SIGNED OFF BY	Interim Head of Finance
AUTHOR	Helen Stocker, Finance Manager
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TO	Executive Overview & Scrutiny Council
DATE	Tuesday, 28 July 2020 Thursday, 10 September 2020 Thursday, 24 September 2020
EXECUTIVE MEMBER	Portfolio holder for Finance

KEY DECISION REQUIRED	Yes
WARDS AFFECTED	(All Wards);

SUBJECT	Treasury Management Outturn Report 2019/20

RECOMMENDATIONS

RECOMMENDATIONS:

That Executive recommend to Council:

(i) To note the Treasury Management Performance for 2019/20;

(ii) To approve the outturn against the 2019/20 Prudential and Treasury Management Indicators and the Annual Treasury Management Report (Annex 1).

REASONS FOR RECOMMENDATIONS

This report confirms compliance with the requirements of the regulatory framework for treasury management.

The Council is required to receive and approve, as a minimum, three treasury reports each year, which incorporate relevant policies, estimates and actuals:

(i) **Prudential and Treasury Indicators and Treasury Strategy** – sets the framework for treasury management activities in the following financial year. The Strategy for 2019/20 was received by Executive on 18 March 2019 and subsequently reported to Council for approval on 11 April 2019.

(ii) **Mid-Year Treasury Management Report** – updates Members on the current borrowing and investment position, whilst amending prudential indicators and revising policies where necessary. The mid-year report for 2019/20 was reported to Executive on 8 November 2019 and approved by Council on 16 January 2020.

(iii) **Annual Treasury Management Outturn Report** – a backward-looking review focussing on the previous year's performance. This report.

EXECUTIVE SUMMARY

This report sets out treasury management performance for 2019/20 including performance against the Prudential and Treasury Management Indicators.

It will be presented to the 28 July 2020 Executive and full Council on 24 September will be asked to approve the recommendations. It will also be considered by Overview & Scrutiny Committee on 10 September. [Committee reporting timescales have been amended for this cycle in response to the COVID-19 pandemic].

Recommendations (i) and (ii) are subject to approval by full Council.

STATUTORY POWERS

1. The Council operates its Treasury Management activity as an integral part of its statutory obligation to effectively manage the Council's finances under the Local Government Act 2003 and associated regulations.

2. Treasury Management activities are undertaken in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management, the CIPFA Prudential Code for Capital Finance in Local Authorities and the Government's Investment Regulations.

BACKGROUND

3. Regulations issued under the Local Government Act 2003 require local authorities to produce an annual review of its treasury management activities for the previous year, including performance against the Prudential and Treasury Management Indicators.

4. The Treasury Management Strategy and Performance Indicators for 2019/20 were previously reported to the Executive on 18 March 2019 and approved by full Council on 11 April 2019

KEY INFORMATION

Treasury Management Strategy

5. Performance during 2019.20 is reported at Annex 1.

6. No prudential limits were breached and, with the exception of compliance with the maximum exposure per institution (details below), all decisions were taken in accordance with the Treasury Management Strategy.

<u>COVID-19 Pandemic - Extraordinary Circumstances</u>

7. One of the most significant challenges from a treasury management perspective was the revised timescales for receipt of planned and emergency Government funding. While these are generally 2020/21 considerations there were some impacts in the final couple of weeks of March 2020 when Government funding was received sooner than originally scheduled.

8. The Treasury Management Strategy specifies the maximum sums that can be invested with any one organisation. There was a period of time spanning year-end when the Council breached its limit on the maximum sum to be invested in a single institution, as specified in the 2019/20 Treasury Management Strategy. This was due to the receipt of significant emergency funding at short notice from the Government. The breach was subsequently addressed by opening additional investment accounts with new institutions to spread the risk.

9. The extended deadline for publication of the Statement of Accounts for 2019/20 as a consequence of the COVID-19 pandemic also means that a small number of 2019/20 figures were not available at the time of preparing this report. The final position will be reported later this year.

OPTIONS

Executive has three options:

Option 1 – note the report and recommend its approval by Council.

Option 2 – note the report but ask officers to provide more detail on specific issues contained in the report before it can be submitted to Council for approval.

Option 3 – reject the report. This would result in non-compliance with the Treasury Management Code of practice and associated regulations.

