REPORT REFERENCE NO.	**RC/20/12**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**12 OCTOBER 2020**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2020-21 – QUARTER 1**
LEAD OFFICER	**DIRECTOR OF FINANCE & RESOURCING (TREASURER)**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2020-21 (to June 2020) be noted.***
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a Code of Practice for Treasury Management. The Code suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Authority is embracing Best Practice in accordance with CIPFA's Code of Practice.
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Investments held as at 30 June 2020.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) as approved at the meeting of the Fire & Rescue Authority held on the 18 February 2020 – Minute DSFRA/38c refers.

1. INTRODUCTION

1.1 The Treasury Management Strategy for Devon and Somerset Fire & Rescue Authority has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in Public Services Code of Practice (the Code) and the CIPFA Prudential Code. The Code recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report, therefore, ensures this Authority is implementing best practice in accordance with the Code and includes:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities;
- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives;
- The receipt by the full Authority of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year;
- The delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

> "The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

1.3 The preparation of this report demonstrates that the Authority is implementing best practice in accordance with the code.

2. ECONOMIC BACKGROUND

2.1 **UK.** Economic growth 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December 2019 which settled the Brexit issue. However, the three monthly Gross Domestic Product (GDP) statistics in January 2020 were disappointing, being stuck at 0.0% growth.

2.2 Since then, the whole world has changed as a result of the coronavirus outbreak. The overall growth rate in quarter 1 of 2020-21 was -2.2%, -1.7% y/y. However, the main fall in growth did not occur until April 2020 when it came in at -24.5% y/y after the closedown of whole sections of the economy. The position is still unclear, however, on:

- the extent of the damage that will have been caused to businesses by the end of the lockdown period;
- how consumer confidence and behaviour may be impacted afterwards;

- whether there could be a second wave of the outbreak; and
- how soon a vaccine will be created and then how quickly it can be administered to the population.

2.3. This leaves huge uncertainties as to how quickly the economy will recover to what was formerly regarded as normality. However, some changes during lockdown are likely to be long lasting e.g. a shift to online purchasing, working from home, etc. The lockdown has also had a sharp effect in depressing expenditure by consumers which means their level of savings have increased and debt has fallen. This could provide fuel for a potential surge in consumer expenditure once some degree of normality returns.

2.4. Although the UK left the European Union (EU) on 31 January 2020, there is still much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020. At the end of June 2020, the UK government rejected extending the transition period beyond 31 December 2020. This has increased the chances of a no-deal Brexit. However, the most likely outcome is expected to be a slim deal on trade in order to minimise as much disruption as possible. However, uncertainty is likely to prevail until the deadline date which will act as a drag on recovery.

2.5 After the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% in January 2020, the onset of the coronavirus epidemic in March 2020 forced it into making two emergency cuts in Bank Rate - first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. In June 2020, the MPC decided to add a further £100bn of QE purchases of gilts, but to be implemented over an extended period to the end of the year. The total stock of QE purchases will then amount to £745bn. It is not currently thought likely that the MPC would go as far as to cut Bank Rate into negative territory, although the Governor of the Bank of England has said all policy measures will be considered. The Governor also recently commented about an eventual tightening in monetary policy – namely that he favours unwinding QE before raising interest rates. Some forecasters think this could be as far away as five years.

2.6. The Government and the Bank were also very concerned to stop people losing their jobs during this lockdown period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months to the end of June 2020 while the country was locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lockdown period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. The furlough scheme was subsequently extended for another three months to October 2020, but with employers having to take on graduated increases in paying for employees during that period. The Bank of England expects the unemployment rate to double to 8%.

2.7. The Government measures to support jobs and businesses will result in a huge increase in the annual budget deficit for the current year, from about 2% to nearly 17%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March 2020, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lockdown is ended. Economic statistics during June 2020 were giving a preliminary indication that the economy was recovering faster than previously expected. However, it may be a considerable time before economic activity recovers fully to its previous level.

