TREASURY MANAGEMENT - QUARTER 3 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 11 February 2020. The Council's debt at 31 December was as follows:

Prudential Indicator	**Limit** £m	**Actual** £m
Authorised Limit - the maximum amount of borrowing permitted by the Council	883	774
Operational Boundary - the maximum amount of borrowing that is expected	868	774

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

	Under 1 Year	**1 - 2 Years**	**3 - 5 Years**	**6 - 10 Years**	**11 - 20 Years**	**21 - 30 Years**	**31 - 40 Years**	**41 - 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%	10%	16%	6%	27%	35%

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

	Under 1 Year	**1 - 2 Years**	**3 - 5 Years**	**6 - 10 Years**	**11 - 20 Years**	**21 - 30 Years**	**31 - 40 Years**	**41 - 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 31 December 2020 was:

	Limit £m	**Quarter 2 Actual** £m
Maturing after 31/3/2021	117	81
Maturing after 31/3/2022	50	40
Maturing after 31/3/2023	50	20

A2. GOVERNANCE

The Treasury Management Policy approved by the City Council on 17 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 31 December 2020.

A3. BORROWING ACTIVITY

Gilt yields were on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields initially spiked upwards in March, we have seen yields fall sharply in response to major western central banks taking rapid policy action to deal with excessive stress in financial markets during March, and starting massive quantitative easing driven purchases of government bonds: these actions also acted to put 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. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. At the close on 31 December, all gilt yields from 1 to 8 years were in negative territory, while even 25-year yields were only at 0.84% and the 50 year at 0.64%.

From the local authority borrowing perspective, HM Treasury imposed two changes of margins over gilt yields for Public Works Loans Board (PWLB) rates in a little over a year, the first without any warning. The first took place on 09 October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11 March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and on 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows:

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **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 (HRA) purposes.

There is likely to be little upward movement in PWLB rates over the next three years as it will take the UK a prolonged period to eliminate spare capacity in the economy so that inflation might start to become a sufficient concern for both the MPC to consider raising Bank Rate, and for gilt holders to require a higher yield.

£60m was borrowed from the PWLB at the HRA certainty rate in the first quarter of 2020/21 to fund the HRA capital programme. These loans were all for £20m and are repayable in 50 years at maturity. These loans have an average interest rate of 1.17%. No further long-term borrowing has been undertaken in 2020/21.

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

The Council's gross borrowing at 31 December 2020 of £774m 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.

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 three quarters 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 financial institutions from Stable to Negative during the quarter ended 30 June 2020, the majority of ratings were affirmed due to the continuing strong credit profiles and wider government support provided to financial markets and economies in general. During Quarter 1 and Quarter 2 2020, banks did make provisions for expected credit losses, while the most recent set of quarterly reports saw a number of entities revise down provisions in light of better economic outlooks. As we move into the next quarters ahead, more information will emerge on actual levels of credit losses. This has the potential to cause rating agencies to revisit their initial rating adjustments if they are found to be misaligned. These adjustments could be negative or positive, although it should also be borne in mind that UK banks, among others, went into this pandemic with strong balance sheets.

It is possible to insure deposits with banks against the risk of the bank defaulting through a financial instrument known as a credit default swap (CDS). CDS prices are therefore market indicators of credit risk. The CDS prices for UK banks spiked upwards at the end of March / early April as the crisis unfolded. They had returned to near pre-pandemic levels by the close of the year. However, sentiment can easily shift.

It is now impossible to earn the level of interest rates commonly seen in previous decades as all short term money market investment rates are barely above zero now that the Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this environment and the fact that increases in the Bank Rate are unlikely to occur before March 2024, investment returns are expected to remain low.

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 to 30th June 2020**	**Portfolio at 30th September 2020**	**Annualised Return to 30th September 2020**	**Portfolio at 31st December 2020**	**Annualised Return to 31st December 2020**
Plain vanilla interest bearing deposits	£375.70	0.98%	£374.2m	0.98%	£415.0m	0.92%	£419.1m	0.93%
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%	£10.3m	13.88%	£10.3m	9.80%
Externally managed corporate bonds	£7.4m	-1.16%	£8.0m	24.28%	£8.0m	18.92%	£7.9m	10.81%
Total	**£392.8m**	**0.99%**	**£392.4m**	**2.02%**	**£433.3m**	**1.58%**	**£437.3m**	**1.31%**

Plain Vanilla Interest Bearing Deposits

The returns on these investments are expected to continue to follow a generally downwards trend 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 because of the start of the coronavirus pandemic.

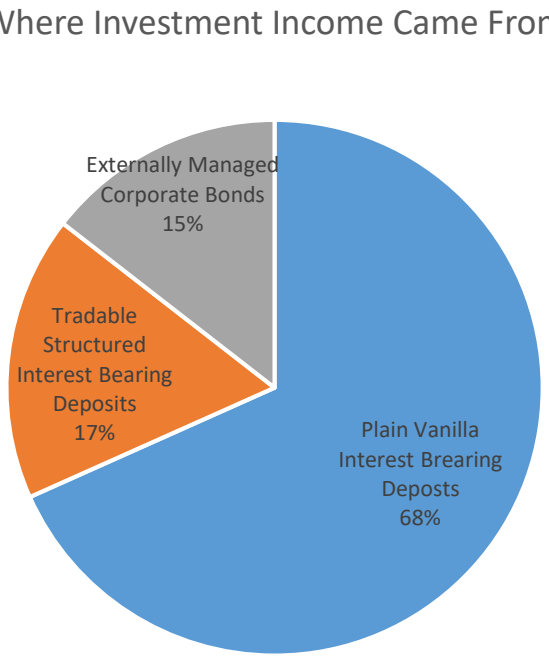
However, liquidity has returned to the financial markets following action by the central banks, and the guaranteed return of at least 1.60% is very attractive against the current 3 month LIBOR rate of 0.03%. Consequently, at 31 December 2020 this investment had a market value of £10.3m reflecting the two and a half years of above market returns that this investment will generate. The market value of this investment should be £10m when it matures in June 2023. It is currently intended to hold this investment until maturity so that the Council will continue to benefit from the above market returns generated by this investment.

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. Because 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 because many of the corporate bonds pre-date the current ultra-low investment rates and are now generating above market returns. It is currently intended to retain the corporate bonds so that the Council will continue to benefit from the above market returns generated by these investments.

Overall Return

The Council made an overall return of 1.31% on its cash investments in the first three quarters of 2020/21. The chart below shows the source of the Council's cash investment income.



32% 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 bounce back in the market value of these investments.

Over the remainder of the year, the vast majority of the Council's investment returns will come from plain vanilla interest bearing deposits, which make up over 95% of the investment portfolio.

Given these factors, the return on the Council's investments over the remainder of the year is likely to be around 1%, well above the current 6 month London Inter Bank Bid (LIBID) bench mark rate of -0.09%.

A5. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

The Council's net debt position at 31 December 2020 is summarised in the table below:

	Principal	**Average Interest Rate**	**Interest to 31 December 2020**
Borrowing (including finance leases & private finance initiative (PFI) schemes)	£774m	3.17%	£18.4m
Investments	(£437m)	(1.31 %)	(£4.1m)
Net Debt	£337m		£14.3m

*Although the Council's investments were £437m at 31 December 2020, the average sum invested over this period was £421m.