Executive is asked to approve Option 1.

LEGAL IMPLICATIONS

10. There are no direct legal implications arising from this report

FINANCIAL IMPLICATIONS

11. The financial implications of the Treasury Outturn 2019/20 were reflected in the budget section of the Quarter 4 Performance Report to Executive on 24 June 2020. There are no additional direct financial implications that arise from this report.

EQUALITIES IMPLICATIONS

12. There are no equalities implications arising from this report.

COMMUNICATION IMPLICATIONS

13. There are no communications implications arising from this report.

RISK MANAGEMENT CONSIDERATIONS

14. Key risks are managed in accordance with Prudential Code indicators, including ensuring Security, Liquidity and Yield for investments. Further details are provided at Annex 1.

OTHER IMPLICATIONS

15. There are no other implications relating to this report.

CONSULTATION

16. Executive will consider this report at its meeting on 28 July 2020. It will also be presented to the Overview & Scrutiny Committee on 10 September 2020.

POLICY FRAMEWORK

17. This report is submitted in accordance with the Council's Treasury Management Policy.

BACKGROUND PAPERS

- Executive 18 March 2019 – *Treasury Management Strategy 2019/20*
- Executive 7 November 2019 – *Half Year Treasury Management Report for 2019/20*
- Executive 24 June 2020 – *Quarter 4 Performance Report 2019/20*

ANNEX 1

ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2019/20

APPENDICES

1. Purpose

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 the previous financial year. 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 that full Council should receive the following reports:

- an annual Treasury Management Strategy in advance of the year (reported to Council on 11 April 2019)
- a mid-year, (minimum), Treasury Update report (reported to Council on 16 January 2020)
- an Annual Review following the end of the year (this report).

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is important in that regard, as it provides details of the outturn position for treasury activities and highlights compliance with the policies previously-approved by full Council. It will be presented to the Overview and Scrutiny Committee for any questions or comments before being reported to the Executive and full Council. [Committee reporting timescales have been amended for this cycle in response to the COVID-19 pandemic].

Member training on treasury management issues was undertaken on 15 October 2019 and 11 March 2020 in order to support Members' in this scrutiny and oversight role.

Link Asset Management continued to provide services as the Council's treasury advisors. Their latest commentary is attached at Appendix 2

2. Summary

During 2019/20, the Council complied with legislative and regulatory requirements. The key prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are set out below:

Table 1: PRUDENTIAL AND TREASURY INDICATORS	**2018/19 Actual £000**	**2019/20 Original Budget £000**	**2019/20 Revised Budget £000**	**2019/20 Actual £000**
Capital Expenditure:				
General Fund (see Table 2)	39,235	45,927	20,827	18,888
Total	**39,235**	**45,927**	**20,827**	**18,888**

Table 1: PRUDENTIAL AND TREASURY INDICATORS	2018/19 Actual £000	2019/20 Original Budget £000	2019/20 Revised Budget £000	2019/20 Actual £000
Capital Financing Requirement: In year change				
General Fund	15,046	39,869	14,769	15,857
Total	**15,046**	**39,869**	**14,769**	**15,857**
Gross Borrowing:				
Long Term credit arrangements	-	-	-	-
External Debt	12,000	40,000	14,900	14,000
Total	**12,000**	**40,000**	**14,900**	**14,000**
Investments:				
Longer than 1 year	25,000	13,000	13,000	13,000
Under 1 year	23,000	35,000	35,000	35,000
Total	**48,000**	**48,000**	**48,000**	**48,000**
Net Borrowing / (Net Investment)	**(36,000)**	**(8,000)**	**(33,100)**	**(34,000)**

The Chief Finance Officer confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, (the Authorised Limit), was not breached.

The challenging investment environment of previous years was amplified in 2019/20, resulting in low investment returns

COVID-19 Pandemic - Extraordinary Circumstances
The treasury and investment impacts of the COVID-19 pandemic which started in late 2019/20 include:

- Less predictable cashflows due to receipt of planned and additional Government funding at short notice and taking on new responsibilities for paying grant funding to businesses on behalf of Government;
- Incurring unplanned expenses as the authority's emergency response plan was implemented;
- A reduction in income receipts across all services and the Collection Fund.