2.8. **Inflation.** The annual inflation rate dropped to 0.5% in May 2020 from 0.8% in April 2020 and could reach zero by the end of the year. Inflation rising over 2% is unlikely to be an issue for the MPC over the next two years as the world economy will be heading into a recession. This has caused a glut in the supply of oil which initially fell sharply in price, although the price has recovered somewhat more recently. Other UK domestic prices will also be under downward pressure; wage inflation was already on a downward path over the last half year and is likely to continue that trend in the current environment where unemployment will be rising significantly. In May's Monetary Policy Report, the Bank of England predicted that inflation would hit their 2% target by 2022. This was in the context of its forecast that GDP would rise by 3% in 2022 after a recovery during 2021. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

2.9. **USA.** Growth in quarter 1 of 2020 fell by an annualised 5.0% and will fall sharply in quarter 2. Once coronavirus started to impact the US in a big way, the Federal Bank (Fed) took decisive action by cutting rates twice by 0.50%, and then 1.00% in March 2020, all the way down to 0.00 – 0.25%. Near the end of March 2020, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

2.10 The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost $367bn and 100% of the cost of lost wages for four months will also be covered. In addition there was $500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

2.11 Non-farm payrolls unexpectedly increased by 2.5 million jobs in May 2020, beating market expectations of an 8 million fall, and after declining by a record 20.7 million in April. The figures suggest that the economic recovery in the US may happen much faster than initially expected. Some states started reopening in mid-May after a two-month shutdown but a few have had to re-impose localised lockdowns since then.

2.12. **EUROZONE.** The Eurozone economy shrank by 3.6% on quarter in the first three months of 2020. So far, the European Central Bank (ECB) has been by far the most important institution in helping to contain the impact of coronavirus and the crisis on financial markets. Since 12 March 2020, it has implemented a range of new policies including providing additional cheap loans for commercial banks and easing capital requirements for the banking sector. Most importantly, the ECB has stepped up and reformed its asset purchase programmes. So far, it has increased its planned asset purchases for this year by €1,470bn on top of the €20bn per month which it was already committed to. The new purchases consist of an additional €120bn within the existing Public Sector Purchase Programme (PSPP), and €1,350bn in the Pandemic Emergency Purchase Programme (PEPP).

2.13. At its 4 June 2020 monetary policy meeting, the ECB Governing Council also committed to continue net asset purchases under the PEPP until at least the end of June 2021 and to continue to reinvest maturing principal payments under the PEPP until at least end-2022. It has also made clear that it would not hesitate to top up PEPP as much as needed to contain the risk of a crisis. Just as important as the size of the PEPP is its flexibility. Whereas previous asset purchase programmes adhered to strict issuer limits, the PEPP was designed to be flexible across "time, asset classes and jurisdictions".

2.14. This means that the ECB can act in the interests of the euro-zone as a whole rather than having to treat each national bond market equally. However, while this overall programme will provide protection over the next year or so, some vulnerable countries, particularly Italy, already started the crisis with a high level of debt to GDP and the crisis will make that level even worse at the same time as GDP growth prospects will have worsened. This leaves a big question over 'what happens after then when financial markets will be concerned that those debt levels are unsustainable?' What is currently missing is a major coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure. The EU's recently-proposed rescue fund, (officially designated "Next Generation EU"), is a major first step towards financial integration in the EU. However, it is striking just how small this package is as the proposed €500 billion of grants amount to about 0.6% of average annual euro-zone GDP (over the seven-year budget period). It will therefore supply relatively little support to the weaker and more vulnerable countries within the EU. This has therefore left individual national governments to implement a patchwork of support measures within each country. This shows up how far away the EU is from being an effective fiscal union.

2.15. **CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lockdown of the country and a major contraction of economic activity in February-March 2020. The Chinese economy shrank 6.8% y/y in Q1 2020, following 6% y/y growth in Q4 of 2019. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems. The post Covid government measures to stimulate more infrastructure investment are likely to result in an increase in inefficient low reward investment.

2.16 **JAPAN** has been struggling to stimulate consistent significant GDP growth for years and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. Japan appears to have escaped the worst effects of the virus - as yet.

2.17 **WORLD GROWTH.** The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019. This year, coronavirus is the inevitable big issue which is going to sweep around most countries in the world and have a major impact in causing a world recession in growth in 2020.

