Agenda Item No:7

Treasury Management Report – Quarter Two Update 2021-22

To:	Strategy & Resources Committee
Meeting Date:	17th December 2021
From:	Chief Finance Officer
Electoral division(s):	All
Key decision:	No
Forward Plan ref:	Not applicable
Outcome:	Through this report the Committee supervises the Council's treasury management, and ensures that public money across the Council's cashflows, borrowing and investments is utilised and deployed effectively and in compliance with the Treasury Management Strategy.
Recommendation:	The Strategy & Resources Committee is recommended to note the Treasury Management Quarter Two Report for 2021/22 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 Update

2.1 A current economic commentary is in Appendix 1, 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 Monetary Policy Committee (MPC) voted unanimously in September to leave the Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; however, two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

2.3 Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, however this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment now the furlough scheme has ended. At the MPC's meeting in February 2022 it will only have available the employment figures for November 2021; to get a clearer picture of employment trends, it will need to wait until the May 2022 meeting when data up until February 2022 will be available. At its May 2022 meeting, it will also have a clearer understanding of the likely peak of inflation.

2.4 CPI: Inflation is expected to remain above the 2% target for longer. The MPC was prepared to accept a temporary spike in inflation caused by sharp increases in monthly inflation figures in late 2021, largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which will eventually work their way out of the system. However, it did flag there is a potential danger that labour shortages could push up wage growth by more than it expects; if this occurs, Consumer Price Inflation (CPI) inflation will stay above the 2%.

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.

3.2 Comparing the forecasts from May to September shows that some PWLB rates have increased marginally. There are also now three increases in the Bank Rate expected over the period to March 24, up to 0.75%, instead of only one increase to 0.25%. However, many PWLB rates were significantly lower than forecast during the earlier part of quarter 2.

Table 1a: Interest Rate Forecast (%) September 2021

Link Group Interest Rate View 29.9.21	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	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

Table 2b: Interest Rate Forecast (%) May 2021

Link Group Interest Rate View	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	0.25	0.25	0.25
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.40	0.40
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.50	0.50
5 yr PWLB	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50
10 yr PWLB	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00	2.00	2.00
25 yr PWLB	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.50	2.60
50 yr PWLB	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.40

Forecasts for Bank Rate

3.3 The above forecast may need revising within a relatively short time frame for the following reasons:

- There is increasing evidence that the economic recovery has slowed down during the summer and now into the autumn; this could lead into stagflation.
- Some current key supply shortages could cause economic activity in some sectors to take a significant hit.
- Rising gas and electricity prices in October and next April, increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action to cool inflation.
- Consumers are sitting on around £200bn of excess savings left over from the pandemic which may start to be released into the economy.
- 1.6 million people came off furlough at the end of September; if some of these people became unemployed, they will have been available to fill labour shortages in many sectors of the economy, helping to reduce supply shortages which have been driving up both wages and costs.
- Further Covid-19 uncertainty heading into winter, on top of flu season, could depress economic activity.

Gilt yields / PWLB rates

3.4 Since the start of 2021, there has been a lot of volatility in gilt yields, and therefore PWLB rates. During September, gilt yields from 5 – 50 years rose steadily, increasing even further following the minutes of the September MPC meeting. Forecasts show a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2024.

3.5 While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant upward risk exposure to forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

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3.6 The Council continues to explore borrowing from the UK Municipal Bonds Agency as an alternative to the PWLB.

4. Summary Portfolio Position

4.1. The level of net debt borrowing set in the Treasury Management Strategy Statement (TMSS) for 31st March 2022 was £805.0m. On 1st April 2021, the net debt was £714.1m, and the actual at 30th September 2021 was £631.1m (excluding all Third-party loans and Equity). This is a decrease in borrowing over the period, due to some loans maturing and not yet being refinanced. Cash flows at the beginning of the year are typically stronger than at the end of the year, as many grant receipts are received in advance of spend (and due to the current Covid-19 pandemic the Council is in receipt of further grants compared to before the pandemic).

4.2 The 2021/22 net borrowing position is expected rise more substantially towards the end of the financial year as capital projects are progressed to completion and financed. However, forecast in-year underspends on the capital programme mean that is likely that the Council's level of net debt borrowing will not reach £805.0m by the end of the year.

4.3 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 Table 2 overleaf.

