Treasury Management (at quarter 1)

Borrowing and Investments

1. The table below shows the year's opening balance of borrowing and investments, the levels as at 30 June 2020 and those predicted for year-end. Forecast borrowing is currently based on the programme approved in February and will be subject to review during the year.

2.

	31-Mar-20 Actual £M	31-Mar-20 Average %	30-Jun-20 Actual £M	30-Jun-20 Average %	31-Mar-21 Forecast £M	31-Mar-20 Forecast %
Long Term Borrowing						
Public Works Loan	257.87	2.88	255.12	2.70	513.70	2.72
LOBO Loans from Banks	9.00	4.89	9.00	4.86	9.00	4.88
	266.87	**2.95**	**264.12**	**2.81**	**522.70**	**2.78**
Short Term Borrowing						
Other Local Authorities	10.00	0.92	5.00	0.67	10.00	0.61
Other						
Total External Borrowing	**276.87**	**0.92**	**269.12**	**2.74**	**532.70**	**2.70**
Other Long Term Liabilities						
PFI Schemes	54.00	9.01	52.48	8.82	50.96	9.16
Deferred Debt Charges (HCC)	13.83	2.66	13.64	2.61	13.46	2.70
Total Gross External Debt	**344.70**	**3.87**	**335.25**	**4.08**	**597.12**	**3.87**
Investments:						
Managed In-House						
Government & Local Authority	0.00	0.00	(10.00)	0.20		
Cash (Instant access)	(31.11)	0.34	(35.72)	0.23	(10.00)	0.06
Cash (Notice Account)	0.00	0.00	(3.14)	0.01	0.00	0.01
Long Term Bonds	(3.01)	5.30	(3.03)	5.30	(3.00)	5.30
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.02)	4.35	(27.02)	3.71	(27.02)	3.00
Total Investments	**(61.15)**	**4.44**	**(78.91)**	**3.12**	**(40.02)**	**2.44**
Net Debt	**283.55**		**256.34**		**557.10**	

3. After taking into account maturing and new debt requirements in year and a reduction in investment balances, there is a current estimated increase in net borrowing of around £273.5M for the year.

4. The interest cost of financing the council's long term and short term loan debt is charged to the general fund revenue account and is detailed below together with a summary of performance to date.

Borrowing

5. The forecast cost of financing the council's loan debt is £15.92M of which £5.0M relates to the HRA however this will be subject to movement as the need for further borrowing during the year becomes more certain.

6. As a result of the current economic uncertainty, the benchmark gilt rates for PWLB loans remain at historic lows, however following the government's announcement on 9th October that the margin on loans has increased from 0.8% to 1.8% an increase of 100 base points or £0.010M for each £1M borrowed, this is now relatively expensive, and market alternatives will be considered in consultation with our advisors, Arlingclose before any long term borrowing is taken.

	These alternatives will not be as straightforward as borrowing from the PWLB and the strength of individual authorities will be scrutinised by investors and commercial lenders to determine the rate.
7.	The Chancellor's March 2020 Budget statement included further significant changes to PWLB policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new HRA loans to 0.80% above equivalent gilt yields: the value of this discount is 1% below the rate at which the authority can usually borrow from the PWLB. There is also £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% available to support specific local authority infrastructure projects for which there is a bidding process.
8.	Short term interest rates have remained low and are likely to do so for the remainder of the year and offer good value, which we will utilise to fund any further borrowing needs in the year, unless a further opportunity arises to secure a long term loan at advantageous rates. We currently have £5M in short term debt and this is expected to increase during the year to replace maturing long term debt, expected reduction in reserves and to fund the forecast capital programme for the year, until a decision is taken with regards to long term borrowing. Any increase in short term borrowing costs will be offset by a reduction in long term costs.
	<u>Investment</u>
9.	The initial reaction to the COVID crisis in March meant that short term liquidity became difficult and Government sought to assist cash flow by providing up front funding as far as possible, both in terms of the grants to businesses administered by the Council on its behalf and the funding to the local authority itself (under the business rates retention scheme). As a result of this grant funding year end investment balances were higher than expected and have remained so during the quarter but are expected to fall throughout the year to an estimated £40M by the end of the year, as we have a number of debt maturities and an ongoing capital programme, but this will be dependent on actual capital spend and movement in balances. Investment balances have ranged between £114M and £61M during the quarter and are currently £79M. The impact of COVID-19 will continue during the year and will be reported at each quarter and as part of the mid-year Treasury Report to Governance Committee.
	<u>External Managed investments</u>
10.	The council has invested £27M in property funds as an alternative to buying property directly. As previously reported these funds offer the potential for enhanced returns over the longer term, but may be more volatile in the shorter term and are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are usually available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed.
11.	Similar to many other property funds, dealing (i.e. buying or selling units) in the fund is currently suspended. The lack of property transactions (as the pandemic intensified) meant that it was not possible for valuers to be confident that their valuations correctly reflected prevailing conditions. To avoid material risk of disadvantage to buyers, sellers and holders of units in the property fund, the management company was obliged to suspend transactions until the required level of certainty is re-established.

