Dorset Council

Audit and Governance Committee

Treasury Management 2019/20 Mid-Year Update

Date of Meeting: 7 November 2019

Portfolio Holder: Cllr Tony Ferrari

Local Member(s): Not applicable

Director: Aidan Dunn, Executive Director Corporate Development

Executive Summary:

This report summarises the treasury management performance and position information for Dorset Council for the financial year to 30 September 2019.

Treasury management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as:
"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Treasury management at the Council is conducted within the framework of CIPFA's Treasury Management Code of Practice. In adopting the code, recommended best practice is for members to approve an annual treasury management strategy report, and then, as a minimum, to receive a mid-year update (this report) and a year-end review of activity and performance compared to this strategy.

Treasury management decisions made by the Council must take into consideration external factors, particularly the wider economic backdrop and the outlook for financial markets and interest rates. Markets remain concerned about the global economic outlook, and this suggests that interest rates will continue to remain relatively low. However, there was a sharp reminder of the risk that interest rates can move upwards too, when HM Treasury unexpectedly announced in October that the margin above gilts yields applied to lending to local authorities would increase from 0.8% to 1.8%.

The combined Capital Financing Requirement (CFR) inherited by Dorset Council from the six predecessor councils at the end of last financial year was £364m. If Private Finance Initiative (PFI) and other finance leases are excluded, the combined underlying borrowing need was £327m.

The Council's actual external borrowing at 30 September 2019 was £197.5m, a net reduction of £35m from the inherited position at the start of the year of £232.5m. The difference between the underlying borrowing need and actual borrowing was approximately £130m, up from £94m at the start of the year, financed temporarily by 'internal borrowing' from reserves and balances that would otherwise have been available for investment.

As at 30 September, the Council held cash and cash equivalents of £30.6m plus investments of £83.0m, together totalling £113.6m, compared to £147.5m at the start of the financial year.

The cost of borrowing is forecast to be below budget for the year, as a result of the early repayment of two loans, and by delaying the replacement of short-term loans that have matured this year. This has, however, meant that balances available for investment have been lower than expected, which has therefore reduced the expected level of interest receivable and investment income. The forecast net cost of treasury management activities (including Minimum Revenue Provision) is £13.6m compared to the budget of £14.9m.

The predecessor councils all had different providers of banking services. Now we have come together as one organisation, having multiple bankers is not the most efficient and effective way to operate, therefore we wish to appoint a single banker. On 17 October 2019 the contract opportunity was advertised on the Official Journal of the European Union (OJEU), with contract award expected late December 2019 and the implementation of changes starting in January 2020.

Later this financial year, a training session open to all Dorset Council's elected members will be provided by officers and advisers to further explain the responsibilities that members have in relation to treasury management.

Equalities Impact Assessment:

This report does not deal with any new strategies or polices that would trigger an impact assessment.

Budget:

All treasury management budget implications are reported as part of the Corporate Budget monitoring Outturn report, alongside the Asset Management reports that include the progress of the capital programme.

Risk Assessment:

This report is for information. However, treasury management is an inherently risky area of activity and a number of controls are embedded in its operation. The key treasury management risks are highlighted as part of the Annual Treasury Management Strategy approved by Council. This report highlights any variances from this strategy and draws out any specific risks which have arisen.

Current Risk: HIGH
Residual Risk MEDIUM

Climate Implications:

None.

Other Implications: Not none.
Recommendation: That the Committee note and comment upon the report.
Reason for Recommendation: To better inform members of Treasury Management process and strategy, in accordance with the corporate requirement to ensure money and resources are used wisely.
Appendices: Appendix 1: External Context and Economic Outlook (Arlingclose) Appendix 2: Borrowing at 30 September 2019 Appendix 3: Cash and Investments at 30 September 2019
Background Papers: Treasury Management strategy Statements 2019/20 Capital Programme Budget and Monitoring reports 2019/20
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1. Introduction

1.1 Local authorities operate a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The role of treasury management is to ensure this cash flow is adequately planned, with surplus monies invested with low risk counterparties, ensuring adequate liquidity initially before then considering optimising investment return.

1.2 The second main function of the treasury management service is the funding of capital plans. These capital plans provide a guide to the borrowing needs of councils, essentially longer-term cash flow planning to ensure capital spending requirements can be met. This management of longer-term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. Also, on occasion, any debt previously drawn may be restructured to meet risk or cost objectives.

