ITEM NO. 11.1

Report of:	**Head of Finance**
Contact Officer:	**Bob Kean**
Telephone No:	**01543 464 334**
Portfolio Leader:	**Leader of the Council**
Report Track:	**Audit & Governance Cttee. 29/07/19 and Council 04/09/19**

COUNCIL

4 SEPTEMBER 2019

ANNUAL TREASURY MANAGEMENT REPORT 2018/19

1 Purpose of Report

1.1 To update members on treasury management activity and performance during the 2018/19 financial year.

2 Recommendations

2.1 To note the annual treasury management report for 2018/19.

2.2 To approve the actual 2018/19 prudential and treasury indicators set out in Appendix 1.

3 Key Issues and Reasons for Recommendation

3.1 Treasury management activity and performance during the 2018/19 financial year.

4 Relationship to Corporate Priorities

4.1 Treasury management and investment activity link in with all of the Council's priorities and spending plans.

5 Report Detail

Background

5.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 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).

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

- an annual treasury strategy in advance of the year
- a mid-year (minimum) treasury update report
- an annual review following the end of the year describing the activity compared to the strategy (this report)

5.3 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.

5.4 The submission of the above reports to the Audit and Governance Committee, to give prior scrutiny before they were reported to the full Council, ensures that this Council complies with the codes requirement. Training has been undertaken by members of the Audit and Governance Committee and further training will be arranged as required.

The Council's Capital Expenditure and Financing

5.5 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.

5.6 The actual capital expenditure forms one of the required prudential indicators. This is detailed in the appendix.

The Council's Overall Borrowing Need

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

5.8 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 (2017/18) plus the estimates of any additional capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2018/19. The table in the appendix highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

5.9 **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 in the appendix demonstrates that during 2018/19 the Council has maintained gross borrowing within its authorised limit.

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

5.11 **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 Position as at 31 March 2019

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

TABLE 1	**31 March 2018 Principal £'000**	**Rate/ Return**	**Average Life (yrs.)**	**31 March 2019 Principal £'000**	**Rate/ Return**	**Average Life (yrs.)**
Total debt (PWLB)	81,605	3.89%	36.68	81,605	3.89%	36.49
CFR	94,924			93,453		
Over / (under) borrowing	(13,319)			(11,848)		
Total investments	11,900	0.52%	0.27	27,000	0.66%	0.13
Short term borrowing	0			0		
Net investments	11,900			27,000		
Net debt	69,705			54,605		

5.12.1 The table below sets out the maturity profile of the external debt held by the Council.

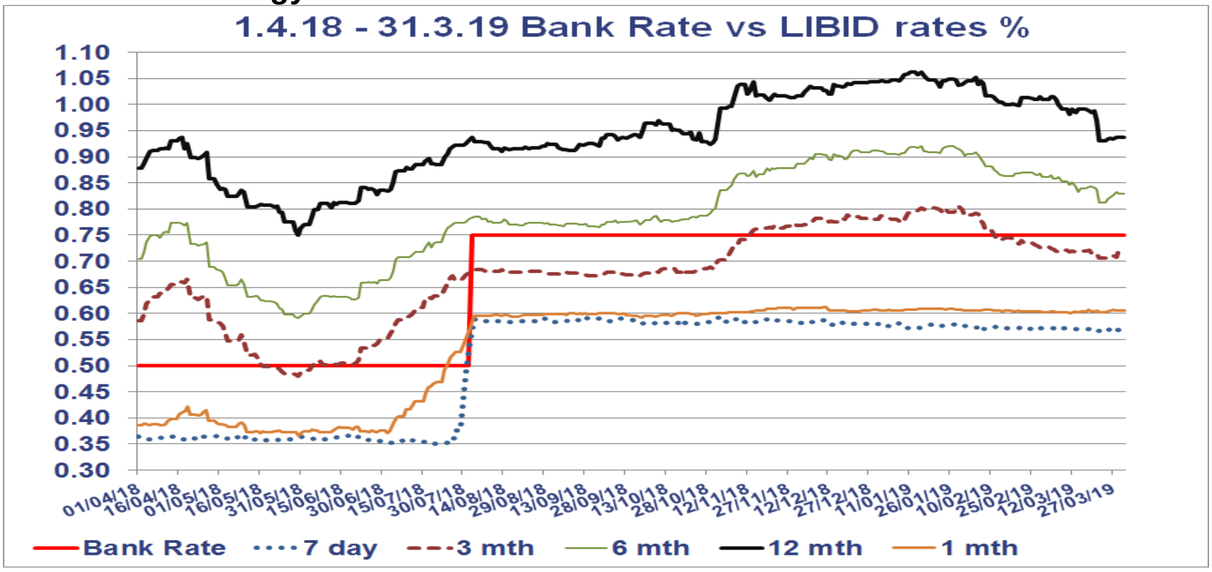
Debt Maturity Profile	**31 March 2018 Actual**	**2018/19 original limits**	**31 March 2019 (actual**
	£m	**£m**	**£m**
Under 12 months	0	0	0
12 months and within 24 months	0	0	0
24 months and within 5 years	0	0	0
5 years and within 10 years	4.4	4.4	4.4
10 years and within 20 years	12.60	12.60	12.60
20 years and within 30 years	0	0	0
30 years and within 40 years	5.36	5.36	5.36
40 years and within 50 years	59.245	59.245	59.245
Total Debt	**81.605**	**81.605**	**81.605**

