Appendix A

Treasury Management Update Report
As At 30th September 2019

Introduction

The Council has 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.

The Council's treasury management strategy for 2019/20 was approved at a meeting on 21 February 2019. The Council has 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 Council'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 Council's Capital Strategy, complying with CIPFA's requirement, was also approved by full Council on 21 February 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-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ringfenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

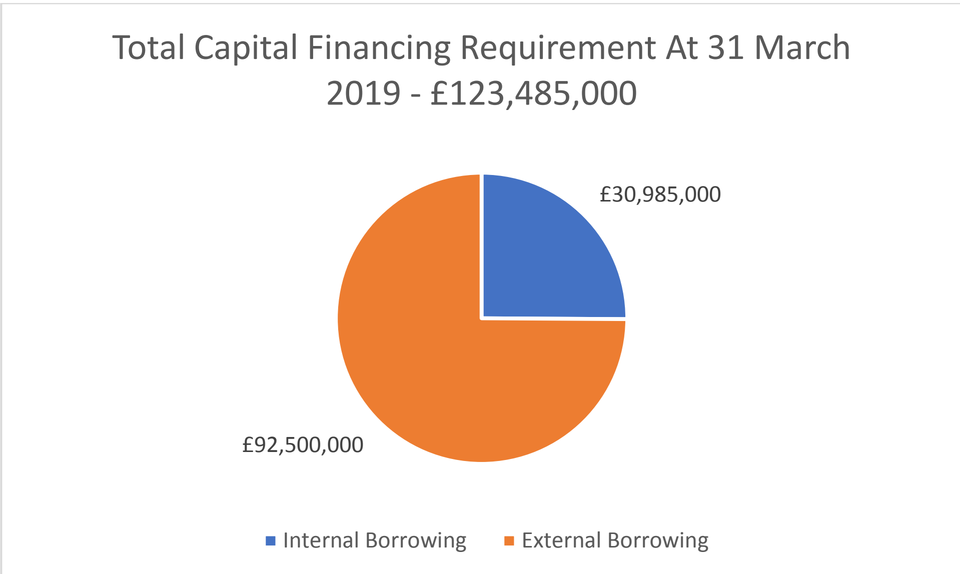
There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

Local Context

On 31st March 2019, the Council had a net investment position of £37.6m 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

	31.03.19 Actual £'000
General Fund CFR HRA CFR	20,456 103,029
Total CFR	**123,485**
External Borrowing	(92,500)
Less: Usable Reserves Less: Working Capital	(50,438) (18,153)
Net Investments	**37,606**



The Council 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

	31.03.19 £000	Movement £000	30.09.19 £000
Long Term Borrowing	(79,000)	0	(79,000)
Short Term Borrowing	(13,500)	10,000	(3,500)
Total Borrowing	**(92,500)**	**10,000**	**(82,500)**
Long Term Investments	2,161	(36)	2,125
Short Term Investments	17,055	(9,515)	7,540
Cash and Cash Equivalents	22,028	7,048	29,076
Total Investments	**41,244**	**(2,503)**	**38,741**
Net Borrowing	**(51,256)**	**7,497**	**(43,759)**

Borrowing Strategy during the period

At 30th September 2019 the Council held £82.5m of loans, which has reduced by £10m from the reported position at 31 March 2019. This is due to the repayment of the short-term borrowing taken out to cover the financial year end position. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

Type of Borrowing	**31 March 2019 £000**	**Movement 2018 £000**	**30 September 2019 £000**
PWLB Fixed Rate Loans	74,500	0	74,500
PWLB Variable Rate Loans	5,000	0	5,000
Barclays Bank Fixed Rate Loan	3,000	0	3,000
Local Authority	10,000	(10,000)	0
Total	**92,500**	**(10,000)**	**82,500**

