LICENSING AUDIT & GENERAL PURPOSES COMMITTEE
25 JANUARY 2021

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN2033

TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2020/21

SUMMARY:
This report sets out the main activities of the Treasury Management and non-Treasury Investment Operations during the first half of 2020/21. Prudential indicators for the 2020/21 financial year have been updated for all treasury management and non-treasury activity during the first half of 2020/21.

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 2020/21.

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operations for the first half of the year 2020/21. 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 20 February 2020. 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 appendices (A to C) set out the Treasury Management operations, Non-Treasury Investment Operations and Prudential Indicators for 2020/21 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 2020/21, 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 2020/21 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 2020/21, 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 2020/21, in accordance with MHCLG Investment Guidance.

Appendix C

- the **Prudential indicators forecast** sets out the forecast prudential indicators position at the end of 2020/21 based on 2020/21 half year position relating to treasury/non-treasury activities and capital financing for 2020/21. Performance is compared to the indicators set out in the Annual Capital Strategy for the year 2020/21.

3 CONCLUSIONS ON THE TREASURY MANAGEMENT AND NON-TRESURY INVESTMENT OPERATIONS DURING 2020/21

3.1 The Council's treasury team continued to concentrate on the security of investments taking due regard for the returns available.

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 2020/21 financial year short-term interest rates have decreased and are forecast to remain low. However, borrowing levels have increased, raising refinancing risk. All treasury management decisions are taken with due regard to refinancing risk.

3.3 Total borrowing at 30 September 2020 is £87.0m, a decrease of £3.0m from 2019/20 year-end position. Year-end borrowing is forecast to be £116.7m below estimated levels due to timing of investment property purchases. The lower level of borrowing and lower interest rates has resulted in forecast interest cost of borrowing reducing by £0.5m.

3.4 The Council is forecast to have non-treasury investments risk exposure of £132.2 of which £91.6 is funded via external loans.

3.5 Return of non-treasury investments is forecast to be below estimated return for 2020/21 due to the deferral of interest on Farnborough International Loan until 2026.

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APPENDIX A

TREASURY MANAGEMENT OPERATION FOR FIRST HALF OF 2020/21

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 2020/21. 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 2020/21, 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 2020/21. This commentary is provided at **Appendix D**.

4 LOCAL CONTEXT

4.1 On 30 September 2020, the Council had net borrowing of £57.8m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes for the 2020/21 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 2020 and the change during the year is shown in Table 1 below.

Table 1: Treasury Management Summary

	31.03.20 Balance £m	**Movement £m**	**30.09.20 Balance £m**	**30.09.20 Rate %**
Long-term borrowing	30.0	25.0	55.0	0.09
Short-term borrowing	60.0	-28.0	32.0	0.08
Total borrowing	**90.0**	**-3.0**	**87.0**	
Long-term investments	-21.9	0	-21.9	4.84
Short-term investments	0	0	0	0.00
Cash and cash equivalents	-5.3	-2.0	-7.3	0.13
Total investments	**-27.2**	**-2.0**	**-29.2**	
Net borrowing/(investments)	**62.8**	**-5.0**	**57.8**	

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 £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	20120/21 Estimate £m	2020/21 Forecast £m
Outstanding borrowing	154.1	125.7
Investment min	-10.0	-10.0
Investments held that can be redeemed	-22.9	-29.2
Liability benchmark	141.2	106.5

5 BORROWING ACTIVITY IN 2020/21

5.1 At 30 September 2020 the Council held £87.0m of loans, an decrease of £3.0m since 31 March 2020, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 September 2020 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.20 Balance £m	Movement £m	30.09.20 Balance £m	30.09.20 Rate %
Total External Borrowing				
Long-term investments	30.0	25.0	55.0	0.09
Short-term investments	60.0	-28.0	32.0	0.08
Total Gross External Debt	**90.0**	**-3.0**	**87.0**	

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 Short-term interest rates remaining much lower than long-term rates, with the Bank of England cutting interest rates to 0.1% on 19th March 2020. The

Council considered it to be more cost effective in the near term to use short-term loans.

