LICENSING AUDIT & GENERAL PURPOSES COMMITTEE
28 SEPTEMBER 2020

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN2027

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 2019/20. Prudential indicators for the 2019/20 financial year have been updated for all treasury management and non-treasury activity during 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 2019/20

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operations for 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 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 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 during 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 during 2019/20, in accordance with MHCLG Investment Guidance.

Appendix C

- the **Prudential indicators forecast** sets out the prudential indicators position at the end of 2019/20Performance 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 £344,000 from 2018/19.

3.2 The increase in return on treasury management activity is less than anticipated due to the down-turn in pooled fund interest at the end of March caused by COVID-19. The impact of COVID-19 will be more prevalent in 2020/21 and the return on investments will be closely monitored

3.3 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.

3.4 Total borrowing at 31 March was £90m, an increase of £28.8m from 2018/19 year-end position. The increased level of borrowing has resulted in interest cost of borrowing increasing by £772,000.

3.5 The Council's non-treasury investments risk exposure at 31 March 2020 of £113.6m of which £72.8m is funded via external loans.

3.6 Return of non-treasury investments is below estimated return for 2019/20 due to the cost associated with commercial property being clarified during the financial year and the impact of COVID-19.

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APPENDIX A

TREASURY MANAGEMENT OPERATION FOR 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 2019/20. This commentary is provided at **Appendix D**.

4 LOCAL CONTEXT

4.1 On 31 March 2020, the Council had net borrowing of £62.9m 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 31 March 2020 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	29.0	30.0	1.45
Short-term borrowing	59.9	0.1	60.0	0.92
Total borrowing	**61.2**	**28.8**	**90.0**	
Long-term investments	-21.9	0	-21.9	4.97
Short-term investments	0	0	0	0
Cash and cash equivalents	-2.3	-3.0	-5.3	0.55
Total investments	**-24.2**	**-3.0**	**-27.2**	
Net borrowing/(investments)	**37**	**25.9**	**62.9**	

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 Outturn
Outstanding borrowing	121.6	103.4
Investment min	4.0	4.0
Liability benchmark	**101.4**	**80.2**

5 BORROWING ACTIVITY IN 2019/20

5.1 At 31 March 2020 the Council held £90m of loans, an increase of £28.8m since 31 March 2019, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31 March 2020 are summarised in Table 3 below.

Table 3: Borrowing Position

	31/03/2019 Balance £m	Net Movement £m	31/03/2020 Balance £m	31/03/2020 Rate %
LEP (long-term)	1.3	-1.3	0	0
Local authorities (long-term)	0	30	30	1.45
LEP (short-term)	0.4	-0.4	0	0
Local authorities (short-term)	59.5	0.5	60	0.92
Total borrowing	**61.2**	**28.8**	**90**	

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	3.0	5.3	0.55	*
Managed externally:					
Pooled Funds:					
CCLA LAMIT Property Fund	3.9	0	3.9	5.26	*
M&G Investments Strategic Corporate Bond Fund	4	0	4	3.5	*
UBS Multi Asset Fund	5	0	5	4.28	*
Kamas	2	0	2	4.98	*
Threadneedle Investments	2	0	2	2.45	*
Schroder Income Maximiser Fund	5	0	5	7.6	*
Total Investments	24.2	3.0	27.2		

