Appendix C

Annual Treasury Management Review 2018/19

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 as follows:
- an annual treasury strategy in advance of the year (Council 20 February 2019)
- a mid year treasury update report (Governance & Audit Committee 13 November 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 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.

1.4 The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the annual treasury strategy by the Scrutiny Panel before it was reported to the full Council.

1.5 This report summarises:
- Capital financing activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- The overall treasury position;
- The Treasury Management Strategy for 2018/19;
- The economy and interest rates;
- Borrowing activity; and
- Investment activity.

2 *Capital expenditure and financing 2018/19*

2.1 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.

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

	2017/18 Actual £'000	2018/19 Original £'000	2018/19 Actual £'000
General Fund capital expenditure	9,038	29,416	14,878
HRA capital expenditure	7,967	9,188	10,226
Total capital expenditure	17,005	38,604	25,104
Resourced by:			
· Capital receipts	2,768	15,818	2,280
· Capital grants	2,928	3,436	1,840
· Capital reserves	5,195	3,634	2,544
· Finance Leases	230		0
· Revenue	4,593	5,454	9,605
New borrowing requirement	1,291	10,263	8,835

3 The Council's overall borrowing need

3.1 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 debt position. 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 2018/19 new borrowing requirement (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the Capital Programme, the Finance team 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.

3.3 The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR. The total CFR can also be reduced by:

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

3.4 The Council's 2018/19 MRP Policy (as required by MHCLG Guidance) was approved as part of the Treasury Management Strategy Report on 21 February 2018.

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

CFR	31-Mar-18 Actual £'000	31-Mar-19 Original £'000	31-Mar-19 Actual £'000
Opening balance	154,597	154,984	154,864
Add unfinanced capital expenditure (as above)	1,291	10,263	8,835
Add on-balance sheet leasing schemes	230	0	0
Write-off of finance lease creditor	(675)	0	(22)
Less MRP/VRP	1,254	1,745	1,322
Closing balance	154,864	163,502	162,355

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

3.7 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 borrowing position** does not, except in the short term, exceed the planned limit. The limit is the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31-Mar-18 Actual £'000	31-Mar-19 Original £'000	31-Mar-19 Actual £'000
Gross borrowing position	141,094	145,701	141,094
CFR	154,864	163,502	162,355

3.8 The **Authorised Limit** is 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.

3.9 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.

3.10 The **actual financing costs as a proportion of net revenue stream** indicator identifies the trend in the cost of capital (borrowing and other long-term obligations cost net of investment income) against the net revenue stream.

	2017/18 £'000	2018/19 £'000
Authorised limit	169,635	180,252
Maximum gross borrowing position	141,094	141,094
Operational boundary	140,537	159,613
Average gross borrowing position	140,075	141,094
Financing costs as a proportion of net revenue stream	10.93%	8.15%

4 Treasury position as at 31 March 2019

4.1 The Council's debt and investment position is organised 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 (as detailed in the introduction), and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2018/19 the Council's treasury position (excluding finance leases) was as follows:

	31-Mar-18 Principal £'000	Rate/ Return %	31-Mar-19 Principal £'000	Rate/ Return %
Fixed rate funding:				
PWLB	104,594	3.80%	104,594	3.80%
LOBO	5,500	3.63%	5,500	3.63%
Market	9,000	4.28%	9,000	4.28%
Local Authorities	2,000	1.02%	2,000	1.02%
Stock Issue	20,000	8.79%	20,000	8.79%
Total debt	**141,094**	**4.46%**	**141,094**	**4.46%**
CFR	154,189		161,680	
Over/ (under) borrowing	(13,095)		(20,586)	
Investments - In house	47,901	0.41%	54,212	0.94%
Total investments	**47,901**	**0.41%**	**54,212**	**0.94%**

4.2 The maturity structure of the debt portfolio is shown below. It should be noted that for LOBO loans, the maturity date is deemed to be the next call date. They are therefore all shown as short-term debt:

