LICENSING AUDIT & GENERAL PURPOSES COMMITTEE
25 NOVEMBER 2019

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN1931

TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2019/20

SUMMARY:
This report sets out the main activities of the Treasury Management and non-Treasury Investment Operations during the first half of 2019/20. Prudential indicators for the 2019/20 financial year have been updated for all treasury management and non-treasury activity during the first half of 2019/20.

RECOMMENDATIONS:
Members are requested to:

(i) Note the contents of this report in relation to the treasury management and non-treasury investment operations carried out during the first half of 2019/20

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operations for the first half of the year 2019/20. This report is a statutory requirement under the CIPFA Code of Practice on Treasury Management.

1.2 Full Council originally approved the Annual Treasury Management Strategy and Non-Treasury Investment Strategy for 2019/20 on 21 February 2019. The Council has 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 remains central to the Council's treasury management and non-treasury investment strategies.

2. PURPOSE

2.1 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2017 ("the Code"), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members be informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

2.2 The CIPFA "Prudential Code" 2017 edition, "Treasury Management Code of Practice" 2017 edition and MHCLG revised guidance February 2018 focus on "non- treasury" investments. With attention on the purchase of investment property and other commercial activities that aim to generate income; but may require external borrowing (or the use of existing cash balances) to raise the cash to finance such activities. Non-treasury investments have been incorporated into the operations report for 2019/20.

2.3 The appendices (A to C) set out the Treasury Management operations, Non-Treasury Investment Operations and Prudential Indicators for 2019/20 and fulfil key legislative requirements as follows:

Appendix A

- The **Treasury Management operations** which sets out how the Council's treasury service operated during the first half of 2019/20, in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Treasury Management Borrowing operations** which sets out the Council's borrowing during the first half of 2019/20 in accordance with CIPFA's Code of Practice on Treasury Management, and;
- The **Treasury Management Investment operations** which sets out the Council's Treasury Management investment operations for the first half of 2019/20, in accordance with CIPFA's Code of Practice on Treasury Management.

Appendix B

- The **Non-Treasury Investment operations** sets out the Council's Non-Treasury investment performance for eth first half of 2019/20, in accordance with MHCLG Investment Guidance.

Appendix C

- the **Prudential indicators forecast** sets out the forecast prudential indicators position at the end of 2019/20 based on 2019/20 half year position relating to treasury/non-treasury activities and capital financing for 2019/20. Performance is compared to the indicators set out in the Annual Capital Strategy for the year 2019/20.

3 CONCLUSIONS ON THE TREASURY MANAGEMENT AND NON-TRESURY INVESTMENT OPERATIONS DURING 2019/20

3.1 The Council's treasury team continued to concentrate on the security of investments taking due regard for the returns available. The re-structing of the investment portfolio during 2018/19 has improved diversification of funds and increase the yield on all treasury management investments by £188,000 from 2018/19.

3.2 With increased levels of borrowing the treasury team continually reviews the borrowing strategy, weighing up interest rate levels and risk of refinancing. During the 2019/20 financial year short-term interest rates have remained low and are forecast to remain low. However, borrowing levels have increased, raising refinancing risk. To mitigate, a proportion of borrowing has been moved to one- and two-year durations.

3.3 Total borrowing at 30 September is £84.3m, an increase of £23.1m from 2018/19 year-end position. Year-end borrowing is forecast to be £116m below estimated levels due to timing of investment property purchases. The lower level of borrowing has resulted in forecast interest cost on borrowing reducing by £270,000.

3.4 The Council is forecast to have non-treasury investments risk exposure of £125.4 of which £82.2 is funded via external loans.

