Report No: 168/2019
PUBLIC REPORT

CABINET

19 November 2019

MID YEAR REPORT ON TREASURY MANAGEMENT AND PRUDENTIAL INDICATORS 2019/20

Report of the Strategic Director for Resources

Strategic Aim:	Sound Financial and Workforce Planning	
Key Decision: No	Forward Plan Reference: FP/090819	
Cabinet Member(s) Responsible:	Mr G Brown, Deputy Leader and Portfolio Holder for Planning, Environment, Property and Finance.	
Contact Officer(s):	Saverio Della Rocca, Strategic Director for Resources	01572 758159 sdrocca@rutland.gov.uk
	Andrew Merry, Finance Manager	01572 758152 amerry@rutland.gov.uk
Ward Councillors	Not Applicable	

DECISION RECOMMENDATIONS
That Cabinet: a) Notes the contents of the report and Appendices A to C. b) Notes the changes made by the Section 151 Officer around Investment Rules (see para 2.2 – 2.3)

1 PURPOSE OF THE REPORT

1.1 This report will update Members with the progress against the Treasury Management Strategy, prudential indicators and whether any policies require revision.

1.2 The underlying purpose of this report also supports the objective in the CIPFA Code of Practice on Treasury Management (revised 2017) and the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance which Members receive reports on and adequately scrutinise the treasury management service.

2 BACKGROUND AND MAIN CONSIDERATIONS

2.1 The Council's mid-year treasury report is included in Appendix A and includes information on the performance of the treasury management service. The key points to note for the six months to 30 September 2019 are:

- The Council has invested with institutions as determined by the revised creditworthiness criteria approved by the Section 151 Officer. The one exception relates to Skipton Building Society (SBS) due to an error on the Council's credit counterparty list provided by Link Asset Services. Officers invested £3 million for 364 days during the first six months of 2019/2 as the counterparty credit list provided by our treasury advisors showed SBS to be meeting the minimum credit criteria for investments up to £5 million and 364 days. It has subsequently been discovered there was an error in the credit list and investments should have been limited to £1m for 6 months. We have reviewed the position (as have our internal auditors who have made no recommendations on this matter) and deem there to be a low risk of default by SBS for the following reasons:

    a) SBS rating is Fitch - F1 (Upper Medium Grade). This means it would fall in the category of £5m and 364 days. The Moody rating is P-2 (Investment Grade) and allows for only £1m investment for 6 months. Our policy is belt and braces and uses the lowest investment rating – this is uncommon across Councils.

    b) As indicated above, we have a risk adverse policy regarding investments and other local authorities would still invest in SBS at the same or greater level than this investment e.g. Leicester City Council base investments only on Fitch ratings at (F1 and above) and allow up to £10m for 1 year, Hinckley & Bosworth Borough allow all investments for 1 year (except money market funds) regardless of rating but allow different limits based on the quality. Under their policy we would be able to invest £9m with Skipton with a maximum of £4m per transaction.

    c) The risk ratings for SBS have not changed since 2016 during this time we have at up to £5m invested with SBS and they have always repaid.

    d) We have looked at the accounts of SBS and the auditor states "We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. We have nothing to report in these respects"

    e) For each deal undertaken a risk of default percentage is calculated, using defaults of similar rated organisations, the risk of default for SBS is 0.097% which equates to £2,910 of the £3m invested. The Overall risk of default on the whole investment portfolio is 0.026% which is well below the 0.1% maximum allowable percentage.

f) There are no concerns around SBS in the media

- The Councils has made a return on investment of 0.97% compared to the LIBOR rate of 0.83%. The Council is outperforming budget by c£160k with the rate of return in line with other council's performance;

- The Council has not undertaken any external borrowing in the six months to 30 September 2019. The Council is still below its authorised limit for borrowing of £33m;

- No external debt was repaid early as there was not a financial business case to do so. The total premium (i.e. the charge for repaying early) for the Council's debt portfolio was £22.61m as at 30th September 2019; and

- No Commercial Investments were made in the first 6 months as no suitable opportunities for investment arose.

2.2 Due to market uncertainty arising from Brexit most UK financial institutions have been placed on a long term negative ratings watch by one of the credit rating agencies (Fitch). The TMSS requires a negative rating watch applying to any counterparty to be suspended from use (irrespective of the fact that other rating agencies may not agree). This would have resulted in operational issues with only several UK counterparties available for investment.

