North Somerset Council

REPORT TO THE AUDIT COMMITTEE

DATE OF MEETING: 19 NOVEMBER 2020

SUBJECT OF REPORT: TREASURY MANAGEMENT OUT-TURN REPORT 2019/20

TOWN OR PARISH: ALL

OFFICER/MEMBER PRESENTING: RICHARD PENSKA, INTERIM DIRECTOR OF FINANCE & PROPERTY

KEY DECISION: N/A

1 REASON:

1.1 This is a report to note for information.

2 RECOMMENDATIONS

2.1 The Audit Committee is asked:

2.2 to note the treasury management out-turn monitoring report to 31st March 2020
2.3 to note the treasury management indicators to 31st March 2020
2.4 to note commercial investment property valuations and returns for 2019/20

3 SUMMARY OF REPORT

3.1 This report informs the Audit Committee of the council's;

- treasury management activities during 2019/20 and confirms that the activities undertaken during the year have complied with both the requirements of the Accountability and Responsibility Framework and the approved Treasury Management Strategy approved by Council in February 2019.

- treasury management indicators for 2019/20, as required by CIPFA's Prudential Code for Capital Finance in Local Authorities.

- commercial investment property valuations and returns for 2019/20.

4 POLICY

4.1 Part 1 (7) of the Financial Regulations, sets out the councils' policy framework with regards to treasury management activities.

4.2 Following the council's adoption of the 2011 edition of the CIPFA *Treasury Management in the Public Services: Code of Practice*, Members are required to approve an annual treasury management strategy before the start of each financial year and then to receive an in-year report and an annual report after the end of each financial year.

4.3 This report confirms that treasury activities during 2019/20 were carried out in accordance with the Treasury Management Policy approved by Council in February 2019.

4.4 The report provides a summary of the valuation of property assets and associated investment returns on commercial investments made under the Council's Commercial Investment Strategy.

5 DETAILS

5.1 Treasury management activities are undertaken by officers within the Financial Management team of the Corporate Services Directorate. The remit of this team is broad and covers a range of day-to-day operational tasks relating to the management of cash-flows and resultant outcomes of borrowing and investment decisions, as well as setting the strategic direction required by the council to deliver its core services and cover key financial risks.

Headline Metrics for the period 1 April 2019 to 31 March 2020

5.2 The average rate of investment return for internally managed investments in 2019/20 was 0.89%, which is 0.33% above the benchmark rate; and returns of 4.4% were achieved on external pooled fund investments.

5.3 Gross interest income earned on all investments totalled £1,451k, against a budget of £801k.

5.4 New additional external borrowing of £1.75m was undertaken during the period.

5.5 The council's Treasury Management Indicators for 2019/20 were approved by Council in February 2019. Performance against the key indicators is shown in **Appendix 4**. All indicators are within target levels.

Summary of Investment Returns

5.6 The balances of the council's investment deposits as at 31st March 2020 and 31st March 2019 are set out in the tables in **Appendix 1**.

5.7 Investment balances at 31st March 2020 have increased by £40m compared to 31st March 2019. This is due to a combination of grants and contributions received in advance at the current year end, largely relating to capital projects and funding towards Covid-19 impacts.

5.8 Forecast gross interest income earned on all investments amounts to £1,451k, compared to the budget of £801k. **Appendix 2** details the investment performance of the different investment types, showing the interest earned over this period.

Summary of Borrowings

5.9 The council's external borrowing as at 31st March 2020 totalled £161.7m and is detailed in **Appendix 3**. New borrowing totalling £1.75m was undertaken during the 2019/20 financial year, and this related to the investment in the street lighting capital project. Borrowing was drawn down from Salix, an organisation who specialises in providing funding for energy efficiency related programmes.

5.10 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the council's revenue budget. The amount of residual debt outstanding as at 31st March 2020 apportioned to North Somerset Council is £12.7m. This borrowing is treated in the council's Statement of Accounts as long term borrowing and is included in the borrowing figures referred to in paragraph 5.9.

Strategic Issues - Investments

5.11 As shown in the charts at **Appendix 1,** the investment portfolio is diversified across Money Market Funds, Local Authorities, the CCLA Property Fund, highly rated UK and Foreign Banks and UK Building Societies. The council uses AAA rated Money Market funds to maintain very short-term liquidity and had overall investments of £125m invested as at 31st March 2020.

5.12 In **Appendix 1, Table 1.2** £46m was placed with the Debt Management Office (DMO) (Government). In the run up to year-end the council transferred highly liquid money market funds deposits into the highly secure DMO in response to the uncertain wider market conditions prevailing at that time, and also the uncertainties surrounding the council's potential response to the Covid-19 pandemic.

5.13 The council does not hold any direct investments with banks in countries within the Eurozone, reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates.