One of the more significant challenges faced from a treasury management perspective was the revised timescales for receipt of planned and emergency Government funding. While these are generally 2020/21 considerations there were some impacts in the final couple of weeks of March 2020 when Government funding was received sooner than originally scheduled.

The Treasury Management Strategy specifies the maximum sums that can be invested with any one organisation. There was a period of time spanning year-end when the Council breached its limit on the maximum sum to be invested in a single institution, as specified in the 2019/20 Treasury Management Strategy. This was due to the receipt of significant emergency funding at short notice from the Government. The breach was subsequently addressed by opening additional investment accounts with new institutions to spread the risk.

The extended deadline for publication of the Statement of Accounts for 2019/20 as a consequence of the COVID-19 pandemic also means that a small number of 2019/20 figures were not available at the time of preparing this report. The final position will be reported later this year.

3. Introduction and Background

This report provides a summary of the Council's treasury management position for the year with regard to borrowing and investments, including:

- Capital investment activity and the impact of this activity on the Council's underlying indebtedness (the 'Capital Financing Requirement');
- Performance against Prudential and Treasury Management indicators;

4. Capital Expenditure and Financing

The Council undertakes capital expenditure to acquire or create 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 resources, the capital expenditure will give rise to a borrowing requirement.

The table below sets out the capital expenditure during 2019/20 and how it was financed.

Table 2: CAPITAL FINANCING	**2018/19 Actual £000**	**2019/20 Original Budget £000**	**2019/20 Revised Budget £000**	**2019/20 Actual £000**
Capital Programme Expenditure	39,235	45,927	20,827	18,962
Less: amounts not defined as Capital by statute	-	-	-	(74)
Total Capital Expenditure				**18,888**
Financed By:				
Capital Grants	3,966	3,048	3,048	(17)

Table 2: CAPITAL FINANCING	2018/19 Actual	2019/20 Original Budget	2019/20 Revised Budget	2019/20 Actual
Capital Receipts	20,133	462	462	2,122
Revenue Contribution	90	-	-	759
Capital Reserves	-	2,417	2,417	
Total Finance	**24,189**	**5,927**	**5,927**	**2,864**
Borrowing in Year	**15,046**	**40,000**	**14,900**	**16,024**

5. Overall Borrowing Need

The underlying need to borrow for capital expenditure is the 'Capital Financing Requirement' (CFR). The Council's CFR for the year is set out below and represents a key prudential indicator.

Table 3: CAPITAL FINANCING REQUIREMENT (CFR)	2018/19 Actual £000	2019/20 Original Budget £000	2019/20 Revised Budget £000	2019/20 Outturn £000
Opening balance	3,781	18,827	18,827	18,827
Add unfinanced capital expenditure (Table 2 above)	15,046	40,000	14,900	16,024
Less MRP/VRP	-	(131)	(131)	(167)
Less PFI & finance lease repayments	-	-	-	-
In year change in CFR	15,046	39,869	14,769	15,857
Cumulative Capital Financing Requirement (CFR)	**18,827**	**58,696**	**33,596**	**34,684**

The Council's treasury team ensures that sufficient cash is available to meet capital expenditure plans and cash flow requirements. This may be sourced through borrowing from external bodies, such as the Government's Public Works Loan Board (PWLB) or private sector lenders, or by utilising available cash balances on a temporary basis.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that the costs of borrowing to fund capital assets are charged to the revenue budget over the life of the asset. In order to achieve this the Council is required to make an annual charge to the revenue budget, the Minimum Revenue Provision (MRP) to reduce its CFR. This is effectively repayment of the associated borrowing.

The 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 for 2019/20 on 11 April 2019.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and that borrowing is only used for a capital purpose, the Council has to ensure that its gross external borrowing does not, except in the short term, exceed the total of the CFR in the preceding year (2018/19) plus the estimates of any additional capital financing requirement for the current (2019/20) and next two financial years. This confirms that the Council is not borrowing to support revenue expenditure. The table below sets out the Council's gross borrowing position against its CFR and confirms that the Council has complied with this prudential indicator.

