Treasury Management Update

Quarter Ended 31 December 2019

This report is intended for the use and assistance of customers of Link Asset Services. It should not be regarded as a substitute for the exercise by the recipient of its own judgement. Link Asset Services exists to provide its clients with advice primarily on borrowing and investment. We are not legal experts and we have not obtained legal advice in giving our opinions and interpretations in this paper. Clients are advised to seek expert legal advice before taking action as a result of any advice given in this paper. Whilst Link Asset Services makes every effort to ensure that all information provided by it is accurate and complete, it does not guarantee the correctness or the due receipt of such information and will not be held responsible for any errors therein or omissions arising there from. Furthermore, Link Asset Services shall not be held liable in contract, tort or otherwise for any loss or damage (whether direct, or indirect or consequential) resulting from negligence, delay or failure on the part of Link Asset Services or its officers, employees or agents in procuring, presenting, communicating or otherwise providing information or advice whether sustained by Link Asset Services customer or any third party directly or indirectly making use of such information or advice, including but not limited to any loss or damage resulting as a consequence of inaccuracy or errors in such information or advice. All information supplied by Link Asset Services should only be used as a factor to assist in the making of a business decision and should not be used as a sole basis for any decision.

Link Asset Services is a trading name of Link Treasury Services Limited (registered in England and Wales No. 2652033). Link Treasury Services Limited is authorised and regulated by the Financial Conduct Authority only for conducting advisory and arranging activities in the UK as part of its Treasury Management Service, FCA register number 150403. Registered office: 6th Floor, 65 Gresham Street, London, EC2V 7NQ.

Contents

Treasury Management Update 3
1. Economic Background 3
2. Interest Rate Forecast..5
3. Annual Investment Strategy..7
4. New Borrowing..12
5. Debt Rescheduling 14
6. Compliance with Treasury and Prudential Limits 14
APPENDIX 1: Prudential and Treasury Indicators for 2019-20 as at 31 December 2019 15

Treasury Management Update

Quarter Ended 31 December 2019

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (annual, mid-year or quarterly reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1. Economic Background

UK. Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 back up to +0.4% and quarter 4 expected to come in around zero. Political and Brexit uncertainty have dampened growth in 2019.

Despite political uncertainty ending with a decisive overall majority for the Conservative government in the December general election which clears the way for the UK to leave the EU on 31 January 2020, we still have much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020.

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until these remaining uncertainties over the likely type of Brexit become clear. If there was a no deal exit, it is likely that Bank Rate would be cut in order to support growth. However, if growth was to flag significantly in any event, the MPC could also cut Bank Rate in 2020. The Government has announced some major spending increases and is expected to make further commitments in the spring budget; these will provide some support to growth and will take some pressure off the MPC to act to stimulate growth by either cutting Bank Rate or implementing other monetary policy measures.

The MPC did have some concerns over the trend in wage inflation, which was on a rising trend, and peaked at a new post financial crisis high of 3.9% in June. Since then, however, it has been falling steadily back to 3.5% in October, (3 month average figure, excluding bonuses). Growth in employment picked up again to 24,000 in the three months to October, after a fall in the previous month's figures. However, this is still well below the 2018 average, although the unemployment rate remained at 3.8 percent, its lowest rate since 1975.

As for **CPI inflation** itself, this fell to 1.5% in October and November and is likely to remain between 1.5% and 2% over the next two years. If there was a no deal Brexit though, it could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

The strong wage inflation figure and the fall in CPI inflation is good news for **consumers** as their spending power is improving in this scenario as the difference between the two figures is now around 2.0%, i.e. a real term increase. Given 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.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the rate of growth to 2.9% for 2018, just below his target of 3%. Growth in quarter 1 of 2019 was a strong 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarter 3. The strong growth in employment numbers during 2018 has subsided into a weaker trend of growth during 2019, indicating that the economy is cooling, while inflationary pressures have also been weakening. After the Fed increased rates by 0.25% in December 2018 to between 2.25% and 2.50%, it has taken decisive action to reverse monetary policy by cutting rates by 0.25% in each of July, September and October in order to counter the downturn in the outlook for US and world growth. The Fed is now likely to pause to see how the economy responds during 2020.