5.14 The council's average investment return from its fixed term cash deposits is currently slightly below the target level of 1%. This is due to interest rates being depressed against the backdrop of continuing uncertainty around Brexit and the Covid-19 pandemic. The inclusion of the £10m pooled investment funds returns of 4.4% however, has meant that overall the council's net returns exceeded 1%.

Strategic Issues - Borrowing

5.15 In October 2019 the Public Works Loan Board (PWLB) raised its base lending rates to local authorities by 1% overnight. This was not expected and saw several authorities who had originally planned to borrow from the PWLB needing to find alternative sources of funding. This provided a boost to the inter-local authority lending rates, which the council was able to take advantage of, lending £14m in several tranches to several local authorities. The council's current debt portfolio is protected from this rate increase, as it is all at fixed rates. However, this PWLB rate increase may impact on decisions regarding the source and timing of future borrowing.

5.16 The borrowing strategy for 2019/20 proposed that the council would consider PWLB borrowing as the primary source of finance for 'unsupported' capital projects, and the UK Municipal Bonds Agency plc as the second source, with decisions being made at the appropriate time to ensure the best value for the taxpayer in terms of rates and potential risk.

5.17 Although the council's current long-term PWLB borrowing is held within fixed rate loans, variable rate borrowing could be considered at some point in the future to hedge against interest rate risk within the investment portfolio.

5.18 It will be necessary to continue to review borrowing requirements and rates throughout the financial year to determine the optimum time to borrow, and from which source, so that the optimum rates can be achieved.

Restructuring debt

5.19 Whilst in an environment of low interest rates the opportunity to repay PWLB borrowing using cash balances and realise any net gains is limited, due to the size of the premiums repayable on early repayment, and the loss of income from cash balances. Previous calculations indicate the premium resulting from the early repayment of the council's portfolio could be between £10m to £35m, depending on options.

5.20 For the same reasons, the early repayment of the councils share of the Ex-Avon loan debt would result in additional costs over and above the current interest payments.

Economic Impacts

5.21 Our treasury management advisor's economic and market review for 2019/20 is included in **Appendix 6**.

5.22 GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed. Production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below trend at 1.1%.

5.23 The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25%, and then swiftly brought them down further to the record low of 0.1%.

Budget Implications

5.24 A breakdown of the revenue budget showing interest income for the period is included in **Appendix 2**. The impact of Covid-19 and the base rate cuts to 0.25% in March 2020, and again to 0.10% soon thereafter, mean these fixed term deposits are becoming increasingly unable to generate returns in line with budgeted expectations, due the current economic conditions and depressed interest rates. The average rate of return achieved in 2019/20 of 0.89% is unlikely to be achieved in 2020/21.

Commercial Investments

5.25 The Council's Commercial Investment Strategy was approved by Council in January 2019. In line with this strategy, the Council has made investments in commercial property to earn investment income, whilst potentially providing capital appreciation, from a portfolio of property investments.

5.26 The strategy provides guidelines to aid investment decisions through assessment of each financial business case, in order to create a balanced portfolio. All commercial investment decisions follow the governance arrangements set out in the Council's financial regulations.

5.27 As noted in the Capital Strategy, £100m was allocated in the capital budget to fund commercial investments. The Council has yet to fully utilise this allocation. The investments made under the strategy to date consists of one outright purchase funded from long term borrowing, the North Worle District Centre, and one property acquired under a finance lease, the Sovereign Centre in Weston super Mare. Other sums have been set aside for improvements to the Sovereign Centre.

5.28 Other assets held as 'investment property' in the Council's statutory accounts, largely consisting of development land and farms, were inherited from predecessor authorities, and are not included in the commercial investment strategy

Cost and valuation

5.29 All investment properties are re-valued annually by the council's valuers, for inclusion in the annual statutory accounts. The valuations are prepared by in-house or independent professional valuers, in line with RICS professional guidance.

5.30 As detailed in **Appendix 5**, the council's portfolio of commercial investment property is valued at £34.8m at 31 March 2020. This is a reduction of £23.9m compared to the value at the 2018/19 year end, and £26.4m compared to the acquisition cost including fees and takes into account the market conditions prevailing at that time.

5.31 The valuation as at 31 March 2020 is significantly reduced over the prior year, due to the impact of Covid-19 on retail property values at the year-end, and the uncertainty this may have on future rental incomes.

5.32 The properties not been revalued since the year-end although the valuers highlight that the value of rental income and capital values are expected to be uncertain during the remainder of 2020 and into 2021, with capital values returning to growth in 2022 and rental growth in 2023.

5.33 The North Worle District Centre is leased to Sainsburys. The food and grocery sector is expected to be better insulated from reductions in the valuation of other retail property. The council is considering investment options for the Sovereign Centre, in line with its continuing redevelopment of the Weston town centre and place-making strategy.

