Council
Tuesday 25 August 2020

Annual Treasury Management Report 2019/20

Report by Gary Fairley, Chief Officer Corporate Solutions

Report for Noting

1 Recommendations

It is recommended that the Council

a) note the Treasury Management Annual Report for 2019/20.

2 Purpose of Report/Executive Summary

The purpose of the report is to inform members of the Treasury Management activity undertaken in 2019/20 and the year-end position.

Date: 4 August 2020
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3 Background

The main points arising from treasury activity in 2019/20 were:

- Total new long term borrowing taken in the year amounted to £50.000 million, comprising the following:-
  - Two £10.000 million maturity loans from PWLB, both drawn on 25 September 2019, with loan tenors of 20 years and 50 years respectively, and at interest rates of 1.76% and 1.68% respectively;
  - Two £15.000 million maturity loans from PWLB, both drawn on 12 March 2020, with loan tenors of 39.5 years and 48.5 years respectively, and at interest rates of 2.36% and 2.32% respectively;

- Total long term borrowing maturing in the year amounted to £9.201 million, comprising the following:-
  - One £8.400 million Maturity Loan with PWLB matured on 14 December 2019 (original tenor 8 years at an interest rate of 2.77%), refinanced by the PWLB borrowing undertaken on 25 September 2019;
  - £0.037 million of PWLB Annuities of various tenors and interest rates;
  - £0.633 million of Annuity and EIP loans from Deutsche Pfandbrief bank, and £0.131 million of Salix interest free loans.

- Three new long term investments were placed, which continue the strategy of cash backing the Council's reserves, as follows:-
  - £10.000 million placed on deposit with Rushmoor Borough Council, for an 18 month period at an interest rate of 1.15%, deposit date 22 July 2019 and maturity date 22 January 2021;
  - £15.000 million placed on deposit with Wokingham Borough Council, for a 36 month period at an interest rate of 1.60%, deposit date 25 March 2020 and maturity date 24 March 2023;
  - £15.000 million placed on deposit with Medway Council, for a 24 month period at an interest rate of 1.80%, deposit date 30 March 2020 and maturity date 30 March 2022;

- The average rate of interest paid on external debt was 3.44% in 2019/20, down from 3.62% in 2018/19 and reflecting the historically low interest rates secured on longer-term PWLB borrowing in 2019/20;

- The average rate of return on investments was 1.15% in 2019/20, exceeding the benchmark of 0.80% for the sixteenth year in succession;

- The pooled internal loans fund rate for General Fund and HRA decreased from 3.12% in 2018/19 (4th lowest in mainland Scotland – see Appendix 1) to 2.95% in 2019/20, which is again expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland;

- Were the pooled internal loans fund rate to have equated to the Scottish weighted average of 3.81%, this would have generated loan charges in 2019/20 of £19.0 million. The Council's actual 2019/20 loan charges for General Services and HRA were £16.4 million, representing a cash saving (compared to the Scotland average) of £2.6 million in 2019/20;

- The appointment of interest between HRA and General Fund was changed in 2017/18, with the HRA charged interest at the weighted average interest rate on the Council's long-term debt, removing interest rate risk for the HRA to support the long-term rent setting strategy. The interest charged to the General Fund provides support to the Council's medium term financial strategy and capital plans. This methodology was retained in 2019/20.

- No debt rescheduling was undertaken during 2019/20.

A detailed report "*Annual Treasury Management Review 2019/20*" on the activity during 2019/20 is attached as Appendix 2.

The Treasury Portfolio at the start and end of the financial year is shown in Tables 1 and 2 below.

Table 1: Loan Portfolio at 1 April 2019 and 31 March 2020

Loan Type	**Principal Outstanding 1 Apr 2019 £000's**	**Principal Outstanding 31 Mar 2020 £000's**	**Movement £000's**
PWLB Annuity	674	637	-37
PWLB Maturity	187,224	228,824	+41,600
LOBO	20,000	20,000	0
Forward Starting Loans	19,464	18,831	-633
Temporary Market Loans	9,000	0	-9,000
Salix Loans	916	785	-131
Total Loans	**237,279**	**269,077**	**+31,798**

Table 2: Investment Portfolio 1 April 2018 and 31 March 2019

Investment Type	**Principal Outstanding 1 Apr 2019 £000's**	**Principal Outstanding 31 Mar 2020 £000's**	**Movement £000's**
Bank Call Accounts	0	11,476	+11,476
Money Market Funds	9,767	14,901	+5,134
Bank Notice Accounts	49,985	14,985	-35,000
Bank Fixed Term Deposit Accounts	0	30,000	+30,000
Other Local Authorities	15,000	40,000	+25,000
Total Investments	**74,752**	**111,363**	**+36,611**

4. Other Issues

The Code recommends that Treasury reports are presented to and scrutinised by Audit Committee in advance of being considered by Council.

The report is being presented to Audit Committee on 22 June 2020 and to Council at the next meeting of Council thereafter, and will be updated to reflect any comments that the Audit Committee have.

