

## CABINET

THURSDAY 28<sup>TH</sup> NOVEMBER 2019

### REPORT OF THE PORTFOLIO HOLDER FOR ASSETS AND FINANCE

#### TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2019/20

##### EXEMPT INFORMATION

None

##### PURPOSE

To present to Members the Mid-year Review of the Treasury Management Strategy Statement and Annual Investment Strategy.

##### RECOMMENDATIONS

**That Council be requested to approve the Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2019/20.**

##### EXECUTIVE SUMMARY

This mid-year report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (revised 2017), and covers the following:-

- An economic update for the first six months of 2019/20;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's Capital expenditure as set out in the Capital Strategy, and Prudential Indicators;
- A review of the Council's investment portfolio for 2019/20;
- A review of the Council's borrowing strategy for 2019/20;
- A review of any debt rescheduling undertaken during 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

The main issues for Members to note are:

1. The Council has complied with the professional codes, statutes and guidance.
2. There are no issues to report regarding non-compliance with the approved prudential indicators.

3. The investment portfolio yield for the first six months of the year is 1.02% (0.77% for the same period in 2018/19) compared to the 3 Month LIBID benchmark rate of 0.66% (0.61% for the same period in 2018/19).

The aim of this report is to inform Members of the treasury and investment management issues to enable all Members to have ownership and understanding when making decisions on Treasury Management matters. In order to facilitate this, training on Treasury Management issues was most recently delivered for Members in November 2019 and will be provided as and when required.

## **RESOURCE IMPLICATIONS**

All financial resource implications are detailed in the body of this report which links to the Council's Medium Term Financial Strategy.

## **LEGAL/RISK IMPLICATIONS BACKGROUND**

Risk is inherent in Treasury Management and as such a risk based approach has been adopted throughout the report with regard to Treasury Management processes.

## **SUSTAINABILITY IMPLICATIONS**

None

## **BACKGROUND INFORMATION**

In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities have been required to prepare a Capital Strategy which is to provide the following:-

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- An overview of how the associated risk is managed
- The implications for future financial sustainability

A report setting out our updated Capital Strategy will be included with the Budget and Medium Term Financial Strategy report presented to Cabinet and Council in February 2020.

The CIPFA Code of Practice on Treasury Management (revised 2017) suggests that Members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This is the second monitoring report for 2019/20 presented to Members this year and therefore ensures the Council is embracing best practice. Cabinet also receives regular monitoring reports as part of the quarterly healthcheck on Treasury Management activities and risks.

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the Treasury Management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the Treasury Management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, Treasury Management is defined as:

*“The management of the local authority’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”*

## **Introduction**

The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (revised 2017) was adopted by this Council on 27<sup>th</sup> February 2018.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's Treasury Management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring Treasury Management policies and practices and for the execution and administration of Treasury Management decisions.
5. Delegation by the Council of the role of scrutiny of Treasury Management strategy and policies to a specific named body. For this Council the delegated body is the Audit and Governance Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2019/20 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's Capital expenditure as set out in the Capital Strategy, and Prudential Indicators;
- A review of the Council's investment portfolio for 2019/20;
- A review of the Council's borrowing strategy for 2019/20;
- A review of any debt rescheduling undertaken during 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

## 1. Economic Update

### 1.1 UK

This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, in September, his proroguing of Parliament was overturned by the Supreme Court and Parliament carried a bill to delay Brexit until 31 January 2020 if there was no deal by 31 October. MPs also voted down holding a general election before 31 October, though one has since been arranged for December 12<sup>th</sup>. At the time of writing the whole Brexit situation is highly fluid and could change radically by the day. Given these circumstances and the imminent general election, any interest rate forecasts are subject to material change as the situation evolves. If the UK does soon achieve a deal on Brexit agreed with the EU then it is possible that growth could recover relatively quickly. The MPC could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy.

The first half of 2019/20 has seen UK **economic growth** fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies.

It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

With regard to the **labour market**, despite the contraction in quarterly GDP growth of -0.2% q/q, (+1.3% y/y), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

In the **political arena**, the general election could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

## **1.2 USA.**

President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further. The strong growth in employment numbers during 2018 has reversed into a falling trend during 2019, indicating that the economy is cooling, while inflationary pressures are also weakening. The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates again in September to 1.75% - 2.00% and is thought likely to cut another 25 bps in December. Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

## **1.3 EUROZONE**

Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1 and then fell to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of TLTROs; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a resumption of quantitative easing purchases of debt. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and unsurprisingly, the ECB stated that governments will need to help stimulate growth by fiscal policy.

