Agenda Item No: 8

Treasury Management Report – Quarter Two Update 2020-21

To:	General Purposes Committee
Meeting Date:	24 November 2020
From:	Chief Finance Officer
Electoral division(s):	All
Forward Plan ref:	Not applicable
Key decision:	No
Outcome:	To provide the quarterly update on the Treasury Management Strategy 2020/21, approved by Council in February 2020.
Recommendation:	The General Purposes Committee is recommended to note the Treasury Management Quarter Two Report for 2020/21 and forward to Full Council to note.

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1. Background

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly (annual, mid-year or quarterly reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

2. Economic Climate Summary

2.1 A current economic commentary is located in Appendix 1, which has been provided by Link Asset Services, the Council's treasury management advisers.

2.2 The Bank of England's Monetary Policy Committee kept the Bank Rate unchanged on 6th August (and subsequently 16th September).

2.3 The fall in GDP in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.

2.4 Cuts in interest rate by the Bank of England earlier in the year were accompanied by an increase in quantitative easing (QE): the purchasing of gilts (mainly) by the Bank of England of £200bn.

2.5 The annual inflation rate in the UK jumped to 1% in July 2020 from 0.6% in June. It is the highest reading since March, as the restrictions caused by the coronavirus pandemic were eased. However, in August's Monetary Policy Report, the Bank of England forecast that inflation is expected to fall further below the 2% target over the rest of 2020, as the cuts in VAT, reductions in headline wages, increases in unemployment weigh on costs.

2.6 It is forecast that the last three months of 2020 are now likely to show no growth as consumers will likely remain cautious on spending and the uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind.

3. Interest Rate Forecast

3.1 The latest forecast for UK Bank Rate along with Public Works Loan Board (PWLB) borrowing rates (certainty rate) from the Council's treasury advisors is set out in Table 1 overleaf.

3.2 Table 1 shows there is likely to be little upward movement in PWLB rates over the next two years as it will take economies a prolonged period to recover all the momentum they will lose in the sharp recession seen this year. Inflation is also likely to be low, at least initially, during this period.

Table 1 Interest Rate Forecast (%) Aug 11, 2020

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

The above table is based on PWLB certainty rates – gilt yields plus 180bps.

Gilt Yields / PWLB Rates

3.3 Gilt yields had, therefore, already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields initially spiked upwards in March, we have seen yields fall sharply in response to major western central banks taking rapid policy action to deal with excessive stress in financial markets during March, and starting massive quantitative easing driven purchases of government bonds: these actions also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds.

3.4 At the close of business on 30th September, all gilt yields from 1 to 6 years were in negative territory, 25-year yields were only at 0.76% and the 50 years at 0.60%.

3.5 There was a consultation with local authorities on possibly further amending PWLB margins running to 31st July. To date, the outcomes of the consultation have yet to be announced but it is clear that HM Treasury are intending to use policy levers through PWLB lending to (at least) dissuade local authorities from investment in commercial property and other assets with the sole focus of generating a yield.

3.6 Following the changes on 11 March 2020 in margins over gilt yields, the current situation for Cambridgeshire County Council is as follows: -

- PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

Whilst the 180bps margin remains in place, the PWLB is an expensive source of borrowing. The County Council has made representations that the outcome of the HM Treasury consultation should be announced as soon as possible.

3.7 As the interest forecast table for PWLB certainty rates (gilts plus 180bps) above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period.

4. Summary Net Borrowing Position

4.1. At the end of September 2020, investments held totalled £95.3m (excluding 3rd party loans) and gross borrowing totalled £772.6m, equating to a net borrowing position of £676.9m. The actual net borrowing excluding 3rd party loans is included in the table below.

4.2 Further analysis on borrowing and investment is set out in the next two sections. A snapshot of the Council's debt and investment position is shown in the table below.

Table 2 Net Borrowing Q2

	Actual as at 31 Jul 2020	Actual as at 31 Aug 2020	Actual as at 30 Sept 2020
	£m	£m	£m
Long term Borrowing (>12mth)	621.8	621.8	630.6
Short term Borrowing (<12mth)	162.0	132.0	142.0
Total Borrowings	783.8	753.8	772.6
Treasury Investment	143.9	80.0	95.3
TOTAL Net Debt/Borrowings	639.9	673.8	677.3

5. Investments

5.1 The Treasury Management Strategy Statement (TMSS) for 2020/21, includes the Annual Investment Strategy for financial assets, was approved by Council in February 2020. It sets out the Council's investment priorities as being:

1. Security of Capital;
2. Liquidity; and then
3. Yield

5.2 The Council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity.

5.3 At 30th September 2020 the Council's investment balances totalled £95.3m; the balance is split between Money Market Funds, Call/Notice accounts and CCLA and Allianz collective investment funds (see below). The balance excludes Third Party Loans and Share Capital.