Table 2: Net Borrowing quarter 2 2021/22

	Actual as at 1 April 2021	Actual as at 30 Sept 2021	In- months change
	£m	£m	£m
Borrowings			
Long term Borrowing (>12mth)	685.7	704.5	18.8
Short term Borrowing (<12mth)	127.0	62.0	-65.0
Total Borrowings	812.7	766.5	-46.2
Treasury Investment	-98.1	-135.3	-37.2
Total Net Debt/Borrowings	714.6	631.2	-83.4

5. Investments

5.1 The Treasury Management Strategy Statement (TMSS) for 2021/22, including the Annual Investment Strategy for financial assets, was approved by Council in February 2021. 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 the Bank Rate is at 0.10%. Some entities are offering negative rates of return in some shorter time periods. Given this environment and the fact that increases in the Bank Rate are unlikely to occur before the end of the current forecast horizon of March 2024, investment returns are expected to remain low.

5.3 At 30th September 2021 the Council's investment balances totalled £135.3m; the balance is split between Money Market Funds, Call/Notice accounts and collective investment funds (see Table 3 below). The balance excludes Third Party Loans and Share Capital.

5.4 Property Fund: During quarter 2, the key focus for CCLA was to protect income. The capital value of the investment at 30th September 2021 was £11.5m (£10.4m at 31st December 20) compared to an original investment value of £12m. Income held up better than expected during the pandemic, reflecting the fund's active asset management strategy and tenant engagement. The dividend rate of return on the initial investment for quarter 2 was 3.5%.

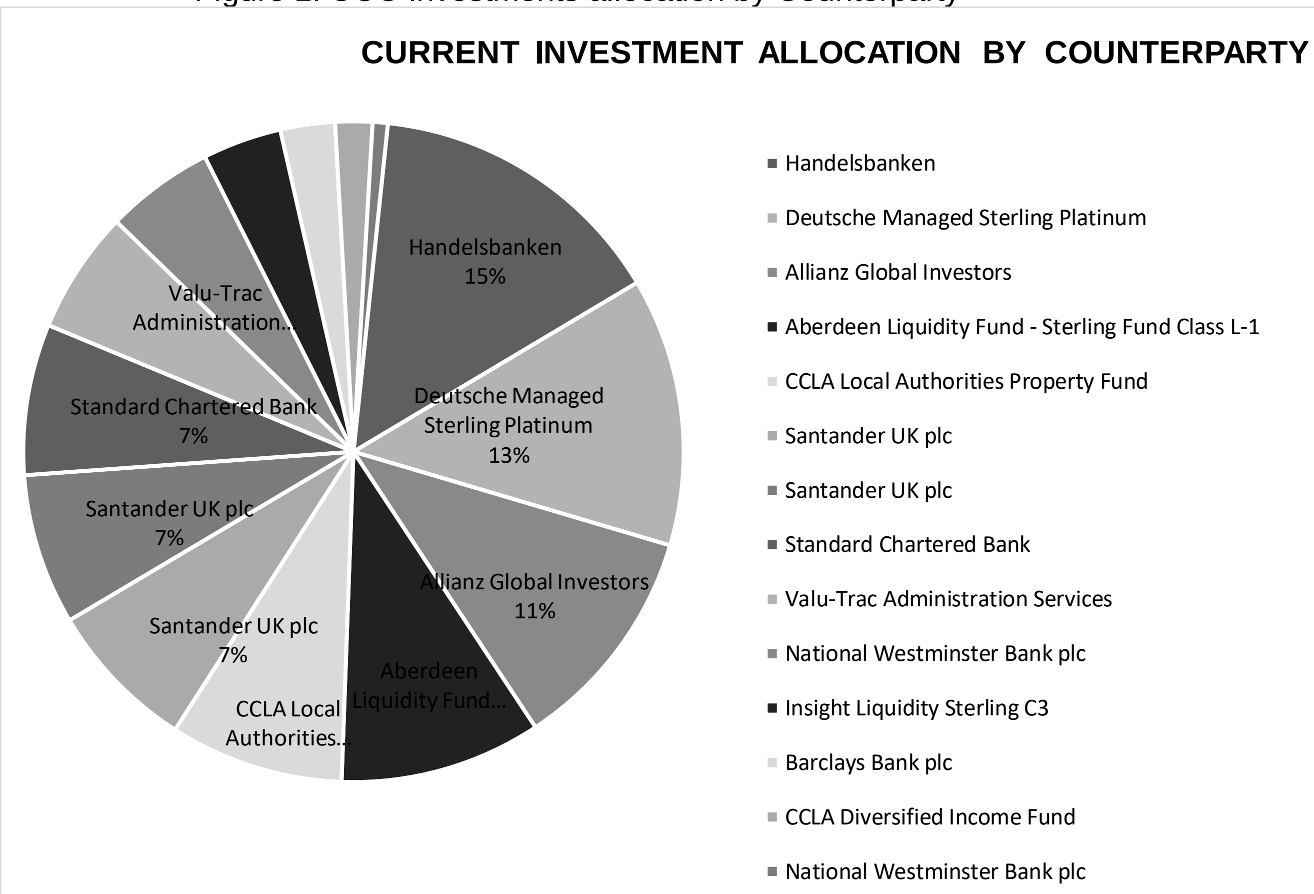
5.5 Diversified Income Fund: During quarter 2, the Council invested a further £350k in this fund, taking the total initial investment to £2.45m. At the end of quarter 2, the capital value of the investment was £2.51m. The dividend rate of return on the initial investment for quarter 2 (prior to the further investment) was 3.2%.

