APPENDIX A

TREASURY MANAGEMENT POSITION FOR THE FIRST QUARTER OF 2020/21

A1. SUMMARY OF TREASURY MANAGEMENT INDICTORS

The City Council originally approved the authorised limit (the maximum amount of borrowing permitted by the Council) and the operational boundary (the maximum amount of borrowing that is expected) on 11th February 2020. The Council's debt at 30th June was as follows:

Prudential Indicator	**Limit** £m	**Actual** £m
Authorised Limit - the maximum amount of borrowing permitted by the Council	883	790
Operational Boundary - the maximum amount of borrowing that is expected	868	790

The maturity structure of the Council's fixed rate borrowing was:

	Under 1 Year	**1 to 2 Years**	**3 to 5 Years**	**6 to 10 Years**	**11 to 20 Years**	**21 to 30 Years**	**31 to 40 Years**	**41 to 50 Years**
Minimum proportion of loans maturing	0%	0%	0%	0%	0%	0%	0%	0%
Maximum proportion of loans maturing	10%	10%	10%	20%	30%	30%	40%	40%
Actual proportion of loans maturing	1%	1%	4%	11%	18%	7%	31%	27%

The maturity structure of the Council's variable rate borrowing was:

	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Minimum proportion of loans maturing	0%	0%	0%	0%	0%	0%	0%	0%
Maximum proportion of loans maturing	10%	10%	10%	20%	30%	30%	30%	30%
Actual proportion of loans maturing	2%	2%	6%	11%	22%	24%	19%	14%

Surplus cash invested for periods longer than 365 days at 30th June 2020 was:

	Limit £m	Quarter 1 Actual £m
Maturing after 31/3/2021	117	66
Maturing after 31/3/2022	50	30
Maturing after 31/3/2023	50	20

A2. GOVERNANCE

The Treasury Management Policy approved by the City Council on 17th March 2020 provides the framework within which treasury management activities are undertaken.

There have been no breaches of these policies during 2020/21 up to the period ending 30th June 2020.

A3. BORROWING ACTIVITY

Gilt yields had already been on a falling trend during the last year up until the coronavirus crisis hit western economies. Since then, we have seen gilt yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies and moved cash into safe haven assets i.e. government bonds. However, major western central banks started massive quantitative easing purchases of government bonds which has acted to maintain downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds; in normal times this would have caused bond yields to rise sharply. At the close of the day on 30 June, all gilt yields from 1 to 5 years were slightly negative while even 25-year yields were at only 0.71% and 50 year at 0.54%. Equity markets have enjoyed a rebound since the lows of March as confidence has started to return among investors that the worst is over and recovery is now on the way.