12.	Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained.
13.	During 2019/20 this investment returned £1.2M at an average yield of 4.35% against the initial investment, however since the onset of the COVID-19 pandemic and the current global economic environment, the value of the fund fell to £26.47M at 31 March 2020 a reduction of £0.53M against the original investment. This trend has continued into 2020/21 and the fund is currently valued at £25.42M, £1.58M lower than original investment. This notional "loss" will only be a cost to the Authority at the point the investment is sold as the Authority is using the alternative fair value through profit and loss (FVPL) accounting and can defer the funds' fair value losses to the Pooled Investment Fund Adjustment Account until 2023/24, by which time it is anticipated that the global economic environment will have improved. The estimated return for the year is expected to reduce to about 75% of that for 2019/20, with £0.9M forecast.
	<u>Financial Review and Outlook for 2020/21</u>
14.	A summary of the external factors, which sets the background for Treasury, as provided by the council's treasury advisors, Arlingclose Ltd, is summarised below. The low for longer interest rate outlook theme that has been at the core of the recommended strategic advice for over a decade remains.
15.	The UK's exit from the European Union took a back seat during the first quarter of 2020/21 as the global economic impact from coronavirus took centre stage. Part of the measures taken to stop the spread of the pandemic included the government implementing a nationwide lockdown in late March which effectively shut down almost the entire UK economy. These measures continued throughout most of the quarter with only some easing of restrictions at the end of May and into June.
16.	Bank Rate was maintained at 0.1% despite some speculation that the Bank of England's Monetary Policy Committee (MPC) might cut further and some MPC members also suggesting that negative rates are part of the Bank's policy tools. In June the Bank increased the asset purchase scheme by £100 billion, taking the recent round of QE to £300bn and total QE to £745 billion. At the same time, the government also implemented a range of fiscal stimulus measures totalling over £300 billion which had been announced in March and designed to dampen the effect of the pandemic on the labour market.
17.	GDP growth contracted by 2.2% in Q1 (Jan-Mar) 2020 pushing the annual growth rate down to -1.6%. The lockdown only came into force on 23rd March, and the markets are braced for a dire set of growth data for Q2. In April UK GDP fell 20.4% month-on-month. On the back of the 5.8% month-on-month fall in March, this means economic output fell by 25% compared to its pre-coronavirus peak in February 2020. The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.2% y/y in May, further below the Bank of England's 2% target.
18.	In the three months to June, labour market data remained largely unchanged on the previous quarter. This is likely due to the government's furlough scheme as more than a quarter of the UK workforce was estimated to be supported by it. The ILO unemployment rate remained unchanged at 3.9% while the employment rate fell to 76.4%. However, employers will have to