	Approved Maximum	31-Mar-18 Actual		31-Mar-19 Actual	
	%	£'000	%	£'000	%
Under 1 year	15.0	5,500	3.9	5,500	3.9
1 - 2 years	15.0	22,000	15.6	0	0.0
2 - 5 years	15.0	0	0.0	22,000	15.6
5 - 10 years	15.0	700	0.5	700	0.5
10 - 20 years	30.0	14,300	10.2	14,300	10.2
20 - 30 years	30.0	36,000	25.5	36,000	25.5
30 - 40 years	40.0	35,394	25.1	35,394	25.1
40 - 50 years	40.0	18,200	12.9	18,200	12.9
Over 50 years	10.0	9,000	6.3	9,000	6.3
		141,094	**100.0**	**141,094**	**100.0**

4.3 All of the Council's investments were for a period of less than one year, and there was not any exposure to variable rates of interest.

4.4 The outturn position for the Central Loans and Investment Account (CLIA) is shown below. This shows the outturn position as being a favourable variance of £92k.

CLIA	Budget £'000	Actual £'000	Variance £'000
Total Interest Paid	6,536	6,593	57
Less: HRA recharge	(5,667)	(5,637)	30
Total less HRA	**869**	**956**	**87**
Total Investments	(269)	(530)	(261)
Less: Item 8 credit	30	112	82
Total less HRA	**(239)**	**(418)**	**(179)**
Total CLIA	**630**	**538**	**(92)**

4.5 The CLIA comprises the Council's borrowing costs and investment income. It is difficult to predict and can be affected by several factors. The majority of the Council's debt is on fixed rates reflecting the longer-term nature of the borrowing decisions. Investments are generally made for shorter periods, making returns more variable. This mix is generally more beneficial when interest rates are high or increasing. It is important to add that the exposure to interest rate movements is regularly monitored to minimise risks to changes in returns. The reasons that have contributed to the above variances include:

- The variance against borrowing costs relates to the additional external borrowing that was taken on during the year. This is mitigated by a proportion of this cost being charged to the Housing Revenue Account.
- The variance against interest income is as a result of a higher level of funds than was envisaged being available for investment, and the rates against some investments being greater than the budgeted figure. A proportion of this income was moved to the Housing Revenue Account, based on average HRA balances and investment returns.

5 The strategy for 2018/19

5.1 The expectation for interest rates within the treasury management strategy for 2018/19 anticipated that Bank Rate would start increasing by 0.25% in quarter 3 and then only increase once more before March 2020. There would also be 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. Continued uncertainty in the aftermath of the 2008 financial crisis 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.

5.2 The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this was kept under review considering the long-term saving resulting from borrowing at very low rates, and to avoid incurring higher borrowing costs in the future. A cost of carry remained during the year on any new long-term borrowing due to the difference between borrowing costs and investment returns.

5.3 The investment policy reflected the Council's low appetite for risk, emphasising the priorities of security and liquidity over that of yield. The main features of the policy were that the Council will apply minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties, which also enables diversification and avoidance of concentration risk. Investment decisions also applies the creditworthiness service provided by Link Asset Services, which combines data from credit rating agencies with credit default swaps and sovereign ratings.

5.4 The Council would only use approved counterparties from countries with a minimum credit rating of 'AA-'. The Council will consider longer-term deals if attractive rates are available within the risk parameters set by the Council. The suggested budgeted return on investments placed for periods up to 100 days during the year was 0.25%.

5.5 Investment returns remained low during 2018/19 but were on a gently rising trend in the second half of the year.

5.6 **Changes in strategy during the year** – the strategy adopted in the original Treasury Management Strategy for 2018/19 approved by the Council on 20 February 2018, was reviewed as part of the mid-year update report. There were no proposed changes to the strategy as a result of this review.