*Annualised return based on income received between April 2019 to March 2020

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

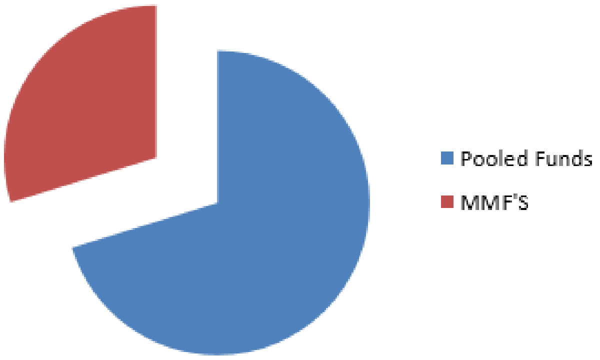


Figure 2: Maturity analysis

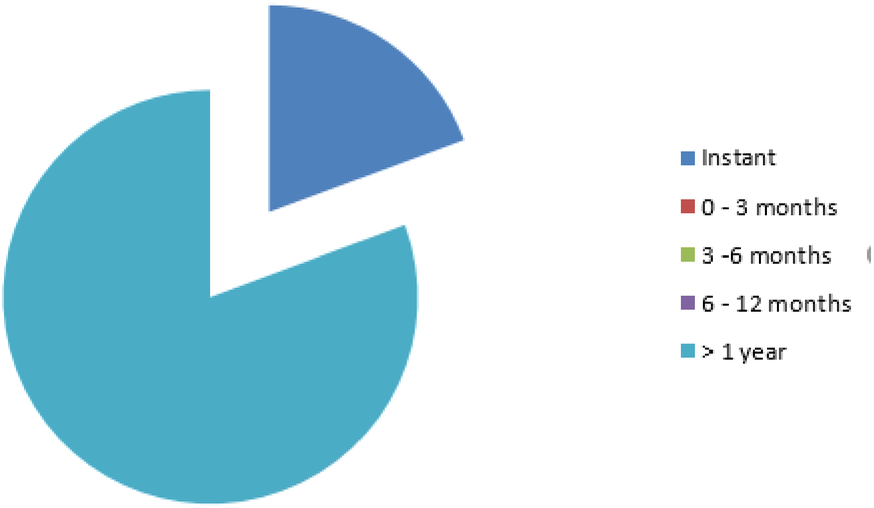


Table 5: Maturity analysis

Maturity Analysis for ALL INVESTMENTS	Type of Counter Party	Amount invested £	% of total investments
Instant	MMF	5,3	19%
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	21.9	81%
Total for all duration periods		**27.2**	**100**

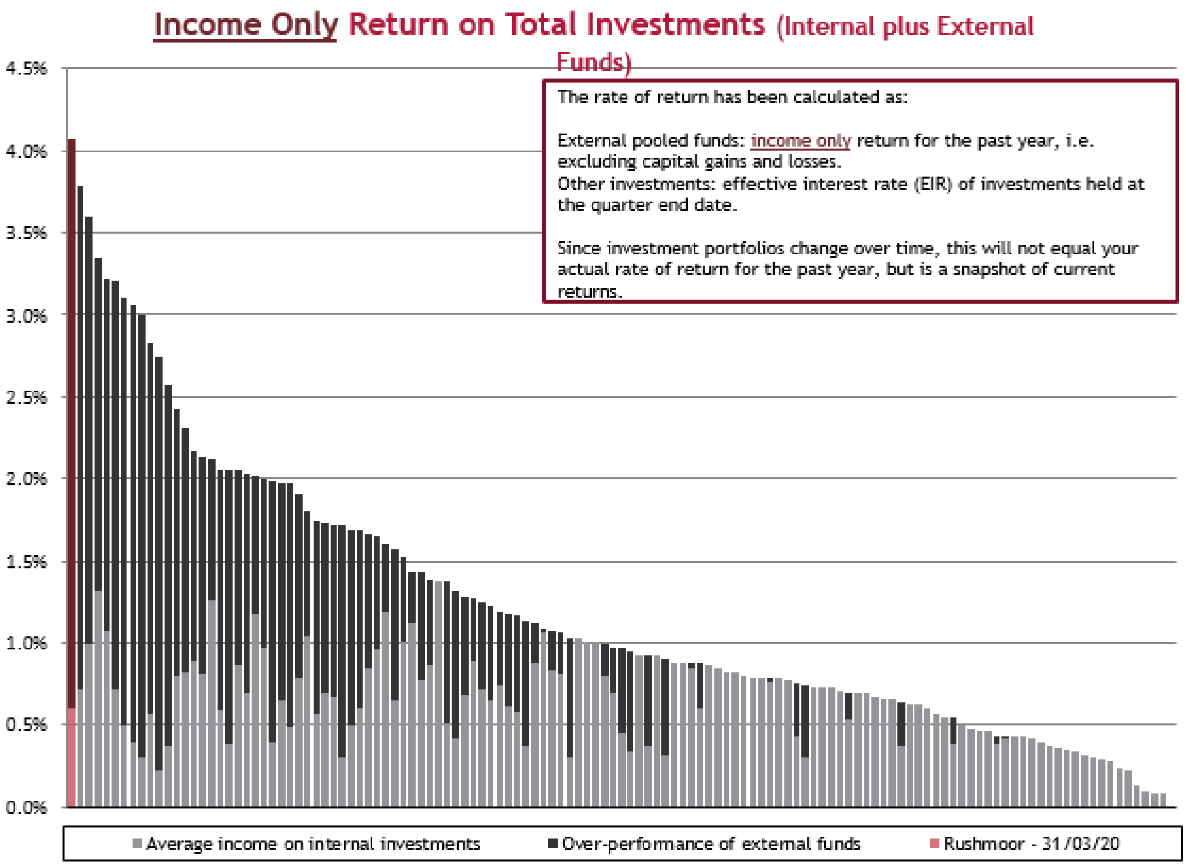
6.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The

