Appendix D

Treasury Management Outturn Report 2019/20

Introduction

In February 2012 the Authority 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 Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2019/20 was approved at a meeting on 29th January 2019. The Authority 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 remains central to the Authority's treasury management strategy.

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 Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 29th January 2019.

External Context

Economic background: UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU. Mr Johnson prorogued Parliament which led some MPs to put forward a bill requiring him to seek a Brexit extension if no deal is in place by 19th October. The move was successful and, having been approved by the House of Lords, was passed into law. The Supreme Court subsequently ruled Mr Johnson's suspension of Parliament unlawful.

Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a

predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October.

Financial markets: After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

Credit background: Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ring-fenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ring-fenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ring-fenced and non-ring-fenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

Local Context

On 31st March 2019, the Authority had net borrowing of £7.896m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £m
General Fund CFR	36.685
Less other debt liabilities	0.0
Total CFR	**36.685**
External borrowing	28.0
Internal borrowing	**8.685**
Less: Usable reserves	15.935
Less: Working capital	12.854
Investments	**20.104**

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 30th September 2019 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.19 Balance £m	**Movement £m**	**30.9.19 Balance £m**	**30.9.19 Rate %**
Long-term borrowing	14.0	5.0	19.0	2.03
Short-term borrowing	14.0	-5.0	9.0	0.76
Total borrowing	**28.0**	**0.0**	**28.0**	**1.62**
Long-term investments	2.0	1.0	3.0	1.60
Short-term investments	16.993	5.0	21.993	0.94
Cash and cash equivalents	1.111	5.177	6.288	0.71
Total investments	**20.104**	**11.177**	**31.281**	**1.38**
Net investments	**-7.896**	**11.177**	**3.281**	

Borrowing Strategy during the period

At 30th September 2019 the Authority held £28.0m of loans, the same position as at 31st March 2019, as part of its strategy for funding previous years' capital programmes. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.19 Balance £m	Net Movement £m	30.9.19 Balance £m
Public Works Loan Board	14.0	5.0	19.0
Banks (LOBO)	0.0	0.0	0.0
Banks (fixed-term)	0.0	0.0	0.0
Local authorities (long-term)	0.0	0.0	0.0
Local authorities (short-term)	14.0	-5.0	9.0
Total borrowing	**28.0**	**0.0**	**28.0**

The Authority'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, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

The Authority has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Authority's borrowing need based on realistic projections, the Authority decided to take advantage of the fall in PWLB borrowing rates in early September by replacing some short term borrowing with medium-term repayment loans (annuity/EIP). The Authority borrowed a total of £5.0m medium fixed rate loans, and allowed £5.0m of short term borrowing to mature, details of which are below. This movement in the Authority's loan structure provides some longer-term certainty and stability and create a more rounded debt portfolio

Long-dated Loans borrowed	Amount £m	Rate %	Period (Years)
PWLB Maturity Loan 1	11.0	2.35	40
PWLB Maturity Loan 2	3.0	2.47	40
PWLB EIP Loan 1	5.0	1.05	15
Total borrowing	**19.0**	**2.03**	

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

Treasury Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £22.86 and £31.28 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.19 Balance £m	Net Movement £m	30.9.19 Balance £m	30.9.19 Income Return %
Banks & building societies (unsecured)	4.261	6.327	10.588	0.96
Government (incl. local authorities)	8.0	0.0	8.0	0.89
Money Market Funds	0.85	4.85	5.7	0.73
Registered Providers	3.0	0.0	3.0	1.60
Other Pooled Funds (CCLA Property Fund)	3.993	0.0	3.993	4.30
Total investments	**20.104**	**11.177**	**31.281**	**1.38**

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure %	Weighted Average Maturity (days)	Internal Investment Rate of Return %	External Investment Rate of Return %	Rate of Return %
31.03.2019	4.65	A+	26	110	1.04	4.61	1.73
30.09.2019	4.75	A+	45	95	0.96	4.36	1.38
Similar LAs	4.26	AA-	61	80	0.86	3.58	1.58
All LAs	4.28	AA-	61	28	0.83	3.32	1.22

£3.993m of the Authority's investments are held in externally managed strategic pooled property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total return of £87,601 (4.30%), which is used to support services in year.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives are regularly reviewed. 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 medium term and the Authority's latest cash flow forecasts, investment in these funds has been maintained.

