Agenda Item	12.a
Report No	RES/43/19

HIGHLAND COUNCIL

Committee: Corporate Resources

Date: 20 November 2019

Report Title: Mid-Year Treasury Management report 2019/20

Report By: Executive Chief Officer, Finance and Corporate Resources

1. Purpose/Executive Summary

1.1 This report is the mid-year treasury management review for the financial year 2019/20 which is prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) revised Code of Practice on Treasury Management in Local Authorities.

1.2 The report highlights the Council's treasury management activities undertaken, provides a commentary on the year to 30 September 2019 and compares activity to the expected activities contained in the annual Treasury Management Strategy Statement and Investment Statement (TMSS) which was approved at Corporate Resources Committee on 27 February 2019.

1.3 This Treasury Management Mid-Year Review 2019/20 is submitted to the Committee for consideration.

1.4 The Prudential Code also requires the Council to report the actual prudential indicators after the financial year end and these are shown as at 30 September 2019 in **Appendix 1.**

2. Recommendations

2.1 Members are asked to:

i. Consider the Treasury Management Mid-Year Review 2019/20.

3. Implications

3.1 Resource – it is likely that loan charges will be as forecast. However, this figure depends on the level of capital expenditure undertaken during the rest of the financial year and market interest rates for short term borrowing and deposits which will continue to be monitored.

3.2 There are Risk implications associated with a strategy of short term borrowing that rates increase and the Council is exposed to refinancing a large portfolio of short term debt at higher interest rates and missing the opportunity to secure favourable rates for longer term borrowing.

3.3 Other Treasury management risk considerations are:-

- Volatility on PWLB/borrowing rates which resulted in 50 year borrowing rates dropping to below 2% in September 2019. In October 2019 the treasury changed the margin over gilt yields used to the calculate PWLB rates to 1% which meant rates have increased and remain volatile.
- Political risk in theory places the UK's sovereign credit rating under some pressure, remembering the UK rating is already on a negative watch from the ratings agencies.
- Potential credit risk/uncertainty to UK Banks. The Governor of the Bank of England has highlighted risks to economic growth issues and the willingness of the BoE to act as required (monetary stimulus/rate changes to support the economy).
- Wider funding considerations such reductions in grants/contributions will impact budget and borrowing plans.

3.4 There are no Legal, Equalities; Climate Change/Carbon Clever; Gaelic or Community (Equality, Poverty and Rural) implications relating this report.

4. Background

4.1 Treasury Management is defined as: "*The management of the local authority's borrowing, investments and 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*".

4.2 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). The primary requirements of the code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the Council of an Annual Strategy Report for the year ahead, a mid–year report and an Annual Review Report of the previous year.
- 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.

- Delegation by the Council of the role of scrutiny of treasury management policies to a specific named body, which in this Council is the Corporate Resources Committee.

4.3 This Treasury Management Mid-Year Review 2019/20 covers the following:

- An economic update for the first six months of 2019/20, provided by the Council's Treasury Advisers, Link Asset Services
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- The Council's capital expenditure (prudential indicators)
- A review of the Council's investment portfolio for 2019/20
- A review of the Council's borrowing strategy for 2019/20
- A review of any debt rescheduling undertaken during 2019/20
- A review of compliance with Treasury and Prudential Limits for 2019/20.

5. Economic update (provided by Link Asset Services)

5.1 The Council has appointed Link Asset Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. **Appendix 2** provides an economic update from Link Asset Services.

5.2 Due to ongoing uncertainty and the outlook for both global and domestic economies, the MPC left Bank Rate unchanged at 0.75% and at the September MPC meeting expressed concern about world growth and the effect that prolonged Brexit uncertainty will have on growth.

5.3 Link Asset Services undertook its last review of interest rate forecasts in October 2019 and these include the increase in margin over gilt yields of 1% introduced on 9 October 2019. The forecast provided by Link Asset Services below is based on an assumption that there is an agreed deal on Brexit in the future and forecasts may need to be materially reassessed depending on future events.

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

5.4 The overall balance of risks to economic growth in the UK and increases in Bank Rate is probably to the downside due to the weight of all the uncertainties over Brexit, as well as the global economy.

6. Treasury Management Strategy Statement and Annual Investment Strategy update

6.1 The Treasury Management Strategy Statement (TMSS) for 2019/20 was approved by Corporate Resources Committee on 27 February 2019. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as security of capital, liquidity and then yield.