6 INVESTMENT ACTIVITY IN 2020/21

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

	31.03.20 Balance £m	Movement £m	30.09.20 Balance £m	30.09.20 Rate %	
Managed in-house:					
Money Market Funds	5.3	2.0	7.3	0.13	*
Managed externally:					
Pooled Funds:					
CCLA LAMIT Property Fund	3.9	0	3.9	6.41	*
M&G Investments Strategic Corporate Bond Fund	4	0	4	1.8	*
UBS Multi Asset Fund	5	0	5	4.71	*
Kamas	2	0	2	4.63	*
Threadneedle Investments	2	0	2	3.53	*
Schroder Income Maximiser Fund	5	0	5	6.78	*
Total Investments	27.2	2.0	29.2		

*Annualised return based on income received between April 2020 to September 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

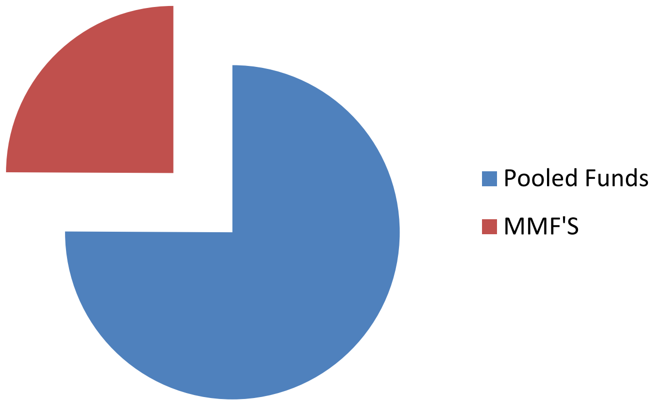


Figure 2: Maturity analysis

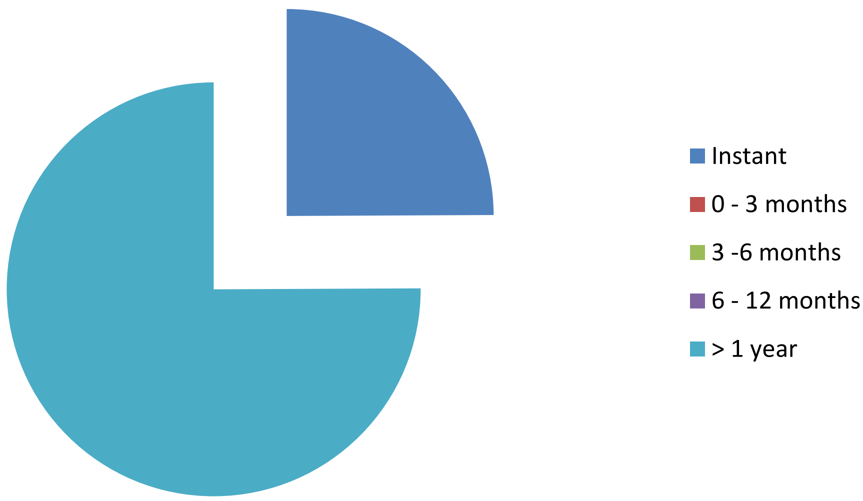


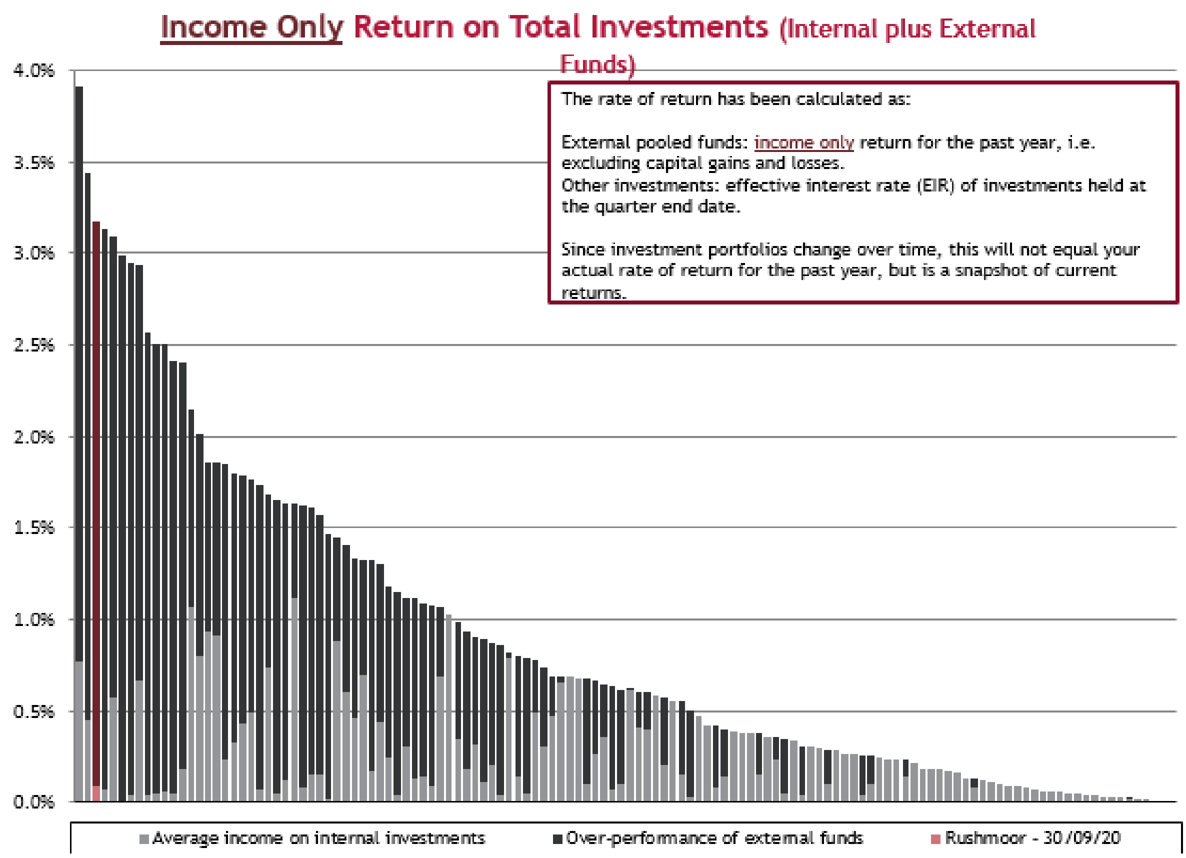
Table 5: Maturity analysis

Maturity Analysis for ALL INVESTMENTS	Type of Counter Party	Amount invested £	% of total investments
Instant	MMF	7,271,000	25%
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	75%
Total for all duration periods		**29,171,000**	**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 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 2020 was 3.17%.

Figure 3: Total income return on investment portfolio



6.5 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
31.03.2020 30.09.2020	3.85 4.50	AA- A+	100% 100%
Similar LAs **All LAs**	**4.15**	**AA-**	**65%**

External Strategic Pooled Funds

6.6 £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. The pooled fund portfolio has generated an average total return during the first half of 2020/21 of 4.84%. Capital returns have decreased by 10.25%. A summary of returns and diversification is set out below.

