Cabinet
27 June 2019

Annual Treasury Management Review 2018/19

Cabinet Member: Councillor Alex White
Responsible Officer: Deputy Chief Executive (S151), Andrew Jarrett

Reason for Report: To provide Members with a review of activities and the actual prudential treasury indicators for 2018/19.

Recommendations(s):

1. **That Members note the treasury activities for the year.**
2. **Approve the actual 2018/19 prudential and treasury indicators in this report.**

Relationship to the Corporate Plan: Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

Financial Implications: Good financial management and administration underpins the entire strategy.

Legal Implications: Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

Risk Assessment: The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

1. Introduction

1.1 The 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 2018/19. 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).

1.2 During 2018/19 the minimum reporting requirements were that the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Cabinet 01/03/2018)
- a mid-year treasury update report (Cabinet 22/11/2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

1.3 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.

2. The Economy and Interest Rates (Narrative provided by Link Asset Services)

2.1 **UK**: After weak economic growth of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% year on year confirming that the UK was the third fastest growing country in the G7 in quarter 4.

2.2 After the Monetary Policy Committee (MPC) raised Bank Rate from 0.5% to 0.75% in August 2018, it is a little surprising that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

2.3 As for CPI inflation itself, this has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

2.4 The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.5%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

2.5 **Brexit**: The biggest issue when doing the Local Authority Strategy (LAS) forecasts these days is what sort of Brexit will we have, if any? We have to make an assumption one way or the other so our starting point is an assumption that the UK will muddle through to an eventual agreed exit being passed by the UK Parliament, and passed by the EU parliamentary processes, by the delayed deadline of 31 October. It ought to be borne in mind too, that such an agreement could be reached at any time between now and 31 October. However, the degree of disagreement within each of the two main political parties is probably now even greater than it was before the first deadline of 29 March. There is, therefore, probably an increased risk that we could get to 31 October and still be in an inconclusive position. UK will have a new prime minister by end of July and that is also expected to influence how the UK achieves Brexit.

2.6 Assuming an agreement is reached, the next known “unknown” that would follow on from that is whether this will be the sort of ‘agreement’ which just kicks the can down the road until the end of a transition period and provides little solid certainty for entrepreneurs to enable them to release the investing decisions that have been pent up since the referendum, or whether it will be a more substantial agreement which will result in a significant boost to GDP in the form of a return to consumer and entrepreneur confidence that sends the economy up a gear. We have taken a cautious view on the ensuing rate of GDP growth over the forecast period of the next three years.

3. Overall Treasury Position as at 31 March 2019

3.1 At the beginning and the end of 2018/19 the Council‘s treasury, (excluding borrowing by PFI and finance leases), position was as follows:

Treasury Position	31 March 2018 Principal (Restated)	31 March 2019 Principal
Total external debt	£42.4m	£40.7m
CFR	£49.2m	£50.8m
Over / (under) borrowing	(£6.8m)	(£10.1m)
Total investments	£26m	£27m
Net debt	£16.4m	£13.7m

3.2 The 2017/18 Capital Financing Requirement (CFR) has changed due to restatements for the following reasons:

3.2.1 The inclusion of loans to 3 Rivers Developments Ltd for £750k; and

3.2.2 Capital receipts of £820k reducing the CFR for Wells Park Development.

4. The Strategy for 2018/19

4.1 Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

5. The Borrowing Requirement and Debt

5.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

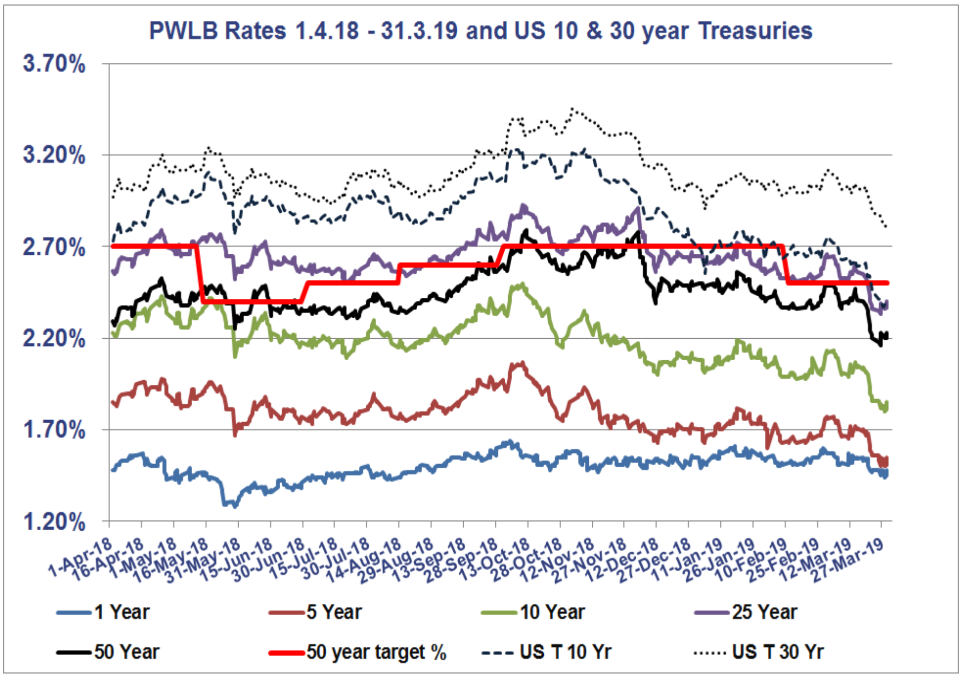
Capital Financing Requirement	31-Mar-18 Actual (Restated)	31-Mar-19 Actual
CFR General Fund (£m)	7.0	9.5
CFR HRA (£m)	42.2	41.3
Total CFR	49.2	50.8

