ANNEX K

Treasury Management Update
Quarter 3 (October-December), 2019-20

Introduction:

The Prudential Code for Capital Finance in Local Authorities (Prudential Code), Treasury Management Code of Practice and, in England, the Ministry of Housing, Communities & Local Government (MHCLG) Investment Guidance recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this Council is implementing best practice.

The Council's Treasury Management Strategy (TMS) for 2019/20 was approved at a meeting on 20th February 2019. The successful identification, monitoring and control of risk set out within the TMS remains central to the Council's treasury operations.

Economic climate:

In brief summary, the fourth quarter of 2019 (calendar year) saw:

- Following the General Election in December, the Government will now progress with achieving Brexit on 31st January 2020;
- Gross Domestic Product (GDP) expanded by 0.4% (quarter on quarter) in Q3, following on from contractions in Q1 and Q2;
- Inflation remained below the Bank of England's 2% target;
- The Monetary Policy Committee (MPC) kept Bank Rate on hold at 0.75%, but did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required.

Interest rate forecast:

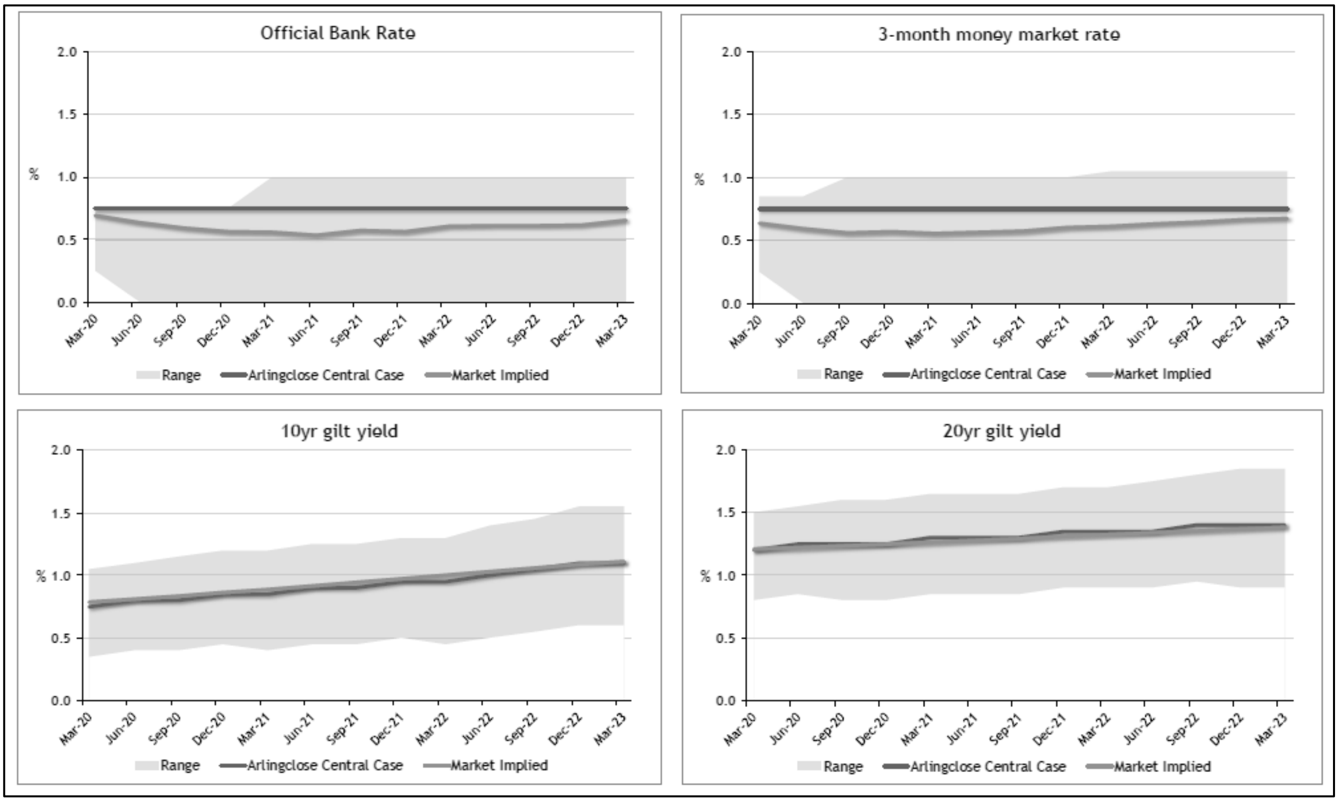
The latest forecast for interest rates of the Councils treasury advisors over the next three years is set out in Table 1, along with a sensitivity analysis of potential upside and downside risk to official bank rate. Chart 1 below plots these, alongside expected market returns and gilt yield (from which Government borrowing rates are derived) forecasts.