5.34 At this time the council has no plans to dispose of these properties.

Income compared to budget

5.35 The investments are required to make a contribution to the council's revenue budgets from inception after allowing for financing costs, as there is no provision available within the revenue budget. After servicing costs, fees and borrowing costs, these assets are budgeted to generate an annual net return to the revenue budget of £0.9m.

5.36 As detailed in **Appendix 5**, the council's commercial investments have provided net income in line with budget, and have also made contributions to reserves, for both 2018/19 and 2019/20.

Yield / Return on investment

5.37 As detailed in **Appendix 5**, the council's commercial investments have provided a yield / return on investment of 1.5% after financing costs, compared to 0.7% in 2018/19.

6 CONSULTATION

6.1 Consultation has been carried out with the Section 151 Finance Officer and Monitoring Officer.

7 FINANCIAL IMPLICATIONS

7.1 The financial implications are contained within the body of the report.

8 LEGAL POWERS AND IMPLICATIONS

8.1 This report is for information only.

9 CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

9.1 The council will continue to avoid any direct treasury management investments in fossil fuel related companies and will engage with its advisors and bankers to explore and assess the potential for any future investment opportunities in funds with a Renewable Energy & Sustainability focus as these products continue to be developed by the market in response to the Climate & Nature Emergency agenda.

10 RISK MANAGEMENT

10.1 The council faces significant different types and degrees of risk in undertaking its Treasury management function, from both internal and external sources. However, the council has implemented, and adheres to, strict policies and internal controls in order to mitigate such risks.

10.2 The council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds, before seeking the best rate of return. Most of its surplus cash is therefore held as short-term investments, and utilises the UK Government and highly rated banks and pooled funds where appropriate.

10.3 The council's primary objective for the management of its debt is to ensure its long-term affordability. Most of its loans have therefore been borrowed from the Public Works Loan Board at long-term fixed rates of interest.

10.4 However the combination of short duration investments and long duration debt can expose the council to the risk of falling investment income during periods of low interest rates. This risk is partially mitigated by holding some longer-term investments, and the reviewing the option to prematurely repay long-term loans.

10.5 The council's lending & borrowing list is regularly reviewed during the financial year. Credit ratings of counter parties are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and borrowing advice is provided by Treasury Management consultants, Arlingclose.

10.6 The CIPFA Treasury Management in the Public Services: Code of Practice requires the council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Audit Committee carries out this scrutiny.

11 EQUALITY IMPLICATIONS

11.1 Not applicable, this report is for information only.

12 CORPORATE IMPLICATIONS

12.1 None

13 OPTIONS CONSIDERED

13.1 None

14 AUTHORS

Mark Anderson, Principal Accountant (Resources), 01934 634616
Melanie Watts, Head of Corporate Accountancy, 01934 634618

15 BACKGROUND PAPERS

Treasury Management Strategy 2019/20, Executive & Council – February 2019

APPENDICES

Appendix 1 Summary of External Investments at 31st March 2020
Appendix 2 Investment and Interest performance in 2019/20
Appendix 3 Summary of Borrowings
Appendix 4 Performance against Treasury Management Prudential Indicators
Appendix 5 Performance of Non-Treasury Management commercial investments
Appendix 6 External context provided by Arlingclose Ltd (treasury advisers)
Appendix 6 Summary Guide to Credit Ratings
Appendix 8 Glossary of Terms

Appendix 1 – Summary of External Investments at 31st March 2020

Table 1.1 Summary of External Investments as at (principal sums)				
	In-House Cash Deposits £m	In-House Pooled Funds £m	Tradition £m	**Total £m**
< 1 Year	105.0	0.0	10.0	**115.0**
> 1 Year	0.0	10.0	0.0	**10.0**
Total - 31st March 2020	**105.0**	**10.0**	**10.0**	**125.0**
Total - 31st March 2019	**60.5**	**10.0**	**10.0**	**80.5**

17.1 The table below shows further analysis of the investments held at 31st March 2020 and 31st March 2019 which adhered to this Strategy.

Table 1.2 Analysis of External Investments (principal sums)			
	31/03/2020 £m	31/03/2019 £m	Movement £m
UK banks	**3.0**	5.0	-2.0
Overseas	**3.0**	11.0	-8.0
UK Building Societies	**3.0**	0.0	3.0
Money Market Funds	**0.0**	0.0	0.0
Debt management Office	**46.0**	6.0	40.0
Local Authorities	**50.0**	48.5	1.5
Pooled Investment Funds	**10.0**	10.0	0.0
Total	**115.0**	**80.5**	**34.5**

Appendix 2 - Investment and Interest performance in 2019/20

17.2 The table below shows the average rates of return achieved during 2019/20 on investments placed by both of the treasury teams.

