Agenda Item No: 7

Treasury Management Report – Quarter Three Update 2020-21

To:	General Purposes Committee
Meeting Date:	23 March 2021
From:	Chief Finance Officer
Electoral division(s):	All
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 Three Report for 2020/21.

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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 included at Appendix 1, which has been provided by Link Asset Services, the Council's treasury management advisers. Some of the key points to note are set out below.

2.2 The Bank of England's Monetary Policy Committee (MPC) kept the Bank Rate unchanged at its key quarterly meeting on 5th November 2020. However, it revised its economic forecast to take into account of the second national lockdown from 5th November to 2nd December 2020. A new stimulus package of £150bn was agreed, with a start date of January 2021, to extend quantitative easing to support the economy.

2.3 The Bank of England left the base rate at 0.1%, and there was no mention of a negative interest rate, which suggests that the MPC remains some way from being persuaded of the case for such a policy at least for the next 6-12 months.

2.4 Overall, the pace of recovery of the UK economy from the shock of the pandemic was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. Subsequently, there has been rapid back-tracking on easing restrictions due to rising case numbers and a new national lockdown from November and severe restrictions being imposed across all four nations in January 2021. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow Gross Domestic Product (GDP) to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022.

2.5 The final agreement regarding the UK's withdrawal from the European Union was agreed on 24th December 2020 and eliminated a significant downward risk to the UK economy.

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 Following the HM Treasury review of PWLB margins over gilt yields on 25th November 2020, all forecasts below now include the 1% reduction in the non-Housing Revenue Account (HRA) Certainty Rate (now gilt yields plus 80bps) announced as a result of the review.

Table 1 Interest Rate Forecast (%) Nov 9, 2020

Link Group Interest Rate View	9.11.20												
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
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	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	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	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	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

The above table shows a reduction of 1.0% on PWLB margins – gilt yields plus 80bps.

Gilt yields / PWLB rates

3.3 Gilt yields had already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. 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. At the close on 31st December 2020, all gilt yields from 1 to 8 years were in negative territory, while even 25-year yields were only at 0.84% and the 50 year at 0.64%.

3.4 Following on from the PWLB consultation review on 31st July, the Chancellor published the result of the consultation on 25th November 2020 and announced the conclusion of the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its forward looking three year capital programme. The new margins over gilt yields, applicable to Cambridgeshire, are as follows: -.

- PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

3.5 There is likely to be little upward movement in PWLB rates over the next three years as it will take the UK a prolonged period to eliminate spare capacity in the economy so that inflation might start to become a sufficient concern for both the MPC to consider raising Bank Rate, and for gilt holders to require a higher yield.

4. Summary Net Borrowing Position

4.1. At the end of December 2020, investments held totalled £72.9m (excluding 3rd party loans) and gross borrowing totalled £767.6m, equating to a net borrowing position of £694.7m. 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 Q3

	Actual as at 31 Oct 2020 £m	Actual as at 30 Nov 2020 £m	Actual as at 31 Dec 2020 £m
Long term Borrowing (>12mth)	660.7	640.7	655.6
Short term Borrowing (<12mth)	142.0	142.0	112.0
Total Borrowings	**802.7**	**782.7**	**767.6**
Treasury Investment	129.9	92.2	72.9
TOTAL Net Debt/Borrowings	**672.8**	**690.5**	**694.7**

5. Investments

5.1 The Treasury Management Strategy Statement (TMSS) for 2020/21, including 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