5.12.2 The following table sets out the Council's investments held at 31 March 2019:

Counterparty	**Start Date**	**End Date**	**Value (£)**	**Rate %**
Santander UK	95 Day Notice		3,500,000	0.85
Aberdeen GBP Liquidity Fund	Money Market Fund		6,000,000	0.79
Federated Prime Fund Class	Money Market Fund		6,000,000	0.79
Deutsche Bank	Money Market Fund		5,500,000	0.73
Bank of Scotland	08/02/2019	08/08/2019	1,000,000	1.00
Bank of Scotland	18/03/2019	18/09/2019	3,000,000	1.00
Bank of Scotland	09/01/2019	09/04/2019	2,000,000	0.90
			27,000,000	

5.13 All investments in the portfolio have a maturity of under 1 year.

Investment strategy and control of interest rate risk



5.14 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% in November 2018. The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Investment interest rates after a disappointing start to the year were therefore on a gently rising trend in the first half of the year, in anticipation that the MPC would raise Bank Rate in August. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

5.15 It was not expected that the MPC would raise Bank Rate again during 2018-19 after August in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019. Value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

5.16 Investment rates were little 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.

5.17 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.

Borrowing strategy and control of interest rate risk

5.18 During 2018-19, 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. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

5.19 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years . In particular the Council has avoided "A cost of carry".This arises if any new long-term borrowing is not immediately used to finance capital expenditure, resulting in a temporary increase in cash balances with a subsequent revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

5.20 However, the policy is subject to continual review, since the council would suffer a financial detriment if new borrowing was required to finance capital expenditure and interest rates were increasing.

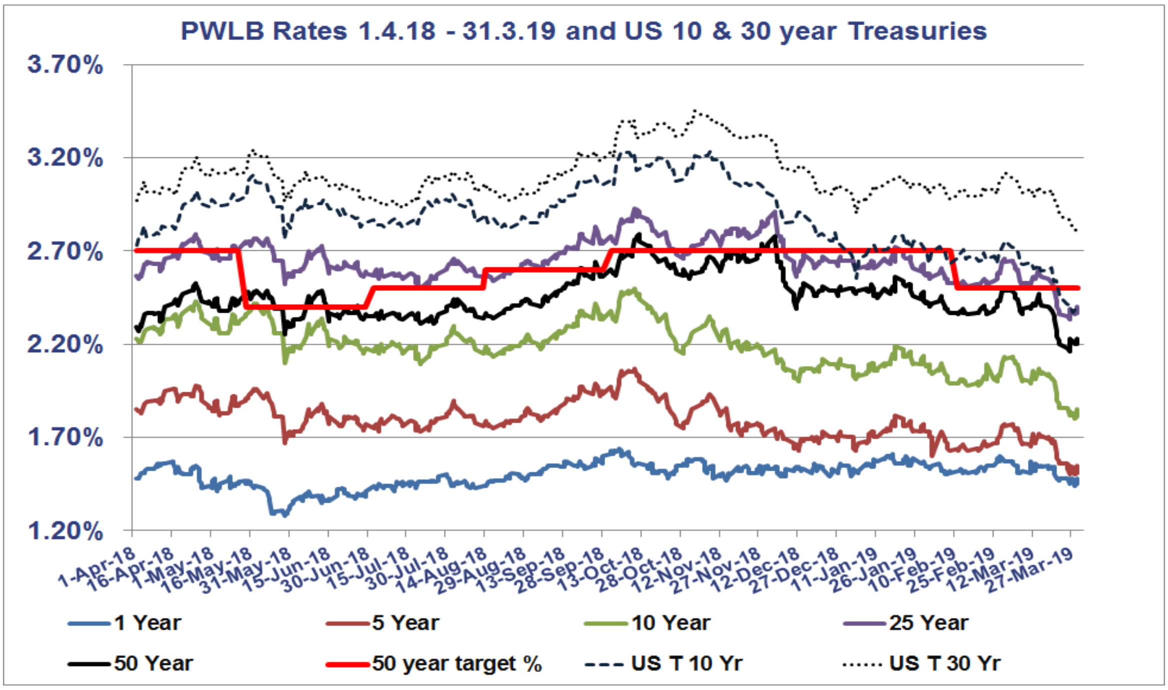
5.21 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Deputy Managing Director therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks;

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

5.22 Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View	12.2.18												
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB Rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%