5.6 Multi-Class Credit Fund: At the end of quarter 2, the valuation of the CCC share of the fund stood at £15.0m. The Council originally invested £14.5m in September 2020, an increase in valuation of £496k. The Council receives dividend payment annually in December; the dividend rate of return on the initial investment for quarter 1 was 2.3%.

5.7 Infrastructure Income Fund: At the end of quarter 2, the valuation of the CCC share of the fund stood at £8.1m. The Council originally invested £8m in May 2021, an increase in valuation of £128k. The Council has received two dividend payments totalling £152k during 2021/22; the dividend rate of return on the initial investment was 3.77% in quarter 2.

5.8 The average level of investment in quarter 2 (excluding third party loans and equity) was £283.1m, which carried a weighted average rate of 1.54%. The level of investment funds varies dependent on the timing of precept receipts, grants, and the progress of the capital programme; at the end of quarter 2 investments (excluding third party loans and equity) totalled £135.3m. Figure 1 below shows the investment by counterparty as at 30th September 2021.

Figure 1: CCC Investments allocation by Counterparty



5.9 Table 3 below summarises the maturity profile of the Council's investment portfolio at the end of quarter 2 2021/22 (excluding third party loans):

Table 3: Investment maturity profile at end of quarter 2 2021/22

		Maturity Period					
		0d	0-3m	3-6m	~5yrs	Total	
Product	Access Type	£m	£m	£m	£m	£m	*%*
Money Market Funds	Same-Day	36.4				36.4	*26.9*
Bank Call Account	Instant Access	40.8				40.8	*30.1*
Notice Account	35 Day Notice			21.0		21.0	*15.5*
Pooled Property Fund	Redemption Period Applies				11.5	11.5	*8.5*
Pooled Diversified Income Fund	Redemption – two days				2.5	**2.5**	*1.8*
Pooled Multi-class credit Fund	Redemption Period Applies				15.1	**15.1**	*11.1*
Income Fund (Energy)	Redemption Period Applies				8.1	**8.1**	*6.0*
	Total	77.1	0.00	21.0	37.2	135.3	*100.0*
	%	*57.0*	*0.00*	*15.5*	*27.5*	*100.0*	

5.10 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 quarter 2:

Table 4: Loans/Equity holdings in This Land companies end of quarter 2 2021/22

Loan Summary	Amount Outstanding (£m)	Repayment Year
Land, Construction & Development loans	113.851	2026/27, 2027/28 and 2028/29
Equity holding	5.851	N/A
Total Loans/Equity in This Land Ltd	119.702	

Table 5: Loans/Equity holdings in Pathfinder Legal Services end of quarter 2 2021/22

Loan Summary	Original Amount (£m)	Amount Outstanding (£m)	Repayment Year
Cashflow loan	0.325	0.325	2029/30
Equity holding	0.475	0.475	-
Total Loans/Equity in Pathfinder Legal Services	0.800	0.800	

Table 6: Third Party Loans Principal Outstanding end of quarter 2 2021/22

Loan Counterparty	Original Amount (£m)	Amount Outstanding (£m)	Repayment Year
Arthur Rank Hospice Charity	4.000	3.360	2042/43
Estover Playing Field 2015 CIC (Guaranteed by March Town Council)	0.350	0.192	2024/25
Wisbech Town Council	0.150	0.150	2043/44
VIVA Arts & Community Group	0.300	0.286	2043/44
Total Third Party Loans	4.800	3.988	

5.11 Investment returns compared to benchmark are shown in Table 7 below.

Table 7: Average Benchmark Performance – quarter 2 2021/22

	Benchmark	Benchmark Return	Council Performance
Quarter 1	3m LIBID	-0.04%	0.08%
Quarter 2	3m LIBID	-0.05%	0.07%
Year To Date	3m LIBID	-0.05%	0.07%

5.12 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 cannot be accessed when required.
- Interest rate risk, arising 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 whilst rates remain low. The Council intends to keep a proportion of the borrowing portfolio short-dated; but is also focused on extending 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 quarter 2, the Council repaid on maturity a total of £56.2m, of which £40m was short-term loans from other local authorities and £16.2m was longer-term loans from other authorities / PWLB. Loans raised during quarter 2 amounted to £26.0m, of which £10.0m was short-term borrowing maturing within 1 year and £16.0m was PWLB loans.