6 The economy and interest rates

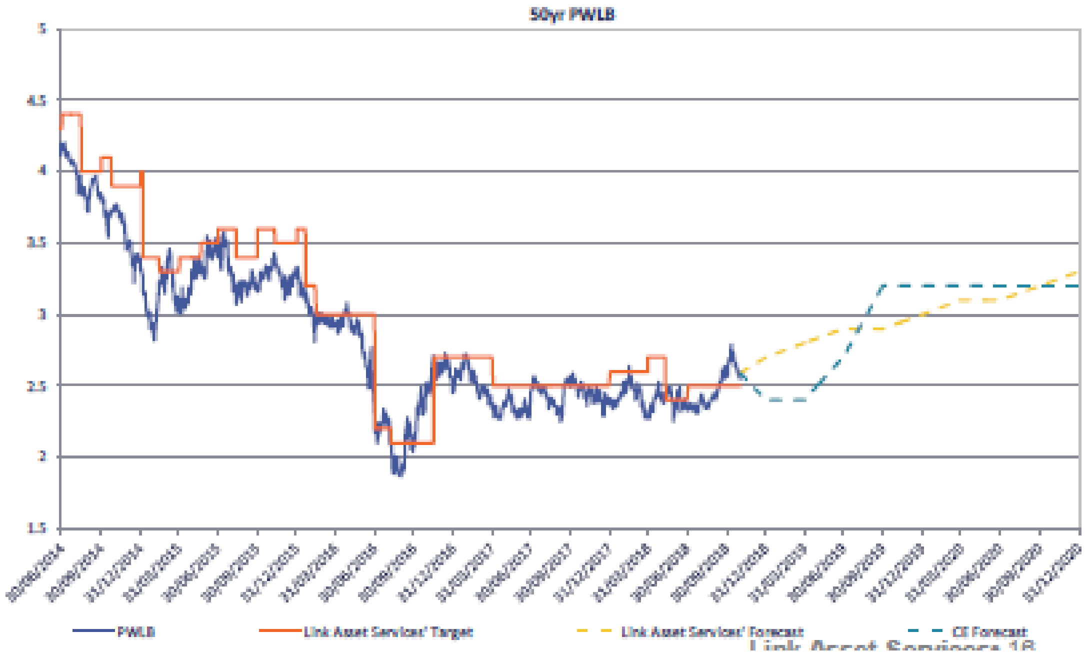
6.1 During the calendar year of 2018, there was a growing market expectation after April 2018 that the MPC was heading in the direction of a rate rise. In August 2018, the bank of England raised the base rate from 0.5% to 0.75% which was only the second rise in over a decade. Short-term investment further after the MPC meeting in November after concerns over the risk of rising inflation and needing to take action sooner than was expected. Since January 2019, the uncertainty around Brexit has had a depressing effect on interest rate expectation which is likely to continue until there is a greater certainty over the direction of exiting the EU.

6.2 For equity markets, this has seen a considerable slump during the year only to pick up and stabilise toward the end of March. The FTSE 100 hit a peak in May reaching 7,900 however concerns uncertainty in the market created a sell-off which saw the FTSE 100 reach 6,500 in December only to stabilise in March at around 7,300.

7 Borrowing

7.1 PWLB 25 and 50 year rates have been stable during the year with minor fluctuations. However, shorter rates were on an increase over the second part of the year given concerns over inflation. During the year, the 50-year PWLB target (certainty) rate for new long term borrowing was 2.50% in the first 3 quarters however rose to 2.75% in the last. The table for PWLB borrowing rates below shows, for a selection of maturity periods, the movement in rates during the course of the financial year.

