Bath & North East Somerset Council		
MEETING	**Cabinet**	
MEETING DATE:	**12 September 2019**	EXECUTIVE FORWARD PLAN REFERENCE: E 3155
TITLE:	**Treasury Management 2019-20 Quarter 1 Performance**	
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council's Investment Position at 30th June 2019
Appendix 3 – Average monthly rate of return for 2019/20
Appendix 4 – The Council's External Borrowing Position at 30th June 2019
Appendix 5 – Arlingclose's Economic & Market Review Q1 of 2019/20
Appendix 6 – Interest & Capital Financing Budget Monitoring 2019/20
Appendix 7 – Summary Guide to Credit Ratings

1 THE ISSUE

1.1 In February 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan for 2019/20.

2 RECOMMENDATION

The Cabinet agrees that;

2.1 The Treasury Management Report to 30th June 2019, prepared in accordance with the CIPFA Treasury Code of Practice, is noted.

2.2 The Treasury Management Indicators to 30th June 2019 are noted.

3 THE REPORT

Summary

3.1 The average rate of investment return for the 2019/20 is 0.95%, which is 0.33% above the benchmark rate.

3.2 The Council's Prudential Indicators for 2019/20 were agreed by Council in February 2019 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

3.3 The Council's investment position as at 30th June 2019 is given in **Appendix 2**. The balance of deposits as at 30th June 2019 and 31st March 2019 are also set out in the pie charts in this appendix.

3.4 Gross interest earned on investments totalled £123k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.95%, which was 0.33% above the benchmark rate of average 7 day LIBID +0.05% (0.62%), mainly due to the placement of a £3m investment in the CCLA Local Authority's Property Fund which is a long term strategic investment earning a higher rate of interest.

Summary of Borrowings

3.5 The Council's external borrowing as at 30th June 2019 totalled £225.1 million and is detailed in Appendix 4..

3.6 The Council's Capital Financing Requirement (CFR) as at 31st March 2019 was £300.7 million. This represents the Council's underlying need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

3.7 The CFR represents the underlying need to borrow and the difference from the current borrowing of £225.1 million, represents re-investment of the internal balances including reserves, reducing the in-year borrowing costs in excess of the potential investment returns.

3.8 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2019 apportioned to Bath & North East Somerset Council is £11.9m. Since this borrowing is managed by an external body and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 3.5.

3.9 The borrowing portfolio as at 30th June 2019 is shown in **Appendix 4**.

Strategic & Tactical Decisions

3.10 The Council's 2019/20 savings and income generation proposals included an item for generating additional investment income through taking a longer term investment approach to £10 million of core investment balances. During the quarter a £3 million investment was placed with the CCLA Local Authority's Property Fund as part of this investment approach which also provides further diversification of the Council's commercial property investment portfolio as set out in the approved Treasury Management Strategy for 2019/20.

3.11 As shown in the charts at **Appendix 2**, the investment portfolio is diversified across Money Market Funds, Local Authorities, the CCLA Property Fund, highly rated UK and Foreign Banks and a UK Building Society. The Council uses AAA rated Money Market funds to maintain very short term liquidity and had overall investments of £48.6m invested as at 30th June 2019.

3.12 The Council does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Council's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

3.13 The Council has reviewed its current investment holdings with its Treasury Management advisors to assess whether any of the investments placed are directly related to companies involved in fossil fuel companies. It was confirmed that the Council does not currently invest directly in equities or certificates of deposits that were not issued by banks or building societies and does not have any investments in fossil fuel companies. The main area where there is a potential for this type of investment is in the strategic diversified income funds which the Council is considering as part of its longer term investment approach, as these funds invest part of their portfolio in equities. A review into the two funds the council is considering using has shown that direct investment in fossil fuel companies forms a low proportion of the overall fund's investments (between 4% and 8%). If these investments are not undertaken it is estimated that there will be a reduction in the forecast investment income of between £100k-£150k in 2019/20.

3.14 The Council's average investment return is currently slightly below the budgeted level of 1.20%, although the rate of return would increase if further longer term strategic investments are made during the remainder of the year.

