ANNEX C

TREASURY MANAGEMENT POSITION 2019/20 – MID YEAR REVIEW & QUARTER 2 UPDATE

1.0 LEGISLATIVE REQUIREMENT

1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following:-

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how associated risk is managed
- the implications for future financial sustainability

1.2 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.3 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.4 Accordingly, treasury management is defined as:

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

1.5 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

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

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

3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Scrutiny committee:

This mid-year report therefore ensures this Council is implementing best practice in accordance with the code and covers the following:

- An economic update for the first part of the 2019/20 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2019/20;
- A review of the Council's borrowing strategy for 2019/20;
- A review of any debt rescheduling undertaken during 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

1.6 The regulatory environment places responsibility on Members for the review and scrutiny of Treasury Management policy and activities. This Mid-Year report therefore updates Members on the current Treasury Management position.

1.7 The Treasury Management Strategy Statement (TMSS) for 2019/20 was approved by this Council on 26 February 2019; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

1.8 The Council's capital expenditure plans at Quarter 2 are financed by external grants or contributions, capital receipts received in the year, capital reserves, revenue contributions or borrowing.

1.9 The Council continues to have an underlying need to borrow for capital purposes and has total external borrowing of £22,700,000 with the Public Works Loan Board (PWLB). Two new loans were taken in Quarter 2, £5,000,000 was taken on 2 September 2019 for ten years at a rate of 1.20% and £5,000,000 was taken on 5 September 2019 at a rate of 1.43% for fifteen years.

1.10 The capital financing requirement for 2019/20 was set at £77,665,000, it has reduced to £57,732,000 due to roll forward of capital expenditure projects to 2020/21. This is the Council's underlying need to borrow for capital purposes. If the Capital Financing Requirement is positive the Council may borrow from the Public Works Loan Board or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The capital expenditure of the Council is mainly supported by grants, contributions, reserves and borrowing.

1.11 The following table shows the treasury management position as at 30 September 2019:-

	30 Sept 19 £000's	**Rate %**
Capital Financing Requirement	57,732	
Borrowing	22,700	2.20
Investments	17,050	0.85

Table 1: Borrowing and Investment position at 30 September 2019

2.0 THE ECONOMY, INTEREST RATES AND TREASURY MANAGEMENT STRATEGY:

2.1 The economic background and interest rate forecast, which sets the environment in which the Council's treasury management operates, is attached at Annex D.

3.0 ANNUAL INVESTMENT STRATEGY 2019/20 – QUARTER 2:

3.1 **Investment Policy** – the Council's investment policy is governed by the Ministry of Housing, Communities and Local Government (MHCLG) guidance, which was implemented in the Treasury Management Strategy Statement (TMSS) for 2019/20, and includes the Annual Investment Strategy approved by Cabinet on 12 February 2019. It sets out the Council's investment priorities as being:

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

3.2 The Council's priority is the security of its surplus funds when investing with financial institutions. However the Council will always aim to achieve the optimum return (yield) on investments in line with its risk appetite and which is commensurate with proper levels of liquidity and security. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months. Investment are placed with highly credit rated financial institutions, using the Council's treasury Management advisers – Link Asset Services - suggested creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link Asset Services.

3.3 As shown by forecasts in Annex D, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rates are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

3.4 **Investments held by the Council** – The Council held £17,050,000 of investments as at 30 September 2019 and the investment portfolio yield for the first 6 months of the year is 0.85%. A full list of investments held as at 30 September 2019 can be seen in the table below:-

Counterparty	Type of Investment	Interest Rate	Amount
Federated	Money Market Fund	0.72%	£2,720,000
Lloyds	175 Day Notice Account	1.13%	£5,730,000
Santander	95 Day Notice Account	1.00%	£4,300,000
Handelsbanken	35 Day Notice Account	0.80%	£4,300,000
TOTAL			**£17,050,000**

Table 2: Investments held by the Council at 30 September 2019

3.5 The average level of funds available for investment purposes during Quarter 2 – 30 September 2019 - was £10,571,964. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

3.6 The table below shows that the Council monitors its cash flow investments against the 7 day rate. The Council outperformed the 7 day benchmark by 0.28%.