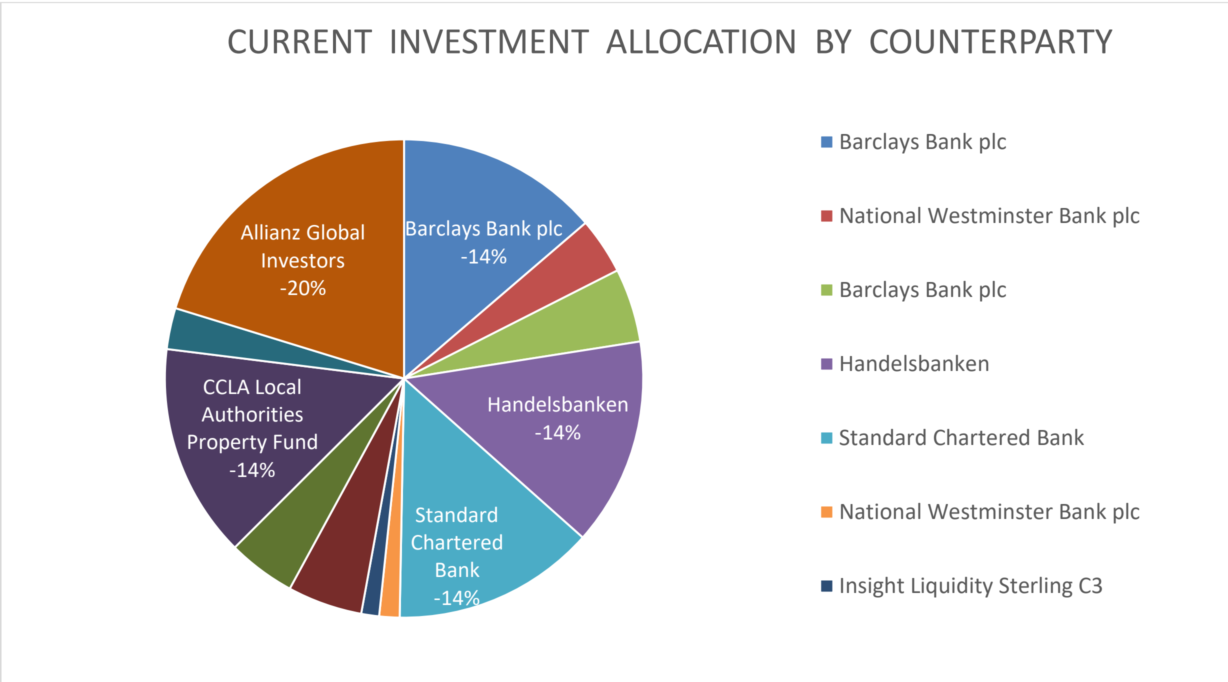
5.2 The Council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. As shown by the interest rate forecasts in section 3, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short term money market investment rates are barely above zero now that Bank Rate is at 0.10%. Some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2024, investment returns are expected to remain low.

5.3 At 31st December 2020 the Council's investment balances totalled £72.9m; 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: Conditions remained difficult in the sector in the final months of 2020 as fresh restrictions limited mobility and forced shop closures. Despite this unhelpful background valuations stabilised before rising in November, the first increase for two years. Values rose broadly. Industrial assets were once again the best performers but there were improvements in parts of the retail sector. Transaction volumes were below the long- term average but showed a welcome increase in the final months of the year. Strong efforts to protect the income flow of the Fund resulted in a 93% collection rate.

5.5 Multi-Class Credit Fund: At the end of Q3, the CCC holding in the fund had increased in value by £257,971, which equates to a share price of £102.40, bringing the fund's value to £14,757,970. The Council originally invested £14.5m in September.

Figure 3: CCC Investments allocation by Counterparty



5.6 The table below summarises the maturity profile of the Council's investment portfolio at the end of Q3 2020/21 (excluding Third Party Loans):

Table 3 - Investment maturity profile at end of Q3 2020/21

Product	Access Type	Maturity Period					
		0d	0-3m	3-6m	~5yrs	Total	
		£m	£m	£m	£m	£m	%
Money Market Funds	Same-Day	7.9				**7.9**	***10.8***
Bank Call Account	Instant Access	16.7				**16.7**	***22.9***
Certificate of Deposits	Fixed Term / Tradeable		0.00	20.0		**20.0**	***27.4***
Notice Account	35 Day Notice			1.0		**1.0**	***1.4***
Pooled Property Fund	Redemption Period Applies				10.5	**10.5**	***14.4***
Pooled Diversified Income Fund	Redemption – two days				2.0	**2.0**	***2.7***
Pooled Multi-class credit Fund	Redemption Period Applies				14.8	**14.8**	***20.3***
	Total	**24.6**	**0.00**	**21.0**	**27.3**	**72.9**	***100.0***
	%	***34.0***	***0.00***	***29.0***	***37.0***	***100.0***	

5.7 Set out below are details of the amounts outstanding on loans and share capital investments classed as capital expenditure advanced to third party organisations at the end of Q3:

Table 4 Third Party Loans Principal Outstanding end of Q3 2020/21

Loan Counterparty	Original Amount (£m)	Amount Outstanding (£m)	Repayment Year
Arthur Rank Hospice Charity	4.000	3.440	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**	**4.131**	

In addition, there is £112.17m on loan to This Land Finance Ltd (a company wholly owned by Cambridgeshire County Council).