5.4 Property Fund Update:
The County Council invests in the Local Authorities Property Fund, managed by CCLA. The trustee is the Local Authority Mutual Investment Trust. Improved pricing stability and a modest increase in transactions volumes allowed the moratorium in dealing in the Fund's units to be lifted and dealings resumed from the September.

Capital values remained flat overall, but the position was not uniform across the sector. Once more retail asset values fell but there was improvement in parts of the office sector and retail assets continued to enjoy broad support. There were no acquisitions or disposals in the quarter, but it was a busy time for lease management activity. There were four substantial renewals completed, the success of which reflected the demand for the Fund's high quality assets in the industrials sector. Overall, the new agreements added £1m to overall income and also reduced the void rate, down to 8.5% including development voids of 2.9%. This compares to an industry average closer to 15%.

Conditions in the sector remain challenging. Recent signs of improved stability have been encouraging and whilst it is important to avoid premature optimism, there are grounds for expecting a more positive environment in the coming year.

5.5 Multi-Class Credit Fund:
During the quarter the Council invested £14.5m in Allianz multi-asset credit fund, following recommendation by our investment advisor and the Commercial & Investment Committee. During the first month invested, Allianz deployed funds from cash towards asset-backed, banking, telecoms, energy, and utilities.

- September was a negative month for credit.
  - The portfolio was down slightly.
  - Allianz deployed capital out of treasuries into a number of new names across corporates.
  - Credit looks reasonably priced with emerging markets looking attractive