6.2 The investment portfolio yield for the first six months of the year is an average rate of 0.82% against a benchmark (7 Day London Inter-bank Offer Rate – LIBID average) of 0.57%.

6.3 The average level of funds available for investment purposes in the first six months of 2019/20 was £76.3m (2018/19 £69.8m). These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of council tax payments, receipt of grants and progress of the capital programme.

6.4 In line with the investment strategy, the Council will only place deposits with counter-parties with a high-creditworthiness. The forecasts in section 5.3 demonstrate that it is a very difficult investment market as rates are very low compared to the previous decade generally around the current 0.75% Bank Rate. Brexit uncertainty and the continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

7. New External Borrowing

7.1 The Capital Financing Requirement (CFR) represents the accumulated net capital expenditure for the General Fund and Housing Revenue account which the Council requires to fund by way of long term debt until the capital projects, comprising the CFR, are fully written off by way of annual loan charges to revenue accounts.

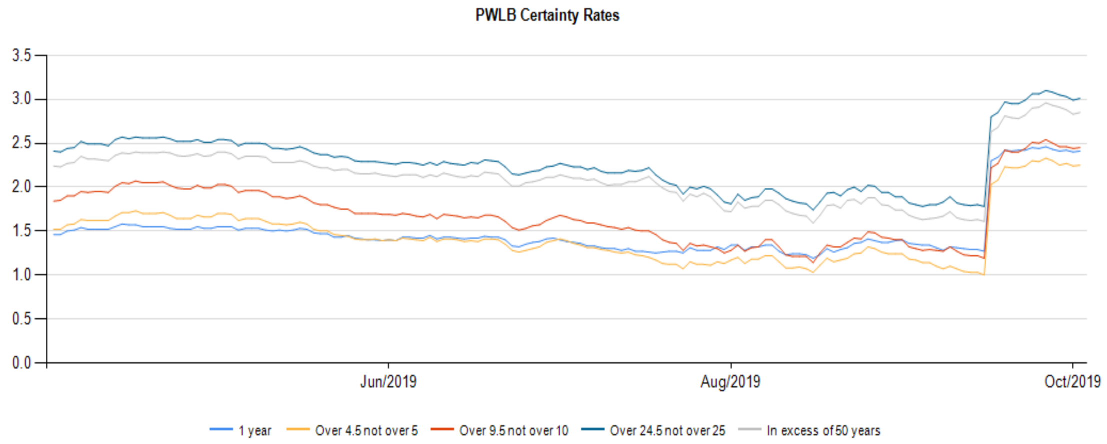
7.2 The balance of external and internal borrowing is generally driven by market conditions, and the need to take a balanced view of savings available from short term and internal borrowing, versus the mitigation of re-financing risk which can be achieved from longer-term borrowing, but at potentially higher cost.

7.3 The table below shows the estimated CFR at 31/03/20 and how it is expected to be funded by short term borrowing and historic long term borrowing.

	£m
Estimated Capital Financing Requirement (CFR) at 31/03/20 See appendix 1 – indicator 2	1,184.3
Less PPP/NPD	-148.8
Estimated CFR 31/03/20	**1,035.5**
Opening Long Term Debt 01/04/19	778.1

Long term maturities (PWLB)	-47.4
New PWLB loans	85.0
Market Loan repays	-1.5
New market loans (Period of 1.5 years)	10.0
Estimated Long Term Debt 31/03/20	**824.2**
Opening short term borrowing 01/04/19	186.0
Raised and repaid to 31 October 2019	-76.5
Replace long term maturities to 31/03/20	19.6
Add estimated net borrowing for new capital expenditure in 2019/20 (November to March)	56.2
Estimated Short Term Debt at 31/03/20	**185.3**
Estimated total long term and short term debt 31/03/20	**1,009.5**
Difference between CFR and borrowing = Funding from internal balances and cash flow	26.0

7.4 The graph and table below shows the movement in PWLB rates from 1 April until 28 October incorporating the certainty rate (0.20% discount on rates for local authorities who have applied for rate). The general trend has been an overall decrease in interest rates for PWLB loans with historically low levels below 2% until 9 October, when the Treasury announced a change in methodology for calculating rates which resulted in an overnight increase of 1% in rates.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.19%	0.99%	1.17%	1.74%	1.58%
Date	03/09/19	08/10/19	03/09/19	03/09/19	03/09/19
High	2.46%	2.33%	2.57%	3.10%	2.96%
Date	21/10/19	21/10/19	21/10/19	21/10/19	21/10/19
Average	1.49%	1.46%	1.73%	2.27%	2.13%

7.5 The following PWLB borrowing was undertaken partly to replace the PWLB loans of £27.9m that were repaid on 3 April 2018 (£25.0m 4.1% and £2.9m 9.3%) and replace short term borrowing in order to manage refinancing risk. This borrowing was undertaken at historically low rates.

