TYNE & WEAR FIRE AND RESCUE AUTHORITY **Item 7**

GOVERNANCE COMMITTEE MEETING: 30th NOVEMBER 2020

SUBJECT: TREASURY MANAGEMENT – SECOND QUARTERLY REVIEW 2020/21

REPORT OF THE FINANCE DIRECTOR

1. Purpose of Report

1.1 The report sets out the Treasury Management performance for the second quarter of the financial year 2020/2021, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by the Authority.

2. Introduction

2.1 Sunderland City Council as Lead Authority performs the treasury management function on behalf of the Fire Authority and this report is therefore based on the Treasury Management data for Sunderland City Council, which also incorporates the investment and borrowing details of the Fire Authority.

3. Summary of Treasury Management Performance for 2020/2021 – Quarter 2

3.1 The Lead Authority's Treasury Management function continues to look at ways to maximise financial savings and increase investment return to the revenue budget, whilst maintaining a balanced risk approach. Public Works Loan Board (PWLB) rates have continued to be volatile, primarily in response to the economic impact of Covid-19 but they also reflect continued uncertainty over the outcome of Brexit negotiations.

3.2 As a result no new borrowing has been taken out to date by the Lead Authority during 2020/2021 but they continue to monitor the position closely. The Fire Authority was also not planning on taking out any new borrowing in this financial year.

3.3 One option to make savings is through debt re-scheduling, however no rescheduling has been undertaken in 2020/2021 as rates have not been considered sufficiently favourable. It should be noted the Authority's interest rate on borrowing is very low, currently 2.90%, and as such the Authority continues to benefit from this low cost of borrowing and from the ongoing savings from past debt rescheduling exercises. Based on advice from the Treasury Management advisor, performance continues to see the Authority's average borrowing rate compare very favourably to other authorities.

3.4 Treasury Management Prudential Indicators are regularly reviewed and the Authority is within all of the limits set for its Treasury Management Prudential Indicators for 2020/2021.

3.5 The investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions which will benefit the Authority.

3.6 The Authority has benefited from additional investment income in the first half of the year of over £100,000 in cash terms based on a higher rate of return in 2020/2021 of 0.73% compared to the benchmark 7-Day LIBID (London Interbank Bid) rate of -0.06% (set at 0.125% less than the corresponding 7-Day LIBOR rate, which due to the fall in gilts means the benchmark rate has become negative). Performance remains above the benchmark rate, whilst still adhering to the prudent policy agreed by the Authority.

3.7 As investments mature during the year, however, the rate of return on investments will reduce and over the whole of the financial year 2020/21 we are anticipating that income from interest receipts will be lower by £40,000 compared to that assumed in the revenue budget for the year, even though current investment performance remains very competitive. The government has recognised this position and has provided additional Covid19 grant funding to compensate the Authority for this in year loss.

3.8 Investment rates available in the market remain lower than those achieved in previous years primarily because of the impact of the drop in the Bank of England Base Rate to 0.10% in response to the covid19 pandemic. Interest rates are continuously monitored so that the Authority can take advantage of any increase in rates when they do occur, but these opportunities continue to be very limited.

3.9 More detailed Treasury Management information is included in Appendix A for information.

3.10 The regular updating of the Authority's Authorised Lending List is required to take into account all recent financial institution mergers and changes in institutions' and Sovereign credit ratings. The Lending List Criteria and Approved Lending List as shown in Appendices B and C respectively have been updated to reflect any changes since the last report to this Committee in August.

4. Recommendation

4.1 The Committee is requested to note the Treasury Management performance during the second quarter of 2020/2021.

4.2 Members are also requested to note the amended Lending List Criteria at Appendix B and the changes to the Approved Lending List at Appendix C.

Appendix A

Detailed Treasury Management Performance – Second Quarter 2020/2021

A1 Borrowing Strategy and Performance

A1.1 The Borrowing Strategy for 2020/2021 was approved by the Authority on 16th March 2020.