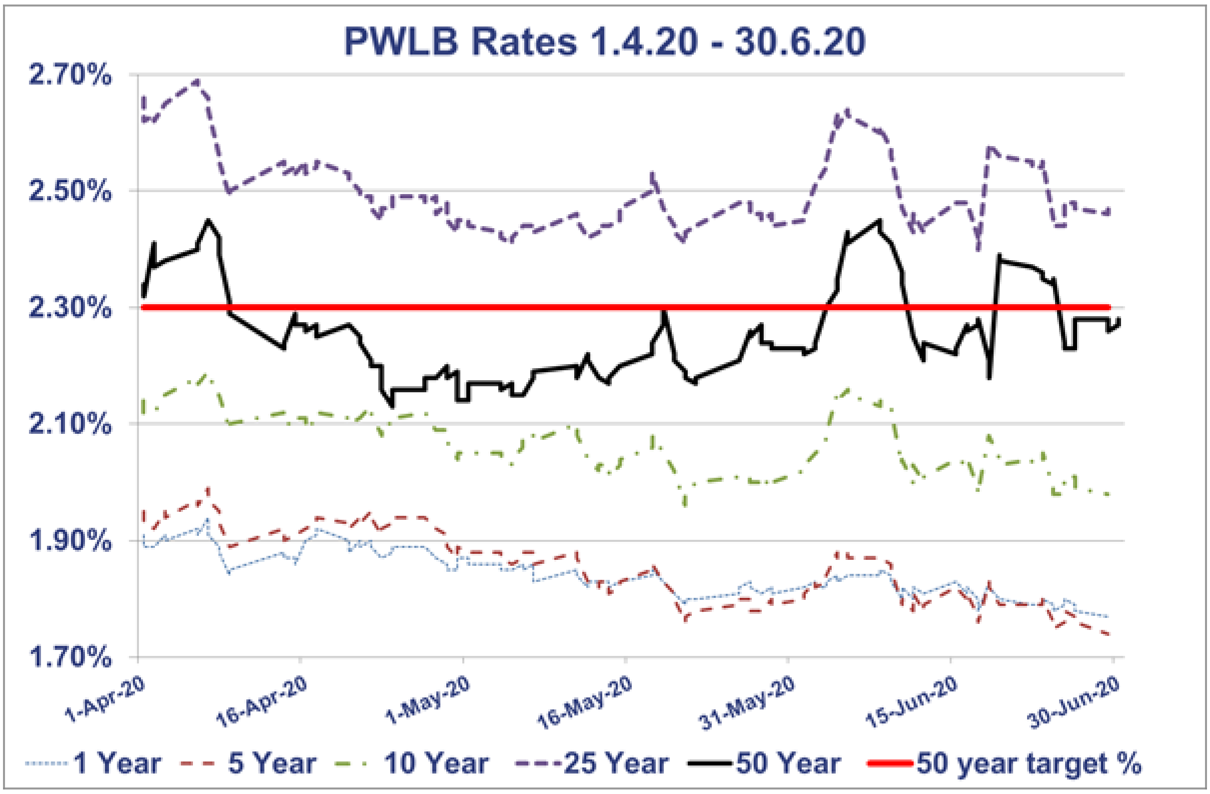
However, HM Treasury imposed two changes of margins over gilt yields for Public Works Loans Board (PWLB) rates in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then at least partially reversed for some forms of borrowing, including borrowing by the Housing Revenue Account (HRA) on 11 March 2020, but not for mainstream General Fund capital schemes. The Government also announced that there would be a consultation with local authorities on possibly further amending these margins; this ended on 31 July. The consultation also proposes that it will no longer allow local authorities to borrow money from the PWLB if their capital programme includes the purchase of assets to generate a yield. The definition of such commercial activity in the consultation is vague.

Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

The Council qualifies to borrow from the PWLB at the certainty rate for both General Fund and Housing Revenue Account purposes.

PWLB rates have fallen a little between the start and end of the quarter with not a great deal of volatility between those dates. The 50 year PWLB target rate for new long term borrowing was at 2.30% during the quarter. This is shown in the graph below.



There is likely to be little upward movement in PWLB rates over the next two years as it will take economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period.

£60m was borrowed from the PWLB at the HRA certainty rate in the first quarter of 2020/21 to fund the HRA capital programme. This was because PWLB rates were very low and because the Council may not be able to access funding from the PWLB in future because of its commercial activities. These loans were all for £20m and are repayable in 50 years at maturity. These loans have an average interest rate of 1.17%.

Whereas this authority has previously relied on the PWLB as its main source of funding, it now has to fundamentally reconsider alternative cheaper sources of borrowing. At the current time, this is a developmental area as this event has also taken the financial services industry by surprise. Various financial institutions have entered the market and made products available to local authorities. However, the market has yet to settle down. Members will be updated as this area evolves.

The Municipal Bonds Agency plans to offer loans to local authorities in 2020. This Authority may make use of this new source of borrowing as and when appropriate.

At the start of the year, the Council had £30m of short term loans to help fund the payment of 3 years' of employer's pension contributions in advance in return for a discount. These loans were repaid in the first quarter of 2020/21.