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.57%	0.85%	£31,223

Table 3: Investment performance for Quarter 2 at 30 September 2019

3.7 The Council's budgeted investment return for 2019/20 was approved at £35,000. In Quarter 2 monitoring it has been reported that the income is estimated to be £75,000, which is an increase of £40,000 due to increased surplus cash invested in short term investments as a result of taking loans from the Public Works Loan Board before capital expenditure has occurred. These have also been invested in a variety of fixed term call accounts that attract higher rates of interest, whilst still remaining accessible. This will be closely monitored throughout the year.

3.8 During the quarter ended 30 September 2019 the approved limits within the Annual Investment Strategy were breached for 2 days due to the incorrect payment method used to a financial institution, which meant that the 40% counterparty balance limit was breached with its own bank Lloyds. Further information is contained in the main body of the report at paragraph 4.10.

3.9 Investment Counterparty Criteria - The current investment counterparty criteria selection was approved in the Treasury Management Strategy Statement by Cabinet and Council in February 2019. In Quarter 2 it has been identified that the limits previously set are now restricting the investment ability of the Council. This is due to the increase in borrowing creating surplus funds that need to be invested in short term accounts so that the money is available when required to meet the capital programme expenditure profile. Therefore it is recommended that the Counterparty limits are increased for approved in this report.

3.10 Individual Limits – These limits will be set at 35% of total investments or £7,000,000 per counterparty whichever is the higher. This is an increase in percentage terms of 5% from 30% and in monetary value by £4,000,000 from £3,000,000. This allows an increased amount to be invested with an individual counterparty whilst still allowing the Council's total investment to be spread between at least 3 different counterparties.

3.11 All other individual counterparty limits will remain as per the Treasury Management Strategy Statement approved in February 2019.

3.12 Group Limits – the group limit will also be as stated for the individual limits as it is important to diversify the risk to a variety of counterparties.

4.0 BORROWING 2019/20 – MID YEAR REVIEW & QUARTER 2 UPDATE

4.1 During Quarter 2 £10,000,000 has been borrowed from the Public Works Loan Board, this has been taken in preparation of the large 2019/20 Capital Programme and it is anticipated that further borrowing will be undertaken during 2019/20. At 30 September 2019 the Council had five loans to the value of £22,700,000 of long term borrowing with the Public Works Loan Board (PWLB). These can be seen in the table below:-

Start Date	End Date	No of Years	Rate	Amount
05/09/16	05/09/21	5	1.05	£1,200,000
07/03/19	07/03/69	50	2.45	£9,000,000
25/03/19	25/03/64	45	2.24	£2,500,000
02/09/19	02/09/29	10	1.20	£5,000,000
05/09/19	05/09/34	15	1.43	£5,000,000
TOTAL				**£22,700,000**

Table 4: Long term borrowing at 30 September 2019

4.2 The table below shows the Public Works Loans Board (PWLB) interest rates which were available for loans during the first six months of 2019/20. The Public Works Loans Board (PWLB) is the mechanism by which the Government allows local authorities to borrow at slightly lower interest rates than are available to other institutions. Certainty rates, as detailed in the table, are interest rates available to local authorities if they inform the Government of their borrowing requirements and are 0.02% (or 20 basis points) below Public Works Loans Board (PWLB) rates. This was introduced by the Government in October 2012.

	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	1.17%	1.01%	1.13%	1.73%	1.57%
Date	03/09/2019	03/09/2019	03/09/2019	03/09/2019	03/09/2019
High	1.58%	1.73%	2.07%	2.58%	2.41%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	17/04/2019
Average	1.40%	1.37%	1.62%	2.20%	2.07%

Table 5: Public Works Loan Board (PWLB) certainty rates up to 30 September 2019

4.3 In relation to further borrowing, it should be noted on 9 October 2019 the Treasury and Public Works Loan Board (PWLB) announced an increase in the margin over gilt yields of 100 basis points on top of the current margin of 80 basis points which this Council has paid prior to this date for new borrowing from the Public Works Loan Board (PWLB). There was no prior warning that this would occur and it now means that the Council has to assess how to finance its external borrowing needs and the financial viability of capital projects in the capital programme due to this unexpected increase in the cost of borrowing.

