Melton Borough Council
Helping people | Shaping places

Cabinet

15 July 2020

Report of: Councillor Ronnie de Burle - Portfolio Holder for Corporate Finance and Resources

Treasury Management Annual Report 2019/20

Corporate Priority:	OG3 Becoming a more agile & commercial Council; securing our financial future
Relevant Ward Member(s):	N/A
Date of consultation with Ward Member(s):	
Exempt Information:	No
Key Decision:	No
Subject to call-in:	No Not key decision

1 Summary

1.1 The report provides a summary of the Treasury activities in 2019-20. The report also covers the actual position on the Prudential Indicators in accordance with the Prudential Code.

2 Recommendations

That Cabinet:

2.1 approves the Treasury Management Annual Report for 2019-20 for submission to the Council

2.2 note the actual position on Prudential Indicators for 2019-20

3 Reason for Recommendations

3.1 It is important that Cabinet are aware of the Council's Treasury Management performance to ensure they can make informed decisions that protect the Council's financial assets while taking regard of financial stability and potential returns.

3.2 The Annual Treasury Report is a requirement of the Council's reporting procedures

3.3 The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both codes through Regulations issued under the Local Government Act 2003.

4 Background

4.1 The Treasury Management Code of Practice is reviewed and the Strategy is approved at the start of each financial year. The following documents in respect of the 2019/20 financial year were approved by the Council as part of the budget setting process on 13 February 2019:-

- Borrowing and Investment Objectives
- Capital Finance Objectives
- Investment and Borrowing Strategies
- Borrowing Limits

4.2 Updates have been provided to Members during the year through the Members Newsletter.

4.3 Continued changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the year end position for treasury activities and highlights compliance with the Council's policies previously approved by members. The Council has complied with the requirement of the Code to give prior scrutiny to all of the above treasury management reports by this meeting before they are reported to the Council.

4.4 During 2019-20 the Council complied with the legislation and regulatory requirements which limit the levels of risk associated with its Treasury Management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means that its capital expenditure was prudent, affordable and sustainable and its treasury practices demonstrated a low risk approach. The key prudential indicators for the year, with comparators, are as follows:

Prudential and treasury indicators	2018/19 Actual £m	2019/20 Original £m	2019/20 Actual £m
Capital expenditure	3.478	3.724	3.168
Capital Financing Requirement: • Non-HRA • HRA • Total	 0.101 31.484 31.585	 0.089 31.484 31.573	 0.089 31.484 31.573
Gross borrowing / Debt	31.413	31.413	31.413

Prudential and treasury indicators	2018/19 Actual £m	2019/20 Original £m	2019/20 Actual £m
Investments: Less than 1 year Longer than1 year	 £18.7m £2.0m (Property Fund)	 £18.1m £2.0m (Property Fund)	 £18.5m £2.0m (Property Fund)

4.4.1 No borrowing was undertaken for any further purpose and the Council's maximum actual borrowing position of £31.413m was within its Statutory Borrowing Limit and the Authorised Limit of £46m. At 31 March 2020, the Council's external debt was £31.413m (£31.413m at 31 March 2019) and its investments totalled £20.1m (£20.7m at 31 March 2019).

4.4.2 The anticipated level of investments in 2019/20 was forecast at £20.1m in February 2019. Since this forecast the level of investments have been higher than predicted due to an underspend on the capital programme in 2019/20.

4.5 The Annual Report provides comprehensive detail of the activities undertaken on treasury management during the last financial year. It provides, at Appendix A, the performance of the prudential indicators against the indices set by the Council as part of the budget setting process.

4.5.1 The key areas to note are:

a) The ratio of the financing costs to the net revenue stream has reduced in respect of the General Fund (-3.80% in 2019-20 compared to -3.74% in 2018-19) and increased marginally in respect of HRA (31.96% in 2019-20 compared to 30.49% in 2018-19 as per Appendix A), due to a reduction in income. You will notice that there has been little movement between the two years on the HRA due to debt levels being stable. On the general fund there are no financing costs (i.e. no debt) therefore the change between years is due to increased investment returns.

b) The gross borrowing, except in the short term, should not exceed the CFR. This is to ensure that borrowing levels are prudent and, over the medium term, the Council's external borrowing, net of investments, is only utilised for a capital purpose. As at 31 March 2020 gross borrowing was below the CFR, primarily due to a small amount of internal borrowing on the HRA.

c) The overall investment rate of return was 1.25% compared to 1.20% in 2018-19.

d) With both the level of balances available for investment and rate of return being higher than budgeted, this has resulted in £138k of additional income against the original budget. This is across both the General Fund and HRA.