EUROZONE. The annual rate of growth has been steadily falling, from 1.8% in 2018 to only 1.1% y/y in quarter 3 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of Targeted Long-term Refinancing Operations (TLTROs); this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and unsurprisingly, the ECB stated that governments will need to help stimulate growth by fiscal policy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. The trade war with the US does not currently appear to be having a particularly significant impact on growth. Major progress still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

JAPAN. has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. The trade war between the US and China on tariffs is a major concern to financial markets and is depressing worldwide growth, as any downturn in China will spill over into impacting countries supplying raw materials to China. Concerns are focused on the

synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during the first ten months of 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been weak which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during 2020 is expected to be weak.

2. Interest Rate Forecast

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

Link Asset Services Interest Rate View	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	3.10	3.10	3.20	3.20	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.80	3.80	3.90	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.80

After the August 2018 increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the MPC has put any further action on hold, probably until such time as the fog of Brexit might clear. While the general election in December 2019 has provided political certainty leading to implementation of the UK leaving the EU on 31.1.20, there is still much uncertainty on what sort of trade deal may be agreed by the end of 2020 and its likely impact on the UK economy. ***The above forecast, and other comments in this report, are based on a central assumption that there will be some form of muddle through agreement on a reasonable form of Brexit trade deal.*** Bank Rate forecasts will have to change if this assumption does not materialise e.g. a no deal Brexit could prompt the MPC to do an immediate cut of Bank Rate. All other forecasts for investment and borrowing rates would also have to change.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

BOND YIELDS / PWLB RATES. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very 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. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen over the last year, many bond yields up to 10 years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 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 record high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

During the first 10 months of 2019 we therefore saw a sharp fall in longer term PWLB rates to completely unprecedented historic low levels - until the Treasury unexpectedly added 1% to all PWLB rates from 9th October 2019. Since then, those fears have partially subsided and gilt yields and PWLB rates have been rising. The potential danger that may be lurking in investor minds is that Japan has become mired in a 20 year malaise of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that many major western economies could be heading into a similar scenario.

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 which now makes it harder for economies 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.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2019/20, which includes the Annual Investment Strategy, was approved by the Council on 7th February 2019. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in higher periods up to 24 months.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31 December 2019. However, the Council's current account did exceed the £5M maximum limit on 15 October by £400K for two days. This occurred as the Housing Subsidy payment received from DWP was £1.1M higher than expected. The increased amount was in respect of the Subsidy being adjusted to reflect figures supplied in the NNDR3 claim. Officers will ensure that this annual change to the Housing Subsidy will in future be identified as early as possible and included in cashflow forecasts. (The adjusted Housing Subsidy payment could be an increase or a decrease). The £5M limit was also exceeded on 4th December by £43K when £91K was unexpectedly received in the afternoon after the cut off time for deals had passed.

The average level of funds available for investment purposes during the quarter was £43.5m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council holds £20.5m core cash balances for investment purposes (i.e. funds available for more than one year). The investment portfolio yield for the first nine months of the year was 1.03% This is the weighted average rate of interest earned on investments held by the Council between 1 April and 31 December. The 1.11% average interest rate shown in the table below is the weighted average rate of interest on outstanding investments on 31 December.

