Appendix A

Treasury Management Six Month Performance Review

1.0 Introduction

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

The Council's treasury management strategy for 2019/20 was approved at a meeting on 27th February 2019. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remain central to the Council's treasury management strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 27th February 2019.

2.0 External Context

2.1 Economic background

Inflation
UK Consumer Price Inflation (CPIH) remained at 1.7% year/year in February 2020, weaker than the consensus forecast of 1.9% and below the Bank of England's target.

In local context, the inflationary pressures have eased and as a result there is reducing pressure on some budgets. However, the MTFS forecast should factor in the rate of inflation in order to accommodate increase in prices in medium to long term.

Labour Market
The most recent labour market data for the three months to December 2019 showed the unemployment rate stabilising at 3.8% while the employment rate increased to 76.5%, a record high since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.9% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.8% excluding bonuses and 1.4% including.

In local context, the Council may find it harder to recruit suitable skilled staff and may have to offer a higher starting salary to attract skilled workers.

Economic Growth

Quarterly UK GDP growth rates throughout 2019 have been affected by temporary, mainly Brexit-related factors, including stock piling and car factory shutdowns. GDP grew by 0.3% in Q3, growth in Q4 is expected to be zero.

Locally, the challenging conditions in the economy will impact on the Council's services that are income generating.

Politics

Politics both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the December General Election and has now delivered on leaving the EU on 31st January. This now takes the UK into the transition phase until 31st December 2020.

Withdrawal from the EU may create skills shortages especially in the construction and tourism industries. Whilst it seems to have a no direct impact on the Council, there may be a role for the Council to engage with the local economy to help to support local businesses where there are skills shortages.

Global Monetary Policy

Tensions have eased somewhat between the US and China announcing the preliminary details of the first phase of a trade deal, in which tariffs due to be implemented in December would not go ahead and some existing tariffs would reduce. The US Federal Reserve maintains its Federal Funds rates in November to a range of 1.75% - 2%, to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown.

Quarterly growth in the euro areas was a little stronger than expected in Q3, although inflation remain weak around 1%, despite a rise in unit labour costs.

A reduction in economic activity could have an adverse effect on the Council's trading operations (e.g. CIS, Markets, Car Parks, Building Control, Development Control and leisure); as well as receipts from business rates and council tax.

Interest Rates Forecast

In January, the Monetary Policy Committee (MCP) voted to maintain the Bank of England Base Rate at 0.75%, in light of the global economy stabilising and the imminent withdrawal from the EU.

The historical low level of interest rates, have made it difficult to achieve a higher rates returns on investment.

2.2 Financial markets

Sentiment in UK financial markets has been boosted by political developments, with the event of the general election reducing uncertainties in the near term around the potential options for Brexit.

The decline in uncertainty has been reflected in asset prices and bond spreads. UK equity prices have also strengthened for UK focused companies, rising on average by 8%.

3.0 Local Context

On 31st March 2020, the Council had net borrowing of £21.37m arising from its revenue income and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.20 Estimate £m	**31.3.20 Actual £m**
General Fund CFR	73.4	71.3
Less: *Other debt liabilities	0.5	0.5
Total CFR	**73.9**	**71.8**
External borrowing	40.0	43.9
Internal borrowing	**33.9**	**27.8**
Less: Usable reserves	43.1	55.5
Less: Working capital	4.00	15.3
Net (Investing) or New Borrowing	**(13.2)**	**(43.0)**

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

The treasury management position at 31st March 2020 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	30.9.19 Balance £m	Movement £m	31.3.20 Balance £m	31.3.20 Rate %
Long-term borrowing	40.23	(0.27)	39.96	-0.67
Short-term borrowing	0.00	4.00	4.00	100
Total borrowing	**40.23**		**43.96**	
Long-term investments	10.46		10.46	
Short-term investments	0.00		0.00	
Cash and cash equivalents	16.05	(3.92)	12.13	-24.4%
Total investments	**26.51**		**22.59**	
Net borrowing	**13.72**		**21.37**	

The movement in short-term borrowing was as a result of maintaining cash balances over £10m to comply with the Markets in Financial Instruments Directive (MiFID), that allows the council access to investment instruments as a professional client rather than a retail client, such Money Market Funds (MMF).

The movement in the cash and cash equivalent has been as result of council tax and NNDR receipts; these funds were invested in bank deposits and Money Market Funds for easy access and liquidity reasons.