2.3 Due to the exceptional market conditions the Treasury Management Strategy allows for changes to be made by the Section 151 officer. The following change has been made:

- The current policy states that any organisation on 'negative watch' from any rating agency is suspended from use;

- This has been updated on advice from Link Asset Services who assert that our policy is very restrictive and overly 'belt and braces' and goes beyond what other Councils do. In this case, the Council will not suspend an organisation if other rating agencies do not have them on negative watch and their rating continues to be above the minimum requirement (assuming their rating has been downgraded by one).

3 CONSULTATION

3.1 No formal consultation is required.

4 ALTERNATIVE OPTIONS

4.1 The report is for noting, there are no alternative options.

5 FINANCIAL IMPLICATIONS

5.1 There are no financial implications arising from this report.

6 LEGAL AND GOVERNANCE CONSIDERATIONS

6.1 The report meets the requirements of both the CIPFA Code of Practice on Treasury Management, the CIPFA Prudential Code for Capital Finance in Local

Authorities and the Council's Financial Procedure Rules. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

6.2 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken;
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities; and
- Under Section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices.

6.3 The Council's Treasury Management Strategy explains how it complies with this legal framework.

7 DATA PROTECTION IMPLICATIONS

7.1 A data protection impact assessment has not been completed as there are no data protection implications.

8 EQUALITY IMPACT ASSESSMENT

8.1 An Equality Impact Assessment (EqIA) has not been completed because the report does not represent the introduction of a new policy or service or a change / to an existing policy or service that has an impact on any particular group

9 COMMUNITY SAFETY IMPLICATIONS

9.1 There are no community safety implications.

10 HEALTH AND WELLBEING IMPLICATIONS

10.1 There are no health and wellbeing implications

11 CONCLUSION AND SUMMARY OF REASONS FOR THE

RECOMMENDATIONS

11.1 The report summarises treasury management performance in the year to date and meets the requirements set out in Section 6.

12 BACKGROUND PAPERS

12.1 Statement of Accounts 2018/19

12.2 Quarter 1 Finance Management Report

12.3 Quarter 2 Finance Management Report

13 APPENDICES

13.1 Appendix A - Treasury Management Mid-Year Report

13.2 Appendix B - Link Commentary on the six months to 30 September 2019

13.3 Appendix C - Glossary

A Large Print or Braille Version of this Report is available upon request – Contact 01572 722577.

APPENDIX A - Treasury Management Mid-Year Report

1 INTRODUCTION

1.1 Background to Treasury Management

1.1.1 The Council is required to operate a balanced budget, which means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed to meet day-to-day running costs and planned capital expenditure. Any surplus monies are invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

1.1.2 The second main function of the treasury management service is the funding of the Council's capital plans as set out in the Budget and Capital Investment Strategy (CIS). These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.1.3 CIPFA defines treasury management as "…The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.2 What framework or rules do we need to follow?

1.2.1 As local authorities have seen a significant drop in local government funding, there has been increased investments in assets – often outside the local authority area – in a bid to generate revenue and balance the books.

1.2.2 Some of the deals that local authorities have entered into, often funded by significant borrowing, have raised concerns with the property deals being much bigger than core Council business such that a crash in property markets could effectively render some Council's 'bankrupt'.

1.2.3 On the back of this activity, updated guidance was produced:

- Prudential Code for Capital Finance in Local Authorities (2011) (Prudential Code) - this has been updated and introduces a formal requirement for a capital strategy to be approved by Council including "the authority's approach to investments and commercial activities including processes, due diligence and defining the authorities risk appetite in respect of these including proportionality in respect of overall resources".

- Treasury Management: Code of Practice and Cross-Sectoral Guidance Notes (Treasury Management Code) - this has been updated and again requires more explicit reference to how non treasury investments are managed – "It is critical that due diligence processes and procedures reflect the additional risk an organisation is taking on. Due diligence procedures should ensure effective

scrutiny of proposed investments, identification of risk to both capital and returns, any external underwriting of those risks, and the potential impact on the financial sustainability of the organisation if those risks come to pass".

- Minimum Revenue Provision - Guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. This prevents various practices such as spreading the MRP charge over a period longer than 50 years or making retrospective changes which give rise to a credit – "Changing the method used to calculate MRP can never give rise to an overpayment, and should not result in a LA making a charge of £nil for the accounting period in which the change is made".

- Guidance on Local Authority investments - Issued under section 15(1)(a) of the Local Government Act 2003. This guidance is consistent with the Codes described above.