Figure 4: Pooled fund diversification

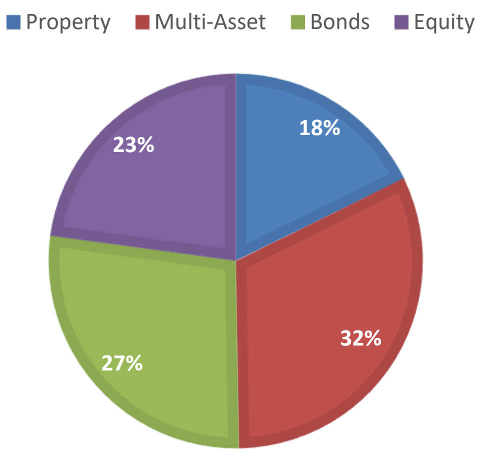


Table 7: Pooled fund diversification

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

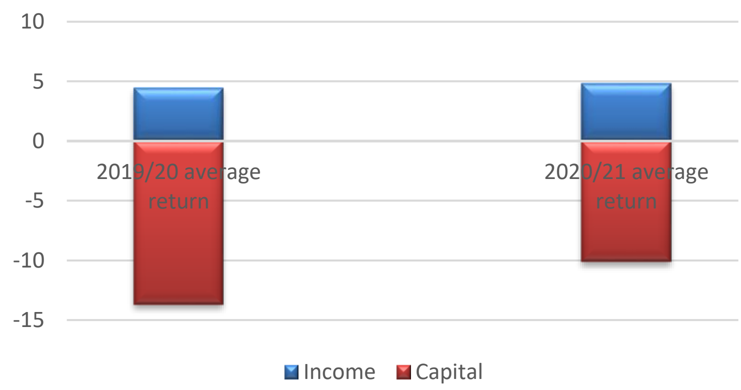


Table 8: Total return breakdown

Type of return	2019/20 average return %	2020/21 average return %
Income	4.46	4.84
Capital	-13.72	-10.25
Total Returns	**-9.26**	**-5.41**

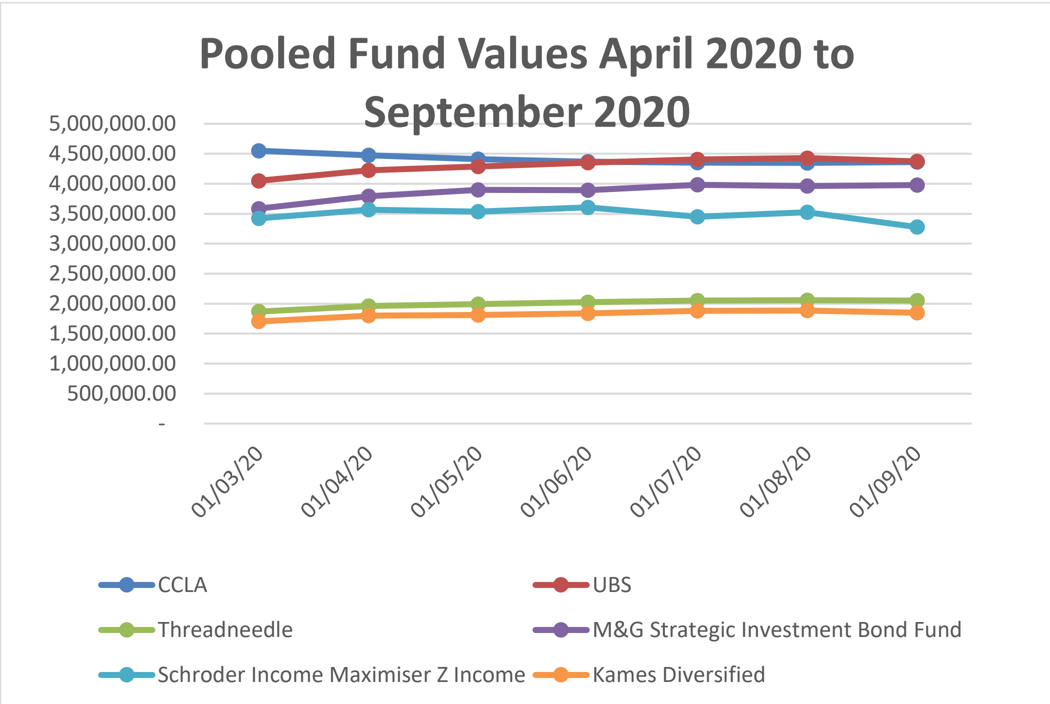
6.7 As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move 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.