3.1 Borrowing Strategy during the period

At 31st March 2020, the Council held £43.96m of loans, an increase of £3.73m to 30th September 2019. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3: Borrowing Position

	30.9.19	Net	31.3.20	31.3.20	31.3.20

	Balance £m	Movement £m	Balance £m	Weighted Average Rate %	Weighted Average Maturity (years)
Public Works Loan Board	40.23	(0.27)	39.96	2.76	23.66
Local authorities (short-term)	-	4.00	4.00	0.72	0.03
Total borrowing	**40.23**		**43.96**		**23.69**

The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

With short-term interest rates remaining much lower than long-term rates, the Council considered it to be more cost effective in the near term to use internal resources or short-term loans instead. The Council had not used short-term loans facility so far in this financial year.

The Council has an increasing CFR due to the capital programme including CIS purchases and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, the Council decided to take some advantage of the fall in external borrowing rates and borrowed £11.96m maturity loans.

Long-dated Loans borrowed	PWLB Reference	Amount £	Rate %	Period (Years)
PWLB 1	495152	5,000,000	3.91	38.7
PWLB 2	495153	5,000,000	3.90	37.7
PWLB 3	502463	563,381	2.24	3.4
PWLB 4	504487	690,150	3.28	26.7
PWLB 5	504598	917,912	3.10	26.8
PWLB 6	504810	457,723	2.91	27.0
PWLB 7	504922	371,493	3.10	27.1
PWLB 8	504993	301,169	2.92	27.2
PWLB 9	505255	597,586	2.31	27.3
PWLB 10	505372	459.383	2.18	27.5
PWLB 11	505649	818,187	2.67	27.8
PWLB 12	506436	5,000,000	2.78	17.5
PWLB 13	508696	7,291,685	2.49	19.0
PWLB 14	508931	533,333	1.48	2.0
PWLB 15	509389	11,963,000	2.18	19.2
Total borrowing		**£39,964,999**	**2.76**	**23.66**

Short-dated Loans borrowed	Broker	Amount £	Rate %	Period (days)
Derbyshire Police & Crime Commissioner	Martins	1,000,000	0.70	20
Harlow District Council	Martins	3,000,000	0.75	31
Total borrowing		**£4,000,000**	**0.725**	**25.5**

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

3.2 Treasury Investment Activity

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held and money borrowed in advance of need. During the year, the Council's investment balances ranged between £2.52m and £20.9 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	30.9.19 Balance £m	Net Movement £m	31.3.20 Balance £m	30.9.19 Income Return %	30.9.19 Weighted Average Maturity days
Banks & building societies (unsecured)	7,612,000	(2,632,000)	4,980,000	0.39	30
Government (incl. local authorities)	-	-	-	-	7
Money Market Funds	8,440,000	(1,290,000)	7,150,000	0.43	7
Loans to other organisation	6,461,000	10,000	6,462,000	3.96	>365
Other Pooled Funds.					
- *Property funds*	4,000,000		4,000,000	4.41	>365
Total investments	**26,513,000**	**(3,912,000)**	**22,592,000**	**3.20**	

The weighted average rate for the investment portfolio up to 30.09.2019 was 3.51%.

3.3 Risk Management

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

Given the increasing risk and low returns from short-term unsecured bank investments, the Council has maintained a diversified portfolio of asset classes as shown in table 4 above. As a result, investment risk was diversified while the average income return has decreased 3.51% to 3.20%.

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

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

	Credit Score	**Credit Rating**	**Bail-in Exposure %**	**Weighted Average Maturity (days)**	**Rate of Return %**
30.09.2019	4.72	A+	100	1	1.32
31.03.2020	4.49	AA-	100	1	1.35
Similar LAs	3.95	AA-	59	53	1.55
All LAs	4.03	AA-	56	20	1.23

*Weighted average maturity

£3.97m of the Council's investments are held in externally managed strategic pooled property funds – CCLA Property Fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. This fund generated an average total return of £168,922 (4.41%), comprising a £76,702 (0.63%) income return from bank deposit and MMFs combined for period of 1st April to 31st March 2020 which is used to support services in year.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates. In light of their performance over the medium-term and the Council's latest cash flow forecasts, investment in these funds has been maintained.