4.6 The 2019-20 financial year has continued to be a testing and difficult economic environment in which to manage investments with investment returns continuing to remain low. Despite disappointing GDP growth figures earlier in the year, there was a gentle rise in investment returns in advance of an increase in the Bank Rate in August 2019. Any subsequent increases in investment rates have since been offset due to concerns regarding Brexit. This was not an easy backdrop in which to undertake treasury management activities, particularly investments but the Council has worked hard to maximise returns which has resulted in an increased average rate of return as outlined in para 4.5.

4.7 The investment portfolio has continued to incorporate more diversification in terms of both counterparty and maturity. As interest rates are currently at low levels given the impact of COVID-19 it is not a good time to be locking funds into very long term investments through standard bank deposits and therefore the portfolio does not extend beyond twelve months. However, in order to maximise investment returns the Council continues to hold £2m in a CCLA property fund which has generated positive returns for the Council.

4.8 **Impact of Covid-19**

The onset of Covid-19 began to have an impact towards the end of 2019/20, resulting in the following:

- The Bank of England reduced the Bank Rate to 0.1% with a corresponding impact on short term investment rates.
- The Council's property Fund investment has shown a fall in valuation of around 5% at the start of 2020/21
- In March 2019 the counterparty limit for MMF investments was increased to £6m to allow management of £11.7m business grant funding provided by Government.
- The implementation of IFRS 16 bringing currently off balance sheet leased assets on to the balance sheet, has been delayed for one year to 2020/21.

4.9 **Implementation of IFRS9**

4.9.1 The implementation of IFRS9 has resulted in a change in the treatment of the £2m investment in the CCLA property fund, such that fluctuations in the value of the fund now impact on the Surplus or Deficit on the Provision of Services.

4.9.2 Following consultation, the MHLG have introduced a mandatory statutory override to mitigate any effect on the General Fund. However, this override has been limited to 5 years to allow councils time to adjust their portfolio of investments, if that is felt necessary.

4.9.3 In 2019/20 there was a reduction in the valuation of the property fund of £74,000 but at present this is just a notional loss. The fund value could reduce further over the course of 2020/21 but in the long term the fund managers expect the fund value to return to previous levels as the economy recoveries from COVID-19. Moving forward the Council has previously approved the establishment of a reserve in order to help offset any potential deficits that might arise in future in advance of the statutory override being removed. The 2020/21 budget includes a budget provision of £60k as part of the managed contributions in the medium term to build up a reserve fund to be called on in the future if required.

5 Main Considerations

5.1 Considerations have been addressed in paragraph 4 to this report.

6 Options Considered

6.1 No other options considered. If the report was not provided councillors would not be aware of ongoing developments and therefore would not be able to represent their residents effectively.

7 Consultation

7.1 Consultation has been undertaken with the portfolio holder regarding the positon for the 2019-20 financial year.

8 Next Steps – Implementation and Communication

8.1 This report will be submitted to the Council meeting on 22nd July 2020.

9 Financial Implications

9.1 The Treasury Management Strategy and Policy are core financial policies which underpin all the work of the Treasury Management function and incorporate any implications arising from the capital programme.

9.2 The impact of COVID-19 continues to be felt with interest rates and associated investment returns reducing. It is still early in the financial year and whilst officers are continuing to maximise returns there is likely to be a shortfall against the investment income budget which will add to the growing financial pressure the Council is facing during this national crisis.

Financial Implications reviewed by: Director for Corporate Services

10 Legal and Governance Implications

10.1 The Local Government Act 2003 provides the powers to invest and borrow as well as providing controls and limits on the activity.

Legal Implications reviewed by: Director for Governance and Regulatory Services

11 Equality and Safeguarding Implications

11.1 There are no direct equality or safeguarding issues arising from this report.

12 Community Safety Implications

12.1 There are no direct links to community safety arising from this report.

13 Environmental and Climate Change Implications

13.1 No implications have been identified.

14 Other Implications (where significant)

14.1 No other implications have been identified

15 Risk & Mitigation

These are assessed as part of the Corporate Services Risk Register.

Risk No	Risk Description	Likelihood	Impact	Risk
1	Loss of investment income during 2020-21 as result of COVID-19 and associated reduction in interest rates	High	Marginal	Medium Risk
2	Reduction in the valuation of the Councils Property Fund investment resulting. The Treasury Management Policy has various limits in place in order to mitigate any likelihood of loss to the Council. A fund has been established to mitigate any losses in the property fund.	Low	Marginal	Low Risk

		Impact / Consequences			
		Negligible	Marginal	Critical	Catastrophic
Likelihood	Score/ definition	1	2	3	4
	6 Very High				
	5 High		1		
	4 Significant				
	3 Low		2		
	2 Very Low				
	1 Almost impossible				

16 Background Papers.

16.1 Treasury Management Strategy Statement 2019/20

17 Appendices

17.1 Appendix A – Annual Treasury Management Review 2019/20

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Annual Treasury Management Review 2019/20

Melton Borough Council
April 2020

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Annual Treasury Management Review 2019/20

Purpose

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

During 2019/20 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 13/02/2019)
- a mid-year, (minimum), treasury update report (Cabinet 27/11/2019)
- an annual review following the end of the year describing the activity compared to the strategy, (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Cabinet before they were reported to the full Council. Member training on treasury management issues was undertaken during the year in September 2019 in order to support members' scrutiny role.