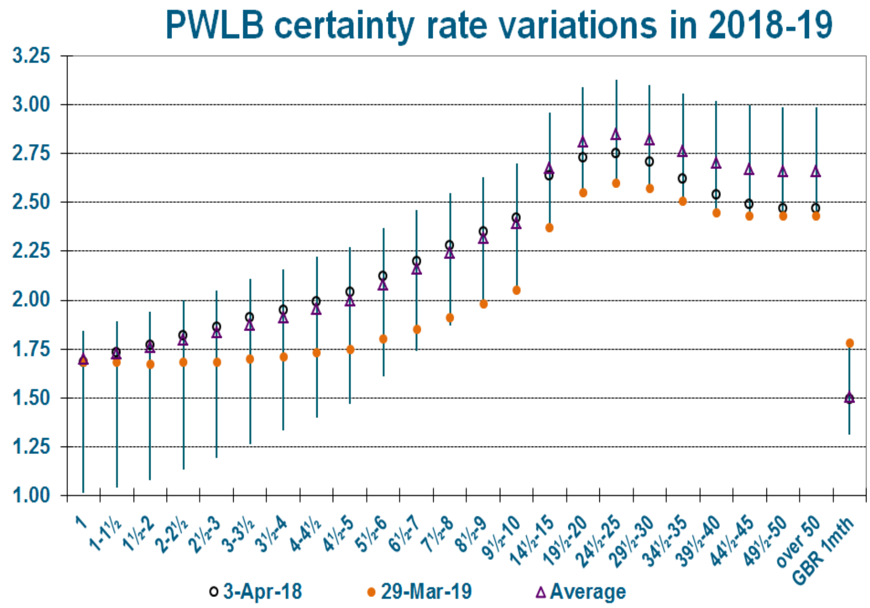
5.2 The movement in general fund CFR is due to loans to 3rd parties.

6. Borrowing Rates in 2018/19

6.1 **PWLB certainty maturity borrowing rates.** Since PWLB rates peaked during October 2018, most PWLB rates have been on a general downward trend, though longer term rates did spike upwards again during December, and, (apart from the 1 year rate), reached lows for the year at the end of March. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields - which determine PWLB rates. Treasury yields have fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

6.2 The graphs and tables for PWLB rates show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.





	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2018	1.48%	1.85%	2.23%	2.57%	2.29%
29/03/2019	1.48%	1.55%	1.85%	2.40%	2.23%
Low	1.28%	1.50%	1.80%	2.33%	2.16%
Date	29/05/2018	26/03/2019	28/03/2019	26/03/2019	26/03/2019
High	1.64%	2.07%	2.50%	2.93%	2.79%
Date	04/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018
Average	1.50%	1.80%	2.20%	2.66%	2.47%

7. Borrowing Outturn for 2018/19

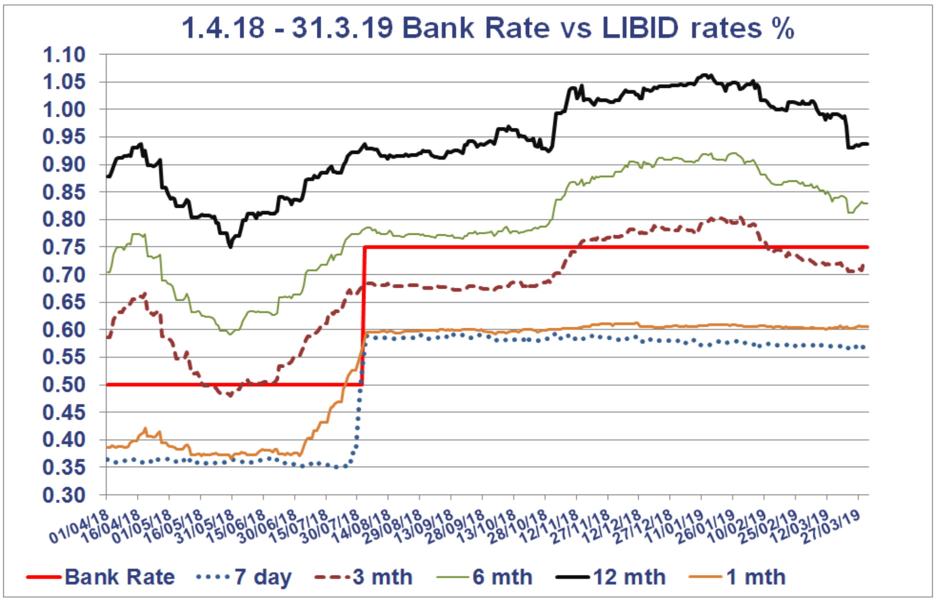
7.1 **Borrowing** – there have been no new loans taken during the year.

