

## Committee report

Committee	<b>AUDIT COMMITTEE</b>
Date	<b>27 JULY 2020</b>
Title	<b>TREASURY MANAGEMENT STRATEGY UPDATE</b>
Report of	<b>TECHNICAL FINANCE MANAGER</b>

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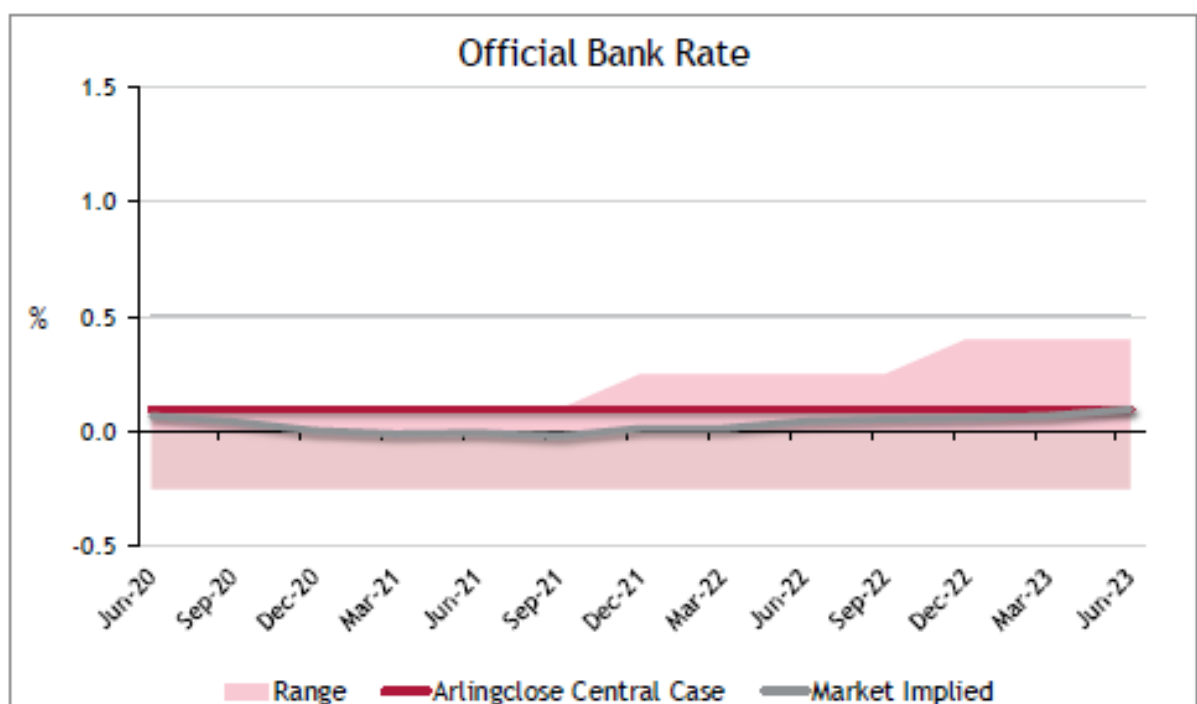
### EXECUTIVE SUMMARY

1. At the Audit Committee meeting on 16 March 2020, the committee adopted the treasury management strategy statement 2020-21.
2. At that meeting, it was noted that the economic climate was changing rapidly as a result of the coronavirus pandemic situation. Members were advised that an update on any potential impacts of the pandemic situation on the approved strategy would be presented at a subsequent meeting.
3. Members are asked to both note this update, and also note that there are no changes required to the treasury management strategy previously adopted.

### ECONOMIC CONTEXT

4. The advent of the coronavirus pandemic in the first quarter of 2020 led to falls in financial markets, not seen since the global financial crisis.
5. In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.
6. The Bank of England, which had held policy rates steady at 0.75 per cent through most of 2019-20, moved in March to cut rates to 0.25 per cent from 0.75 per cent and then swiftly thereafter brought them down further to the record low of 0.1 per cent. Bank rate has been maintained at 0.1 per cent during the first quarter of 2020-21, despite some speculation that the Bank of England's Monetary Policy Committee (MPC) might cut it further; some MPC members are also suggesting that negative rates are part of the Bank's policy tools. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK.

7. Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30 per cent at its worst point with stock markets in other countries seeing similar huge falls. Equity markets started recovering in April; while still down on their pre-crisis levels, the Dow Jones and FTSE 100 and 250 indices have made up around half of the losses. In March, sterling touched its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile.
8. As the extent of the losses that banks and building societies will suffer due to the impact from the coronavirus epidemic remains uncertain but is expected to be substantial, in early June following Arlingclose's stress testing of the institutions on the counterparty list<sup>1</sup> using bail-in analysis<sup>2</sup>, a number of UK banks and building societies were suspended from the counterparty list for unsecured deposits. Although much better capitalised than before the 2007-09 financial crisis, under the current economic circumstances these entities were suspended for reasons of prudence. For those remaining on the list, the duration advice remains up to 35 days<sup>3</sup>.
9. Information provided by the council's treasury management advisers, Arlingclose Limited at the end of May 2020, suggests that the medium-term global economic outlook is weak, and that it is likely to be some time before demand recovers to pre-crisis levels due to rises in unemployment, the on-going need for virus control measures and the impact on consumer/business confidence.
10. Arlingclose predict that there will be significant economic bounce in the second half of 2020, but the subsequent pace of recovery will be limited. This will result in central banks maintaining low interest rates for the medium term. Arlingclose project that the UK bank rate is likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero; indeed, money markets have taken the unprecedented step of pricing in a chance of negative bank rate.
11. The chart below shows the Arlingclose central case projections for interest rates as at May 2020, along with upside and downside risks.



## LOCAL CONTEXT

12. The tables below show the council's net borrowing position as at 30 June 2020.

### **Borrowings**

	£'000	Average interest	Years to final maturity
PWLB maturity	84,388	5.10%	7.1
PWLB EIP	117,614	1.99%	22.5
Total PWLB	202,002	3.29%	16.1
LOBO loans	5,000	4.27%	21.4
Other LA loans	75,000	1.06%	0.5
<b>Total borrowing</b>	<b>282,002</b>	<b>2.71%</b>	<b>12.1 years</b>

*PWLB – Public Works Loans Board*

*EIP – Equal Instalments of Principle repayment profile*

*LOBO – Lender Option, Borrower Option*

*LA – Local Authority*

### **Investments**

	£'000	Average interest	Days to final maturity
Money market funds	28,000	0.28%	1.0
DMO deposits	38,000	0.01%	12.5
Other LA deposits	25,000	0.86%	98.6
IWPF deposits	7,200	1.00%	191.0
<b>Total investments</b>	<b>98,200</b>	<b>0.38%</b>	<b>44.3 days</b>

*DMO – Debt Management Office*

*IWPF – Isle of Wight Council Pension Fund*

13. During the first three months of this financial year, the council renewed some of its short-term local authority loans in advance of their original maturity dates. This was to ensure that the council had sufficient funds available to mitigate the risk of significantly reduced income from operational activities, including parking, regulatory services and leisure centres.
14. While income in these areas has been significantly reduced, the council has also received grant funding from central government to cover business rate grant payments and other coronavirus-related activities, resulting in a significant amount of surplus cash in the period between receipt of the grant and payment out to beneficiaries.
15. The council regularly receives economic update information from Arlingclose Limited, including recommendations on suitable investment counterparties, and the recommended amount and duration of such deposits.

<sup>1</sup> Counterparty list: the list of those organisations to whom the council is approved to lend or deposit surplus cash balance

<sup>2</sup> Bail-in analysis: the extent that deposits (investments) in a bank/building society would be at risk should the bank/building society fail, and not be supported by “bail-in” funds from government. Arlingclose have examined the accounts of banks/building societies, and assessed each according to the risk to investors’ funds.

<sup>3</sup> duration advice up to 35 days: deposits should not be made where the notice period for the withdrawal of funds is greater than 35 days.