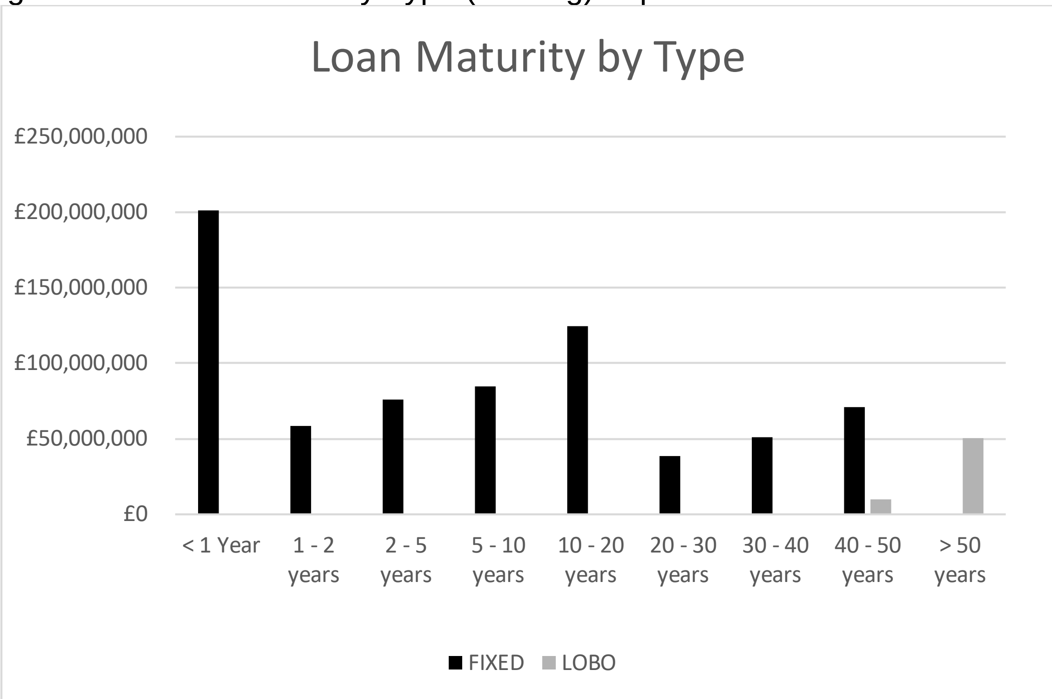
6.4 At the end of quarter 2, the Council held £766.5m of borrowing of which £62m was short-term borrowing that matures in less than 1 year from date of issue. The Council continues to be able to re-finance loans as required, generally at this time at a lower interest rate than the maturity loan. As opportunities arise, we are seeking longer loan terms, rather than less than 1 year, in view of the current conditions.

6.5 Table 8 below sets out the maturity profile of the Council's borrowing portfolio at the end of quarter 2; £458.9m.1m is held with the PWLB, £247.0m from other local authorities, £45.0m in market loans and £15.5m is a single market Lender Option Borrower Option (LOBO) loan. Of the £766.5m of borrowing, £201.4m (including both short-term and longer-term loans) will mature in less than 1 year, therefore potentially requiring refinancing.

Table 8: Loan Maturity Profile (Closing) – quarter 2 2021/22

Term remaining	Borrowing	
	£m	%
< 1 Year	£201,365,333	26.27
1 - 2 years	£58,688,333	7.66
2 - 5 years	£76,246,000	9.95
5 - 10 years	£84,661,667	11.05
10 - 20 years	£124,323,333	16.22
20 - 30 years	£38,666,667	5.04
30 - 40 years	£51,000,000	6.65
40 - 50 years	£81,000,000	10.57
> 50 years	£50,500,000	6.59
Total	£766,451,333	100.0

Figure 2: Loan Maturities by Type (Closing) – quarter 2 2021/22



6.6 The market LOBO loan is included in Table 8 at final maturity rather than next potential call date. In the current low interest rate environment, the likelihood of the lender exercising their option to increase the interest rate on this loan - 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 quarter 2. 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 March 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22.

