments

4.2 **The Expected Borrowing Need** – This was set out in Table C (above) and demonstrates that at 30 September 2020 Council is currently projecting and under-borrowed position to reduce risks in investments held and the cost of carry on investments. Current investments yield approx 0.10%, long term borrowing rates for periods greater than 25 years are currently between 1.57% to 1.93%, depending on length of term for borrowing. It should be noted that due to the recent announcement on PWLB interest rates, the borrowing rates are significantly different than in September 2020, when long term borrowing rates for periods greater than 25 years are currently between 2.42% to 2.76%, depending on length of term for borrowing. This introduces an element of interest rate risk, as longer term borrowing rates may rise; however, this position is being carefully monitored.

4.3 **Debt rescheduling and new borrowing** – The Council has not undertaken any debt rescheduling during the first half of 2020/21. In the year to date naturally maturing debt of £143.230m has been repaid which has been mainly funded by loans from other local authorities.

4.4 **Debt Charges** – The revised estimate for debt charges for both the General Fund and the HRA is shown in Table H.

Table H:

£000	2020/21 Original Estimate	Current Position	2020/21 Revised Estimate
Borrowing	21,565	10,783	21,565
Other Long Term Liabilities	10,777	5,389	10,777
Total	**32,342**	**16,172**	**32,342**

4.5 **Investments** – The objectives of the Council's investment strategy are to ensure the re-payment of the principal and interest of its investments on time with the level of investment return being a secondary objective. Following on from the economic background above, the current investment climate has one over-riding risk consideration which is the risk of default.

4.5.1 The Council held £16.178m of cash investments at 30 September 2020, and the constituent parts of the investment position are detailed in Table I:

Table I:

£000	Country	< 1 Year	1 – 2 Years	2 – 3 Years
Banks	UK	1,178	Nil	Nil
Money Market Fund		11,000	Nil	Nil

Local Authorities		4,000	Nil	Nil
Total		16.178	Nil	Nil

4.5.2 Table J details the revised budget position for investment income. The original estimate has decreased by £0.019m due to ongoing interest rates.

Table J:

£000	**2020/21 Original Estimate**	**Current Position**	**2020/21 Revised Estimate**
Investment Income	75	32	56

4.5.3 A regulatory development to address risk is the consideration and approval of benchmarks relating to investment security, liquidity and the level of return. Benchmarks are currently widely used to assess the level of return and investment performance, however the application of security and liquidity benchmarks are more subjective in nature.

- **Security** - The Council's maximum security risk benchmark for the current portfolio in relation to investment periods of up to one year (when compared to historic default tables) was set at 0.09% and the Strategic Lead - Resources can report that there have been no defaults of principal sums invested in the year to date.

- **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.

- **Liquidity** – The Strategic Lead - Resources can report that liquidity arrangements were adequate during the year to date and that the liquidity facilities and benchmarks set by the Council as noted below were maintained:

    - Bank overdraft - £1.000m; and
    - Liquid short term deposits of at least £5.000m available on an overnight basis.

- **Return on Investments** – The Strategic Lead - Resources can report that investment return to date average 0.36%. Table K illustrates how this average return compares with the local benchmarks.

Table K:

Benchmark	Benchmark Return	Average Return
7 day LIBID rate	-0.06%	0.36%
1 month LIBID rate	-0.02%	0.36%
Council's Instant Access Account	0.10%	0.36%

- **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 can be seen from above). 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.

5 Key Treasury Management Indicators

5.1 This part of the report is structured to update:

- Actual and estimates of the ratio of financing costs to net revenue stream;
- Upper limits on interest rate exposure:
- The maturity structure of borrowing; and
- Total principal sums invested.

5.2 **Actual and estimates of the ratio of financing costs to net revenue stream** – This indicator (as shown below in Table L) identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream.

Table L:

	2020/21 Original Estimate	2020/21 Revised Estimate
General Fund	9.62%	9.34%
HRA	25.91%	24.84%

5.3 **Upper Limits On Fixed and Variable Rate Exposure** – These indicators identify a maximum limit for fixed and variable interest rates based upon the debt position and were set at 100% and 50% respectively for 2020/21. The Strategic Lead – Resources reports that the Council operates within these limits.

5.4 **Maturity Structures Of Borrowing** – These maximum limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) which are due to naturally mature in any given period as detailed in Table M and show that the Council operates within limits set.

Table M:

Maturity Structure of Fixed Interest Rate Borrowing	2020/21 Original Limits	Current Position
Under 12 months	50%	32.48%
12 months to 2 years	50%	9.33%
2 years to 5 years	50%	5.20%
5 years to 10 years	50%	4.34%
10 years to 20 years	50%	8.13%
20 years to 30 years	50%	5.17%
30 years to 40 years	50%	5.51%
40 years to 50 years	100%	18.28%
50 years to 60 years	100%	11.56%
60 years to 70 years	100%	0%

5.5 **Total Principal Funds Invested** – These limits are set to reduce the need to temporarily borrow to cover any unexpected expenditure, and show limits to be placed on investments with final maturities beyond each year-end. The Council currently invests sums for periods greater than 365 days in Clydebank Property Company and hub West Scotland as detailed in Table N.

Table N:

	2020/21 Original Estimate	Current Position	2020/21 Revised Estimate
Principal sums invested > 365 days (maximum limit £7m)	£0.495m	£0.495m	£0.495m