APPENDIX 1 – ANNEX 2

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**	**31.12.2019 Balance £M**	**Average Yield/Rate %**	**31.03.2020 Estimated Balance £M**
External Borrowing				
Public Works Loan Board (PWLB)	197.34	278.86	2.62	247.87
Market Loans	9.00	9.00	4.86	9.00
Total Long Term Borrowing	**206.34**	**287.86**	**2.72**	**256.87**
Temporary Borrowing	40.00	5.35	0.87	57.81
Total External Borrowing	**246.34**	**293.21**	**2.66**	**314.68**
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)	(29.60)	(0.66)	(10.00)
Local Authority	(9.00)	(40.00)	(0.77)	(0.00)
Cash (Notice Account)		(5.00)	(0.95)	(5.00)
Short Term Bonds	(1.60)	(0.00)	(1.09)	(0.00)
Long Term Bonds	(6.03)	(3.01)	(5.30)	(3.00)
Property Fund	(27.00)	(27.00)	(4.42)	(27.00)
Total Investments	**(69.69)**	**(104.61)**	**(4.00)**	**(45.00)**
Net Borrowing	**176.65**	**188.60**		**269.68**

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 £93.03M 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.

Borrowing

5. The forecast cost of financing the council's loan debt is £14.52M of which £5.2M 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 £5M in short term debt and this is expected to increase to £58M 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 £104.6M but are expected to fall throughout the year to an estimated £45M 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, but this will be dependent on actual capital spend and movement in balances.
	<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 December 2019 the sell price of our total investments were valued at £27.06M a notional "gain" of £0.06M 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 £1.2M 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's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.
12.	GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.
13.	The headline rate of UK Consumer Price Inflation remained the same in November 2019 at 1.5% year-on-year, the same as October 2019, however continuing to fall from highs of 2.1% in July and April 2019 as accommodation services and transport continued to contribute to a level of inflation below the BOE target of 2%. Labour market data continues to be positive. The ILO unemployment rate continues to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November

2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.

14. Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%. The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. 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 suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

15. The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%). The fallout from the US-China trade war continues which, risks contributing to a slowdown in global economic activity in 2019. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the ECB and IMF has led to a change of stance in 2019. Quantitative easing has continued and been extended.

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.

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	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 £3.01M. 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 £77.61M of internal investment which is higher than normal. Our target is to reduce this to a £10M working balance to reduce borrowing and therefore net interest costs but this will be dependent on actual capital spend and movement in balances.
22.	Investments managed internally are currently averaging a return of 0.93% which is higher than the average of 0.81% whilst still maintaining the average credit rating of AA-. Total income return at 1.81% is also slightly higher than the average for both unitary (1.65%) and LA's (1.43%). However due to a fall in the capital value of our external funds of 2.02% our total investment return at 1.28% is lower than both unitary (1.66%) and LA's (1.67%) across Arlingclose's client base, but as previously reported it is the income return at 4.42% that is the driver to invest plus they are deemed less risky than buying individual properties and do not constitute capital spend.