1.2.4 The Council approved a Strategy in February 2019 (report 05/2019) which covered:

- The Capital Prudential Indications
- Borrowing Starategy
- Annual Investment Strategy and Commerical Investment Policy
- The Treasury Prudential Indicators and MRP Statement

1.2.5 The TMS allows for treasury investment in property funds, corporate bonds alongside short term deposits. The Council developed a Commercial Investment Policy that allows for capital investments in property etc that yield a positive net return for the Revenue Account to help subsidise the provision of other Council services, this was included as part of the Capital Investment Strategy.

2 THE CAPITAL PRUDENTIAL INDICATORS 2019/20

2.1 Capital Expenditure

2.1.1 The Council's capital expenditure plans as set out in the budget are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

2.1.2 The capital expenditure prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. As at 30 September 2019 the Council estimates that it will have capital projects approved of £20.126m. The details of this are shown in Quarter 2 Financial Management Report (Report No: 170/2019)

2.1.3 The Council's forecast capital expenditure for 2019/20 is £6.7m. The Quarter 2 report (170/2019) contains detailed analysis of the revised capital programme and financing. The £6.7m was financed as per the table below. The financing need represents an increase in borrowing requirements.

	2019/20 Treasury Strategy Estimate*	2019/20 Original Estimate **	2019/20 Revised Estimate
	£000	**£000**	**£000**
Total Projects	578	6,747	6,715
Total Commercial Activities/ non-financial investments	10,000	10,000	0
Total ring fenced grants-unallocated	2,915	0	0
Capital Expenditure	**13,493**	**16,747**	**6,715**
Financed by:			
Capital Receipts	0	192	283
Capital Grants & Contributions	3,293	5,667	5,467
Revenue	0	0	278
Total Financing	**3,293**	**5,859**	**6,028**
Net financing need for the year	**10,200**	**10,888**	**687**
Net financing need relating to commercial investments	10,000	10,000	0
Percentage of total net financing need	98%	92%	0%

* The Treasury Management Strategy report was presented to Cabinet on 15 January 2019, before the Capital Programme was approved.
** The 2018/19 Outturn Report 79/2019 updated the Capital Programme with 2019/20 carry forwards and additional capital schemes.

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

2.2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

2.2.2 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

2.2.3 The Council's CFR forecast for 2019/20 is shown below; both the overall CFR and with the commercial activities CFR separately identified and represents a key prudential indicator.

	2018/19 Actual	2019/20 Treasury Strategy Estimate	2019/20 Revised Estimate
	£000	**£000**	**£000**
CFR – 1 April	**21,859**	**21,244**	**21,246**
Movement in Year -			
Net financing need for the year (from table at para 2.1.3)	0	12,487	687
MRP	(613)	(664)	(664)
Total Movement in Year	(613)	11,823	23
CFR – 31 March	**21,246**	**33,067**	**21,269**

	2018/19 Actual	2019/20 Treasury Strategy Estimate	2019/20 Revised Estimate
	£000	**£000**	**£000**
CFR Commercial Activities – 1 April	**0**	**0**	**0**
Movement in Year -			
Net financing need for the year	0	10,000	0
MRP	0	0	0
Total Movement in Year	0	10,000	0
CFR Commercial Activities – 31 March	**0**	**10,000**	**0**

3 BORROWING

3.1 Borrowing objectives

3.1.1 Councils borrow to fund capital expenditure or refinance/reschedule existing borrowing e.g. replace one loan with one at a lower rate. There are 7 types of borrowing outlined in the strategy.

3.1.2 Effectively, the Council works out its capital expenditure plans and then calculates how much it needs to borrow having considered whether it should fund capital expenditure using other options. The Council's objectives are to:

- avoid external borrowing as far as possible (i.e. use other sources of funding first where possible) unless that borrowing yields income or deliver savings beyond the cost of borrowing;

- repay borrowing early if this is financially prudent and viable;
- reduce its borrowing charge if this represents value for money;
- ensure any new borrowing is affordable; and
- work within prudential indicator limits.

3.2 Current borrowing portfolio

3.2.1 The Council currently has loans outstanding of £22.436m of which £21.386m are long term loans with the Public Works Loans Board (PWLB). PWLB is managed as part of the UK Debt Management Office, which is a HM Treasury Executive Agency. The remainder is a £630k Local Enterprise Partnership interest free loan which matures in 2023, and an interest free Salix loan of £420k repayable in 2020. Included within the £21.386m is £8.232m of debt that was inherited from Leicestershire in the Local Government Re-organisation in 1997.