Figure 3: CCC Investments allocation by Counterparty

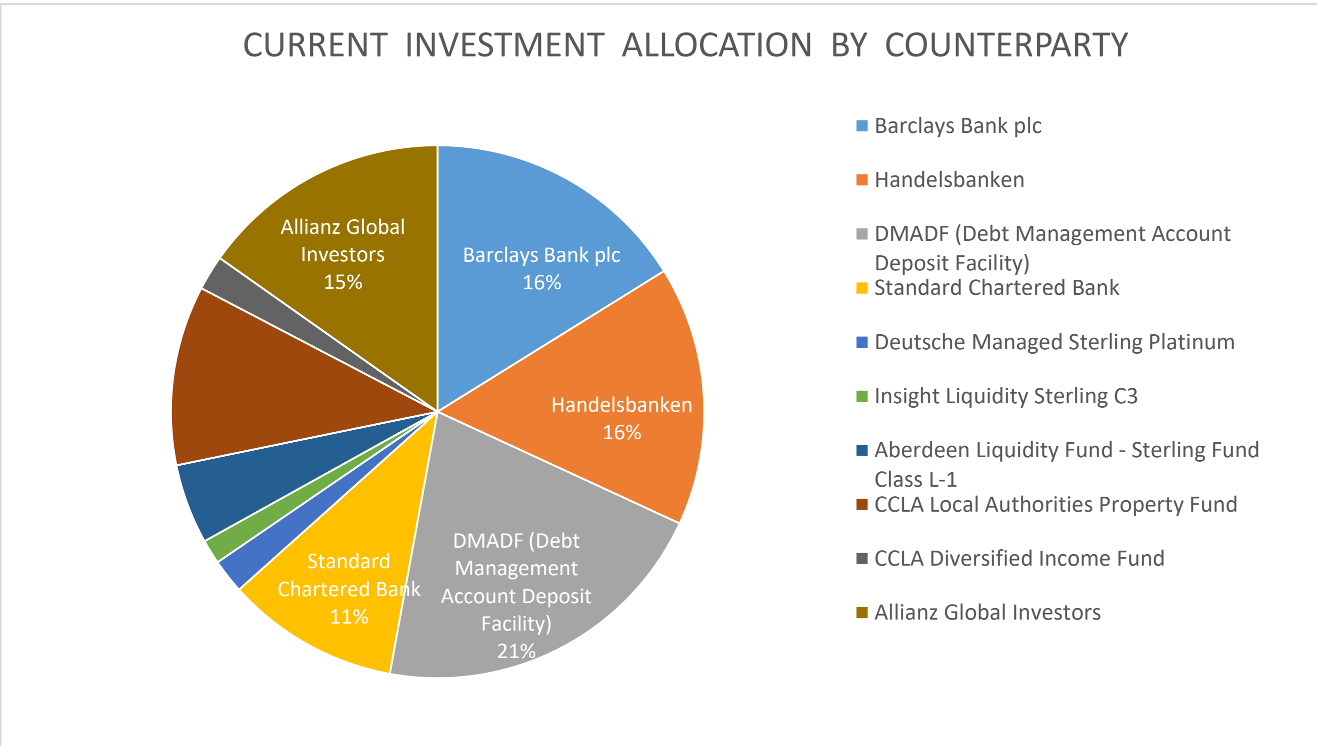


Table 3 below summarises the maturity profile of the Council's investment portfolio at the end of Q2 2019/20 (excluding Third Party Loans):

Table 3 - Investment maturity profile at end of Q2 2020/21

Product	Access Type	Maturity Period					
		0d	0-3m	3-6m	~5yrs	Total	
		£m	£m	£m	£m	£m	%
Money Market Funds	Same-Day	8.0				**8.0**	***8.4***
Bank Call Account	Instant Access	40.4				**40.4**	***42.4***
Certificate of Deposits	Fixed Term / Tradeable		0.00	20.0		**20.0**	***21.0***
Pooled Property Fund	Redemption Period Applies				10.4	**10.4**	***10.9***
Pooled Diversified Income Fund	Redemption – two days				2.0	**2.0**	***2.1***
Pooled Multi-class credit Fund	Redemption Period Applies				14.5	**14.5**	***15.2***
	Total	**48.4**	**0.00**	**20.0**	**26.9**	**95.3**	***100.0***
	%	***51.0***	***0.00***	***21.0***	***28.0***	***100.0***	

5.6 Set out below are details of the amounts outstanding on loans and share capital investments classed as capital expenditure advanced to third party (non-subsidiary) organisations at the end of Q2:

Table 4 Third Party Loans

Loan Counterparty	Original Amount (£m)	Amount Outstanding (£m)	Repayment Year
Arthur Rank Hospice Charity	4.000	3.520	2042/43
Estover Playing Field 2015 CIC (Guaranteed by March Town Council)	0.350	0.249	2024/25
Wisbech Town Council	0.150	0.150	2043/44
VIVA Arts & Community Group	0.300	0.296	2043/44
Total Third Party Loans	**4.800**	**4.215**	

5.7 Investment balances are forecast to reduce by the financial year end as internal resources from temporary positive cashflow surpluses are applied to fund expenditure demands in lieu of fully funding the borrowing requirement (internal borrowing) on a net basis. This process effectively reduces the cost of carrying additional borrowing at a higher cost than the income that could be generated through short term investment of those balances, as well as reducing investment counterparty credit risk.

Table 6: Average Benchmark Performance - Q2 2020/21

	Benchmark	Benchmark Return	Council Performance
Q1	**3m LIBID**	0.61%	0.60%
Q2	**3m LIBID**	0.60%	0.63%
Q2(YTD)	**3m LIBID**	0.61%	0.62%

5.8 Leaving market conditions aside, the Council's return on investments is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument:

- Credit risk is the consideration of the likelihood of default and is controlled through the creditworthiness policy approved by Council.
- The duration of an investment introduces liquidity risk; the risk that funds can't be accessed when required.
- Interest rate risk; the risk that arises from fluctuating market interest rates.

These factors and associated risks are actively managed by the Council's Finance team.

6. Borrowing

6.1 The Council can raise cash through borrowing in order to fund expenditure on its capital programme for the benefit of Cambridgeshire. The amount of new borrowing needed each year is determined by capital expenditure plans and projections of the Capital Financing Requirement, underlying borrowing requirement, forecast cash-backed reserves and both current and forecast economic conditions.

6.2 The Council will continue to utilise short to medium-term borrowing from other local authorities 'and authorised brokers as the PWLB rate is not favourable at present. The Council intends to keep a proportion of the borrowing portfolio short-dated; in doing so, the Council will also be in the position to take up any funding opportunities that could arise in the near term.

6.3 In Q2, the Council repaid on maturity a total of £56.1m, of which £55.0m was short-term loans from other local authorities and £1.16m was longer-term loans from other authorities and PWLB. Loans raised during Q2 amounted was £45m. Of which short-term borrowing maturing within 1 year was £35m, and £10m of fixed-term loans maturing within 2-3 years.

