CABINET

THURSDAY 20TH AUGUST 2020

COUNCIL

TUESDAY 15TH SEPTEMBER 2020

REPORT OF THE PORTFOLIO HOLDER FOR ASSETS AND FINANCE

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2019/20

EXEMPT INFORMATION

None

PURPOSE

The Annual Treasury report is a requirement of the Council's reporting procedures. It covers the Treasury activity for 2019/20, and the actual Prudential Indicators for 2019/20.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes in accordance with Regulations issued under the Local Government Act 2003. It also provides an opportunity to review the approved Treasury Management Strategy for the current year and enables Members to consider and approve any issues identified that require amendment.

RECOMMENDATIONS

That Cabinet ask Council to;

1. **Approve the actual 2019/20 Prudential and Treasury Indicators within the report and shown at Appendix 1;**
2. **Accept the Annual Treasury Management Report for 2019/20; and**
3. **Further to the Assembly Rooms update report to Cabinet on 30th July, Council approve the financing of the projected £1.2m overspend and the increase required in the capital programme.**

EXECUTIVE SUMMARY

This report covers Treasury operations for the year ended 31st March 2020 and summarises:

- the Council's Treasury position as at 31st March 2020; and
- Performance Measurement

The key points raised for 2019/20 are

1. The Council's Capital Expenditure and Financing 2019/20
2. The Council's Overall Borrowing Need
3. Treasury Position as at 31st March 2020
4. The Strategy for 2019/20
5. Borrowing Outturn for 2019/20
6. Investment Outturn for 2019/20
7. Performance Measurement
8. The Economy and Interest Rates
9. Other Issues

The Treasury Function has achieved the following favourable results:

- The Council has complied with the professional codes, statutes and guidance;
- There are no issues to report regarding non-compliance with the approved prudential indicators;
- The Council maintained an average investment balance externally invested of £67.6m and achieved an average return of 1.01% (budgeted at £41.7m and an average return of 1.0%).
- This result compares favourably with the Council's own Benchmarks of the average 7 day and the 3 month LIBID rates for 2019/20 of 0.53% and 0.63%;
- The closing weighted average internal rate on borrowing is 4.05% (4.05% for 2018/19);
- The Treasury Management Function has achieved an outturn investment income of £686k compared to an original budget of £418k. Investment balances were higher than budgeted throughout the year, however average interest rates started to fall.
- We also received £147k in dividends from our property fund investments (£108k in 2018/19), compared to a budget of £240k. However the net value of the investments had fallen by £130k as at 31st March 2020. Following recommendation by the Corporate Scrutiny Committee to Cabinet on 30th July it was agreed that a review of property funds is undertaken for scrutiny by the Audit and Governance Committee, before any further investments under existing delegations are made - to inform the Treasury Management Mid-Year Review report for consideration by Council in December 2020.

During 2019/20 the Council complied with its legislative and regulatory requirements.

The Executive Director Finance confirms that there was no overall increase in borrowing within the year and the Authorised Limit was not breached.

At 31st March 2020, the Council's external debt was £63.06m (£63.06m at 31st March 2019) and its external investments totalled £55.26m (£64.92m at 31st March 2019).

RESOURCE IMPLICATIONS

There are no financial implications or staffing implications arising directly from the report.

LEGAL/RISK IMPLICATIONS BACKGROUND

The Council is aware of the risks of passive management of the Treasury Portfolio and with the support of Link Asset Services, the Council's current Treasury advisers, has proactively managed its debt and investments during the year.

EQUALITIES IMPLICATIONS

None

SUSTAINABILITY IMPLICATIONS

None

REPORT AUTHOR

If Members would like further information or clarification prior to the meeting please contact Stefan Garner, telephone 01827 709242 or email stefan-garner@tamworth.gov.uk

LIST OF BACKGROUND PAPERS

- Local Government Act 2003;
- Statutory Instruments: 2003 No 3146 & 2007 No 573;
- CIPFA Code of Practice on Treasury Management in Public Services;
- Treasury Management Strategy 2019/20 (Council 26th February 2019);
- Treasury Management Mid-Year Review 2019/20 (Council 10th December 2019);
- Treasury Outturn Report 2018/19 (Council 10th September 2019);
- CIPFA Treasury Benchmarking Club Report 2019.