4.4 Representations has been made to HM Treasury to suggest that areas of capital expenditure that the Government are keen to see move forward should not be subject to such a large increase in borrowing. Whereas this Council has previously relied on the Public Works Loan Board (PWLB) as its only source of funding, it now has to reconsider alternative sources of borrowing. At the current time, this is under consideration as this event was unexpected in the financial services industry. We are expecting that various financial institutions will enter the market or make products available to local authorities. Members will be updated as this area evolves.

4.5 Whereas this Council has previously relied on the Public Works Loan Board (PWLB) as its only source of funding, it now has to reconsider alternative cheaper sources of borrowing. At the current time, this is under consideration as this event was unexpected in the financial services industry. We are expecting that various financial institutions will enter the market or make products available to local authorities. Members will be updated as this area evolves.

4.6 It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. This Authority may make use of this new source of borrowing as and when appropriate.

4.7 **Treasury Borrowing** – Due to the overall financial position and the underlying need to borrow for capital purposes, external borrowing of £12,700,000 had been taken up to Quarter 1 2019/20 from the Public Works Loan Board (PWLB). The Council took two new loans with the Public Works Loan Board (PWLB) during Quarter 2, 2019/20 for £5,000,000 each making the total borrowing at the end of Quarter 2 to be £22,700,000.

4.8 It is anticipated that further borrowing will be required in 2019/20 to support the overall Capital Programme.

4.9 **Rescheduling of Borrowing** – Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted Public Works Loan Board (PWLB) new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. The 100bps increase in Public Works Loan Board (PWLB) rates from 9 October 2019 only applied to new borrowing rates, not to premature repayment rates.

4.10 **Repayment of Borrowing** – the Council did not have any borrowing to repay during Quarter 2 of 2019/20

5.0 <u>OTHE AREAS FOR CONSIDERATION</u>

5.1 **Changes in risk appetite -** The 2018 CIPFA Capital and Treasury Management Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to members’ attention in treasury management update reports.

ANNEX D

Economic Update

United Kingdom

This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or before 31 October, with or without a deal. However, in September 2019, his proroguing of Parliament was overturned by the Supreme Court and Parliament carried a bill to delay Brexit until 31 January 2020 if there is no deal by 31 October 2019.

MPs also voted down holding a general election before 31 October, though one is likely before the end of 2019. So far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. At the time of writing the whole Brexit situation is highly fluid and could change radically by the day. Given these circumstances and the likelihood of an imminent general election, any interest rate forecasts are subject to material change as the situation evolves.

If the UK does soon achieve a deal on Brexit agreed with the EU then it is possible that growth could recover relatively quickly. The Monetary Policy Committee (MPC) could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation.

On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently and the Monetary Policy Committee (MPC) would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy.

The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies.

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

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

With regard to the labour market, despite the contraction in quarterly GDP growth of -0.2% q/q, (+1.3% y/y), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3.

Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than Consumer Price Index inflation), earnings grew by about 2.1%.

As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The latest Gross Domestic Product statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the Monetary Policy Committee will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

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

USA

President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further.

The strong growth in employment numbers during 2018 has reversed into a falling trend during 2019, indicating that the economy is cooling, while inflationary pressures are also weakening The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates again in September to 1.75% - 2.00% and is thought likely to cut another 25 bps in December.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

EUROZONE

Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1 and then fell to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019.

German GDP growth fell to -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in Euro Zone growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the European Central Bank to take new measures to stimulate growth.

At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of Targeted Longer-Term Refinancing Operations; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new Targeted Longer-Term Refinancing Operations will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in Euro Zone and world growth has gathered momentum so at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a resumption of quantitative easing purchases of debt.

It also increased the maturity of the third round of Targeted Longer-Term Refinancing Operations from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and unsurprisingly, the European Central Bank stated that governments will need to help stimulate growth by fiscal policy.