1.3 Accordingly, treasury management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as:
"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.4 The Council has adopted CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code). The Code recommends that local authorities produce for each financial year, as a minimum:

- An annual strategy in advance of the year;
- A mid-year update describing activity for the year to date compared to the strategy (this report), and;
- An annual review of activity following the end of the year.

1.5 The Council's treasury management strategy for 2019/20 was approved by the Shadow Dorset Council on 20 February 2019. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

1.6 The 2017 CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was also approved by the Shadow Dorset Council on 20 February 2019.

2. Treasury Management Advisers

2.1 The Council employs professionally qualified and experienced staff with responsibility for making borrowing and investment decisions. Officers are supported by external advisers who are specialists in their fields. The Council currently employs Arlingclose Limited as treasury management advisers.

2.2 This approach ensures that the Council has access to a wide pool of relevant market intelligence, knowledge and skills, that would be very difficult and costly to replicate internally. However, whilst advisers provide support to the internal treasury function,

final decisions on treasury matters always remain with the Council.

3. External Context (Economic Background and Outlook)

3.1 Treasury management decisions made by the Council must take into consideration external factors, particularly the wider economic backdrop and the outlook for financial markets and interest rates. Appendix 1 provides further details of the views of Arlingclose.

3.2 The UK economy has displayed a marked slowdown in growth largely due to both Brexit uncertainty and the downturn in global activity. In response, expectations of interest rate rises have eased dramatically. The Bank of England has maintained Bank Rate at 0.75%, noting the deterioration in global activity and sentiment but confirmed that monetary policy decisions related to Brexit could be in either direction. Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy.

3.3 Returns on government bonds (gilt yields) have fallen to historic lows as investors look for 'safe havens'. Arlingclose expects gilt yields to remain at low levels for the foreseeable future. This has direct implications for the Council's treasury management decisions as many financial instruments are priced in relation to gilt yields, for example, loans from the Public Works Loans Board (PWLB).

3.4 Borrowing from the PWLB is priced at a fixed margin above the government's cost of borrowing, as measured by gilt yields. On 9 October 2019, HM Treasury announced that the margin on any new borrowing would increase by 1.0% from 0.8% to 1.8%, with immediate effect. So, for example, on 8 October Dorset Council could have borrowed from the PWLB for 20 years at approximately 1.7%, but on 9 October the rate for the same borrowing would have been 2.7% (assuming no other changes in gilts markets).

3.5 This change has no immediate direct impact for the Council as it only applies to new borrowing, and there are no plans to take out any long-term borrowing from the PWLB or any other source this financial year. It is unlikely that we will be looking to take out any long term borrowing in 2020/21 either, but this may depend on the final capital programme agreed.

3.6 However, it is likely that the changes will exert some upward pressure on rates available from other sources of long-term and short-term borrowing, and possibly on investment returns too. Officers are due to meet with Arlingclose on 11 November to discuss treasury strategy, and the implications of this change will be taken into consideration

3.7 The scheduled date for the UK to leave the EU is 31 October 2019 and there remains uncertainty as to whether a deal will be agreed by this date. As 31 October approaches the Council will ensure there is sufficient access to liquid funds in UK-domiciled banks and Money Market Funds.

4. Local Context

4.1 The six predecessor councils all had different balance sheets and different treasury management priorities and therefore each had developed different treasury

management strategies to suit their individual circumstances. For example, the county council had a relatively high borrowing requirement so it had prioritised reducing the cost of debt by using reserves and balances to 'offset' this borrowing need in order to reduce risk and keep interest costs low. In contrast, the district and boroughs tended to have relatively low or no borrowing requirement, so their strategies had focused on using their reserves and balances to generate higher returns from their investment portfolios. Dorset Council will now need to develop its own strategy, fit for its needs, and officers will be meeting with Arlingclose to discuss options on 11 November 2019.

4.2 The creation of two new unitary councils in Dorset has made it necessary to divide Dorset County Council's assets and liabilities as at 31 March 2019 between Dorset Council and Bournemouth, Christchurch and Poole (BCP) Council. The principles for this process of disaggregation were agreed as part of preparations for setting up the two new councils. Officers from both councils are currently working through the DCC balance sheet detail to ensure the principles are applied correctly and consistently. The results of this exercise will have an impact on Dorset Council's capital financing requirements.

