North Somerset Council

Report to the AUDIT COMMITTEE

Date of Meeting: 19 NOVEMBER 2020

Subject of Report: TREASURY MANAGEMENT MID-YEAR REPORT 2020/21

Town or Parish: ALL

Officer/Member Presenting: RICHARD PENSKA, INTERIM DIRECTOR OF FINANCE & PROPERTY

Key Decision: NA

Reason:
This is a report to note for information.

Recommendations
The Audit Committee is asked:

- to note the treasury management in-year monitoring report to 30th September 2020
- to note the treasury management indicators to 30th September 2020
- to note commercial investment property returns to 30th September 2020

1. Summary of Report

a. This report informs the Audit Committee of the council's;
   - treasury management activities during the first six months of 2020/21 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 2020.
   - treasury management indicators for 2020/21, as required by CIPFA's Prudential Code for Capital Finance in Local Authorities.
   - commercial investment strategy and performance to September 2020.

2. Policy

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

b. 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.

c. The report provides an update on the valuation of property assets and associated investment returns on commercial investments made under the council's Commercial Investment Strategy.

3. Details

a. 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 2020 to 30 September 2020

b. The council's average investment return from in-house fixed term cash deposit investments is currently below the budgeted level. This is largely due to the budget being set before the Covid-19 pandemic, which has resulted in significant reductions in interest rates and treasury activity across the globe. The returns generated by the £10m of pooled investment funds across the 6-month period are 4.11%, and have helped to stabilise the overall position.

c. Forecast gross interest income earned on all investments amounts to £804k against a budget of £1,333k. **Appendix 2** details the investment performance of the different investment types, showing the interest earned over this period.

d. The average rate of investment return for internally managed investments in 2020/21 is 0.65% (30/09/19: 0.89%). In addition, the rate of return for external pooled funds is 4.13%.

e. No additional external borrowing has been undertaken during the period 1 April to 30 September 2020.

f. The council's Treasury Management Indicators for 2020/21 were agreed by Council in February 2020 and performance against the key indicators is shown in **Appendix 4.** All indicators are within target levels.

Summary of Investment Returns

g. The council's investment position as at 30th September 2020 is given in **Appendix 1**. The balance of deposits as at 30th September 2020 and 31st March 2020 are also set out in the tables in this Appendix. A comparison is also given showing the position as at 31st March 2020.

h. In **Appendix 1**, Table 1.3 compares the council's interest returns against a basket of 20 English unitary councils and against a wider basket of 139 local authorities. The council's rate of return at 30th September was 0.65% (30/09/19: 0.89%), which was 0.65% above the benchmark rate of average 7-day LIBID (0.00%), mainly due to the maturity of several deposits placed in the prior year when rates were higher.

Summary of Borrowings

i. The council’s external borrowing as at 30th September 2020 totalled £160.22 million and is detailed in **Appendix 3**. No new borrowing has been undertaken since 1 April 2020.

j. 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 c£13m. This borrowing is managed by an external body and treated in the council’s Statement of Accounts as long term borrowing, it is included in the borrowing figures referred to in paragraph 3.i.

Strategic Issues - Investments

k. So far 2020 has been an unprecedented year in terms of cash flow impacts and general levels of uncertainty. Following the introduction of Covid-19 restrictions in March, the government announced multiple streams of financial support across the public and private sector, many of which were to be administered by local authorities, and at pace. Significant sums of money were given to the council, some to fund additional new expenditure and other funds which were required to be paid over to businesses and other organisations within the council’s supply chain (in excess of £40m).

l. The council has also experienced further uncertainties with the management and forecasting of its income related receipts from taxpayers across this period, which traditionally are very stable and largely linked to monthly direct debit processes. The government intervened at an early stage of Lockdown and announced additional support to businesses in the form of business rate relief for those in the retail, leisure and hospitality sectors, the impact of this change equates to c£28m for the council as their rates liabilities will be funded by the government for all of 2020/21. Direct debits were postponed for two months whilst this change was actioned, and in many cases individual payment arrangements have been agreed to reflect the hardship being faced.