The Council's gross borrowing at 30th June 2020 of £790m is within the Council's Authorised Limit (the maximum amount of borrowing approved by City Council) of £883m and also within the Council's Operational Boundary (the limit beyond which borrowing is not expected to exceed) of £868m.

The Council plans for gross borrowing to have a reasonably even maturity profile. This is to ensure that the Council does not need to replace large amounts of maturing borrowing when interest rates could be unfavourable.

The actual maturity profile of the Council's borrowing is within the limits contained within the Council's Treasury Management Policy (see paragraph A1).

Early Redemption of Borrowing

Debt rescheduling opportunities have been limited in the current economic climate and following the various increases in the margins added to gilt yields which has impacted PWLB new borrowing rates since October 2010. During the quarter ended 30 June 2020 no debt rescheduling was undertaken.

With the exception of two loans all the Council's borrowings to finance capital expenditure are fixed rate and fixed term loans. This reduces interest rate risk and provides a high degree of budget certainty.

The Council's borrowing portfolio is kept under review to identify if and when it would be financially beneficial to repay any specific loans early. Repaying borrowing early invariably results in a premium (early repayment charges) by the PWLB that are sufficiently large to make early repayment of borrowing financially unattractive to the Council.

No debt rescheduling or early repayment of debt has been undertaken during the first quarter of 2020/21 as it has not been financially advantageous for the Council to do so.