5.8 As forecast in the quarter 2 report, investment balances have reduced significantly from £95.3m at 30th September 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 5: Average Benchmark Performance – Q3 2020/21

	Benchmark	Benchmark Return	Council Performance
Q1	**3m LIBID**	0.61%	0.60%
Q2	**3m LIBID**	0.60%	0.63%
Q3	**3m LIBID**	-0.08%	0.06%
Q3(YTD)	**3m LIBID**	-2.34%	0.43%

5.9 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 well as PWLB following the recent rate reduction. The Council intends to keep a proportion of the borrowing portfolio short-dated; but is focused on extended the average duration of loans in the portfolio, whilst there are opportunities to fix loans for extended maturities at historically low levels.

6.3 In Q3, the Council repaid on maturity a total of £75.0m, of which £40.0m was short-term loans from other local authorities and £35.0m was longer-term loans from other authorities and PWLB. Loans raised during Q3 amounted to £70m. Of which short-term borrowing maturing within 1 year was £10m, and £60m of fixed-term loans maturing within 2-3 years.

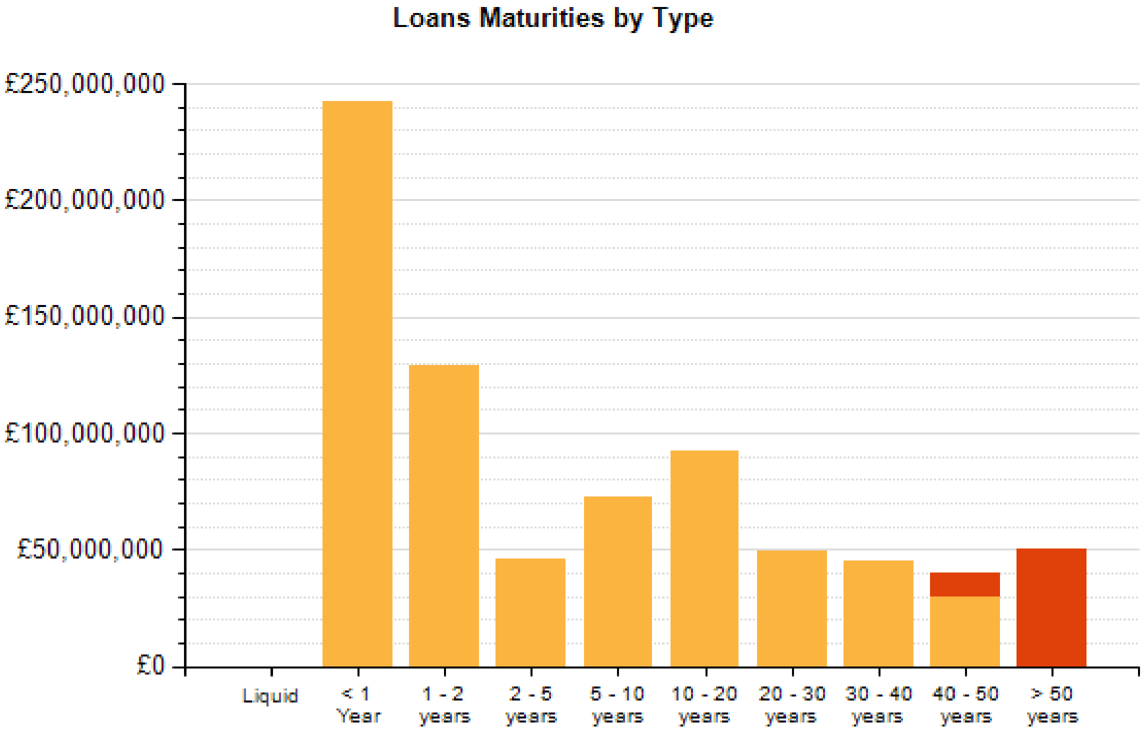
6.4 At the end of Q3, the Council held £767.6m of borrowing of which £242m matures in less than 1 year. The Council continues to be able to re-finance loans as required, generally at this time at a lower interest rate than the maturity loan. As opportunities arise we are seeking longer loan terms, rather than less than 1 year, in view of the current conditions.