On the political front, Austria, Spain and Italy are in the throes of forming coalition governments with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

#### **1.4 CHINA**

Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress also still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. The trade war with the US does not appear currently to have had a significant effect on GDP growth as some of the impact of tariffs has been offset by falls in the exchange rate and by transshipping exports through other countries, rather than directly to the US.

#### **1.5 JAPAN**

Japan has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

#### **1.6 WORLD GROWTH**

The trade war between the US and China is a major concern to financial markets and is depressing worldwide growth, as any downturn in China will spill over into impacting countries supplying raw materials to China. Concerns are focused on the synchronised general weakening of growth in the major economies of the world compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns have resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been sub 50 which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during the rest of this financial year is weak.

**1.7 Interest rate forecasts**

The Council’s treasury advisor, Link Asset Services, has provided the following forecast. This forecast includes the increase in margin over gilt yields of 100bps introduced on 9.10.19.

Link Asset Services Interest Rate View										
	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit at some point in time. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That’s shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a “gradual pace and to a limited extent” is now also conditional on “some recovery in global growth”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

**Bond yields / PWLB rates.** There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession.



The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

What we saw during the last half year up to 30 September is a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but due to a correlation between US treasuries and UK gilts, which at various times has been strong but at other times weaker, in the UK. However, forecasting the timing of this and how strong the correlation is likely to be, is very difficult to do with any degree of confidence.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt fuelled boom which now makes it harder for economies to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

### **The balance of risks to the UK**

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

One risk that is both an upside and downside risk is that all central banks are now working in very different economic conditions than before the 2008 financial crash. There has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for eleven years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could, therefore, over or under-do increases in central interest rates.

**Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:**

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor, though more recently concerns have arisen over her health.
- **Other minority EU governments**. Austria, Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Italy, Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

**Upside risks to current forecasts for UK gilt yields and PWLB rates**

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

## 2. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2019/20 was approved by Council on 26th February 2019.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

## 3. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

### 3.1 Prudential Indicator for Capital Expenditure

This table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2019/20 Original Programme	Budget B'fwd from 2018/19	Virements in Year	Total 2019/20 Budget	Actual Spend @ Period 6	Predicted Outturn	2019/20 Revised Estimate*
	£m	£m	£m	£m	£m	£m	£m
General Fund	0.983	17.929	-	18.912	3.155	8.494	18.315
HRA	8.927	22.354	-	31.281	9.000	27.413	29.883
<b>Total</b>	<b>9.910</b>	<b>40.283</b>	<b>-</b>	<b>50.193</b>	<b>12.156</b>	<b>35.908</b>	<b>48.198</b>

\* Includes potential expenditure slippage into 2020/21 of £12.29m relating mainly to Gungate development, Gateways projects, Amington Woodland & Cycleway, Property Fund investments and Solway LATC, High Rise lifts and Tinkers Green and Kerria redevelopment.

### 3.2 Changes to the Financing of the Capital Programme

The following table draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2019/20	2019/20	2019/20
	Capital Programme	Predicted Outturn	Budget *
	£m	£m	£m
Unsupported	0.295	6.278	8.668
Supported	9.615	29.630	41.525
<b>Total spend</b>	<b>9.910</b>	<b>35.908</b>	<b>50.193</b>
Financed by:			
Grants - Disabled Facilities	0.400	0.400	0.400
Coalfields Grant	-	-	0.222
Section 106's	0.100	0.437	1.032
GF Receipts	-	4.624	13.359
GF Reserve	-	0.614	1.055
Sale of Council House Receipts	0.188	0.487	0.601
HRA Receipts	2.150	3.368	3.368
HLF Assembly Rooms Lottery	-	0.128	0.128
Grants - Assembly Rooms (SLGF/Arts Council)	-	0.081	0.081
Public Contributions (Assembly Rooms)	-	-	0.050
HLF/Donation - Castle Mercian Trail	-	0.470	0.531
Other Contributions	-	-	-
MRR	2.805	5.315	5.463
HRA 1-4-1 Replacements Receipts	0.650	0.784	1.034
HRA Reserve	2.422	9.556	10.286
HRA Regeneration Fund	0.900	3.366	3.916
<b>Total Financing</b>	<b>9.615</b>	<b>29.630</b>	<b>41.525</b>
<b>Borrowing need</b>	<b>0.295</b>	<b>6.278</b>	<b>8.668</b>

\* includes potential expenditure slippage into 2020/21

However, it should be noted that due to receipt of Homes England grant of c.£5m, it is likely that the planned borrowing for the Regeneration of Tinkers Green and Kerria will be reduced to c.£2m.