Future Strategic & Tactical Issues

3.15 Our treasury management advisors economic and market review for the first quarter 2019/20 is included in Appendix 5.

3.16 There was a rise in quarterly GDP growth in the first calendar quarter for 2019 to 0.5%, from 0.2% in Q4 2018 with stockpiling ahead of the (now delayed) 29th March Brexit distorting data. Production and construction registered positive output and growth, however at the end of June 2019, the seasonally adjusted Markit UK Construction PMI (Purchasing Manager's Index) logged a record-low figure of 43.1, suggesting that construction has suffered a largest contraction in output since April 2009. GDP growth was 1.8% year/year, however with the service sector slowing and a weaker global backdrop, the outlook is for subdued growth.

3.17 The benefits of the Council's current policy of internal borrowing are monitored regularly against the likelihood that long term borrowing rates are forecast to rise in future years. The focus remains on the rate of increase and the medium-term peak.

3.18 The borrowing to take place in 2019/20 will therefore driven by a need to maintain an appropriate working cash balance rather than any immediate changes to interest rates.

Budget Implications

3.19 A breakdown of the revenue budget showing interest and capital financing and the forecast year end position based on the period April to June is included in Appendix 6. This is forecast to budget at this stage of the financial year.

4 STATUTORY CONSIDERATIONS

4.1 This report is for information only.

5 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

5.1 The financial implications are contained within the body of the report.

6 RISK MANAGEMENT

6.1 A risk assessment related to the issue and recommendations has been undertaken, in compliance with the Council's decision making risk management guidance.

6.2 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

6.3 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

6.4 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year.

7 CLIMATE CHANGE

7.1 A review of the Council's current investment holdings to assess any direct investment holdings in fossil fuel companies has been undertaken as set out in paragraph 3.13 of the report.

8 OTHER OPTIONS CONSIDERED

8.1 None

9 CONSULTATION

9.1 Consultation has been carried out with the Cabinet Member for Resources, Section 151 Finance Officer and Monitoring Officer.

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Background papers	*2019/20 Treasury Management & Investment Strategy*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2019/20 Prudential Indicator	**Actual as at 30th June 2019**
	£'000	£'000
Borrowing	440,000	225,087
Other long term liabilities	2,000	0
Cumulative Total	**442,000**	**225,087**

2. Operational limit for external debt
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2019/20 Prudential Indicator	**Actual as at 30th June 2019**
	£'000	£'000
Borrowing	409,000	225,087
Other long term liabilities	2,000	0
Cumulative Total	**411,000**	**225,087**

3. Upper limit for fixed interest rate exposure

This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2019/20 Prudential Indicator	Actual as at 30th June 2019
	£'000	£'000
Fixed interest rate exposure	**409,000**	**205,807***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the Lender exercise this option to increase the rate).

4. Upper limit for variable interest rate exposure

While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2019/20 Prudential Indicator	Actual as at 30th June 2019
	£'000	£'000
Variable interest rate exposure	**222,000**	**20,000**

5. Upper limit for total principal sums invested for over 364 days

This is the maximum amount of total investments which can be over 364 days. 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.

	2019/20 Prudential Indicator	Actual as at 30th June 2019
	£'000	£'000
Investments over 364 days	**50,000**	**0**

6. Maturity Structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk.

	Upper Limit	Lower Limit	Actual as at 30th June 2019
	%	%	%
Under 12 months	50	Nil	13.3*
12 months and within 24 months	75	Nil	0
24 months and within 5 years	75	Nil	0
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	86.7

* The CIPFA Treasury management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date (which are at 6 monthly intervals for the £20m of LOBO's). However, the Council would only consider repaying these loans if the Lenders exercised their options to alter the interest rate.

7. Average Credit Rating*

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**.