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 4.28% as compared with 4.1% in 2018-19. The increase needs to be considered against the backdrop of COVID-19, which significantly reduced returns during Match 2020. The diversification of investment portfolio has reduced the potential impact on the Council.

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 March 2020 was 4.07%.

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 31.03.2019	3.73 3.85	AA- AA-	100% 100%
Similar LAs **All LAs**	**3.95**	**AA-**	**59%**

External Strategic Pooled Funds

6.7 £21.9m of the Council's investments are held in externally managed strategic pooled equity funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. During 2019/20 these funds generated an average total return of -£1.9m (-8.75%), comprising a £1.1m (4.97%) income return which is used to support services in year, and -£3m (-13.72%) of unrealised capital loss.

6.8 In a relatively short period since the onset of the COVID-19 pandemic, the global economic fallout was sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, businesses and individuals. Volatility measured by the VIX index was almost as high as during the global financial crisis of 2008/9 and evidenced in plummeting equity prices and the widening of corporate bond spreads, very close to rivalling those twelve years ago. Gilt yields fell but credit spreads widened markedly reflecting the sharp deterioration in economic and credit conditions associated with a sudden stagnation in economies, so corporate bonds yields (comprised of the gilt yield plus the credit spread) rose and prices therefore fell.

6.9 A summary of returns and diversification is set out below.

Figure 4: Pooled fund diversification

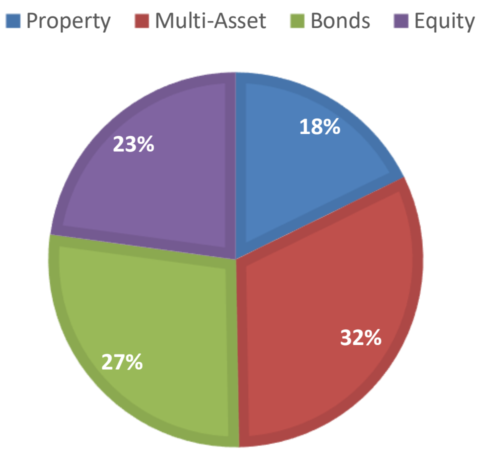


Table 7: Pooled fund diversification

Type of Pooled Fund	Amount invested £m	% of total investments
Property	3.9	18%
Multi-Asset	7.0	32%
Bonds	6.0	27%
Equity	5.0	23%
Total	**21.9**	**100%**

Figure 5: Total returns year-on-year comparison

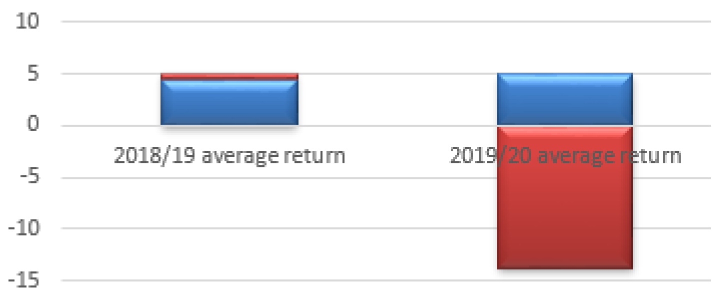


Table 8: Total return breakdown

Type of return	2018/19 average return %	2019/20 average return %

Income	4.46	4.97
Capital	0.54	-13.72
Total Returns	**5.000**	**-8.75**

6.10 The Council is using the alternative fair value through profit and loss (FVPL) accounting and must defer the funds' fair value losses to the Pooled Investment Fund Adjustment Account until 2023/24.

