

Cherwell District Council

Accounts, Audit and Risk Committee

17 March 2021

Treasury Management Report – Q3 2020-21

Report of the Director of Finance

This report is public

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 Quarter 3 2020/21 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 (provided by Arlingclose 11 January 2021)

- 3.1 Economic background: Some good news came during the quarter as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK Medicines and Healthcare products Regulatory Agency (MHRA) provided authorisation for emergency supply of two COVID-19 vaccines in December and the rollout to individuals in the highest priority groups began in earnest.
- 3.2 A Brexit trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline. Having been agreed with the European Union (EU) on Christmas Eve, the Brexit trade deal was voted through the House of Commons by 521 votes to 73 and then written into law after passing through the House of Lords and given royal assent.
- 3.3 The Bank of England (BoE) maintained Bank Rate at 0.1% during the quarter but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its December interest rate announcement, the BoE noted that plans to roll out COVID-19 vaccines would reduce some of the downside risks to the economic outlook but that recent rises in the number of infections is likely to lead to weaker GDP growth than had been predicted in its November Monetary Policy Report.
- 3.4 Government initiatives continued to support the economy as the furlough (Coronavirus Job Retention) scheme was extended once again to April 2021, supporting some 10 million jobs, and meaning that by then time the government would have provided taxpayer support to jobs for over a year.
- 3.5 GDP growth rebounded by 16.0% (upwardly revised from first estimate of 15.5%) in Q3 2020 (Jul-Sep) according to the Office for National Statistics (ONS), pulling the annual growth rate up to -8.6% from -20.8% in Q2. Construction rose by a huge 41% over the quarter, services output was up almost 15% as was production output. However, recent monthly estimates of GDP have shown growth is slowing and only a 1.1% monthly rise was managed in September.
- 3.6 The headline rate of UK Consumer Price Inflation (CPI) rose to 0.3% year/year in November, below expectations (0.6%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 0.6% year/year (0.8% expected). The weaker-than-expected readings were due to falling prices for clothing as Black Friday deals started earlier than usual and for food and non-alcoholic drinks.
- 3.7 In the three months to October, labour market data showed the unemployment rate increased from 4.3% to 4.9% while wages rose 2.7% for total pay in nominal terms (2.8% for regular pay) and was up 1.9% in real terms (2.1% for regular pay). The employment rate fell to 75.2% from 75.8%. Unemployment is expected to increase strongly once the various government job support schemes come to an end, with the BoE predicting unemployment could peak at almost 8% in the second quarter of 2021.
- 3.8 The US economy rebounded at an annualised rate of 33.4% in Q3 2020 (Jul-Sep), fuelled by more than \$3 trillion in pandemic relief. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25%.

- 3.9 The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.
- 3.10 Financial markets: Equity markets continued to rise, and the Dow Jones beat its pre-crisis peak on the back of continued outperformance by a small number of technology stocks. The FTSE indices continued to perform well, with the more internationally focused FTSE 100 getting back to around 60% of its pre-March level while the more UK-focused FTSE 250 was closer to 80% of its previous peak over the same period.
- 3.11 Ultra-low interest rates prevailed through the quarter. Gilt yields remained low but volatile over the period with the yield on some short-dated UK government bonds continuing to remain negative. The 5-year UK benchmark gilt yield started the October–December period at -0.07% and ended at -0.09% (with much volatility in between). The 10-year gilt yield fell from 0.23% to 0.19% over the same period but peaked at 0.40% in November during a volatile quarter. The 20-year fell from 0.76% to 0.69%. 1-month, 3-month and 12-month SONIA bid rates averaged -0.01%, 0.06% and 0.07% respectively over the three months.
- 3.12 At the end of December, the yield on 2-year US treasuries was around 0.12% while for 10-year treasuries the yield was 0.92%. German bund yields remain negative across most maturities.
- 3.13 Credit review: After rising in late October/early November, credit default swap spreads declined over the remaining period of the calendar year to broadly pre-pandemic levels and the gap in spreads between UK ringfenced and non-ringfenced entities remained. At the end of the period Barclays Bank Plc was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The ringfenced banks were trading between 33 and 36bps.
- 3.14 During the period Moody's downgraded the UK sovereign rating to Aa3 with a Stable outlook which then impacted a number of other UK institutions, banks and local government. These included Cornwall Council and Guildford BC which were downgraded to Aa3. Transport for London, Aberdeen CC, Lancashire CC, Lloyds Bank and HSBC Bank downgraded to A1 and Warrington BC was downgraded to A2.
- 3.15 While the approval of two coronavirus vaccines is a credit positive, there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. 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.