3.2.2 No additional borrowing has been undertaken so far in 2019/20. The last time the Council actually borrowed from the PWLB was in 2008 to contribute towards funding the Oakham bypass, the value of this loan was £4m.

3.2.3 All PWLB loans have been borrowed on a maturity basis. Interest payments will be made every six months on equal instalments throughout the term of the loan, with the principal being re-paid on the maturity date.

3.2.4 The table below shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing. A key prudential indicator is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR.

	2018/19 Actual £000	**2019/20 TMS Estimate £000**	**2019/20 Revised Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Gross Debt	22,436	27,226	22,436	27,436	27,436
Capital Financing Requirement (CFR)	21,246	33,067	21,269	31,352	31,982
Under / (Over) borrowing	(1,190)	5,841	(1,167)	3,916	4,546

*Under Borrowing Position explained in Treasury Management Strategy 2019/20 (5/2019)

3.2.5 Within the above figures the level of debt and the CFR relating to commercial activities / non-financial investment is

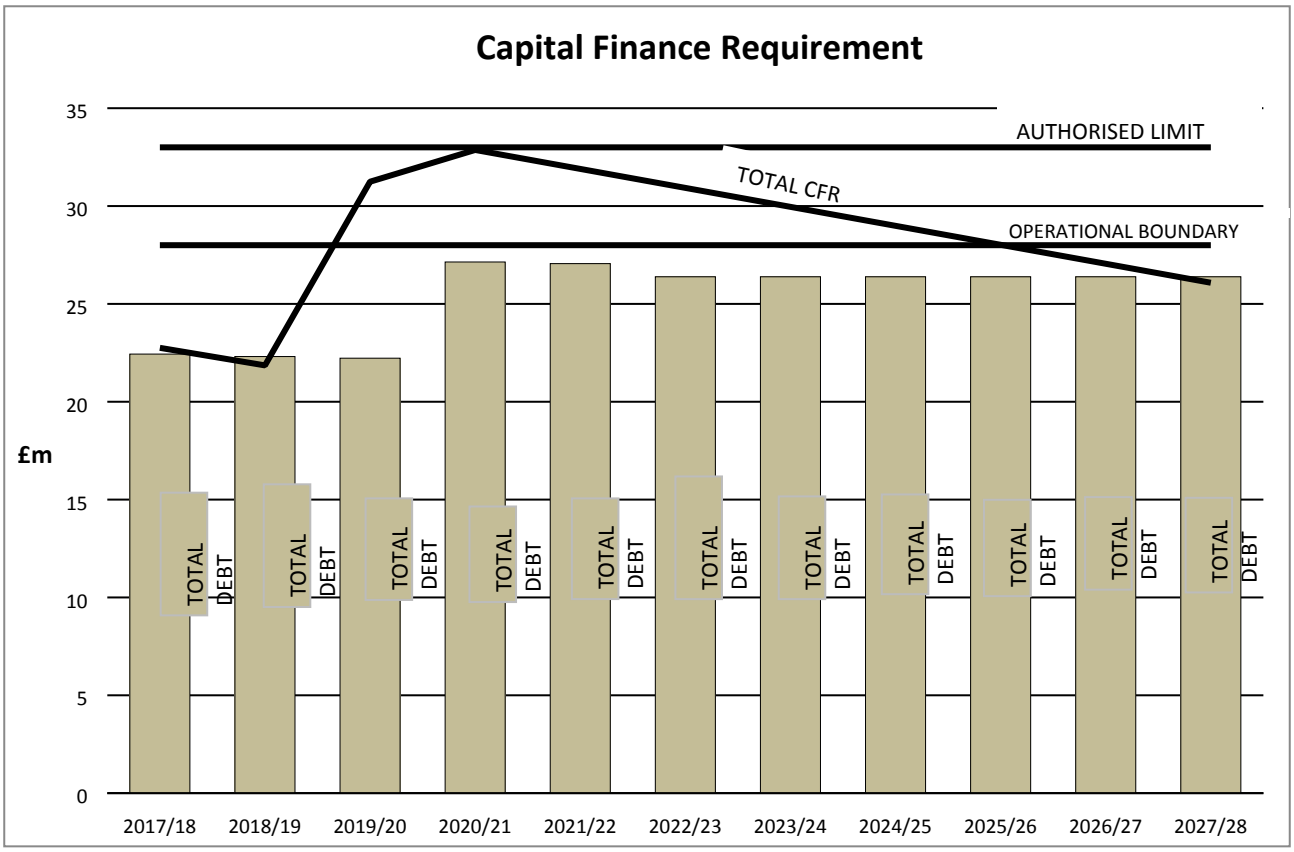
Commercial Activities	**2018/19 Actual £000**	**2019/20 TMS Estimate £000**	**2019/20 Revised Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Gross Debt	0	5,000	0	5,000	5,000
Capital Financing Requirement (CFR)	0	10,000	0	10,000	9,992
Under / (Over) borrowing	0	5,000	0	5,000	4,992