m. As a result of all of these changes and uncertainties, the council’s investment strategy was temporarily updated to prioritise security and liquidity of cash-flows, putting the bulk of external funding received into “safe havens” such as the DMO and inter-authority lending until such time as it has been needed. This has meant that the portfolio has been less diverse than in previous years, but also that investment balances have been more volatile and investment periods significantly shorter than planned in the budget.

n. The council would usually optimise its ability to generate higher yields at the start of a financial year as it locks in a proportion of its investment balances for longer periods of time as opportunities across the world are presented, unfortunately that has not been the case in 2020/21, it should also be noted that yields have been hardest hit in the inter-local authority and DMO markets and have now moved into a negative yield, meaning that should the council wish to invest short-term funding with the DMO, then it will cost the council to do this, rather than to receive a return.

o. 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 had historically used AAA rated Money Market funds to maintain very short-term liquidity, but following the temporary suspension in March 2020 of one of the funds that would normally be used (that fund currently remains suspended at 30 September 2020), liquid cash was instead placed with the DMO and the council's instant access deposit account. This has had an impact on yields but has maintained security and liquidity.

p. The council had overall investments of £119.5m as at 30th September 2020, which is lower than the balance held at the end of March, but recognises the grant payments have been made to businesses over recent months.

q. In **Appendix 1**, Table 1.2 includes £11m currently placed with the Debt Management Office (Government). This is MOD funding received and earmarked for the Winterstoke Bridge repair works. After Heads of Terms are finalised, the cash requirements profile may result in some of this money being placed in longer term investments until needed.

r. 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.

PWLB Borrowing Rate Increase

s. On 9th October 2019, the PWLB increased the margin applied to loan rates by 100 basis points (1%) without warning; the new margin above gilts is now 180 basis points for certainty rate loans. This shift in policy was implemented by HM Treasury, who cite a substantial increase in the use of PWLB loans at some authorities in recent months, as the cost of borrowing has fallen to record lows, and state that 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.

t. The PWLB published a consultation paper seeking feedback from councils on the impact of this increase in rates and on how lending from the PWLB may change moving forward. The consultation paper does not give any indication as to whether the increase in margin is likely to be reduced soon.

u. As of 30th September 2020, the 25-year PWLB certainty rate for maturity loans was 2.76%.

v. In line with the council's Treasury Management advisor's advice, the council will continue to consider borrowing rates offered by alternative lenders, including other

Local Authorities, alongside PWLB rates in order to minimise, where possible, its costs of borrowing.

Commercial Investments

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

<u>Cost and valuation</u>

x. Commercial investment properties are re-valued annually by the council's valuers, for inclusion in the annual accounts. Hence no update on the valuation of the council's commercial investment property is available over the those included in the draft annual accounts for 2019/20. Updates on the valuation of the investment properties will be included in the council's 2020/21 annual accounts and the Treasury Management Out-turn report for 2020/21.

<u>Income compared to budget</u>

y. After servicing costs, fees and borrowing costs, these assets are budgeted to generate an annual net return to the revenue budget of £0.9m.

z. As detailed in **Appendix 5**, the council's commercial investments are forecast to provide net income £0.4m below budget in 2020/21, at £0.5m.

aa. As can be seen from the sections above, the council's overall cash-flows have been significantly impacted by Covid-19 and this is also the case for its commercial investments as the retail and hospitality sectors have suffered closures and restrictions.

bb. The investment at North Worle remains as budgeted and forecast as the main store remained open and trading throughout Covid, and the council has continued to receive income as planned.

cc. The investment at the Sovereign Centre has seen an impact from Covid as there have been closures to shops and facilities at the Centre and the car park over the past six months, some of which have been temporary although some of which are likely to be ongoing. Non-essential retailers have experienced significant issues and the council does recognise that it will receive less income compared to the budgeted position. A forecast is provided in Appendix 5 although it should be noted that this is a fluid and changeable situation and so further updates will be provided in later reports.

