Report to:	**Cabinet**
Date:	**9 July 2019**
Title:	**Treasury Management Annual Report 2018/19**
Report of:	**Chief Finance Officer**
Cabinet member:	**Councillor Stephen Holt, Financial Services**
Ward(s):	**All**
Purpose of report:	**To report on the activities and performance of the Treasury Management service during 2018/19**
Decision type:	**Budget and Policy Framework**
Officer recommendation(s):	**(1) Agree the annual Treasury Management report for 2018/19.** **(2) Approve the 2018/19 prudential and treasury indicators included.**
Reasons for recommendations:	**Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code) and this has to be reported to Full Council in September 2019.**
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1 Introduction

1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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).

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 (Council 21 February 2018)
- a mid year (minimum) treasury update report (Council 12 December 2018)
- an annual report following the year describing the activity compared to the strategy (this report).

In addition Treasury Management updates are included in the quarterly performance management reports, considered by both the Cabinet and Scrutiny Committee.

Recent changes in the regulatory environment place a much greater onus 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.

This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit & Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 23 November 2015 in order to support Members' scrutiny role. Further training is expected to take place in 2019-20.

1.2 This report summarizes:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement (CFR));
- Reporting of the required prudential and treasury indicators and changes to be approved;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Debt activity and investment activity.

2.0 The Council's 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.

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 £m	2018/19 Estimate £m	2018/19 Actual £m
Non-HRA capital expenditure	45.0	46.1	38.9
HRA capital expenditure	6.3	4.3	4.7
Total capital expenditure	**51.3**	**50.4**	**43.6**
Resourced by:			
• Capital receipts	1.4	0.6	6.5
• Capital grants & external funding	9.9	2.7	4.2
• Capital Reserves	4.9	4.4	4.2
• Revenue	-	-	0.5
Use of internal balances/ borrowing	**35.1**	**42.7**	**28.2**

3.0 <u>The Council's overall borrowing need</u>

3.1 The Capital Financing Requirement (CFR) represents the Council's total underlying need to borrow to finance capital expenditure, i.e. capital expenditure that has not been resourced from capital receipts, capital grants and contributions or the use of reserves. Some of this borrowing is from the internal use of cash balances.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

3.3 **Reducing the CFR** – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). 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 CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2018/19 on 7 February 2018.

The Council's CFR for the year is shown below, and represents a key prudential indicator. The figures include a credit sales agreement on the balance sheet, which increases the Council's borrowing need, the CFR.

CFR	31 March 2018 Actual £m	31 March 2019 Original Indicator £m	31 March 2019 Actual £m
Opening balance	88.9	146.2	122.6
Add unfinanced capital expenditure (per table 2.0)	35.0	42.7	28.2
Less MRP	(1.3)	(1.5)	(0.9)
Closing balance	122.6	187.4	149.9

3.5 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the Authorised Limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2017/18 plus the expected changes to the CFR over 2018/19 and 2019/20. This indicator allows the Council some flexibility to borrow in advance of its immediate capital need in 2018/19. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2018Actual £m	31 March 2019 Original Estimate £m	31 March 2019 Actual £m
Net borrowing position	105.1	166.3	123.6
CFR	122.6	187.4	149.9

The Authorised limit - the Authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. 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.

	2018/19
Authorised limit	£202.4m
Maximum gross borrowing position	£166.7m
Operational boundary	£187.4m
Average gross borrowing position	£114.3m
Financing costs as a proportion of net revenue stream:	
Non HRA	12.3%
HRA	13.3%

4.0 Treasury Position as at 31 March 2019

4.1 The Council's debt and investment position is organised by staff within Financial Services in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2018/19 the Council's treasury position was as follows:

TABLE 1	31 March 2018 Principal	Rate/Return	31 March 2019 Principal	Rate/Return
Fixed rate funding:				
-PWLB	£67.6m		£87.1m	
-Market	£37.5m		£36.5m	
- Serco Paisa	£0.4m		£0.0m	
Total debt	**£105.5m**	**2.87%**	**£123.6m**	**2.74%**
CFR	£122.6m		£149.9m	
Over/ (under) borrowing	(£17.2m)		(£26.3m)	
Total investments (excl. cash)	**£0m**		**£0m**	

The Council held cash balances of £2.2m in a current account on which interest of 0.65% was being earned.