3.5 Return of non-treasury investments is forecast to be below estimated return for 2019/20 due to the cost associated with commercial property being clarified during the financial year

Contact Details:

Report author:
Alan Gregory - Finance Manager
01252 398443
Alan.Gregory@rushmoor.gov.uk

Head of Service:
David Stanley - Executive Head of Finance
01252 398440
David.Stanley@rushmoor.gov.uk

APPENDIX A

TREASURY MANAGEMENT OPERATION FOR FIRST HALF OF 2019/20

1 INTRODUCTION

1.1 The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure the Council can meet its capital spending obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2 TREASURY MANAGEMENT ADVICE

2.1 The Council continued to engage the services of Arlingclose for independent treasury advice during the year 2019/20. Arlingclose provide specialist treasury support to 25% of UK local authorities. They provide a range of treasury management services including technical advice on debt and investment management and long-term capital financing. They advise on investment trends, developments and opportunities consistent with the Council's Treasury Management Strategy.

2.2 With the exception of pooled funds all investment activity is carried out by the Council's own treasury team with advice from Arlingclose, and having due regard to information from other sources such as the financial press and credit-rating agencies.

2.3 Pooled funds are managed at the discretion of the external fund managers associated with each fund. It should however be noted that whilst the funds are externally managed, the decision as to whether to invest lies solely with the Council in accordance with its Treasury Management Strategy.

2.4 The needs of the Council's treasury management staff for training in investment management are assessed on an ongoing basis and as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. During 2019/20, staff attended relevant workshops provided by Arlingclose and other service providers.

3 EXTERNAL CONTEXT

3.1 The Council's treasury management advisors have provided commentary on the economic background that prevailed during the first half of 2019/20. This commentary is provided at **Appendix D**.

4 LOCAL CONTEXT

4.1 On 30 September 2019, the Council had net borrowing of £53.1m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes for the 2019/20 financial year is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The projected CFR is summarised in **Appendix C**.

4.2 The treasury management position at 30 September 2019 and the change during the year is shown in Table 1 below.

Table 1: Treasury Management Summary

	31.3.19 Balance £m	**Movement £m**	**30.9.19 Balance £m**	**30.9.19 Rate %**
Long-term borrowing	1.3	49.6	50.9	1.26
Short-term borrowing	59.9	-26.5	33.4	0.79
Total borrowing	**61.2**	**23.1**	**84.3**	
Long-term investments	-21.9	0	-21.9	5.8
Short-term investments	0	0	0	0
Cash and cash equivalents	-2.3	-7	-9.3	0.64
Total investments	**-24.2**	**-7**	**-31.2**	
Net borrowing/(investments)	**37**	**16.1**	**53.1**	

4.3 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as CFR, but that cash and investment balances are kept to a minimum level of £4m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	2019/20 Budget	2019/20 Forecast
Outstanding borrowing	121.6	116.0
Investment min	4.0	4.0
Liability benchmark	100.0	94.8

5 BORROWING ACTIVITY IN 2019/20

5.1 At 30 September 2019 the Council held £84.3m of loans, an increase of £23.1m since 31st March 2019, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 September 2019 are summarised in Table 3 below.

Table 3: Borrowing Position

	31/03/2019 Balance £m	Net Movement £m	30/09/2019 Balance £m	30/09/2019 Rate %
LEP (long-term)	1.3	-0.4	0.9	0
Local authorities (long-term)	0	50	50	1.26
LEP (short-term)	0.4	0	0.4	0
Local authorities (short-term)	59.5	-26.5	33	0.79
Total borrowing	**61.2**	**23.1**	**84.3**	**1.03**

5.2 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.

5.3 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 short-term loans.

6 INVESTMENT ACTIVITY IN 2019/20

6.1 The Council holds significant invested funds. During the year, the Council's investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	Balance at 31/03/19 £m	Movement in year	Balance at 30/09/19 £m	Average Rate %	
Managed in-house:					
Money Market Funds	2.3	7.0	9.3	0.68	*
Managed externally:					
Pooled Funds:					
CCLA LAMIT Property Fund	3.9	0	3.9	5.07	*
M&G Investments Strategic Corporate Bond Fund	4	0	4	3.79	*
UBS Multi Asset Fund	5	0	5	4.33	*
Kamas	2	0	2	5.82	*
Threadneedle Investments	2	0	2	3.09	*
Schroder Income Maximiser Fund	5	0	5	10.54	*
Total Investments	24.2	7.0	31.2		

*Annualised return based on income received between April 2019 to September 2019

6.2 The following chart illustrates the spread of investment by type of investment (figure 1) along with maturity analysis (figure 2).