Table 4: GROSS BORROWING POSITION	**2018/19 Actual £000**	**2019/20 Original Budget £000**	**2019/20 Revised Budget £000**	**31 March 2020 (2019/20) Actual £000**
Gross External Borrowing Position (Table 1)	**12,000**	**40,000**	**14,900**	**14,000**
Cumulative CFR (Table 3)	18,827	58,696	33,596	34,684
(Under) / Over Funding of CFR	**(6,827)**	**(18,696)**	**(18,696)**	**(20,684)**

The Authorised Limit - the Authorised Limit is the 'affordable borrowing limit' required by s3 of the Local Government Act 2003. Once this has been approved, the Council does not have authority to borrow above this level without formal adoption of a revised Limit. The table below confirms that the Council has maintained gross borrowing within its Authorised Limit during 2019/20

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 confirms the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the 'Net Revenue Stream' (the Council's revenue budget).

TABLE 5: COST of CAPITAL AGAINST NET REVENUE STREAM	2019/20
Authorised Limit	£80m
Maximum gross borrowing position during the year	£14m
Operational Boundary	£70m
Average gross borrowing position	£12.5m
Net financing costs as a proportion of Net Revenue Stream	7.87%

6. Treasury Position at 31 March 2020

The Council's debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks across all treasury management activities. Procedures and controls to achieve these objectives are well established both through officer and Member reporting and through officer activity as set out in the Council's Treasury Management Practices. At the end of 2019/20 the Council's treasury position was as follows:

Table 6: DEBT PORTFOLIO	31 March 2019 Principal £000	Rate / Return %	Average Life (years)	31 March 2020 Principal £000	Rate / Return %	Average Life (years)
Fixed rate funding:						
PWLB	-	-	-	-	-	-
Market Loans:						
Northern Ireland Housing	5,000	0.90%	3 months	-	-	-
Portsmouth City Council	7,000	1.00%	3 months	-	-	-
Portsmouth City Council	-	-	-	3,000	1.00%	1 year
Portsmouth City Council	-	-	-	5,000	1.20%	1.5 years
Lincolnshire County Council	-	-	-	6,000	1.00%	1 year
Total	**12,000**	**0.96%**		**14,000**	**1.07%**	
Variable Rate Funding:						
PWLB	-	-	-	-	-	-
Market Loans	-	-	-	-	-	-
Total Debt	**12,000**	**0.96%**	**3 months**	**14,000**	**1.07%**	**1.2 years**

Table 6: DEBT PORTFOLIO	31 March 2019 Principal £000	Rate / Return %	Average Life (years)	31 March 2020 Principal £000	Rate / Return %	Average Life (years)
CFR (Table 3)	18,827			34,684		
Over / (Under) Borrowing	**(6,827)**			**(20,684)**		

Table 7: INVESTMENT PORTFOLIO	31 March 2019 Principal £000	Rate/ Return %	Average Life (years)	31 March 2020 Principal £000	Rate/ Return %	Average Life (years)
Investments:						
- In-House	48,000	1.27%	1.6 years	35,000	0.50%	1 year
- With Brokers	0	-	-	13,000	1.56%	2.5 years
Total Investments	**48,000**	**1.27%**	**1.6 years**	**48,000**	**0.90%**	**1.67 years**

The maturity structure of the debt portfolio is set out below:

Table 8: INVESTMENT PORTFOLIO	31 March 2019 Actual	2018/19 Original Limits	31 March 2020 Actual
Under 12 months	100%	100%	64%
12 months and within 24 months	0%	100%	36%
24 months and within 5 years	0%	100%	0%
5 years and within 10 years	0%	100%	0%
10 years and within 20 years	0%	100%	0%
20 years and within 30 years	0%	100%	0%
30 years and within 40 years	0%	100%	0%
40 years and within 50 years	0%	100%	0%

The limit for maturity structure of the debt portfolio at 100% reflects the fact that the Council has little external borrowing at present.

Table 9: INVESTMENT PORTFOLIO	Actual 31 March 2019 £000	Actual 31 March 2019 %	Actual 31 March 2020 £000	Actual 31 March 2020 %
Treasury investments				
Banks	8,000	17%	5,000	10%
Building Societies - rated	40,000	83%	18,000	38%
Local authorities	0	0%	0	0%
Money Market Funds	0	0%	25,000	52%
Total	**48,000**	**-**	**48,000**	**-**