	2019/20 Prudential Indicator	**Actual as at 30th June 2019**
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AA**

* *The calculation excludes the strategic investment in the CCLA Local Authority's Property Fund which is unrated.*

APPENDIX 2
March
The Council's Investment position at 30th June 2019
The term of investments is as follows:

Term Remaining as at 30th June 2019	**Balance at 30th June 2019**
	£'000's
Notice (instant access funds)	15,620
Up to 1 month	10,000
3 month to 6 months	20,000
CCLA Property Fund (Strategic)	3,000
Total	**48,620**

The investment figure is made up as follows:

	Balance at 30th June 2019
	£'000's
B&NES Council	45,958
Schools	2,662
Total	**48,620**

The Council had a total average net positive balance of £51.9m during the period April 2019 to June 2019.

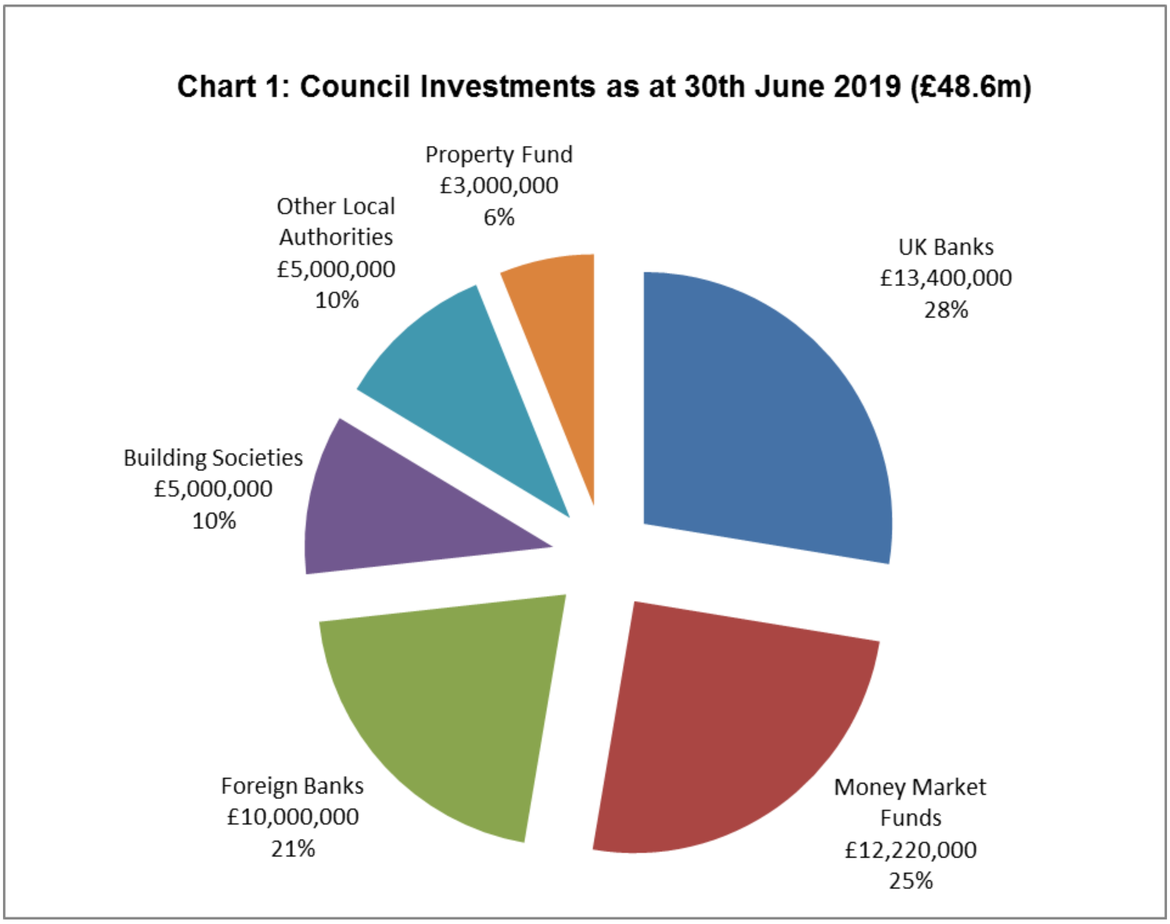


Chart 2: Council Investments as at 31st March 2019 (£39.7m)