5 Report Implications (Resource, Digital and Risk)

5.1 Resource

Treasury Management activity during the year has been effective in minimising the cost of borrowing and maximising investment income within the parameters set by the strategy for the year.

Although benefits from Treasury Management activity continue to accrue there are no direct financial implications or other resource issues arising from this report.

The loan charges associated with Capital Expenditure and Treasury Management activity during 2019/20 are reported in the Financial Monitoring 2019/20 – General Fund Revenue report elsewhere on today's agenda.

5.2 Digital

None.

5.3 Risk

As the Council follows the requirements of CIPFA Code of Practice and the Prudential Code this minimises the risks involved in Treasury Management activities place. For those risks that do exist there are robust and effective controls in place to further mitigate the level of risks. These include further written Treasury Management Practices, which define the responsibilities of all staff involved.

5.4 Ensuring Equalities (if required a separate IIA must be completed)

This report does not recommend any change to policy or practice and therefore does not require an Equalities Impact Assessment.

5.5 Additional Report Implications

See Appendix A

Appendices:-

Appendix 1: Loans Fund Rate Comparison with other Scottish Local Authorities
Appendix 2: Annual Treasury Management Review 2019/20

Appendix 3: Investment Benchmarking Analysis 2019/20

APPENDIX A – Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Not applicable

A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☐ Holistic Working
- ☐ Hub and Spoke
- ☐ Modern
- ☒ Sustainable
- ☒ Transformational
- ☐ Preventative
- ☐ Asset-based
- ☒ Continuous Improvement
- ☐ One size fits one
- ☐ None of the above

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☐ One Council Working with you, for you
- ☒ Preventative and Sustainable
- ☐ Efficient and Modern
- ☐ Innovative and Ambitious
- ☐ None of the above

A.4 Delivering Best Value

The report does not directly impact on Delivering Best Value.

A.5 Involving Communities and Other Stakeholders

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Link Asset Services, the Council's appointed Treasury Consultants.

A.6 Impact on Performance and Outcomes

The strategies adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and investment. This in turn helps to ensure that the Council's capital expenditure is sustainable in revenue terms.

A.7 Adopting a Preventative Approach

Not applicable.

A.8 Supporting Sustainable Development

Not applicable.

Appendix 1:-

Loans Fund Pooled Rate Comparison 2018/19

Authority	2018/19
West Dunbartonshire	2.770%
Dumfries & Galloway	3.050%
Perth & Kinross	3.055%
Midlothian	3.120%
Aberdeenshire	3.270%
East Lothian	3.270%
North Lanarkshire	3.540%
Inverclyde	3.650%
Fife	3.670%
Dundee City	3.695%
East Dunbartonshire	3.720%
Falkirk	3.740%
Argyll & Bute	3.800%
Aberdeen City	3.820%
West Lothian	3.860%
East Renfrewshire	3.880%
South Lanarkshire	3.940%
Glasgow City	4.000%
Highland	4.010%
South Ayrshire	4.010%
North Ayrshire	4.090%
Scottish Borders	4.100%
Renfrewshire	4.110%
East Ayrshire	4.150%
Stirling	4.160%
Moray	4.190%
Angus	4.350%
Edinburgh City	4.660%
Clackmannanshire	4.915%

The Pooled Loans Fund Rate combines the interest paid by the Council on money borrowed, with the interest earned by the Council on money invested, along with other charges such as internal interest allowed, premiums written off and treasury-related expenses to arrive at a weighted average “loans fund rate” figure for each authority, as noted in the final column above.

Appendix 2

Annual Treasury Management Review 2019/20

Midlothian Council
June 2020

Contents

This Council is required by regulations issued under the Local Government in Scotland 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 12/02/2019);
- a mid-year, (minimum), treasury update report (Council 12/11/2019);
- 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 Audit Committee before they are reported to the full Council.

1. The Council's Capital Expenditure and Financing 2019/20

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.

Table 1: Capital Expenditure + Financing			
	2018/19 Actual £000	**2019/20 Budget £000**	**2019/20 Actual £000**
General Fund			
Capital Expenditure	18,209	45,373	30,978
Available Funding	18,045	25,051	26,062
Borrowing Required	**164**	**20,322**	**4,916**
HRA			
Capital Expenditure	14,718	54,519	24,936
Available Funding	11,086	5,507	11,951
Borrowing Required	**3,632**	**49,012**	**12,985**
General Fund and HRA			
Capital Expenditure	32,927	99,892	55,914
Available Funding	29,131	30,558	38,013
Borrowing Required	**3,796**	**69,334**	**17,901**

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 what resources have been used to pay for the capital spend. It represents the 2019/20 unfinanced capital expenditure (see above table), plus 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 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 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 Scheduled Debt Amortisation (or loans repayment), to reduce the CFR. This is effectively a repayment of the borrowing need. 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 minimum loan repayment each year through an additional revenue charge.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table 2: Council's Capital Financing Requirement			
	31-Mar-19	**2019/20**	**31-Mar-20**
CFR:	**Actual**	**Budget**	**Actual**
	£000	**£000**	**£000**
Opening balance	**£ 280,214**	**£ 284,964**	**£ 274,582**
Add Borrowing Required	£ 3,797	£ 69,334	£ 17,900
Less scheduled debt amortisation	£ (9,429)	£ (8,241)	£ (9,098)
Closing balance	**£ 274,582**	**£ 325,196**	**£ 283,384**

Borrowing activity is constrained by prudential indicators for net 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 (2018/19) plus the estimates of any additional capital financing requirement for the current (2019/20) and next three financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows 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 (excluding PFI schemes). The Council has complied with this prudential indicator.