Investments at 31 December 2019

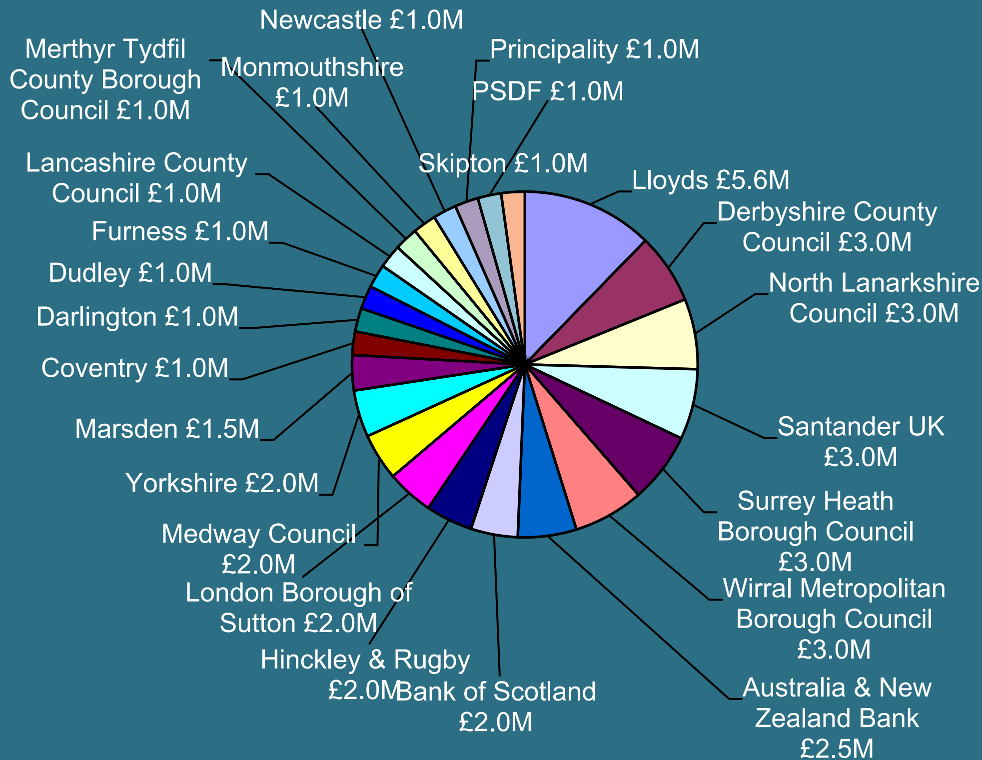
	Amount £	Average Interest Rate %
Managed By NHDC		
Banks	13,100,000	0.97
Building Societies	5,000,000	0.91
Local Authorities	18,000,000	0.93
Money Market Fund	1,000,000	0.72
NHDC To Total	**37,100,000**	**0.94**
Managed by Tradition		
Building Societies	8,500,000	1.42
Tradition Total	**8,500,000**	**1.42**
TOTAL	**45,600,000**	**1.11**

In percentage terms, this equates to:

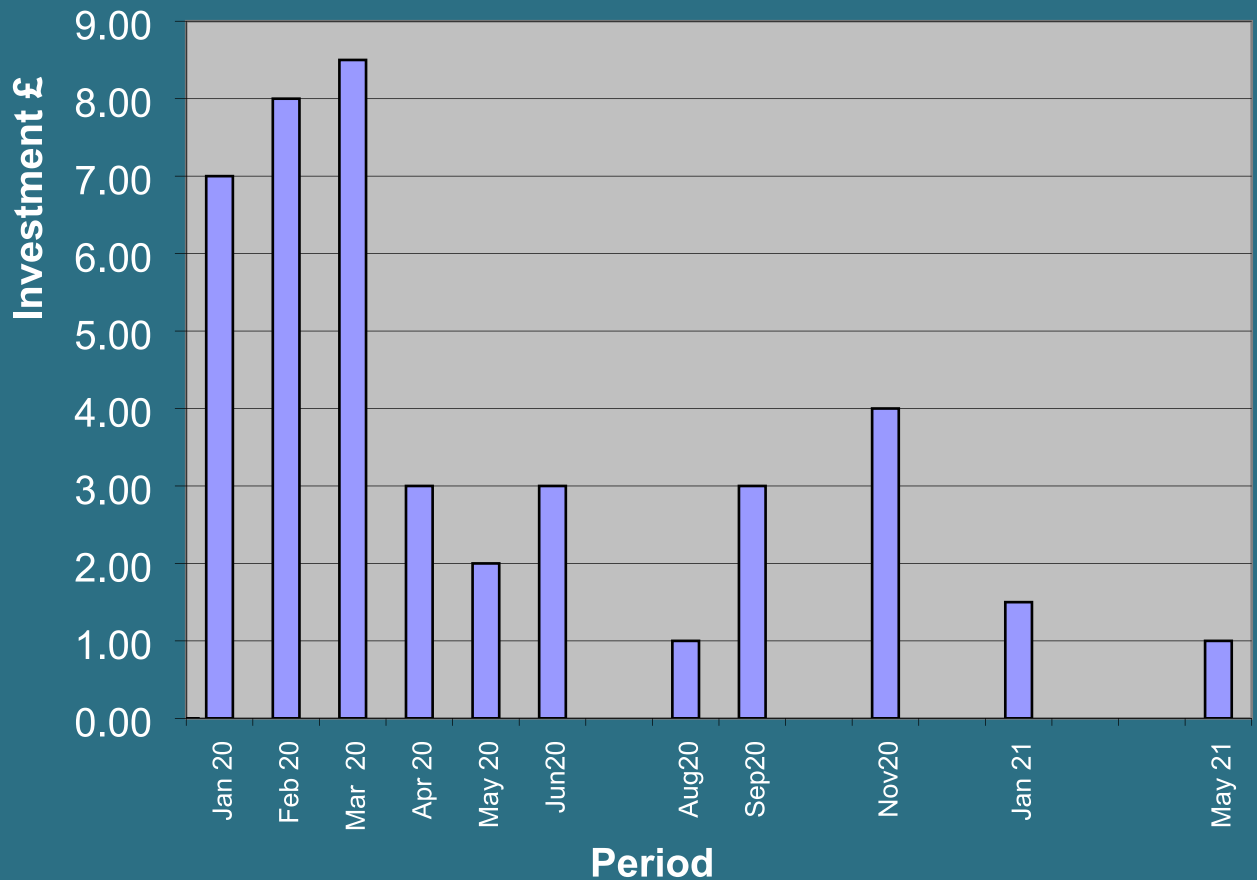
	Percentage
Money Market Funds	2
Local Authorities	42
Banks	25
Building Societies	31

The approved 19/20 strategy is that no more than 60% of investments should be placed with Building Societies with a maximum value of £18M. The value at 31 December was £13.5M

The pie chart below shows the spread of investment balances as at 31 December 2019. This is a snapshot in time that demonstrates the diversification of investments.