Interest Rate Forecasts

2.18. The Authority's treasury advisor, Link Asset Services, has provided the following forecast (as set out overleaf):

Link Asset Services Interest Rate View								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

2.19. Uncertainty over Brexit caused the MPC to leave Bank Rate unchanged during 2019 and at its January 2020 meeting. However, since then the coronavirus outbreak has transformed the economic landscape: in March, the MPC took emergency action twice to cut Bank Rate first to 0.25%, and then to 0.10%. It is now unlikely to rise for the next two years pending a protracted recovery of the economy from this huge set back.

2.20. Their central assumption is that there will be some form of muddle through agreement on a reasonable form of Brexit trade deal but the coronavirus outbreak could affect the timing of reaching a deal. As there is so much uncertainty around the impact of, and pace of recovery from this outbreak, the above forecasts currently only cover two years, not three as provided in the past.

3. TREASURY MANAGEMENT STRATEGY STATEMENT

ANNUAL INVESTMENT STRATEGY

3.1 The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement (TMSS) was approved by the Authority on the 18 February 2020. It outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity
- Yield

3.2 The Authority will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep a significant proportion of investments short term. This will not only cover short term cash flow needs but will also seek out value available in significantly higher rates in periods up to 12 months with highly credit rated financial institutions using the Link suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Link.

3.3 Creditworthiness.

Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during this quarter, 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. Although CDS prices, (these are market indicators of credit risk), for UK banks spiked upwards at the end of March due to the liquidity crisis throughout financial markets, those CDS prices have returned to more average levels since then.

3.4 A full list of investments held as at 30 June 2020 are shown in Appendix A.

3.5 The average level of funds available for investment purposes during the quarter was £42.117m (£39.886m at the end of 2019/20). These funds were available on a temporary basis and the level of funds was dependent on the level of reserves, timing of precept payments, receipt of grants and progress on the Capital Programme.

Benchmark	Benchmark Return	Authority Performance	Investment interest to Quarter 1
3 Month LIBID	0.26%	0.85%	£0.063m.

3.6 As illustrated overleaf, the Authority outperformed the 3 month LIBID benchmark by 0.59bp. It is currently anticipated that the actual investment return for the whole of 2020-21 will surpass the Authority's budgeted investment target of £0.201m by £0.071m. However, there is much economic uncertainty and low interest rates at the moment so this forecast is likely to be revised down.

BORROWING STRATEGY

Prudential Indicators:

3.7 It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's' approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

3.8 A full list of the approved limits (as amended) are included in the Financial Performance Report 2020-21, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to June 2020 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

3.9 The Authority has not taken any external loans since June 2012 and has been using cash resources to meet any capital expenditure. The amount of outstanding external borrowing as at 30 June 2020 was £25.444m, forecast to reduce to £24.851m by the end of the financial year as a result of standard loan repayments. All of this debt is at fixed rate with the remaining principal having an average rate of 4.21% and average life of 25 years.

Loan Rescheduling

3.10 No debt rescheduling was undertaken during the quarter. The Authority will continue to work closely with our treasury advisors to explore any opportunities to repay existing loans, however current Public Works Loan Board early repayment rates mean there is no financial benefit in undertaking premature loan repayment at this time.