	contribute towards furlough payments from August and the scheme is due to stop at the end of October; unemployment is expected to rise as a result.
19.	The US economy contracted at an annualised rate of 5.0% in Q1 2020. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% while the US government announced a $2 trillion fiscal stimulus package. Relations between the US and China, which had briefly improved when Phase 1 of the trade agreement was signed in January, deteriorated over the quarter. With little room to move on interest rates, the European Central Bank maintained interest rates at 0% and the rate on the deposit facility (which banks may use to make overnight deposits with the Eurosystem) at -0.5% and announced a further huge, open-ended commitment to buy €600bn of bonds under its Pandemic Emergency Purchase Programme (PEPP) which can be reinvested out to 2022. This lifted the ECB's total bond buying support package to €1.35trillion.
20.	The medium-term global economic outlook is very weak. While containment measures taken by national governments in response to coronavirus are being eased, it is likely to be some time before demand recovers to pre-crisis levels due to rises in unemployment, the on-going need for virus control measures and the impact on consumer/business confidence. The responses from the Bank of England, HM Treasury as well as other central banks and governments have been significant and will act to support the recovery when it occurs, by keeping financial conditions stable and many businesses solvent/employees employed than would otherwise have been the case. There will be an economic bounce in the second half of the year, as businesses currently dormant begin production/supply services once more. However, the scale of the economic shock to demand and the probable on-going social distancing measures necessary before a vaccine is produced will mean that the subsequent pace of recovery is limited.
21.	Our treasury advisor, Arlingclose, expects the Bank Rate to remain at the current 0.10% level and additional monetary loosening in the near future through further financial asset purchases (QE). While the Arlingclose central case for Bank Rate is no change, further cuts to Bank Rate to zero or even into negative territory cannot be ruled out. Downside risks remain in the near term, as households and businesses react to an unprecedented set of economic circumstances. Gilt yields are expected to remain very low in the medium term. Some shorter-term gilt yields will remain around zero until either the Bank expressly rules out negative Bank Rate or growth prospects improve.

	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Official Bank Rate												
Upside risk	0.00	0.00	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35

	Credit background
22.	The UK sovereign rating was downgraded to AA- in March which was followed by a number of actions on UK and also non-UK banks from early April onwards. As the extent of the losses that banks and building societies will suffer due to the impact from the coronavirus epidemic remains uncertain but is expected to be substantial, in early June following Arlingclose's stress testing of the institutions on the counterparty list using bail-in analysis, a number of UK banks and building societies were suspended from the counterparty list for unsecured deposits. Although much better capitalised than before the 2007-09 financial crisis, under the current economic circumstances these entities were suspended for reasons of prudence. For those remaining on the list, the duration advice remains up to 35 days.
23.	**Investment Performance**
24.	The council's advisors undertake quarterly investment benchmarking across its client base. As reported previously our portfolio was more diversified and at higher interest rates than the average as a result of moving into the bond programme earlier than most clients, but there is now more competition for bonds from both government bodies and other local authorities, so opportunities to replace maturing bonds are limited and we will see a fall in suitable instruments. With this in mind, and following discussions with our advisors, it was decided to move more into property funds, which are a longer term investment, and to short term investments for cash flow purposes.
25.	Our current investments in bonds is now £3M following maturities in 2019/20 and we maintained the property funds at £27M, with all other cash being placed in short term deposits as shown in paragraph 2.
26.	As detailed in paragraph 9 our cash balances have been higher than usual. As a result we had £49M in short term investment which is above our normal working balances. Our target is to reduce this to a £10M working balance to reduce borrowing and therefore net interest costs but this will be dependent on actual capital spend and movement in balances.
27.	Investments managed internally are currently averaging a return of 0.51% which is higher than the average of 0.38% whilst still maintaining the average credit rating of AA-. Total income return at 1.72% is also higher than the average for both unitary (1.07%) and LA's (0.96%). However due to a fall in the capital value of our external funds of -7.49% our total investment return -0.74% is lower than both the average unitary (-0.56%) and LA's (-0.30%) across Arlingclose's client base, but as previously reported it is the income return at 4.21% that is the driver to invest plus they are deemed less risky than buying individual properties and do not constitute capital spend.