Table 3: Council's Gross Borrowing Position			
	31-Mar-19	2019/20	31-Mar-20
	Actual	Budget	Actual
	£000	£000	£000
Gross Borrowing	£ 237,279	£ 290,770	£ 269,077
CFR	£ 274,582	£ 325,196	£ 283,384

The authorised limit – this Council has kept within its authorised external borrowing limit as shown by the table below. Once this has been set, the Council does not have the power to borrow above this level.

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 is acceptable subject to the authorised limit not being breached.

Table 4: Gross Borrowing against Authorised Limit / Operational Boundary	
	2019/20
Authorised limit - borrowing	£524,349
Operational boundary - borrowing	£346,056
Maximum gross borrowing position	£248,652
Average gross borrowing position	£234,727

3. Treasury Position as at 31 March 2020

The Council's 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 Purpose section of this report, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2019/20 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 5: Treasury Position

	31 March 2019 Principal	Rate/ Return	Average Life (Yrs)	31 March 2020 Principal	Rate/ Return	Average Life (Yrs)
Debt						
Fixed Rate Debt						
PWLB	£ 187,899	3.75%	27.27	£ 229,462	3.43%	30.27
Market	£ 34,380	2.32%	23.20	£ 24,616	2.89%	30.70
Total Fixed Rate Debt	**£ 222,279**	**3.53%**	**26.64**	**£ 254,078**	**3.38%**	**30.31**
Variable Rate Debt						
PWLB	£ -	n/a	n/a	£ -	n/a	n/a
Market	£ 15,000	4.63%	31.71	£ 15,000	4.63%	31.71
Total Variable Rate Debt	**£ 15,000**	**4.63%**	**32.71**	**£ 15,000**	**4.63%**	**32.71**
Total debt/gross borrowing	**£ 237,279**	**3.47%**	**27.02**	**£ 269,078**	**3.47%**	**30.45**
CFR	**£ 274,879**			**£ 283,384**		
Over/ (under) borrowing	**£ (37,600)**			**£ (14,306)**		
Investments						
Fixed Rate Investments						
In House	£ 15,000	1.70%	1.0000	£ 70,000	1.43%	1.71
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Fixed Rate Investments	**£ 15,000**	**1.70%**	**1.00**	**£ 70,000**	**1.43%**	**1.71**
Variable Rate Investments						
In House	£ 59,751	0.96%	0.41	£ 26,378	0.59%	0.18
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Variable Rate Investments	**£ 59,751**	**0.96%**	**0.41**	**£ 26,378**	**0.59%**	**0.18**
Total Investments	**£ 74,751**	**1.11%**	**0.53**	**£ 96,378**	**1.20%**	**1.29**
Net Borrowing	**£ 162,528**			**£ 172,700**		

The maturity structure of the debt portfolio was as follows:

Table 6: Maturity Structure of Debt Portfolio								
	31-Mar-19		2019/20			31-Mar-20		
	Actual		Original Limits			Actual		
	£000	%	%			£000	%	
Under 12 months	£ 18,263	8%	0%	to	50%	£ 9,230	3%	
12 months to 2 years	£ 9,266	4%	0%	to	50%	£ 1,490	1%	
2 years to 5 years	£ 3,827	2%	0%	to	50%	£ 3,720	1%	
5 years to 10 years	£ 5,509	2%	0%	to	50%	£ 14,560	5%	
10 years to 20 years	£ 62,653	26%	0%	to	50%	£ 63,229	23%	
20 years to 30 years	£ 15,179	6%	0%	to	50%	£ 14,265	5%	
30 years to 40 years	£ 75,534	32%	0%	to	50%	£ 90,534	34%	
40 years to 50 years	£ 42,048	18%	0%	to	50%	£ 67,049	25%	
50 years and above	£ 5,000	2%	0%	to	50%	£ 5,000	2%	
Total	**£ 237,279**	**100%**				**£ 269,077**	**100%**	

The maturity structure of the investment portfolio was as follows:

Table 7: Maturity Structure of Investment Portfolio		
	31-Mar-19	31-Mar-20
	£000	£000
Investments		
Under 1 Year	£ 74,751	£ 81,363
Over 1 Year	£ -	£ 30,000
Total	**£ 74,751**	**£ 111,363**

The exposure to fixed and variable interest rates on debt was as follows:-

Table 8: Fixed/Variable Interest Rate Exposure of Debt Portfolio							
	31-Mar-19		2019/20			31-Mar-20	
	Actual		Original Limits			Actual	
	£000	%	%			£000	%
Fixed Interest Rate Exposure	£222,279	92%	0%	to	100%	£254,077	94%
Variable Interest Rate Exposure	£ 15,000	6%	0%	to	30%	£ 15,000	6%
Total	**£237,279**	**98%**				**£269,077**	**100%**

4. The Strategy for 2019/20

During 2019-20, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. the Chief Officer, Corporate Solutions therefore monitored interest rates in financial markets and adopted a pragmatic strategy to take new long term borrowings based on the low interest rate environment and the Council's capital plans over the current and forthcoming financial years.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years.