APPENDICES

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Borrowing and Investment Rates

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2019/20 the minimum reporting requirements were complied with:

- an annual treasury strategy in advance of the year (Council 26th February 2019)
- a mid-year (minimum) treasury update report (Council 10th December 2019)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, Cabinet has received quarterly Treasury management updates as part of the Financial Healthcheck Reports.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to provide scrutiny of all of the above Treasury Management Reports to the Audit and Governance Committee. Member training on Treasury Management issues was provided in November 2019, and will be provided as and when required in order to support members' scrutiny role.

During 2019/20, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows.

Prudential & Treasury Indicators	2018/19 Actual £m	2019/20 Estimate £m	2019/20 Actual £m
Capital Expenditure			
Non HRA	10.515	17.803	**4.734**
HRA	9.266	30.221	**20.462**
Total	19.781	48.024	**25.196**
Capital Financing Requirement			
Non HRA	0.828	2.235	**3.523**
HRA	68.041	75.255	**68.532**
Total	68.869	77.490	**72.055**
Gross Borrowing			
External Debt	63.060	63.060	**63.060**
Investments			
Longer than 1 year	3.820	-	**3.720**
Less than 1 year	64.941	26.369	**55.261**
Total	68.761	26.369	**58.981**
Net Borrowing	(5.701)	36.691	**4.079**

It should be noted that **£21.08m** of Capital scheme spend has been re-profiled into 2020/21 (also including re-profiling from previous years) which has increased investment balances.

The Executive Director Finance confirms that there was no overall increase in borrowing in year and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2019/20 continued the challenging investment environment of previous years, namely low investment returns.

1. The Council's Capital Expenditure and Financing 2019/20

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply internal funds, the capital expenditure would give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2018/19 Actual £m	2019/20 Estimate £m	2019/20 Actual £m
Capital Expenditure	10.515	17.803	**4.734**
Financed in year	10.515	16.488	**1.982**
Unfinanced capital expenditure	-	1.315	**2.752**
HRA	2018/19 Actual £m	2019/20 Estimate £m	2019/20 Actual £m
Capital Expenditure	9.266	30.221	**20.462**
Financed in year	9.266	23.007	**19.970**
Unfinanced capital expenditure	-	7.214	**0.492**

It should be noted that the outturn for the 2019/20 Capital Programme and associated unfinanced capital expenditure includes a projected overspend of £1.2m relating to the Assembly Rooms project (as detailed in the update report to Cabinet on 30th July). As such, Council are now formally requested to approve the financing of the projected £1.2m overspend and the increase required in the capital programme.

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2019/20 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2019/20 MRP Policy (as required by MHCLG Guidance) was approved as part of the Treasury Management Strategy Report for 2019/20 on 26th February 2019.

The Council's CFR for General Fund and the HRA for the year are shown below, and represent a key prudential indicator.

CFR: General Fund	31st March 2019 Actual £m	31st March 2020 Budget £m	31st March 2020 Actual £m
Opening balance	0.885	1.037	**0.828**
Add unfinanced capital expenditure (as above)	-	1.315	**2.752**
Less MRP/VRP	(0.057)	(0.117)	**(0.056)**
Less PFI & finance lease repayments	-	-	**-**
Closing balance	0.828	2.235	**3.524**

CFR: HRA	31st March 2019 Actual £m	31st March 2020 Budget £m	31st March 2020 Actual £m
Opening balance	68.041	68.041	**68.041**
Add unfinanced capital expenditure (as above)	-	7.214	**0.492**
Less MRP/VRP	-	-	**-**
Less PFI & finance lease repayments	-	-	**-**
Closing balance	68.041	75.255	**68.533**

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Gross borrowing and the CFR	31st March 2019 Actual £m	31st March 2020 Budget £m	31st March 2020 Actual £m
Gross borrowing position	63.060	63.060	63.060
CFR	68.869	77.490	72.055

The lower than estimated CFR reflects re-profiling of spend within the capital programme to 2020/21 and lower than forecast borrowing relating to the Tinkers Green and Kerria Regeneration scheme due to receipt of grant funding (which is expected to total £5.2m).

The Authorised Limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2019/20 the Council has maintained gross borrowing within its authorised limit.