Table 9: INVESTMENT PORTFOLIO	Actual 31 March 2019 £000	Actual 31 March 2019 %	Actual 31 March 2020 £000	Actual 31 March 2020 %
Bond funds	-	-	-	-
Property funds	-	-	-	-
Total managed externally	**-**	**-**	**-**	**-**
TOTAL TREASURY INVESTMENTS	**48,000**	**100%**	**23,000**	**100%**

Table 10: INVESTMENT PORTFOLIO	Actual 31 March 2019 £000	Actual 31 March 2019 %	Actual 31 March 2020 £000	Actual 31 March 2020 %
Non-Treasury Investments				
Third party loans & share capital:	-	-	-	-
Subsidiaries – Greensand Property Holdings Ltd	2,321	2%		
Companies – Horley Business Park Development LLP	734	1%	TBC[2]	TBC[2]
Associate – Pathway for Care Ltd [1]	912	1%		
Investment Property	98,445	96%		
TOTAL NON-TREASURY INVESTMENTS	**102,412**	**100%**	TBC[2]	TBC[2]
Treasury investments	48,000	32%	48,000	
Non-Treasury investments	102,412	68%	TBC[2]	TBC[2]
TOTAL – ALL INVESTMENTS	**150,412**	**100%**	TBC[2]	

Note 1: Third party loan and share capital information includes expected credit loss.

Note 2: Values to be confirmed. The Council is in the process of reviewing asset categories during closedown of the 2019/20 financial year. This will result in some investment property assets being reclassified as assets to support initiatives for the wellbeing of the community. At the time of preparing this report the review was not complete due to the extended deadline for closedown as part of the response to the COVID-19 Pandemic. The updated tables will be reported later in the year.

The maturity structure of the investment portfolio is set out below:

Table 11: ALL TREASURY INVESTMENTS	2018/19 Actual £000	2019/20 Budget £000	2019/20 Actual £000
Investments:			
Longer than 1 year	25,000	13,000	13,000
Up to 1 year	23,000	35,000	35,000
Total	**48,000**	**48,000**	**48,000**

7. Borrowing Outturn 2019/20

Loans were drawn during the year to fund the net unfinanced capital expenditure.

Table 12: LOANS						
Lender	Principal	Type	Interest Rate	Start date	Maturity Date	Duration
Short-term Market Loan	£6m	Fixed interest rate	1.00%	18/12/2019	18/12/2020	12 months
Short-term Market Loan	£3m	Fixed interest rate	1.00%	18/12/2019	18/12/2020	12 months
Long-term Market Loan	£5m	Fixed interest rate	1.20%	18/12/2019	18/06/2021	18 months

This compares well with the 2019/20 budget assumption that long term borrowing would be at an interest rate of 2.54%.

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.

8. Investment Outturn 2019/20

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance and was implemented in the Treasury Management Strategy approved by the Council on 11 April 2019. The Policy sets out the approach for choosing investment counterparties based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, such as rating outlooks, credit default swaps and bank share prices etc.

Investment activity during the year conformed to the approved Policy and the Council experienced no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. Core cash resources comprised usable reserves as follows:

Table 13: USABLE RESERVES	2018/19 Actual £000	2019/20 Actual £000
General Fund Balance	**12,547**	7,963
Earmarked Reserves	**25,042**	33,902
Usable Capital Receipts	**627**	**TBC**[1]
Capital Grants Unapplied	**16,038**	
Total	**54,254**	**TBC**[1]

Note 1: Values to be confirmed. At the time of preparing this report the review was not complete due to the extended deadline for closedown as part of the response to the COVID-19 Pandemic. The updated tables will be reported later in the year.

Investments - the Council maintained an average balance of £48m of investments in 2019/20 which earned an average rate of return of 0.95%. This compares with a budget assumption of £48m investment balances earning an average rate of 1.0%. The comparable external performance indicator is the average 12-month LIBID uncompounded rate, which was 0.5445%. Total investment income was £1.271 million compared to a budget of £0.607 million

9. Other Treasury Management Matters

Pooled Investment Funds. The Council had no pooled investment funds during the year.

Non-treasury management investments. The Council's current approach to making property investment decisions is set out in its Capital Investment Strategy which explains how investment decisions are made, how delivery is approached and how risks are managed. In order to support investment decisions, the Council relies on the principles established in its evolving Commercial Investment Strategy and powers under the Localism Act 2011. This forms the framework for maximisation of new and existing income streams to secure financial sustainability.

