APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2019/20

1. INTRODUCTION AND BACKGROUND

The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2009 was adopted by this Council in February 2010 and this Council fully com/plies with its requirements. The Code was revised in 2011 and further revised in 2017.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the Council of an annual treasury management strategy report (including the annual investment strategy report) for the year ahead, a mid year review and an annual review report of the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions, which in this Council is the Chief Officer Resources.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specified named body which in this Council is the Corporate Overview Scrutiny Committee.

Treasury management in this context is defined as:

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the mid-year review report of treasury management activities, for the financial year 2019/20.

2. THIS TREASURY MANAGEMENT MID YEAR REVIEW REPORT COVERS

- Economic Background during the period
- Interest Rate Forecast
- Treasury Advisors
- The Council's treasury position as at 30 September 2019;
- Borrowing and investment rates for the first half of 2019/20;
- Mid-year review of the borrowing strategy 2019/20;
- Borrowing outturn for the first half of 2019/20;
- Debt rescheduling for the first half of 2019/20;

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2019/20

- Compliance with treasury limits and Prudential Indicators for the first half of 2019/20;
- Mid-year review of the investment strategy for 2019/20;
- Investment outturn for the first half of 2019/20;
- Other treasury management issues.

3. ECONOMIC BACKGROUND DURING PERIOD

The first half of 2019/20 has seen UK **economic growth** fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

With regard to the **labour market** employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

In the **political arena**, if there is a general election soon, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

4. INTEREST RATE FORECASTS

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit at some point in time. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.
It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 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.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2019/20

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor, though more recently concerns have arisen over her health.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Italy, Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status.
- **Geopolitical risks,** for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

5. TREASURY ADVISORS

The Council uses external treasury management advisors. The Council recognises that responsibility for Treasury Management decisions remains with the Authority at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The Council retendered for the provision of Treasury Management advisory services as a result of the existing contract expiring on 30th April 2017. This resulted in the appointment of Link Asset Services for a period of two years until 20th April 2019, with an option to extend for a further two years, this option has been exercised by the Chief Officer Resources and Link have been appointed to the 30th April 2021.

6. TREASURY POSITION AS AT 30 SEPTEMBER 2019

The Council's debt and investment position at the beginning of the year and the end of the half year was as follows:

This illustrates that the total debt outstanding as at 30 September 2019 was £160.3 million, comprising of long term debt of £108.7 million and short term debt of £51.6 million.

	31March 2019 Principal	Average Rate/ Return	30Sept 2019 Principal	Average Rate/ Return	Increase/ (Decrease) in Borrowing

Cyngor Bwrdeistref Sirol Blaenau Gwent County Borough Council

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2019/20

	£000		£000		£000
Fixed Rate Funding:					
- PWLB	72,700	4.64%	82,700	4.72%	10,000
- Market Loans	19,000	2.05%	22,000	0.69%	3,000
Variable Rate Funding:					
- Market (LOBO *)	4,000	4.50%	4,000	4.50%	0
Total Long Term Debt	***95,700***	***4.19%***	***108,700***	***3.89%***	***13,000***
Short Term Loans(<365 days)	61,649	0.90%	51,649	0.85%	(10,000)
Total Debt	***157,349***	***2.85%***	***160,349***		***3,000***
Investments:					
- Short Term	4,000		4,000		
Total Investments	***4,000***		***4,000***		

** LOBO – Lenders Option Borrowers Option. This loan has a fixed rate for the first two years of 3.85%. The remaining period of the loan (which we are now in) has a rate of 4.5%, but the lender can increase this rate at six month intervals.*

7. BORROWING AND INVESTMENT RATES IN 2019/20

The following table displays a selection of interest rates prevailing as at 1st April 2019 and 30th September 2019.