Link Asset Services Interest Rate View 5.8.19	Sep-19	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	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	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	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	1.20	1.30	1.50	1.60	1.70	1.70	1.80	1.90	2.00	2.00	2.10
10yr PWLB Rate	1.50	1.60	1.80	1.90	2.00	2.00	2.10	2.20	2.30	2.30	2.40
25yr PWLB Rate	2.10	2.30	2.40	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00
50yr PWLB Rate	2.00	2.20	2.30	2.40	2.50	2.60	2.60	2.70	2.80	2.90	2.90

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.

5. The Economy and Interest Rates

UK. Brexit. The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Teresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the coronavirus outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but it is obviously heading for a big hit in March – April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

USA. Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost $367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be $500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of March.

EUROZONE. The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank

(ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, 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%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, 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 to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

JAPAN has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It appears to have missed much of the domestic impact from coronavirus in 2019-20 but the virus is at an early stage there.

WORLD GROWTH. The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

6. Borrowing Rates in 2019/20

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.

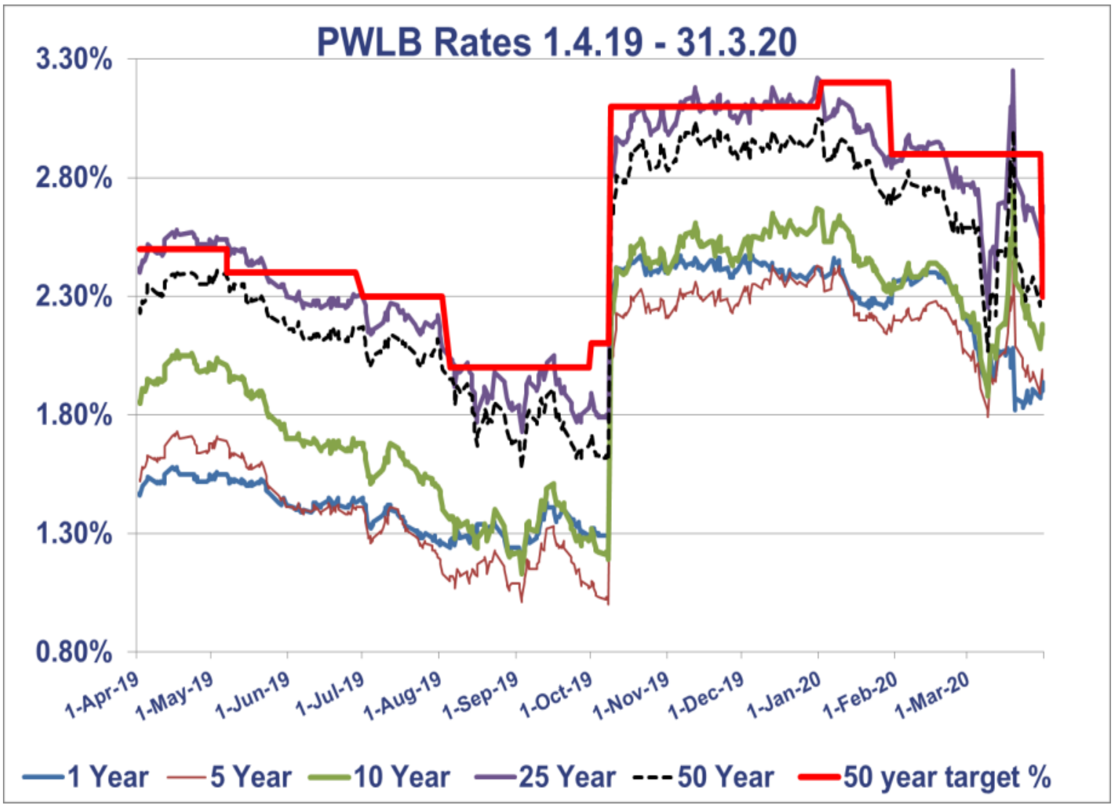
Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved 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 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It is clear that 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.

Following the changes on 11 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.



	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%

Short-dated market money:- sourced from other UK public bodies, rates fluctuated throughout the year from 0.15%-0.80% for 1 to 12 month maturities.

7. Borrowing Outturn for 2019/20

New Treasury Borrowing:-

New loans were drawn to fund the net unfinanced capital expenditure and naturally maturing debt.