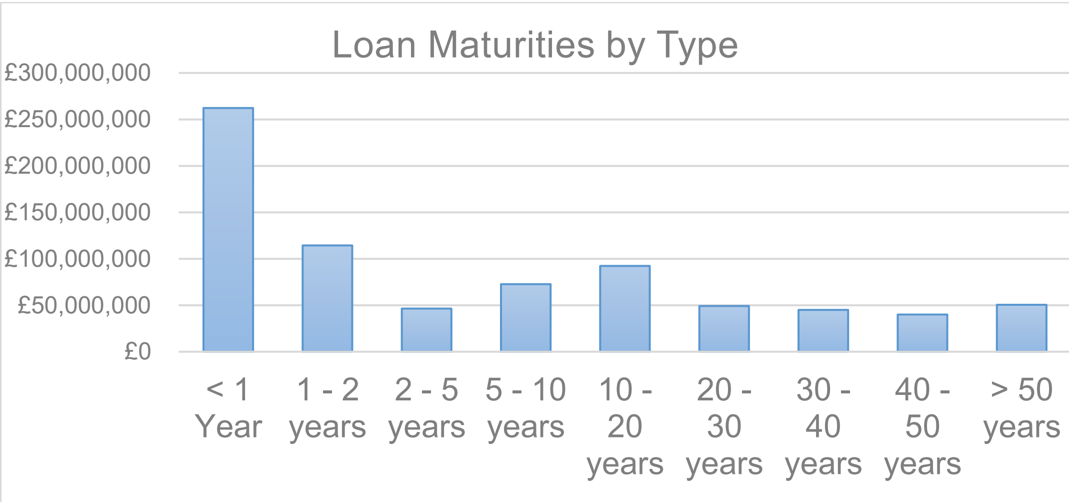
6.4 At the end of Q2, the Council held £772.6m of borrowing of which £262m matures in less than 1 year. The Council continues to be able to re-finance loans as required, generally this year at a lower interest rate than the maturity loan. As opportunities arise we are seeking longer loan terms, typically 2-3 years rather than less than 1 year, in view of the current conditions, and as we await the outcome of the PWLB consultation.

6.5 Table 7 overleaf sets out the maturity profile of the Council's borrowing portfolio at the end of Q2. £372.1m is held with the PWLB, £340.0m from other local authorities, £45m in market loans and £15.5m in a single market Lender Option Borrower Option (LOBO) loan.

Table 7: Loan Maturity Profile - Q2 2020/21

Term remaining	Borrowing	
	£m	%
< 1 Year	£262,232,333	33.94%
1 - 2 years	£114,365,333	14.80%
2 - 5 years	£46,419,000	6.00%
5 - 10 years	£72,683,667	9.41%
10 - 20 years	£92,323,333	11.95%
20 - 30 years	£49,160,000	6.36%
30 - 40 years	£45,000,000	5.82%
40 - 50 years	£40,000,000	5.18%
> 50 years	£50,500,000	6.54%
Total	**£772,683,667**	**100.0**

Figure 4 Loan Maturities by Type -Q2 2020/21



6.6 Market LOBO loans are included in Table 7 at their final maturity rather than their next potential call date. In the current low interest rate environment the likelihood of lenders exercising their option to increase the interest rates on these loans - and so triggering the Council's option to repayment at par - is considered to be low.

6.7 The Council is in an internally borrowed cash position and balances will need to be replenished at some point in the future (subject to expenditure demands). This strategy is prudent while investment returns are lower than the cost of servicing debt and also serves to mitigate counterparty risk. The Council therefore plans to maintain this internal borrowing position but will closely monitor those reserves, balances and cashflows supporting this approach.

6.8 No borrowing rescheduling was undertaken during Q2. Rescheduling opportunities are limited in the current economic climate. For PWLB loans, due to the spread between the carrying rate of existing borrowing and early redemption rates, substantial exit (premium) costs would be incurred. For market borrowing, the lender uses the certainty of the loans cashflow profile to hedge against forecast interest rate movements and so would pass the cost of unwinding these instruments onto the Council as an exit (premium) cost. Officers continue to monitor the position regularly.

7. Change of Banking Provider

7.1 As previously reported to GPC, NatWest bank were successful in a procurement process to become the Council's bankers. During the quarter preparations advanced substantially for NatWest to take over the Council's main accounts and those for the Pension Fund as well as for individual teams with specific business needs for an imprest account. The project has entailed detailed system configuration between the bank and the Council and the industry wide protocols for either automatically switching or notifying customers and stakeholders of the change have been instigated.