APPENDIX 1

PRUDENTIAL AND TREASURY INDICATORS

1.1 PRUDENTIAL INDICATORS	2018/19 Actual £000	2019/20 Original Budget £000	2019/20 Revised Budget £000	2019/20 Actual £000
Capital Expenditure				
General Fund (Table 2)	39,235	45,927	20,827	18,888
Ratio of net financing costs to net revenue stream				
General Fund	(4.98%)	(2.37%)	(2.37%)	(7.87%)
Gross Debt				
Brought forward 1 April	-	12,000	12,000	12,000
Carried forward 31 March	12,000	16,400	14,000	14,000
In year borrowing requirement	12,000	4,400	2,000	2,000
Capital Financing Requirement				
Opening CFR (Table 3)	3,781	18,827	18,827	18,827
In year CFR change (Table 3)	15,046	39,869	14,769	15,857
Closing CFR (Table 3)	18,827	58,696	33,596	34,684
Annual change in Capital Financing Requirement				
General Fund	15,046	39,869	14,769	15,857

1.2 TREASURY MANAGEMENT INDICATORS	**2018/19**	**2019/20**	**2019/20**	**2019/20**
	Actual	**Original Budget**	**Revised Budget**	**Actual**
	£000	**£000**	**£000**	**£000**
Authorised Limit for External Debt				
Borrowing	80,000	80,000	80,000	80,000
Other long-term liabilities	-	-	-	-
Total	80,000	80,000	80,000	80,000
Operational Boundary for External Debt				
Borrowing	70,000	70,000	70,000	70,000
Other long-term liabilities	-	-	-	-
Total	**70,000**	**70,000**	**70,000**	**70,000**
Actual External Debt	12,000	40,000	14,900	14,000

1.3 MATURITY STRUCTURE OF FIXED RATE BORROWING DURING 2019/20	**Target upper limit**	**Target lower limit**	**Actual**
Under 12 months	100%	0%	64%
12 months and within 24 months	100%	0%	36%
24 months and within 5 years	100%	0%	0%
5 years and within 10 years	100%	0%	0%
10 years and within 20 years	100%	0%	0%
20 years and within 30 years	100%	0%	0%
30 years and within 40 years	100%	0%	0%
40 years and within 50 years	100%	0%	0%
Maturity structure of Investments during 2019/20	upper limit	lower limit	
Longer than 1 year	£20m	£0m	£13m
Up to 1 year	-	-	£35m
Total	£20m	£0m	£48m

APPENDIX 2

LINK ASSET SERVICES COMMENTARY – APRIL 2020

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 Teresa 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.

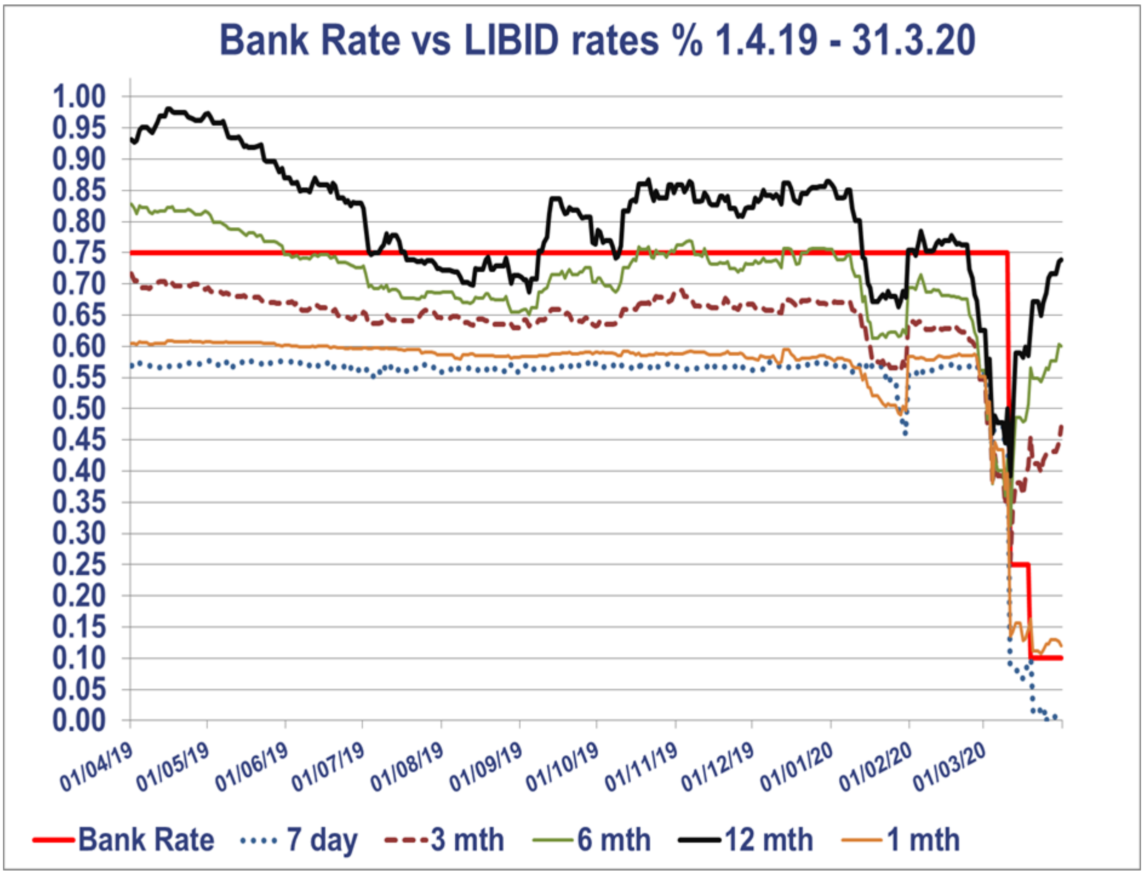
However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of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