7.2 **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.

8. Investment Rates in 2018/19

8.1 Investment rates were hardly changed during August to October but rose sharply after the MPC meeting of 1 November was unexpectedly hawkish about their perception of building inflationary pressures, particularly from rising wages. However, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

8.2 Continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.



9. Investment Outturn for 2018/19

9.1 **Investment Policy** – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Cabinet on 1 March 2018. 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).

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

9.3 **Investments held by the Council** - the Council maintained an average balance of £22m of internally managed funds. The internally managed funds earned an average rate of return of 1.07%. The comparable performance indicator is the 3 month uncompounded rate that was 0.6753%. We have amended the benchmark from the average 7-day LIBID rate as our investments are on average 112 days. The Council held £5m invested in Churches, Charities and Local Authorities (CCLA) property funds earning dividends of 4.41% in 18/19.

10. Other Issues

10.1 IFRS9

10.1.1 Risk management will need to take account of the 2018/19 Accounting Code of Practice proposals for the valuation of investments. Whilst for many authorities, this may not be a significant issue, key considerations to include:

10.1.2 Expected credit loss model. Whilst this should not be material for day to day treasury investments such as bank deposits, this is likely to be problematic for some funds e.g. property funds, (and also for non-treasury management investments dealt with in the capital strategy e.g. longer dated service investments, loans to third parties or loans to subsidiaries).

10.1.3 The valuation of investments previously valued under the available for sale category e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar, will be changed to **Fair Value through the Profit and Loss (FVPL).**

10.2 **Non-treasury management investments (Includes extract from Capital Strategy 2019/20)**

10.2.1 With Central Government financial support for local public services declining, the Council invests in Commercial Property for financial gain and for Economic Development purposes. It lends to its subsidiary 3 Rivers Developments Ltd to develop land and commercial income generating projects. We charge interest on loans to 3 Rivers Developments Ltd at a commercial rate. As at 31 March 2019 we have lent £2.613m to 3 Rivers Developments Ltd.

10.2.2 With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include the timing of debt repayments; development market values; development costs and profitability of the subsidiary. These risks are managed by due diligence of business cases. Although there is no cap to the level of lending between the Authority and the subsidiary, advance approval of the level of lending is required from Cabinet before the start of each financial year, with reference to the company's Annual Report.

10.2.3 **Governance:** Decisions on commercial investments are made by the Deputy Chief Executive (S151) in conjunction with the Leadership Team members, in line with the criteria and limits approved by Council in the Treasury Management Strategy Statement. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved alongside the capital programme.

10.2.4 The Council also has commercial activities in retail properties, which expose it to normal commercial risks. The over-arching ethos behind these activities is economic regeneration and retention of premises within the town centre rather than the income stream.

11. Conclusion

11.1 The financial year 2018/19 overall was a good year for Treasury. The internally managed investments achieved income above budget of £147k, while the CCLA dividends of £214k were above budget by £9k.

11.2 The cash flow and funding was balanced throughout 2018/19 without the need to borrow from PWLB. There were no new loans.

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Background papers: Link Annual Treasury Management Review template

Circulation of the report: Councillor White, Leadership Team, Group Manager for Finance.

Appendix 1: Prudential and Treasury Indicators

During 2018/19, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual Prudential and Treasury Indicators	31-Mar-18 Actual (Restated)	31-Mar-19 Actual
Capital Expenditure:		
General Fund	4,984	3,587
HRA	4,288	6,030
Total	**9,272**	**9,617**
Capital Financing Requirement:		
General Fund	7,060	9,460
HRA	42,346	41,385
Total	**49,406**	**50,845**
Gross Borrowing	**42,825**	**41,029**
Investments		
Longer than 1 year	5,000	5,000
Under 1 year	21,000	22,000
Total	**26,000**	**27,000**
Net Borrowing	**16,825**	**14,029**

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 two 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 2018/19.

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 2018/19 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 is 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.

Treasury Management Indicators	2017/18	2018/19
Authorised Limit for external debt -		
Borrowing	£55.0m	£61.0m
Other Long Term Liabilities		£3.0m
TOTAL	**£55.0m**	**£64.0m**
Operational boundary		
Borrowing	£50.0m	£53.0m
Other Long Term Liabilities		
TOTAL	**£50.0m**	**£53.0m**
Average external debt	£42.449m	£40.718m
Maximum HRA debt limit	£53.744m	£53.744m

The maturity structure of the debt portfolio was as follows:

Maturity Structure of Fixed Rate Borrowing	31-Mar-18 Actual(£m)	31-Mar-19 Actual(£m)
Under 12 months	1.73	1.78
12 months and within 24 months	1.78	1.83
24 months and within 5 years	5.63	5.73
5 years and within 10 years	10.19	10.47
10 years and within 20 years	22.68	20.68
Over 20 years	0.44	0.22