Bath & North East Somerset Council		
MEETING	**Cabinet**	
MEETING DATE:	**7th November 2019**	EXECUTIVE FORWARD PLAN REFERENCE: E 3158
TITLE:	**Treasury Management Performance Report to 30th September 2019**	
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 September 2019
Appendix 3 – Average monthly rate of return for 1st 6 months of 2019/20
Appendix 4 – The Council's External Borrowing Position at 30th September 2019
Appendix 5 – Arlingclose's Economic & Market Review Q2 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 for the first six months of 2019/20.

2 RECOMMENDATION

The Cabinet agrees that;

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

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

2.3 This Treasury Management Report and attached appendices are reported to November 2019 Council and Corporate Audit Committee.

3 THE REPORT

Summary

3.1 The average rate of investment return for the first six months of 2019/20 is 0.99%, which is 0.37% 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 September 2019 is given in **Appendix 2**. The balance of deposits as at 30th September 2019, compared to those as at 30th June 2019, are also set out in the pie charts in this appendix.

3.4 Gross interest earned on investments totalled £281k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.99%, which was 0.37% above the benchmark rate of average 7 day LIBID +0.05% (0.62%). This excess is mainly due to the £5m investment held in the CCLA Local Authority 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 September 2019 totalled £234.4 million and is detailed in **Appendix 4**. This includes additional PWLB borrowing of £10 million that was taken out on 4th September 2019 following reductions in PWLB borrowing rates.

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 between that and the current borrowing of £234.4 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 September 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, an additional £2 million investment was placed with the CCLA Local Authority's Property Fund as part of this investment approach, bringing the total investments of this type to £5 million. This 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 of £61.2 million as at 30th September 2019 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.

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's average investment return is currently slightly below the budgeted level of 1.20%, although the impact of this is offset by the Council investment balances being higher than forecast.

Future Strategic & Tactical Issues

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

3.15 The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

3.16 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.

3.17 Any additional borrowing to take place in 2019/20 will therefore be balanced between a need to maintain an appropriate working cash balance and taking advantage of favourable movements in long term borrowing rates.

PWLB Borrowing Rate Increase

3.18 On 9th October 2019, the PWLB increased the margin applied to loan rates by 100 basis points (1%) without warning; the new margin above gilts is now 180 basis points for certainty rate loans. This shift in policy was implemented by HM Treasury, who cite a substantial increase in the use of PWLB loans at some authorities in recent months, as the cost of borrowing has fallen to record lows, and state that HM Treasury is therefore restoring interest rates to levels available in 2018, by increasing the margin that applies to new loans from the PWLB by 100bps (one percentage point) on top of usual lending terms.

3.19 In line with the Council's Treasury Management advisor's advice, the Council will continue to consider borrowing rates offered by alternative lenders, including other Local Authorities, alongside PWLB rates in order to minimise, where possible, its costs of borrowing.

Budget Implications

3.20 A breakdown of the revenue budget showing interest and capital financing and the forecast year end position based on the period April to September is included in **Appendix 6**. An overall underspend of £2.186m is currently forecast, mainly related to the re-phasing of capital spend and the reduction in PWLB interest rates leading to lower than forecast borrowing costs and minimum revenue provision (MRP) requirement. This is partly offset by lower internal income related to service charges for funding debt costs in relation to the re-phased capital projects.

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 The Council will continue to review its investments to minimise direct investment in fossil fuel related companies.

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 September 2019
	£'000	£'000
Borrowing	440,000	234,366
Other long term liabilities	2,000	0
Cumulative Total	**442,000**	**234.366**

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 September 2019
	£'000	£'000
Borrowing	409,000	234,366
Other long term liabilities	2,000	0
Cumulative Total	**411,000**	**234,366**

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 September 2019
	£'000	£'000
Fixed interest rate exposure	**409,000**	**214,366***

* 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 September 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 September 2019**
	£'000	£'000
Investments over 364 days	**50,000**	**5,000**

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 September 2019**
	%	%	%
Under 12 months	50	Nil	12.8*
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	4.3
10 years and above	100	Nil	82.9

* 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 September 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