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

Link Asset Services Interest Rate View 31.3.20								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

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.

The 2019/20 capital programme expenditure was delayed due to a combination of £29.74 million slippage and £0.412 million underspends, as reported to the June 2020 cycle of committees, in section 3 of the Quarterly Performance Report (Q4 – January to March 2020). This delay resulted in the Council having cash surpluses to invest, which put the Council in the flexible and strong position of being able to support the community, as the COVID-19 pandemic emerged. Additional Money Market Funds have been used to maintain cash flexibility in the pandemic. This approach has provided benefits in terms of reducing the counterparty risk exposure, by having investments placed in a larger number of institutions in the financial markets.

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; this would have 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, is expected to continue, although slowed in 2019/20 due to the impact of the COVID-19 pandemic. However, the policy of running down spare cash balances is being kept under review to avoid incurring higher borrowing costs in the future when this authority 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 Head of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks.

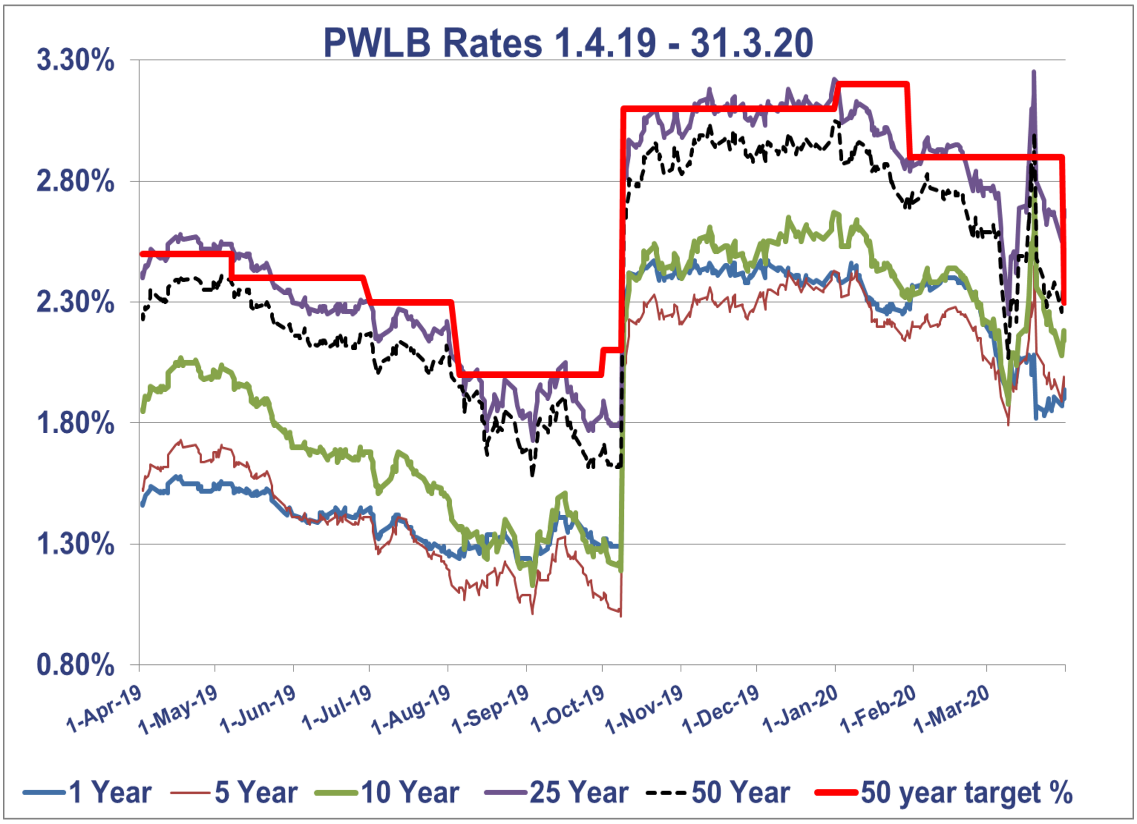
During emerging stage of COVID-19 the Head of Finance received daily treasury reports.