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 Communities at the heart of everything we do

There are no significant implications for this priority.

8.2 A good quality of life for everyone

There are no significant implications for this priority.

8.3 Helping our children learn, develop and live life to the full

There are no significant implications for this priority.

8.4 Cambridgeshire: a well-connected, safe, clean, green environment

There are no significant implications for this priority.

8.5 Protecting and caring for those who need us

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

10.1 None

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

During the quarter ended 30th September 2021 *(quarter 2 of financial year 2021/22):*

- There was only a 0.1% m/m rise in GDP in July as rising virus cases and product/labour shortages stalled the recovery.
- There were signs that activity failed to pick up momentum in August and September as shortages worsened.
- Virus restrictions were lifted in full and the ending of the furlough scheme.
- There was a sharp acceleration in CPI inflation to a nine-year high of 3.2% in August.
- and strong gains in gilt yields, while sterling weakened, and the FTSE 100 made little headway.

The economic recovery stalled in quarter 2, despite the full lifting of COVID-19 restrictions on activity. The 0.1% m/m gain in GDP in July was much weaker than the 1.0% m/m increase in June and left the economy 1.0% below its February 2020 pre-pandemic level. Services output was particularly weak, falling by 0.3% m/m. In part, this was due to a rise in consumer caution prompted by the uptick in COVID-19 cases.

Public finances data for August revealed that the government's financial position isn't as bad as the Office for Budget Responsibility predicted back in March. But any windfall looks set to be used to reduce borrowing at a faster pace, rather than provide any extra support to the economy. Indeed, the £12bn rise in annual spending on social care announced in September is set to be fully funded by the new health and social care levy.

We now expect the economy to return to its pre-virus level by January, which is a few months later than we previously thought. For one thing, the end of summer has brought an uptick in new COVID-19 infections. Although these are yet to translate into more hospitalisations, this could be a headwind for consumer-facing services if households become more cautious. For another, the combined effect of September's petrol shortages, higher household energy bills, and the ending of the furlough scheme threaten to depress (non-fuel) consumption.

Consumer price inflation jumped from 2.0% in July to a nine-year high of 3.2% in August and is on track to reach 4.5% by the end of this year. Base effects linked to the sharp fall in prices in August 2020, mainly driven by the Eat Out to Help Out restaurant discount scheme, accounted for around 0.9 percentage points (ppt) of the 1.2 ppt rise. But there were signs that a pick-up in underlying price pressures accounted for the remaining 0.3 ppt, which was driven by inflation in hotels, new and second-hand cars and food. The jump in inflation in August came alongside further signs that cost pressures are still building earlier in the price pipeline. The prices balances of the IHS Markit/CIPS composite PMI rose sharply, suggesting that shortages are increasingly feeding through to higher prices. Meanwhile, manufacturing input producer price inflation (PPI) picked up from 10.4% in July to 11.0% in August and output PPI rose from 5.2% to 6.0%.

Appendix 2: Treasury and Prudential Indicators Quarter 2

Treasury / Prudential Indicator	2021/22 Indicator	2021/22 Quarter 2
Authorised limit for external debt (Inc' loans raised to on-lend to Housing & Investment Company)	-----£1,074.0m-----	
Operational boundary for external debt (Inc' loans raised to on-lend to Housing & Investment Company)	----- £1,044.0m-----	
Total Net Borrowing – Quarter 2	--------£631.1m------	
Capital Financing Requirement (CFR) *[Including PFI and Finance Lease Liabilities]*	£984.4m	£984.4m
Ratio of financing costs to net revenue streams	8.8%	7.67%
Upper limit of fixed interest rates based on net debt*	150%	98%
Upper limit of variable interest rates based on net debt*	65%	2%
Principal sums invested over 365 days (exc' third party loans)	£50.0m	£37.1m
Maturity structure of borrowing limits**: -		
Under 12 months	Max. 80% Min. 0%	26.27%
12 months to 2 years	Max. 50% Min. 0%	7.66%
2 years to 5 years	Max. 50% Min. 0%	9.95%
5 years to 10 years	Max. 50% Min. 0%	11.05%
10 years and above	Max. 100% Min. 0%	45.07%

*The interest rate exposure is calculated a percentage of net debt. Due to the mathematical calculation exposures could be greater than 100% or below zero (i.e. negative) depending on the component parts of the formula.

**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.