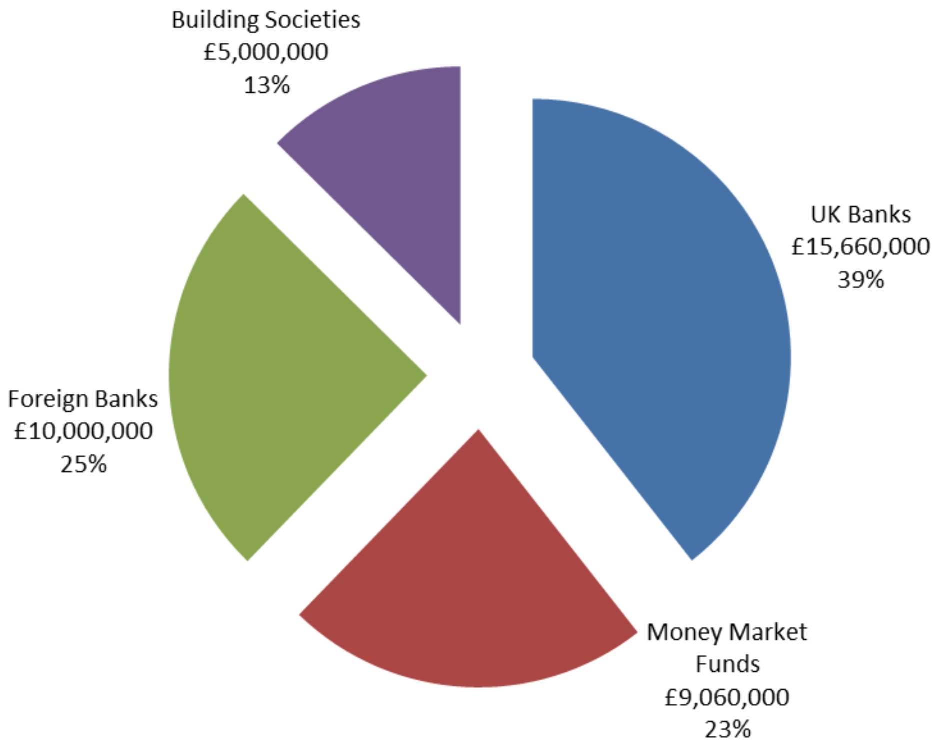
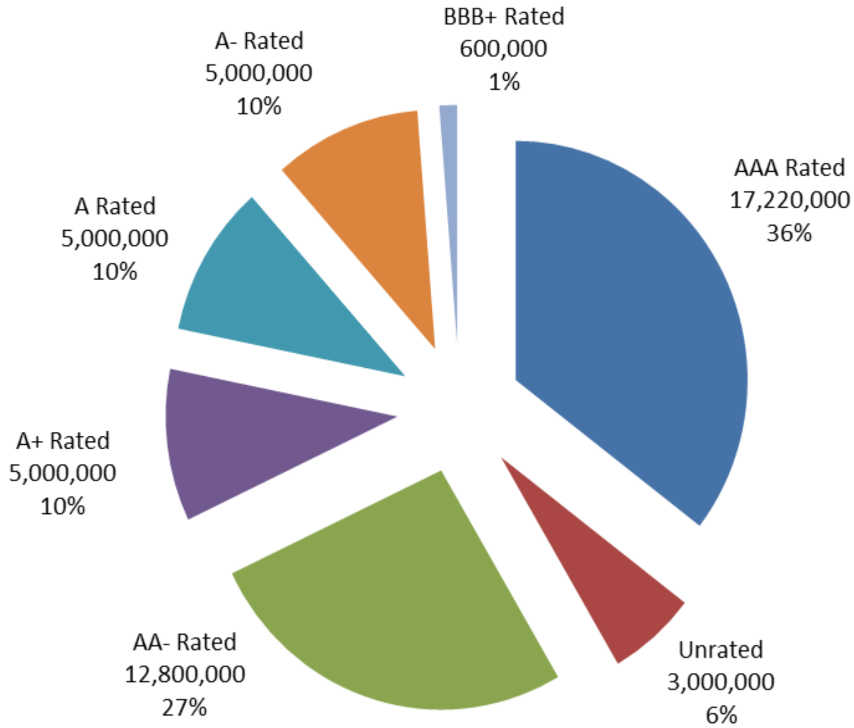