### 3.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The following table shows the Capital Financing Requirement (CFR), which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

#### Prudential Indicator – Capital Financing Requirement

We are on target to achieve the original forecast Capital Financing Requirement.

#### Prudential Indicator – the Operational Boundary for External Debt

	2018/19	2019/20	2019/20	2019/20
	Outturn	Capital Programme	Projected Outturn	Budget
	£m	£m	£m	£m
CFR – Non Housing	0.828	2.235	1.959	2.159
CFR – Housing	68.041	75.255	73.065	75.255
Total CFR	68.869	77.490	75.024	77.414
<b>Net movement in CFR</b>	<b>(0.057)</b>	<b>8.412</b>	<b>6.155</b>	<b>8.545</b>
Operational Boundary				
Expected Borrowing	63.060	63.060	63.060	63.060
Other long term liabilities	-	-	-	-
<b>Total debt 31st March</b>	<b>63.060</b>	<b>63.060</b>	<b>63.060</b>	<b>63.060</b>

### 3.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2018/19	2019/20	2019/20	2019/20
	Outturn	Original Estimate	Projected Outturn	Budget
	£m	£m	£m	£m
Gross borrowing	63.060	63.060	63.060	63.060
Less investments	68.761	26.369	43.805	41.415
Net borrowing	(5.701)	36.691	19.255	21.645
CFR (year end position)	68.869	77.490	75.024	77.414

The Executive Director Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

<b>Authorised Limit for External Debt</b>	<b>2019/20 Original Indicator</b>	<b>Current Position</b>	<b>2019/20 Revised Indicator</b>
Borrowing	84.642	84.642	84.642
Total	84.642	84.642	84.642

#### **4. Investment Portfolio 2019/20**

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in Section 1, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short-term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

The Council held £66.634m of investments as at 30<sup>th</sup> September 2019, excluding investments in property funds (£64.94m at 31<sup>st</sup> March 2019) and the investment portfolio yield for the first six months of the year is 1.02% against a benchmark of the 3 months LIBID of 0.66%. A full list of investments held as at 30<sup>th</sup> September 2019 is detailed in **APPENDIX 1**.

The Executive Director Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2019/20.

The Council's budgeted investment return for 2019/20 is £418k, and performance for the year is projected to be £250k above budget, due to additional funds available to invest (due to increased capital slippage). However, a shortfall of £91k in respect of property fund interest and dividends is forecast, due to a delay in making any further investments in property funds due to the uncertainty around the Brexit and the current economic situation. The value of property fund investments as at 30<sup>th</sup> September 2019 was £3.78m (£3.82m at 31<sup>st</sup> March 2019).

## CIPFA Benchmarking Club

The Council is a member of the CIPFA Treasury Management Benchmarking Club which is a means to assess our performance over the year against other members. Our average return for In House Investments for the period April to September 2019 was 1.0% compared to the group average of 1.02% (information from CIPFA Benchmarking Report Quarter 2 2019/20). This is considered to be a reasonable result in light of the current financial climate, our lower levels of deposits/funds and shorter investment time-lines due to Banking sector uncertainty, when compared to other Authorities.

This can be analysed further into the following categories:

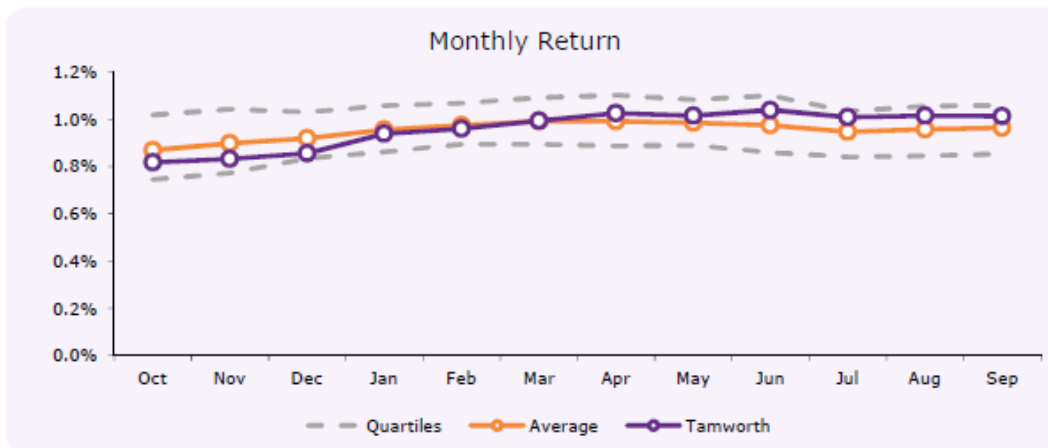
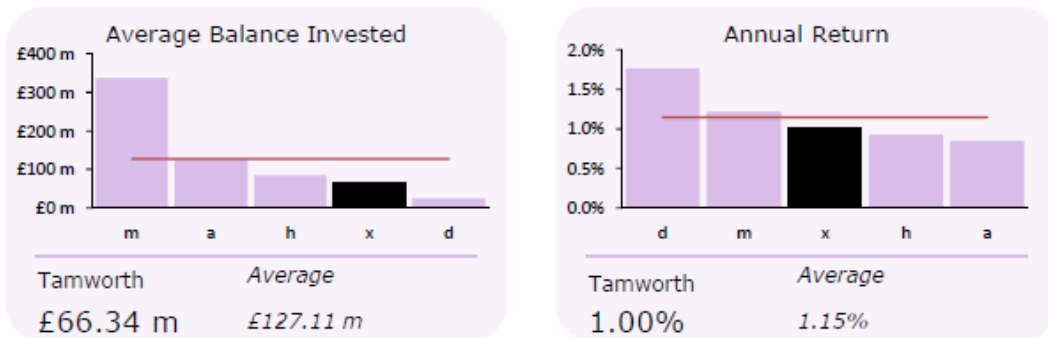
Category	Average Balance Invested		Average Annual Return Received	
	£m		%	
	Tamworth Borough Council	CIPFA Benchmarking Club	Tamworth Borough Council	CIPFA Benchmarking Club
Fixed Investments (up to 30 days)	-	0.1	-	0.8
Fixed Investments (between 31 and 90 days)	-	2.2	-	0.8
Fixed Investments (between 91 and 364 days)	20.1	35.3	1.1	1.4
Fixed Investments (between 1 year and 3 years)	6.6	45.8	1.0	1.0
Fixed Investments (over 3 years)	-	8.0	-	1.8
Callable and Structured Deposits	-	28.7	-	1.3
Notice Accounts	20.0	11.2	1.0	1.3
Money Market Funds (Constant Net Asset Value)	11.6	23.7	0.7	0.9
Money Market Funds (Variable Net Asset Value)	-	18.0	-	0.5
DMADF	-	0.6	-	0.5
CDs, Gilts and Bonds	7.9	7.2	1.2	2.9
<b>Average of all investments (Managed in House)</b>	<b>66.3</b>	<b>127.1</b>	<b>1.0</b>	<b>1.2</b>

\* Excludes property funds / Variable rate MMF

The data above and graphs below display that despite the Council being a small investor in the markets, in the main performance is only marginally lower in those areas where both the Council and other member authorities invest.

The main variances arise from longer term fixed investments (in excess of 1 year) and instruments that the council do not currently get involved with i.e. Callable and Structured Deposits which are longer term deposits which (in line with our use of the Link Asset Services methodology and our approved specified limits in our Treasury Management strategy) are currently prohibited for Tamworth Borough Council and affirms our 'low appetite for risk' in the continuing unsettled markets.