<u>Yield / Return on investment</u>

dd. As detailed in **Appendix 5**, the council's commercial investments are forecast to provide an annual yield / return on investment of 0.8% in 2020/21, compared to 1.5% in 2019/20.

Budget Implications

ee. A breakdown of the revenue budget showing interest income and the forecast year end position based on the period April to September is included in **Appendix 2**. Investment income is forecast to fall £0.5m short of budget at this stage of the financial year. The actual investment income out-turn will be heavily dependent on what happens to interest rates over the next 6 months, as well as any council funding decisions around the use of balances versus borrowing.

4. Consultation

a. Consultation has been carried out with the Section 151 Finance Officer.

5. Financial Implications

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

6. Legal Powers and Implications

a. This report is for information only.

7. Climate Change and Environmental Implications

a. The council will continue to avoid any direct treasury management investments in fossil fuel related companies and will engage with its advisors 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.

8. Risk Management

a. The council does face significant types and degrees of risk in this area, 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.

b. 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.

c. 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.

d. 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 the inclusion of some longer-term investments and the option to prematurely repay some long-term loans.

e. The council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

f. 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.

9. Equality Implications

a. Not applicable, this report is for information only.

10. Corporate Implications

a. None

11. Options Considered

a. None

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Background Papers:

Treasury Management Strategy 2020/21, Executive & Council – February 2020

Appendices:

Appendix 1 Summary of External Investments at 30th September 2020
Appendix 2 The council's Investment and Interest monitoring position at 30th September 2020
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 7 Summary Guide to Credit Ratings
Appendix 8 Glossary of Terms

Appendix 1 – Summary of External Investments at 30th September 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	99.5	0.0	10.0	**109.5**
> 1 Year	0.0	10.0	0.0	**10.0**
Total - 30th Sept 2020	**99.5**	**10.0**	**10.0**	**119.5**
Total - 31st March 2020	**105.0**	**10.0**	**10.0**	**125.0**

A1.1 The table below shows further analysis of the investments held at 31st March and 30th September 2020 which adhered to this Strategy.

Table 1.2 Analysis of External Investments (principal sums)			
	30/09/2020 £m	31/03/2020 £m	Movement £m
UK banks	**0.0**	3.0	-3.0
Overseas	**0.0**	3.0	-3.0
UK Building Societies	**0.0**	5.0	-5.0
Money Market Funds	**0.0**	0.0	0.0
Debt management Office	**49.5**	46.0	3.5
Local Authorities	**60.0**	58.0	2.0
Pooled Investment Funds	**10.0**	10.0	0.0
Total	**119.5**	**125.0**	**-5.5**

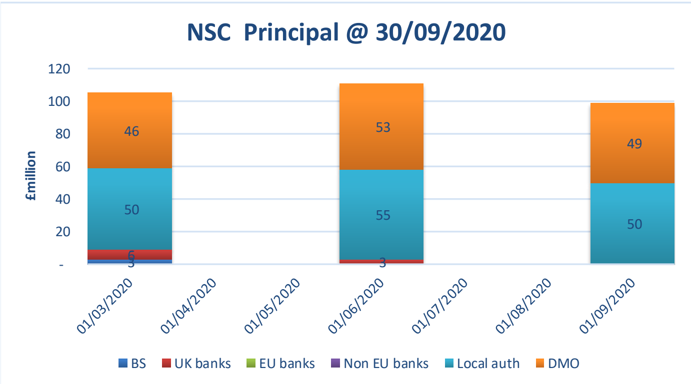
A1.2 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in the table below.