3.3 Treasury Indicators: Limits to Borrowing Activity

3.3.1 ***The operational boundary*** - This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

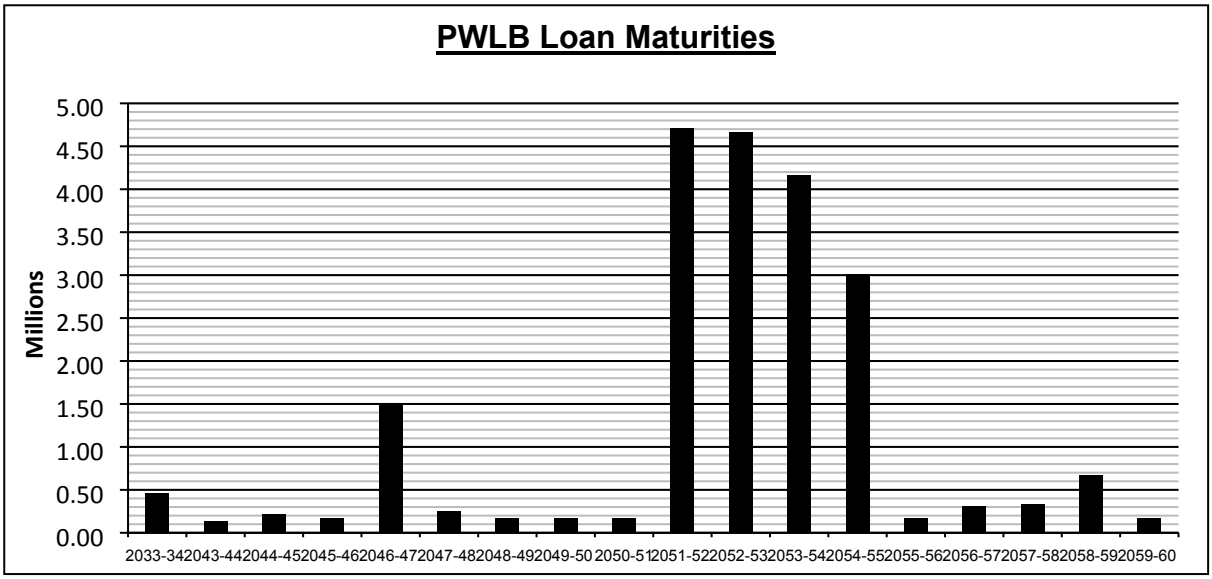
3.3.2 ***The authorised limit for external debt***. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

3.3.3 The graph below shows where we currently are against all of the borrowing prudential indicators.



3.4 Debt Repayment and rescheduling

3.4.1 The table below demonstrates when PWLB debt is due to be repaid.



3.4.2 The latest advice from Link, the Council's Treasury Management Advisors, indicates that the premium at 30 September 2019 was £22.61m. This would mean it would cost £22.61m in addition to the £21.386m principal totalling £43.996m, in order to repay the Council's PWLB loans.

4 INVESTMENT STRATEGY REVIEW

4.1 Investment overview

4.1.1 The Council receives substantial income from council tax, business rates and central government. The majority of council tax and business rates payments are received between April and January, with expenditure being fairly static throughout the year.

4.1.2 During the first half year investments have ranged from £37.9m to £42.1m. The table below shows the level of investments held at 30 September 2019 and the forecasted balances to the end of the Financial Year.

	Investments 31-Mar-19 £000	**Investments 30-Sep-19** £000	**Forecast Investments 31-Mar-20** £000
UK Banks *(f)*	17,505	18,888	13,000
UK Building Societies *(f)*	4,000	13,000	8,000
UK Local Authorities	13,000	7,000	9,000
Total Fixed Interest Rates *(f)*	**34,505**	**38,888**	**30,000**
Total Variable Interest Rates *(v)*	**0**	**0**	**0**
Total Investments	**34,505**	**38,888**	**30,000**

4.1.3 Most of the Councils investments are made at fixed interest rates over 6 -12 months. For cash flow purposes, some funds are held in instant access accounts.