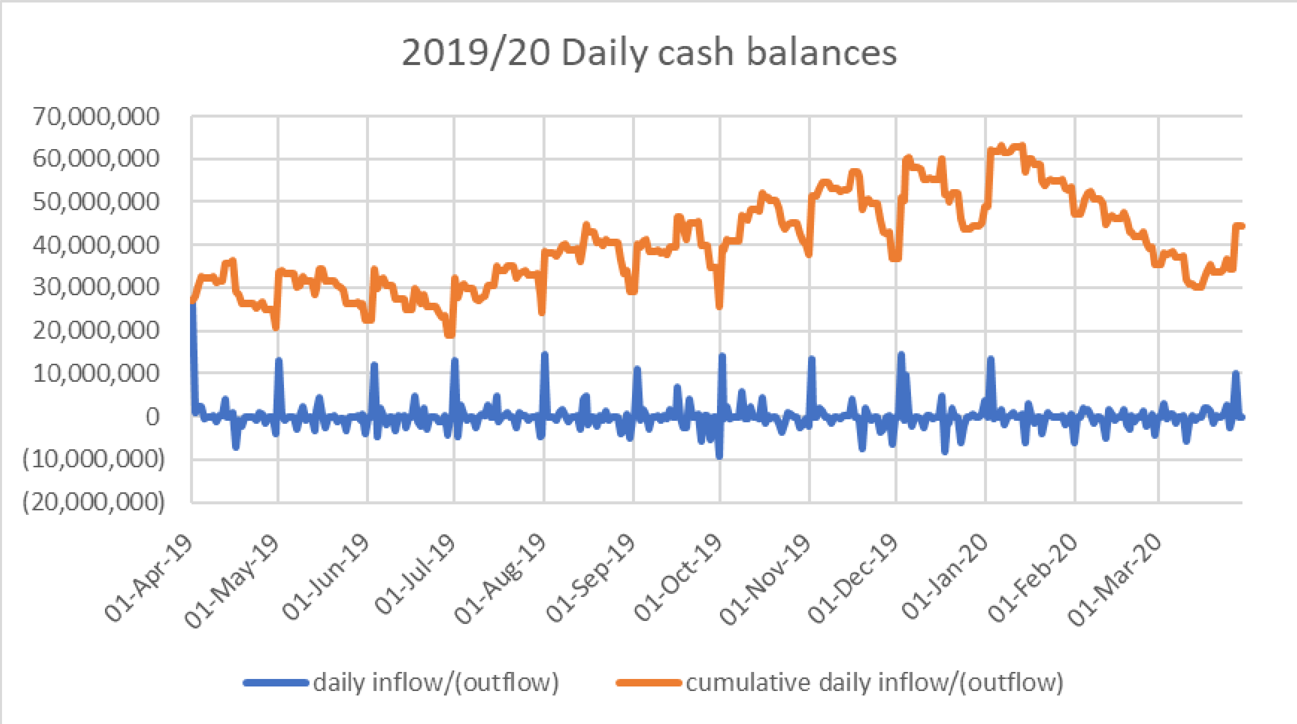
	In-house				Tradition			
	Ave Return (%)	Return (£m)	Ave Duration (days)	Ave Loans (No.)	Ave Return (%)	Return (£m)	Ave Duration (days)	Ave Loans (No.)
Qtr 1 – b/fwd & to 30 Jun	0.47%	0.44	93	37	0.64%	0.06	146	4
Qtr 2 – to 30 Sept	0.20%	0.19	40	13	0.19%	0.02	40	1
Qtr 3 – to 31 Dec	0.17%	0.16	30	17	0.18%	0.02	34	2
Qtr 4 – to 31 Mar	0.04%	0.04	3	16	0.05%	0.01	2	2
Annual Average for Fixed Term deposits	**0.89%**	**0.83**	**166**	**83**	**1.06%**	**0.11**	**222**	**9**
Benchmark	0.66%				0.66%			
CCLA pooled fund	4.83%	0.24	365	NA	NA	NA	NA	NA
UBS Multi Asset Fund	2.45%	0.16	365	NA	NA	NA	NA	NA
Investec Diversified Income Fund	3.03%	0.04	365	NA	NA	NA	NA	NA