Figure 1: Type of Counterparty

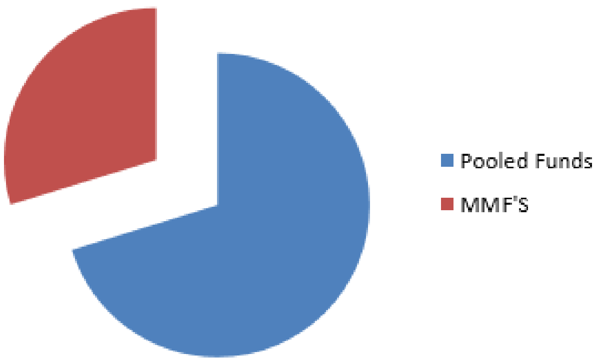


Figure 2: Maturity analysis

Table 5: Maturity analysis

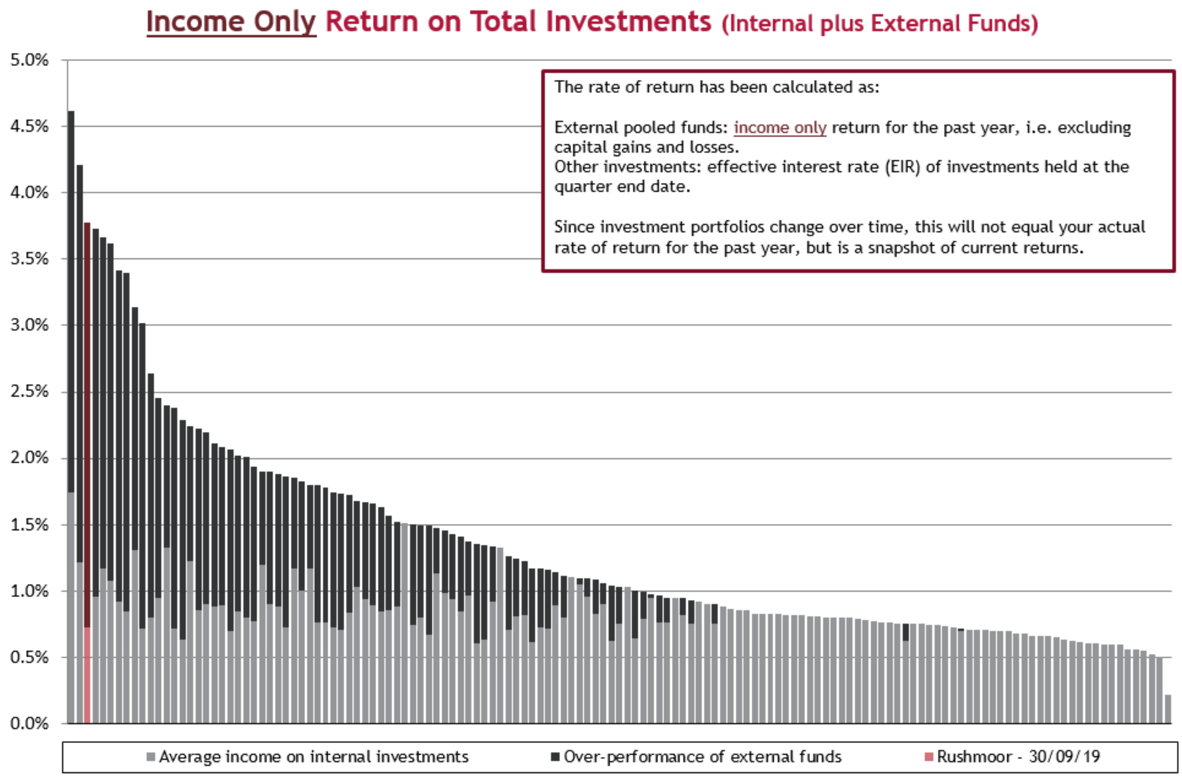
Maturity Analysis for ALL INVESTMENTS	Type of Counter Party	Amount invested £	% of total investments
Instant	MMF	9,275,000	30%
0 - 3 months	Pooled Fund	0	0%
3 -6 months	Pooled Fund	0	0%
6 - 12 months	Pooled Fund	0	0%
> 1 year	Pooled Fund	21,900,000	70%
Total for all duration periods		**31,175,000**	**100**