4.3 Extracts from the Council's opening balance sheet are summarised in Table 1 below. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR) less Private Finance Initiative (PFI) and other finance lease liabilities. Usable reserves and working capital are the underlying resources available for investment or to temporarily offset the borrowing need.

Table 1: Balance Sheet Summary

	01/04/2019 Actual £m
Total Capital Financing Requirement (CFR)	**364**
Less PFI and other lease finance liabilities	37
Underlying Borrowing Requirement (UBR)	**327**
External borrowing	233
Internal borrowing	94
Balances available for internal borrowing:	
Usable reserves	170
Working capital	71
Total available for internal borrowing	**241**
Surplus available for investment	**147**

4.4 The treasury management position at 30 September 2019 and the change during the year is summarised in Table 2 below.

Table 2: Treasury Management Summary

	31.03.19 Balance £m	Net Movement £m	30.09.19 Balance £m	30.09.19 Rate %
Long-term borrowing	201.1	-20.1	181.0	3.9%
Short-term borrowing	31.4	-14.9	16.5	1.0%
Total Borrowing	**232.5**	**-35.0**	**197.5**	**3.7%**
Investments	80.5	2.5	83.0	2.8%
Cash and cash equivalents	67.0	-36.4	30.6	0.8%
Total Cash and Investments	**147.5**	**-33.9**	**113.6**	**2.24%**
Net Borrowing	**85.0**	**-1.1**	**83.9**	

4.5 On 31 March 2019, the Council had net borrowing of £85m arising from its revenue and capital income and expenditure, and by 30 September this had fallen marginally to £84m.

5 Borrowing

5.1 At 30 September 2019 the Council held £197.5m of loans, a decrease of £35m from 31 March 2019, as part of its strategy for funding previous and current years' capital programmes. Two long-term loans of £10m each were repaid in full in April 2019. Three short-term loans for £30m in total matured in the first half of 2019/20, and three new short-term loans totalling £15 m were drawn down in the year to date.

5.2 Outstanding loans at 30 September 2019 are summarised in Table 3 below, with further detail in Appendix 2.

Table 3: Borrowing Position

	31.03.19 Balance £m	Net Movement £m	30.09.19 Balance £m	30.09.19 Average Rate %	30.09.19 Average Maturity (years)
Public Works Loan Board	86.4	0.0	86.4	4.0	17.7
Banks (fixed-term)	25.6	0.0	25.6	4.7	57.1
Banks (LOBO)	31.0	-20.0	11.0	4.6	56.6
Local authorities (long-term)	15.0	0.0	15.0	4.4	39.7
Local authorities (short-term)	30.0	-15.0	15.0	0.8	0
Other lenders (fixed-term)	25.0	0.0	25.0	3.9	45.7
Other lenders (LOBO)	19.5	0.0	19.5	2.6	12.6
Total Borrowing	**232.5**	**-35.0**	**197.5**	**3.7**	**28.3**

5.3 The chief objective of the Council (and its predecessors) when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change being a secondary objective.

5.4 With short-term interest rates remaining much lower than long-term rates, the Council considers it to be more cost effective in the near term to use internal resources or borrow rolling short-term loans instead. This strategy has enabled the Council to reduce net borrowing costs (despite foregone investment income) and to reduce overall treasury risk. The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long-term borrowing has been maintained.

5.5 The Council holds LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No lenders have exercised their options during the year to date.

5.6 On assessment of the LOBO portfolio with Arlingclose, some loans presented restructuring opportunities with substantial value from a negotiated settlement with the lender. The risks and benefits, including restructuring savings, were assessed and £20m of LOBOs were repaid in April 2019, which has also helped reduce exposure to the risk of options being exercised in the longer term.

5.7 Three short-term loans have matured in the year to date, totalling £30m - £5m from Essex County Council repaid in May 2019, £15m from the Greater London Authority in June 2019 and £10m from Middlesbrough Council in July 2019. These loans have been replaced in part by the following three new short-term loans totalling £15m:

Lender	Drawdown Date	Maturity Date	Amount £	Interest Rate
Essex County Council	20/09/2019	20/01/2020	£5,000,000	0.72%
Derbyshire Pension Fund	25/09/2019	27/04/2020	£5,000,000	0.80%
Leicester City Council	26/09/2019	26/05/2020	£5,000,000	0.82%

5.8 In November 2017, Dorset County Council entered into a forward commitment to borrow £20m Council has also entered into a forward commitment to borrow £20m in November 2019 at a rate of 2.52% for a minimum period of 23 years, and a maximum of 48 years. This reduced exposure to the risk of interest rate rises in the intervening two year period at a rate lower than the comparable PWLB rate available, without incurring the cost of borrowing for that period.