6.8 Details of the Council's investment activity together with returns generated during 2020/21 are outlined as follows:

6.9 **Capital returns** – the Council's pooled fund portfolio has recovered well during the 2020/21 year, as the country came out of the first COVID-19 lockdown. Aggregation of the Council's pooled funds resulted in an overall net increase in fair value for the year 2020/21 of around £711,000 (an aggregate increase of 3.71% of overall pooled funds invested).

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

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



6.11 **Income Returns_**– The income returned by fund for the period to 30 September 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 6.41% annualised income during 2020/21.

- 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 4.71% annualised income during 2020/21.

- 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 3.53% annualised income during 2020/21

- 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 1.80% annnualised income during 20120/221.

- 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 6.78% annualised during 2020/21.

- 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 4.63% annualised during 2020/21.

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.

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

Table 9: Investment Limits

	30.9.20 Actual £m	2020/21 Limit £m	Complied?
Any group of pooled funds under the same management	**21.9**	**25.0**	Yes
Money Market Funds	**7.3**	**25.0**	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.

	30.9.20 Actual	2020/21 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.

	30.9.20 Actual £m	2020/21 Target £m	Complied?
Total sum borrowed in past 3 months without prior notice	0	1.0	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:

	30.9.20 Actual	2020/21 Limit	Complied?
Upper limit on one-year impact of a 1% **rise** in interest rates.	£439,000	£500,000	YES
Upper limit on one-year impact of a 1% **fall** in interest rates.	£330,000	£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:

	30.9.20 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	100%	100%	0%	YES
12 months and within 24 months	0%	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:

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	£21.9m	£21.9m	£21.9m
Limit on principal invested beyond year end	£90.0m	£90.0m	£90.0m
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 2020/201 is shown in the table below.

Budgeted income and outturn	2020/21 Estimate £000	2020/21 Forecast £000	Variance £000
Interest receivable	(1,600)	(900)	700
Interest Payable	1,370	868	(502)
Net Amount	**(230)**	**(32)**	**198**

APPENDIX B

NON-TREASURY INVESTMENT OPERATIONS FOR FIRST HALF OF 2020/21

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 £113.9m of such investments at as 30 September 2020 in:

- directly owned property £107m
- 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

	2020/21 Estimate	2020/21 Forecast
Proportion	14.3%	14.7%

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 As reported in the Revenue Budget Monitoring Report for Q2 (FIN2031) the Council and the other funding consortium funding partners agreed to defer interest payments to provide cashflow support to Farnborough International Limited (FIL) following the cancellation of the 2020 Airshow.

3.3 The primary creditor (Barclays) has proposed to capitalise interest in-line with the Intercreditor Agreement. Unless a compromise can be reached the Council would not receive deferred interest until 2026.

3.4 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	2020/21 Approved Limit	20/21 Actual	20/21 Forecast
Local businesses	6.7	6.7	6.7
Employees	0.1	0.1	0.1
Subsidies and Partnership	3.5	0	0.6
TOTAL	**10.3**	**6.8**	**7.4**

3.5 As the interest on FIL loan has been deferred no interest has been received by the Council during the first 6 months of 2020/21 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 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	**2020/21**	**2020/21**
	Approved Limit	**Forecast**
Subsidiaries and Partnerships	0.5	0.4
TOTAL	**0.5**	**0.4**

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	**2019/20 Transactions**			**2020/21 estimated transactions**	
	Purchase cost	**Gains or (losses)**	**Value in accounts**	**Purchase cost**	**Estimated year-end Value**
Mixed use	4.5	0.0	4.5	0.0	4.5
Industrial units	24.2	0.1	24.3	0.0	24.3
Retail	34.3	-5.0	29.3	15.7	45.0
Offices	51.0	-2.5	48.5	2.1	50.6
TOTAL	**114.0**	**-7.4**	**106.6**	**17.8**	**124.4**

Return on Commercial investment

5.2 Commercial property investments generated £4.03m 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 2.74%.

5.3 The return on commercial property is forecast to be higher that the reported level in the non-treasury investment strategy to Council on 20 February 2020. This is due to lower cost of borrowing.