3.4 Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held £55.04m of such investments in:

- directly owned property £54.9m

- shareholding in subsidiaries £0.1m

Table 6: Property held for investment purposes in £'000

Property	**Actual**	**31.3.2020 actual**	
	Purchase cost	**Gains or (losses)**	**Value in accounts**
Existing Portfolio	19,644	1,581	21,225
2 Stonehill	1,400	400	1,800
80 Wilbury Way	2,200	(330)	1,870
Shawlands Retail Park	6,500	(2,000)	4,500
1400 & 1500 Parkway	5,425	(1,025)	4,400
Units 21a, 21b,23a,b,c Little End Road, St Neots	3,200	(300)	2,900
Rowley Centre, St Neots	7,600	(1,850)	5,750
Tri-link, Wakefield	13,750	(1,250)	12,500
TOTAL	**59,719**	**(4,774)**	**54,945**

These investments generated £3.6m of investment income for the Authority in 2019/20 after taking account of direct costs, representing a rate of return of 6.5%.

The Authority is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Authority is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net profit, the Authority's contingency plans for continuing to provide these services, are to use reserves where necessary to offset any negative variances in the final outturn. Unallocated general fund balances and budget surplus reserve can be used in case of a downturn in investment income to meet any detrimental effect.

Table 7: Proportionality of Investments in £'000

	2018/19 Actual	2019/20 Actual	2020/21 Budget	2021/22 Budget	2022/23 Budget
Gross service expenditure	75,729	77,760	72,303	69,710	58,836
Investment income	2,753	3,283	5,654	5,290	5,345
Proportion	3.6%	4.22	7.82%	7.59%	9.1%

4.0 Compliance

The Finance Manager (s151 officer) reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 8: Debt Limits

	31.3.20 Actual £m	2019/20 Operational Boundary £m	2019/20 Authorised Limit £m	Complied?
General	10.00	70.00	80.00	Yes
Loans	9.71	15.00	20.00	Yes
CIS	24.25	30.00	30.00	Yes
Total debt	**43.96**	**115.00**	**130.00**	

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

Table 9: Investment Limits

	31.3.20 Actual £m	2019/20 Limit £m	Complied?
Deposit Accounts			
NatWest	0.78	1.00	Yes
Debt Management Office (DMO)	-	unlimited	Yes
Santander	2.00	4.00	Yes
Handelsbanken	0.60	4.00	Yes
Barclays	1.600	4.00	Yes
Money Market Funds			
BlackRock Institutional sterling liquidity Fund	0.50	2.00	Yes
CCLA Public Sector Deposit Fund	0.90	1.00	Yes
Federated Short Term Prime Fund	1.30	2.00	Yes
Insight Liquidity Funds	1.25	2.00	Yes
Legal & General Sterling Liquidity Fund	1.20	2.00	Yes
Aberdeen Liquidity Fund	1.00	2.00	Yes
Invesco	1.00	2.00	Yes

5.0 Treasury Management Indicators

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

Security

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

	30.3.20 Actual	2019/20 Target	Complied?
Portfolio average credit rating	A+	A-	Yes

Liquidity

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

	31.3.20 Actual £m	**2019/20 Target £m**	**Complied?**
Total cash available within 3 months	13.8	2.0	Yes

Interest Rate Exposures

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

Interest rate risk indicator	**31.3.20 Actual**	**2019/20 Limit**	**Complied?**
Upper limit on one-year revenue impact of a 1% rise in interest rates	0	£128,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	0	£128,000	Yes

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

Maturity Structure of Borrowing

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

	30.3.20 Actual	**Upper Limit**	**Lower Limit**	**Complied?**
Under 12 months	9.09%	80%	0%	Yes
12 months and within 24 months	1.21%	80%	0%	Yes
24 months and within 5 years	1.28%	80%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	88.42%	100%	0%	Yes

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

6.0 Outlook for 2020/21

In February 2020, China experienced an air bourne virus, referred to as Covid 19. Regions within China went into lock down to prevent the spread of this virus. The global economy has gone into financial shock due to worldwide lockdown in all the major economies, Europe, Asia and America.

Since February, the UK has also experienced an economic lockdown to stop the spread of this virus. In response to this, the Bank of England has reduced the based rate to 0.1%, with inflation falling to 0.5%. GDP has reduced by 2.2% in March and forecast show that the UK economy is likely to see its GDP fall by 11.5%, the highest expected fall within the developed world. This has been compounded by the failure to conclude a trade deal with Europe by the end of 2020.

Unemployment is forecast to increase to 8% in the next few months from 3.9% once the effects of furloughing staff comes to an end in October. This will be the biggest increase in unemployment since 1971 when records began.

The long-term impact on the economy and unemployment is still incomplete as the UK moves out of lock-down, together with the fear of a second wave as we approach winter. The effect of this pandemic on the global economy is estimated to be about £9.6tn, with the IMF estimating that it will take two years for the world output to return to level pre-covid.