Counterparty	Amount £m	Rate %	Start Date	Maturity Date	Period (years)
Public Works Loan Board	5.0	2.19	30/05/19	31/03/69	49.5
Public Works Loan Board	5.0	2.18	04/06/19	30/09/61	42.5
Public Works Loan Board	5.0	2.11	18/06/19	31/03/69	49.5
Public Works Loan Board	10.0	2.10	04/07/19	31/03/62	42.5
Public Works Loan Board	5.0	2.01	08/07/19	31/03/69	49.5
Public Works Loan Board	5.0	2.03	09/07/19	30/09/68	49.0
Public Works Loan Board	20.0	1.94	08/08/19	31/03/69	49.5
Public Works Loan Board	10.0	1.84	09/08/19	31/03/66	46.5
Public Works Loan Board	10.0	1.74	19/08/19	31/03/68	48.5
Public Works Loan Board	10.0	1.58	05/09/19	31/03/67	47.5
Total PWLB	**85.0**				

7.6 It is anticipated that over the remainder of the financial year, no further new long-term borrowing will be undertaken though this is dependent on rates. Markets remain volatile, and favourable short-term borrowing opportunities are likely to be available to the Council. However, the strategy remains flexible and consideration will be given to long term borrowing based on prevailing market conditions.

7.7 In consultation with Link Asset Services, the market situation is constantly monitored and borrowing strategies reviewed on a regular basis.

8. Impact of changes to PWLB borrowing rates

8.1 As detailed in section 7.4 of this report and section 5.4 of the Treasury Management Summary of Transaction report, on the 9 October all PWLB borrowing rates for new borrowing were increased by 1%. This change does not affect any existing loans held with the PWLB.

8.2 Up until that point the Council had been taking advantage of the historically low PWLB rates to undertake long term borrowing at these rates, thereby increasing security around refinancing risks. The Council's strategy for the year has been to allow flexibility to take advantage of longer term borrowing if rates were favourable and as such £85m of long term borrowing at an average rate of below 2% has been undertaken.

8.3 Given the rise in PWLB rates it is the view of Officers that PWLB borrowing no longer represents best value and so any borrowing undertaken in the remainder of the year will likely be short term only. Whilst rates on short term borrowing will fluctuate it is expected that any short term borrowing undertaken will be at an interest rate of around 1%. Such an approach is consistent with the approved strategy. Having a strategy that blends short and long term borrowing gives this Council flexibility for opportunistic long term borrowing whilst at the same time trying to optimise the security afforded by long term loans against the lower interest rates available on shorter term borrowing.

8.4 Directors of Finance and other local authority representatives from across the UK are lobbying the UK Government to reverse the PWLB rates increase and should rates reduce consideration will be given to further PWLB borrowing.

8.5 The change to the PWLB rates is not expected to have any material impact on the affordability of the Council's current capital plan which was based on the average loans fund rate reducing over time. All new borrowing undertaken has been at a rate significantly below the current average rate and so will contribute to reductions in that rate. In future if the Council is unable to continue to reduce its average loans fund rate this will begin to impact on the affordability of new capital projects.

8.6 The Council has recently assessed a number of commercial business cases and has used the prevailing PWLB borrowing rates as a proxy for estimating the cost of borrowing related to those projects. Given the increase in the PWLB rates any future business cases will have higher borrowing costs and therefore will likely see lower levels of return as a result; this may reduce the volume of viable business cases that are progressed.

9. Debt rescheduling

9.1 No debt rescheduling was undertaken during the first six months of 2019/20 as there were no cost effective opportunities.

10. Compliance with Treasury and Prudential Limits

10.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Capital Expenditure Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy Statement (TMSS) agreed in February 2019.

10.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's TMSS and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in **Appendix 1**, comparing the initial limits agreed for the year, and updated year-end forecasts.