6.3 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.

6.4 During 2018/19 the Council restructured its investment portfolio, to reduce risk through greater product diversification. As a result, average treasury management investment income return was 4.65% as compared with 4.1% in 2018-19.

6.5 Investment Income Benchmarking: The graph below has been produced by Arlingclose and demonstrates that the Council income only returns on total investment portfolio for the last 12 months up to September 2019 was 3.78%.

Figure 3: Total income return on investment portfolio



6.6 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 6 below.

Table 6: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**
31.03.2019	3.73	AA-	100%
30.09.2019	4.73	A+	100%
Similar LAs	**4.22**	**AA-**	**61%**
All LAs			

External Strategic Pooled Funds

6.7 £21.9m of the Council's investments are held in externally managed strategic pooled equity, multi-asset, bond and property funds where short-term security and liquidity are lesser considerations, and objectives are regular revenue income and long-term price stability. During 2018/19 the funds were re-structured to reduce risk through diversification and to increase capital and income returns over the long-term. Income returns have increased in 2019/20 compared with 2018/19. The pooled fund portfolio has generated an average total return during the first half of 2019/20 of 5.80%. Capital returns have decreased by 0.48%. A summary of returns and diversification is set out below.

Figure 4: Pooled fund diversification

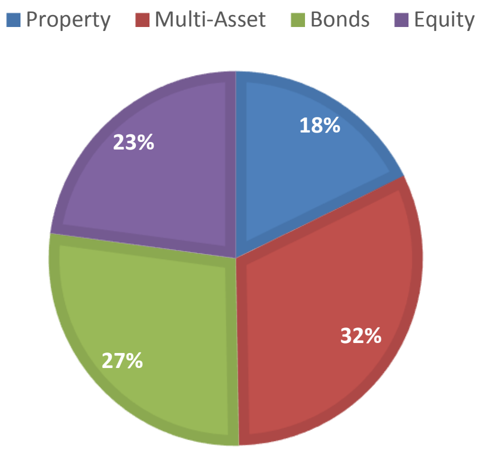


Table 7: Pooled fund diversification

Type of Pooled Fund	Amount invested £	% of total investments
Property	3,882,128	18%
Multi-Asset	7,000,000	32%
Bonds	6,000,000	27%
Equity	5,000,000	23%
Total	**21,882,128**	**100%**

Figure 5: Total returns year-on-year comparison

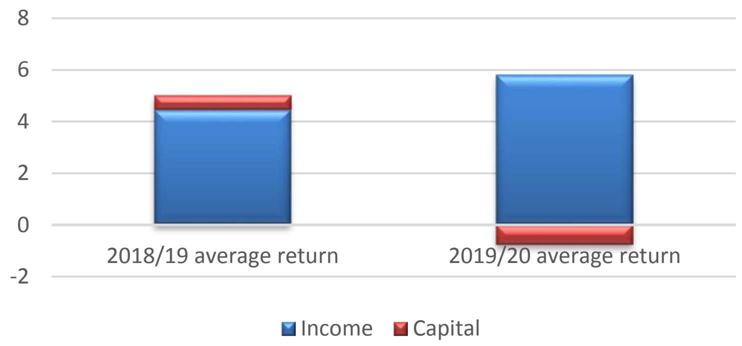


Table 8: Total return breakdown

Type of return	2018/19 average return %	2019/20 average return %
Income	4.46	5.8
Capital	0.54	-0.76
Total Returns	**5.000**	**5.04**