The loans drawn were:-

Table 9: New Loans Taken in Financial Year 2019/20						
Lender	**Date Taken**	**Principal £000's**	**Interest Rate**	**Fixed/ Variable**	**Maturity Date**	**Term (Yrs)**
PWLB Maturity	25 Sep 2019	£ 10,000	1.76%	Fixed	25 Sep 1939	20.00
PWLB Maturity	25 Sep 2019	£ 10,000	1.68%	Fixed	25 Sep 2069	50.00
PWLB Maturity	12 Mar 2020	£ 15,000	2.36%	Fixed	12 Sep 2059	39.50
PWLB Maturity	12 Mar 2020	£ 15,000	2.32%	Fixed	12 Sep 2068	48.50
Market	Various	£ 26,500	0.23%-0.82%	Variable interest rate	Various	0.09-0.18
Total		**£ 76,500**				

Maturing Debt:-

The following table gives details of treasury debt maturing during the year:-

Table 10: Maturing Debt in Financial Year 2019/20						
Lender	**Date Repaid**	**Principal £000's**	**Interest Rate**	**Fixed/ Variable**	**Date Originally Taken**	**Original Term (Yrs)**
PWLB	14 Dec 2019	£ 8,400	2.77%	Fixed	14 Dec 2011	8.00
Salix	Various	£ 131	0.00%	Fixed	Various	7-8 years
Deutsche Pfandbriefbank	Various	£ 357	2.63%	Fixed	29 Jun 2017	28.00
Deutsche Pfandbriefbank	Various	£ 276	2.73%	Fixed	15 Nov 2018	25.50
Market	Various	£ 35,500	0.23%-0.82%	Variable interest rate	Various	0.09-0.18
Total		**£ 44,664**				

Rescheduling:-

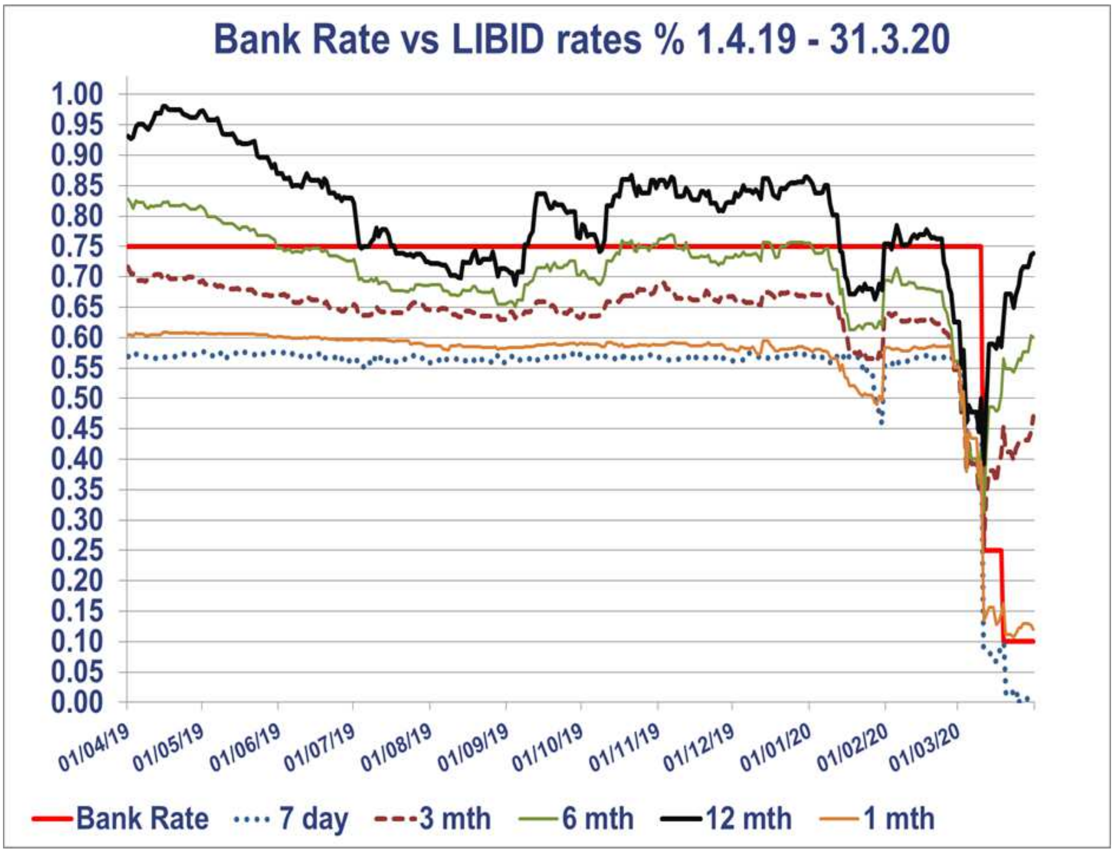
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Summary of debt transactions:-

The average interest rate payable on external debt decreased from 3.62% at the start of 2019/20 to 3.44% at the end of 2019/20. The average life of debt within the loan portfolio lengthened from 26.96 years to 30.33 years.

8. Investment Rates in 2019/20

Money market fund rates started the year between 0.31%-0.78%, trending at base rate levels throughout the year, and mirroring the decreases in bank rate, with a slight lag due to the longer durational element of money market fund portfolios.