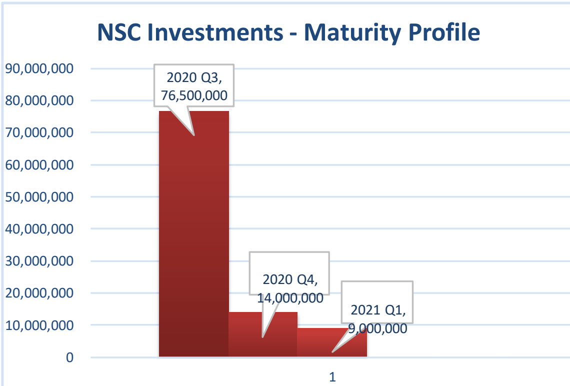
Table 1.3 Investment Benchmarking – Treasury investments managed in-house					
	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
31/03/2020	3.90	AA-	7%	84	1.12
30/09/2020	3.68	AA-	0%	67	0.65
Similar LAs	**4.32**	**AA-**	**72%**	**31**	**0.88**
All LAs	**4.16**	**AA-**	**64%**	**18**	**0.90**

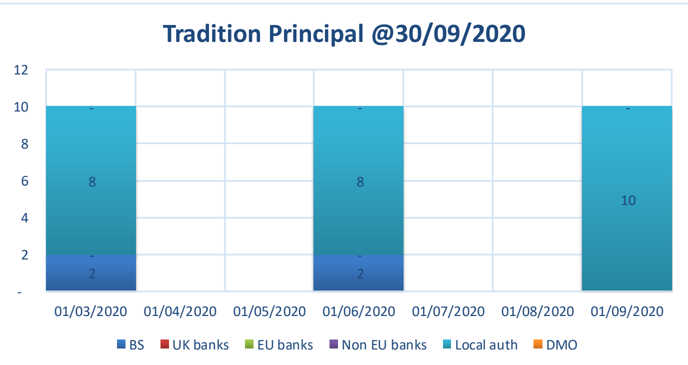
A1.3 The council's credit score is a numerical representation of the average credit rating of its counterparties, (AAA being 1, AA+ being 2, etc). The council's rating fluctuates around A+ and AA- which is comparable with other authorities and in line with the council's strategy. The council is less exposed to bail-in compared to the other authorities and its weighted average maturity is around 2 months at 30 September which is longer than the other authorities' average, while the lower returns from its fixed term cash deposit investments compared with those authorities would appear to be due to the council prioritising the inter local authority and DMO, and not using money market funds in order to prioritise security and liquidity over yield.

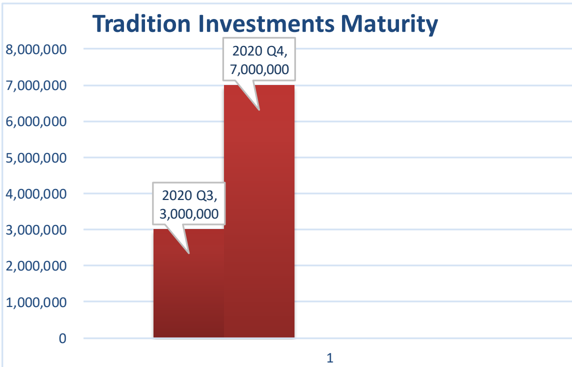
Appendix 2 -The council's Investment and Interest monitoring position at 30th September 2020

Interest Forecast compared to Budget 2020-21								
Average Principal £'000	Average Duration (Days)	Average % Return		Type	Budget £'000	Forecast £'000	Variance £'000	Potential Forecast £'000
94,647	41	0.30%	NSC Investments Income	FTCD	775	268	507	(15)
9,225	294	0.82%	Tradition	FTCD	60	76	(16)	0
-	0	0	MMF	Shares	24	0	24	(2)
9,000	365	0.01%	Deposit	VTCD	9	1	8	0
5,000	365	4.11%	CCLA	Shares	200	205	(5)	
4,000	365	4.05%	Multi Asset Funds - Investec	Shares	113	162	(49)	
1,000	365	4.53%	Multi Asset Funds - UBS	Shares	37	45	(8)	
			Pensions	Foregone Interest	115	47	68	
					1333	804	529	(17)









A2.1 News:

At month-end the adverse interest income budget variance was £529k, with a potential for a small improvement of £17k arising from potential future investments up to year-end.