4.1.4 The revised budget position for investment income is:

	Original Estimate 2019/20 £000	**Received to 30-Sep-19** £000	**Revised Estimate 2019/20** £000
Investment Income	188	185	348
Other Interest Received *	12	12	12
Total	200	197	360

* The Council also receives interest from sources other than investments. A Housing Association has been recharged £12k for the principal and interest of loans that the Council has made to it, the final payment will be in 2051/52.

4.2 Investment rules

4.2.1 Like us as individuals, the Council will invest surplus money in various ways to get a return on balances thus generating extra income. As per our overall objectives,

we ensure that these surplus balances are managed in a way to maximise the income potential whilst having regard to security risk.

4.2.2 The Council's investment strategy primary objectives, in order of importance are:

- safeguarding the re-payment of the principal and interest of its investments on time – losing any funds like in the case of Icelandic banks would be very significant in this financial climate;
- ensuring adequate liquidity – the Council does not want to run short of money so it cannot pay its bills or does not have money available to make investments in capital expenditure;
- maximising the investment return – this is clearly important but the Council does not want to maximise returns at the expense of the first two objectives.

4.2.3 Investments have been made with approved institutions with one exception. Officers invested £3million for 364 days in Skipton Building Society (SBS) due to an error on the Council's credit counterparty list provided by Link Asset Services. The counterparty credit list provided by our treasury advisors showed SBS to be meeting the minimum credit criteria for investments up to £5million and 364 days. It has subsequently been discovered there was an error in the credit list and investments should have been limited to £1m for 6 months. We have reviewed the position and deem there to be a low risk of default by SBS for the following reasons:

(i) SBS rating is Fitch - F1 (Upper Medium Grade). This means it would fall in the category of £5m and 364 days. The Moody rating is P-2 (Investment Grade) and allows for only £1m investment for 6 months. Our policy is belt and braces and uses the lowest investment rating – this is uncommon across Councils.

(ii) As indicated above, we have a risk adverse policy regarding investments and other local authorities would still invest in SBS at the same or greater level than this investment e.g. Leicester City Council base investments only on Fitch ratings at (F1 and above) and allow up to £10m for 1 year, Hinckley & Bosworth Borough allow all investments for 1 year (except money market funds) regardless of rating but allow different limits based on the quality. Under their policy we would be able to invest £9m with Skipton with a maximum of £4m per transaction.

(iii) The risk ratings for SBS have not changed since 2016 during this time we have at up to £5m invested with SBS and they have always repaid.

(iv) We have looked at the accounts of SBS and the auditor states "We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. We have nothing to report in these respects"

(v) For each deal undertaken a risk of default percentage is calculated, using defaults of similar rated organisations, the risk of default for SBS is 0.097% which equates to £2,910 of the £3m invested. The Overall risk of default on

the whole investment portfolio is 0.026% which is well below the 0.1% maximum allowable percentage.

(vi) There are no concerns around SBS in the media.

4.2.4 Due to market uncertainty arising from Brexit most UK financial institutions have been placed on a long term negative ratings watch by one of the credit rating agencies (Fitch). The TMSS requires a negative rating watch applying to any counterparty to be suspended from use (irrespective of the fact that other rating agencies may not agree). This would have resulted in operational issues with only several UK counterparties available for investment.

4.2.5 Due to the exceptional market conditions the Treasury Management Strategy allows for changes to be made by the Section 151 officer. The following change has been made:

- The current policy states that any organisation on 'negative watch' from any rating agency is suspended from use;
- This has been updated on advice from Link Asset Services who assert that our policy is very restrictive and overly 'belt and braces' and goes beyond what other Councils do. In this case, the Council will not suspend an organisation if other rating agencies do not have them on negative watch and their rating continues to be above the minimum requirement (assuming their rating has been downgraded by one).

4.2.6 The minimum Council criteria is:

	Fitch Rating	**Moody's Rating**	**Standard & Poor's Rating**	**Money Limit**	**Time Limit**
Upper limit category	F1+/ AA-	P-1/Aa3	A-1+/AA-	£5m	3 years
Middle Limit Category	F1/A-	P-1/A3	A-2/A-	£5m	364 days

4.2.7 Any credit rating which is on Negative Watch should be approached with an assumption that the rating downgrade of one notch will take place, therefore this approach will ensure the risk is mitigated as counterparties will still meet the Council's minimum credit criteria should a downgrade occur. Any institution on negative watch would therefore be suspended from use unless it has the following minimum credit rating.