6. Treasury Investments

6.1 The Council holds significant levels of invested funds, representing income received in advance of expenditure plus balances and reserves held. Cash, cash equivalents and investments held on 30 September 2019 are detailed in Appendix 3 and summarised in Table 4 below.

Table 4: Treasury Investments Position

	31.03.19 Balance £m	Net Movement £m	30.09.19 Balance £m	2019/20 Income Return (p.a.)
Cash and Cash Equivalents:				
Banks & Building Societies (unsecured)	46.2	-36.1	10.1	0.40%
Covered bonds (secured)	0.0	0.0	0.0	0.00%
Government (including local authorities)	19.4	5.7	25.1	0.50%
Corporate bonds and loans	0.0	0.0	0.0	0.00%
Money Market Funds	33.7	-2.1	31.5	0.73%
Less 'co-mingled' Dorset LEP Balances*	-32.3	-3.8	-36.1	0.40%
Total Cash and Cash Equivalents	**67.0**	**-36.4**	**30.6**	**0.82%**
Investments:				
Short-dated bond funds	3.0	0.0	3.0	1.97%
Strategic bond funds	10.7	0.2	10.9	2.30%
Equity income funds	42.0	0.0	42.0	2.89%
Property funds	18.1	2.2	20.4	2.28%
Multi asset income funds	6.7	0.0	6.7	4.55%
Real Estate Investment Trusts (REITS)	0.0	0.0	0.0	0.00%
Total Investments	**80.5**	**2.5**	**83.0**	**2.77%**
Total Cash and Investments	**147.5**	**-33.9**	**113.6**	**2.24%**

**The Dorset Local Enterprise Partnership balances are co-mingled with Dorset Council's.*

6.2 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.3 Table 5 below summarises the risk and return metrics of the Council's investments and compares them with the averages for all the local authority clients of Arlingclose.

Table 5: Treasury Investments Benchmarking

	Credit Rating	Credit Score	Bail-in % Exposure	Weighted Average Maturity (days)	Rate of Return %
Dorset Council	AA-	3.97	62%	11	1.4%
English unitaries (21)	AA-	4.31	74%	39	1.2%
All authorities (139)	AA-	4.27	62%	28	1.2%

6.4 Arlingclose calculate the credit score by applying a score to each investment (AAA = 1, AA+ = 2 etc.) and taking the average, weighted by the size of each investment. Unrated

investments are assigned a score based on their perceived risk. Arlingclose also calculate the proportion of investments exposed to 'bail-in' risk. (A bail-in provides relief to a financial institution on the brink of failure by requiring the cancellation of debts owed to creditors and depositors. In comparison, a bailout involves the rescue of a financial institution by external parties, typically governments, using taxpayers' money for funding.)

6.5 £83m of the Council's investments are held in externally managed strategic pooled investment vehicles (bond, equity, multi-asset and property funds) where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.

6.6 These funds have no defined maturity date, but are available for withdrawal after a notice period, and their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the expectation that over a three to five-year period total returns should exceed cash interest rates.

7. Non-Treasury Investments

7.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

7.2 As at 30 September 2019, the Council held no such investments.

8. Treasury Performance

8.1 The Council measures the financial performance of its treasury management activities in terms of its impact on the revenue budget as shown in table 6 below.

Table 6: Treasury Performance

	Budget £m	Forecast £m	Variance £m
Interest Payable	10.5	7.9	2.6
Debt Rescheduling Charges	0.1	0.3	-0.2
Minimum Revenue Provsion (MRP)	8.6	9.2	-0.6
Total Payable	**19.2**	**17.4**	**1.8**
Interest and Investment Income	-4.3	-3.8	-0.5
Net Payable / (Receivable)	**14.9**	**13.6**	**1.3**

8.2 The cost of borrowing is forecast to below budget for the year, largely as a result of the early repayment of the two LOBO loans, and by delaying the replacement of the short-term loans that have matured this year. This does, however, mean that balances available for investment have been lower than expected, which has therefore reduced the expected level of interest and investment income.