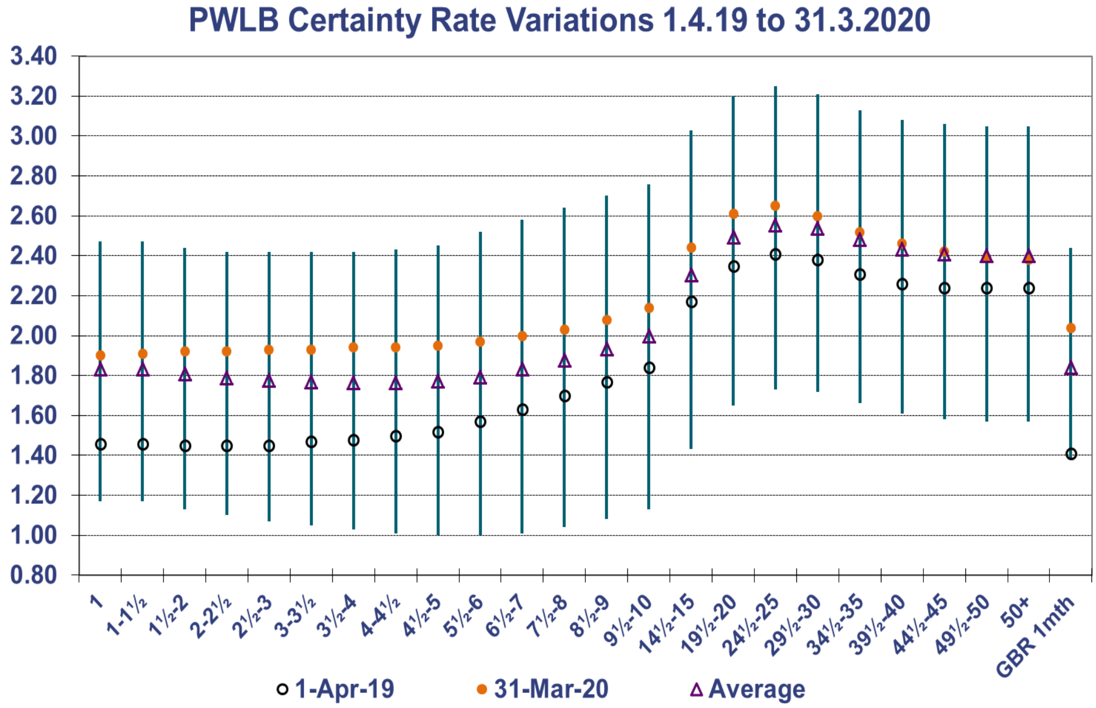
It was felt that there was a risk of a FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), so long term borrowings were postponed, in favour of short-term borrowing.

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

Link Asset Services Interest Rate View	31.3.20							
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50





	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%

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 4 June. 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.