	1/4/2019	30/09/2019
Bank Base Rate	0.75%	0.75%
7 day LIBID	0.57%	0.57%
PWLB 10 year Maturity	2.05%	1.47% *
PWLB 15 year maturity	2.37%	1.78% *
PWLB 25 year maturity	2.60%	2.03% *

***Please note – HM Treasury on the 9th October added a 1% margin to these rates**

8. MID YEAR REVIEW OF THE BORROWING STRATEGY FOR 2019/20

The Treasury Management Strategy Statement for 2019/20 was approved by Council in March 2019. The Borrowing Strategy adopted as part of this was as follows:

To utilise the Authority's overdraft facility:

To fund unexpected daily cash deficits;
To fund temporary cash shortfalls where there are no other sources of funding available within the marketplace.

To borrow over the short term:
To fund temporary cash shortfalls;
To maintain a suitably balanced maturity profile; to make short term savings required in order to meet budgetary constraints;
In anticipation of securing longer term loans at more attractive rates.

To borrow over the long term:
To reduce the Authority's average cost of borrowing;
To maintain a stable, longer term portfolio;
To maximise the potential for future debt rescheduling.

If appropriate to avoid all new external borrowing:
To maximise savings in the short term;
To run down temporary investment levels;
To minimise exposure to interest rate and credit risk.

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer term stability of the debt portfolio. With short term interest rates generally much lower than long term rates, it can be cost effective in the short term to either use internal resources, or to borrow short term loans instead.

However, due to uncertainty surrounding Brexit and the PWLB rates reducing to record lows, the Authority has been able to borrow in recent months into the longer term at affordable rates. This has allowed the Authority to be able to reduce long term borrowing costs and reduce overall treasury risk. The benefits of short term borrowing will be monitored regularly against the potential for securing advantageous longer term rates when the opportunity arises.

Borrowings undertaken during the period (see section 9 below) have been done so in accordance with this strategy and in the current economic climate it is considered that the approved strategy is still fit for purpose and therefore no revisions are proposed.

9. BORROWING OUTTURN FOR THE FIRST HALF OF 2019/20

Long Term Borrowing

Definition

Long term borrowing relates to debt taken out for a period of greater than one year. It is taken out for periods of 1 year up to 50 years. This borrowing is required to finance capital expenditure undertaken in the year that is funded through:

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2019/20

- Borrowing approvals from Welsh Government, known as un-hypothecated supported borrowing (USB), for which revenue support for the borrowing costs is provided through the revenue support grant;
- Prudential borrowing, for which borrowing costs are funded through revenue savings.

Total outstanding as at 30th September 2019

The total long term debt outstanding as at 30th September 2019 was £108.7 million. This is made up of debt taken from the Public Works Loan Board (PWLB), from other local authorities (through the market place), and from the market (LOBO). This debt is due to be repaid within the following years:

Maturing Within	**£000s**
1YR	11,269
1-2YRS	8,665
2-3YRS	5,697
3-4YRS	7,919
4-5YRS	2,764
5-6YRS	14,051
6-10YRS	17,722
10-15YRS	13,555
15+ YRS	27,054
Total	**108,700**

New borrowings for the First Half of 2019/20

Due to advantageous interest rates, during the first half of 2019/20, the Authority entered into long term borrowing arrangements of £ 13 million.

Short Term Borrowing

Definition

Short term borrowing relates to debt taken out for a period of less than one year i.e. it will all be fully repaid within a year. These short term loans are taken out to manage the Authority's short term cash flow i.e. to fund deficits in cash flow on a daily basis pending receipt of income from grants or other sources, or pending the taking out of longer term debt to fund capital expenditure whilst we wait for advantageous longer term borrowing opportunities. Current short term borrowing rates are very low and are forecast to stay at these levels for the medium term. The Authority is therefore taking advantage of such rates and is borrowing short term to fund its capital expenditure and maturing debt until such time the market indicates that long term rates are more advantageous.

Total outstanding as at 30th September 2019

The total short term debt outstanding as at 30th September 2019 was £51.6 million. This is made up of debt taken from other local authorities through the market place.

New borrowings for the First Half Year of 2019/20

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2019/20

Appendix A lists the short term loan activity during for the first half year and shows that over the period a total of £61.6 million loans were brought forward from the previous year and £56.5 million of new short term loans were raised. A total of £66.5 million of these loans were repaid during the first half year, leaving a balance outstanding as at 30th September of £51.6 million.