The Operational Boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual Financing Costs as a Proportion of Net Revenue Stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Borrowing Limits	GF £m	HRA £m	Total £m
Authorised limit	5.235	79.407	84.642
Maximum gross borrowing position	-	63.060	63.060
Operational boundary	-	63.060	63.060
Average gross borrowing position	-	63.060	63.060
Budgeted financing costs as a proportion of net revenue stream %	(3.01)	29.39	26.39
Actual financing costs as a proportion of net revenue stream %	(9.39)	27.44	18.05

3. Treasury Position as at 31st March 2020

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2019/20 the Council's treasury (excluding borrowing by finance leases) position was as follows:

General Fund	31st March 2019 Principal £m	Rate/ Return %	Average Life yrs	31st March 2020 Principal £m	Rate/ Return %	Average Life yrs
Total debt	**-**	**-**	**-**	**-**	**-**	**-**
CFR	***0.828***	**-**	**-**	***3.523***	**-**	**-**
Over / (under) borrowing	***(0.828)***	**-**	**-**	***(3.523)***	**-**	**-**
Investments:						
- in house	36.209	0.82	-	37.525	1.01	-
Total investments	***36.209***	***0.82***	**-**	***37.525***	***1.01***	**-**

HRA	31st March 2019 Principal £m	Rate/ Return %	Average Life yrs	31st March 2020 Principal £m	Rate/ Return %	Average Life yrs
Fixed rate funding:						
-PWLB	63.060	4.05	35.735	63.060	4.05	34.73
Total debt	***63.060***	***4.05***	***35.74***	***63.060***	***4.05***	***34.73***
CFR	***68.041***	**-**	**-**	***68.532***	**-**	**-**
Over / (under) borrowing	***(4.981)***	**-**	**-**	***(5.472)***	**-**	**-**
Investments:	-	-	-			
- in house	*28.732*	*0.82*	-	17.736	1.01	-
Total investments	***28.732***	***0.82***	**-**	***17.736***	***1.01***	**-**

Maturity Structures

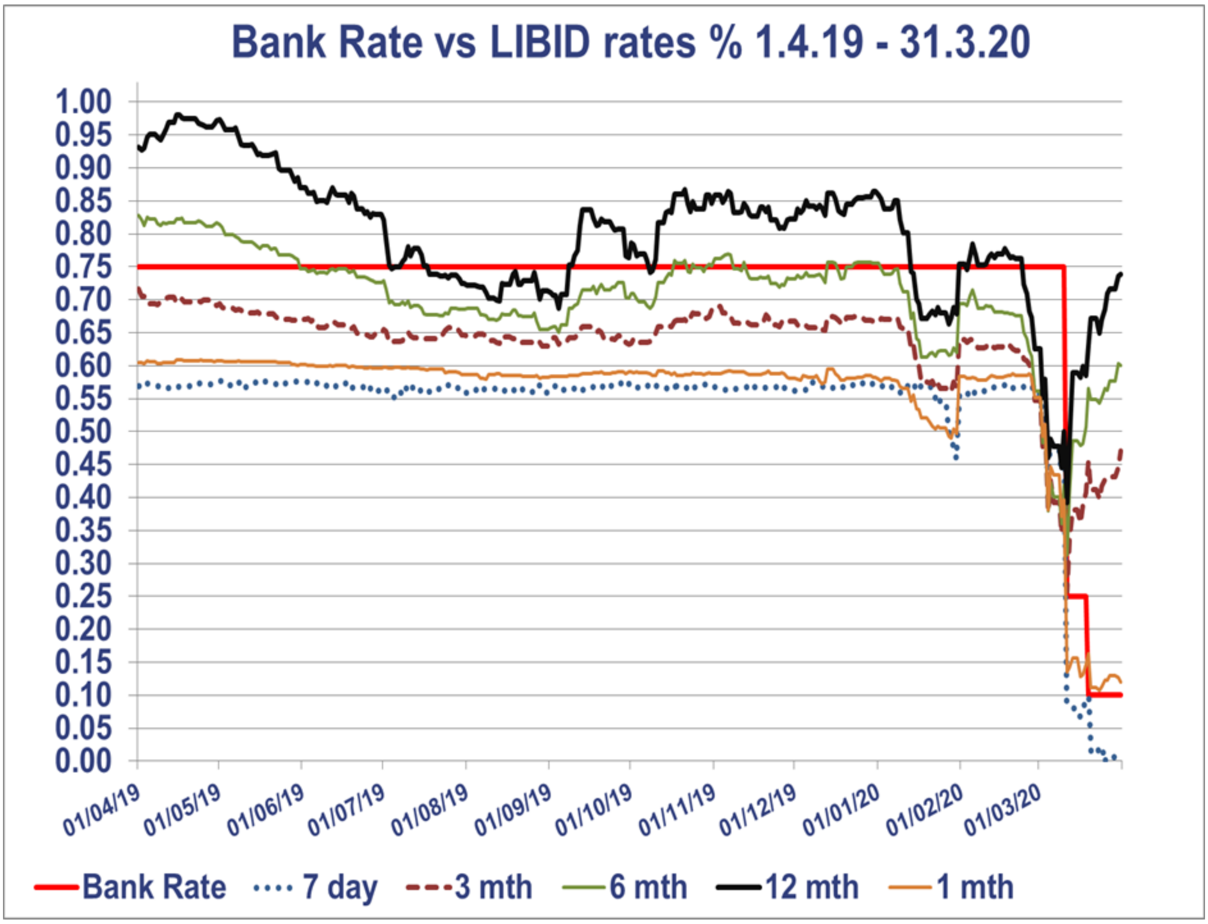
The maturity structure of the debt portfolio was as follows:

Duration	31st March 2019 Actual £m	2019/20 original limits %	31st March 2020 Actual £m
Under 12 months	-	20	**-**
12 months and within 24 months	-	20	**-**
24 months and within 5 years	-	25	**-**
5 years and within 10 years	-	75	**-**
10 years and within 15 years	5	100	**5**
15 years and within 50 years	58	100	**58**

All investments held by the Council were invested for up to one year, with the exception of £3.8m invested in property funds, which are held for the longer-term, 5 – 10 years.

4. The Strategy for 2018/19

4.1 Investment strategy and control of interest rate risk



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.75	0.58	0.61	0.72	0.83	0.98
High Date	01/04/2019	09/05/2019	15/04/2019	01/04/2019	01/04/2019	15/04/2019
Low	0.10	0.00	0.11	0.26	0.31	0.39
Low Date	19/03/2020	25/03/2020	23/03/2020	11/03/2020	11/03/2020	11/03/2020
Average	0.72	0.53	0.56	0.63	0.70	0.80
Spread	0.65	0.58	0.50	0.46	0.52	0.59

Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020.

Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

4.2 Borrowing strategy and control of interest rate risk

During 2019/20, the Council maintained an under-borrowed position. This meant that the capital borrowing need (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances and incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Executive Director Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

PWLB Borrowing Rates

PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 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 30 years. We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 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.

Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks also started quantitative easing purchases of government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.