16. Based on the outcome of Arlingclose's bank stress tests, as detailed in paragraph 8 above, the council has removed all unsecured bank deposits from its investment portfolio and has restricted its investment counterparties to approved money market funds, local authorities and the central government Debt Management Office.
17. To ensure that operational cash flow is not compromised, the council has over two thirds of its surplus cash invested in deposits that can be accessed within two weeks.
18. The council does not believe that there is any need at this time to revise the investment and borrowing strategies set out in the approved treasury management strategy, nor to restrict the approved counterparties list contained therein.

## STRATEGIC CONTEXT

19. The treasury management strategy forms part of the council's overall budget strategy, specifically supporting the first outcome of the latest [Corporate Plan 2019-22](#) - a financially balanced and sustainable council.
20. The strategy specifically supports the council's capital programme and the medium-term financial strategy, ensuring the key priorities of the council are deliverable within the reduced resources available to the council.

## FINANCIAL / BUDGET IMPLICATIONS

21. There are no direct financial or budgetary implications arising from the review of the treasury management strategy and policy. However, the establishment of effective arrangements for the regular monitoring and review of the council's treasury management arrangements is a key part of the effective budget management of the council.
22. Even with the reduced interest rates compared to those forecast in the treasury management strategy and the budget for 2020-21, interest income for the financial year is currently expected to exceed the £0.16 million budget. Primarily this is due to higher than anticipated surplus cash balances.
23. Similarly, despite renewing some short term borrowing earlier than was perhaps required, the council anticipates savings will be returned against the interest payable budget of £9.65 million as lower interest rates mean that any new borrowing will be cheaper than forecast.

## LEGAL IMPLICATIONS

24. The Local Government Act 2003 and subsequent regulations require the council to set out its annual strategy with regard to both borrowing and the repayment of external debt. The act and subsequent regulations require the council to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes (the TM Code) and The Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

## EQUALITY AND DIVERSITY

25. The council, as a public body, is required to meet its statutory obligations under the Equality Act 2010 to have due regard to eliminate unlawful discrimination, promote

equal opportunities between people from different groups and to foster good relations between people who share a protected characteristic and people who do not share it. The protected characteristics are: age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation.

26. The treasury management strategy is not considered to have any impacts on the protected characteristics.

## RISK MANAGEMENT

27. Treasury management activities have a high level of risk in that they relate to transactions that can amount to several million pounds which are undertaken with external bodies. When the council has surplus monies to invest, there are risks if those organisations to whom it lends default on repayment. The costs to the council of its treasury management activities are dependent on fluctuating interest rates.
28. The overall strategy of borrowing short-term and avoiding long-term debt carries the risk that, if interest rates suddenly rise, when longer term debt is eventually required, it will cost more.
29. The council manages these risks by adopting a treasury management strategy which includes a statement of treasury management practice specifically relating to risk, covering the following risk areas:
- Credit and counterparty risk – who the council is permitted to lend to and borrow from and what instruments it can utilise.
  - Liquidity risk – ensuring that sufficient, but not excessive, funds are available when needed.
  - Interest rate risk – minimising the council's exposure to significant fluctuations in interest rates, both investment income and borrowing costs, by continually reviewing the instruments it uses.
  - Exchange rate risk – minimising the council's exposure to foreign exchange risk by restricting the exposure to foreign currency investments and overseas counterparties.
30. The committee's overview of the council's treasury management arrangements plays an important part in the council's overall governance regime. It has an important role to play in the monitoring of treasury management activities, including overview of the risks faced by this function both internally, which are directly controllable through segregation of duties and reporting arrangements, and externally, controllable through the monitoring of counterparties and lending limits, and also regular monitoring of general economic factors.

## RECOMMENDATION

31. That the committee note the update on the council's treasury management strategy in light of the broader economic situation.
32. That the committee note there are no amendments required at this time to the previously approved treasury management strategy statement 2020-21.

## BACKGROUND PAPERS

33. Audit Committee 16 March 2020, paper H: approval of treasury management strategy  
<https://www.iow.gov.uk/Meetings/committees/Audit%20Committee/16-3-20/PAPER-H.pdf>

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