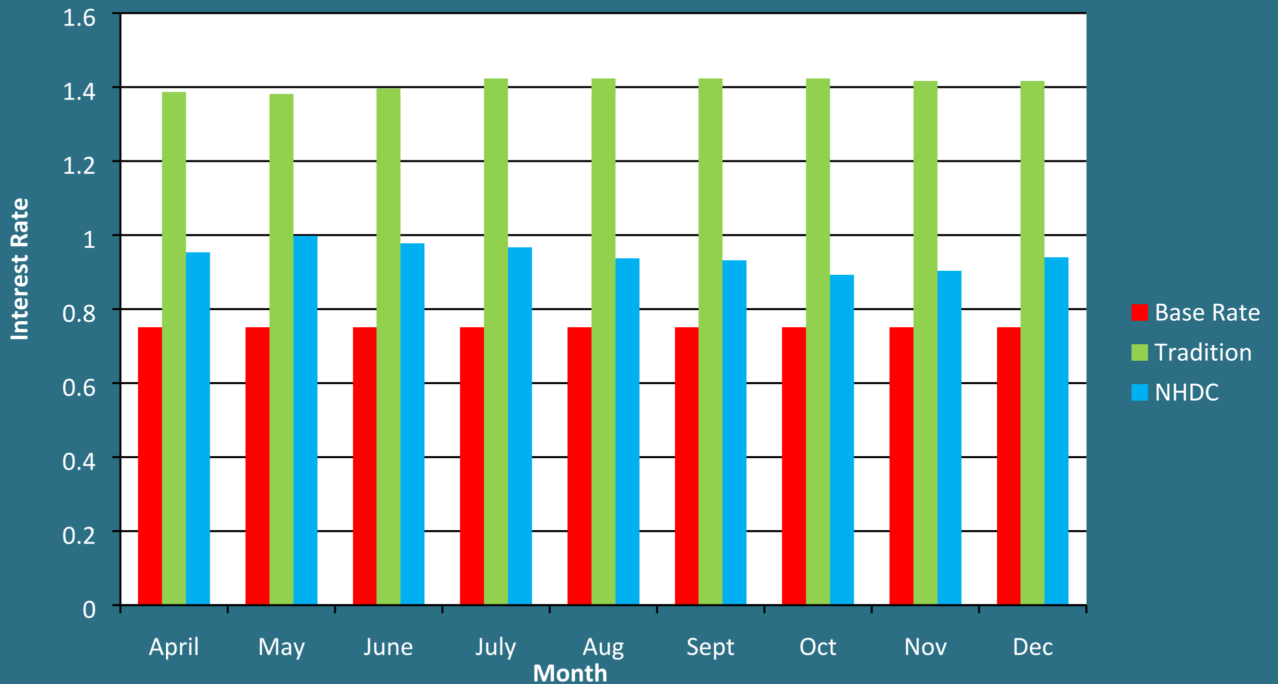


The chart below shows the Council's investment maturity profile. (This does not include the £1.0M held in the Public Sector Deposit Fund Money Market account or £2.6M held in the Lloyds current account which can be called back on any day).



The Council's Original budgeted investment return for 2019/20 was £0.300M. The projection reported in the 1st quarter report increased to £0.372M and based on current investments and cashflow forecasts it is expected that the Council will generate £0.418M of interest. The large increase in investment income from Original budget to 3rd quarter projection is mainly due to reprofiling of the Capital programme.

The graph below shows the average rate of interest on outstanding investments at 31 December.



The higher rates achieved through Tradition reflect that these are longer-term investments. In general, the Council can currently achieve similar rates for the same length of investment. The Council only undertakes new investments through Tradition where the rate achieved (after fees) are greater than what the Council could achieve for a similar investment.

Treasury indicator below shows the capital value and expected income from Capital Investment assets, alongside any borrowing that is attached to those assets and the expected cost of that borrowing.

Year	Capital value of investment assets £m	Original Expected annual income from investment assets £m	Revised Expected annual income from investment assets £m	Expected annual income from investment assets after future investment £m	Loans linked to investment assets £m	Expected annual borrowing costs for loans linked to investment assets £m
2019/20	18.899	1.089	1.156	1.156	0	0
2020/21	25.820	1.139	1.209	1.373	4.0	0.162
2021/22	29.820	1.189	1.259	1.423	4.0	0.162
2022/23	33.820	1.189	1.259	1.423	4.0	0.162

2023/24	38.820	1.189	1.259	1.423	4.0	0.162
2024/25	49.420	1.189	1.259	1.423	4.0	0.162

New borrowing costs are based on a 25 year Annuity loan from PWLB and an MRP life of 40 years.

4. New Borrowing

No long term borrowing was undertaken during the quarter / nine months ended 31 December 2019.

Based on 3rd quarter estimate for capital expenditure, the Council's capital financing requirement (CFR) for 2019/20 is expected to be -£5.390 (-£5.91M at the end of 18/19). The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances (internal borrowing). The CFR is negative as the Council has more cash investments than borrowing. The balance of external and internal borrowing is generally driven by market conditions.

It is anticipated that long term borrowing will not be undertaken during this financial year.