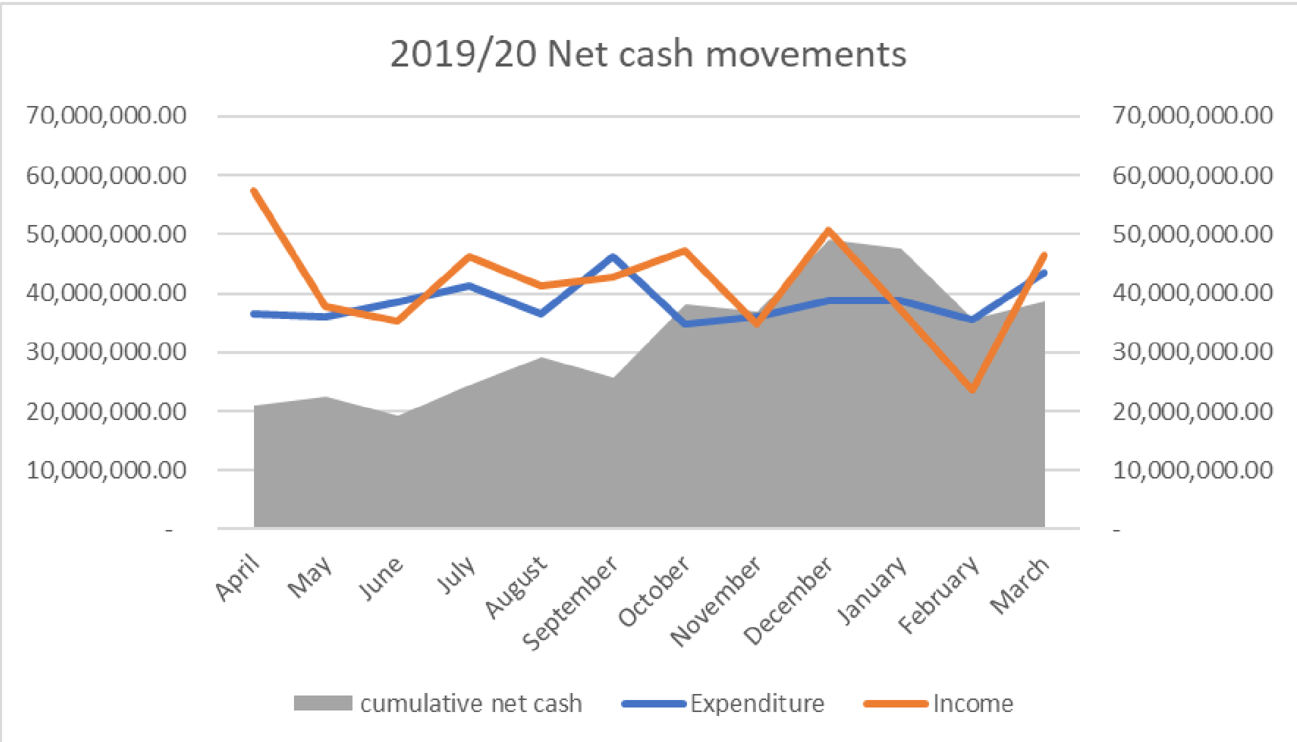
17.3 Both categories of investments exceeded the annual benchmark comparisons for the year, although it should be noted that the official benchmark, which is largely driven by the bank base rate, continued to remain at an all-time low throughout the year, and so does make a simple comparison to the defined benchmark less relevant.

17.4 The table shows that the council's in-house team achieved a marginally lower average rate of return during the year from its investments than that of the external fund manager. However the number and 'duration' of investments placed by each team differs significantly. This impacts on the interest rate achieved, with the yield curve offering higher rates of return for longer investment periods.

17.5 As noted above, the primary function of the council's treasury team is to manage cash-flows. Although cash balances can be high at the start of any given week, they may easily be required for expenditure in the next week, meaning that the council can only invest for a limited duration, often at very low rates. The majority of the council's returns are generated at the start of the financial year, when durations of term deposits are maximised to coincide with the council's cash flow profile and where yields are higher. The CCLA and other pooled investment funds offer a significantly higher return than traditional cash deposits.

17.6 The table below shows the daily cash inflows and outflows over the year. It demonstrates the semi-regular peaks and troughs in income and expenditure. For the first 10 months of the year, income tends to exceed expenditure, resulting in a build up of cash balances. After January, the reduction in monthly council tax income receipts means these balances are depleted in the last two months of the year. This is illustrated in the second table below.





Investment Interest Budgets 2019/20

17.7 The table below shows that the council achieved £1.451m in interest during the year, which is £0.650m more than budgeted. This is also £0.270m higher than the £1.181m level achieved in 2018/19. The increase in investment balances during the year, as well as the continued impact from increases in the base rate, resulted in improved returns.

	In-House – Cash Deposits	In-House – MM Funds	Tradition UK Ltd	CCLA Property Fund	Other Pooled Funds	**TOTAL**
	£000	£000	£000	£000	£000	**£000**
Actual Interest Generated	826	83	108	226	208	**1,451**
Investment Interest Budget	375	16	60	200	150	**801**
Variance to Budget	451	67	48	26	58	**650**

17.8 The council also utilises the CCLA property fund and two diversified income funds, held in the medium term, on a smaller proportion of the council's balances, to provide additional diversification, and protection against EU bail-in risk, whilst generating greater returns.