### Combined Investments (excl. impaired investments)



Monthly Return (Oct 18 - Sept 19)													
	Oct	Nov	Dec	Jan	Feb	March	April	May	June	July	Aug	Sept	Year
Balance £'m	70.4	69.8	71.7	73.4	71.2	67.5	67.4	66.9	67.0	68.2	68.9	70.3	<b>66.3</b>
Interest £'k	48.8	47.8	52.1	58.4	52.3	57.0	56.8	57.6	57.2	58.4	59.3	58.5	<b>664.1</b>
Return	0.82%	0.83%	0.86%	0.94%	0.96%	0.99%	1.02%	1.01%	1.04%	1.01%	1.01%	1.01%	<b>1.00%</b>
Upper Quartile	1.02%	1.04%	1.03%	1.06%	1.07%	1.09%	1.10%	1.08%	1.10%	1.03%	1.05%	1.06%	<b>1.49%</b>
Average	0.87%	0.90%	0.92%	0.95%	0.97%	0.99%	0.99%	0.98%	0.97%	0.95%	0.96%	0.96%	<b>1.15%</b>
Lower Quartile	0.74%	0.77%	0.83%	0.86%	0.89%	0.89%	0.89%	0.89%	0.86%	0.84%	0.84%	0.85%	<b>0.88%</b>
% Diff from Avg	-0.05%	-0.06%	-0.06%	-0.02%	-0.02%	0.00%	0.03%	0.03%	0.06%	0.06%	0.06%	0.05%	<b>-0.15%</b>



### **Investment Counterparty Criteria**

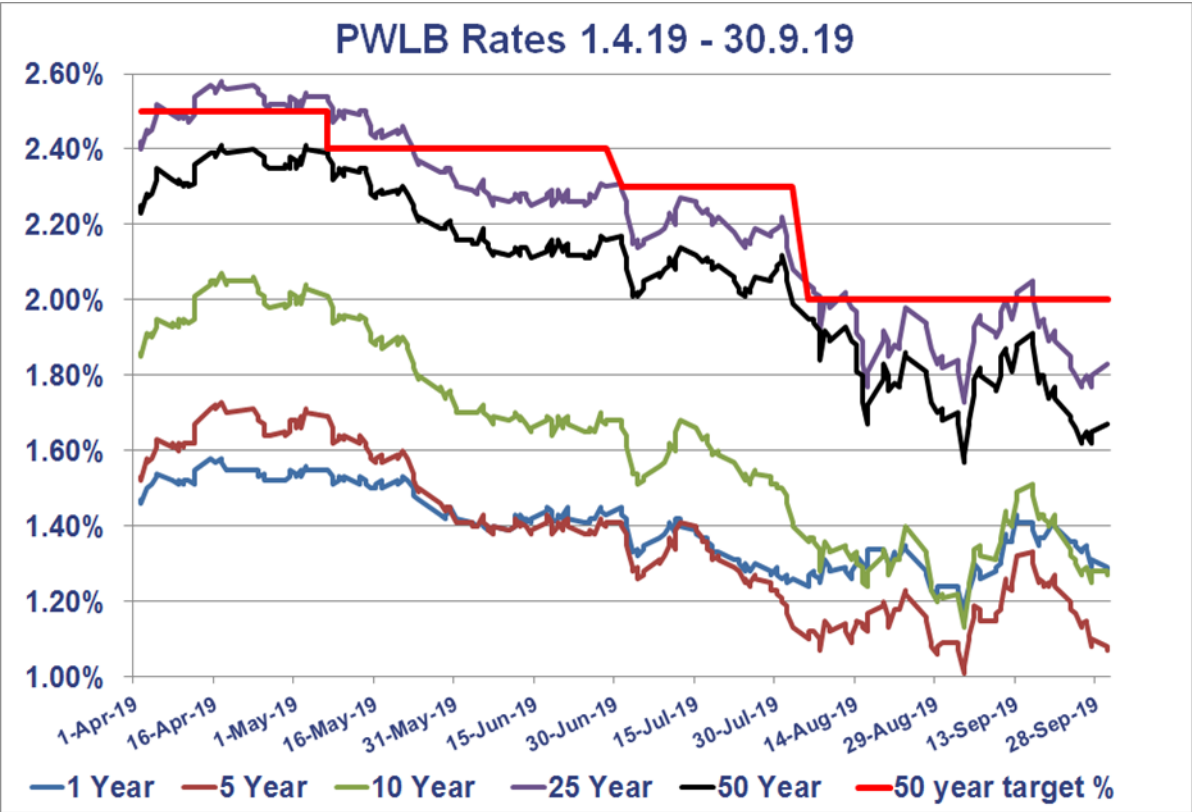
The current investment counterparty criteria selection approved in the TMSS and as approved by Council on 26th February 2019 meets the requirements of the Treasury Management function.

### **5. Borrowing**

The Council's estimated revised capital financing requirement (CFR) for 2019/20 is £75.024m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 3.4 shows the Council has borrowings of £63.060m and plans to utilise £11.964m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

It is not anticipated that any additional borrowing will be undertaken during 2019/20.