Designation: Executive Chief Officer, Finance and Corporate Resources

Date: 7 November 2019

Author: Edward Foster, Head of Corporate Finance and Commercialism

Background Papers: Treasury Live System and Integra financial ledger

https://www.highland.gov.uk/meetings/meeting/4088/corporate_resources_committee

Appendix 1

Estimated Treasury Position and Prudential Indicators
Figures are for financial year unless otherwise titled in italics

Prudential Indicator		**2019/20 Original £m**	**2019/20 Revised £m**
1.	**Capital expenditure**		
	Gross capital expenditure		
	General Fund including PPP	142.1	106.1
	Housing Revenue Account	47.3	44.8
	Total gross capital expenditure	**189.4**	**150.9**
	Income - General Fund	(78.9)	(47.8)
	Income - HRA	(10.7)	(23.3)
	Total income	**(89.6)**	**(71.1)**
	Net capital expenditure		
	General Fund	63.2	58.3
	HRA	36.6	21.5
	Total net capital expenditure	**99.8**	**79.8**
	Loan charge instalments General Fund	(30.6)	(30.3)
	Loan charge instalments HRA	(9.9)	(9.6)
	Total instalments	**(40.5)**	**(39.9)**
	Net borrowing for new capital expenditure		
	General Fund	32.6	28.0
	HRA	26.7	11.9
	Total net borrowing for new capital expenditure	**59.3**	**39.9**
2.	**Capital Financing Requirement (CFR) at 31 March**		
	General Fund excluding PPP/NPD	729.2	740.9
	Housing Revenue Account	287.3	276.6
	Joint Boards	18.0	18.0
	PPP	148.8	148.8
	Total	**1,183.3**	**1,184.3**

Prudential Indicator		2019/20 Original £m	2019/20 Revised £m
	Treasury Position at 31 March		
	Borrowing – Long term	758.5	824.2
	Borrowing – Short term	240.0	185.3
	Other Long Term Liabilities (PPP/NPD)	148.8	148.8
	Total Debt	**1,147.3**	**1,158.3**
	Investments	50.0	50.0
	Net Borrowing	**1,097.3**	**1,108.3**
3.	**Ratio of financing costs to net revenue stream**		
	General Fund including PPP/NPD	13.3%	13.2%
	Housing Revenue Account	36.5%	36.5%

Prudential Indicator		2019/20 Maximum £m	2019/20 Actual £m
4.	**Authorised Limit for Borrowing**	1,049.7	972.6 (Aug 19)
5.	**Operational Boundary for Borrowing**	1,013.7	972.6 (Aug 19)
6.	**Interest rate exposures of debt net of investments**		
	Upper Limit (Fixed)	1,034.9	932.1 (June 2019)
	Upper Limit (Variable)	361.8	-17.0* (June 2019)
7.	**Maturity structure of fixed rate borrowing (against maximum position**)		
	Under 12 months	30.0%	22.1% (June 2019)
	12 months to 2 years	30.0%	3.0% (Sept 2019)
	2 years to 5 years	40.0%	5.5% (June 2019)
	5 years to 10 years	50.0%	11.3% (June 2019)
	10 years and above	100.0%	64.7% (June 2019)
8.	**Upper limit for the maturing of investments made for periods longer than 364 days**	20.0	Nil
9.	**Short term borrowing as a % of outstanding long term debt (maximum position)**	25.0%	16.8% (June 2019)
10.	**Variable interest debt as a % of outstanding long term debt (maximum position)**	35.0%	4.1% (June 2019)

*Negative as higher level of investments than variable borrowing

Appendix 2

Economic update (provided by Link Asset Services)

UK

This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, in September, his proroguing of Parliament was overturned by the Supreme Court and Parliament carried a bill to delay Brexit until 31 January 2020 if there is no deal by 31 October. MPs also voted down holding a general election before 31 October, though one is likely before the end of 2019. So far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. At the time of writing the whole Brexit situation is highly fluid and could change radically by the day. Given these circumstances and the likelihood of an imminent general election, any interest rate forecasts are subject to material change as the situation evolves. If the UK does soon achieve a deal on Brexit agreed with the EU then it is possible that growth could recover relatively quickly. The MPC could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy.

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, despite the contraction in quarterly GDP growth of -0.2% q/q, (+1.3% y/y), in quarter 2, 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. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. 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. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

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.

USA

President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further. The strong growth in employment numbers during 2018 has reversed into a falling trend during 2019, indicating that the economy is cooling, while inflationary pressures are also weakening The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates again in September to 1.75% - 2.00% and is thought likely to cut another 25 bps in December. Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

EU

Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1 and then fell to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars. 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 in the second half of 2018 and into 2019, 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 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. 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. On the political front, Austria, Spain and Italy are in the throes of forming coalition governments with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

China

Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress also still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. The trade war with the US does not appear currently to have had a significant effect on GDP growth as some of the impact of tariffs has been offset by falls in the exchange rate and by transhipping exports through other countries, rather than directly to the US.

