

# **Cherwell District Council**

## **Accounts, Audit and Risk Committee**

**Date of Meeting 23 September 2020**

### **Treasury Management Report – Q1 2020-21**

#### **Report of the Executive Director of Finance**

This report is public

Appendix 1 is exempt from publication by virtue of paragraph 3 of Schedule 12A of Local Government Act 1972

#### **Purpose of report**

To receive information on treasury management performance and compliance with treasury management policy for 2020-21 as required by the Treasury Management Code of Practice.

#### **1.0 Recommendations**

The meeting is recommended:

- 1.1 To note the contents of the June 2020 Treasury Management Report.

#### **2.0 Introduction**

- 2.1 In 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports. This quarterly report provides an additional update.
- 2.2 The Council's Treasury Management strategy for 2020-21 was approved at a meeting on 24 February 2020. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Council's treasury management strategy.
- 2.3 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24 February 2020.

## 3.0 Report Details

### External Context

- 3.1 Economic background: 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.
- 3.2 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.
- 3.3 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.
- 3.4 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 23<sup>rd</sup> 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.
- 3.5 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.
- 3.6 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.
- 3.7 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.
- 3.8 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.

- 3.9 Financial markets: After selling off sharply in March, equity markets started recovering in April and while still down on their pre-crisis levels, the Dow Jones and FTSE 100 and 250 have made up around half of the losses. Measures implemented by central banks and governments continue to maintain some degree of general investor confidence, however volatility remains.
- 3.10 Ultra-low interest rates and the flight to quality continued to keep gilts yields low over the period with the yield on some short-dated government bonds turning negative. The 5-year UK benchmark gilt yield dropped from 0.18% at the beginning of April 2020 to -0.06% on 30<sup>th</sup> June. The 10-year benchmark gilt yield fell from 0.31% to 0.14% over the same period, and the 20-year from 0.69% to 0.52%. 1-month, 3-month and 12-month bid rates averaged 0.04%, 0.28% and 0.44% respectively over the quarter.
- 3.11 Over the quarter (April–June), the yield on 2-year US treasuries fell from 0.24% to 0.20% while that on yield on 10-year treasuries fell from 0.63% to 0.61%. German bund yields remain negative.
- 3.12 Credit review: After rising sharply in late March, credit default swap spreads slowly eased over the quarter but remained above their pre-crisis levels.
- 3.13 Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and also non-UK banks from early April onwards. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as downgrading Close Brothers' long-term rating to A-. Network Rail Infrastructure and LCR Finance's long-term ratings were downgraded from AA to AA-. HSBC Bank and HSBC UK Bank were the exceptions however, with Fitch upgrading their long-term ratings to AA-.
- 3.14 Fitch affirmed the ratings of Canadian banks but revised their outlook to negative. The agency also downgraded the long- and short-term ratings of Australia's four largest banking groups. It upgraded the long-term deposit rating of both Bayerische Landesbank and Landesbank Baden-Wuerttemberg (LBBW) but downgraded the viability ratings, and revised outlooks to negative. Fitch later placed three Singapore banks on Rating Watch Negative.
- 3.15 S&P also took action on a range of UK and European banks, affirming their ratings but revising their outlook downwards due to the economic consequences of COVID-19. Moody's downgraded the long-term rating of Nationwide BS from Aa3 to A1 and S&P downgraded the long- and short-term ratings of HSBC Bank PLC and HSBC UK Bank PLC to A+ and A-1 respectively
- 3.16 In May, Fitch and S&P downgraded TfL's long-term rating to A+ from AA- after the 95% reduction in tube and train fares which make up 47% of TfL's revenue. However, the UK government agreed to a £1.6 billion support package which will help ease some of the stress TfL faces.
- 3.17 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.

### **Summary position and strategy**

- 3.18 As at the end of June 2020 the Council had borrowing of £144m and investments of £24.4m – a net borrowing position of £119.6m. Appendix 1 details the schedule of borrowing and investments as at 30 June 2020.
- 3.19 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 Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk.

### **Borrowing Update**

- 3.20 On 9 October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders.
- 3.21 The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields. £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% was made available to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.
- 3.22 The consultation titled "Future Lending Terms" allows stakeholders to contribute to 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.
- 3.23 The consultation deadline was extended and closed on 31 July 2020 with implementation of the new lending terms expected in the latter part of this calendar year. The Council has submitted its response to this consultation.
- 3.24 Municipal Bonds Agency (MBA): The MBA has revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency issued its first bond in March 2020 on behalf of Lancashire County Council.

3.25 If the Council intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

**Borrowing performance for 3 months ended 30 June 2020**

3.26 The Council requires external borrowing to fund its capital programme, and had total debt of £144m at the report date. £75m (52%) of the current debt is at fixed rate for the medium-long term from the Public Works Loan Board (PWLB), with the remainder borrowed short term from other local authorities (at fixed rates, but on a rolling basis with various durations, therefore effectively variable rate).

3.27 The Council’s chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required,

3.28 The table below shows the borrowing position during and at the end of the reporting period:

	<b>Borrowing Amount £</b>	<b>Interest Rate</b>	<b>Interest Budget* £</b>	<b>Interest Actual* £</b>	<b>Variance £</b>
Apr-June 2020	£143.5m (average)	1.64% (annualised)	£659k	£599k	£60k
As at 30/6/20	£144m	1.61%	-	-	-

\* Interest payable relates to externals loans only, excluding finance lease interest of £46k

3.29 The table below shows average borrowing rates for the reporting period:

<b>Borrowing Benchmarking</b>	<b>3-year</b>	<b>5-year</b>	<b>10-year</b>	<b>20-year</b>
PWLB Maturity rate	2.04%	2.05%	2.27%	2.67%

3.30 Interest payable for the full year is forecast to be £432k under budget, mainly due to lower interest rates than forecast.