6.11 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 maintained.

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

6.12 **Capital returns** – the Council's pooled funds continued to experience some variations in performance during the year 2019/20. COVID-19 had a significant impact on the capital value during March 2020 resulting in the aggregation of the Council's pooled funds returning an overall net decrease in fair value for the year 2019/20 of £3.1m (an aggregate decrease of -13.72% of overall pooled funds invested).

6.13 There is variation in performance across the portfolio as shown in figure 6 and 7 below.

<u>Figure 6: Movement in capital value of pooled funds during over the last 6 years</u>

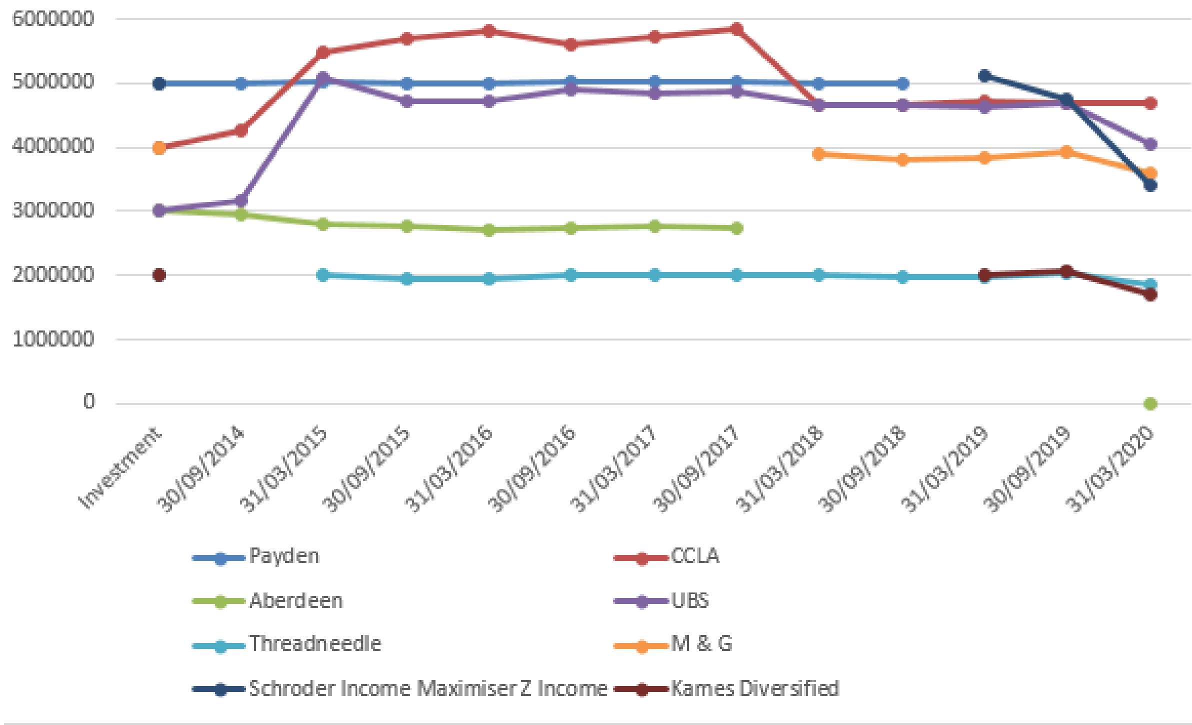
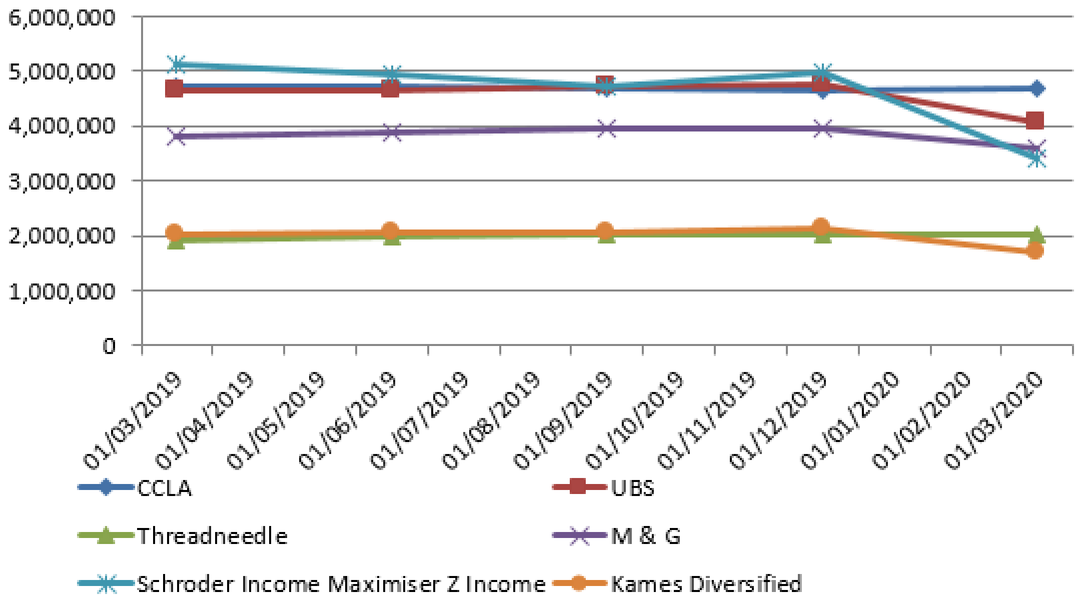