9. Compliance (with the CIPFA Code and the Council's Treasury Management Strategy)

9.1 All treasury management activities undertaken during the period complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific debt and investment limits is demonstrated below.

9.2 Debt Limits: The operational boundary is the limit beyond which external debt is not normally expected to exceed, based on the CFR plus an allowance for short term borrowing that might be required for cash flow purposes or unexpected calls on capital resources. The authorised limit is based on the operational boundary but includes a margin to allow for unusual or unpredicted demands on cash. The Council has complied with the authorised limit and operational boundary for external debt as demonstrated in table 7 below.

Table 7: Debt Limits

	Maximum to date £m	31.09.19 Actual £m	Operational Boundary £m	Authorised Limit £m	Complied Yes/No
Borrowing	232.5	197.5	388.0	398.0	Yes
PFI & Finance Leases	37.0	36.0	37.0	37.0	Yes
Total Capital Financing	**269.5**	**233.5**	**425.0**	**435.0**	

9.3 Investment Limits: All investments during the financial year to 30 September 2019 were compliant with the parameters for approved investment counterparties and limits. Appendix 3 summarises the positions as at 30 September 2019.

10. Treasury Management Indicators

10.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

10.2 Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Table 8: Security

	31.09.19 Actual	2019/20 Target	Complied Yes/No
Portfolio average credit rating or score	4.0	6.0	Yes

10.3 Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period. In addition, the Council aims to hold a minimum of £10m readily available in same day access bank accounts and Money Market Funds.

Table 9: Liquidity

	30.09.19 Actual	2019/20 Target	Complied Yes/No
Total cash available within 100 days	50%	36%	Yes

10.4 Interest Rate Exposure: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Table 10: Interest Rate Exposure

	30.09.19 Actual £000s	2019/20 Target £000s	Complied Yes/No
Upper limit on one-year revenue impact of a 1% rise in interest rates	230	300	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	230	300	Yes

10.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

10.6 Sums invested for longer than a year: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 11: Investments beyond year end

	2019/20 £m	2020/21 £m	2021/22 £m
Actual principal invested beyond year end	0.0	0.0	0.0
Limit on principal invested beyond year end	20.0	20.0	20.0
Complied (Yes/No)	Yes	Yes	Yes

10.7 Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing in the Treasury Management Strategy agreed by the Shadow Dorset Council set the upper limit for all periods at 100%. Therefore, the following table compares the maturity structure against the percentage limits used by Dorset County Council in 2018/19.

Table 12: Maturity Structure of Borrowing

	30.09.19 Actual £m	% of Total Borrowing	Upper Limit	Lower Limit	Complied Yes/No
Under 12 months	27.5	13.9%	25%	0%	Yes
12 Months to 2 Years	21.0	10.6%	25%	0%	Yes
2 Years to 5 Years	31.6	16.0%	25%	0%	Yes
5 Years to 10 Years	10.0	5.1%	35%	0%	Yes
10 Years to 15 Years	0.0	0.0%	35%	0%	Yes
15 Years to 20 Years	0.0	0.0%	35%	0%	Yes
20 Years to 25 Years	0.0	0.0%	45%	0%	Yes
25 Years to 30 Years	0.0	0.0%	45%	0%	Yes
30 Years to 35 Years	41.8	21.2%	45%	0%	Yes
35 Years to 40 Years	15.0	7.6%	45%	0%	Yes
40 Years to 45 Years	0.0	0.0%	45%	0%	Yes
45 Years to 50 Years	25.0	12.7%	45%	0%	Yes
50 Years and above	25.6	13.0%	75%	0%	Yes
Total	**197.5**	**100.0%**			

10.8 Time periods start on the first day of each financial year, so borrowing maturing “under 12 months” is all borrowing that may mature before the end of this financial year. The maturity date used is the earliest date on which the lender can demand repayment or the borrower has the option to repay without penalty. The next option dates on LOBOs have therefore been treated as the potential repayment date.

11. Member and Officer Training

11.1 The high level of risk inherent in treasury management means officers need to be adequately experienced and qualified. Officers attend national treasury management events and training courses, and have regular strategy and review meetings with advisers, as well as regular telephone contact.

11.2 A training session for all Dorset Council’s elected members will be provided by officers and advisers to further explain the responsibilities that members have in relation to treasury management. Further training will also be provided from time to time.