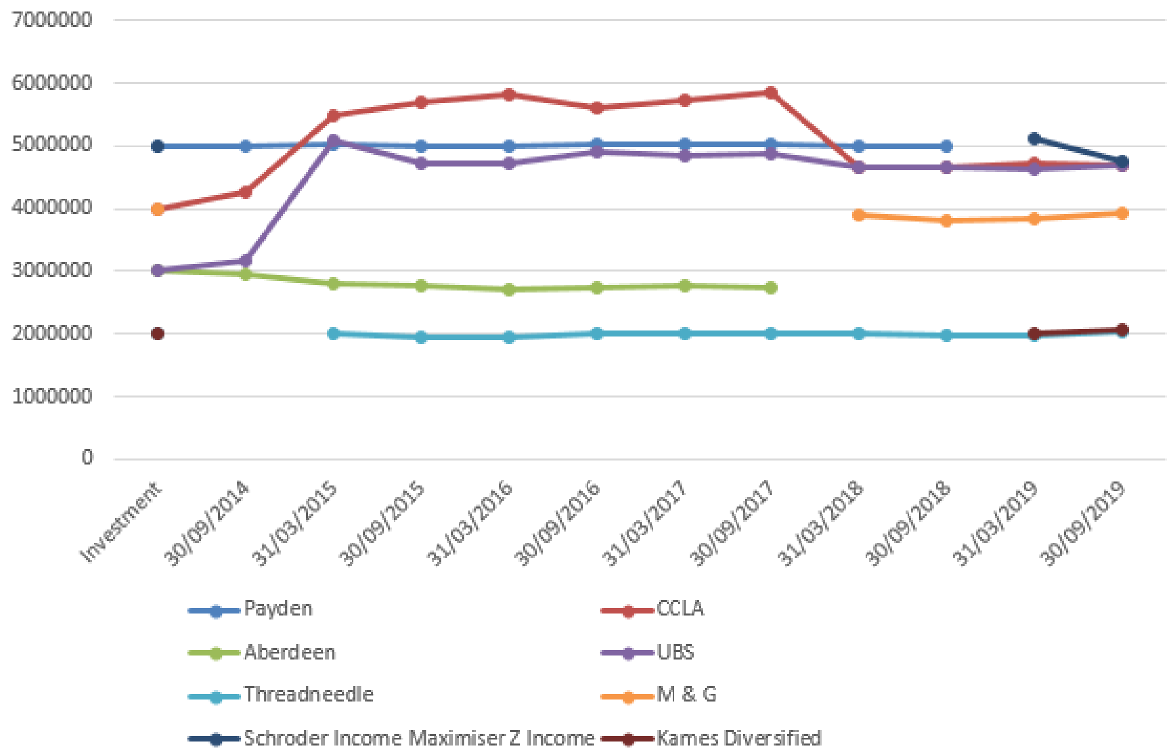
6.8 As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move 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-/long-term and the Council's latest cash flow forecasts, investment in these funds has been increased.

6.9 Details of the Council's investment activity together with returns generated during 2019/20 are outlined as follows:

6.10 **Capital returns** – the Council's pooled funds have continued to experience some variations in performance during the year 2019/20. Aggregation of the Council's pooled funds resulted in an overall net decrease in fair value for the year 2019/20 of around £167,000(an aggregate decrease of 0.76% of overall pooled funds invested).