Figure 7: Movement in capital value of pooled funds during 2019/20



6.14 **Income Returns** – The income returned by fund for the period to 31 March 2020 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 5.26% 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 4.27% 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 2.45% 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 3.5% 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 7.6% 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 4.98% 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

	2019/20 Actual £m	**2019/20 Limit £m**	**Complied?**
Any group of pooled funds under the same management	21.9	25.0	Yes
Money Market Funds	5.3	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.

	2019/20 Actual	**2019/20 Target**	**Complied?**
Portfolio average credit rating	AA-	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.

	2019/20 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:

	2019/20 Actual	2019/20 Limit	Complied?
Upper limit on one-year impact of a 1% **rise** in interest rates.	-£407,000	£500,000	YES
Upper limit on one-year impact of a 1% **fall** in interest rates.	£397,000	£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:

	2019/20 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	67%	100%	0%	YES
12 months and within 24 months	33%	100%	0%	YES
24 months and within 5 years	0%	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 Actual £000**	**2019/20 Revised Forecast £000**	**Variance £000**
Interest receivable	(1,686)	(1,600)	(86)
Interest Payable	954	880	74
Net Amount	**(732)**	**(720)**	**(12)**

APPENDIX B

NON-TREASURY INVESTMENT OPERATIONS FOR 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 £113.6m of such investments at as 31 March 2020 in:

- directly owned property £106.6m
- loans to local businesses and landlords £6.8m
- 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 Outturn**
Proportion	14.5%	12.8%

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 Approved Limit**	**2019/20 Actual**
Local businesses	6.7	6.7
Employees	0.1	0.1
TOTAL	**6.8**	**6.8**

Service loans have generated 4% return for the Council during 2019/20 financial year

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 Limited 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 Actual
Subsidiaries and Partnerships	10	0.2
TOTAL	**10**	**0.2**

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 £106.6m as outline in table 4 below.

Table 4: Property held for investment purposes in £ millions

Property by type	2018/19 Carry forward	2019/20 Actual transactions	
		Purchase cost	Yearend Value
Mixed use	4.5	0.0	4.5
Industrial units	24.1	0.2	24.3
Retail	34.3	14.2	48.5
Offices	17	12.3	29.3
TOTAL	**79.9**	**26.7**	**106.6**

Return on Commercial investment

5.2 Commercial property investments generated £3.0m 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 2.85%.

5.3 The return on commercial property is 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, MRP charges and the impact of COVID-19.