Table 1: Interest Rate Forecast

	Mar 2020	Jun 2020	Sept 2020	Dec 2020	Mar 2021	Jun 2021	Sept 2021	Dec 2021	Mar 2022	Jun 2022	Sept 2022	Dec 2022	Mar 2022
Official Bank Rate													
Upside Risk	-	-	-	-	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Arlingclose View	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%
Downside Risk	(0.50%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)	(0.75%)

There are many risks to the forecast set out above, principally around the arising primarily from the Government's policy around Brexit and the transitionary period, and a listing of underlying assumptions is attached at Appendix A. Budget estimates prudently include sensitivity analysis of the impact that a continued low-interest rate environment would have upon the Council.

Chart 1: Interest Rate Forecast



Annual Investment Strategy

The Annual Investment Strategy forms part of the Council's TMS. It sets out this Council's investment priorities as being:

1. **S**ecurity of capital sums invested;
2. **L**iquidity of funds to meet expenditure demands; and then
3. **Y**ield

The Council aims to achieve the best possible return (yield) on investments commensurate with and not to the detriment of proper levels of security and liquidity.

Table 2 below summarises the investment maturity position at 31st December 2019.

Table 2: Investment Maturity Position at 31st December 2019

Period	Product type / Maturity	Amount	
		£	%
Instant Access	Banks	£15,360	0.0
	Money Market Funds	£82,550,000	29.7
		£82,565,360	**29.7**
Fixed Term - Local Authorities	0-3 months to maturity	**£2,000,000**	**0.7**
Fixed Term – Central Government	0-3 months to maturity	**£75,000,000**	**26.9**
Certificates of Deposit – Banks	0-3 months to maturity	£24,000,488	8.6
	3-6 months to maturity	£79,069,085	28.4
		£103,069,573	**37.0**
Property Fund	4-5 years to maturity*	**£15,210,161**	**5.5**
YourMK LLP	Capital injection	£100	0.0
	4-5 years to maturity	£540,331	0.2
		£540,431	**0.2**
Total Investment Portfolio		**£278,385,525**	**100.0**

* In order to recoup initial BID/OFFER pricing spread. Cash deposits of £15.0m. Monthly valuation dates for purchase/sale of units - redemptions may be delayed should the fund be required to raise cash to meet this commitment, potentially up to 6 months.

Following the vote in Parliament in favour of the Prime Minister's Brexit Withdrawal Agreement Bill, the UK is fully expected to leave the EU on the scheduled leave date of 31st January 2020 and enter into a post-Brexit transition period. The bill would also ban an extension to this transition period which means if a trade deal cannot be reached by 31st December 2020 the UK would then be forced to trade with the EU under a no-deal scenario. As this new leave date approaches, the Council will ensure it continues to hold accounts open with UK domiciled banks, Money Market Funds and the Debt Management Account Deposit Facility (DMADF) with the Debt Management Office (DMO) to avoid any market disruption directly impacting on its liquidity.

Financial markets trade on confidence and certainty – both of which continue to be in short supply. The Bank of England maintained Bank Rate to 0.75% in December following a 7-2 vote by the Monetary Policy Committee (MPC). Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report (formerly the Quarterly Inflation Report) suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal. Investment rates remain low in short term durations, with some but limited pickup in value for medium to longer durations for the increased risk, as markets price in a near term rate cuts and a continued lower-for-longer bank rate thereafter.

Investment balances at the 31st March 2019 were £235.862m. Due to the front-loaded nature of various government funding streams the average level of funds available for investment purposes during quarter 3 (financial year) was £292.8m.

Balances are now forecast to fall to circa £230.0m by 31st March 2020 as internal resources are applied to fund capital expenditure demands in lieu of further borrowing, effectively reducing the cost of carrying debt at higher cost than income generated through investment of balances.