Japan

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 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 compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns have resulted in government bond yields in the developed world falling significantly during 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 sub 50 which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during the rest of this financial year is weak.

Agenda Item	**12.b**
Report No	**RES/44/19**

HIGHLAND COUNCIL

Committee: Corporate Resources Committee

Date: 20 November 2019

Report Title: Treasury Management – Summary of Transactions Quarter ended 30 September 2019

Report By: Executive Chief Officer, Finance and Resources

1. Purpose/Executive Summary

1.1 This report on the treasury management transactions undertaken within the period is submitted to Committee for Members' scrutiny and in compliance with CIPFA's Code of Practice on Treasury Management.

1.2 This report sets out treasury management transactions during the period (see **Appendix 1**), reflecting activity undertaken to manage the Council's cash flows, and borrowing to fund capital expenditure. It also demonstrates compliance with the Council's prudential indicators (see **Appendix 2**).

2. Recommendations

2.1 Members are asked to consider the Treasury Management Summary of Transactions report.

3. Implications

3.1 Resource and Risk – the policy of using short term borrowing is at a lower cost than longer term borrowing and achieves savings but there are associated risks such as rates increasing and/or appropriate borrowing may not be available when required. During this quarter, in order to manage this risk and take advantage of favourable PWLB rates, short term borrowing has been replaced by long term borrowing and details are included in this report.

3.2 There are no Legal, Community (Equality, Poverty and Rural), Climate Change/Carbon Clever or Gaelic implications arising as a direct result of this report.

4. Treasury Management Strategy 2019/20

4.1 The strategy set in February 2019 was that during 2019/20 the plan was to continue to use short term borrowing to fund the capital programme but consider long term borrowing to replace maturities and in order to manage refinancing risks.

4.2 At the end of June 2019, the level of short term borrowing was £157.0m (£186.0m at end of March 2019), with PWLB rates continuing to be favourable and in order to manage risk further PWLB borrowing was undertaken.

5. Borrowing undertaken and repayments made

5.1 There was temporary borrowing of £19.5m undertaken in the period July to September 2019 and £67.0m of temporary loans were repaid. At 30 September 2019, the total temporary loans balance was £109.5m with an average rate of 0.97% (£157.0m at 30 June 2019, average rate 0.97%).

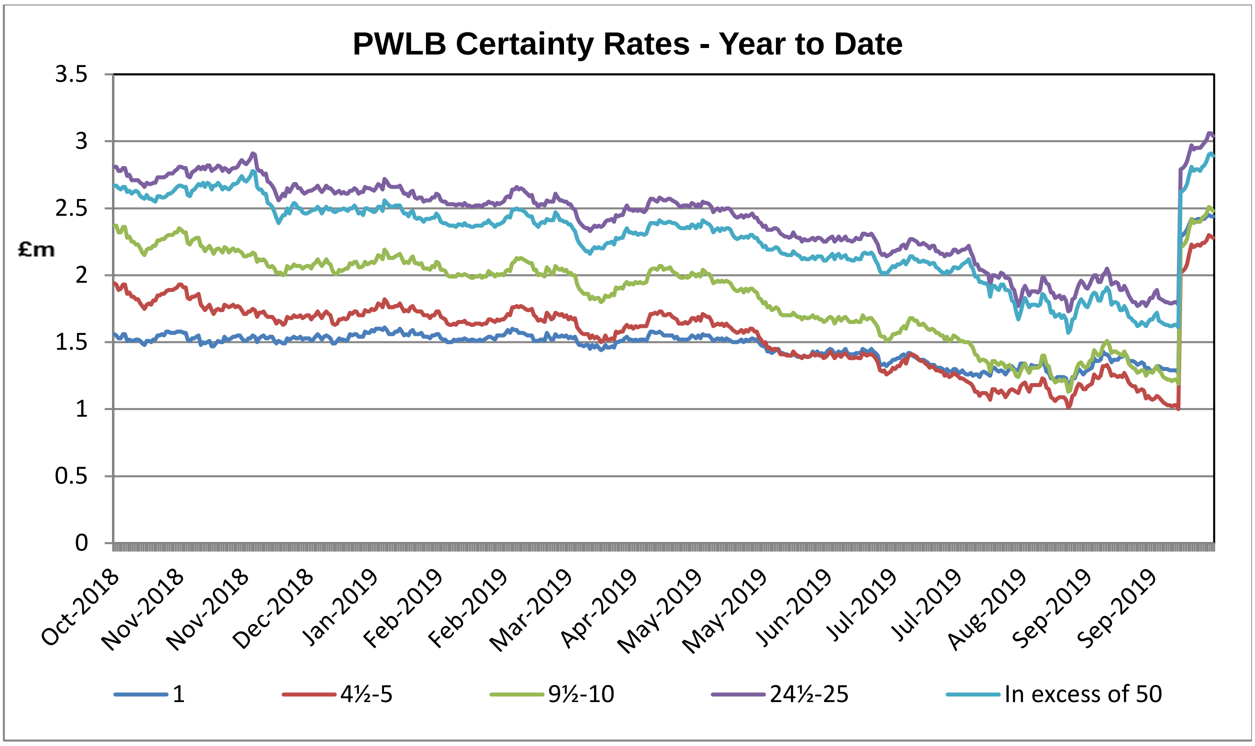
5.2 At the end of the quarter, the total of Public Work Loans Board (PWLB) loans was £698.1m (£629.4m at the end of June 19) and long term Market loans was £145.8m.

