Cheltenham Borough Council
Council – 16th December 2019
Treasury Mid-Term Report 2019/20

Accountable member	**Cabinet Member for Finance, Councillor Rowena Hay**
Accountable officer	**Executive Director Finance and Assets (Section 151 Officer), Paul Jones**
Accountable scrutiny	**Treasury Management Panel**
Ward(s) affected	**All**
Significant Decision	**Yes**
Executive summary	The Treasury Management Strategy for 2019/20 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the council to approve treasury management semi-annual and annual reports.
Recommendations	The Treasury Management Panel considered this report on the 25th November 2019 and recommended this on to Council **:** **1. Note the contents of the summary report of the treasury management activity during the first six months of 2019/20.**

Financial implications	All financial implications are detailed throughout the report **Contact officer: Andrew Sherbourne, andrew.sherbourne@cheltenham.gov.uk, 01242 264337**
Legal implications	The Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) requires the authority to approve a Treasury Management Strategy before the start of each financial year and to keep it updated throughout the year. The report fulfils the authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code. **Contact officer: Shirin Wotherspoon, shirin.wotherspoon@tewkesbury.gov.uk, 01684 272696**
HR implications (including learning and organisational development)	None arising directly from this report **Contact officer: Julie McCarthy, julie.mccarthy@cheltenham.gov.uk. 01242 264355**

Key risks	As noted in Appendix 1
Corporate and community plan Implications	The purpose of the report is to improve corporate governance, a key objective for the Council
Environmental and climate change implications	None arising directly from this report

1. Background

1.1 In February 2011 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice (*the CIPFA Code) which requires members to approve the treasury management semi-annual and annual reports.

1.2 The Council's treasury management strategy for 2019/20 was approved at a meeting on 25th March 2019. The Council has borrowed and 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 remain central to the council's treasury management strategy.

1.3 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 25th March 2019.

2. Economic update for the first six months

2.1 UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2% 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.

2.2 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.

2.3 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 had 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.

2.4 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.

2.5 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.

3. Financial Markets

3.1 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.

3.2 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.

3.3 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%.

3.4 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-.

4. Treasury Management Summary position 1/4/2019 to 30/9/2019

4.1 On the 31st March 2019, the Council had net borrowing of £101.059m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £m
General Fund CFR	90.475
HRA CFR	44.750
Total CFR	**135.225**
Less: Usable reserves	28.712
Less: Working capital	5.454
Net borrowing	**101.059**

4.2 The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 30th September 2019 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.19 Balance £m	**Movement £m**	**30.9.19 Balance £m**	**30.9.19 Rate %**
Long-term borrowing	112.595	(0.320)	112.275	3.27
Short-term borrowing	8.00	42.000	50.000	0.68
Total borrowing	**120.595**	**41.680**	**162.275**	**2.47**
Long-term investments	7.000	-	7.000	5.41
Short-term investments	9.325	(2.000)	7.325	1.46
Cash and cash equivalents	2.745	6.347	9.092	0.70
Icelandic	0.466	(0.041)	0.425	-
Total investments	**19.536**	**4.306**	**23.842**	**2.33**
Net borrowing	**101.059**	**37.374**	**138.433**	

4.3 The Council's current strategy has been to fund a £39m capital asset purchase made in August 2019 with the use of temporary borrowing and then either take long term borrowing or use future capital receipts to repay it. Currently interest rates for this borrowing are around 0.70% which is much cheaper than fixing it to a long term loan. The Treasury in October 2019 increased PWLB Loan rates by 1% by giving officers one hour notice.