A1.2 The Borrowing Strategy is based upon interest rate forecasts from a wide cross section of City institutions. The view when the Treasury Management Policy and Strategy was drafted, prior to the global Covid-19 pandemic, was that the 0.75% Bank of England (BoE) Base Rate would remain unchanged until March 2021 where it was expected to rise by 0.25% to 1.00%, followed by a further projected 0.25% increase in June 2022. PWLB borrowing rates were also expected to rise, albeit gently, during 2020/2021 across all periods but it was recognised that they could be subject to exceptional levels of volatility due to continued uncertainty over the outcome of Brexit negotiations and other geopolitical developments throughout the world, which affect the financial markets.

A1.3 The UK's GDP data for Q3 reported record growth of 15.5% compared to the previous quarter as lockdown restrictions were lifted and demand was released into the economy. However, the Office for National Statistics (ONS) report that the economy is still 9.7% down in overall terms compared to the level at the end of 2019 and investment within the economy remains weak. With the second lockdown now underway and signs of recovery tailing off at the end of Q3 the outlook for Q4 is not as encouraging. Continued uncertainty over Brexit negotiations and whether an agreement can be reached by the end of the transition period on 31st December have done little to settle the financial markets, although recent Covid19 vaccine announcements have provided some optimism that the pandemic can be managed. The outcome of the US election and the position President-elect Joe Biden will take with the UK in future trade negotiations will become clearer in the coming months, but he has already indicated tackling Covid-19 and re-joining climate change talks as well as a number of other domestic issues will be his initial priorities.

A1.4 As expected, the BoE's November Monetary Policy Committee (MPC) meeting voted to leave the Base Rate unchanged at 0.10%, a record low. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December 2020 which will put back economic recovery and do further damage to the economy. The MPC also agreed a further tranche of Quantitative Easing of £150bn to start in January when the programme of £300bn announced in April – June runs out. Public borrowing is now likely to increase by about £30bn to around £420bn (21.7% of GDP) as a result of the new lockdown. The MPC reiterated recovery would take time and considerable challenges to the economy remain after the end of the second lockdown when tiered regional restrictions return to get on top of Covid-19 infection rates. Positive indications of an effective vaccine and the extension of furlough through the Government's Job Support Scheme to 31st March 2021 have bolstered the markets and will help limit the degree of further damage to the economy.

A1.5 The annualised CPI inflation rate rose from 0.2% in August to 0.5% in September. This was largely due to increased transport costs and rises within the restaurant/hospitality sector, following the end of the ‘Eat Out to Help Out’ scheme. The November MPC scaled down growth expectations for 2020 and 2021 with inflation expected to be slightly above its 2% target by the beginning of 2023. It does not believe there is any need to tighten monetary policy and any increase in the Base Rate is likely to be some years away given the underlying economic expectations.

A1.6 Investment rates are likely to remain at very low levels throughout 2020/2021. With short-term investment rates forecast to be materially below long-term borrowing rates, it is likely that some investment balances will temporarily be used to fund long-term borrowing requirements. Such funding is wholly dependent upon market conditions and will be reassessed if the appropriate conditions arise.

A1.7 Link Asset Services, the Authority’s treasury advisors, reviewed their interest rate forecasts in November in light of continued volatility in the financial markets caused by the Covid-19 pandemic and taking account of the second national lockdown from 5th November to 2nd December. They do not anticipate any change in the current BoE Base Rate of 0.10% within their forecast timeframe, which has been extended to March 2024. These forecasts, and MPC decisions, will be liable to further amendment as updated economic data becomes available should any emerging developments in the financial markets occur.

A1.8 The following table shows the average PWLB rates for Quarters 1 and 2.

2020/2021	**Qtr 1* (Apr - Jun) %**	**Qtr 2* (Jul – Sep) %**
7 days notice	-0.04	-0.07
1 year	1.84*	1.76*
5 year	1.85*	1.74*
10 year	2.07*	2.02*
25 year	2.50*	2.57*
50 year	2.26*	2.39*

*rates take account of the 0.2% discount to PWLB rates available to eligible authorities that came into effect on 1st November 2012.