9. Investment Outturn for 2019/20

Investment Policy:-

The Council's investment policy is governed by Scottish Government Investment Regulations, which have been implemented in the annual investment strategy approved by the Council on 12 February 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.

Investments held by the Council:-

The Council maintained an average balance of £86.727 million of internally managed funds. The internally managed funds earned an average rate of return of 1.15%. The comparable performance indicator is the average 12-month LIBID un-compounded rate, which was 0.80%.

10. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities.

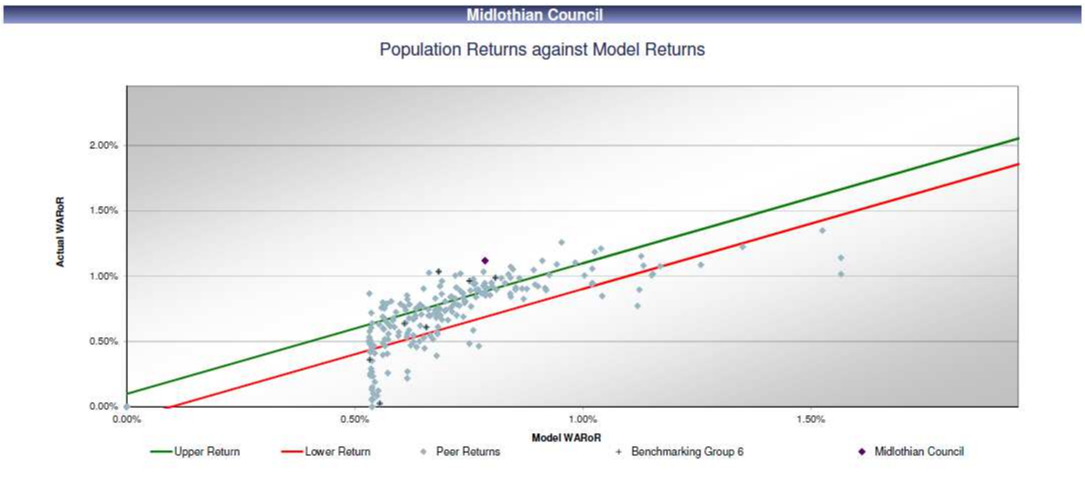
Loans Fund Rate

Combining the interest paid (earned) on external debt (investments) with charges for premiums written off and internal interest allowed into an average Loans Fund Rate, Midlothian's result of 3.12% for 2018/19 was the fourth lowest Loans Fund Rate amongst all mainland authorities in Scotland (see Appendix 1).

The comparative Loans Fund Rate for 2019/20, of 2.95%, is once again expected to be one of the lowest when benchmarked against all mainland authorities in Scotland (note that at present, these benchmark figures are not yet available).

Investment Benchmarking

The Council participates in the Scottish Investment Benchmarking Group set up by its Treasury Management Consultants, Capita. This service provided by Capita provides benchmarking data to authorities for reporting and monitoring purposes, by measuring the security, liquidity and yield within an individual authority portfolio. Based on the Council's investments as at 31 March 2020, the Weighted Average Rate of Return (WARoR) on investments of 1.12% against other authorities is shown in the graph below:-



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	1.12%	0.79%	0.33%	0.69%	0.88%	Above

** Models for 30 June 2019, 30 September 2019 and 31 December 2019 are attached as Appendix 3.*

As can be seen from the above graph, Midlothian is performing above the Capita model benchmarks (red to green lines), and is achieving one of the highest Weighted Average Rates of Return (WARoR) for the Weighted Average

Credit Risk held, not only amongst peer Councils within the Benchmarking Group but also amongst the population of authorities across the UK.

Debt Performance

Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. In this respect, the relevant figures for Midlothian are incorporated in the table in Section 3.

11. Conclusion

The Council's overall cost of borrowing continues to benefit significantly from proactive Treasury Management activity.