7.2

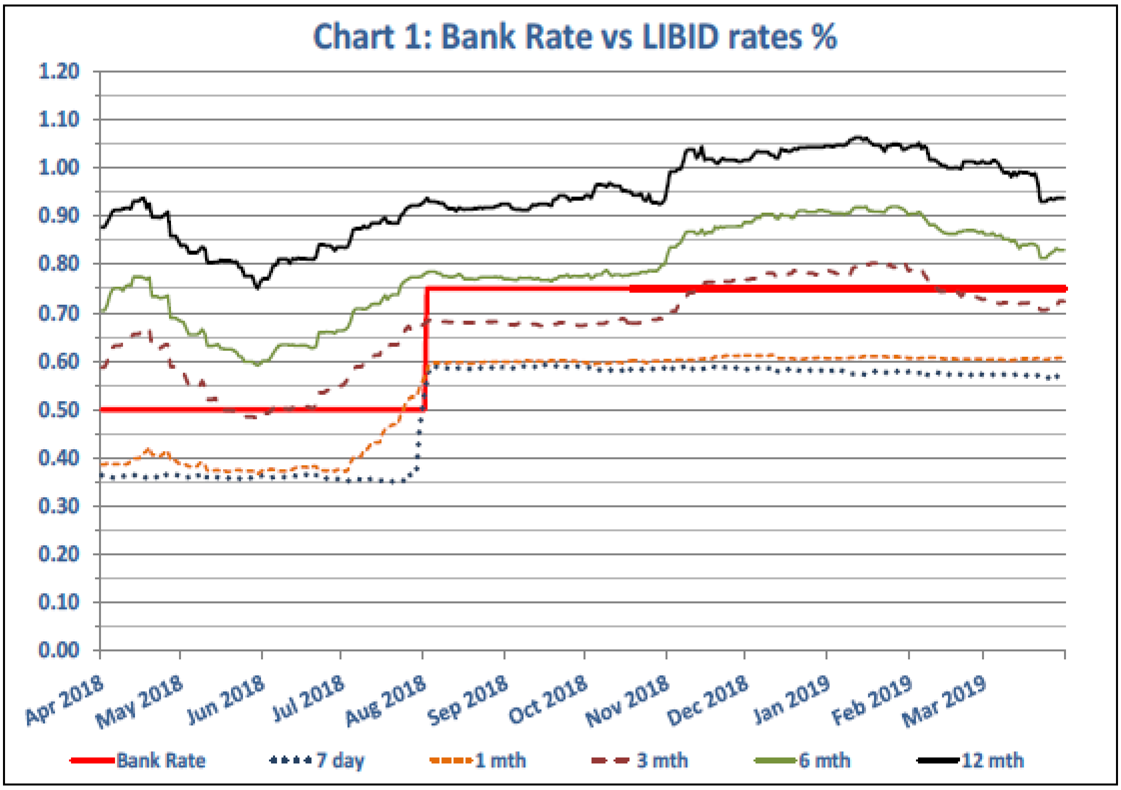


7.3 The Council's total debt outstanding at 31 March 2018 was £141.1m, which had not changed since the previous year. Due to the low rates available, this resulted in the average interest rate on the Council's debt at the end of the year reducing to 4.46%.

7.4 The Council's approach during the year was primarily to use cash balances to finance new capital expenditure. This minimised counterparty risk incurred on investments, and maximised treasury management budget savings as investment rates were much lower than most new borrowing rates.

8 Investments

Investments rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from 0.50% and reached a peak at the end of March. Bank Rate was duly raised from 0.50% to 0.75% in August 2018 and remained at that level for the rest of the year. However, further increases are expected over the next few years.



8.1 The Council manages its investments in-house, and its cash balances comprise revenue and capital resources and cash flow monies. The Council's investment policy is governed by MHCLG investment guidance, which was implemented in the Annual Investment Strategy approved by the Council on 20 February 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.)

8.2 The investment activity during the year conformed to the approved strategy, the Council had no liquidity difficulties, and no institutions in which investments were made during 2018/19 had any difficulty in repaying investments and interest in full.

8.3 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-Mar-18 £'000	31-Mar-19 £'000
Balances	9,491	12,498
Earmarked Reserves	23,963	23,080
Provisions	2,628	4,526
Capital Reserves	2,004	4,044
Total	**38,086**	**44,148**

8.4 The Council's internally managed funds earned an average rate of return of 0.84%. The comparable performance indicator is the average 3-month LIBID rate (London Interbank Bid Rate – the rate charged by one bank to another for a deposit) (uncompounded), which was 0.72%.

Details	2017/18 %	2018/19 %
Temporary Investments	0.43	0.83
Overnight and Deposit Account	0.39	0.72
Total	**0.41**	**0.78**
Benchmark (3 month LIBID)	0.29	0.72
Return as a % of the Benchmark	143.4%	108.0%

8.5 The Council had temporary investments totalling £54.3m outstanding as at 31 March 2019. Of this, £32.5m relates to fixed-term deposits that are due to mature during 2019/20, £17.8m is held in 'AAA' rated money market funds, and the remaining £5m is held in notice accounts. All of the deposits were made in accordance with the 2018/19 Annual Investment Strategy. A full list of investments held as at 31 March 2019 is shown in **Appendix A** (confidential).