The following long term repayment was made;

i. PWLB £1.3m (rate 1.86%) taken out in April 2013 for 6.5 years

5.3 As PWLB rates continued their decrease from mid-April (see the graph below) and in order to lock into historically low rates and manage interest rate risk the following PWLB borrowing was undertaken.

i. £10.0m (rate 2.10%) for 42.5 years
ii. £5.0m (rate 2.01%) for 49.5 years
iii. £5.0m (rate 2.03%) for 49.0 years
iv. £20.0m (rate 1.94%) for 49.5 years
v. £10.0m (rate 1.84%) for 46.5 years
vi. £10.0m (rate 1.74%) for 48.5 years
vii. £10.0m (rate 1.58%) for 47.5 years



5.4 It should be noted on 9 October 2019 the following announcement was made by the PWLB and following this, rates immediately rose by 1% for all lending periods.

1. The Government recognises that the freedoms for local authorities to borrow under the Prudential Framework are fundamental to supporting local capital strategies and authorities' organisational objectives, including regeneration, supporting local growth and service delivery. The PWLB supports this activity by on-lending Government borrowing from the capital markets to local authorities to deliver capital investment.

2. The maximum net amount of PWLB loans that can be outstanding at any time is subject to a statutory limit. In order to ensure that lending continues to be available for local authorities that need it, the Government has legislated to increase the lending limit from £85bn to £95bn.

3. PWLB lending is offered at a fixed margin above the Government's cost of borrowing, as measured by gilt yields. The Treasury raised the margin over gilts to 100bps (one percentage point) in 2010, to better reflect the availability of capital finance, and lowered it to 80bps over gilts in 2013 for qualifying authorities.

4. Some local authorities have substantially increased their use of the PWLB in recent months, as the cost of borrowing has fallen to record lows. 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.

5. This restoration of normal PWLB lending rates will apply to all new loans with immediate effect. The Government will monitor the impact of this change and keep rates policy under review.

The full announcement is available at this link:
https://www.dmo.gov.uk/media/16115/hmt-letter-9-october-2019.pdf

6. Deposits

6.1 The rates on call accounts and money market funds for short term deposits have continued their decrease, albeit marginal from 31 March 2019.

During July and August 2019 £19.0m was placed on a 95 day notice deposit with Bank of Scotland at a relatively attractive rate of 1.10% and in July 2019 £10.0m was placed on a 95 day notice account also at 1.10% with Santander. Notice has been served on these deposits to mature to cover expected cash flow pressure points in 2019/20.

6.2 A full list of all counterparties at 30 September 2019 is at **Appendix 3**

6.3 When placing temporary deposits the Council uses a weekly credit rating list provided by Link Treasury Services Ltd, to assess the risks involved in lending to individual counterparties. The Council's lending policy is constantly monitored in conjunction with this matrix. This gives a balance of operational flexibility and risk awareness in managing the Council's temporary investments.

6.4 The Council's Treasury Management Strategy Statement and Investment Statement (TMSS) for 2019/20 was approved at Corporate Resources Committee on 27 February 2019, any amendment to it would require to be approved by Committee.