17.9 **Current Pooled Funds held:**

17.10 The Council holds the same pooled fund balances as at the previous year end. The initial amounts invested were:
- CCLA (property fund) - £5m;
- Investec (multi-asset) - £4m;
- UBS (multi-asset) - £1m

17.11 In a relatively short period since the onset of the Covid-19 pandemic, the global economic fallout was sharp and significant. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, businesses and individuals.

17.12 The falls in the capital values of the underlying assets were reflected in the 31st March 2020 fund valuations with most funds registering negative capital returns over 12 months to March. Despite decent income returns in 2019/20, these funds will post negative total return over the one-year period due to the capital component of total returns. The CCLA temporarily suspended trading in March 2020 due to significant valuation uncertainty surrounding its underlying property assets, although have since reopened trading again.

17.13 The council is using the alternative fair value through profit and loss (FVPL) accounting and must defer the funds' fair value losses to the Pooled Investment Fund Adjustment Account until 2023/24.

17.14 Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. Considering their performance over the medium- / long-term and the council's latest cash flow forecasts, investment in these funds has been maintained.

17.15 These investments are held to generate income streams, rather than capital appreciation. They continue to provide a return of around 4%, compared to a return of less than 1% on the council's short-term investments thereby providing diversification and balance. As with any fund purchase, a capital loss was initially incurred when these investments were taken out although this will be made up over time. The funds' fair values appear to have stabilised after a sharp fall in March 2020 following emergence of Covid-19. The cumulative capital loss on these investments is £820k as at 30 September 2020. This is a £92k improvement across the portfolio since 31 March 2020.

17.16 This should be compared to the annual revenue income from these investments, at £434k for the current year 2019/20.

Appendix 3 – Summary of Borrowings

Long-term PWLB debt profile (principal only) as at 31st March 2020		
	Debt £m	Average Rate %
Less than 1 year	0.34	4.75
Between 1 and 2 years	6.50	3.96
Between 2 and 5 years	24.26	3.31
Between 5 and 10 years	31.17	4.01
Over 10 years	84.95	4.32
	147.22	4.00

17.17 During the year, the council received addition loan funding from SALIX totalling £1.75m to finance capital expenditure on green initiatives, in this case energy efficient replacement street lighting. This borrowing is repayable within 2 years.

17.18 In addition, the council also has long-term borrowing obligations of £12.8m in respect of the former Avon County Council, although these loans are currently administered by Bristol City Council meaning that the council's overall long-term debt stands at £161.7m.

17.19 During the year the council repaid the following loan which had reached its maturity date.

Long-term Borrowing repaid during 2019/20				
	Ref	Principal £m	Interest Rate %	Maturity Date
Loan repaid at maturity	PWLB 10	1.0	5.50	30/09/2019

Appendix 4 - Performance against Treasury Management Prudential Indicators

Introduction

17.20 Having adopted both the CIPFA Treasury Management in the Public Services Code of Practice, and the Prudential Code for Capital Finance in Local Authorities, the council is required to set 'indicators' which demonstrate that it follows good practice, and has implemented and operates within appropriate systems of control before making capital financing and treasury management decisions.

Prudential Indicators: 'Prudential' Code

17.21 The Prudential Code was updated in 2017 following consultation with local authorities to improve the transparency of investment decisions. Changes to the Code include the requirement to produce a capital strategy, and the inclusion of prudential indicators within the report, to allow the reader to understand how overall debt levels link with the capital programme and investment decisions, and how this debt will be repaid.

17.22 Treasury management is concerned with keeping sufficient, but not excessive, cash available to meet the council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed.

17.23 The following Treasury Management prudential indicators were set in the Treasury Management Strategy for 2019/20. The limits are shown below, together with the actual indicators for 2019/20.

<u>Affordable borrowing limit / Authorised limit</u>

17.24 The council is legally obliged to set an affordable borrowing limit (also termed the 'authorised limit' for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the affordable limit.

17.25 The council approved the following authorised limit for its total external debt gross of investments for 2019/20. This limit separately identifies borrowing from other long-term liabilities, such as finance leases or lease premium incentives. The actual level of external debt is shown and is well within the limits set at the start of the year.

Authorised Limit for External Debt	**2019/20 Limit £m**	**2019/20 Actual £m**
Borrowing – NSC	219	161.7
Other Long-Term Liabilities (Avon debt, leases, temporary borrowing etc)	55	22.8
Authority Total	**274**	**184.5**

17.26 The council also approved the following operational boundary for external debt for the same period. The operational boundary for external debt was based on the same estimates as the authorised limit, but reflected estimates of the most likely, prudent, but not worst-case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements. As can be seen below, the actual level of external debt is well within the operational boundary set at the start of the year.