A1.9 High levels of volatility in the financial markets have continued during 2020/2021. Uncertainty around the global rise in Covid-19 infection rates and the impact on world economies, the outcome of Brexit negotiations and tensions between China and the USA have led to gilt yields decreasing as investors moved from riskier assets such as shares into bonds. Investor cash flow uncertainties and the need to maintain liquidity in these unprecedented times has depressed short-term rates available to very low levels as a result.

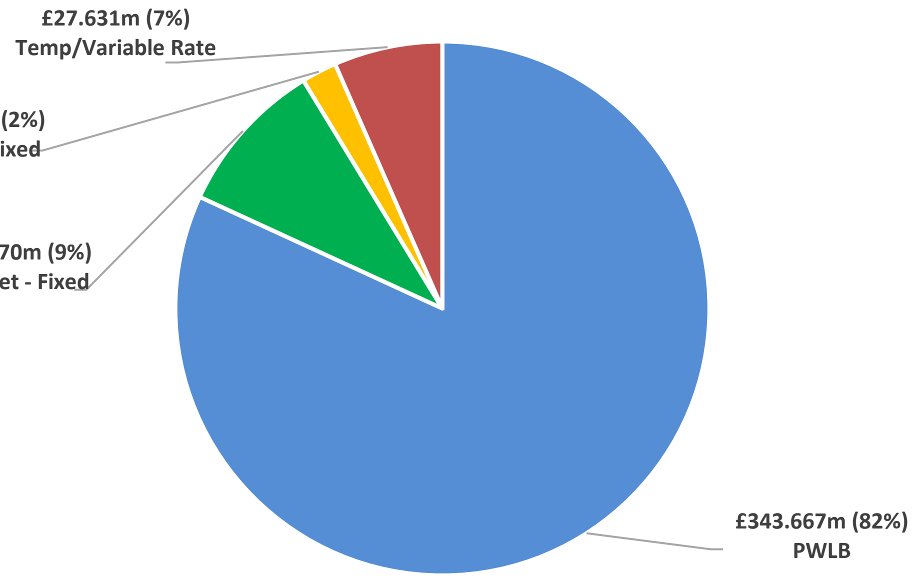
A1.10 Link Asset Services predict a gradual rise in PWLB rates reaching 1.80%, 2.10%, 2.50% and 2.30% for 5, 10, 25 and 50-year durations respectively by 31st March 2021 with further increases of 0.20% to 0.30% by March 2024. With so many external influences weighing on the UK economy, interest rate forecasting remains very difficult. From time to time, gilt yields, and consequently PWLB rates, can be subject to exceptional levels of volatility which could occur at any time during the forecast period. In addition, PWLB rates are subject to ad hoc decisions by the UK Government to change the margin over gilt yields charged in PWLB rates. The Treasury consultation on reviewing PWLB margins and lending ended on 31st July and it is expected the Certainty Rate will be revised downwards but the timing of the announcement and its implementation remain unclear.

A1.11 The strategy for 2020/2021 is to adopt a pragmatic and flexible approach in identifying the low points in the interest rate cycle at which to borrow, and to respond to any changing circumstances to seek to secure benefit for the Authority. A benchmark financing rate of 4.25% for long-term borrowing was set for 2020/2021 in light of the views prevalent at the time the Treasury Management policy was set in March 2020.

A1.12 Due to high levels of volatility in the financial markets, with borrowing rates forecast to remain low over the short-term, no new borrowing has been undertaken in the current financial year to 30th September 2020. The Treasury Management team continues to closely monitor PWLB rates to assess the value of possible further new borrowing in line with future capital programme requirements.