Summary position and strategy

- 3.16 As at the end of December 2020 the Council had borrowing of £162m and investments of £28.6m – a net borrowing position of £133.4m (30/9/20: £136.6m).

- 3.17 Lower 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 performance for 9 months ended 31 December 2020

- 3.18 The Council requires external borrowing to fund its capital programme, and had total debt of £162m at the report date. £75m (46%) 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).
- 3.19 The Council's chief objective when borrowing is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required,
- 3.20 The table below shows the borrowing position during and at the end of the reporting period:

	Borrowing Amount	Interest Rate	Interest Paid Budget*	Interest Paid Actual*	Variance
Apr-Dec 2020	£149.6m (average)	1.54% (annualised)	£1.654m	£1.731m	£0.077m
As at 31/12/20	£162m	1.32%	-	-	-

* Interest payable relates to external loans only, excluding finance lease interest of £139k

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

Borrowing Benchmarking	1 year	3 year	5 year	10 year	20 year	50 year
PWLB Maturity rate	1.86%	1.84%	1.88%	2.14%	2.61%	2.47%

- 3.22 Interest payable for the full year is forecast to be £16k over budget (adverse variance).

- 3.23 A full list of current borrowing is shown below:

Lender	Principal Borrowed £	Maturity Date
Elmbridge Borough Council	5,000,000	04/01/2021
Bromley Borough Council	5,000,000	21/01/2021
London Borough of Newham	10,000,000	15/02/2021
Greater London Authority	5,000,000	19/02/2021
Vale of Glamorgan Council	2,000,000	19/03/2021
Derbyshire Pension Fund	10,000,000	01/04/2021
Islington Borough Council	5,000,000	19/04/2021
Derbyshire County Council	5,000,000	20/04/2021
St Helens Council	10,000,000	14/05/2021
Rugby Borough Council	5,000,000	08/07/2021

North of Tyne Combined Auth.	10,000,000	29/09/2021
West Yorkshire Fire & Rescue	5,000,000	12/10/2021
Lincolnshire County Council	5,000,000	15/10/2021
Oxfordshire County Council	5,000,000	15/07/2022
PWLB - ref 506477	21,000,000	19/10/2024
PWLB - ref 116158	6,000,000	25/09/2025
PWLB - ref 114322	6,000,000	19/09/2026
PWLB - ref 507455	10,000,000	31/05/2028
PWLB - ref 116160	6,000,000	25/09/2029
PWLB - ref 114324	6,000,000	19/09/2030
PWLB - ref 507456	5,000,000	31/05/2033
PWLB - ref 116162	5,000,000	25/09/2034
PWLB - ref 114326	5,000,000	19/09/2035
PWLB - ref 507457	5,000,000	31/05/2048
TOTAL	162,000,000	

Investment performance for 9 months ended 31 December 2020

- 3.24 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.
- 3.25 Up to and including 31 December 2020, the Council has received over £32m central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. These funds are disbursed as early as possible, dependant on applications and subject to eligibility criteria and verification procedures. Funding held on account is temporarily invested in short-dated, liquid instruments.
- 3.26 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.
- 3.27 In 2020/21 the Council expects to receive lower income from its cash and short-dated money market investments than it did in previous years. 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.
- 3.28 The table below shows the investment position during and at the end of the reporting period:

	Investment Amount	Interest Rate	Interest Earned Budget	Interest Earned Actual	Variance £
Apr-Dec 2020	£30.3m (average)	0.32% (annualised)	(£76k)	(£73k)	£3k
As at 31/12/20	£28.6m	0.17%	-	-	-

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

Investment Benchmarking	Overnight	7-day	1-month	3-month
LIBOR	0.05%	0.06%	0.08%	0.17%
SONIA (mid-rate)	0.09%	0.12%	0.12%	0.21%

3.30 Interest receivable for the full year is forecast to be £16k below budget (adverse variance).

3.31 The Council's cash investments are held primarily for liquidity purposes and therefore are 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.

3.32 A full list of current investments is shown below:

Counterparty	Principal Deposited £	Maturity Date/ Notice period
<u>Fixed Term Deposits</u>		
DMADF	5,520,000	13/01/2021
DMADF	1,000,000	22/02/2021
Darlington Borough Council	2,000,000	21/05/2021
Merseyside Police	2,000,000	01/07/2021
Thurrock Borough Council	2,000,000	14/10/2021
Lancashire County Council	2,000,000	01/11/2021
Redcar & Cleveland Borough Council	2,000,000	02/12/2021
South Cambridgeshire District Council	2,000,000	16/12/2021
<u>Money Market Funds</u>		
Goldman Sachs Asset Management	5,000,000	Same day
Federated Investors UK	4,991,000	Same day
<u>Call Account</u>		
Handelsbanken	47,309	Same day
TOTAL	28,558,309	

Non-treasury investment activity.

3.33 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.

- 3.34 As at 31 December 2020, the Council held £93.6m of investments in the form of shares (£33.1m) and loans (£60.5m) to subsidiary companies and other organisations, primarily Graven Hill and Crown House.
- 3.35 The loan elements of these non-treasury investments generate a higher rate of return than earned on treasury investments, but this reflects the additional risks to the Council of holding such investments.
- 3.36 For the 9 months to 31 December 2020 these loans have earned interest of £3.231m, an adverse variance of £24k against budget income of £3.255m. The full year forecast is expected to show an adverse variance of £56k.

Overall performance

- 3.37 The overall performance for the 9 months to 31 December 2020 is as follows:

	Budget £k	Actual £k	Variance £k
Borrowing costs*	1,793	1,870	77
Treasury income	(76)	(73)	3
Non-treasury income	(3,255)	(3,231)	24
Total cost/(income)	(1,538)	(1,434)	104

*Borrowing costs include finance lease interest of £139k.

- 3.38 The full year forecast is expected to show an overall adverse variance against budget of £88k:

	Budget £k	Actual £k	Variance £k
Borrowing costs	2,390	2,406	16
Treasury income	(101)	(85)	16
Non-treasury income	(4,339)	(4,283)	56
Total cost/(income)	(2,050)	(1,962)	88

Economic and interest rate forecast

- 3.39 Our Treasury advisers, Arlingclose, provided the following outlook for the remainder of 2020/21, and interest rate forecast:
- 3.40 The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.
- 3.41 Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.
- 3.42 Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.

- 3.43 The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.
- 3.44 Brexit, whatever the outcome of current negotiations, will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.
- 3.45 Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term 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, the deployment of vaccines or if the UK leaves the EU without a deal.
- 3.46 Arlingclose expects Bank Rate to remain at the current 0.10% level. The central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.

	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
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	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	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

- 3.47 Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.
- 3.48 Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period comes to an end.

4.0 Conclusion and Reasons for Recommendations

- 4.1 This report details the Treasury Performance for the Council for the period ending 31 December 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. The variances to budget as noted above are included in the Monthly Performance, Finance and Risk Monitoring Report to Executive.

Comments checked by:

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Legal Implications

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

Comments checked by:

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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:

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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

- None

Background papers

None

Report Author and contact details

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