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

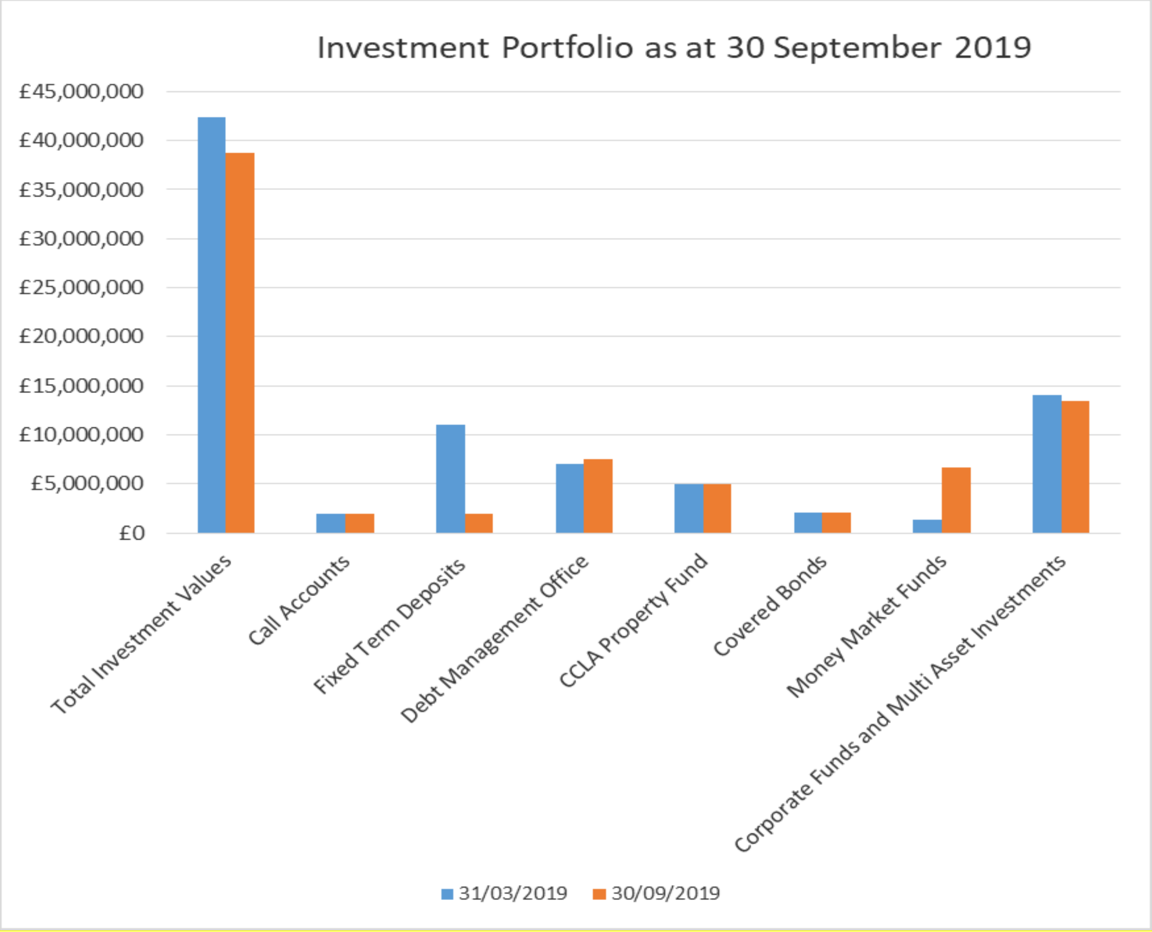
The Council is currently reviewing its capital programme and therefore may have plans to borrow for both the General Fund and Housing Revenue Account at a future point in time.

Treasury Investment Activity

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £38.26 million and £60.40 million due to timing differences between income and expenditure. The investment position as at 30th September 2019 is shown in table 4 below.

Table 4: Treasury Investment Position

Type of Investment	31 March 2019 £000	Movement 2018 £000	30 September 2019 £000
Call Accounts	1,916	51	1,967
Fixed Term Deposits	11,000	(9,000)	2,000
Debt Management Office	7,042	498	7,540
Property Fund	5,000	10	5,010
Covered Bonds	2,128	(4)	2,124
Money Market Funds	1,310	5,390	6,700
Corporate and Multi Asset Funds	14,000	(600)	13,400
Total Investments	**42,396**	**(3,655)**	**38,741**



Both the CIPFA Code and government guidance require the Council 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 Council'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.

Given the increasing risk and low returns from short-term unsecured bank investments, the Council has further diversified into higher yielding asset classes. During the period, the Council invested £2m into the Schroder Income Maximser Fund.

The table below shows counterparty credit quality as measured by credit ratings and the percentage of the in-house investment portfolio exposed to bail-in risk. This is an extract from Arlingclose's quarterly investment benchmarking

<u>Table 5: Investment Benchmarking – Treasury investments managed in-house</u>

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Rate of Return %**
31.03.2019	Not Applicable	Not Applicable	Not Applicable	Not Applicable
30.09.2019	3.65	AA-	56%	1.84
Similar LAs	4.26	AA-	61%	1.58
All LAs	4.28	AA-	62%	1.22

£18.0m of the Council's investments are held in externally managed strategic pooled 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 £262k, comprising of a £222k (2.91%) income return which is used to support services in year, and £40k (0.50%) in respect of capital growth.

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 Council'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 / long-term and the Council's latest cash flow forecasts, investment in these funds has been increased, with £2m being invested in the Schroder Income Maximiser Fund as detailed above.