	Fitch Rating	Moody's Rating	Standard & Poor's Rating	Money Limit	Time Limit
Minimum credit rating on negative watch	F1+/A	P-1/A2	A-1/A	£5m	364 days

4.3 Investment Performance

4.3.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. An example of a performance indicator often used for the investment treasury function is internal returns above the 6 month LIBOR rate (the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another). The Council monitored performance against the LIBOR rate for the first six months of 2019/20 and the results are shown below.

	2018/19	2019/20 (Q1)	2019/20 (Q2) (Cumulative)
RCC Returns (%)	0.83	0.93	0.97
LIBOR (%)	0.91	0.85	0.83

4.3.2 The Council is outperforming budget by c£60k with the rate of return in line with other council's performance.

4.4 Affordability Prudential Indicators

4.4.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

4.4.2 **Ratio of Financing Costs to Net Revenue Stream** - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	Original Estimate 2019/20 £000	Forecast Quarter 2 2019/20 £000
Financing Costs		
Capital Financing Costs	1.697	1.765
Interest Receivable	(0.240)	(0.360)
A	1.457	1.405

Revenue Stream		
Government Grants	3.812	5.295
Retained Business Rates	5.214	5.355
Council Tax	26.597	26.431
B	35.62	37.08
Ratio (A divided by B as a percentage)	4.09%	3.79%

4.4.3 The estimates of financing costs include current commitments and the proposals in the budget report.

5 CAPITAL INVESTMENT STRATEGY

5.1 Continued reductions in Government funding and reduced investment income from traditional Treasury Management investments are still anticipated reinforcing the need for the Council to maximise income from other sources. In its efficiency plan (Report 151/2016) approved by Council in September 2016, the Council noted that one of its strategies for reducing the gap in the MTFP was to make better use of assets/capital resources: “The Council recognises that investing in new assets or enhancing/making better use of existing assets can have a beneficial impact in terms of a revenue payback or reducing revenue costs. Officers have been asked to bring forward proposals to be considered”

5.2 The Capital Investment Strategy published alongside the TMS identified the key principles of:

- Focus capital investment on delivery of council objectives and priorities
- Maximise and promote best use of available funds
- Ensure strong governance over decision-making
- Ensure plans are affordable, prudent and sustainable

5.3 Commercial investments are made in accordance with the Commercial Investment Policy which details the criteria and minimum requirements for appraising potential investments.

5.4 During the first 6 months of 2019-20 no commercial investments have been identified.

Appendix B. Link Asset Services Commentary on the Economy and Interest Rates

1 ECONOMICS UPDATE

UK. This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, in September, his proroguing of Parliament was overturned by the Supreme Court and Parliament carried a bill to delay Brexit until 31 January 2020 if there is no deal by 31 October. MPs also voted down holding a general election before 31 October, though one is likely before the end of 2019. So far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. At the time of writing, (first week in October), the whole Brexit situation is highly fluid and could change radically by the day. Given these circumstances and the likelihood of an imminent general election, any interest rate forecasts are subject to material change as the situation evolves. If the UK does soon achieve a deal on Brexit agreed with the EU, including some additional clarification wording on the Irish border backstop, then it is possible that growth could recover relatively quickly. The MPC could then need to address the issue of whether to raise Bank Rate when there is very little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in government departments and services annual expenditure budgets and expenditure on infrastructure projects, to boost the economy.

The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that the prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need

to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020. In the political arena, if there is a general election soon, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further. The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates again in September to 1.75% - 2.00% and is thought likely to cut another 25 bps in December. Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

EUROZONE. Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1 and then fell to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars. 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 in the second half of 2018 and into 2019, 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%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of TLTROs; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress also still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. The trade war with the US does not appear currently to have had a significant effect on GDP growth as some of the impact of tariffs has been offset by falls in the exchange rate and by transhipping exports through other countries, rather than directly to the US.

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.