4.4 As at 31st March 2019 the Council held loans of £120.595m but has significantly borrowed more as mentioned in paragraph 4.3, taking the balance to £162.275m as at 30th September 2019. The weighted average interest rate on these loans is 2.47% down from 3.11% in March 2019. Borrowing costs are expected to be in line with the budget at the end of the 2019/20 financial year. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.19 Balance £m	2019/20 Movement £m	30.9.19 Balance £m	30.9.19 Rate %
Public Works Loan Board	96.695	(0.320)	96.375	3.15
Banks (LOBO)	7.000	0	7.000	4.24
Banks (fixed-term)	8.900	0	8.900	3.82
Local authorities (short-term)	8.000	42.000	50.000	0.70
Total borrowing	**120.595**	**41.680**	**162.275**	**2.47**

5. Investments

5.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six month period the council's investment balance ranged between £16.799m and £30.461m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.19 Balance £m	Net Movement £m	30.9.19 Balance £m	30.9.19 Rate of Return %
Banks & Building Societies (unsecured)	6.000	-	6.000	1.00
Local Authorities	3.000	(2.000)	1.000	1.00
Money Market Funds/ Call Accounts	2.745	5.256	8.001	0.69
CCLA Property Fund	3.000	-	3.000	4.00
Schroders Maximiser Fund	2.000	-	2.000	9.05
CCLA Diversified Income Fund	2.000	-	2.000	3.88
Gloucestershire Airport Loan	0.325	-	0.325	3.75
Total Investments	**19.070**	**3.256**	**22.326**	**2.33**

5.2 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 optimum rate of return, or yield. All investments made to date in this financial year have been in line with the approved lending list set in February 2019.

5.3 In February 2019 the Council's Investment income for 2019/20 was budgeted to be £471,909. The average cash balances representing the council's reserves and working balances, was £22.303m during the period this report covers. The Council anticipates an investment outturn of £500,000 at a rate of return of 2.33% for this financial year. Estimated surplus for investment income is £28.091k for the financial year.

5.4 Table 5 below shows the current valuations of the Pooled Funds portfolio at the end of September 2019 compared with the opening balances of 2019/20. These investments were made with the intention to hold them for a minimum of five years and the capital value can fluctuate from one year to another.

Table 5: Pooled Funds

FUND NAME	Initial Investment	1 April Fund Value	30th Sept Fund Value	Dividends paid out in 2019/20 as at 30 Sept	Gain / (Loss) for 2019/20	Gain / (Loss) to Initial Principal
	£	£	£	£	£	£
CCLA Property Fund	3,000,000	2,877,602	2,850,727	62,825	(26,875)	(149,273)
Schroders Income Maximiser Fund	2,000,000	1,774,692	1,641,035	92,033	(133,657)	(358,965)
CCLA Diversified Income Fund	2,000,000	2,003,727	2,071,711	34,720	67,984	71,711
Total	**7,000,000**	**6,656,021**	**6,563,473**	**189,578**	**(92,548)**	**(436,527)**

5.5 Net loans and investments are estimated to be in line with the budget come the end of 2019/20 financial year.

5.6 The Housing Revenue Account (HRA) has kept its revenue reserves and balances close to what was estimated for 2019/20 budget and is expected to come in on budget for interest payable on these.

6. Outlook for the remainder of 2019/20

6.1 The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased dramatically.

6.2 There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance.

6.3 The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out and the risk of this event remains for 2020. The upcoming general election may change the political landscape too.

6.4 Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

6.5 Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will continue to offer longer-term borrowing

Table 6: Interest rate forecast

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Cas	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

6.1 Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the first six months complied fully with the CIPFA Code of Practice and the Authority’s approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Table 7: Debt Limits

	30.9.18 Actual £m	**2019/20 Operational Boundary**	**2018/19 Authorised Limit**	**Complied? Yes/No**
Borrowing	162.275	288.00	298.00	Yes
Total debt	**162.275**	***288.00***	**298.00**	

Council approved on 14th October 2019 the authorised borrowing limit and operational boundary limit are increased to the new levels as shown above in table 7.

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

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Appendices	Risk Assessment – Appendix 1
Background information	Treasury Management Strategy, Council 14th October 2019