The Council's Investment position at 30th September 2019

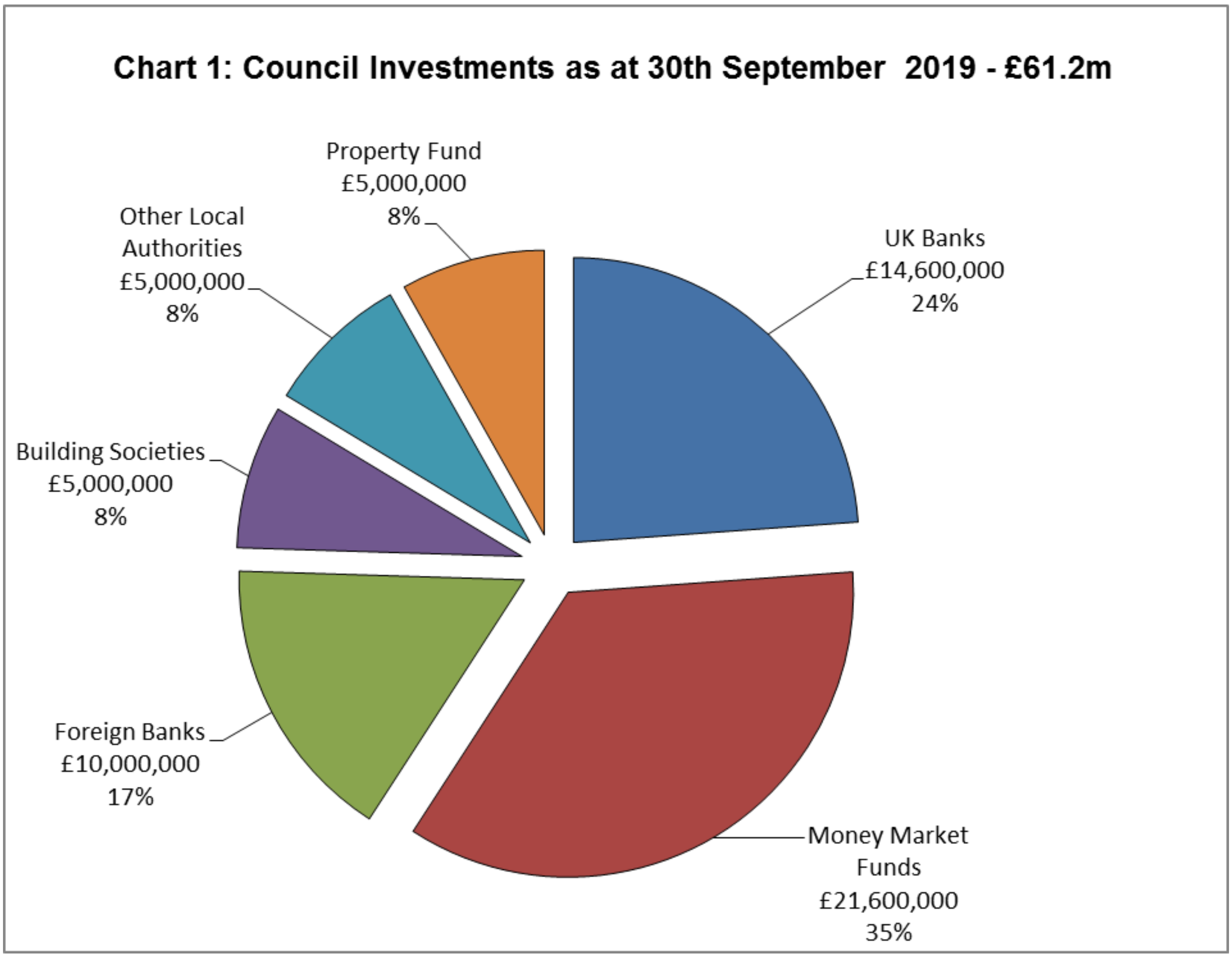
The term of investments is as follows:

Term Remaining	**Balance at 30th September 2019**
	£'000's
Notice (instant access funds)	26,200
Up to 1 month	10,000
3 month to 6 months	20,000
CCLA Property Fund (Strategic)	5,000
Total	**61,200**

The investment figure is made up as follows:

	Balance at 30th September 2019
	£'000's
B&NES Council	58,018
Schools	3,182
Total	**61,200**

The Council had a total average net positive balance of £56.6m during the period April 2019 to September 2019.