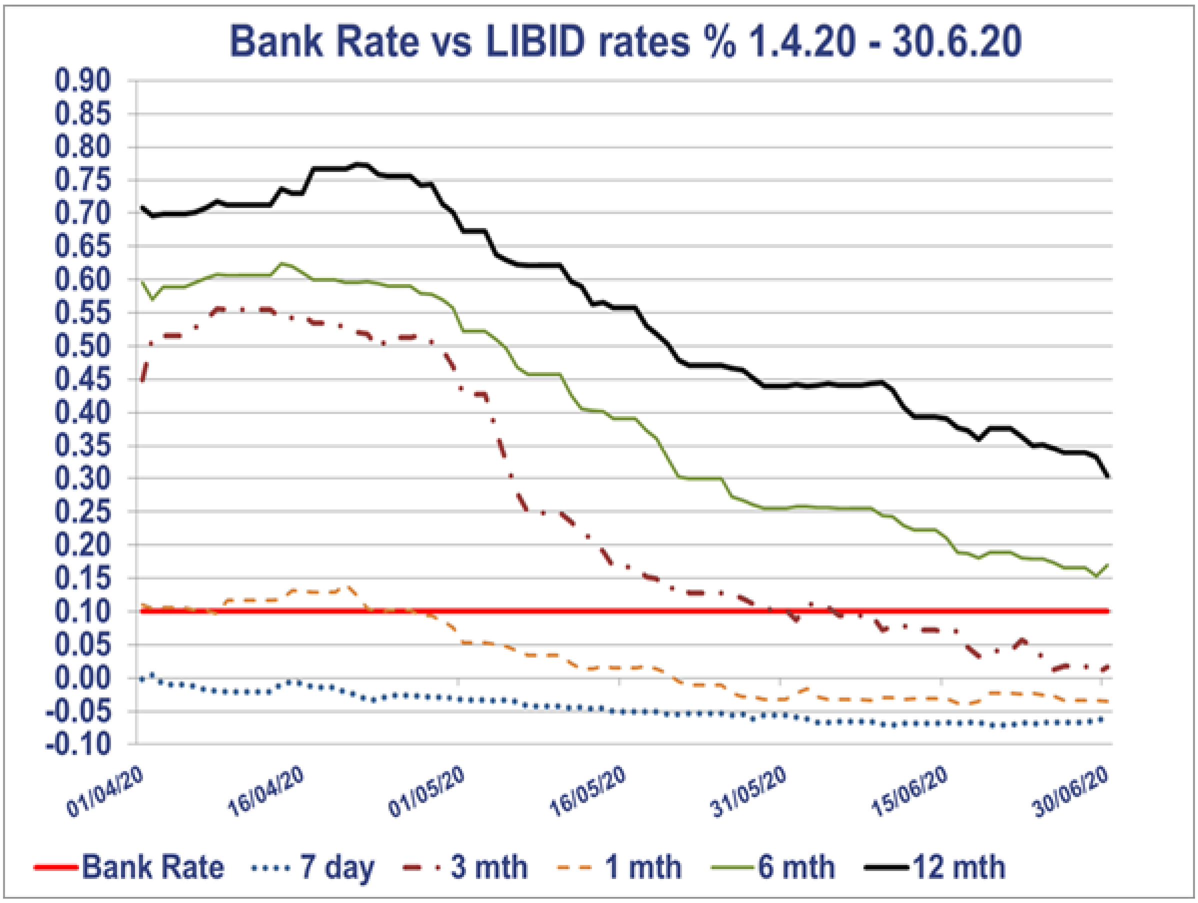
A4. INVESTMENT ACTIVITY

Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during this quarter, due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks.

Although credit default swap (CDS) prices, (these are market indicators of credit risk), for UK banks spiked upwards at the end of March due to the liquidity crisis throughout financial markets, those CDS prices have returned to more average levels since then.

Uncertainty over Brexit caused the MPC to leave Bank Rate unchanged during 2019 and at its January 2020 meeting. However, since then the coronavirus outbreak has transformed the economic landscape: in March, the MPC took emergency action twice to cut Bank Rate first to 0.25%, and then to 0.10%. It is now unlikely to rise for the next two years pending a protracted recovery of the economy from this huge set back.

Actual market investment rates (London Interbank Bid rate) are shown in the graph below.



The Council's cash investment portfolio consists of the following.

	Portfolio at 31st March 2020	**Return in 2019/20**	**Portfolio at 30th June 2020**	**Annualised Return in Quarter 1 of 2019/20**
Plain vanilla interest bearing deposits	£375.7	0.98%	£374.2m	0.98%
Tradable structured interest bearing deposits where the interest rate or the maturity date is determined by certain criteria	£9.7m	2.05%	£10.2m	22.55%
Externally managed corporate bonds	£7.4m	-1.16%	£8.0m	24.28%
Total	**£392.8m**	**0.99%**	**£392.4m**	**2.02%**

Plain Vanilla Interest Bearing Deposits

The return on plain vanilla interest bearing deposits in 2019/20 was reduced through the need to provide £0.6m to write off the investment in Victory Energy Services Limited (VESL). The underlying return on these deposits in 2019/20 before providing for the write off of the investment in VESL was 1.16%. Therefore the underlying return on these investments has fallen by 18 basis points in the first quarter of 2020/21. This trend is expected to continue as when the current investments mature, it is unlikely that it will be possible to replace them with new investments paying the previous rates.

Tradable Structured Interest Bearing Deposits

This now consists of a single collared floating rate note purchased in June 2018 with a nominal value of £10m maturing in June 2023. Interest is paid at the 3 month London Inter Bank Offer Rate (LIBOR) with a floor of 1.60% and a cap of 3.50%. Interest is currently being paid at 1.60%.

At the end of 2019/20 this investment had a market value of £9.7m because the financial markets had become illiquid.

However, liquidity has returned to the financial markets and the guaranteed return of at least 1.60% is very attractive against the current 3 month LIBOR rate of 0.14%. Consequently at 30th June 2020 this investment had a market value of £10.2m. The market value of this investment should be £10m when it matures in June 2023.