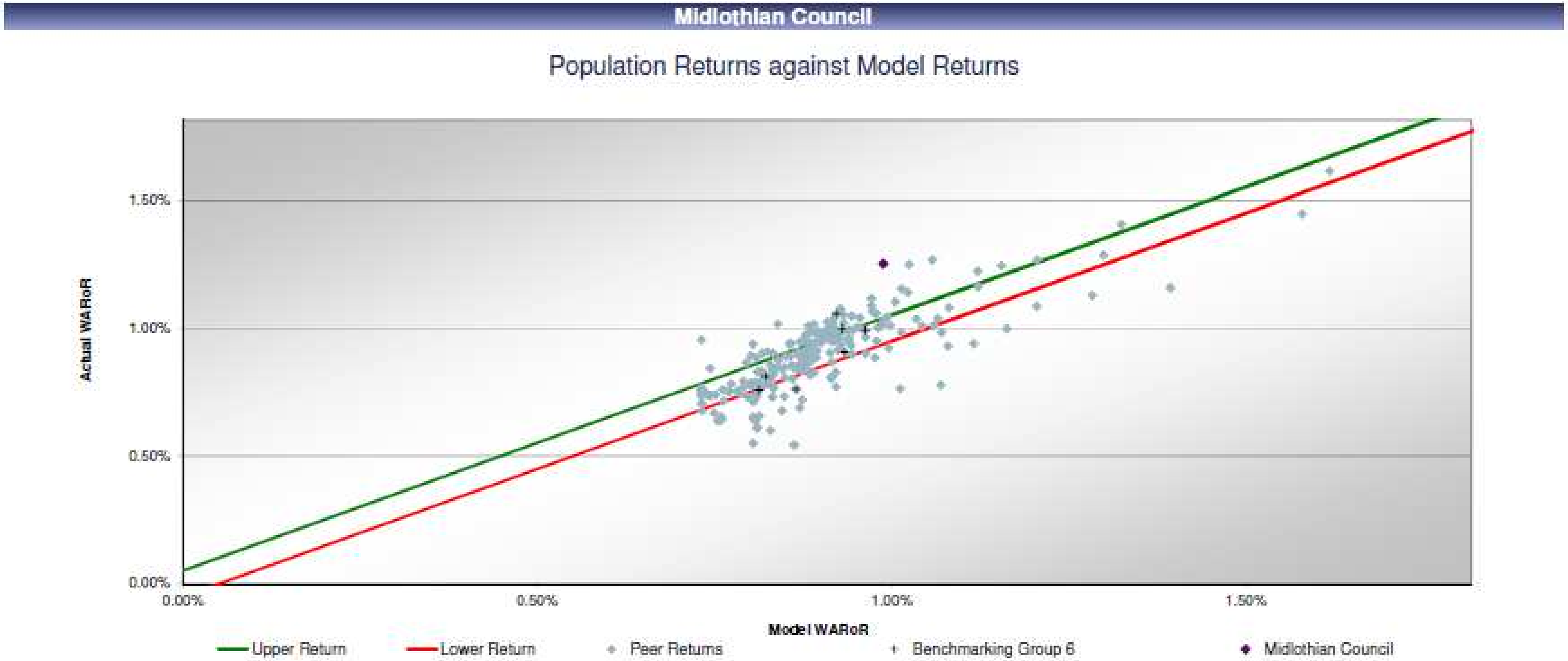
The cost of long term borrowing has been maintained by taking up opportunities to borrow from the PWLB at low interest rates.

A better than average return on investments has been achieved for the sixteenth consecutive year and Midlothian continues to perform above the Link model benchmarks and is achieving one of the highest Weighted Average Rates of Return (WARoR) for the Weighted Average Credit Risk held, not only amongst peer Councils within the Benchmarking Group but also amongst the population of authorities across the UK.

Overall Midlothian's Loans Fund Rate of 2.95% for the year is expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland.

Appendix 3

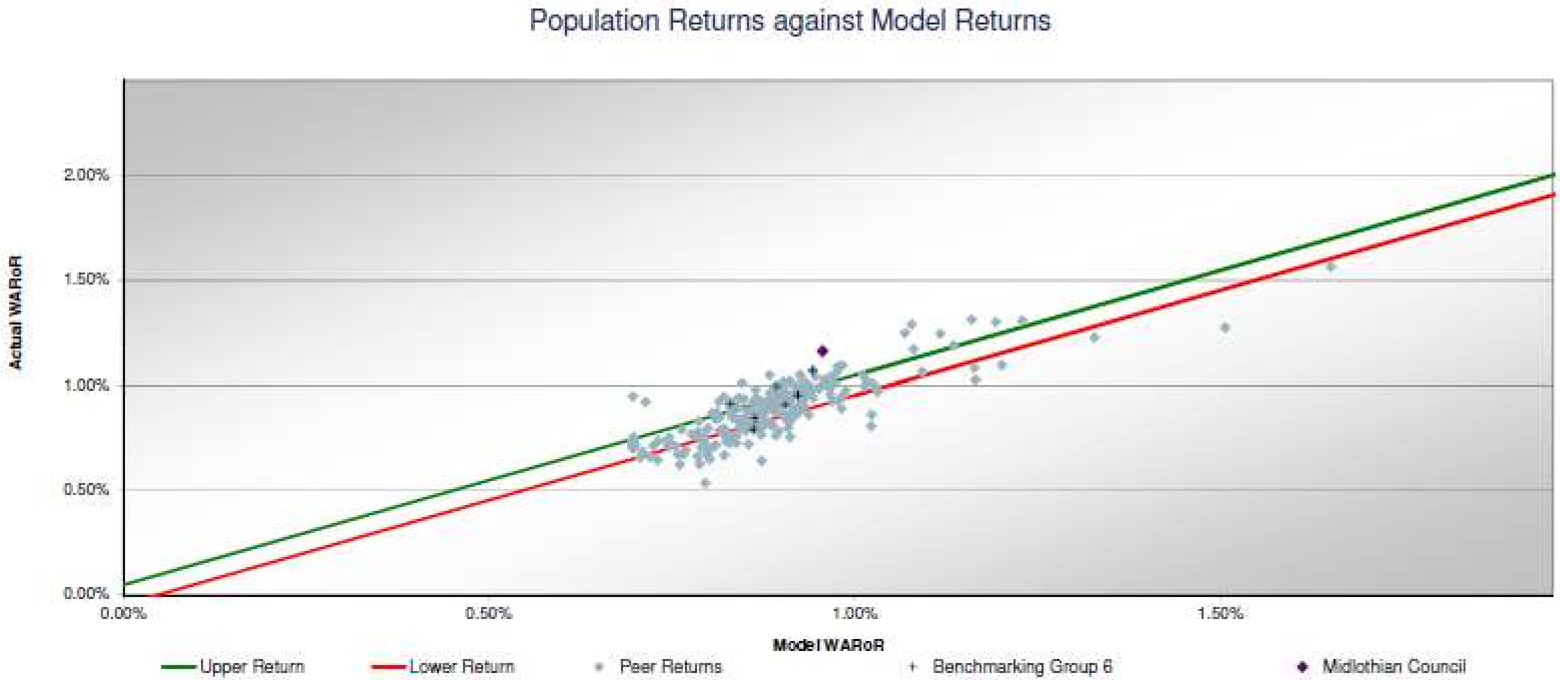
Midlothian Council Investment Portfolio return as at 30 June 2019