On 4th November 2020 the Bank of England's Monetary Policy Committee voted unanimously to maintain the official Bank Rate at 0.1%.

A2.4 Risks and Strategy:

While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Money markets have priced in a chance of negative Bank Rate.

UK banks are now much better capitalised than before the 2008 financial crisis, but governments have legislated against taxpayer-funded bailouts. Any bank or building society in financial trouble is now likely to be rescued via a 'bail-in', which if large enough, will result in losses for wholesale depositors. Bail-in risk is minimised through use of investments which do not have such risk, such as local authorities and pooled funds, and maintaining a diverse portfolio of investments in banks and building societies.

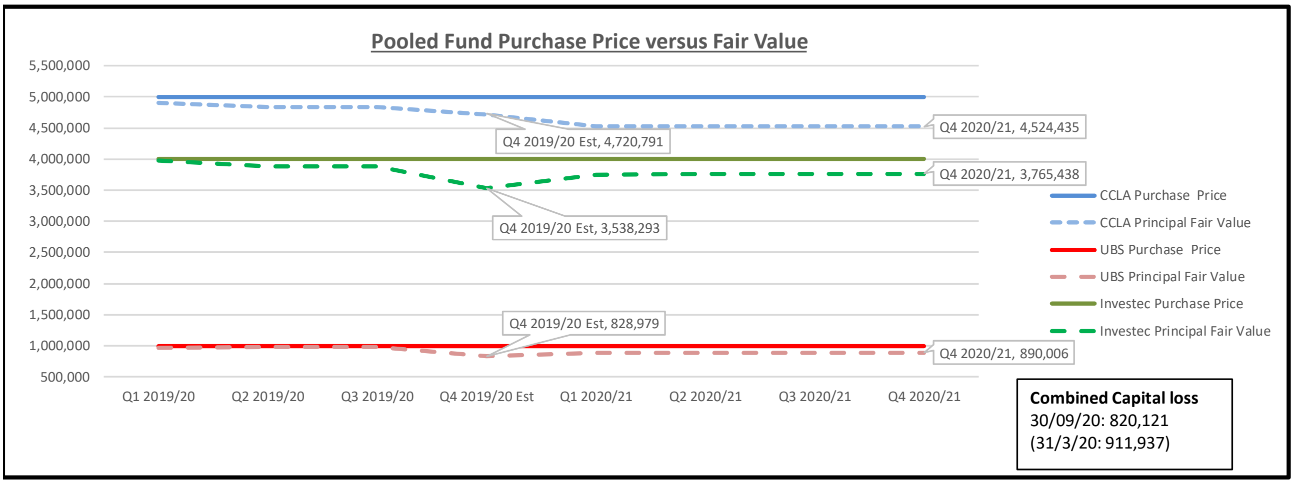
The council's approved 'Investment Strategy' provides enough flexibility to effectively minimise these risks. No amendment to the current investment strategy is proposed.

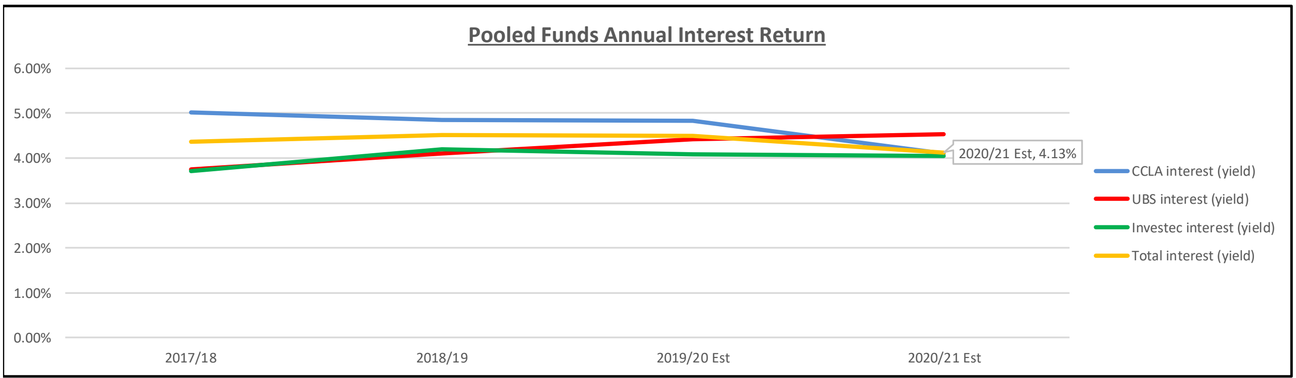
A2.8 Current NSC Pooled Funds Held:

The purchase price of the long-term investments held in pooled funds are: CCLA (property fund) £5m; Investec (multi-asset fund) £4m; UBS (multi-asset fund) £1m, totalling £10m.

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. A capital loss was incurred when these investments were taken out. 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.

This should be compared to the annual revenue income from these investments, forecast at £412k for the current year 2020/21.





A2.11 Approach for the rest of the year:

The council will continue to look to broaden the number of counter parties for less than 12 months, in order to maximise flexibility and minimise exposure. In order to address credit risks outstanding at the year-end, the council will look to maintain or increase lower risk local authority investments over the remaining months of 2020/21. This may result in further pressures on the council's interest income budgets but at the same time this should protect capital values and ensure liquidity.

January to March is traditionally a period when council cash receipts reduce, as no council tax instalments are received. Hence the council has plans in place to manage its cash balances to ensure enough funds continue to be available to meet payments as they fall due. Following reprofiling of some taxpayer instalments earlier in the year, this may not be as clear cut as in previous years. In addition, there are likely to be increased pressures on cash collectability as well as on local authority spending between now and the year-end.

Appendix 3 – Summary of Borrowings

Long-term PWLB debt profile (principal only) as at 30th September 2020		
	Debt £m	Average Rate %
Less than 1 year	0.34	4.75
Between 1 and 2 years	12.50	3.09
Between 2 and 5 years	23.26	3.76
Between 5 and 10 years	31.17	4.10
Between 10 and 20 years	59.95	4.47
Over 20 years	20.00	2.94
	147.22	**3.96**

A3.1 In addition, the council has long-term borrowing obligations of £12.8m in respect of the former Avon County Council. These loans are currently administered by Bristol City Council. With 1.75m Salix loan added in 2019/20, the council's overall long-term debt stands at £161.7m.

Appendix 4 - Performance against Treasury Management Prudential Indicators

A4.1 Introduction

A4.2 Having adopted both the CIPFA Treasury Management in the Public Services Code of Practice, and also the Prudential Code for Capital Finance in Local Authorities, the council is required follow the elements within the Guidance and 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.

A4.3 Prudential Indicators: ‘Prudential’ Code

A4.4 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 overall debt levels in conjunction with the capital programme and investment decisions and how this will be repaid.

A4.5 Treasury management is concerned with keeping enough 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.

A4.6 The following Treasury Management prudential indicators were set for 2020/21 as part of the MTFP process. The estimates are shown below together with the actual indicators for 2020/21.

A4.7 <u>Affordable borrowing limit</u>

A4.8 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 limit.

A4.9 The following Treasury Management prudential indicators were set for 2020/21 as part of the MTFP process. The estimates are shown below together with the actual indicators for 2020/21.

A4.10 In respect of its external debt, the council approved the following authorised limit for its total external debt gross of investments for 2020/21. 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	**2020/21 Limit £m**	**2020/21 Actual £m**
Borrowing – NSC Other Long-Term Liabilities (Avon debt, leases, temporary borrowing etc)	223 30	161.7 22.8
Authority Total	**253**	**184.5**

A4.11 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	**2020/21 Limit £m**	**2020/21 Actual £m**
Borrowing – NSC Other Long-Term Liabilities (Avon debt, leases, temporary borrowing etc)	211 30	161.7 22.8
Authority Total	**241**	**184.5**

A4.12 Treasury Management Indicators: '<u>Treasury Code</u>'

A4.13 <u>Interest rate exposures</u>

A4.14 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.