New Borrowing

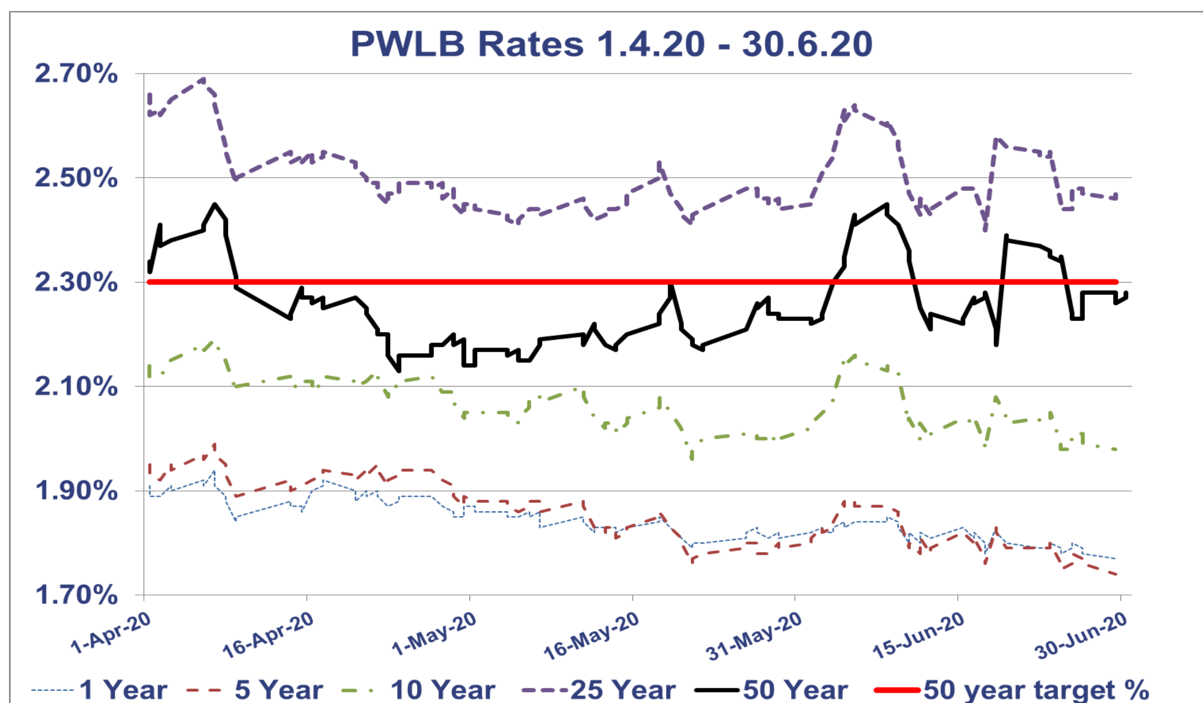
3.11 PWLB rates have not been on any consistent trend in this quarter. During the quarter, the 50 year PWLB target (certainty) rate for new long term borrowing was marginally reduced to 2.16%.

3.12 No new borrowing was undertaken during the quarter and none is planned during 2020-21 as a result of the Authority's adopted financial strategy to utilise revenue funds (revenue budget and reserves) to finance capital investment needs for the medium term.

PWLB rates quarter ended 30 June 2020

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.77%	1.74%	1.96%	2.40%	2.13%
Date	30/06/2020	30/06/2020	22/05/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.69%	2.45%
Date	08/04/2020	08/04/2020	08/04/2020	07/04/2020	07/04/2020
Average	1.84%	1.85%	2.07%	2.50%	2.26%

3.13 Borrowing rates for this quarter are shown below.



Borrowing in Advance of Need

3.14 The Authority has not borrowed in advance of need during this quarter.

4. SUMMARY AND RECOMMENDATION

4.1 In compliance with the requirements of the Chartered Institute of Public Finance and Accountancy Code of Practice of Treasury Management, this report provides the Committee with the first quarter report on treasury management activities for 2020-21 to June 2020. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken so far, with priority being given to liquidity and security over yield. Whilst investment returns are recovering as a result of the increase in interest rates, the Authority is still anticipating that investment returns will meet the budgeted target, as rates were forecast to rise when the budget was set.

AMY WEBB
Director of Finance & Resourcing (Treasurer)

APPENDIX A TO REPORT RC/20/12

Investments as at 30 June 2020					
Counterparty	**Maximum to be invested**	**Amount Invested**	**Call or Term**	**Period invested**	**Interest rate(s)**
	£m	£m			
Goldman Sachs	7.000	2.000	T	12 mths	0.96%
Bank of Scotland	7.000	5.000	T	12 mths	1.25%
Mid & East Antrim Borough Council	8.000	1.500	T	12 mths	0.90%
London Borough of Enfield	7.000	5.000	T	12 mths	0.90%
Standard Chartered Bank	7.000	4.000	T	6 mths	1.06%
Blackpool Borough Council	7.000	5.000	T	6 mths	0.80%
Belfast City Council	7.000	5.000	T	10 mths	0.90%
Aberdeen Standard	7.000	6.000	C	Instant Access	Variable
Black Rock	7.000	5.000	C	Instant Access	Variable
Barclays Bank	7.000	0.001	C	Instant Access	Variable
Total Amount Invested		**38.501**			