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	1.25%	0.99%	0.26%	0.94%	1.04%	Above

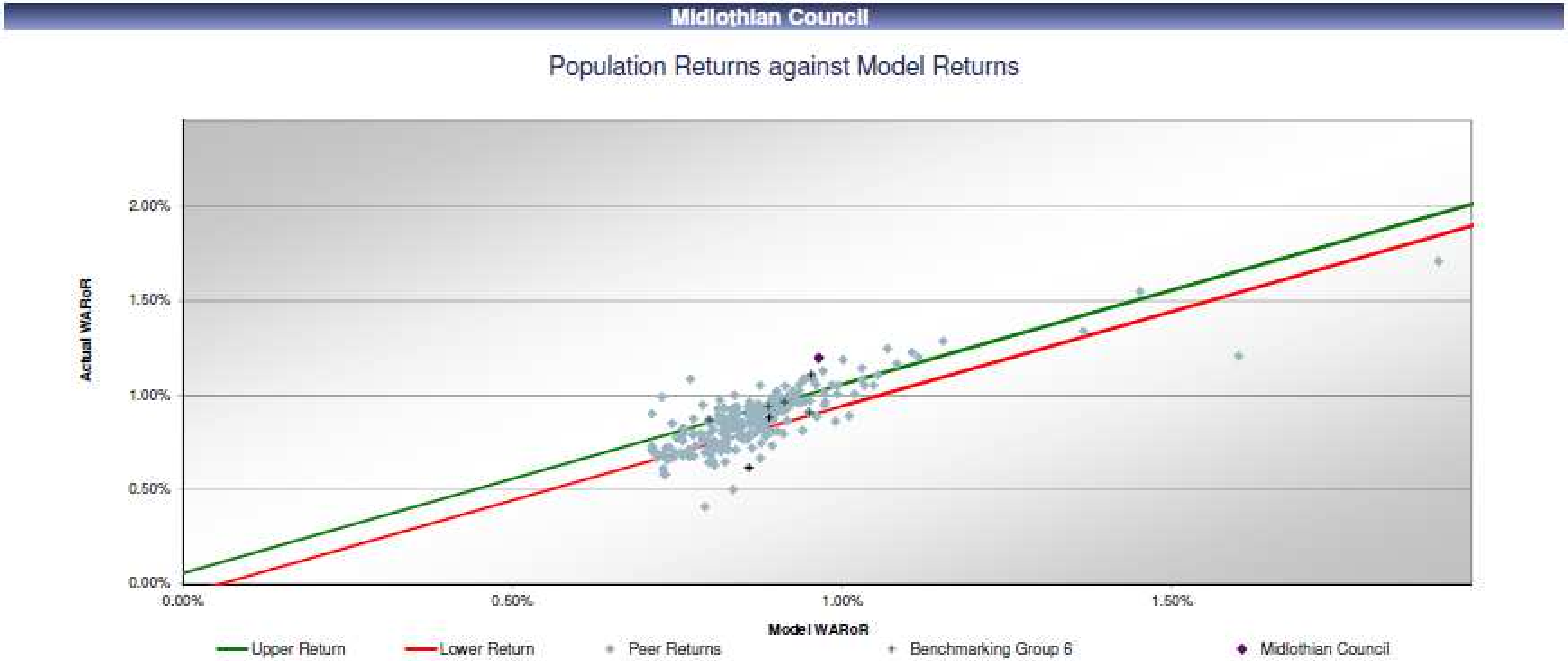
Midlothian Council Investment Portfolio return as at 30 September 2019

Midlothian Council



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	1.16%	0.96%	0.21%	0.91%	1.00%	Above

Midlothian Council Investment Portfolio return as at 31 December 2019



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	1.20%	0.96%	0.23%	0.91%	1.02%	Above