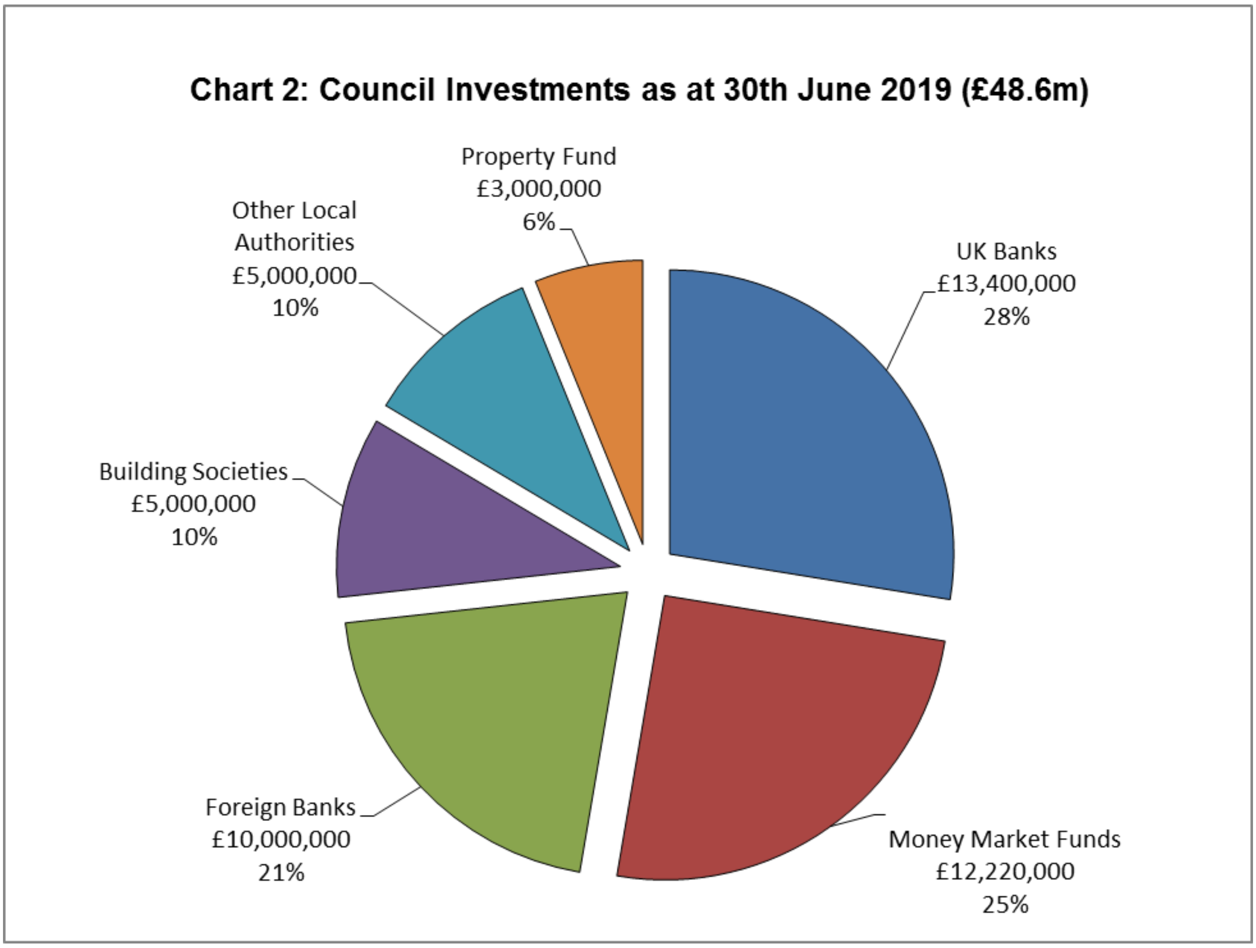


Chart 2: Council Investments as at 30th June 2019 (£48.6m)
Property Fund
£3,000,000
6%
Other Local
Authorities
£5,000,000
10%
UK Banks
£13,400,000
28%
Building Societies
£5,000,000
10%
Foreign Banks
£10,000,000
21%
Money Market Funds
£12,220,000
25%