On the political front, Austria, Spain and Italy are in the throes of forming coalition governments with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

CHINA

Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Progress also still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. The trade war with the US does not appear currently to have had a significant effect on Gross Domestic Product growth as some of the impact of tariffs has been offset by falls in the exchange rate and by transhipping exports through other countries, rather than directly to the US.

JAPAN

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

WORLD GROWTH

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

Concerns are focused on the synchronised general weakening of growth in the major economies of the world compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns have resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks.

INTEREST RATE FORECAST

The Council's treasury advisor, Link Asset Services, has provided the following forecast: This forecast includes the increase in margin over gilt yields of 100 basis points introduced on 9 October 2019.

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

Table 1: Link Asset Services' Interest Rate Forecasts

The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit at some point in time. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That's shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth".

Brexit uncertainty has had a dampening effect on UK Gross Domestic Product growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September Monetary Policy Committee meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

Bond yields / Public Works Loan Board rates. There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years.

We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

What we saw during the last half year up to 30 September is a near halving of longer term Public Works Loan Board rates to completely unprecedented historic low levels. (See paragraph 7 for comments on the increase in margin over gilt yields of 100bps introduced on 9.10.19.) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but due to a correlation between US treasuries and UK gilts, which at various times has been strong but at other times weaker, in the UK. However, forecasting the timing of this and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt fuelled boom which now makes it harder for economies to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.

- The balance of risks to increases in Bank Rate and shorter term Public Works Loan Board rates are broadly similarly to the downside.

One risk that is both an upside and downside risk is that all central banks are now working in very different economic conditions than before the 2008 financial crash. There has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for eleven years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could, therefore, over or under-do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.

- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- A resurgence of the **Eurozone sovereign debt crisis**. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new unlikely alliance of two very different parties will endure.

- Weak capitalisation of some **European banks**, particularly Italian banks.

- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor, though more recently concerns have arisen over her health.

- **Other minority EU governments**. Austria, Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.

- **Italy, Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.

There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.

- **Geopolitical risks**, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and Public Works Loan Board rates

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

ANNEX E

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

2019/20 – 30 SEPTEMBER 2019

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits – the Authorised Limit and the Operational Boundary - as detailed below. The Council approved the Treasury and Prudential Indicators (affordability limits), for the 2019/20 financial year at Council on 26 February 2019 in the Treasury Management Strategy Statement.

The main purpose of the indicators is to control how much a Council needs to borrow.
In 2019/20, The Treasury Management Strategy Statement approved the capital financing requirement at £77,665,000 which gives the Council the ability to either use surplus funds to support the capital expenditure or to take external borrowing; this has been revised down at Quarter 2 in accordance with the requirement of the capital programme to £57,732,000.

The Prudential and Treasury Indicators are detailed below as approved at Council prior to the beginning of the 2019/20 financial year – Original Budget - and Quarter 2 Actual:

1. PRUDENTIAL INDICATORS	**2019/20**	**2019/20**
Extract from budget and rent setting report	**Original Budget**	**Actual Q2**
	£'000	**£'000**
Capital Expenditure	44,317	27,959
Capital Financing Requirement 31 March 2020	77,665	57,732
Capital Financing Requirement – Brought Forward	37,664	38,170
Capital Financing Requirement – Council Services	1,913	4,312
Capital Financing Requirement – Commercial Activities	38,088	15,250
Annual Change in the Capital Financing Requirement	-	19,933
In year borrowing requirement	40,001	19,562
Brought forward 1 April	12,664	12,700
Carried forward 31 March	52,665	32,262
Ratio of financing costs to net revenue stream	2.87%	3.95%

2. TREASURY MANAGEMENT INDICATORS	2019/20	2019/20
	Original Budget	Actual Q2
	£'000	£'000
Authorised Limit for external debt	81,000	81,000
Operational Boundary for external debt	79,400	79,400
External debt	52,665	22,700
Investments	5,000	17,050

Maturity structure of fixed rate borrowing during 2019/20	Lower limit	Upper limit
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%

Annex F

Third Party Companies update at Qtr. 2 2019/20

Introduction

The purpose of this Annex is to provide information in line with the Local Government Ethical Standards and The Review undertaken by the Committee on Standards in Public Life. This identified areas of 'best practice' for local authorities which represent a benchmark for ethical practice. One area included that the Council should report on separate bodies they have set up or which they own as part of their annual governance statement. The Annual Governance Statement is presented to the Audit Governance and Standards Committee on an annual basis in July each year.