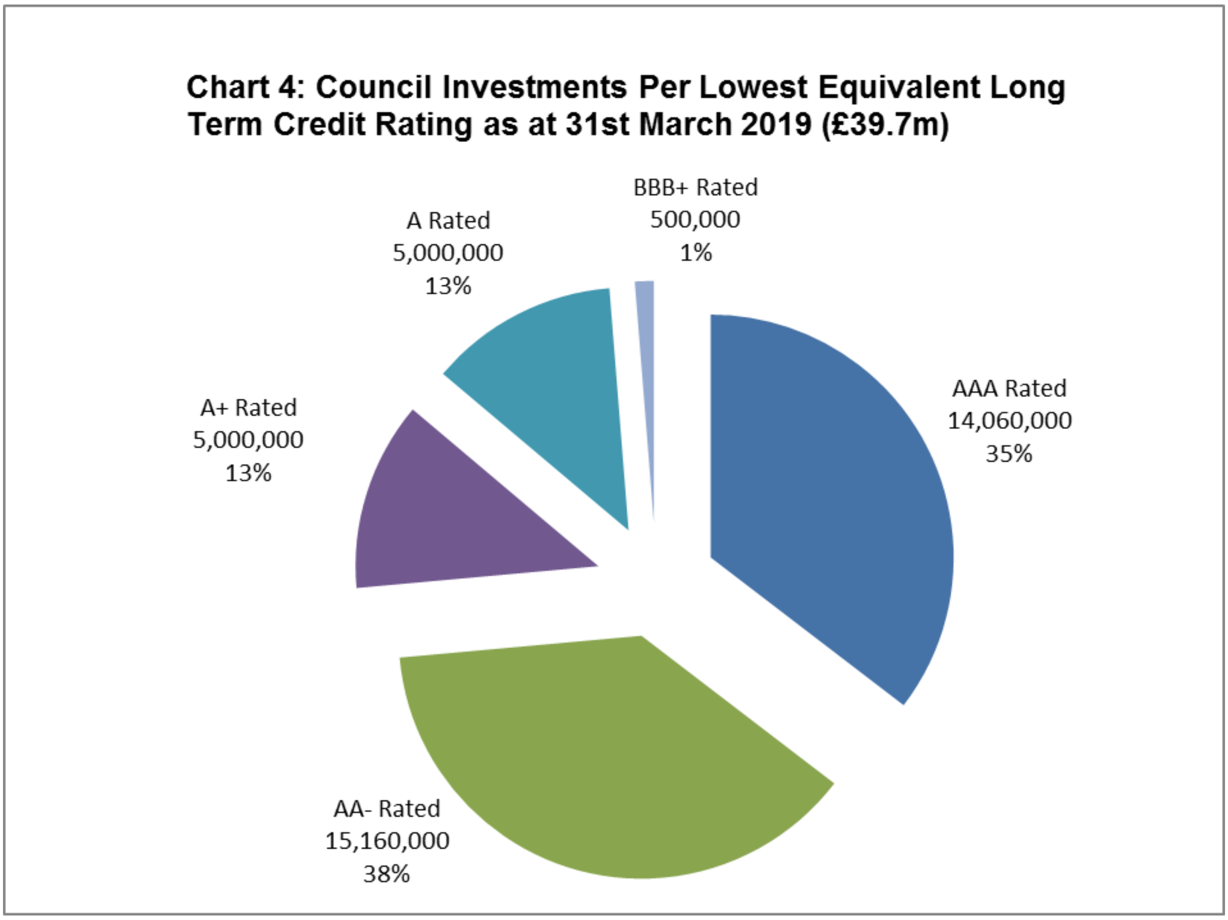