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness, (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£'000 General Fund	2018/19 Actual	2019/20 Budget	2019/20 Actual
Capital expenditure	**993**	**768**	**319**
Financed in year	993	768	319
Unfinanced capital expenditure	**0**	**0**	**0**

£'000 HRA	2018/19 Actual	2019/20 Budget	2019/20 Actual
Capital expenditure	**2,485**	**2.956**	**2,849**
Financed in year	2,485	2,956	2,849
Unfinanced capital expenditure	**0**	**0**	**0**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2019/20 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need, (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2019/20 MRP Policy, (as required by MHCLG Guidance), was approved as part of the Treasury Management Strategy Report for 2019/20 on 13/02/2019.

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR (£'000): General Fund	31 March 2019 Actual	31 March 2020 Budget	31 March 2020 Actual
Opening balance	113	101	101
Less PFI & finance lease repayments	(12)	(12)	(12)
Closing balance	101	89	89

CFR (£'000): HRA	31 March 2019 Actual	31 March 2020 Budget	31 March 2020 Actual
Opening balance	31,484	31,484	31,484
Closing balance	31,484	31,484	31,484

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

£'000	31 March 2019 Actual	31 March 2020 Budget	31 March 2020 Actual
Gross borrowing position	31,514	31,502	31,502
CFR	31,585	31,573	31,573
(Under) / over funding against CFR	(71)	(71)	(71)

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2019/20 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2019/20
Authorised limit (£'000)	46,000
Maximum gross borrowing position during the year (£'000)	31,514
Operational boundary (£'000)	36,502
Average gross borrowing position (£'000)	31,514
Financing costs as a proportion of net revenue stream: General Fund HRA	-3.74% 31.96%

3. Treasury Position as at 31 March 2020

The Council's treasury management debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2019/20 the Council's treasury, (excluding borrowing by PFI and finance leases), position was as follows:

DEBT PORTFOLIO	31 March 2019 Principal £'000	Rate/ Return %*	Average Life Yrs	31 March 2020 Principal £'000	Rate/ Return %*	Average Life Yrs
Fixed rate funding:						
-PWLB	31,413	3.72%	32	31,413	3.72%	32
CFR	31,484			31,484		
Over / (under) borrowing	(71)			(71)		
Total investments	20,710	1.2%	£18.7m under 1yr £2m over 1 yr	20,500	1.25%	£18.5m under 1 yr £2m over 1 yr
Net debt	**10,702**	**1.93%**		**10,913**	**1.77%**	

'* - Rate on average of balances over the year

The maturity structure of the debt portfolio was as follows:

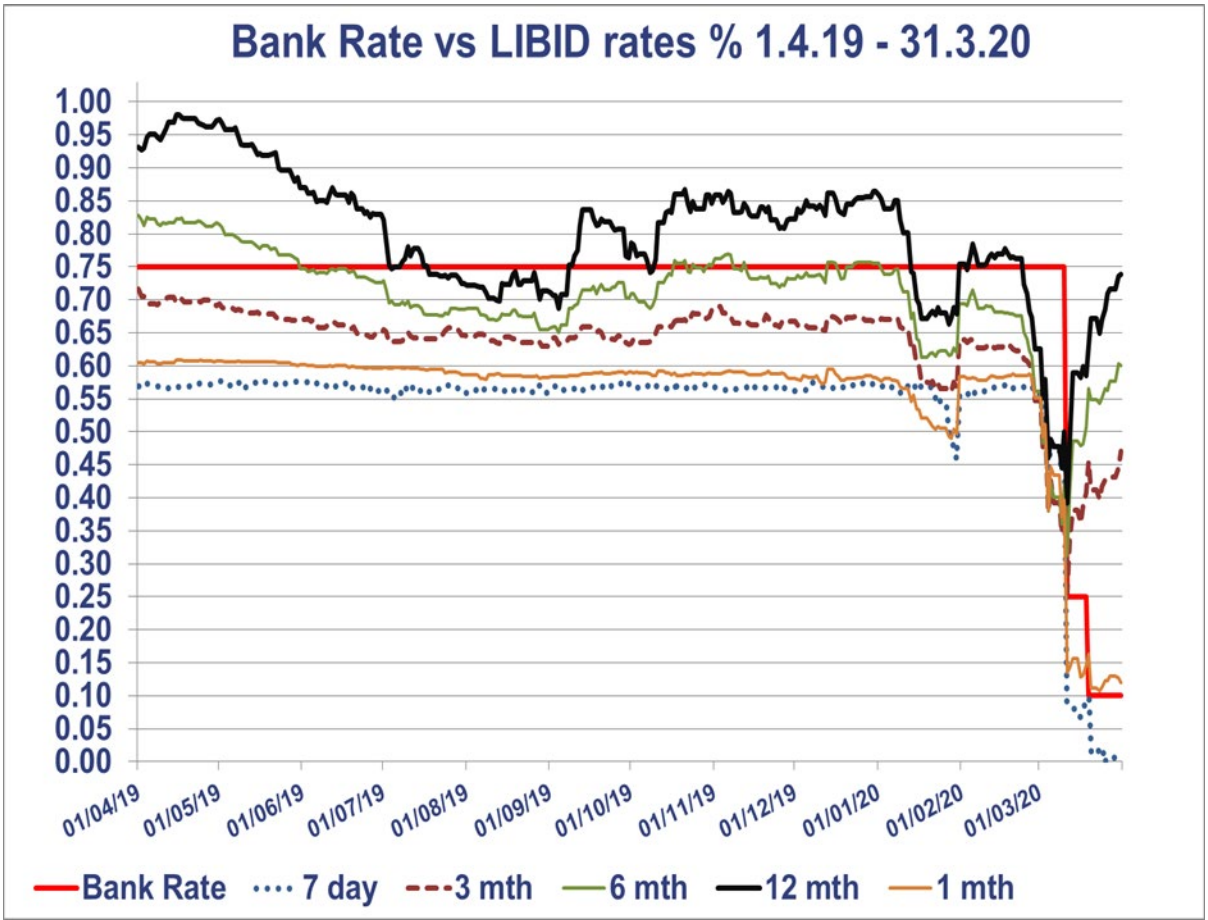
	31 March 2019 Actual £'000	31 March 2020 Actual £'000
24 months and within 5 years	0	98
5 years and within 10 years	4,098	4,300
10 years and within 20 years	600	300
20 years and within 30 years	10,000	10,000
30 years and within 40 years	10,840	10,840
40 years and within 50 years	5,875	5,875

The maturity structure of the investment portfolio was as follows:

	31 March 2019 Actual £000	2019/20 Budget £000	31 March 2020 Actual £000
Investments			
Longer than 1 year	2,000	2,000	2,000
Up to 1 year	18,710	11,019	18,500
Total	20,710	13,019	20,500

4. The Strategy for 2019/20

4.1 Investment strategy and control of interest rate risk



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.75	0.58	0.61	0.72	0.83	0.98
High Date	01/04/2019	09/05/2019	15/04/2019	01/04/2019	01/04/2019	15/04/2019
Low	0.10	0.00	0.11	0.26	0.31	0.39
Low Date	19/03/2020	25/03/2020	23/03/2020	11/03/2020	11/03/2020	11/03/2020
Average	0.72	0.53	0.56	0.63	0.70	0.80
Spread	0.65	0.58	0.50	0.46	0.52	0.59

Link Asset Services Interest Rate View 31.3.20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020.

Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

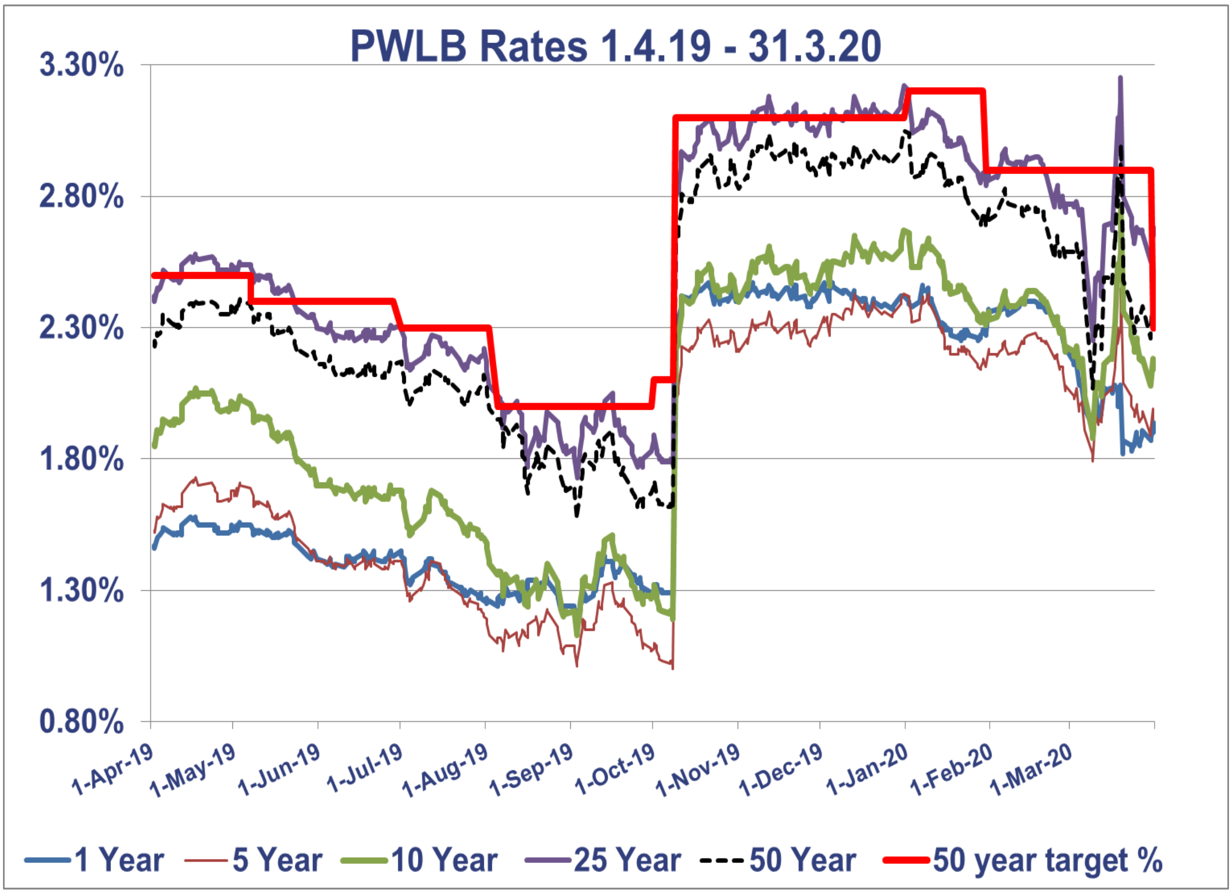
Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. The Council has no new requirements for borrowing at present and isn't expecting to undertake new borrowing during 2020/21.