In order for the Council to provide a full picture of the relationship with separate bodies and abide by the Nolan principle of openness and to be transparent the information included here reports on the financial position of the Council's Third party companies.

Third Party Companies

The Council currently has one third party company – a Joint venture Partnership with Wykeland – Central Northallerton Development Company Ltd that was formed in October 2017.

In addition, in September 2019 Council, it was approved that delegated authority be given to the Chief Executive to set up a further wholly owned company for the purpose of acquiring and managing investment properties. Information will be reported to Members in due course as a result of the approval to set up the wholly owned company which includes the investment strategy, the appointment of legal and financial advisors in line with the Council's procurement rules and the appoint of Lambert Smith Hampton as property advisors and property managers.

Central Northallerton Development Company Limited

Annual Accounts 2018/19 - Central Northallerton Development Company Limited has produced final accounts for two years where the Annual Report and Financial Statements 31 March 2019 for 2018/19 are published at Companies House and are also available on the Council's website. The link is as follows:
https://www.hambleton.gov.uk/info/20257/council_budget_and_spending/267/statement_of_accounts/4

Quarter 2 2019/20 as 30 September 2019 - Attached at Appendix A is Central Northallerton Development Company Limited's financial portion at Quarter 2 2019/20. The following information highlights information from the accounts:

- The accounts show a profit for the financial period from 1 April 2019 to 30 September 2019 is £1,210;

- The 'Turnover' is the rent received from Crosby Road Car Park of £45,046 where HDC receives 100% of the initial £55,000, £55,000 to £70,000 goes to CNDCL (of which HDC will receive 50%) and then after £70,000 HDC receives 60% and Wykeland 40%. This is detailed in the 4 September 2018 Cabinet report;

- The 'Investment Properties' in the balance sheet mainly relate to the Crosby Road Car park;

- The ‘Inventories’ figure in the balance sheet mainly relates to the development of the south side of the Treadmills site;

- The ‘Loan from Hambleton District Council’ in the balance sheet of £2,415,248 is in relation to the land transfer of the former prison site; and

- The loss brought forward from previous years is £67,271.

Appendix A

Statement of Comprehensive income for the year ended 31 March 2020 - for the period ending 30 September 2019

	Period ended 30-Sep-19	Year ended 31-Mar-19
Turnover	45,046	1,661,249
Cost of Sales	0	(1,676,706)
Gross profit (loss)	45,046	(15,457)
Administrative expenses	(43,835)	(39,391)
Loss on ordinary activities before taxation	**1,210**	**(54,848)**
Tax on loss on ordinary activities	0	0
Profit/(Loss) for the financial year/period	**1,210**	**(54,848)**

Balance Sheet at 30 September 2019

	30-Sep-19	31-Mar-19
Fixed Assets		
Investment Properties	31,159	0
Current Assets		
Inventories	1,468,126	1,156,395
Debtors	215,638	1,993,409
Cash at bank and in hand	584,474	0
	2,268,238	3,149,804
Creditors: amounts falling due in within one year	49,793	(801,823)
Net Current assets/(liabilities)	**2,318,031**	**2,347,981**
Total assets less current liabilities	**2,349,190**	**2,347,981**
Creditors: amounts falling due after more than one year	(2,415,248)	(2,415,248)
Net Liabilities	**(66,057)**	**(67,267)**
Capital and Reserves		
Called up share capital	4	4
Profit and loss account	(66,061)	(67,271)
Total shareholder' deficit	**(66,057)**	**(67,267)**

Statement of changes in equity for the year ended 31 March 2019

	Profit and loss account £	Total shareholders' deficit £
Balance at 31 March 2019	**(67,271)**	**(67,267)**
Profit for the financial year to date	1,210	1,210
Balance at 30 September 2019	**(66,061)**	**(66,057)**