A1.13 The Lead Authority's borrowing portfolio position as at 30th September 2020 is set out below, (which includes the Authority's loan debt of £11.695m):

Borrowing Summary at:	**30 September 2020**	
	Principal	**Ave rate %**
Fixed		
PWLB	343,666,667	2.97
Market - Fixed	39,570,383	4.41
Other - Fixed	8,954,092	0.02
	392,191,142	3.05
Variable		
Temporary/Other - Variable	27,630,855	0.72
	27,630,855	0.72
TOTAL:	**419,821,997**	**2.90**



A2 Treasury Management Prudential Indicators – 2020/2021

A2.1 All external borrowing and investments undertaken in 2020/2021 have been subject to the monitoring requirements of the Prudential Code. Under the Code, Authorities must set borrowing limits (Authorised Borrowing Limit for External Debt and Operational Boundary for External Debt) and must also report on the Authority's performance for all of the other Treasury Management Prudential Indicators.

A2.2 The statutory limit under section 3(1) of the Local Government Act 2003 (which is also known as the Authorised Borrowing Limit for External Debt) was set by the Authority for 2020/2021 as follows:

	£m
Borrowing	32.183
Other Long-Term Liabilities	17.067
Total	**49.250**

The Operational Boundary for External Debt was set as shown below:-

	£m
Borrowing	27.183
Other Long-Term Liabilities	17.067
Total	**44.250**

A2.3 Both the Authorised Limit and the Operational Limit include an element for long-term liabilities relating to PFI schemes and finance leases. These have been brought onto the Authority's Balance Sheet in compliance with International Financial Reporting Standards (IFRS).

A2.4 The Authority's maximum external debt in respect of 2020/2021 (to 30th September 2020) was £37.543 million and is within the limits set by both of these indicators.

A2.5 The table below shows that all other Treasury Management Prudential Indicators set by the Lead Authority, (which includes the Authority's data), have been complied with:

Prudential Indicators		2020/2021 (to 30th Sept 2020)	
		Limit £'000	**Actual £'000**
P9	**Maturity Pattern**	Upper Limit	
	Under 12 months	50%	7.94%
	12 months and within 24 months	60%	1.79%
	24 months and within 5 years	80%	2.38%
	5 years plus	100%	87.97%
	A lower limit of 0% for all periods		
P10	**Upper limit for total principal sums invested for over 365 days**	75,000	0

A3 Investment Strategy – 2020/2021

A3.1 The Investment Strategy for 2020/2021 was also approved by the Authority on 16th March 2020. The general policy objective for the Authority is the prudent investment of its treasury balances. The Authority's investment priorities in order of importance are:

a) The **security** of capital;
b) The **liquidity** of its investments and then;
c) The Authority aims to achieve the **optimum yield** on its investments but this is commensurate with the proper levels of security and liquidity.

A3.2 As at 30th September 2020, funds managed by the Lead Authority's in-house team on behalf of the Authority amounted to £27.514 million and all investments complied with the approved Annual Investment Strategy.

A3.3 The following table shows the return received on these investments compared with the benchmark 7-Day LIBID (London Interbank Bid) rate, which the Authority uses to assess its performance. Importantly it is anticipated that investment returns will fall during the second half of 2020/21.

	2020/2021 Return %	**2020/2021 Benchmark %**
Return on investments (to 30th September 2020)	0.727	-0.056*

* the 7-Day LIBID rate is set at 0.125% less than the corresponding 7-Day LIBOR rate, which due to the fall in gilts means the benchmark rate has become negative.

A3.4 Investments placed in 2020/2021 have been made in accordance with the approved Investment Strategy and comply with the Counterparty Criteria in place, shown in Appendix B, which is used to identify organisations on the Approved Lending List.

A3.5 Investment rates available in the market remain at lower compared to previous years and reflect the fall in the BoE Base Rate from 0.75% to 0.25% on 11th March 2020 and then to an historic low of 0.10% on 19th March 2020.

A3.6 Due to the volatility in the financial markets resulting from Covid-19 the Authority has followed advice from its Treasury Management advisers and has operated a more risk averse strategy by placing more funds in shorter dated liquid investments.