Operational Limit for External Debt	2019/20 Limit £m	2019/20 Actual £m
Borrowing – NSC	211	161.7
Other Long-Term Liabilities (Avon debt, leases, temporary borrowing etc)	50	22.8
Authority Total	**261**	**184.5**

Treasury Management Indicators: 'Treasury Code'

Interest rate exposures

17.27 The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget, and which is used to update the budget quarterly during the year. This allows any adverse changes to be accommodated. The analysis will also inform whether new borrowing is taken out at fixed or variable interest rates.

Maturity structure of borrowing

17.28 This indicator applies to the financial years 2019/20-2021/22. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. This indicator is set to control the council's exposure to refinancing risk. These limits are shown below, together with the actual percentage of borrowing that is maturing in each period.

Maturity Structure of Borrowing	Upper Limit	Lower Limit	Actual 2019/20	Complied?
Under 12 months	50%	0%	0.23%	Yes
12 months and within 24 months	30%	0%	4.42%	Yes
24 months and within 5 years	40%	0%	16.48%	Yes
5 years and within 10 years	50%	0%	21.17%	Yes
10 years and above	100%	0%	57.70%	Yes

Principal sums invested for periods longer than 364 days

17.29 The purpose of this indicator is to control the council's exposure to the risk of incurring losses by seeking early repayment of its investments. The total principal sums invested to final maturities beyond the period end are shown below. The council is required to set a maximum amount to be invested beyond the end of the financial year for the forthcoming financial year and the following two years.

Principal sums invested for periods longer than 364 days	2019/20 £m	2020/21 £m	2021/22 £m
Upper Limit of Principal sums invested beyond the year	66	60	60
Actual principal sums invested beyond one year	10	10	10
Complied?	Yes	Yes	Yes

Appendix 5 - Performance of Non-Treasury Management commercial investments

The council's portfolio of commercial investment property is valued at £34.8m at 31 March 2020. This is a reduction of £23.9m compared to the value at the 2018/19 year end, and £26.4m compared to the acquisition cost including fees.

Table A5.1: Property held for investment purposes – Cost and valuations

Property	Acquisition cost (inc fees) £m	31/3/2019 Valuation £m	31/3/2020 Valuation £m	Change over acquisition £m	Change over prior year £m
North Worle District Centre	40.2	37.6	30.7	(9.5)	(6.9)
Sovereign Centre	21.0	21.1	4.1	(16.9)	(17.0)
Total	**61.2**	**58.7**	**34.8**	**(26.4)**	**(23.9)**

The council's commercial investments have provided net income in line with budget, and made contributions to reserves, for both 2018/19 and 2019/20.

Table A5.2: Property held for investment purposes – Net return compared to budget

Property	Net Budget 2018/19 £m	Net Out-turn 2018/19 £m	Net Budget 2019/20 £m	Net Out-turn 2019/20 £m
Fees	**0.2**	**0.2**	**0.2**	**0.2**
North Worle District Centre				
- Expenditure	1.8	1.8	1.8	1.7
- Rental income	(2.4)	(2.4)	(2.4)	(2.4)
- Contribution to reserves	0	0	0	0.1
- Total	**(0.6)**	**(0.6)**	**(0.6)**	**(0.6)**
Sovereign Centre				
- Expenditure	0	2.3	3.1	2.8
- Rental income	0	(2.5)	(3.9)	(3.7)
- Contribution to reserves	0	0.2	0.3	0.4
- Total	**0**	**0**	**(0.5)**	**(0.5)**
Total (income)/expenditure	**(0.4)**	**(0.4)**	**(0.9)**	**(0.9)**

Taking into account their net revenue income, rather than capital valuation, the commercial investments have provided the following returns on investment:

The council's commercial investments have provided a yield / return on investment of 1.5%, compared to 0.7% in 2018/19, after allowing for the cost of borrowing.

Table A5.3: Property held for investment purposes – Net return on investment compared to budget

Property	Net Budget 2018/19 £m	Net Out-turn 2018/19 £m	Net Budget 2019/20 £m	Net Out-turn 2019/20 £m
Fees	0.2	0.2	0.2	0.2
North Worle District Centre				
- Net return	(0.6)	(0.6)	(0.6)	(0.6)
- Cost	40.2	40.2	40.2	40.2
- Return on investment	**1.5%**	**1.5%**	**1.5%**	**1.5%**
Sovereign Centre				
- Net return	0	0	(0.5)	(0.5)
- Cost	21.0	21.0	21.0	21.0
- Return on investment	**0**	**0**	**2.4%**	**2.4%**
Total return on investment	**0.7%**	**0.7%**	**1.5%**	**1.5%**

Appendix 6 - External context provided by Arlingclose Ltd (treasury advisers)

Economic background:

17.30 Economic background: The UK's exit from the European Union and future trading arrangements, had remained one of major influences on the UK economy and sentiment during 2019/20. The 29th March 2019 Brexit deadline was extended to 12th April, then to 31st October and finally to 31st January 2020. Politics played a major role in financial markets over the period as the UK's tenuous progress negotiating its exit from the European Union together with its future trading arrangements drove volatility, particularly in foreign exchange markets. The outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

17.31 The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% y/y in February, below the Bank of England's target of 2%. Labour market data remained positive. The ILO unemployment rate was 3.9% in the three months to January 2020 while the employment rate hit a record high of 76.5%. The average annual growth rate for pay excluding bonuses was 3.1% in January 2020 and the same when bonuses were included, providing some evidence that a shortage of labour had been supporting wages.

17.32 GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed and production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.

17.33 Then coronavirus swiftly changed everything. COVID-19, which had first appeared in China in December 2019, started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global Financial Crisis as part of a flight to quality into sovereign debt and other perceived 'safe' assets.

17.34 In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

17.35 The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% from 0.75% and then swiftly thereafter brought them down further to the record low of 0.1%. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK.

17.36 The US economy grew at an annualised rate of 2.1% in Q4 2019. After escalating trade wars and a protracted standoff, the signing of Phase 1 of the trade agreement between the US and China in January was initially positive for both economies, but COVID-19 severely impacted sentiment and production in both countries. Against a slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from of 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19 related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already on (or below) the floor, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

Financial markets:

17.37 Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March sterling touch its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile. The flight to quality caused gilts yields to fall substantially. The 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March. The 10-year benchmark yield fell from 1% to 0.4%, the 20-year benchmark yield from 1.47% to 0.76% over the same period. 1-month, 3-month and 12-month bid rates averaged 0.61%, 0.72% and 0.88% respectively over the period.

17.38 Since the start of the calendar 2020, the yield on 2-year US treasuries had fallen from 1.573% to 0.20% and from 1.877% to 0.61% for 10-year treasuries. German bund yields remain negative.

Credit background:

17.39 In Q4 2019 Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative. The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

17.40 After remaining flat in January and February and between a range of 30-55bps, Credit Default Swap spreads rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern. Spreads declined in late March and through to mid-April but remain above their initial 2020 levels. NatWest Markets Plc (non-ringfenced) remains the highest at 128bps and National Westminster Bank Plc (ringfenced) still the lowest at 56bps. The other main UK banks are between 65bps and 123bps, with the latter being the thinly traded and volatile Santander UK CDS.

17.41 While the UK and Non-UK banks on the Arlingclose counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks was cut to 35 days in mid-March.

17.42 Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and Non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and

German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-.

Appendix 7 - Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicates an issuer that has entered bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.

Appendix 8 – Glossary of Terms

Authorised Limit – the maximum amount of external debt at any one time in the financial year.

Bank Rate – the Bank of England base rate.

Capital Financing Requirement – financing needs of the council – i.e. the requirement to borrow.

CIPFA - the Chartered Institute of Public Finance and Accountancy. The institute is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work, in public service bodies, in the national audit agencies and major accountancy firms.

CLG – Communities and Local Government – see MHCLG.

Counterparty – the organisation the council is investing with.

Credit Rating – an assessment of the credit worthiness of an institution.

Creditworthiness – a measure of the ability to meet debt obligations.

Finance Lease - a finance lease is a lease that is primarily a method of raising finance to pay for assets, rather than a genuine rental. The latter is an operating lease. The key difference between a finance lease and an operating lease is whether the lessor (the legal owner who rents out the assets) or lessee (who uses the asset) takes on the risks of ownership of the leased assets. The classification of a lease (as an operating or finance lease) also affects how it is reported in the accounts.

Gilts – long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange.

LIBID – London Interbank BID Rate – the interest rate at which London banks are willing to borrow from one another.

MHCLG – Ministry of Housing, Communities and Local Government. The Government department that sets policy on supporting local government, communities and neighbourhoods, regeneration, housing, planning building and the environment and fire.

Minimum Revenue Provision - the minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing.

Money Market - the market in which institutions borrow and lend.

Money Market Rates – interest rates on money market investments.

Operational Boundary – the most likely, prudent but not worst-case scenario of external debt at any one time.

Pooled Funds – investments are made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification and professional money management.

Prudential Code – a governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the council are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good practice.

Prudential Indicators – indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment.

PWLB (Public Works Loans Board) - a central government agency which provides long and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities can borrow to finance capital spending from this source.

Sovereign – the countries the council can invest in.

Treasury Management – the management of the council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risk associated with those activities and the pursuit of optimum performance with those risks.

Treasury Management Practices – schedule of treasury management functions and how those functions will be carried out.

Variable Net Asset Value money market funds – the principal invested may fluctuate below that invested.