6.5 Table 6 below sets out the maturity profile of the Council's borrowing portfolio at the end of Q3 £380.1m is held with the PWLB, £327.0m from other local authorities, £45m in market loans and £15.5m in a single market Lender Option Borrower Option (LOBO) loan.

Table 6: Loan Maturity Profile – Q3 2020/21

Term remaining	Borrowing	
	£m	%
< 1 Year	£242,232,333	31.56%
1 - 2 years	£129,365,333	16.85%
2 - 5 years	£46,419,000	6.05%
5 - 10 years	£72,683,667	9.47%
10 - 20 years	£92,323,333	12.03%
20 - 30 years	£49,080,000	6.39%
30 - 40 years	£45,000,000	5.86%
40 - 50 years	£40,000,000	5.21%
> 50 years	£50,500,000	6.58%
Total	**£767,603,667**	**100.0**

Figure 4 Loan Maturities by Type -Q3 2020/21



6.6 Market LOBO loans are included in Table 6 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 Q3. 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. Compliance with Treasury and Prudential Limits

7.1 The Council's treasury and prudential indicators are shown in Appendix 2.

7.2 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 31st December 2020, the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement for 2020/21. The Chief Finance Officer reports that no difficulties are envisaged for the current year in complying with these indicators.

7.3 All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

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 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.

10. Source documents guidance

10.1 None

Appendix 1: Detailed economic commentary from the Council's external Treasury Management Advisor (prepared in January 2021)

During the quarter ended 31st December 2020*:*

- The UK and EU signed a Brexit deal.
- Effective COVID-19 vaccines were announced and started to be rolled out.
- A second lockdown in November and a strict tiering system was imposed in December.
- The MPC announced an extra £150bn of Quantitative Easing (QE).
- The Chancellor announced a new fiscal package worth £55bn (2.4% of GDP) to support the economy.
- The positive news on Brexit and vaccines boosted the pound and the FTSE 100.

The Brexit deal the EU and UK signed on 24th December 2020 came too late to give a boost to GDP growth in Q4. In fact, GDP probably fell again in the final quarter. The second COVID-19 lockdown imposed in November and the subsequent tier system, which kept hospitality businesses closed in much of the country, could mean that GDP fell by about 3.5% q/q in Q4. Indeed, our CE BICS Indicator suggests that the economy fell by 8.0% m/m in November and that the economy did not rebound by much in December.

Consumer spending appears to have held up much better than in the previous England-wide lockdown in March/April. Retail sales "only" fell by 3.8% m/m in November, a fraction of the 18.1% m/m fall in April. This still left them 2.7% above their pre-crisis level and there was a much smaller drop in car sales in November than in April, (-29% m/m vs -98% m/m). What's more, the mini-boom in the housing market meant mortgage approvals rose to 104,969 in November, leaving them 43% above their pre-crisis level.

However, much of the resilience of retail sales is because November's lockdown was less strict as schools, factories and construction sites stayed open. This meant that petrol sales held up much better, "only" falling by 16.6% m/m compared to the 51.8% m/m contraction in April. Also firms have improved at selling online. Indeed, the value of all the goods sold on the internet rose by 6.3% m/m in November. What's more, the more widespread Tier 4 COVID-19 restrictions, which closely resemble November's lockdown, raise the chances that the economy stagnates, if not contracts, in the first three months of 2021.

The reduced ability of households to spend during November's lockdown meant that they repaid £1.5bn of unsecured loans in that month. But lower debt and higher savings means that consumers will be in a good position to boost spending once COVID-19 restrictions are eased.

In response to the second lockdown, in November the Chancellor announced a further £55bn, (2.4% of GDP), of COVID-related spending in 2020/21 on top of the total £280bn, (14.5% of GDP), of policy support previously announced. He also extended the furlough scheme, which pays up to 80% of an employee's wages and was due to end on 31st October 2020, until 30th April 2021, and announced that businesses forced to close would be able to get a grant of £3,000 per month.