A3.7 Advice also continues that the above guidance is not applicable to institutions considered to be very low risk, mainly where the government holds shares in these organisations (i.e. RBS) and therefore have the UK Government rating applied to them, or separately in respect of Money Market Funds which are AAA rated.

A3.8 The regular updating of the Authorised Lending List is required to take into account financial institution mergers and changes in institutions' credit ratings. The Approved Lending List is shown in Appendix C with all changes indicated in bold where these have changed since the last Treasury Management report.

Lending List Criteria **Appendix B**

Counterparty Criteria

The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisers.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

Fitch / S&P's Long Term Rating	Fitch Short Term Rating	S&P's Short Term Rating	Moody's Long Term Rating	Moody's Short Term Rating	Maximum Deposit £m	Maximum Duration
AAA	F1+	A1+	Aaa	P-1	120	2 Years
AA+	F1+	A1+	Aa1	P-1	100	2 Years
AA	F1+	A1+	Aa2	P-1	80	2 Years
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	75	2 Years
A+	F1	A-1	A1	P-1	70	365 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	65	365 days
A-	F1 / F2	A-2	A3	P-1 / P-2	50	365 days
Local Authorities (limit for each local authority)					30	2 years
UK Government (including debt management office, gilts and treasury bills)					300	2 years
Money Market Funds (CNAV, LVNAV and VNAV) Maximum amount to be invested in Money Market Funds is £120m with a maximum of £50m in any one fund.					120	Liquid Deposits
Local Authority controlled companies					40	20 years

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AA- will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of 2 years.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above; these new limits are as follows:

Appendix B (continued)

Country Limit
It is proposed that only non-UK countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £50m which can be invested in other countries provided they meet the above criteria. A separate limit of £300m will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

Country	**Limit £m**
UK	300
Non-UK	50

Sector Limit
The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below:

Sector	**Limit £m**
Central Government	300
Local Government	300
UK Banks	300
Money Market Funds	120
UK Building Societies	100
Foreign Banks	50

Group Limit
Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the UK continues to have a sovereign credit rating of AA-; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix C.

Approved Lending List **Appendix C**

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
UK	**AA-**	-	**Aa3**	-	AA	-	300	
Lloyds Banking Group							Group Limit 70	
Lloyds Bank Plc (RFB)	A+	F1	**A1**	P-1	A+	A-1	70	2 years
Lloyds Bank Corporate Markets plc (NRFB)	A+	F1	A1	P-1	A	A-1	65	2 years
Bank of Scotland Plc (RFB)	A+	F1	**A1**	P-1	A+	A-1	70	2 years
Royal Bank of Scotland Group (See Note 1)							Group Limit 75	
The Royal Bank of Scotland Plc (RFB)	A+	F1	A1	P-1	A	A-1	75	2 years
National Westminster Bank Plc (RFB)	A+	F1	A1	P-1	A	A-1	75	2 years
NatWest Markets plc (NRFB)	A+	F1	Baa2	P-2	A-	A-2	75	2 years
Santander UK plc	A+	F1	**A1**	P-1	A	A-1	65	365 days
Barclays Bank plc (NRFB)	A+	F1	A1	P-1	A	A-1	65	365 days
Barclays Bank plc (RFB)	A+	F1	A1	P-1	A	A-1	65	365 days
Clydesdale Bank *	A-	F2	Baa1	P-2	BBB+	A-2	0	
Co-Operative Bank Plc	B-	B	B3	NP	-	-	0	
Goldman Sachs International Bank	**A+**	F1	A1	P-1	A+	A-1	**70**	365 days
HSBC Bank plc (NRFB)	AA-	F1+	**A1**	P-1	A+	A-1	70	365 days
HSBC UK Bank plc (RFB)	AA-	F1+	Aa3	P-1	A+	A-1	70	365 days
Nationwide BS	A	F1	A1	P-1	A	A-1	65	365 days
Standard Chartered Bank	A+	F1	A1	P-1	A	A-1	65	365 days
Top Building Societies (by asset value)								
Nationwide BS (see above)								
Coventry BS	A-	F1	A2	P-1	-	-	50	365 days
Leeds BS	A-	F1	A3	P-2	-	-	50	365 days