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	**2020/21 Estimate**	**2020/21 Forecast**
Service investments: Loans	10.3	7.4
Service investments: Shares	0.5	0.4
Commercial investments: Property	125.8	124.4
TOTAL INVESTMENTS	136.6	132.2
Commitments to lend	0	0
TOTAL EXPOSURE	136.6	132.2

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

	2020/21 Estimate	**2020/21 Forecast**
Service investments: Loans	4.4	2.9
Service investments: Shares	0.5	0.4
Commercial investments: Property	87.2	88.2
TOTAL FUNDED BY BORROWING	92.1	91.6

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)

	20120/21 Estimate	**2020/21 Forecast**
Treasury management investments	4.9%	3.1%
Service investments: Loans	3.87%	0.5%
Service investments: Shares	0%	0%
Commercial investments: Property *	2.3%	2.7%
ALL INVESTMENTS	2.7%	2.7%

6.5 The above table shows a forecast reduction in Treasury management investments and Service Investment Loans net of all finance costs in 2020/21. This is due to the economic downturn as a result of COVID-19. Commercial Property shows a forecast improvement in return net of all finance costs in 2020/21. This is due to the reduced cost of borrowing as a result of lower bank of England interest rates.

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

Table 8: Other investment indicators

Indicator	2020/21 Estimate	2020/21 Forecast
Debt to net service expenditure ratio	13.7	9.9
Commercial income to net service expenditure ratio	0.8	0.7

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

	2020/21 Estimate	2012021 Forecast
General Fund services	55.4	33.2
TOTAL	55.4	33.2
External sources	8.0	6.0
Own resources	1.0	1.0
Debt	46.4	26.3
TOTAL	**55.4**	**33.2**

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

	2020/21 Estimate	2020/21 Forecast
Own resources	2.2	2.2

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

	2020/21 Estimate	2020/21 Forecast
General Fund services	154.0	128.3
MRP	-2.2	-2.2
IFRIC 4 Lease Adjustment	2.3	-0.4
TOTAL CFR	**154.1**	**125.7**

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

	2020/21 Estimate	**2020/21 Forecast**
Debt (incl. leases)	154.1	125.7
Capital Financing Requirement	208.4	189.2
Difference	54.3	63.5

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

	2020/21 limit	**2020/21 Forecast**
Authorised limit – total external debt	169.1	140.7
Operational boundary – total external debt	164.1	135.7

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

	2020/21 Estimate	**2020/21 Forecast**
Financing costs (£m)	3.5	3.0
Proportion of net revenue stream	34%	29.1%

APPENDIX D

Market commentary regarding the year 2020/21 from the Council's treasury management advisors Arlingclose

External Context

Economic commentary

The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the 'Eat Out to Help Out' (EOHO) offer.

GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme. The Office for National Statistics' preferred measure of CPIH which includes owner-occupied housing was 0.5% y/y.

In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the BoE has forecast unemployment could hit a peak of between 8% and 9%.

The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is 'moderately' above the 2% average target, particularly given it has been below target for most of the last decade.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

Financial markets:
Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.23% respectively over the period.

At the end of September, the yield on 2-year US treasuries was around 0.13% while that on 10-year treasuries was 0.69%. German bund yields remain negative across most maturities.

Credit background:
Credit default swap spreads eased over most of the period but then started to tick up again through September. In the UK, the spreads between ringfenced and non-ringfenced entities remains, except for retail bank Santander UK whose CDS spread remained elevated and the highest of those we monitor at 85bps while Standard Chartered was the lowest at 41bps. The ringfenced banks are currently trading between 45 and 50bps.

After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned an AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.