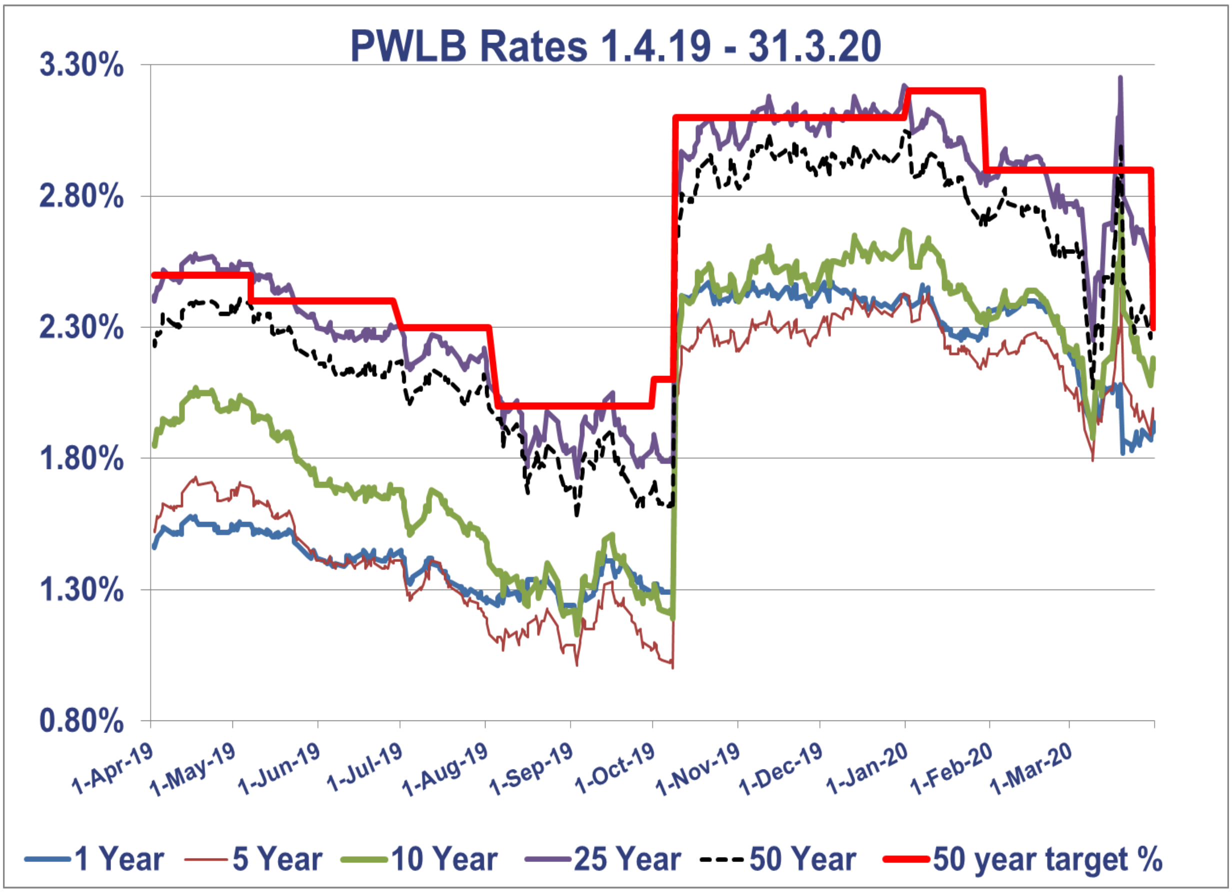
However, HM Treasury has imposed **two changes in the margins over gilt yields for PWLB rates** in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then partially reversed for some forms of borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ends on 31st July. It is clear that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

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

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

There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020-21.

The graph and tables for PWLB rates below and in Appendix 2 show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



5. Borrowing Outturn for 2019/20

Treasury Borrowing
Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Borrowing in Advance of Need
The Council has not borrowed more than, or in advance of, its needs, purely in order to profit from the investment of the extra sums borrowed.

Rescheduling
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

6. Investment Outturn for 2019/20

Investment Policy – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 26th February 2019. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised the following:

Balance Sheet Resources General Fund	31st March 2019 £m	31st March 2020 £m
Balances	6.113	**6.882**
Earmarked Reserves	7.951	**9.387**
Provisions	1.815	**2.032**
Usable Capital Receipts	17.656	**17.279**
Capital Grants Unapplied	0.048	**0.256**
Total GF	**33.583**	**35.836**

Balance Sheet Resources HRA	31st March 2019 £m	31st March 2020 £m
Balances	4.485	**6.252**
Earmarked Reserves	16.460	**7.789**
Provisions	-	**-**
Usable Capital Receipts	5.704	**2.896**
Total HRA	**26.649**	**16.937**

Total Authority Resources	**60.232**	**52.773**

Investments held by the Council – the Council maintained an average balance of £67.6m of internally managed funds. The internally managed funds earned an average rate of return of 1.01%. The comparable performance indicator is the average 7-day

LIBID rate which was 0.53%. This compared with a budget assumption of £41.7m investment balances earning an average rate of 1.0%.

7. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table in section 3)*.* The Council's performance indicators were set out in the Annual Treasury Management Strategy Statement.

This service has set the following local performance indicator:

- *Average external interest receivable in excess of 3 month LIBID rate;*

  Whilst the assumed benchmark for local authorities is the 7 day LIBID rate, a higher target is set for internal performance.

  The actual return of 1.01% compared to the average 3 month LIBID of 0.63% (0.38% above target).