Table 3 below shows the Council continued to outperform the investment return benchmark by 25 basis points in Q3 - largely due to an average dividend return of c.4.3% on the Councils investments held with CCLA Property Fund. Latest projections for interest income for the financial year are reported through the Budget Monitoring process.

Table 3: Benchmark Performance

	Benchmark	**Benchmark Return**	**Council Performance**
Q1	3 month LIBID	0.76%	1.03%
Q2	3 month LIBID	0.71%	0.97%
Mid-Year Average	*3 month LIBID*	*0.75%*	*1.00%*
Q3	**3 month LIBID**	**0.67%**	**0.92%**

New Borrowing

No new borrowing for capital purposes was undertaken during the quarter.

Table 4 below sets out the profile of existing borrowing held at 31st December 2019.

Table 4: Borrowing Profile as at 31st December 2019

	Borrowing	
	£m	**%**
Under 12 months	3.234	0.7
1-2 years	6.667	1.4
2-5 years	46.220	9.9
5-10 years	59.350	12.7
Over 10 years	351.324	75.3
	466.795	**100.0**

Debt Restructuring

No debt rescheduling was undertaken during the quarter. Debt rescheduling opportunities have been limited due to the current economic climate and consequent structure of interest rates following increases in PWLB new borrowing rates in October 2010 and October 2019. Officers continue to monitor the position regularly.

Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) were approved alongside the TMSS on 20th February 2019.

During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's TMSS and shown in Appendix B.

Appendix A
Interest Rate Forecast Commentary; Arlingclose

Underlying assumptions to interest rate forecast

- The global economy has entered a period of weaker growth in response to political issues. The UK economy continues to experience slower growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations are low.

- Some improvement in global economic data and a more positive outlook for US/China trade negotiations has prompted worst case economic scenarios to be pared back.

- The new Conservative UK government will progress with achieving Brexit on 31st January 2020. The more stable political environment will prompt a partial return in business and household confidence in the short term, but the subsequent limited Brexit transitionary period, which the government is seeking to enforce, will create additional economic uncertainty.

- UK economic growth stalled in Q 4 2019 Inflation is running below target at 1.5%. The inflationary consequences of the relatively tight labour market have yet to manifest, while slower global growth should reduce the prospect of externally driven pressure, although escalating geopolitical turmoil could continue to push up oil prices.

- The first few months of 2020 will indicate whether the economy benefits from restored confidence. The Government will undertake substantial fiscal easing in 2020-21 which should help support growth in the event of a downturn in private sector activity.

- The weak outlook for the UK economy, and current low inflation, has placed pressure on the Bank of England to loosen monetary policy. Two Monetary Policy Committee (MPC) members voted for an immediate cut in the last two MPC meetings of 2019. The evolution of the economic data and political moves over the next few months will inform policy, but upside risks to Bank Rate are very limited.

- Central bank actions and escalating geopolitical risks will produce volatility in financial markets including bond markets.

Appendix B
Forecast Treasury and Prudential Indicators as at 31st December 2019

Prudential Indicator	2019/20 Indicator	Q3 2019-20
Authorised limit for external debt	----- £755.000m	-----
Operational boundary for external debt	----- £725.000m	-----
Gross borrowing	£465.398m	£466.795m
Capital Financing Requirement (CFR)	£697.315m	£714.007m
Ratio of financing costs to net revenue streams: GF	10.11%	10.84%
HRA	38.03%	38.03%
Limit of fixed interest rates based on net debt	£715.000m	£281.725m
Limit of variable interest rates based on net debt	£30.000m	-£93.316m
Principal sums invested > 365 days	£50.000m	£15.265m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 15% Min. 0%	0.7%
12 months to 2 years	Max. 15% Min. 0%	1.4%
2 years to 5 years	Max. 50% Min. 0%	9.9%
5 years to 10 years	Max. 50% Min. 0%	12.7%
10 years and above (breakdown below)	Max. 100% Min. 50%	75.3%
10 years to 20 years	*Max. 100%* *Min. 50%*	*31.9%*
20 years to 30 years		*6.9%*
30 years to 40 years		*23.4%*
40 years to 50 years		*13.1%*
Beyond 50 years		*0.0%*
		75.3%