A4.15 <u>Maturity structure of borrowing</u>

A4.16 This indicator applies to the financial years 2020/21-2022/23. 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 2020/21**	**Complied?**
Under 12 months	50%	0%	0.23%	Yes
12 months and within 24 months	30%	0%	8.49%	Yes
24 months and within 5 years	40%	0%	15.80%	Yes
5 years and within 10 years	50%	0%	21.17%	Yes
10 years and above	100%	0%	54.31%	Yes

A4.17 <u>Principal sums invested for periods longer than 364 days</u>

A4.18 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	**2020/21 £m**	**2021/22 £m**	**2022/23 £m**
Upper Limit of Principal sums invested beyond the year	60	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 commercial investments are forecast to provide net income £0.4m below budget in 2020/21, at £0.5m.

Table A5.1: Property held for investment purposes – Net return compared to budget at Month 6

Property	Net Budget 2019/20 £m	Net Out-turn 2019/20 £m	Net Budget 2020/21 £m	Net actual spend to M6 2020/21 £m	Projected Out-turn 2020/21 £m
Fees	**0.2**	**0.2**	**0.2**	**0.1**	**0.2**
North Worle District Centre	**(0.6)**	**(0.6)**	**(0.7)**	**(1.1)**	**(0.7)**
Sovereign Centre	**(0.5)**	**(0.5)**	**(0.4)**	**0.4**	**0**
Total (income) / expenditure	**(0.9)**	**(0.9)**	**(0.9)**	**(0.6)**	**(0.5)**

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

The council's commercial investments are forecast to provide a yield / return on investment of 0.8% in 2020/21, compared to 1.5% in 2019/20.

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

Property	Net Budget 2019/20 £m	Net Out-turn 2019/20 £m	Net Budget 2020/21 £m	Net actual spend to M6 2020/21 £m	Projected Out-turn 2020/21 £m
Fees	0.2	0.2	0.2	0.1	0.2
North Worle District Centre					
- Net return	(0.6)	(0.6)	(0.7)	(1.1)	(0.7)
- Cost	40.2	40.2	40.2	40.2	40.2
- (Return) / Loss on investment	**(1.5%)**	**(1.5%)**	**(1.7%)**	**(2.7%)**	**(1.7%)**
Sovereign Centre					
- Net return	(0.5)	(0.5)	(0.4)	0.4	(0)
- Cost	21.0	21.0	21.0	21.0	21.0
- (Return) / Loss on investment	**(2.4%)**	**(2.4%)**	**(1.9%)**	**1.9%**	**0%**
Total (Return) / Loss on investment	**(1.5%)**	**(1.5%)**	**(1.5%)**	**(0.1%)**	**(0.8%)**

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

Economic update (Provided by Arlingclose)

The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the ‘Eat Out to Help Out’ (EOHO) offer.

GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England’s 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme. The Office for National Statistics’ preferred measure of CPIH which includes owner-occupied housing was 0.5% y/y.

In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the BoE has forecast unemployment could hit a peak of between 8% and 9%.

The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is ‘moderately’ above the 2% average target, particularly given it has been below target for most of the last decade.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

Financial markets: Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and

250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.23% respectively over the period.

At the end of September, the yield on 2-year US treasuries was around 0.13% while that on 10-year treasuries was 0.69%. German bund yields remain negative across most maturities.

Credit review: Credit default swap spreads eased over most of the period but then started to tick up again through September. In the UK, the spreads between ringfenced and non-ringfenced entities remains, except for retail bank Santander UK whose CDS spread remained elevated and the highest of those we monitor at 85bps while Standard Chartered was the lowest at 41bps. The ringfenced banks are currently trading between 45 and 50bps.

After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned an AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

Arlingclose outlook for remainder of 2020/21

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been supressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose’s central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

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 is 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.