4.2 The maturity structure of the debt portfolio excluding Serco Paisa was as follows:

	31 March 2018 Actual £m	2018/19 Original limits £m	31 March 2019 Actual £m
Under 12 months	23.00	20.0	28.1
12 months and within 24 months	5.00	4.0	-
24 months and within 5 years	14.02	22.0	18.3
5 years and within 10 years	1.52	2.1	-
10 years and above	61.51	111.3	77.2

The exposure to fixed and variable rates (including Serco Paisa) was as follows:

	31 March 2018 Actual £m	2018/19 Original Limits £m	31 March 2019 Actual £m
Principal - Debt Fixed rate	105.5	159.4	123.6
Principal – Investments Variable rate	0	N/a	0

5.0 <u>The Strategy for 2018/19</u>

5.1 The expectation for interest rates within the treasury management strategy for 2018/19 anticipated that Bank Rate would not start rising from 0.5% until quarter 3 2019 and then only increase once more before 31.12.19. 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.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

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.

6.0 Borrowing Outturn for 2018/19

6.1 **Treasury Borrowing**.

Borrowing – new loans totalling £20m were drawn down from PWLB in 2018/19 to fund the net unfinanced capital expenditure and to replace maturing loans. Interest rates for PWLB borrowing was between 1.70% and 2.28% compared with a budget assumption of 2.5%. Various temporary loans were taken to cover cash flow requirements. All loans drawn were for fixed rate and are detailed in Appendix A.

Rescheduling – no debt rescheduling was carried out during the year as there was no financial benefit to the Council.

Repayment – £4m of long term PWLB debt was repaid at maturity on 19 June 2018 and £433,333 was an instalment repayment for the repayment (EIP) loans. Various temporary loans were repaid during the year, see Appendix A.

Summary of debt transactions – the overall position of the debt activity resulted in a fall in the average interest rate by 0.1%, representing a saving to the General Fund.

7.0 Interest Rates in 2018/19

7.1 The tight monetary conditions following the 2008 financial crisis continued through 2018/19 with little material movement in the shorter term deposit rates.

7.2 Bank Rate remained at 0.5% until 1 August 2018 when it rose to 0.75%. Investment rates remained very low. With many financial institutions failing to meet the Council's investment criteria, the opportunities for investment returns were limited. The investment rates at the beginning, average and end of the year are provided below.

Investment Term	Interest Rate March 2018	Average Rate	Interest rate April 2019
Overnight	0.45%	0.50%	0.55%
1 Month	0.50%	0.60%	0.70%
3 Months	0.75%	0.78%	0.80%
6 Months	0.90%	0.85%	0.80%
12 Months	1.00%	0.98%	0.95%

The PWLB rates (including the 0.2% reduction for Certainty Rate) at the beginning, average and end of the year are provided below.

Term	Interest Rate	Average Rate	Interest rate

	March 2018		April 2019
1 Year	1.47%	1.47%	1.46%
5 Years	1.85%	1.69%	1.52%
10 Years	2.23%	2.04%	1.84%
25 Years	2.57%	2.49%	2.41%
50 Years	2.29%	2.27%	2.24%

8.0 Investment Outturn for 2018/19

8.1 **Investment Policy** – the Council's investment policy is governed by MHCLG guidance, which was been implemented in the annual investment strategy approved by the Council on 21 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, and the Council had no liquidity difficulties.

8.3 **Resources** – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2018 £m	31 March 2019 £m
Balances	3.03	3.13
Earmarked reserves	8.70	7.80
HRA	5.19	5.94
Major Repairs Reserve	0.86	1.06
Capital Grants & Contributions	4.77	2.60
Usable capital receipts	7.54	7.55
Total	**30.09**	**28.08**

8.4 **Investments held by the Council** - the Council maintained an average balance of £6.4m of internally managed funds. The internally managed funds earned an average rate of return of 0.55%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.36%. This excludes the Council's investment with Lloyds Bank of £1m for 5 years, (matured January 2019) at 3.03% which supported the Local Authority Mortgages Scheme (LAMS).

9.0 The Economy and Interest Rates Forecast

9.1 The Brexit delay means that rate hikes are not likely to be considered before

October but with the Bank of England (BoE) expecting growth to be stronger than previously, there could be a fairly early move from the BoE thereafter. Any moves, however, are likely to be gradual. The economy will probably remain drifting for a year or so, but a Brexit deal would put the UK in a good position to gather pace in 2021. If so, then analysts suggest that Gross Domestic Product (GDP) growth, interest rates and sterling could strengthen more than markets are currently projecting. A no deal exit would still have the greater short term impact, but some economists believe that any outcome would not be as bad as some believe. A softer Brexit deal seems the more likely outcome, though. In the current circumstances, the economy will remain in limbo for the remainder of the year and overseas demand is unlikely to offer support as recent global economic weakness will not be reversed in the short term.