5.23 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. The Fed in America increased the Fed Rate four times in 2018, making nine increases in all in this cycle, to reach 2.25% – 2.50% in December. However, it had been giving forward guidance that rates could go up to nearly 3.50%. These rate increases and guidance caused Treasury yields to also move up. However financial markets considered by December 2018, that the Fed had gone too far, and discounted its expectations of further increases. Since then, the Fed has also come round to the view that there are probably going to be no more increases in this cycle. The issue now is how many cuts in the Fed Rate there will be and how soon, in order to support economic growth in the US. But weak growth now also looks to be the outlook for China and the EU so this will mean that world growth as a whole will be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

Borrowing Outturn

5.24 **Borrowing** - Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

5.25 In accordance with the planned treasury strategy the General Fund did use £1.5 million of capital receipts to repay borrowing, however the overall level of borrowing to the authority has not reduced as this borrowing was taken on by the Housing Revenue Account.

Investment Outturn

5.26 **Investment Policy** - the Council’s investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 07/02/2018. 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, bank share prices etc).

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

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

Balance Sheet Resources	31 March 2018	31 March 2019
	£'000	£'000
Earmarked Fund balances / reserves		
General Fund	9,786	10,835
General Fund working balance	3,136	2,916
HRA	2,074	5,225
HRA working balance	1,739	1,573
Sub Total	**16,735**	**20,549**
Capital receipts		
GF	2,471	7,371
HRA	593	1,006
Sub Total	**3,064**	**8,377**
Provisions	2,266	3,238
Major Repairs Reserve	883	2,433
Other - grants receipts in advance	602	664
Total core funds	**23,550**	**35,261**

5.29 **Investments held by the Council**

- The Council maintained an average balance of £26.5m of internally managed funds.
- The internally managed funds earned an average rate of return of 0.65%.
- The comparable performance indicator is the average 7-day LIBID rate, which was 0.51%.
- Total investment income was £175,452 compared to a budget of £90,000.

6 Implications

6.1 Financial

The financial implications have been referred to throughout the report.

6.2 Legal

The legal implications have been referred to throughout the report.

6.3 Human Resources

There are no human resource implications arising from this report.

6.4 Section 17 (Crime Prevention)

There are no implications arising from this report.

6.5 Human Rights Act

There are no identified implications in respect of the Human Rights Act 1998 arising from this report.

6.6 Data Protection

There are no implications arising from this report.

6.7 Risk Management

Treasury management is a high risk area due to the large amounts of money dealt with on a daily basis. However, the Council has a Treasury Policy and Strategy in place which is approved each year for the following 12 months. The Council also has advice on investment and lending from the leading company in the field and has instituted a strict control and delegation of duties regime which reduces risk to a minimum.

6.8 Equality & Diversity

There are no identified implications arising form this report.

6.9 Best Value

The strategy ensures that best value is provided to the Council.

7 Appendices to the Report

Appendix 1: Prudential and Treasury Indicators

Appendix 2: Investments Portfolio Analysis

Previous Consideration

None

Background Papers

Available in Financial Services.

ITEM NO. 11.10

Appendix 1

1. PRUDENTIAL INDICATORS	2017/18	2018/19	2018/19
	Actual	Estimate	Actual
	£'000	£'000	£'000
Capital Expenditure (HRA)	10,039	7,682	6,349
Capital Expenditure (GF)	2,560	3,353	2,907
Notional Capital expenditure – Finance Leases	1,312		
Ratio of financing costs to net revenue stream (HRA)	16.62% *	16.72%	16.74%
Ratio of financing costs to net revenue stream (GF)	5.9%	4.4%	2.8%
Gross borrowing requirement (GF) - Finance Leases	1,105	1,105	1,105
Gross debt	81,605	81,605	81,605
Capital Financing Requirement as at 31 March (HRA)	81,509*	82,515	82,504
Capital Financing Requirement as at 31 March (GF)	14,971	10,949	10,949
Annual change in Cap. Financing Requirement (HRA)		1,006	995
Annual change in Cap. Financing Requirement (GF)		-4,022	-4,022
2. TREASURY MANAGEMENT INDICATORS			
Authorised Limit for external debt -	111,410	109,385	109,385
Operational Boundary for external debt	99,110	97,885	97,885
Actual external debt	81,605	81,605	81,605

* adjusted following Voluntary MRP reversed

Maturity structure of fixed rate borrowing during 2018/19	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

ITEM NO. 11.11

Appendix 2

The following table sets out an analysis of investments held at 31 March 2019 (together with a comparator at 31 March 2018).

INVESTMENT PORTFOLIO	**Actual 31.3.18**	**Actual 31.3.18 %**	**Actual 31.3.19**	**Actual 31.3.19 %**
Money Market Funds	£6.9m	58%	£17.5m	65%
Banks	£5.0m	42%	£9.5m	35%
TOTAL TREASURY INVESTMENTS	£11.9m	100%	£27.0m	100%