7.2 Accounts were switched at the beginning of quarter 3, and the early indications are that this has been a relatively smooth process. The project to move maintained school bank accounts is underway and continuing.

8. Alignment with corporate priorities

8.1 A good quality of life for everyone
There are no significant implications for this priority.

8.2 Thriving places for people to live
There are no significant implications for this priority.

8.3 The best start for Cambridgeshire's children
There are no significant implications for this priority.

8.4 Net zero carbon emissions for Cambridgeshire by 2050
There are no significant implications for this priority.

9. Significant Implications

9.1 Resource Implications
This report provides information on performance against the Treasury Management Strategy. Decisions on treasury management, which are driven by the capital programme and the Council's overall financial position, will impact the Debt Charges Budget and are reported through the Budget Monitoring process.

9.2 Procurement/Contractual/Council Contract Procedure Rules Implications
There are no significant implications for this category.

9.3 Statutory, Legal and Risk Implications
The Council continues to operate within the statutory requirements for borrowing and investments. Further details can be found within the Prudential Indicators in Appendix 2.

9.4 Equality and Diversity Implications

There are no significant implications for this category.

9.5 Engagement and Communications Implications
There are no significant implications for this category.

9.6 Localism and Local Member Involvement
There are no significant implications for this category.

9.7 Public Health Implications
There are no significant implications for this category.

Have the resource implications been cleared by Finance? Yes
Name of Financial Officer: Tom Kelly

Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the LGSS Head of Procurement? Not applicable

Has the impact on statutory, legal and risk implications been cleared by the Council's Monitoring Officer or LGSS Law? Not applicable

Have the equality and diversity implications been cleared by your Service Contact? Not applicable

Have any engagement and communication implications been cleared by Communications? Not applicable

Have any localism and Local Member involvement issues been cleared by your Service Contact? Not applicable

Have any Public Health implications been cleared by Public Health Not applicable

10. Source documents

10.1 Source documents

None

Appendix 1: Detailed economic commentary from the Council's external Treasury Management Advisor (prepared in early October)

During the quarter ended 30th September 2020*:*

- There was a quicker-than-expected recovery in GDP in June and July.
- Retail spending rose 4.0% above its pre-virus level, but the recovery in investment lagged behind.
- There was a second wave of the virus and a tightening in COVID-19 restrictions in September.
- In September, the Chancellor announced a new fiscal package worth £5bn (0.2% of GDP) to support the economy.
- Concerns about a second wave and a no deal Brexit weighed on the FTSE 100 and the pound.
- There were divisions on the Monetary Policy Committee over the possible use of negative interest rates.

The initial economic recovery appears to have been quicker than anticipated. GDP rose by 2.4% m/m in May as manufacturing and construction work resumed, by 8.6% m/m in June as non-essential retail stores reopened, and by 6.6% m/m in July as pubs and restaurants reopened. The rise in the all sector PMI from 57.1 in July to 58.7 in August suggests that recovery continued at a strong pace in August. Indeed our 'CE BICS Indicator' suggests that the economy grew by 5.0% m/m in August.

Consumer spending appears to have recovered strongly. Retail sales rose by 0.8% m/m in August, pushing sales 4.0% above their pre-pandemic level. The mini-boom in the housing market meant transactions rose by 28.9% y/y in August. Nationwide house prices rose by 0.9% m/m in September, which pushed up the annual rate to 5% – a four-year high. The Eat Out to Help Out, (EOHO), restaurant discount scheme and pent-up demand, also suggest that non-retail spending did well in August.

But this strength largely reflects the government's fiscal support since March. Indeed, it is encouraging that the bulk of the 4 million workers that have come off the furlough scheme between May and the end of July have gone back to their jobs rather than into unemployment or inactivity.

Even so, there have been signs that households' appetite for credit is waning. Consumer credit rose by only £0.3bn in August compared to July's £1.1bn rise. Admittedly, it could be that consumers are just using cash saved during lockdown to finance big ticket purchases. Indeed, the household saving rate surged from 9.6% in Q1 to a record-high of 29.1% in Q2. But consumer confidence has also weakened, slipping from -16.6 in August to -17.9 in September according to the EC.

What's more, having fallen by 26.5% q/q in Q2, business investment still seems to be well below pre-pandemic levels. According to the latest ONS Business Impact of the COVID-19 Survey (BICS), 38% of businesses said their plans to expand had been scaled back or cancelled since the pandemic. And the Bank of England's Agents survey suggested that investment intentions remain close to their record lows.

