TO: GOVERNANCE AND AUDIT COMMITTEE
29 JANUARY 2020

TREASURY MANAGEMENT REPORT 2020/21 AND 2019/20 MID-YEAR REVIEW
(Director of Finance)

1 PURPOSE OF DECISION

1.1 The Council must operate a balanced budget, which broadly means cash raised during the year plus any use of reserves will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity before considering maximising investment return.

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 longer term cash flow planning needs to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

1.3 The Local Government Act 2003 requires a local authority to "have regard to" guidance issued by, or specified by, the Secretary of State. As such, the Council is required to have regard to the Prudential Code and the Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

1.4 The Code of Practice requires the Council's annual Treasury Management Strategy (and associated documents) to be examined and reviewed by a responsible body. An additional primary requirement of the code is for the receipt by Full Council of a Mid-Year Review of the Treasury Management activities of the authority.

1.5 This report seeks to achieve both these requirements of updating Members on progress in 2019/20 and to review the Treasury Management Report for 2020/21.

2 RECOMMENDATIONS

2.1 That the Committee consider and review the Mid-Year Review Report.

2.2 That the Committee agree that the Mid-Year Review Report be circulated to all Members of the Council.

2.3 That the Committee review the Treasury Management Report in Annex A for 2020/21 prior to its approval by Council.

3 REASONS FOR RECOMMENDATIONS

3.1 The reasons for the recommendations are set out in the report.

4 ALTERNATIVE OPTIONS CONSIDERED

4.1 The Code of Practice requires the Council's annual Treasury Strategy to be examined and reviewed by a responsible body and for that body to review progress of the Council's treasury management activities. The Governance and Audit Committee has been nominated by Council to be that body.

5 SUPPORTING INFORMATION

Mid-Year Review

5.1 This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first nine months of 2019/20
- A review of the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy
- The Council's capital expenditure
- A review of the Council's investment portfolio for 2019/20
- A review of compliance with Treasury and Prudential Limits for 2019/20

Economic Update

5.2 It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% to date due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That's shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth. This will be an ongoing issue through 2020.

5.3 There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc.

5.4 This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

5.5 During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this and how strong the correlation is likely to be is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

5.6 Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

5.7 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Treasury Management Strategy Statement Review

5.8 The Treasury Management Strategy Statement (TMSS) for 2019/20 was approved by the Council on 24th February 2019. There are no policy changes to the TMSS.

Review of Investment and Debt Portfolio 2019/20

5.9 The Council held £12.197m of investments as at 31 December 2019 and the investment portfolio yield for the first nine months of the year is 0.65% against a benchmark (Local Authority 7-Day Rate) of 0.16%.

Investment	Maturity	Amount (£'000)	Rate (%)
Money Market Funds			
Aberdeen	1 Day	6,997	0.758
Black Rock	1 Day	2,497	0.691
Federated	1 Day	2,850	0.729
Federated Cash Plus	2 Day	4,023	0.885
Goldman Sachs	1 Day	6,997	0.673
Deutsche	1 Day	500	0.645
Total Investments		**23,864**	

5.10 The 2019/20 interest budget assumed that an average interest rate of 0.5% would be earned on the Council's investment portfolio. As such the interest rate earned on the years surplus cash should be in line with target

5.11 As at 31 December 2018 the Council's debt portfolio was as follows

Short Term Market Loans

Counterparty	Amount £	Rate	Start Date	Maturity Date
Cambridge	5,000,000	0.98%	30/04/2019	31/01/2020
Kensington	5,000,000	0.98%	29/04/2019	29/01/2020
Renfrewshire	5,000,000	0.95%	28/08/2018	29/01/2020
Kensington	5,000,000	0.90%	17/12/2018	22/04/2020
	20,000,000			

PWLB Loans

PWLB	Amount	Rate	Start Date	Maturity Date
PWLB	10,000,000	2.60%	09/02/2017	31/03/2062
PWLB	10,000,000	2.60%	09/02/2017	31/03/2066
PWLB	10,000,000	2.42%	20/06/2017	31/03/2063
PWLB	10,000,000	2.41%	20/06/2017	31/03/2064
PWLB	20,000,000	1.85%	21/11/2017	21/11/2024
PWLB	10,000,000	2.50%	21/11/2017	21/11/2062
PWLB	10,000,000	2.14%	03/12/2018	03/12/2028
	80,000,000			

Compliance with Treasury and Prudential Limits for 2019/20

5.12 The Director of Finance can confirm that the approved limits within the Annual Investment Strategy were not breached during the first nine months of 2019/20 and no changes to these limits are proposed for the remaining 3 months.

Treasury Management Report 2020/21

5.13 The Council is required to have regard to the Prudential Code and Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). Under these requirements the Council must set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. At its meeting on 2 March 2011 Council nominated the Governance and Audit Committee as the responsible body to examine and assess the effectiveness of the treasury management strategy and policies and recommend them to Council.

5.14 The attached Treasury Management Report 2020/21 (Annex A) was approved by the Executive, as a part of the Council's overall budget proposals, on 17 December 2019 and outlines the Council's Prudential Indicators for 2020/21 to 2022/23 in addition to setting out the expected treasury strategy and operations for this period. The Executive requested that the Governance and Audit Committee review each of the key elements. Following this review the Treasury Management Report and associated documents will be presented to Council for approval on 26 February 2020.

6 ADVICE RECEIVED FROM STATUTORY AND OTHER OFFICERS

Borough Solicitor

6.1 None.

Borough Treasurer

6.2 The financial implications are contained within the report.

Equalities Impact Assessment

6.3 None.

Strategic Risk Management Issues

6.4 The Treasury Management Report deals directly with the strategic management of risk associated with the Council's treasury management activities

7 CONSULTATION

Principal Groups Consulted

7.1 The Overview & Scrutiny Commission was consulted on the budget proposals, including the Treasury Management Strategy, in December.

Background Papers

None

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