<u>Readiness for Brexit</u>: The scheduled leave date for the UK to leave the EU is now 31st October 2019 and there remains little political clarity as to whether a deal will be agreed by this date and, unless the exit date is pushed back yet again, the potential

of a no-deal Brexit has increased significantly. As 31st October approaches the Council will ensure there are enough accounts open at UK-domiciled banks and Money Market Funds to hold sufficient liquidity 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 Council as well as other non-financial assets which the Council holds primarily for financial return. 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 Council also holds £2.47m of such investments held as loans to local businesses, charities, partnerships and sports clubs. These investments generated £44k of investment income for the Council in the first six months representing an average rate of return of 3.61%.

Treasury Performance

The Council 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 30.09.19 £000	Budget 30.09.19 £000	Variance 30.09.19 £000
Interest Paid	220	292	(72)
Interest Received	(326)	(704)	(378)

Compliance

The Strategic Finance Advisor and S151 Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Table 7: Specific Investment Limits

	Maximum Exposure	2019/20 Limit	Complied
Any single organisation (except UK government)	£1.800m	£9m each	✓
UK central government and UK local authorities	£15.200m	Unlimited	✓
Any group of organisations under the same ownership	£2.000m	£9m per Group	✓
Any group of pooled funds under the same management	£5.000m	£21m per Manager	✓
Negotiable instruments held in a broker's nominees account	£2.000m	£21m per Broker	✓
Foreign countries	£0	£9m per Country	✓
Registered providers	£0	£21m in Total	✓
Loans to unrated corporates	£0	£9m in Total	✓
Money market funds	£16.860m	£42m in Total	✓
Real Estate Investment Trusts	£0	£21m in Total	✓

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

Table 8: Debt Limits

	30.09.19 Actual £000	**2019/20 Operational Boundary £000**	**2019/20 Authorised Limit £000**	**Complied**
Borrowing	82,500	200,000	220,000	✓

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. However, the Council stayed well within this limit during the period.

Treasury Management Indicators

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

Security: The Council 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.

	30.09.19 Actual	2019/20 Target	Complied
Portfolio average credit rating	AA-	A-	✓

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.09.19 Actual	2019/20 Target	Complied
Total cash available within 3 months	£32.7m	£21.0m	✓

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	30.9.19 Actual	2019/20 Limit	Complied?
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	(£0.042m)	(£0.121m)	✓
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£0.042m	£0.121m	✓

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

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

	30.09.19 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	4.24%	50%	0%	✓
1 year and within 2 years	4.24%	50%	0%	✓
24 months and within 5 years	33.94%	50%	0%	✓
5 years and within 10 years	49.09%	75%	0%	✓
10 years and above	8.49%	100%	0%	✓

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 Council'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	£0m	£0m
Limit on principal invested beyond year end	£40m	£24m	£24m
Complied	✓	✓	✓

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, however, increased.

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

Appendix B

Investments as at 30 September 2019

Borrower	**Amount £**	**Rate of Interest %**	**Date of Investment**	**Date of Maturity**
Lloyds Bank Plc	2,000,000	1.000	16/07/2019	16/01/2020
Debt Management Office	2,000,000	0.520	10/06/2019	14/10/2019
Debt Management Office	1,400,000	0.510	08/07/2019	11/11/2019
Debt Management Office	330,000	0.510	09/07/2019	11/11/2019
Debt Management Office	1,900,000	0.520	12/08/2019	09/12/2019
Debt Management Office	1,910,000	0.530	10/09/2019	13/01/2020
Leeds Building Society	1,062,959	1.565	24/04/2015	16/11/2020
Leeds Building Society	1,061,489	1.622	01/05/2018	16/11/2020
NatWest	167,029	0.050	N/A	On Demand
Aberdeen Standard Liquidity	3,400,000	Variable	N/A	On Demand
Federated Money Market Fund	3,300,000	Variable	N/A	On Demand
CCLA Investment Fund (Public Sector Deposit Fund)	1,000,000	Variable	N/A	On Demand
Santander	1,800,000	Variable	N/A	On Demand
CCLA Local Authority Property Fund	5,010,035	Variable	N/A	On Demand
Columbia Threadneedle Strategic Bond Fund	2,004,510	Variable	N/A	On Demand
Investec Diverse Income Fund	2,899,687	Variable	N/A	On Demand
Payden and Rygel Sterling Reserve Fund	2,006,910	Variable	N/A	On Demand
Federated Cash Plus	1,039,663	Variable	N/A	On Demand
Royal London Enhanced Cash Plus Fund (Class Y)	996,345	Variable	N/A	On Demand
Aberdeen Investments - Sterling Short Duration Cash Fund (K2)	1,042,222	Variable	N/A	On Demand
Schroder Income Maximser Fund	2,000,000	Variable	N/A	On Demand
Aviva Government Money Market Fund	410,000	Variable	N/A	On Demand
TOTAL	**38,740,849**			