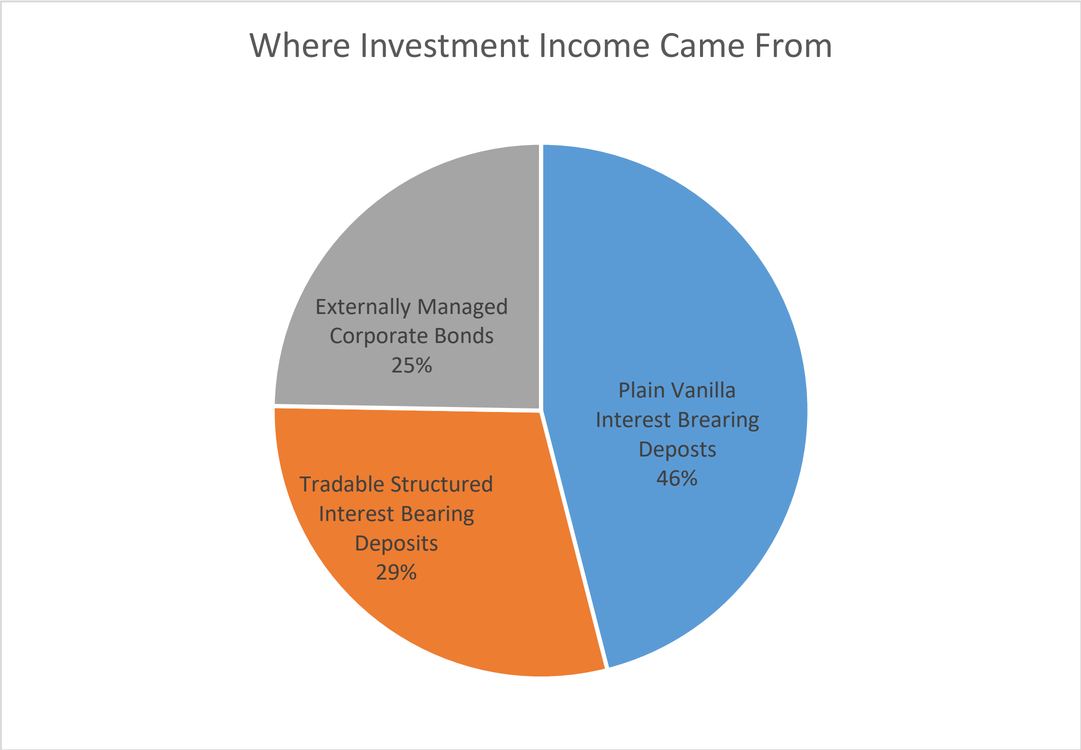
Externally Managed Corporate Bonds

The shortage of liquidity in the financial markets in March 2020 also caused the market value of corporate bonds to fall sharply. As a consequence of this the Council's externally managed corporate bonds made a negative return of 1.16% in 2019/20.

The corporate bond portfolio has been defensively managed and has no direct exposure to the energy, travel, hospitality, or non-food retail sectors. Now that liquidity has returned to the financial markets the value of the corporate bond portfolio has made a strong recovery.

Overall Return

The Council made an overall return of 2% on its cash investments in the first quarter of 2020/21. The chart below shows the source of the Council's cash investment income.



54% of the Council's investment income came from externally managed corporate bonds and tradable structured interest bearing deposits, despite these investments making up less than 5% of the investment portfolio. However, much of these gains result from a recovery in the market value of these investments and the level of returns experienced in the first quarter of 2020/21 is unlikely to be sustained.

Over the remainder of the year, the vast majority of the Council's investment returns are likely to come from plain vanilla interest bearing deposits which make up over 95% of the investment portfolio. The returns on this type of investment are falling in line with market interest rates.

Given these factors, the return on the Council's investments over the remainder of the year is likely to be less than 1%.

A5. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

The Councils net debt position at 30th June 2020 is summarised in the table below.

	Principal	**Average Interest Rate**	**Interest to 30th June 2020**
Borrowing (including finance leases & private finance initiative (PFI) schemes)	£790m	3.65%	£7.2m
Investments	(392m)	(2.02%)	(£1.9m)
Net Debt	£398m		£5.3m

*Although the Council's investments were £392m at 30th June 2020, the average sum invested over this period was £381m.