8. The Economy and Interest Rates

UK. Brexit. The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Theresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the **coronavirus outbreak**. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in **quantitative easing (QE),** essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but it is obviously heading for a big hit in March – April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

USA. Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost $367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be $500bn of funding from the

Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of March.

EUROZONE. The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. 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, 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%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, 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 to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

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. It appears to have missed much of the domestic impact from coronavirus in 2019-20 but the virus is at an early stage there.

WORLD GROWTH. The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

9. Other Issues

International Financial Reporting Standard (IFRS) 9 – Financial Instruments.

The 2018/19 Accounting Code of Practice introduced changes in way investments are valued and disclosed in the Council's Statement of Accounts. Key considerations are:-

- Expected credit loss model. Whilst not material for vanilla treasury investments such as bank deposits, this does impact our investment in property funds
- The valuation of investments previously valued under the available for sale category e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar, will be changed to **Fair Value through the Profit and Loss (FVPL).**

Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This is effective from 1st April 2018, and applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

Investment in Property Funds

Investment in property funds was included within the Commercial Investment Strategy, with the aim of generating improved returns of c.4-5% p.a. (plus asset growth) being long term investments of between 5 – 10 years (minimum) in order to make the necessary returns (after set up costs).

Utilising the capital receipt proceeds of the sale of the Golf Course, a budget of £12m was allocated to long-term investment in a number of property funds. To date, the Council has invested £1.85m with Schroders UK Real Estate Fund and £2m with Threadneedle Property Unit Trust, total investment £3.85m. The funds have achieved an estimated return of 3.8% during 2019/20, however, capital value has fallen by £99k.

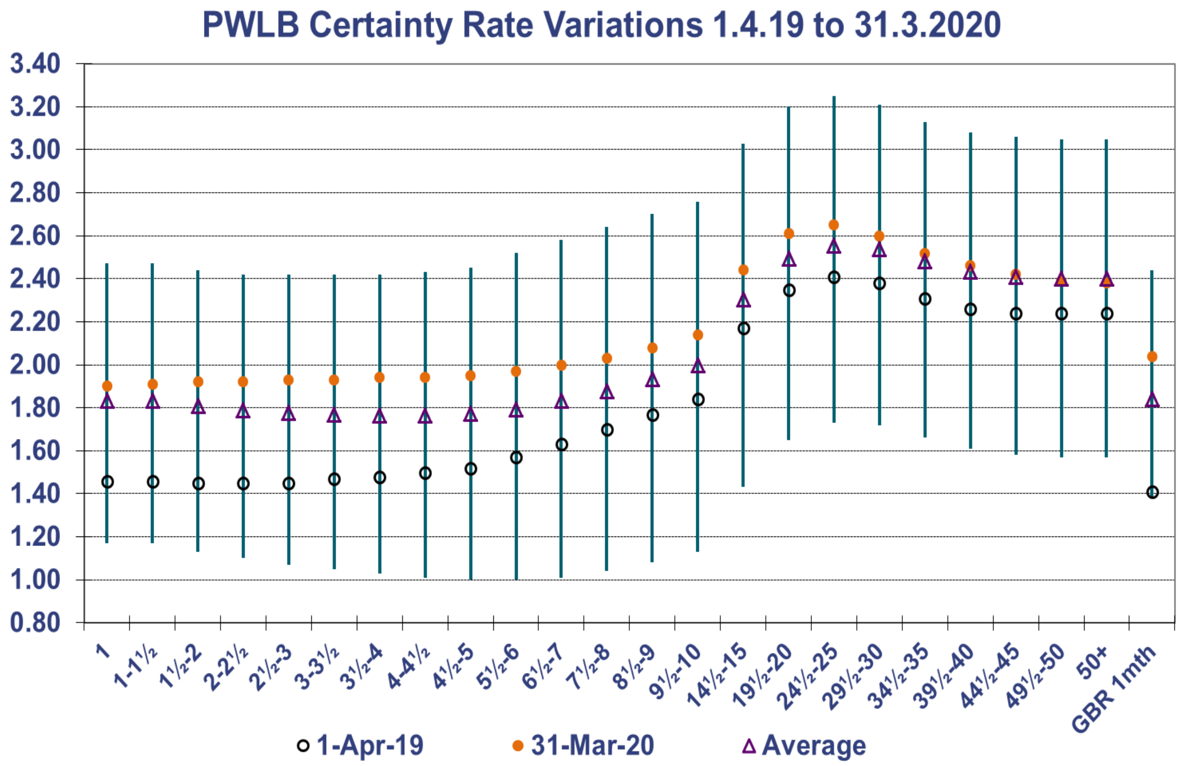
We received £147k in dividends from our property fund investments (£108k in 2018/19), compared to a budget of £240k. However the net value of the investments had fallen by £130k as at 31st March 2020. Investments in property are subject to fluctuations in value over the economic cycle and should also yield capital growth in the longer term as the economy grows.