3.2 Interest rate forecasts

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View											
	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	1.20	1.30	1.50	1.60	1.70	1.70	1.80	1.90	2.00	2.00	2.10
10yr PWLB Rate	1.50	1.60	1.80	1.90	2.00	2.00	2.10	2.20	2.30	2.30	2.40
25yr PWLB Rate	2.10	2.30	2.40	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00
50yr PWLB Rate	2.00	2.20	2.30	2.40	2.50	2.60	2.60	2.70	2.80	2.90	2.90

The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit at some point in time. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That's shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

Bond yields / PWLB rates. There has been much speculation recently that we are currently in a bond market bubble. While inflation targeting by the major central banks has been successful over the last thirty 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 thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten 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. However, stock markets are also currently

at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

What we have seen during the last half year is a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but due to a correlation between US treasuries and UK gilts, which at various times has been strong but at other times weaker, in the UK. However, forecasting the timing of this and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

One risk that is both an upside and downside risk is that all central banks are now working in very different economic conditions than before the 2008 financial crash. There has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for eleven years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could, therefore, over or under-do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Brexit – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new unlikely alliance of two very different parties will endure.
- Weak capitalisation of some European banks, particularly Italian banks.
- German minority government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018.

However, this makes little practical difference as she has continued as Chancellor, though more recently concerns have arisen over her health.

- Other minority EU governments. Austria, Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.
- Italy, Austria, the Czech Republic and Hungary now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- There are concerns around the level of US corporate debt which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- Geopolitical risks, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- Brexit – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Appendix C: Treasury Management Glossary of Terms

Authorised Limit (Also known as the Affordable Limit): A statutory limit that sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities).
Balances and Reserves: Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
Bank Rate: The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". This rate is also referred to as the 'repo rate'.
Basis Point: A unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent). In most cases, it refers to changes in interest rates and bond yields. For example, if interest rates rise by 25 basis points, it means that rates have risen by 0.25% percentage points. If rates were at 2.50%, and rose by 0.25%, or 25 basis points, the new interest rate would be 2.75%.
Bond: A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.
Capital Expenditure: Expenditure on the acquisition, creation or enhancement of capital assets.
Capital Financing Requirement (CFR): The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
Capital Receipts: Money obtained on the sale of a capital asset.
Credit Rating: Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.
Counterparty List: List of approved financial institutions with which the Council can place investments with.
Debt Management Office (DMO): The DMO is an Executive Agency of Her Majesty's Treasury and provides direct access for local authorities into a government deposit facility known as the

DMADF. All deposits are guaranteed by HM Government and therefore have the equivalent of a sovereign triple-A credit rating.
Gilts: Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged'. Being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
LIBID: The London Interbank Bid Rate (LIBID) is the rate bid by banks on Eurocurrency deposits (i.e. the rate at which a bank is willing to borrow from other banks).
LIBOR: The London Interbank Offered Rate (LIBOR) is the rate of interest that banks charge to lend money to each other. The British Bankers' Association (BBA) work with a small group of large banks to set the LIBOR rate each day. The wholesale markets allow banks who need money to be more fluid in the marketplace to borrow from those with surplus amounts. The banks with surplus amounts of money are keen to lend so that they can generate interest which it would not otherwise receive.
Maturity: The date when an investment or borrowing is repaid.
Money Market Funds (MMF): Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Minimum Revenue Provision (MRP): An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.
Voluntary Revenue Provision (VRP): An additional contribution over and above the MRP that the Council can choose to make to reduce the CFR which in turn will reduce the MRP for future years.
Non Specified Investment: Investments which fall outside the MHCLG Guidance for Specified investments (below).
Operational Boundary: This linked directly to the Council's estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.
Prudential Code: Developed by CIPFA and introduced on 01/4/2004 as a professional code of practice to support local authority capital investment planning within a clear,

affordable, prudent and sustainable framework and in accordance with good professional practice.
Prudential Indicators: Prudential indicators are a set of financial indicators and limits that are calculated in order to demonstrate that councils' capital investment plans are affordable, prudent and sustainable. They are outlined in the CIPFA Prudential Code of Practice. They are indicators that must be used to cover the categories of affordability, prudence, capital spending, external debt/borrowing and treasury management. They take the form of limits, ratios or targets which are approved by Council before 1 April each year and are monitored throughout the year on an on-going basis. A council may also choose to use additional voluntary indicators.
Public Works Loans Board (PWLB): The PWLB is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.
Revenue Expenditure: Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.
(Short) Term Deposits: Deposits of cash with terms attached relating to maturity and rate of return (Interest).
Specified Investments: Term used in the MHCLG Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than one year. UK government, local authorities and bodies that have a high credit rating.
Supported Borrowing: Borrowing for which the costs are supported by the government or third party.
Temporary Borrowing: Borrowing to cover peaks and troughs of cash flow, not to fund capital spending.
Unsupported Borrowing: Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.
Yield: The measure of the return on an investment.