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 Actual
Service investments: Loans	6.8	6.8
Service investments: Shares	10	0.2
Commercial investments: Property	119.1	106.6
TOTAL INVESTMENTS	135.8	113.6
Commitments to lend	0	0
TOTAL EXPOSURE	135.8	113.6

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	2019/20Actual
Service investments: Loans	2.2	2.2
Service investments: Shares	2	0.2
Commercial investments: Property	73.0	70.4
TOTAL FUNDED BY BORROWING	77.2	72.8

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 Actual
Treasury management investments	4.2%	4.3%
Service investments: Loans	4.1%	4.0%
Service investments: Shares	1.1%	0%
Commercial investments: Property *	7.6%	2.8%
ALL INVESTMENTS	6.3%	3.18%

* MRP is charged at the budgeted level for all assets funded from borrowing. This impacts on the forecast performance of Commercial Property Investments shown in the table above.

6.5 The above table shows a 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 Actual**
Debt to net service expenditure ratio	8.2	8.0
Commercial income to net service expenditure ratio	0.5	0.6

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	46.2
TOTAL	**70.2**	**46.2**
External sources	11.3	3.0
Own resources	0.1	0.2
Debt	58.8	43.0
TOTAL	**70.2**	**46.2**

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 Actual
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 Actual
General Fund services	119.1	103.8
MRP	-1.4	-1.4
IFRIC 4 Lease Adjustment	2.5	-0.4
TOTAL CFR	**120.2**	**102.0**

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	102.0
Capital Financing Requirement	172.5	178.4
Difference	50.9	76.4

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 Actual**
Authorised limit – total external debt	137.0	117.0
Operational boundary – total external debt	132.0	112.0

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	2.4
Proportion of net revenue stream	10.6%	23.0%

APPENDIX D

Market commentary regarding the year 2019/20 from the Council's treasury management advisors Arlingclose

<u>External Context</u>

Economic commentary

The UK's exit from the European Union and future trading arrangements, had remained one of major influences on the UK economy and sentiment during 2019/20. The 29th March 2019 Brexit deadline was extended to 12th April, then to 31st October and finally to 31st January 2020. Politics played a major role in financial markets over the period as the UK's tenuous progress negotiating its exit from the European Union together with its future trading arrangements drove volatility, particularly in foreign exchange markets. The outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% y/y in February, below the Bank of England's target of 2%. Labour market data remained positive. The ILO unemployment rate was 3.9% in the three months to January 2020 while the employment rate hit a record high of 76.5%. The average annual growth rate for pay excluding bonuses was 3.1% in January 2020 and the same when bonuses were included, providing some evidence that a shortage of labour had been supporting wages.

GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed and production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.

Then coronavirus swiftly changed everything. COVID-19, which had first appeared in China in December 2019, started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global Financial Crisis as part of a flight to quality into sovereign debt and other perceived 'safe' assets.

In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% from 0.75% and then swiftly thereafter brought them down further to the record low of 0.1%. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK.

The US economy grew at an annualised rate of 2.1% in Q4 2019. After escalating trade wars and a protracted standoff, the signing of Phase 1 of the trade agreement between the US and China in January was initially positive for both economies, but COVID-19 severely impacted sentiment and production in both countries. Against a slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from of 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19 related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already on (or below) the floor, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

Financial markets:
Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March sterling touch its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile. The flight to quality caused gilts yields to fall substantially. The 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March. The 10-year benchmark yield fell from 1% to 0.4%, the 20-year benchmark yield from 1.47% to 0.76% over the same period. 1-month, 3-month and 12-month bid rates averaged 0.61%, 0.72% and 0.88% respectively over the period.

Since the start of the calendar 2020, the yield on 2-year US treasuries had fallen from 1.573% to 0.20% and from 1.877% to 0.61% for 10-year treasuries. German bund yields remain negative.

Credit background:
In Q4 2019 Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative. The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

After remaining flat in January and February and between a range of 30-55bps, Credit Default Swap spreads rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern. Spreads declined in late March and through to mid-April but remain above their initial 2020 levels. NatWest Markets Plc (non-ringfenced) remains the highest at 128bps and National Westminster Bank Plc (ringfenced) still the lowest at 56bps. The other main UK banks are between 65bps and 123bps, with the latter being the thinly traded and volatile Santander UK CDS.

While the UK and Non-UK banks on the Arlingclose counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks was cut to 35 days in mid-March.

Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and Non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-.