Readiness for Brexit: The scheduled leave date for the UK to leave the EU is now 31st January 2019 and there remains little political clarity as to whether a deal will be agreed by this date and there is the possibility that the exit date is pushed back yet again. As 31st January approaches the Authority will ensure there are enough accounts open at UK-domiciled banks and Money Market Funds to hold sufficient liquidity required in the near term and that its account with the Debt Management Account Deposit Facility (DMADF) remains available for use in an emergency.

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. *For English Authorities:* 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.

The Authority also held £37.4m of such investments in directly owned property as shown in the table below:

Property	Purchase date	Purchase Price	Total Investment	Current Rent	Yield on investment	Sector
Challenge House, Tewkesbury	Dec-16	£8,730,000	£9,083,736	£565,115	6.22%	Office
Challenge House, Tewkesbury	Dec-16	£5,820,000	£6,055,824	£376,743	6.22%	Industrial
Retail units, Clevedon	Jul-06	£2,199,250	£2,299,110	£158,085	6.88%	Retail
The Chase, Hertford	Nov-17	£3,700,000	£3,937,861	£262,058	6.65%	Office
SPL House, Ellesmere Port	Nov-17	£3,490,000	£3,770,482	£242,035	6.42%	Industrial
Wickes, Trowbridge	Dec-17	£5,542,000	£5,929,910	£313,518	5.29%	Retail
Edmund House, Leamington	Aug-18	£3,610,000	£3,851,000	£226,016	5.87%	Office
M&S, Walton on the Naze	Oct-18	£4,335,000	£4,619,280	£231,000	5.00%	Retail
Total		**£37,426,250**	**£39,547,202**	**£2,374,570**	**6.00%**	

These investments generated £2.374m of investment income for the Authority after taking account of direct costs, representing a rate of return of 6.0%.

Treasury Performance

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

Table 6: Performance

	Actual £	**Budget £**	**Over/ Under £**	**Actual %**	**Benchmark %**	**Over/ under**
Treasury Investments	205,258	197,411	7,847	1.38	0.57	0.81
Borrowing	226,851	325,250	98,399	1.62	N/A	N/A
GRAND TOTAL	**-21,593**	**-127,839**	**106,246**	**N/A**	**N/A**	**N/A**

Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy *or explain the areas of non-compliance*. Compliance with specific investment limits is demonstrated in table 7 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

Table 7: Debt Limits

	Q2 Maximum	**30.9.19 Actual**	**2019/20 Operational Boundary**	**2019/20 Authorised Limit**	**Complied?** Yes/No
Borrowing	31.0	28.0	50.0	55.0	Yes
Total debt	31.0	28.0	50.0	55.0	Yes

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Table 8: Investment Limits

	Q2 Maximum	30.9.19 Actual	2019/20 Limit	Complied? Yes/No
Any single organisation, except the UK Government	£3.993	£3.993	£4m each	Yes
UK Central Government	£0.0	£0.0	unlimited	Yes
Any group of organisations under the same ownership	£3.993	£3.993	£4m per group	Yes
Any group of pooled funds under the same management	£3.993	£3.993	£4m per manager	Yes
Negotiable instruments held in a broker's nominee account	**£0.0**	**£0.0**	£5m per broker	Yes

Limit per non-UK country	**£2.0**	**£2.0**	£2m per country	Yes
Registered providers and registered social landlords	**£3.0**	**£3.0**	£4m in total	Yes
Unsecured investments with building societies	**£2.0**	**£2.0**	£2m in total	Yes
Money Market Funds	**£8.0**	**£5.7**	50% of total portfolio balance	Yes
Real Estate Investment Trusts	**£0.0**	**£0.0**	£4m in total	Yes

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.19 Actual	**2019/20 Target**	**Complied?**
Portfolio average credit rating	A+	A	Yes

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.19 Actual	**Upper Limit**	**Lower Limit**	**Complied?**
Under 12 months	32%	100%	0%	Yes
12 months and within 24 months	0%	100%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	68%	100%	0%	Yes

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2019/20	2020/21	2021/22
Actual principal invested beyond year end	£2m	£1m	£1m
Limit on principal invested beyond year end	£6m	£4m	£4m
Complied?	Yes	Yes	Yes

Outlook for the remainder of 2019/20

The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased dramatically.

There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance.

Parliament appears to have frustrated UK Prime Minister Boris Johnson's desire to exit the EU on 31st October. The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out for 2019 and the risk of this event remains for 2020. The risk of a general election in the near term has now materialised.

Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will continue to offer longer-term borrowing opportunities

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Cas	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75