Chart 3: Council Investments Per Lowest Equivalent Long Term Credit Rating as at 30th June 2019 (£48.6m)





APPENDIX 3
Average rate of return on investments for 2019/20

	April %	May %	June %	Average for Period
Average rate of interest earned	0.83%	1.01%	1.01%	0.95%
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.62%	0.62%	0.62%	0.62%
Performance against Benchmark %	+0.21%	+0.39%	+0.39%	+0.33%

APPENDIX 4
Council's External Borrowing at 30th June 2019

BORROWING	Amount (£)	Start	Maturity Date	Interest Rate
LONG TERM				
PWLB	10,000,000	15/10/04	15/10/34	4.75%
PWLB	5,000,000	12/05/10	15/08/35	4.55%
PWLB	5,000,000	12/05/10	15/02/60	4.53%
PWLB	5,000,000	05/08/11	15/02/31	4.86%
PWLB	10,000,000	05/08/11	15/08/29	4.80%
PWLB	15,000,000	05/08/11	15/02/61	4.96%
PWLB	5,300,000	29/01/15	08/04/34	2.62%
PWLB	5,000,000	29/01/15	08/10/64	2.92%
PWLB	18,171,857	20/06/16	20/06/41	2.36%
PWLB	9,302,947	24/02/17	16/02/40	2.28%
PWLB	9,390,197	04/04/17	16/02/43	2.26%
PWLB	7,981,019	08/05/17	15/02/42	2.25%
PWLB	6,860,955	10/08/17	10/04/67	2.64%
PWLB	9,550,430	13/12/17	10/10/42	2.35%
PWLB	9,560,139	06/03/18	10/10/42	2.52%
PWLB	9,853,265	10/09/18	20/07/43	2.42%
PWLB	9,663,545	06/03/18	10/10/47	2.62%
PWLB	9,703,206	06/12/18	20/06/43	2.38%
PWLB	9,900,534	12/12/18	20/06/68	2.59%
PWLB	4,849,066	13/12/18	20/06/43	2.25%
PWLB	20,000,000	11/02/19	20/07/68	2.52%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
Eurohypo Bank*	10,000,000	27/04/05	27/04/55	4.50%
Sub Total - Long Term	**215,087,159**			
SHORT TERM				
Gloucestershire C C	5,000,000	25/11/14	19/12/19	2.05%
Gloucestershire C C	5,000,000	19/12/14	19/12/19	2.05%
Sub Total - Short Term	**10,000,000**			
Overall Total	**225,087,159**			

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals. Should the lender use the option to change the rate, then at this point the borrower has the option to repay the loan without penalty.

APPENDIX 5

Economic and market review for April to June 2019

Economic background: UK Consumer Price Inflation (CPI) for June 2019 was 2.0% year/year, coming in at consensus and meeting the Bank of England's inflation target. The most recent labour market data for the three months to May 2019 showed the unemployment rate remain at a low of 3.8% while the employment rate of 76.0% dipped by 0.1%, the first quarterly decrease since June to August 2018. The 3-month average annual growth rate for pay excluding bonuses was 3.6% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.7%.

There was a rise in quarterly GDP growth in the first calendar quarter for 2019 to 0.5%, from 0.2% in Q4 2018 with stockpiling ahead of the (now delayed) 29th March Brexit distorting data. Production and construction registered positive output and growth, however at the end of June 2019, seasonally adjusted Markit UK Construction PMI (Purchasing Manager's Index) logged a record-low figure of 43.1, suggesting that construction has suffered a largest contraction in output since April 2009. GDP growth was 1.8% year/year, however with the service sector slowing and a weaker global backdrop the outlook was for subdued growth.