The extraordinary fiscal cost of the crisis is being reflected in public finance figures. Indeed, the government borrowed an extra £31.6bn in November, the third highest figure on record, taking total borrowing this financial year so far to £240.9bn compared to £57.4bn in the whole of 2019/20. What's more, borrowing is likely to remain high over the next few months as the new restrictions keep many businesses closed and millions of workers on the furlough scheme. We expect the budget deficit to reach about £420bn, (21.7% of GDP), in 2020/21, its highest since WW2 and slightly more than the £400bn the OBR forecast in its November report.

However, beyond the next few months we think the outlook is much brighter now a Brexit deal has been signed and an effective vaccine is being rolled out. Indeed, we are now more optimistic than the OBR and the Bank of England. Admittedly, custom checks and procedures will still be required on goods moving between the UK and the EU for the first time since 1973, so there will probably be some disruption at the ports in early 2021.

Any disruption at the borders will probably be short-lived as firms will quickly become familiar with the new procedures. The Brexit deal removes the uncertainty and downside risk of a no deal, and for the first time in four-and-a-half years, businesses can now plan knowing the shape of the UK/EU relationship.

What's more, in contrast to what most other forecasters appear to have assumed, we are not convinced that the COVID-19 crisis will significantly reduce the economy's supply capacity and prevent it from returning to the pre-crisis trend. Our analysis suggests that permanent hits to supply are most likely to happen after recessions associated with financial crises and wars, as they reduce the supply of credit or destroy large parts of the capital stocks. Neither of those things has happened this time. As such, we expect the economy to be just 1% smaller in 2024/25 compared to if the pandemic had never happened and to get back to its pre-virus trend later in the decade.

So, rather than running a deficit of 3.9% of GDP by 2025/26 as the OBR expects, we think the deficit may have returned to around 2.5% of GDP by then. In this case, there may not be much of a fiscal hole to fill. In fact, the danger is that fiscal policy is tightened too soon to fill a perceived hole in the public finances caused by the crisis that never materialises.

As a result, we think that the £150bn of Quantitative Easing (QE) that the Bank committed to at its meeting on 4th November 2020 may prove to be the last loosening of policy it will need to do. The risk to this view is that the Bank may want to respond to the latest lockdown, but even if it does, we think it will increase the pace of the asset purchases already announced, rather than increasing its total QE. The Bank is also probably not ready to implement negative rates yet so this currently limits its ability to cut rates.

However, unlike the financial markets, we do not think the Bank will raise rates in the next five years. Admittedly, the end of the VAT cut for the hospitality industry on 31st March 2021 and higher oil prices, will probably push inflation briefly above 2.0% in late 2021. But the time spent above 2.0% is likely to be fleeting. We expect inflation to be closer to 1.5% in 2022 than 2.0%. Even if inflation did rise to 2.0%, the Bank has said it would need to be convinced it will stay above 2.0% before it tightens policy. As such, Bank Rate may not rise above 0.10% for around five years. After all, in the minutes of its December meeting the MPC said risk management considerations implied that policy should lean strongly against downside risks to the outlook: we, therefore, expect the MPC to wait until the economy is fully recovered from the crisis before it considers raising rates.

Appendix 2: Treasury and Prudential Indicators Q3

Treasury / Prudential Indicator	**2020/21 Indicator**	**2020/21 Q3**
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-----	
Total Outstanding Borrowing – Q3	--------£767.6m------	
Capital Financing Requirement (CFR) *[Including PFI and Finance Lease Liabilities]*	£m	£992.8m
Ratio of financing costs to net revenue streams	8.8%	7.6%
Upper limit of fixed interest rates based on net debt	150%	109%
Upper limit of variable interest rates based on net debt	65%	-7%
Principal sums invested over 365 days (exc' third party loans)	£50.0m	£27.3m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 80% Min. 0%	31.56%
12 months to 2 years	Max. 50% Min. 0%	16.85%
2 years to 5 years	Max. 50% Min. 0%	6.05%
5 years to 10 years	Max. 50% Min. 0%	9.47%
10 years and above	Max. 100% Min. 0%	36.07%

- 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 6 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.