6.11 There is variation in performance across the portfolio as shown in figure 6 below.

Figure 6: Movement in capital value of pooled funds during over the last 5 years



6.12 **Income Returns** – The income returned by fund for the period to 30 September 2019 is analysed below:

- CCLA's Local Authorities' Mutual Investment Trust - £3.9 million investment at commencement of the year. The Property Fund is designed to achieve long-term capital growth and income from investments in the commercial property sector. The fund has returned 5.07% annualised income during 2019/20.

- UBS Multi-Asset Income Fund - £5 million investment. This fund follows a strategy of reducing volatility exposure levels by spreading investments across a diversified range of asset classes. This fund has returned 4.33% annualised income during 2019/20.

- Threadneedle Strategic Bond Fund - £2 million investment. The fund aims to provide income and capital appreciation through investment grade and high yield bonds. This fund has returned 3.09% annualised income during 2019/20

- M & G Corporate Bond Fund - £4m investment. This fund aims for a target total return of 3-5% from a combination of investment income or capital appreciation. This fund has returned 3.79% annnualised income during 2019/209.

- Schroder Income Maximiser Fund - £5m investment made in December 2018. The fund aims to provide both income and capital growth, delivering a target income of 7% per annum. The fund has returned 10.54% annualised during 2019/20.

- Kames Diversified Monthly Income Fund - £2m investment made in February 2019. The fund aims is to provide income with the potential for capital growth over the medium term. The fund has returned 5.82% annualised during 2019/20.

7 TREASURY MANGEMENT COMPLIANCE PERFORMANCE

7.1 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

7.2 **Compliance -** The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy with the exception of current account balance limits. As set out in the Council's 2019/20 Treasury Management Strategy there is a £2m limit on the main current account. At the commencement of the 2019/20 financial year there were 5 working days when the Council held balances in its main current account above the £2m. The excess balances were due to timing differences between raising funds and purchasing property. The finance section manages treasury activity rigorously and is exploring options to mitigate such timing differences in the future.

7.3 Compliance with specific investment limits is demonstrated in table 9 below.

Table 9: Investment Limits

	30.9.19 Actual £m	**2019/20 Limit £m**	**Complied?**
Any group of pooled funds under the same management	**21.9**	**25.0**	Yes
Money Market Funds	**9.3**	**20.0**	Yes

8 TREASURY MANAGEMENT INDICATORS

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

8.2 **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.

	30.9.19 Actual	**2019/20 Target**	**Complied?**
Portfolio average credit rating	A+	A-	YES

8.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each period without giving prior notice.

	30.9.19 Actual £m	**2019/20 Target £m**	**Complied?**
Total sum borrowed in past 3 months without prior notice	0	2.0	YES

8.4 **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 interest rates will be:

	30.9.19 Actual	**2019/20 Limit**	**Complied?**
Upper limit on one-year impact of a 1% **rise** in interest rates.	-£389,000	£500,000	YES
Upper limit on one-year impact of a 1% **fall** in interest rates.	£365,000	£500,000	YES

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

8.6 **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:

	30.9.19 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	40%	100%	0%	YES
12 months and within 24 months	24%	100%	0%	YES
24 months and within 5 years	36%	100%	0%	YES
5 years and within 10 years	0%	100%	0%	YES
10 years and above	0%	100%	0%	YES

8.7 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.

8.8 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2019/20	2020/21	2021/22
Actual principal invested beyond year end	£21.9m	£21.9m	£21.9m
Limit on principal invested beyond year end	£40.0m	£40.0m	£40.0m
Complied?	YES	YES	YES

8.9 **Total Investment Yield:** The Council's revised estimates regarding investment yields and costs compared to the actual outturn for 2019/20 is shown in the table below.

Budgeted income and outturn	2019/20 Estimate £000	2019/20 Forecast £000	Variance £000
Interest receivable	(1,082)	(1,270)	(188)
Interest Payable	1,056	786	(270)
Net Amount	(26)	(484)	(458)

APPENDIX B

NON-TREASURY INVESTMENT OPERATIONS FOR FIRST HALF OF 2019/20

1 INTRODUCTION

1.1 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 Council 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.