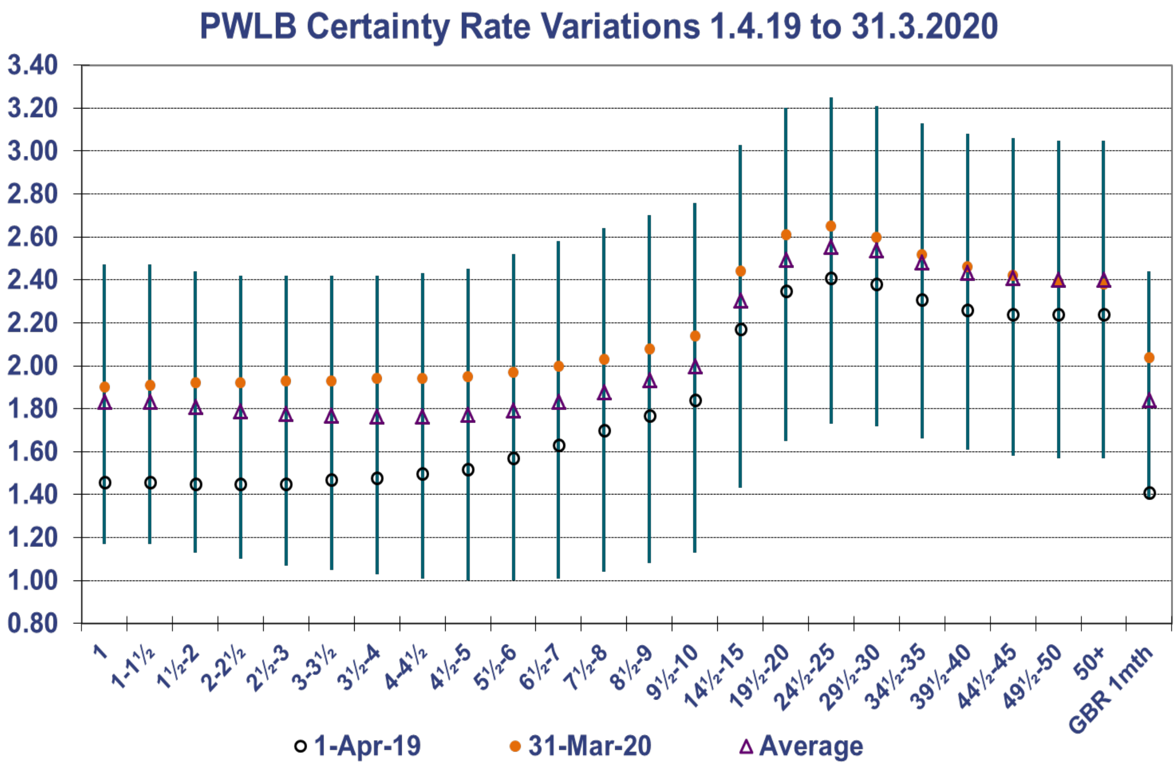
4.2 Borrowing strategy and control of interest rate risk

In the light of the investment position identified in paragraph 5.1 above, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk. However, as anticipated no new borrowing was required during 2019-20.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View 31.1.20	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.50	2.60	2.70	2.80	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	2.70	2.80	2.90	3.00	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.30	3.40	3.50	3.60	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.20	3.30	3.40	3.50	3.80





	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	1.46%	1.52%	1.84%	2.41%	2.24%
31/03/2020	1.90%	1.95%	2.14%	2.65%	2.39%
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.45%	2.76%	3.25%	3.05%
Date	21/10/2019	19/03/2020	19/03/2020	19/03/2020	31/12/2019
Average	1.83%	1.77%	2.00%	2.56%	2.40%

PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks also started quantitative easing purchases of government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.

However, HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then partially reversed for some forms of borrowing on 11th March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ended on 4 June. It would appear the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream and this is expected to be made clear in the outcome of the consultation when published.

Following the changes on 11th March 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020-21.

5. Borrowing Outturn

There were no borrowing requirements during 2019/20.

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

6. Investment Outturn

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 13/02/2019. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£'000)	31 March 2019	31 March 2020
Balances	4,890	5,194
Earmarked reserves	9,449	8,975
Provisions	566	587
Usable capital receipts	5,313	6,012
Total	**20,218**	**20,768**

Investments held by the Council

- The Council maintained an average balance of £24.8m of internally managed funds.
- The internally managed funds earned an average rate of return of 1.25%.
- The comparable performance indicator is the average 7-day LIBID rate, which was 0.5338%.
- Total investment income was £310,639 compared to a budget of £172,286

8. Other Issues

1. Covid-19

a) Interest Rates

The end of 2019-20 saw interest rates fall following the impact of Covid-19. There was a particular effect on short term rates as the Bank of England reduced the Bank Rate to 0.1%. Although longer term rates have bounced back the net effect is likely to result in lower levels of return on investments during 2020-21.

b) Property Fund

The Council's property Fund investment has shown a fall in valuation of around 5% at the start of 2020/21, particularly due to the impact on the retail sector. The Property Fund managers are expecting to see returns from the Fund balance out over the year at around 10-15% less than 2019-20.

c) Counterparty limits

In March 2019 the counterparty limit for MMF investments was increased to £6m, in view of the timing and level of Government grants to help deal with the coronavirus outbreak.

d) IFRS 16

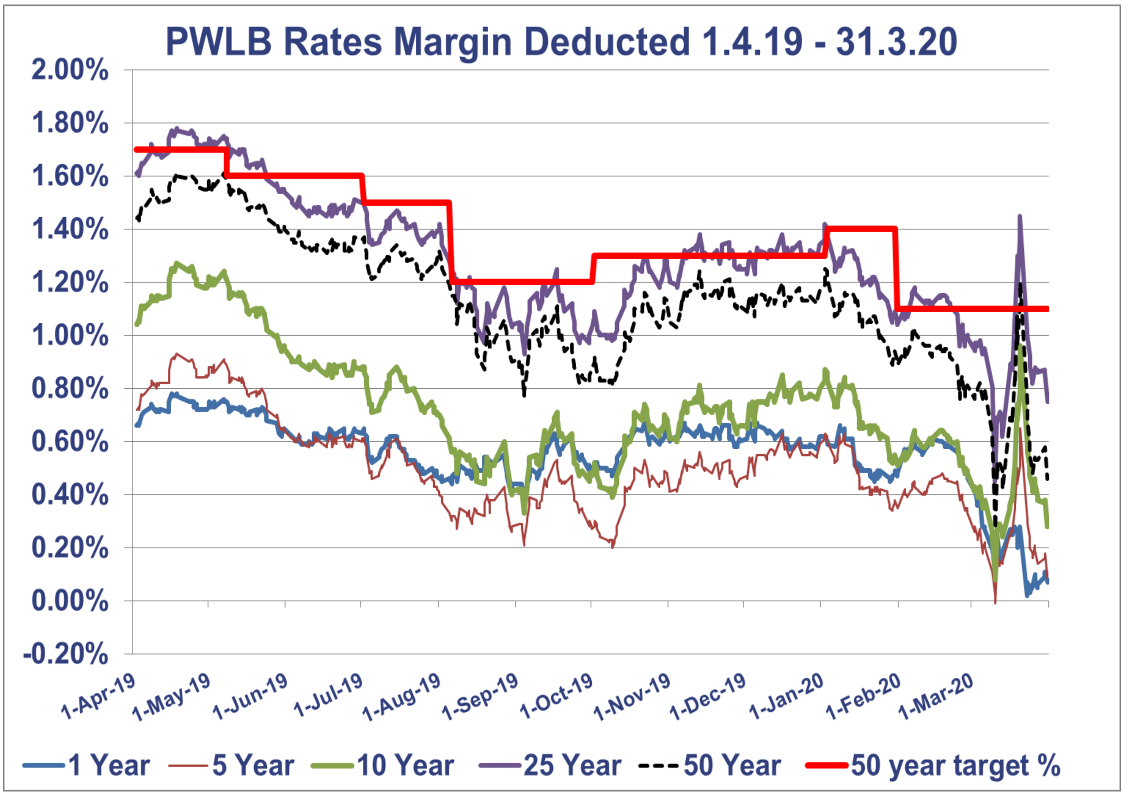
The implementation of IFRS 16 bringing currently off balance sheet leased assets on to the balance sheet, has been delayed for one year to 2020/21 due to the impact of Covid-19.