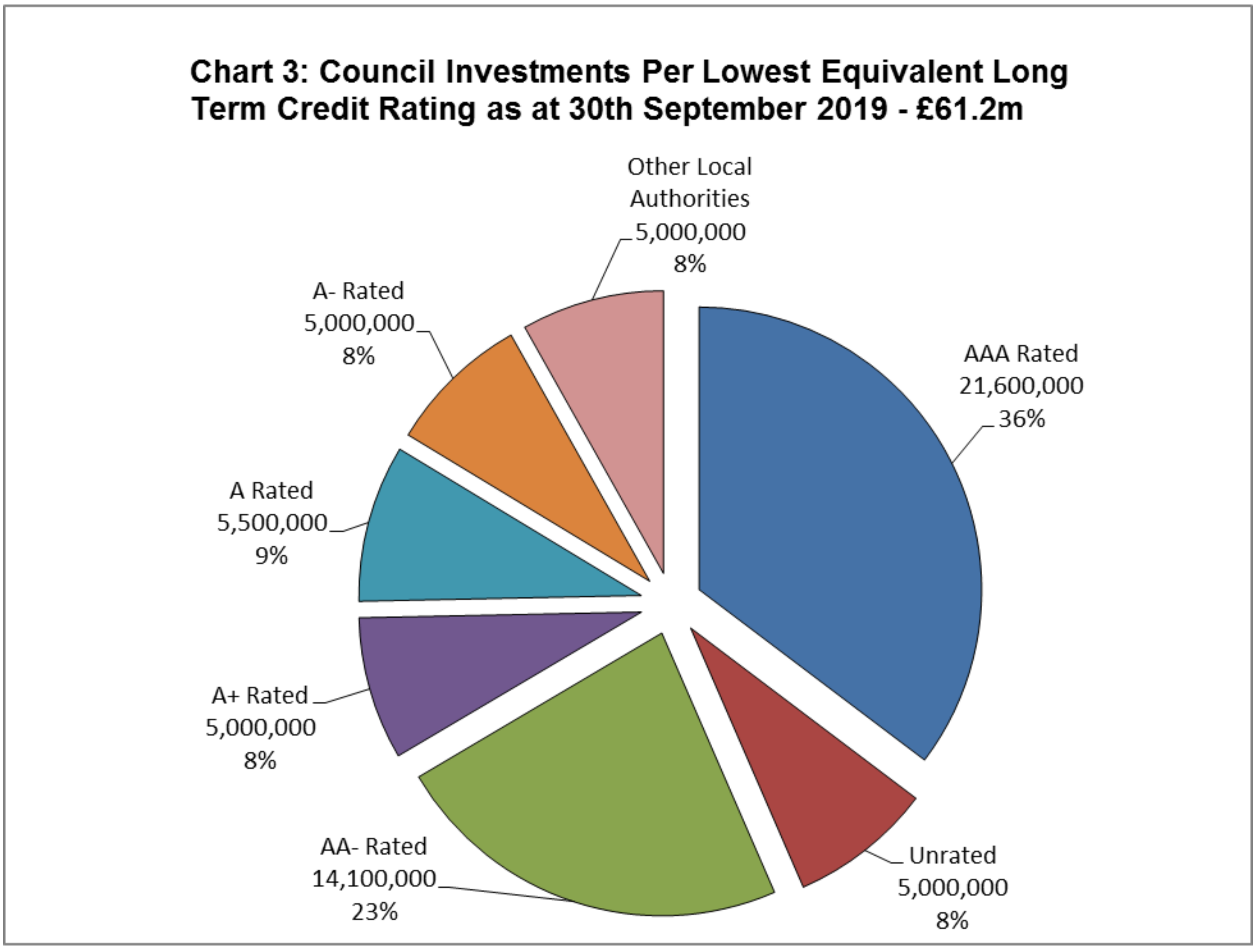
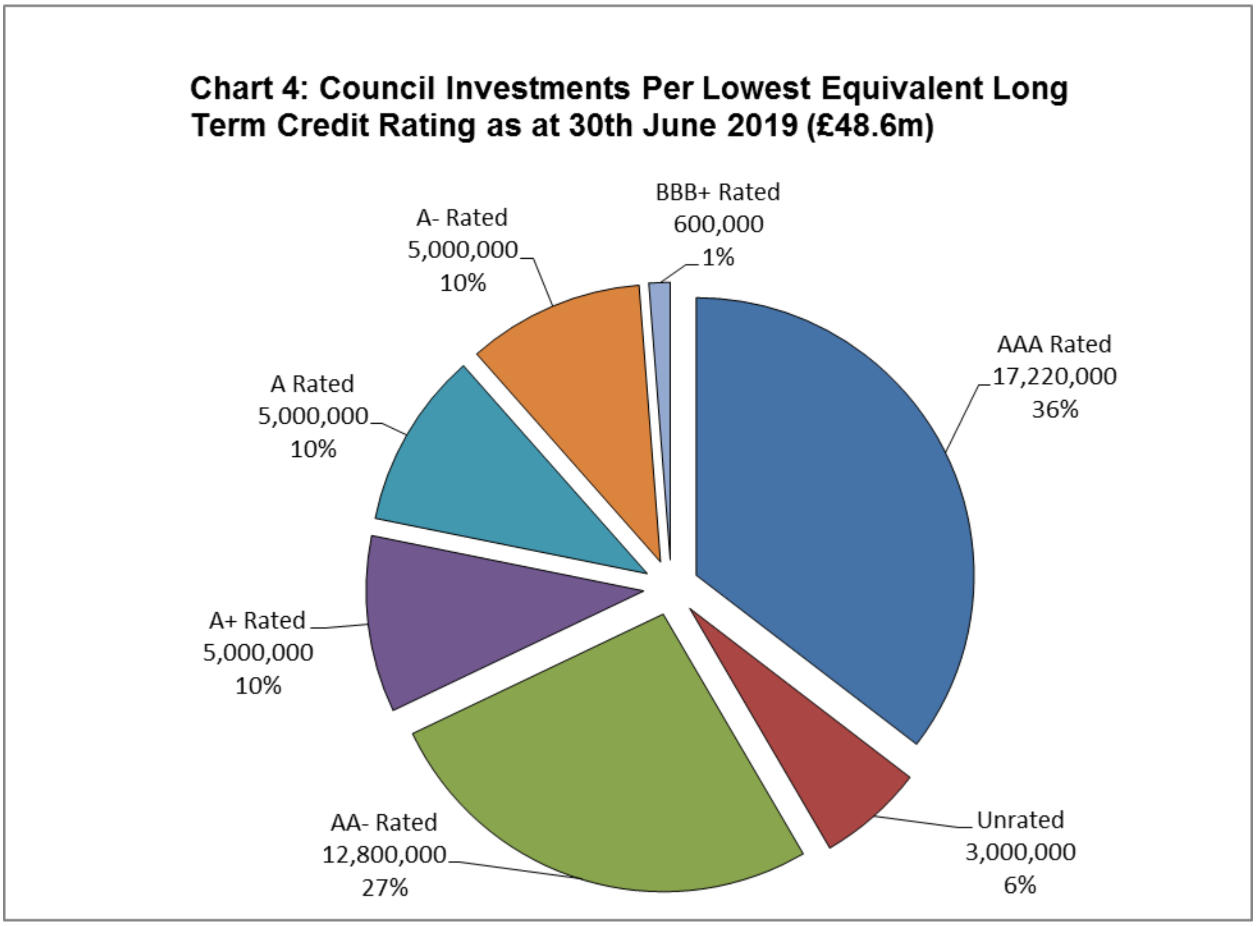