Meanwhile, there have been worrying signs that activity started to drop in September. Footfall on UK high streets had fallen to -45% y/y by mid-September. And despite not even having returned to its pre-crisis level, seasonally adjusted car production dropped by 24% m/m in August.

The mounting fiscal cost of the crisis is being reflected in public finance figures. Indeed, the government borrowed another £35.9bn in August, leaving borrowing in the year to date at £173.5bn. That's already the highest cash figure on record, with seven months of the financial year still to go (the previous record was £158.3bn in 2009/10). Add in the effects of the weak economy and we think that the Chancellor could end up borrowing £370bn (18.4% of GDP) in 2020/21 as a whole.

But the new package is unlikely to fully offset the hit to GDP and employment from the government's COVID-19 restrictions announced on 22 September. Indeed, the UK has begun to grapple with a second wave of coronavirus infections. This won't prevent some sectors from continuing to recover but will cause others to go backwards.

That is why we think that an impressive rebound in GDP of about +18% q/q will give way to no rise at all in October. Meanwhile, we still expect the unemployment rate to rise further, from 4.1% in July to 7% in Q4 2021.

This supports our existing view that the Bank of England will ease monetary policy further. Admittedly, the sharp drop in CPI inflation from +1.0% in July to +0.2% in August, due to the effects of the cut in VAT for hospitality/tourism and August's EOHO restaurant discount scheme, probably represents the low point for inflation. We expect CPI inflation to have risen to +0.6% in September and it could temporarily rise to 2.0% at the end of 2021. But the big picture is that it will be a few years before the economy is strong enough to sustain CPI inflation at the Bank of England's 2% target.

For the next 6-12 months, we think that QE will remain the tool of choice and that another £250bn of QE will be used over the next year, significantly more than the consensus forecast.

There are two key downside risks to the outlook. The first of these is the possibility that restrictions are tightened much further to contain the spread of coronavirus.
A no deal on 31 December is unlikely to spell disaster for the economy. But it could lead to a hit to GDP of 1-3% depending on the type of no deal, setting back the UK's recovery from the recession.

The concerns about the consequences for the economy from a second wave of COVID-19 and a no deal Brexit have reduced the FTSE 100 almost back to May's level and weakened the pound from $1.35 to $1.28. Some spreads of corporate bonds over gilt yields such as BBB ones, have started to tick up. With COVID-19 and a no deal Brexit risks rising, the risks to our forecast that the FTSE 100 will rebound to its pre-crisis level by the end of 2022 and that the pound will climb back to $1.35 if there is a Brexit deal are firmly on the downside.

In the euro-zone, there is further evidence that the economic recovery is grinding to a halt. This has resulted in short-time working policies being extended in Europe's Big Four until the end of the year at a minimum. And there is a good chance that the ECB will provide additional stimulus soon, perhaps making the TLTROs more generous.

The continued economic recovery in the US in the face of its second wave in June and July has been impressive, but GDP remains below pre-virus levels. And while the Fed adopted "a flexible form of average inflation targeting" in August, it has offered no hints it is contemplating adding more stimulus soon. But the calls for more stimulus may grow louder if the recovery slows, particularly if Congress can't agree on more fiscal support.

Appendix 2: Treasury and Prudential Indicators

Prudential Indicator	**2020/21 Indicator**	**2020/21 Q2**
Authorised limit for external debt (Inc' loans raised to on-lend to Housing & Investment Company)	-----£1,093.0m-----	
Operational boundary for external debt (Inc' loans raised to on-lend to Housing & Investment Company)	----- £1,063.0m-----	
Capital Financing Requirement (CFR) *[Including PFI and Finance Lease Liabilities]*	£992.8m	£945.0m
Ratio of financing costs to net revenue streams	8.8%	7.94%
Upper limit of fixed interest rates based on net debt	150%	106%
Upper limit of variable interest rates based on net debt	65%	-6%
Principal sums invested over 365 days (exc' third party loans)	£50.0m	£26.9m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 80% Min. 0%	33.9%
12 months to 2 years	Max. 50% Min. 0%	14.8%
2 years to 5 years	Max. 50% Min. 0%	6.0%
5 years to 10 years	Max. 50% Min. 0%	9.4%
10 years and above	Max. 100% Min. 0%	35.9%

The Treasury Management Code of Practice guidance notes requires that maturity is determined by the earliest date on which the lender can trigger repayment, which in the case of LOBO loans is the next break/call point. This approach differs to Table 7 at paragraph 6.5 above, which instead shows the Council's LOBO loan at maturity date as the likelihood of the option being exercised is low.