The table and graph below show the movement in PWLB Certainty Rates for the first six months of the year to date. PWLB rates have been on a falling trend during this period and longer rates have almost halved to reach historic lows. The 50 year PWLB target (certainty) rate for new long term borrowing fell from 2.5% to 2% during this period.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.01%	1.13%	1.73%	1.57%
Date	03/09/2019	03/09/2019	03/09/2019	03/09/2019	03/09/2019
High	1.58%	1.73%	2.07%	2.58%	2.41%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	17/04/2019
Average	1.40%	1.37%	1.62%	2.20%	2.07%

**Increase in the cost of borrowing from the PWLB**

On 9 October 2019 the Treasury and PWLB announced an increase in the margin over gilt yields of 100bps on top of the current margin of 80 bps which this authority has paid prior to this date for new borrowing from the PWLB. There was no prior warning that this would happen and it now means that every local authority has to fundamentally reassess how to finance their external borrowing needs and the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing. Representations are going to be made to HM Treasury to suggest that areas of capital expenditure that the Government are keen to see move forward e.g. housing, should not be subject to such a large increase in borrowing.

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. We are expecting that various financial institutions will enter the market or make products available to local authorities. Members will be updated as this area evolves.

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. This Authority may make use of this new source of borrowing as and when appropriate.

## 6. Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

The 100bps increase in PWLB rates from 9.10.19 only applied to new borrowing rates, not to premature repayment rates.

## 7. Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports. There are no such changes to report to Members at this stage.

## REPORT AUTHOR

Please contact Stefan Garner, Executive Director Finance, extension 242, or Jo Goodfellow, Head of Finance, extension 241.

## LIST OF BACKGROUND PAPERS

<i>Background Papers -</i>	<i>Local Government Act 2003</i>
	<i>CIPFA Code of Practice on Treasury Management in Public Services 2017</i>
	<i>Annual Report on the Treasury Management Service and Actual Prudential Indicators 2018/19 – Council 10<sup>th</sup> September 2019</i>
	<i>Treasury Management Strategy &amp; Prudential Indicators Report 2019/20 - Council 26th February 2019</i>
	<i>Budget &amp; Medium Term Financial Strategy 2019/20 - Council 26th February 2019</i>
	<i>Financial Healthcheck Period 6, September 2019</i>
	<i>CIPFA Treasury Management Benchmarking Club Report Quarter 2, September 2019</i>

**APPENDIX 1**

**Investments held as at 30<sup>th</sup> September 2019:**

Borrower	Deposit £	Rate %	From	To	Notice
National Westminster Bank plc	4,001,183	1.1300%	27-Nov-18	26-Nov-19	-
Lloyds Bank	1,000,000	1.1000%	30-Nov-18	29-Nov-19	-
Lloyds Bank	1,000,000	1.1000%	30-Nov-18	29-Nov-19	-
Bank of Scotland	2,000,000	1.1000%	03-Jan-19	03-Jan-20	-
Bank of Scotland	2,000,000	1.1000%	04-Jan-19	03-Jan-20	-
Lloyds Bank	1,000,000	1.1000%	08-Feb-19	07-Feb-20	-
Bank of Scotland	2,000,000	1.1000%	11-Feb-19	10-Feb-20	-
Thurrock Council	7,000,000	1.1200%	13-Mar-19	13-Feb-20	-
Lloyds Bank	2,000,000	1.2500%	03-Apr-19	03-Apr-20	-
Lloyds Bank	2,000,000	1.2500%	03-Apr-19	03-Apr-20	-
Barclays Bank	2,000,000	0.8400%	05-Apr-19	07-Oct-19	-
Thurrock Council	3,000,000	0.9000%	10-Apr-19	10-Oct-19	-
National Westminster Bank plc	2,000,791	0.9200%	28-Jun-19	26-Jun-20	-
National Westminster Bank plc	4,001,583	0.8300%	05-Jul-19	26-Jun-20	-
Goldman Sachs	10,000,000	1.17%	-	-	180 day
Santander	10,000,000	1.00%	-	-	180 day
MMF – PSDF	2,187,000	0.73%*	-	-	On call
MMF – Federated	3,000,000	0.96%*	-	-	On call
MMF – Federated	3,446,504	0.73%*	-	-	On call
<b>Total</b>	<b>63.634</b>	<b>1.02 (avg)</b>			

\* Interest rate fluctuates daily dependant on the funds investment portfolio, rate quoted is approximate 7 day average.