2. IFRS 9 fair value of investment

Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS 9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This became effective from 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

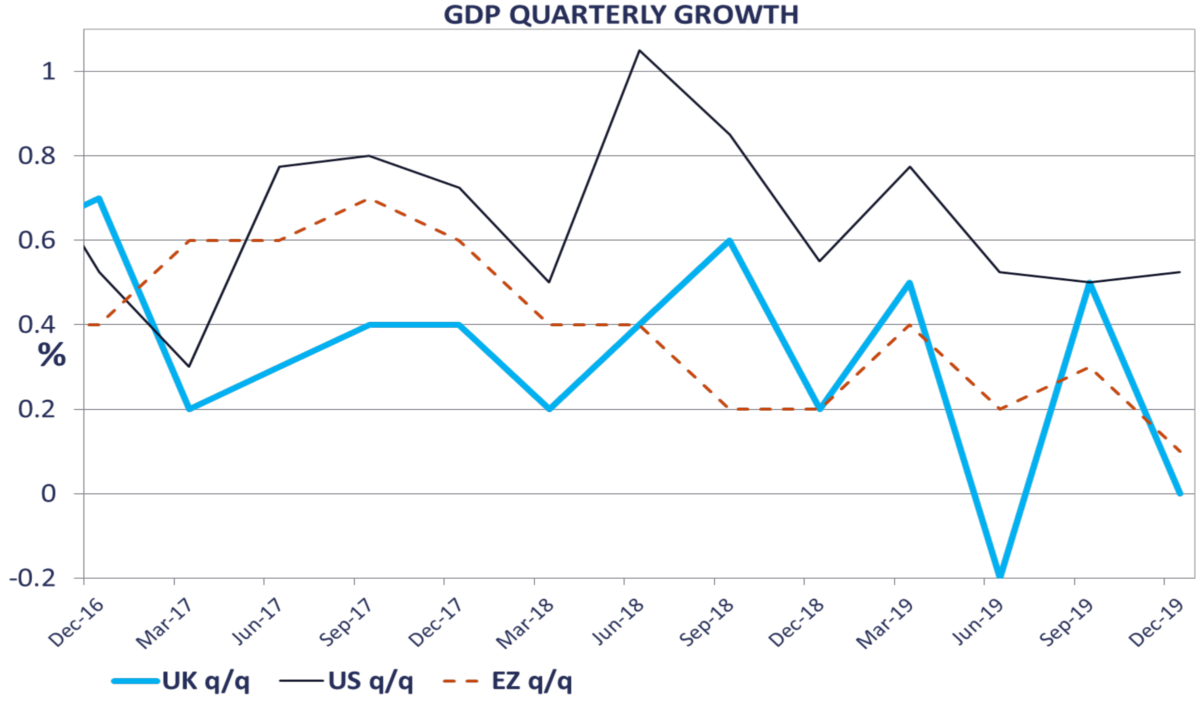
Appendix 1: Graphs

The graphs and tables in paragraph 4.2 are for PWLB certainty rates. On 9.10.19, the margin over gilt yields for PWLB certainty rates was increased from 80 bps to 180 bps. The graph below shows PWLB rates less the margins added over gilt yields. This graph therefore shows more clearly the ***actual movements in gilt yields*** during the year on which PWLB rates are based.