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Nottingham BS **	-	-	Baa2	P-2	-	-	0	
Principality BS **	BBB+	F2	Baa2	P-2	-	-	0	
Skipton BS **	A-	F1	Baa1	P-2	-	-	0	
West Bromwich BS **	-	-	Ba3	NP	-	-	0	
Yorkshire BS **	A-	F1	A3	P-2	-	-	50	365 days
Money Market Funds							120	Liquid
Prime Rate Stirling Liquidity	AAA				AAA		50	Liquid
Insight Liquidity Fund	AAA		-		AAA		50	Liquid
Aberdeen Liquidity Fund (Lux)	AAA		AAA		AAA		50	Liquid
Deutsche Managed Sterling Fund	AAA		Aaa		AAA		50	Liquid
Foreign Banks have a combined total limit of £50m								
Australia	AAA		Aaa		AAA		50	
Australia and New Zealand Banking Group Ltd	A+	F1	Aa3	P-1	AA-	A-1+	50	365 days
Commonwealth Bank of Australia	A+	F1	Aa3	P-1	AA-	A-1+	50	365 days
National Australia Bank	A+	F1	Aa3	P-1	AA-	A-1+	50	365 days
Westpac Banking Corporation	A+	F1	Aa3	P-1	AA-	A-1+	50	365 days
Canada	AA+		Aaa		AAA		50	
Bank of Nova Scotia	AA-	F1+	Aa2	P-1	A+	A-1	50	365 days
Royal Bank of Canada	AA	F1+	Aa2	P-1	AA-	A-1+	50	2 years
Toronto Dominion Bank	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
Denmark	AAA		Aaa		AAA		50	
Danske A/S	A	F1	A2	P-1	A	A-1	50	365 days
Finland	AA+		Aa1		AA+		50	
OP Corporate Bank plc	WD	WD	Aa3	P-1	AA-	A-1+	50	2 years
Germany	AAA		Aaa		AAA		50	
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
Landwirtschaftliche Rentenbank	AAA	F1+	Aaa	P-1	AAA	A-1+	50	2 years
NRW Bank	AAA	F1+	Aa1	P-1	AA	A-1+	50	2 years
Netherlands	AAA		Aaa		AAA		50	

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Bank Nederlandse Gemeenten	AAA	F1+	Aaa	P-1	AAA	A-1+	50	2 years
Cooperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank Nederland)	**A+**	**F1**	Aa3	P-1	A+	A-1	50	365 days
Nederlandse Waterschapsbank N.V	-	-	Aaa	P-1	AAA	A-1+	50	2 years
Singapore	AAA		Aaa		AAA		50	
DBS Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
Oversea Chinese Banking Corporation Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
United Overseas Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
Sweden	AAA		Aaa		AAA		50	
Svenska Handelsbanken AB	AA	F1+	Aa2	P-1	AA-	A-1+	50	2 years
Switzerland	AAA		Aaa		AAA		50	
Credit Suisse AG	A	F1	A1	P-1	A+	A-1	50	365 days
UBS AG	AA-	F1+	Aa2	P-1	A+	A-1	50	365 days
USA	AAA		Aaa		AA+		50	
Bank of New York Mellon	AA	F1+	Aa1	P-1	AA-	A-1+	50	2 years
JP Morgan Chase Bank NA	AA	F1+	Aa1	P-1	A+	A-1	50	365 days
Wells Fargo Bank NA	AA-	F1+	Aa1	P-1	A+	A-1	50	365 days

Notes

Note 1 **Nationalised / Part Nationalised**
The counterparties in this section will have the UK Government's AA- rating applied to them thus giving them a credit limit of £75m.

* The Clydesdale Bank (under the UK section) is owned by National Australia Bank

** These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the Prudential Regulation Authority (PRA) is classed as a UK bank for the purposes of the Approved Lending List.