

## Treasury Management

### Borrowing and Investments

1. The table below shows the year's opening balance of borrowing and investments, current levels and those predicted for year-end. Forecast borrowing is currently based on month 6 capital monitoring and will be subject to review during the year.

Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Authority continued its strategy of keeping borrowing and investments below their underlying levels in order to reduce risk and make a net saving.

2.

	31-Mar-20 Actual £M	31-Mar-20 Average %	30-Sep-20 Actual £M	30-Sep-20 Average %	31-Mar-21 Forecast £M	31-Mar-21 Forecast %
<b>Long Term Borrowing</b>						
Public Works Loan	257.87	2.88	250.10	2.70	368.60	2.72
LOBO Loans from Banks	9.00	4.89	9.00	4.86	9.00	4.86
	<b>266.87</b>	<b>2.95</b>	<b>259.10</b>	<b>2.73</b>	<b>377.60</b>	<b>2.78</b>
<b>Short Term Borrowing</b>						
Other Local Authorities	10.00	0.92	0.00	0.39	10.00	0.64
Other	0.36	0.92	0.36	0.39	0.36	0.64
<b>Total External Borrowing</b>	<b>277.23</b>	<b>2.85</b>	<b>259.46</b>	<b>2.73</b>	<b>387.96</b>	<b>2.71</b>
<b>Other Long Term Liabilities</b>						
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
<b>Total Gross External Debt</b>	<b>345.06</b>	<b>3.87</b>	<b>325.59</b>	<b>4.08</b>	<b>452.38</b>	<b>3.62</b>
<b>Investments:</b>						
<b>Managed In-House</b>						
Government & Local Authority	0.00	0.00	(10.00)	0.11		
Cash (Instant access)	(31.11)	0.34	(28.80)	0.07	(10.00)	0.03
Cash (Notice Account)	0.00	0.00	(2.01)	0.00	0.00	0.00
Long Term Bonds	(3.01)	5.30	(3.03)	5.30	(3.00)	5.30
<b>Managed Externally</b>						
Pooled Funds (CCLA) & Shares	(27.02)	4.35	(27.02)	3.84	(27.02)	3.00
<b>Total Investments</b>	<b>(61.15)</b>	<b>4.44</b>	<b>(70.86)</b>	<b>3.89</b>	<b>(40.02)</b>	<b>2.43</b>
<b>Net Debt</b>	<b>283.91</b>		<b>254.73</b>		<b>412.36</b>	

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 £128.45M for the year, this is less than previously reported as a number of schemes have been deferred to 2021.

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 £15.75M of which £4.94M 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

	<p>margin on loans has increased from 0.8% to 1.8% an increase of 100 base points or £10k 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.</p> <p>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.</p>
7.	<p>The Chancellor's March 2020 Budget statement included further significant changes 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.</p> <p>The consultation includes developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to allow authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.</p> <p>The consultation closed on 31st July 2020 with the announcement and implementation of the revised lending terms expected in later in the year or early next year. Depending on the outcome of the consultation there may be a need to revisit plans to invest in property.</p>
8.	<p>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 an opportunity arises to secure a long term loan at advantageous rates.</p> <p>Although we currently do not have any short term debt we anticipate borrowing from November onwards 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.</p>
	<p><u>Investment</u></p>
9.	<p>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 year to date 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 year and are currently £71M.</p> <p>Continued downward pressure on short-dated cash brought net returns on money market funds close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.</p>

	<p>On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities.</p> <p>This supports our decision to only borrow for cash flow purposes at this stage as savings on borrowing costs more than offset the loss on short term investments.</p> <p>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.</p>
	<p><u>External Managed investments</u></p>
10.	<p>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.</p> <p>Because these funds have no defined maturity date but are usually available for withdrawal after a notice period (90 days), their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed.</p>
11.	<p>Similar to many other property funds, dealing (i.e. buying or selling units) in the fund was suspended by the fund in March 2020.</p> <p>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.</p> <p>Since then conditions in the property market have stabilised and valuation clarity and certainty have improved across its various segments, to the extent that valuers, with guidance from the Royal Institute of Chartered Surveyors, believe that the uncertainty around valuation is no longer applicable. The dealing suspension was lifted in September 2020.</p>
12.	<p>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.</p>
13.	<p>During 2019/20 this investment returned £1.2M at an average yield of 3.84% 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.</p> <p>This trend has continued into 2020/21 and the fund is currently valued at £25.37M, £1.63M 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.</p>

The estimated return for the year has improved from the last quarter and is now expected to be about 85% of that for 2019/20, £1.03M.

## Financial Review and Outlook for 2020/21

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.

	Dec-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
<b>Official Bank Rate</b>													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
<b>Arlingclose Central Case</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>
Downside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

15. The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been suppressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed. The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.
16. However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.
17. This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.
18. Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.
19. Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.
20. Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve. Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

	<b><u>Credit background</u></b>
21.	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, this then stabilised, and it has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned a AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.
22.	There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.
23.	<b><u>Investment Performance</u></b>
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 continued to be higher than usual. As a result, we had £41M 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 0.43% which is higher than the average of 0.27% whilst still maintaining the average credit rating of AA-. Total income return at 1.79% is also higher than the average for both unitary (0.88%) and LA's (0.90%).  However due to a fall in the capital value of our external funds of -6.72% (an improvement from last quarter at -7.49%) our total investment return at -0.67% is slightly lower than both the average unitary (-0.63%) and LA's (-0.46%) across Arlingclose's client base, but as previously reported it is the income return at 4.14% on NAV (Net Asset Value) that is the driver to invest plus they are deemed less risky than buying individual properties and do not constitute capital spend.