1.2 The purpose of non-treasury investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

1.3 The second main function of investment management is to generate potential returns and monitor performance of returns on a regular basis.

1.4 The Council also holds £105.9m of such investments at as 30 September 2019 in:

- directly owned property £99m
- loans to local businesses and landlords £6.7m
- shareholding in subsidiaries £0.2m

2 PROPORTIONALITY

2.1 The Council is becoming increasingly dependent on profit generating investment activity to achieve a balanced revenue budget. Table 1 below shows the forecast proportion of gross service expenditure funded by investment activity.

Table 1: Proportionality of Investments

	2019/20 Estimate	**2019/20 Forecast**
Proportion	14%	8.9%

3 SERVICE IMPROVEMENT LOANS

3.1 The Council lends money to its subsidiaries, local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enables to development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business.

3.2 The Council performance and upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 2: Loans for service purposes in £ millions

Category of borrower	2019/20	19/20	19/20
	Approved Limit	**Actual**	**Forecast**
Local businesses	6.7	6.7	6.7
Employees	0.1	0.1	0.1
TOTAL	**6.8**	**6.7**	**6.7**

Service loans have generated 4.27% return for the Council during the first 6 months of 2019/20 financial year and this level of return is expected to 4.01% for the whole of 2019/20.

4 SERVICE INVESTMENTS: SHAREHOLDING IN SUBSIDIARIES

4.1 The Council invests in the shares of its subsidiary and holds a financial share in a development partnership and Rushmoor Homes to support local public services and stimulate local economic growth.

4.2 The Council performance and upper limits on the sum invested in each category of shares have been set as follows:

Table 3: Shares held for service purposes in £ millions

Category of company	2019/20 Approved Limit	2019/20 Forecast
Subsidiaries and Partnerships	10	0.5
TOTAL	**10**	**0.5**

5 COMMERCIAL INVESTMENT: PROPERTY

5.1 The Council invests in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services. The forecast transactions during 2019/20 will increase the overall portfolio to £118.2m as outline in table 4 below.

Table 4: Property held for investment purposes in £ millions

Property by type	2018/19 Transactions			2019/20 estimated transactions	
	Purchase cost	Gains or (losses)	Value in accounts	Purchase cost	Estimated year-end Value
Mixed use	4.48	0.06	4.54	3.62	8.2
Industrial units	24.51	-0.37	24.14	0.0	24.1
Retail	32.82	-2.13	30.68	13.3	44.0
Offices	20.57	-4.99	15.58	26.3	41.9
TOTAL	**82.37**	**-7.44**	**74.93**	**43.2**	**118.2**

Return on Commercial investment

5.2 Commercial property investments generated £3.8m of net investment income for the Council after taking account of direct costs, cost of borrowing and Minimum Revenue Provision (MRP) representing a rate of return of 3.9%.

5.3 The return on commercial property is forecast to be lower that the reported level in the non-treasury investment strategy to Council on 21 February 2019. This is due to clarification of all costs and MRP charges.

6 NON-TREASURY INVESTMENT INDICATORS

6.1 The Council measures and manages its exposures to non-treasury investment risks using the following indicators.

6.2 **Total risk exposure:** This indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans.

Table 5: Total investment exposure in £millions

Total investment exposure	**2019/20 Estimate**	**2019/20 Forecast**
Service investments: Loans	6.7	6.7
Service investments: Shares	10	0.5
Commercial investments: Property	119.1	118.2
TOTAL INVESTMENTS	135.8	125.2
Commitments to lend	0	0
TOTAL EXPOSURE	135.8	125.2

6.3 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Table 6: Investments funded by borrowing in £millions

	2019/20 Estimate	2019/20 Forecast
Service investments: Loans	2.2	2.2
Service investments: Shares	2	0.5
Commercial investments: Property	73.0	79.5
TOTAL FUNDED BY BORROWING	77.2	82.2