3.31 A full list of current borrowing is shown at exempt Appendix 1.

**Investment performance for 3 months ended 30 June 2020**

3.32 Funds available for investment are on a temporary basis, and the level of funds available is mainly dependent on the timing of precept payments, receipt of grants and funding of the Capital Programme.

3.33 On 1 April 2020 the Council received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £26.7m was received and temporarily invested in short-dated, liquid instruments. This funding was disbursed by the end of July 2020.

3.34 In a relatively short period since the onset of the COVID-19 pandemic in March and the ensuing enforced lockdown in many jurisdictions, the global economic fallout has been sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, business and individuals.

- 3.35 In 2020/21 the Council expects to receive lower income from its cash and short-dated money market investments than it did in 2019/20 and earlier years.
- 3.36 Dividends and income paid will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact.
- 3.37 The table below shows the investment position during and at the end of the reporting period:

	<b>Investment Amount £</b>	<b>Interest Rate</b>	<b>Interest Budget £</b>	<b>Interest Actual £</b>	<b>Variance £</b>
Apr-Jun 2020	£37.9m (average)	0.39% (annualised)	£25k	£37k	£12k
As at 30/6/20	£24.4m	0.39%	-	-	-

- 3.38 The table below shows average money-market rates for the reporting period:

<b>Investment Benchmarking</b>	<b>Overnight</b>	<b>7-day</b>	<b>1-month</b>	<b>3-month</b>
LIBOR	0.06%	0.08%	0.16%	0.39%
SONIA (mid-rate)	0.09%	0.15%	0.16%	0.38%

- 3.39 Interest receivable is currently ahead of target, and is forecast to be approximately £22k above budget at the end of the year. Cash balances during the period were higher than expected due to government grants being received up-front, offsetting the lower than forecast interest rates.
- 3.40 The Council's cash investments are held primarily for liquidity purposes and therefore only available for relatively short-term deposits in a restricted selection of high-quality instruments, which often generate sub-LIBOR/SONIA returns e.g. the UK Debt Management Office (part of HM Treasury) which is highly secure but earns only a low rate of interest.
- 3.41 A full list of current investments is shown at exempt Appendix 1.

#### **Non-treasury investment activity.**

- 3.42 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.
- 3.43 As at 30 June 2020, the Council holds £75m of investments in the form of shares (£29.1m) and loans (£45.9m excluding accrued interest) to subsidiary companies and other organisations, primarily Graven Hill and Crown House.
- 3.44 The loan elements of these non-treasury investments generate, or are expected to generate, a higher rate of return than earned on treasury investments, but this reflects the additional risks to the Council of holding such investments.

#### **Overall performance**

3.45 The overall performance for the 3 months to 30 June 2020 is as follows:

	<b>Budget £k</b>	<b>Actual £k</b>	<b>Variance £k</b>
Borrowing costs*	705	645	(60)
Treasury income	(25)	(37)	(12)
Non-treasury income	(1,075)	(1,072)	3
Total cost/(income)	(395)	(464)	(69)

\*Borrowing costs include finance lease interest of £46k

3.46 The full year forecast is expected to achieve savings against budget of approximately £472k.

3.47 Our Treasury advisers, Arlingclose, provided the following outlook for the remainder of 2020/21:

3.48 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.

3.49 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.

3.50 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.

3.51 Arlingclose expects 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.

3.52 Downside risks remain in the near term, as households and businesses react to an unprecedented set of economic circumstances.

	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
<b>Official Bank Rate</b>												
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
<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>
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

3.53 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.

## 4.0 Conclusion and Reasons for Recommendations

- 4.1 This report details the Treasury Performance for the Council for the period ending 30 June 2020. It is submitted to the Accounts, Audit and Risk Committee for information as required by the Treasury Management Code of Practice.

## 5.0 Consultation

None

## 6.0 Alternative Options and Reasons for Rejection

- 6.1 The following alternative options have been identified and rejected for the reasons as set out below.

Option 1: To request further information on the performance reported.

## 7.0 Implications

### Financial and Resource Implications

- 7.1 There are no financial implications arising directly from any outcome of this report.

Comments checked by:

Michael Furness, Assistant Director – Finance

01295 221845, [Michael.Furness@cherwell-dc.gov.uk](mailto:Michael.Furness@cherwell-dc.gov.uk)

### Legal Implications

- 7.2 There are no legal implications arising directly from any outcome of this report.

Comments checked by:

Richard Hawtin, Team Leader – Non-contentious Business

01295 221695, [richard.hawtin@cherwell-dc.gov.uk](mailto:richard.hawtin@cherwell-dc.gov.uk)

### Risk Implications

- 7.3 It is essential that this report is considered by the Audit Committee as it demonstrates that the risk of not complying with the Council's Treasury Management Policy has been avoided

Comments checked by:

Louise Tustian, Head of Insight and Corporate Programmes

01295 221786, [louise.tustian@cherwell-dc.gov.uk](mailto:louise.tustian@cherwell-dc.gov.uk)

## 8.0 Decision Information

Key Decision:

N/A



**Financial Threshold Met:** N/A

**Community Impact Threshold Met:** N/A

**Wards Affected**

All.

**Links to Corporate Plan and Policy Framework**

Links to all areas of Corporate Plan.

**Lead Councillor**

None.

**Document Information**

**Appendix number and title**

- Appendix 1 - CDC schedule of borrowing and investments at 30 June 2020 - EXEMPT

**Background papers**

None

**Report Author and contact details**

Ian Robinson – Finance Business Partner  
01295 221762, [ian.robinson@cherwell-dc.gov.uk](mailto:ian.robinson@cherwell-dc.gov.uk)