The following table gives a summary which shows that the average rate of interest paid was in line with the benchmark.

	Total Value of Loans during the period	Average Loan	Interest paid during the period	Average Interest Rate	Benchmark Interest Rate *
Short Term borrowing	£118M	£2.31M	£259K	0.85%	1.00%

** Benchmark = 1.0% Budgeted interest rate for short term borrowings*

7. DEBT RESCHEDULING

No debt rescheduling was undertaken during the period.

8. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operates within the treasury limits and Prudential Indicators set out in the Treasury Strategy Statement 2019/20, approved by Council in March 2019.

Operational Boundary for external debt
The Council resolved that this limit be set at £155 million for 2019/20 .The average level of borrowings to the 30th September was £156 million, marginally above the limit set.

The operational boundary can be exceeded on an occasional basis, and this is to be expected due to cash flow fluctuations. Sustained breaches however, would indicate that either the limit has been set too low, or that the Authority is breaching its prudential boundaries and that corrective action needs to be taken.

Monitoring of the operational boundary is undertaken on a daily basis and any such continual breaches would be investigated and a recommended course of action reported to Council.

Authorised Limit for external Debt
The Council resolved that this limit be set at £171 million for 2019/20. The Authorised Limit is set having regard to the operational boundary above.

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2019/20

The average level of borrowings for the first half year to the 30th September was £156 million, so well within the limit set.

The Authorised Limit must not be breached.

Maturity Structure of Fixed Rate Borrowing

The Council resolved the following limits for the maturity structure of fixed rate borrowings for 2019/20;

	Upper Limit	Lower Limit	Actual as at 30/09/ 2019
under 12 months	20%	0%	10.37%
12 months and within 24 months	20%	0%	7.97%
24 months and within 5 years	50%	0%	15.07%
5 years and within 10 years	75%	0%	29.23%
10 years and above	95%	25%	37.36%

The actual debt maturity profile at 30th September 2019 is well within the limits set.

Upper Limit on Variable Interest Exposure

Council resolved the upper limit on variable rate exposures for 2019/20 should be set at 30% of outstanding long term debt. This strategy limits the proportion of interest which is subject to variable rate terms and hence protects the Council against increased costs in times of rising interest rates.
The actual level of variable borrowings is £4 million (LOBO) which equates to 3.7% of the outstanding long term debt as at 30th September 2019, so is well within the limit set.

9. MID YEAR REVIEW OF INVESTMENT STRATEGY FOR 2019/20

The Annual Investment Strategy for 2019/20 adopted by Council in March 2019 was to maintain only temporary, short term investments and to make those investments in accordance with anticipated cash flow requirements (including the investing of sums borrowed at prevailing low interest rates in anticipation of capital spending). The Council's investment priorities are:

a. the security of capital;
b. The liquidity of its investments.

The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to the security of its investments.

In order to ensure that the Authority's investments are secure and that risk is minimised an investment matrix is used to determine investment counterparties, which factors in Fitch and Moody's credit ratings, credit default swap (CDS) spread data, and credit rating agency comments.

APPENDIX 1

TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2019/20

Currently, the only approved investment counterparties available to the Authority are Barclays, the Authority's bank, the Debt Management Account Deposit Facility (DMADF) and other local Authorities. Whilst interest rates receivable on these counterparties is low security of the capital sum is high.

This strategy has been adhered to in determining the investments for the first half of 2019/20 outlined in section 11 below.

10. INVESTMENT OUTTURN FOR THE FIRST HALF OF 2019/20

Appendix B gives details of the investments made during the first half of the year, and the following table gives a summary, which shows the Authority's average rate of return was below the benchmark.

	Total Value of Investments during period	Average Investment	Investment Returns	Average Rate of Return	Benchmark Return *
Internally Managed	£170M	£2.7M	£35k	0.55%	0.57%

** Benchmark = 7 day LIBID 0.57%*

No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

11. OTHER TREASURY MANAGEMENT ISSUES

None to report