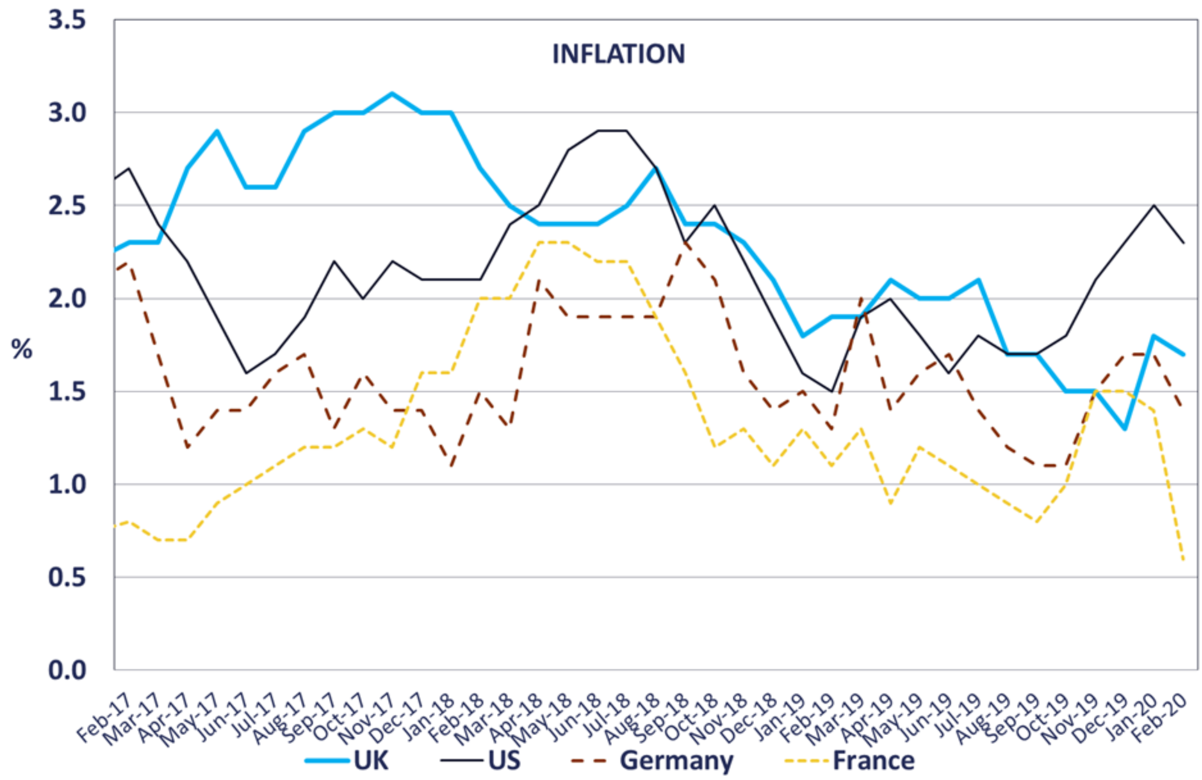


	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	0.66%	0.72%	1.04%	1.61%	1.44%
31/03/2020	0.10%	0.15%	0.34%	0.85%	0.59%
Low	0.02%	-0.01%	0.08%	0.45%	0.27%
Date	20/03/2020	09/03/2020	09/03/2020	09/03/2020	09/03/2020
High	0.78%	0.93%	1.27%	1.78%	1.61%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	17/04/2019
Average	0.55%	0.49%	0.72%	1.28%	1.12%

UK, US and EZ GDP growth



Inflation UK, US, Germany and France



Appendix 2: Investment Portfolio

Investments held as at 31 March 2020 compared to our counterparty list:

Melton Borough Council

Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default	Expected Credit Loss (£)
MMF Invesco	3,000,000	0.54%		MMF	AAA	0.000%	3
Qatar National Bank	1,000,000	1.32%	30/04/2019	29/04/2020	A	0.004%	39
HSBC UK Bank Plc (RFB)	1,500,000	0.20%		Call31	A+	0.004%	62
Qatar National Bank	2,000,000	1.27%	06/06/2019	05/06/2020	A	0.009%	175
Goldman Sachs International Bank	1,000,000	0.95%	01/07/2019	30/06/2020	A	0.012%	121
Goldman Sachs International Bank	1,000,000	0.96%	22/08/2019	21/08/2020	A	0.019%	190
Lloyds Bank Plc (RFB)	3,000,000	1.10%	12/09/2019	11/09/2020	A+	0.022%	653
Lloyds Bank Plc (RFB)	1,000,000	1.10%	20/09/2019	18/09/2020	A+	0.023%	227
Goldman Sachs International Bank	2,000,000	1.03%	01/11/2019	30/10/2020	A	0.028%	566
Qatar National Bank	1,000,000	1.24%	15/11/2019	13/11/2020	A	0.030%	302
Qatar National Bank	2,000,000	1.07%	03/02/2020	01/02/2021	A	0.041%	816
Borrower - Funds	**Principal (£)**	**Interest Rate**	**Start Date**	**Maturity Date**			
CCLA Property Fund	2,000,000						
Total Investments	**£20,500,000**						
Total Investments - excluding Funds	**£18,500,000**	**0.95%**				**0.017%**	**£3,153**
Total Investments - Funds Only	**£2,000,000**						

The Historic Risk of Default column is based on the lowest long term rating. If clients are using this % for their Expected Credit Loss calculation under IFRS 9, please be aware that the Code does not recognise a loss allowance where the counterparty is central government or a local authority since relevant statutory provisions prevent default. For these instruments, the Expected Credit Loss will be nil. Please note that we are currently using Historic Default Rates from 1990-2019 for Fitch, 1983-2019 for Moody's and 1981-2019 for S&P.