6.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 7: Investment rate of return (net of all costs)

	2019/20 Estimate	2019/20 Forecast
Treasury management investments	4.2%	4.5%
Service investments: Loans	4.1%	4.0%
Service investments: Shares	1.1%	0%
Commercial investments: Property *	7.6%	3.9%
ALL INVESTMENTS	6.3%	3.9%

* For the purposes of this report it has been assumed that MRP is charged at the budgeted level for all assets funded from borrowing and is considered a prudent forecasting position. This assumption impacts on the forecast performance of Commercial Property Investments shown in the table above. The actual level of MRP to be charged for the year will be considered as part of the closure of accounts process taking into account statutory guidance.

6.5 The above table shows a forecast reduction in commercial property investment return net of all finance costs in 2019/20. This is due to the additional borrowing and MRP costs accrued when purchasing investment property with the aid of external loans during 2019/20 and lower than expected returns on commercial properties.

6.6 The Council has considered the following additional indicators prudent to report given the investment activities.

Table 8: Other investment indicators

Indicator	**2019/20 Estimate**	**2019/20 Forecast**
Debt to net service expenditure ratio	8.2	9.1
Commercial income to net service expenditure ratio	0.5	0.4

APPENDIX C

PRUDENTIAL INDICATORS

1.1 **Prudential Indicators:_**The following indications are required by the CIPFA "Prudential Code" 2017 edition

1.2 **Estimates of Capital Expenditure:** The Council's planned capital expenditure and financing may be summarised as follows.

Table 1: Capital Expenditure and Financing in £ million

	2019/20 budget	2019/20 Forecast
General Fund services	70.2	62.5
TOTAL	70.2	62.5
External sources	11.3	9.6
Own resources	0.1	0.2
Debt	58.8	52.7
TOTAL	**70.2**	**62.5**

1.3 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue, which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 2: Replacement of debt finance in £ million

	2019/20 budget	2019/20 Forecast
Own resources	1.4	1.4

1.4 **Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Table 3: Estimates of Capital Financing Requirement in £ millions

	2019/20 budget	2019/20 Forecast
General Fund services	119.1	113.5
MRP	-1.4	-1.4
IFRIC 4 Lease Adjustment	2.5	2.5
TOTAL CFR	**120.2**	**114.6**

1.5 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Table 4: Gross Debt and the Capital Financing Requirement in £ millions

	2019/20 budget	**2019/20 Forecast**
Debt (incl. leases)	121.6	116.0
Capital Financing Requirement	172.5	165.2
Difference	50.9	49.3

1.6 **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 5: Affordable borrowing limit in £m

	2019/20 limit	**2019/20 Forecast**
Authorised limit – total external debt	137.0	116.0
Operational boundary – total external debt	132.0	116.0

1.7 **Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Table 6: Ratio of financing cost to net revenue stream

	2019/20 budget	**2019/20 Forecast**
Financing costs (£m)	1.1	0.6
Proportion of net revenue stream	10.6%	0.6%

APPENDIX D

Market commentary regarding the year 2017/18 from the Council's treasury management advisors Arlingclose

External Context

Economic commentary

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.

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.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU. Mr Johnson prorogued Parliament which led some MPs to put forward a bill requiring him to seek a Brexit extension if no deal is in place by 19th October. The move was successful and, having been approved by the House of Lords, was passed into law. The Supreme Court subsequently ruled Mr Johnson's suspension of Parliament unlawful.

Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

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.

Financial markets:
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.

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%.

Credit background:
Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ringfenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

Outlook for the remainder of 2019/20
The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased

dramatically.

There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance.

Parliament appears to have frustrated UK Prime Minister Boris Johnson's desire to exit the EU on 31st October. The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out for 2019 and the risk of this event remains for 2020. The risk of a general election in the near term has, however, increased.

Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

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

	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