12. Procurement of Banking Services

12.1 The predecessor councils all had different providers of banking services – Dorset County Council banked with NatWest, Purbeck District Council with Lloyds, and East Dorset District Council, North Dorset District Council, West Dorset District Council and Weymouth and Portland Borough Council with HSBC.

12.2 Now that the predecessor councils have come together as one organisation, having multiple bankers is not the most efficient and effective way to operate, so we wish to appoint a single provider of banking services for Dorset Council.

12.4 An open tender process will be followed, and on 17 October 2019 the contract opportunity was advertised on the Official Journal of the European Union (OJEU). Contract award is expected late December 2019, with the implementation of changes starting from early January 2020. Full details of the implementation plan will be agreed with the successful tenderer.

Aidan Dunn
Executive Director of Corporate Development
October 2019

Appendix 1: External Context and Economic Outlook (Arlingclose September 2019)

Economic background: UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

The first estimate of Q2 GDP growth showed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.5% as Brexit uncertainties impacted on business planning and decision-making.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU. Mr Johnson prorogued Parliament which led some MPs to put forward a bill to block the UK from leaving without a deal. The move was successful and having been approved by the House of Lords will now pass into law.

Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut interest rates in a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced a global slowdown. These elevated concerns have caused government yield curves in the US and UK to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October.

Financial markets: After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.28% at the start of September before recovering to 0.49% by the middle of the month. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.43% before bouncing back to 0.71% and the latter falling from 1.35% to 0.84% before rising again to 1.06%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield

curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently trading around -0.71 and -0.72% respectively.

Credit background: Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ringfenced bank NatWest Markets plc fell back to around 83bps by the middle of September, while for the ringfenced entity, National Westminster Bank plc, the spread fell slightly from 40bps to 38bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 32 and 66bps at the end of the period.

There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

Outlook for the remainder of 2019/20

The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased dramatically.

Prime Minister Boris Johnson has pledged to exit the EU on 31st October with or without a deal. It is unlikely the UK will be able to negotiate a different withdrawal deal before the deadline. The probability of a no-deal EU exit has therefore increased, which has implications for the future path of interest rates.

There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance

Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose judges that the risks are significantly weighted to the downside.

Bank Rate	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Upside Risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside Risk	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

Gilt yields have fallen to historic lows. The risks to economic growth from global political uncertainty appear to have crystallised, dampening rate expectations and dragging yields lower. Arlingclose expects gilt yields to remain at low levels for the foreseeable future and see the risks as broadly balanced. Volatility will continue to offer longer-term borrowing opportunities.

Readiness for Brexit: The scheduled leave date for the UK to leave the EU is now 31st October 2019 and there remains little political clarity as to whether a deal will be agreed by this date and, unless the exit date is pushed back yet again, the potential of a no-deal Brexit has increased significantly. As 31st October approaches the Authority will ensure there are enough accounts open at UK-domiciled banks and Money Market Funds to hold sufficient liquidity and that its account with the Debt Management Account Deposit Facility (DMADF) remains available for use in an emergency.

Appendix 2: Borrowing as at 30 September 2019

Ref	Lender	Loan Type	Drawdown Date	Next Option	Date Matures	Years Remaining	Amount O/S £000s	Rate %
Loan 2	PWLB	Annuity	25/07/2003	n/a	25/03/2023	3.50	3,960	4.70
Loan 3	PWLB	Annuity	21/12/2004	n/a	25/03/2023	3.50	70	4.65
Loan 10	PWLB	Maturity	01/03/2006	n/a	25/03/2051	31.50	8,820	3.95
Loan 11	PWLB	Maturity	09/10/2006	n/a	25/03/2052	32.50	15,000	4.10
Loan 12	PWLB	Maturity	02/08/2007	n/a	25/09/2052	33.00	8,000	4.55
Loan 14	PWLB	Maturity	23/08/2007	n/a	25/09/2053	34.00	10,000	4.45
Loan 28	PWLB	Maturity	07/09/2010	n/a	25/02/2025	5.40	10,000	3.74
Loan 29	PWLB	Maturity	07/09/2010	n/a	25/03/2030	10.50	10,000	3.98
Loan 30	PWLB	Maturity	03/11/2011	n/a	25/03/2021	1.50	20,000	3.30
Loan 13	Barclays	Maturity	30/07/2007	n/a	30/07/2077	57.800	15,600	4.625
Loan 24	Lancashire CC	Maturity	25/09/2011	n/a	25/11/2059	40.20	15,000	4.39
Loan 31	Siemens	LOBO	25/09/2012	25/09/2022	25/09/2032	13.00	10,000	2.60
Loan 32	Siemens	LOBO	16/11/2011	21/12/2022	21/12/2032	13.24	9,500	2.53
Loan 48	BAE Systems	LALN	11/12/2017	07/11/2042	11/12/2065	46.20	25,000	3.90
Loan 57	Essex County Council	Maturity	20/09/2019	n/a	20/01/2020	0.30	5,000	0.72
Loan 58	Derbyshire Pension Fund	Maturity	27/04/2019	n/a	27/04/2020	0.60	5,000	0.80
Loan 59	Leicester City Council	Maturity	26/09/2019	n/a	26/05/2020	0.65	5,000	0.82
Loan 61	Barclays Bank	Maturity	14/11/2006	n/a	16/11/2076	57.10	10,000	4.79
Loan 62	KBC Bank N.V.	LOBO	14/11/2006	14/11/2019	16/11/2076	57.10	11,000	4.59
Loan 63	PWLB	Maturity	16/10/2009	n/a	16/10/2019	0.14	50	2.66
Loan 64	PWLB	Maturity	05/03/2010	n/a	05/03/2020	0.40	500	2.96
Total / Weighted Average						**28.84**	**197,500**	**3.73**