The MTFS includes budgeted income of £300k for 2020/21 (£480k pa from 2021/22) arising from investment of the full £12m budgeted, however, due to uncertainty around arrangements for Brexit and the associated impact on the economy, and then the further uncertainty and impact on property fund values as a result of the coronavirus, it has been decided to delay any further investment in property funds until there is more clarity.

Following recommendation by the Corporate Scrutiny Committee to Cabinet on 30th July it was agreed that a review of property funds is undertaken for scrutiny by the Audit and Governance Committee, before any further investments under existing delegations are made to inform the Treasury Management Mid-Year Review report for consideration by Council in December 2020. This will allow opportunity for the review to be informed by the trading experience of the property funds up to the half year, Quarter 2 of 2020/21 financial year - including the impact of the pandemic on rental income and therefore property fund returns.

1. PRUDENTIAL INDICATORS	2018/19	2019/20	2019/20
Extract from budget and rent setting report	**Actual**	**Original**	**Actual**
Capital Expenditure	**£m**	**£m**	**£m**
Non - HRA	10.515	17.803	4.734
HRA	9.266	30.221	20.462
TOTAL	19.781	48.024	25.196
	-		
Ratio of financing costs to net revenue stream	%	**%**	**%**
Non - HRA	(6.16)	(3.01)	(9.39)
HRA	29.17	29.39	27.44
	-		
Gross borrowing requirement General Fund	£m	**£m**	**£m**
brought forward 1 April	0.885	1.037	0.828
carried forward 31 March	0.885	2.352	3.580
in year borrowing requirement	-	1.315	2.752
Gross borrowing requirement HRA	£m	**£m**	**£m**
brought forward 1 April	68.041	68.041	68.041
carried forward 31 March	68.041	75.255	68.533
in year borrowing requirement	-	7.214	0.492
	£m	**£m**	**£m**
Gross debt	63.060	63.060	63.060
	-		
Capital Financing Requirement	£m	**£m**	**£m**
Non – HRA	0.828	2.235	3.524
HRA	68.041	75.255	68.533
TOTAL	68.869	77.490	72.057
	-		
Annual change in Capital Financing Requirement	£m	**£m**	**£m**
Non – HRA	(0.057)	1.198	2.696
HRA	-	7.214	0.492
TOTAL	(0.057)	8.412	3.188

2. TREASURY MANAGEMENT INDICATORS	2018/19	2019/20	2019/20
	Actual	**Original**	**Actual**
	£m	**£m**	**£m**
Authorised Limit for external debt - General Fund			
borrowing	5.547	5.235	5.235
other long term liabilities	-	-	-
TOTAL	5.547	5.235	5.235
	-		
Authorised Limit for external debt - HRA	-		
borrowing	79.407	79.407	79.407
other long term liabilities	-	-	-
TOTAL	79.407	79.407	79.407
	-		
Operational Boundary for external debt - General Fund	£m	**£m**	**£m**
borrowing	-	-	-
other long term liabilities	-	-	-
TOTAL	-	-	-
	-		
Operational Boundary for external debt - HRA	£m	**£m**	**£m**
borrowing	63.060	63.060	63.060
other long term liabilities	-	-	-
TOTAL	63.060	63.060	63.060
	-		
Actual external debt	£m	**£m**	**£m**
	63.060	63.060	63.060



	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	1.46%	1.52%	1.84%	2.41%	2.24%
31/03/2020	1.90%	1.95%	2.14%	2.65%	2.39%
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.45%	2.76%	3.25%	3.05%
Date	21/10/2019	19/03/2020	19/03/2020	19/03/2020	31/12/2019
Average	1.83%	1.77%	2.00%	2.56%	2.40%