Designation: Executive Chief Officer, Finance and Resources

Date: 29 October 2019

Author: Edward Foster, Head of Corporate Finance & Commercialism

Background Papers: Treasury Live System & Integra financial ledger

Appendix 1

Treasury Management - Summary of Transactions for the Quarter to 30 September 2019

Type of Borrowing	Outstanding debt at start of quarter £m	Raised £m	Repaid £m	Outstanding debt at end of quarter £m	Average Interest Rate 1 Jul 19 %	30 Sep 19 %
Public Works Loan Board	629.4	70.0	(1.3)	698.1	4.66	4.39
Market Loans	107.8	0	0	107.8	3.86	3.86
LOBO Market Loans	38.0	0	0	38.0	4.86	4.86
Temporary Loans (term less than 1 year)	157.0	19.5	(67.0)	109.5	0.97	0.96
Bank Balance	(0.1)	0	(0)	(0.1)		
GROSS EXTERNAL BORROWING	**932.1**	**89.5**	**(68.3)**	**953.3**		
Temporary Deposits	(54.9)	(209.6)	185.9	(78.6)	0.81	0.91
NET EXTERNAL BORROWING	877.2	(120.1)	117.6	874.7		
				Total loan average	3.96	3.95

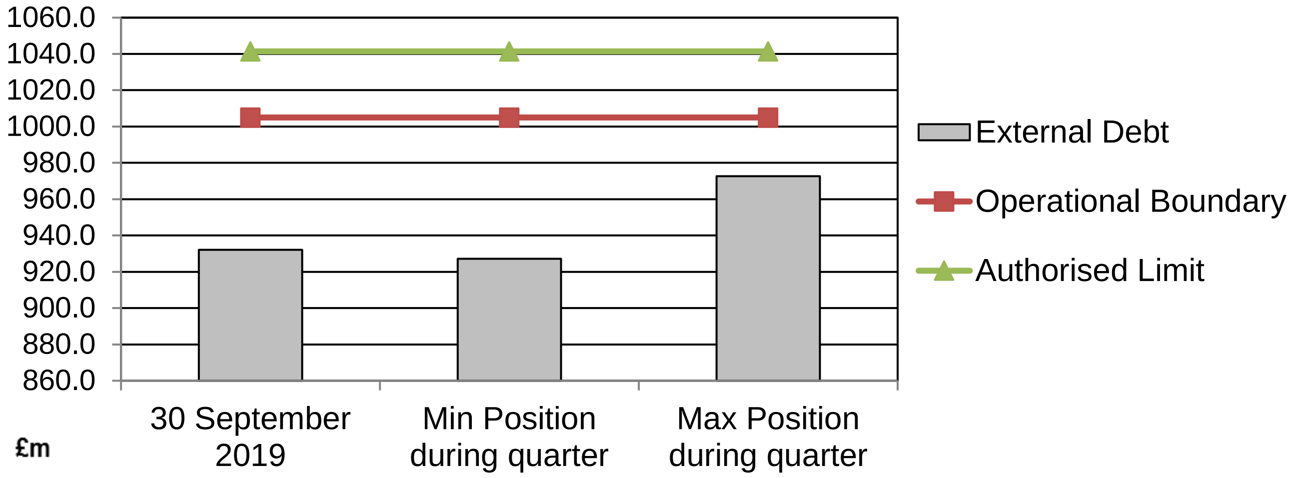
Borrowing / Lending internal parameters as per approved Treasury Management Practices	**Actual %**	**Approved Max %**
Short term borrowing as % of the Council's total outstanding debt	11.5%	25.0%
Borrowing at variable rates of interest as % of the Council's total outstanding loan debt	4.0%	35.0%