Appendix 3: Cash, cash equivalents and investments as at 30 September 2019

	Holding £s	Credit Rating	Limit £s	Complied Yes/No
Banks & Building Societies				
HSBC	2,682,000	AA-	10,000,000	Yes
Leeds Building Society	4,017,766	A-	10,000,000	Yes
Lloyds Account	1,667,859	A+	10,000,000	Yes
NatWest	713,000	A+	10,000,000	Yes
Santander	1,005,000	A+	10,000,000	Yes
Sub-Total	**10,085,625**			
UK Government (including Local Authorities)				
UK Debt Management Office	25,100,000	n/a	Unlimited	Yes
Sub-Total	**25,100,000**			
Money Market Funds				
Aberdeen Standard MMF	9,176,000	AAA	20,000,000	Yes
Blackrock MMF	2,754,000	AAA	20,000,000	Yes
DB MMF	2,755,000	AAA	20,000,000	Yes
Federated Prime Rate MMF	12,125,000	AAA	20,000,000	Yes
Goldman Sachs MMF	2,215,000	AAA	20,000,000	Yes
HSBC MMF	2,518,000	AAA	20,000,000	Yes
Sub-Total	**31,543,000**		**100,000,000**	Yes
Short-Dated Bond Funds				
Threadneedle Sterling Short-Dated Corporate Bond Fund	3,007,776	n/a	20,000,000	Yes
Sub-Total	**3,007,776**			
Strategic Bond Funds				
M&G Strategic Corporate Bond Fund	4,943,287	n/a	20,000,000	Yes
Threadneedle Strategic Bond Fund	5,947,063	n/a	20,000,000	Yes
Sub-Total	**10,890,350**			
Equity Income Funds				
CCLA Diversifed Income Fund	2,031,512	n/a	20,000,000	Yes
Host Capital Charteris Premium Income Fund	2,818,225	n/a	20,000,000	Yes
Investec Diversified Income Fund	6,274,905	n/a	20,000,000	Yes
M&G Global Dividend Fund	9,640,189	n/a	20,000,000	Yes
Payden Sterling Reserve Fund Gbp Distributing	7,070,414	n/a	20,000,000	Yes
Royal London Enhanced Cash Plus Fund	1,992,968	n/a	20,000,000	Yes
Schroders Income Maximiser Fund	6,293,239	n/a	20,000,000	Yes
Threadneedle UK Equity Income Fund	5,911,447	n/a	20,000,000	Yes
Sub-Total	**42,032,899**			
Property Funds				
Lime Property Fund Unit Trust	2,778,985	n/a	40,000,000	Yes
CCLA Local Authorities' Property Fund (LAMIT)	17,580,267	n/a	40,000,000	Yes
Sub-Total	**20,359,252**			
Multi Asset Income Funds				
UBS Multi Asset Income Fund	6,730,920	n/a	20,000,000	Yes
Sub-Total	**6,730,920**			
Total	**149,749,822**			
Less Dorset LEP co-mingled balances	-36,108,000			
Net Total	**113,641,822**			