Politics has been a big driver over the last quarter. The 29th March Brexit deadline was extended to 12th April and then to 31st October 2019: there is still no clear consensus as to the terms on which the UK will leave the EU. Theresa May announced her resignation as Prime Minister and leader of the Conservative Party in May and the leadership contest for her successor is ongoing with Boris Johnson the current favourite.
The struggling British high street has continued to dominate headlines with the Arcadia group being saved from collapse in June following an agreement for rent reductions from landlords. The car industry has also struggled in the UK and beyond with announcements of cuts to 12,000 jobs across Europe by Ford.

With the deterioration in the wider economic environment, compounded by Brexit-related uncertainty and the risk of a no-deal Brexit still alive, the speech by Bank of England Governor Mark Carney in early July signalled a major shift to the Bank's rhetoric and increased the possibility of interest rate cuts, rather the Bank's erstwhile 'gradual and limited' rate hike guidance.

Globally, tensions between the US and China became progressively more fraught with US President Donald Trump threatening to more than double tariffs on some Chinese goods. There were also moves in both the US and UK to block or restrict access to markets by Chinese telecoms giant Huawei. Amid low inflation and a weak economy in the Eurozone Mario Draghi signalled in late June that another round of stimulus (QE) may be likely. The US and EU have also carved the path for interest rates to be cut in the future.
Financial markets: 2018 was a year to forget in terms of performance of riskier asset classes, most notably equities. However, since the beginning of 2019 markets have rallied, and the FTSE 100 is up over 10% in pure price terms for the first 6 months of the calendar year. Nearly all of these gains were realised in the last quarter of FY 2018/19, as Q1 2019/20 has only seen a modest increase of around 2%.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. Gilt yields fell - the 5-year benchmark gilt yield falling to 0.63% at the end of June from 0.75% at the start of April.

There were falls in the 10-year and 20-year gilts over the same period dropping from 1.00% to 0.83% and from 1.47% to 1.35% respectively. Money markets rates stabilised with 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.60%, 0.68% and 0.92% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. The US yield curve inverted (10-year Treasury yields were lower than US 3-month money market rates) in March 2019 and this relationship remained and broadened throughout the period. History has shown that a recession hasn't been far behind a yield curve inversion. Germany sold 10-year Bunds at -0.24% in June, the lowest yield on record. Bund yields had been trading at record lows in the secondary market for some time, however the negative yield in the primary market suggests that if investors were to hold until maturity, they are guaranteed to sustain a loss - highlighting the uncertain outlook for Europe's economy.

Credit background: Credit Default Swap (CDS) spreads fell slightly across the board during the quarter, continuing to remain low in historical terms. After hitting around 97bps at the start of the period, the spread on non-ringfenced bank NatWest Markets plc fell back to around 82bps at the end of June, while for the ringfenced entity, National Westminster Bank plc, the spread fell from 67bps to 58bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 28 and 59bps at the end of the period.

S&P upgraded RBS Group and its subsidiaries, including National Westminster Bank PLC, Natwest Markets PLC, The Royal Bank of Scotland and Ulster Bank Ltd. S&P raised the long-term issuer ratings by one notch due to RBS Group's strengthened credit fundamentals following a long period of restructuring. S&P believes the group and its subsidiaries have enhanced their capacity to manage the current UK political and economic uncertainties.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Barclays Bank PLC to positive from stable to reflect the bank's progress in its restructuring plans, including de-risking the balance sheet, improving its risk profile and profitability and resolving litigation issues in the US. Moody's also revised the outlook to stable from negative for Goldman Sachs International Bank, reflecting a slowdown in loan growth as well as a stronger revenue growth for sales and trading.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2019/20 (April to June 2019)

April 2019 to March 2020	YEAR END POSITION Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	ADV/FAV
Interest & Capital Financing				
- Debt Costs	9,106	9,106	0	
- Internal Repayment of Loan Charges	(11,271)	(11,271)	0	
- Ex Avon Debt Costs	1,100	1,100	0	
- Minimum Revenue Provision (MRP)	8,403	8,403	0	
- Interest on Balances	(620)	(620)	0	
Total	**6,718**	**6,718**	**0**	

APPENDIX 7

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicates an issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.