Appendix 2

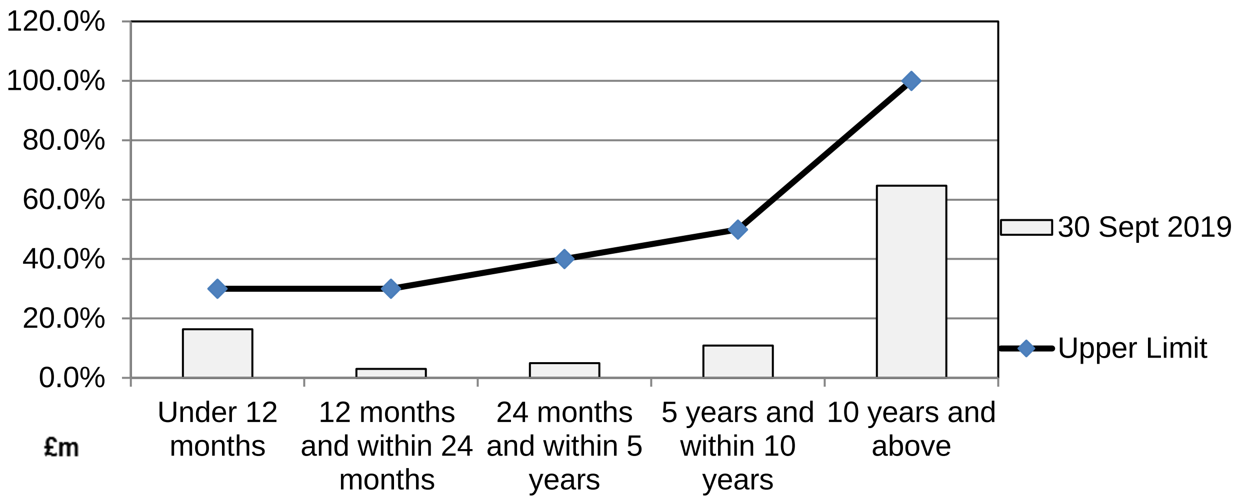
Treasury Management - Prudential Indicators

The Council has complied with all the prudential limits set in the TMSS 2019/20.

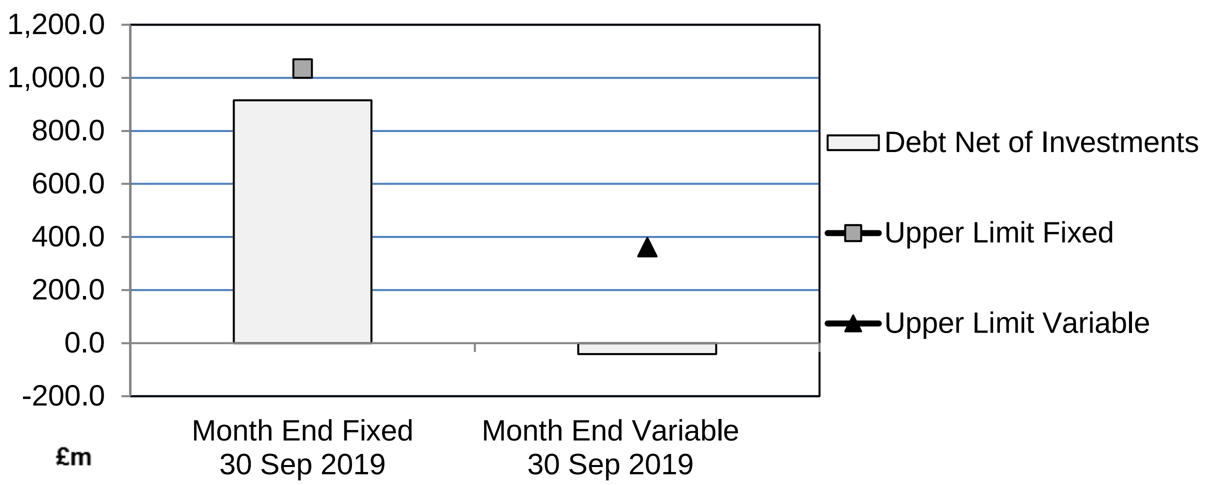
External Debt



Maturity Structure of Fixed Rate Borrowing



Debt Net of Investments



Month end variable is negative as the investments are greater than the variable debt.

Appendix 3

List of Counterparties

The following table is a list of current counterparties used, amount deposited with each counterparty and the Link credit rating as at 30 September 2019.

As stated in the TMSS for unavoidable short term operational reasons, limits are occasionally breached and this is communicated to management immediately.

Counterparty	Total amount £m	Counter party limit £m	Link credit rating Sep 19	Amount £m	Deposit Type	Rate Sep 19 %	Duration
Clydesdale Bank	8.5	10.0	No colour - zero	8.5	Call	0.75	N/A
Insight Investments MMF	11.1	20.0	AAA rated	11.1	Call	0.71	N/A
Bank of Scotland	19.0	20.0	Orange – 12 months	19.0	95 DN	1.10	N/A
Aberdeen Liquidity MMF	20.0	20.0	AAA rated	20.0	Call	0.74	N/A
BlackRock ICS MMF	0.1	20.0	AAA rated	0.1	Call	0.68	N/A
Santander	20.0	20.0	Red – 6 months	10.0	180 DN	1.10	N/A
				10.0	95 DN		
Total Deposits	**78.7**			**78.7**			