Chart 3: Council Investments Per Lowest Equivalent Long Term Credit Rating as at 30th September 2019 - £61.2m
Other Local
Authorities
5,000,000
8%
A- Rated
5,000,000
8%
AAA Rated
21,600,000
36%
A Rated
5,500,000
9%
A+ Rated
5,000,000
8%
AA- Rated
14,100,000
23%
Unrated
5,000,000
8%



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

	April %	May %	June %	July %	August %	Sept. %	Average for Period
Average rate of interest earned	0.83%	1.01%	1.02%	0.97%	1.07%	1.04%	**0.99%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.62%	0.62%	0.62%	0.61%	0.61%	0.62%	**0.62%**
Performance against Benchmark %	+0.21%	+0.39%	+0.40%	+0.36%	+0.46%	+0.42%	**+0.37%**

APPENDIX 4

Council's External Borrowing at 30th September 2019

	Amount Outstanding (£)	Start Date	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	9,123,689	24/02/17	16/02/40	2.28%
PWLB	9,233,416	04/04/17	16/02/43	2.26%
PWLB	7,847,604	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	9,704,754	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	19,897,321	11/02/19	20/07/68	2.52%
PWLB	10,000,000	04/09/19	20/07/44	1.40%
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	**224,366,515**			
SHORT TERM				
Gloucestershire C C	5,000,000	25/11/14	25/11/19	2.05%
Gloucestershire C C	5,000,000	19/12/14	19/12/19	2.05%
Sub Total - Short Term	**10,000,000**			
TOTAL BORROWING	**234,366,515**			

*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 Jul 2019 to September 2019**__

Economic background: UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

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

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

The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October.

Financial markets: After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

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

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

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2019/20

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	7,915	(1,191)	FAV
- Internal Repayment of Loan Charges	(11,271)	(9,992)	1,279	ADV
- Ex Avon Debt Costs	1,100	1,100	0	
- Minimum Revenue Provision (MRP)	8,403	6,145	(2,258)	FAV
- Interest on Balances	(620)	(636)	(16)	FAV
Total	**6,718**	**4,532**	**(2,186)**	**FAV**

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.