Treasury Management

Borrowing and Investments

1. The table below shows the year's opening balance of borrowing and investments, current levels and those predicted for year-end.

2.

Borrowings and Investments	01.04.2019 Balance £M	30.09.2019 Balance £M	Average Yield/Rate %	31.03.2020 Estimated Balance £M
External Borrowing				
Public Works Loan Board (PWLB)	197.34	281.61	2.62	247.87
Market Loans	9.00	9.00	4.86	9.00
Total Long Term Borrowing	**206.34**	**290.61**	**2.72**	**256.87**
Temporary Borrowing	40.00	15.36	0.91	40.59
Total External Borrowing	**246.34**	**305.97**	**2.66**	**297.46**
Borrowings and Investments	**01.04.2019 Balance £M**	**30.09.2019 Balance £M**	**Average Yield/Rate %**	**31.03.2020 Estimated Balance £M**
Investments				
Cash (Instant access)	(26.06)	(73.44)	(0.70)	(11.89)
Local Authority	(9.00)	(20.00)	(0.74)	(0.00)
Cash (Notice Account)		(5.00)	(0.95)	
Short Term Bonds	(1.60)	(3.02)	(1.09)	(0.00)
Long Term Bonds	(6.03)	(3.01)	(5.30)	(3.01)
Property Fund	(27.00)	(27.00)	(4.24)	(27.00)
Total Investments	**(69.69)**	**(131.47)**	**(3.85)**	**(41.90)**
Net Borrowing	**176.65**	**174.50**		**255.56**

3. After taking into account maturing and new debt requirements in year and a reduction in investment balances, there is an estimated increase in net borrowing of £79.28M for 2019/20.

4. The interest cost of financing the council's long term and short term loan debt is charged to the general fund revenue account and is detailed below together with a summary of performance to date.

<u>Borrowing</u>

5. The forecast cost of financing the council's loan debt is £14.6M of which £5.5M relates to the HRA however this will be subject to movement as the need for further borrowing during the year becomes more certain.

6. As a result of the current economic uncertainty, the benchmark gilt rates for PWLB loans have fallen to historic lows. In order to secure this advantageous rate, a £90M 15 year EIP (Equal Instalment Payment) loan was taken at 1.12% in early September. Rates have since risen following the government's announcement on 9th October that the margin on loans

	has increased from 0.8% to 1.8% an increase of 100 base points or £10k for each £1M borrowed.
7.	Short term interest rates have remained low and are likely to do so for the remainder of the year and offer good value, which we will utilise to fund any further borrowing needs in the year, unless a further opportunity arises to secure a long term loan at advantageous rates. We currently have £15M in short term debt and this is expected to increase to £40M to replace maturing long term debt, expected reduction in reserves and to fund the forecast capital programme for the year.
	<u>Investment</u>
8.	As a result of taking the PWLB loan, balance are higher than usual at £131.5M but are expected to fall throughout the year to an estimated £42M by the end of the year as we have a number of debt maturities in the second half of the year and an ongoing capital programme.
	<u>External Managed investments</u>
9.	The council has invested £27M in property funds as an alternative to buying property directly. As previously reported these funds offer the potential for enhanced returns over the longer term, but may be more volatile in the shorter term and are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. As at the 30th September 2019 the sell price of our total investments were valued at £27.19M a notional "gain" of £0.19M against the initial investments of £27M. This is a reduction from that previously reported and reflects the current economic climate. The estimated return for the year is £1.0M if yields remain around current levels.
	<u>Financial Review and Outlook for 2019/20</u>
10.	A summary of the external factors, which sets the background for Treasury, as provided by the council's treasury advisors, Arlingclose Ltd, is provided below. The low for longer interest rate outlook theme that has been at the core of the recommended strategic advice for over a decade remains.
11.	The UK economy continues to face a challenging outlook as the government negotiates the country's exit from the European Union. The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.
12.	UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

13.	The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October.
14.	After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April. Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period. Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter.
15.	Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.
16.	Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will continue to offer longer-term borrowing opportunities, however this may now be impacted by the PWLB increasing the margin for borrowing.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Cas	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

	Credit background
17.	There were few credit rating changes during the quarter, none of which have impacted on our investment strategy.
18.	**Investment Performance**
19.	The council's advisors undertake quarterly investment benchmarking across its client base. As reported previously our portfolio was more diversified and at higher interest rates than the average as a result of moving into the bond programme earlier than most clients, but there is now more competition for bonds from both government bodies and other local authorities, so opportunities to replace maturing bonds are limited and we will see a fall in suitable instruments. With this in mind, and following discussions with our advisors, it was decided to move more into property funds, which are a longer term investment, and to short term investments for cash flow purposes.

20.	During the last quarter further bonds matured and our investments in bonds is now £6.02M and is expected to fall to £3.01M by the end of the year. We have maintained the property funds at £27M, with all other cash being placed in short term deposits as shown in paragraph 2.
21.	As detailed in paragraph 6 above a £90M loan was taken from PWLB at beginning of September leading to a temporary increase in our cash balances. As a result we had 59% (£78.44M) of our overall investment in unsecured funds which is higher than normal but is in line with other Unitary Authorities (63%) for this time of year. Our target is to reduce this to a £10M working balance to reduce borrowing and therefore net interest costs.
22.	Investments managed internally are currently averaging a return of 0.85% which is slightly higher than the average of 0.83% whilst still maintaining the average credit rating of AA-. Total income return at 1.56% is also higher than the average for both unitary (1.19%) and LA's (1.22%) and our total investment return at 1.58% is again higher than both unitary (1.48%) and LA's (1.34%) across Arlingclose's client base. This is lower than previously reported due to the current high level of cash balances which are depressing the overall return but will be utilised throughout the year leaving us with the strategic investments and a minimal cash flow balance which have a forecast average return of 3.30%. The main investment is in property funds which is currently returning 4.36% (including capital gain), but as previously reported the value of the funds are more volatile and can go down as well as up but are deemed less risky than buying individual properties and do not constitute capital spend and it is the income return at 4.30% that is the driver to invest.