Loans Outstanding at 31 December 2019:

	Amount	Average Interest Rate
	£	%
Public Works Loans Board	£431k	9.76

Estimated outstanding debt:

Year	Forecast Borrowing £m	Forecast other long-term liabilities £m *	Forecast Total External Debt £m	Operational Boundary £m	Authorised Limit £m
31st March 2019 (Acual)	0.440	2.628	3.068	4.2	10
31st March 2020 (Forecast)	0.423	2.125	2.548	4.0	10
31st March 2021 (Forecast)	4.185	1.622	5.807	6.9	12
31st March 2022 (Forecast)	4.016	1.119	5.135	6.9	12

31st March 2023 (Forecast)	3.845	0.616	4.461	5.5	12
31st March 2024 (Forecast)	4.783	0.113	4.896	6.0	12

* Comprises the finance lease relating to Letchworth Multi-storey car park and the forecast impact of the finance lease for waste vehicles.

The external borrowing forecast can be used to give an indication of the borrowing that may be required, which is combined with outstanding existing borrowing. The Council will also borrow for short-term cash-flow needs if required. The actual borrowing that is taken out will depend on the latest forecasts and the offers that are available at the time that it is required. There will also be a consideration of when any other borrowing becomes due, with the aim of achieving a spread of these dates. This is to try and avoid refinancing risk. The Council is required to set indicators for the maturity structure of its borrowing. Given the low level of borrowing that the Council currently has and is forecast to have, it is considered appropriate to maintain full flexibility as to the exact duration of any borrowing undertaken.

To manage refinancing risk, the Council sets limits on the maturity structure of its borrowing. However, these indicators are set relatively high to provide sufficient flexibility to respond to opportunities to repay or take out new debt (if it was required), while remaining within the parameters set by the indicators. Due to the low level of existing borrowing, the under 12 months limits have a broad range to allow for cash-flow borrowing (if it was required).

Maturity Period	Lower %	Upper %
Under 12 months	0	100
12 months to 2 years	0	50
2 years to 5 years	0	60
5 years to 10 years	0	70
10 years to 20 years	0	80
20 years and above	0	100

The Council does not have a need to borrow in this financial year, so therefore does not currently need to apply a Minimum Revenue Provision (MRP).

There is a prudential indicator that compares the net cost of financing (i.e. borrowing costs less income generated from investments) with the net revenue budget of the Council. However, the indicator below considers the cost of borrowing as a % of the net revenue budget of the Council.

Year	Estimated cost of borrowing £m	Forecast net revenue budget	Estimated cost of borrowing as a % of net revenue budget
2019/20	0.042	14.821	0.28
2020/21	0.203	14.808	1.37
2021/22	0.202	14.911	1.35
2022/23	0.201	15.021	1.34
2023/24	0.239	15.021	1.59

The Council is required to set a prudential indicator that estimates financing costs (cost of borrowing less income from investments) as a percentage of its net revenue budget.

Year	Estimated cost of borrowing £m	Less: Forecast of interest earned £m	Net Financing Costs £m	Forecast net revenue budget	Estimated cost of borrowing as a % of net revenue budget
2019/20	0.042	0.418	-0.376	14.821	-2.537
2020/21	0.203	0.417	-0.214	14.808	-1.445
2021/22	0.202	0.516	-0.314	14.911	-2.106
2022/23	0.201	0.526	-0.325	15.021	-2.164
2023/24	0.239	0.584	-0.345	15.021	-2.297

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter.

6. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators, (affordability limits), are included in the approved TMSS.

APPENDIX 1: Prudential and Treasury Indicators for 2019-20 as at 31 December 2019

Treasury Indicators	2019/20 Budget £'000	31.12.19 Actual £'000
Authorised limit for external debt	9,000	431
Operational boundary for external debt	3,600	431
Gross external debt	2,548	431

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	17	17
12 months to 2 years	18	18
2 years to 5 years	58	58
5 years to 10 years	82	82
10 years to 20 years	15	15
20 years to 30 years	250	250

Prudential Indicators	2019/20 Budget £'000	31.12.19 Actual £'000
Capital expenditure	5,886	979
Capital Financing Requirement (CFR)	-0.063	-5.715
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	-1.969	-2.01