The degree and timing of the slowing of global economic growth has caught some economists by surprise, with the external sector now thought likely to weigh more on the UK economy over the next few years. The weakness of the Eurozone (EZ), the UK's largest trading partner is a worry. Export orders are already in decline, tracking the global trend. The global situation is not seen as either deteriorating or improving in the near term so that is likely to ensure that export growth will remain subdued, which is reflected in the export orders balances of the manufacturing Purchasing Managers Index (PMI).

A Brexit deal may see Sterling strengthen, which in turn would be a further drag on exports, though the post-referendum weakening offered little boost so the impact could be marginal. Trade tensions and tariffs will also dent exports. The biggest influence, though, remains Brexit, with stockpiling of imported goods ahead of the October separation a factor. Some of the levels of stockpiling may be exaggerated, but a sharp jump in imports over the year is forecast. However, post Brexit, these levels will fall back sharply in subsequent years. Net trade is forecast to make a negative contribution to GDP this year, while the trade deficit may surge on increased imports.

Consumers are expected to prop up the economy as they seem unperturbed by Brexit, with spending growth tracking real incomes higher, though the latter may have peaked. Spending has been supported by a decline in the savings rate when earnings growth has slowed, but this has not dulled household investments. Business investment has, however, been held back by Brexit, having declined in Q4 and investment intentions suggesting further declines ahead. The ability and need to invest is there, but uncertainty is the deciding factor, and were a deal to be agreed, there would be a lag before investment bounced.

The unemployment rate should hold around the 3.9% level over the next year or so, before edging higher in 2021. The tight market will ensure that wage growth should remain around an average of 3-3.5%. With rising wage growth and subdued productivity growth, unit labour costs have edged a little above the long term average.

Temporary factors and persistent labour cost pressures will likely push inflation through the 2% level for a period but CPI remained just below the target for a third month in March. Food inflation is expected to pick up quite sharply this year, while the raising of the utility price cap will also offer some upside pressure to inflation. Given that energy retailers purchase in advance the impact could, therefore, result in upside pressures for twelve or so months, before recent declines in wholesale prices start to benefit retail prices. Core inflation is also expected to pick up, with wage growth indicating rising core services inflation to over 3% in 2020. Some of the rising wage costs in the services' sector have been absorbed by firms but once a Brexit deal has been agreed this may prove an opportune time to rebuild margins by raising prices.

Overall inflation is forecast to rise to 2.5% in 2020, where core inflation is also projected to peak. Retail Price Index (RPI) will be pushed higher by mortgage interest payments, if expected interest rate hikes are forthcoming, but that is probably still some way off.

9.2 The Council's treasury advisor, Link, provides the following forecast as at June 2019:

	End Q2 2019	End Q3 2019	End Q4 2019	End Q1 2020	End Q2 2020	End Q3 2020	End Q4 2020
Bank Rate	0.75%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%
5yr PWLB Rate	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.20%
10yr PWLB Rate	2.10%	2.20%	2.30%	2.40%	2.50%	2.50%	2.60%
25yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
50yr PWLB Rate	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%

The Link central forecast is for the Bank Rate to increase to 1.00% in quarter 1 of 2020.

10.0 Executive Summary and Conclusion

10.1 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	2017/18 Actual £m	2018/19 Original Estimate £m	2018/19 Actual £m
Actual capital expenditure	51.3	50.4	43.6
Total Capital Financing Requirement: • Non-HRA • HRA • Total	 80.0 42.6 122.6	 144.8 42.6 187.4	 107.3 42.6 149.9
Net borrowing	105.1		123.6
External debt	105.1		123.6

Investments (all under 1 year)	-		-

Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the Authorised limit), was not breached.

The financial year 2018/19 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

11 Corporate plan and council policies

11.1 The priority themes were considered as part of the overall Capital Programme which forms part of the Tresury Management Strategy.

12 Financial appraisal

12.1 Financial appraisals were considered as part of the overall Capital Programme which forms part of the Tresury Management Strategy.

13 Legal implications

13.1 Comment from the Legal Services Team is not necessary for this routine monitoring report.

14 Risk management implications

14.1 Risks relating to the timing of borrowing and terms of borrowing are considered and advice is provided by Link. Risk management is considered for each of the schemes within the Capital Programme.

15 Equality analysis

15.1 Equality issues are considered

16 Appendices

There are no appendices to this report.

17 Background papers

The Background Papers used in compiling this report were as follows:

CIPFA Treasury Management in the Public Services code of Practice (the Code)
Cross-sectorial Guidance Notes
CIPFA Prudential Code
Treasury Management Strategy and Treasury Management Practices adopted by the Council on 18 May 2010.
Link Asset Services Citywatch and interest rate forecasts

To inspect or obtain copies of background papers please refer to the contact officer listed above.

Appendix A

Temporary loans taken during 2018-19

Lender - Temp Debt	£m	Start Date	End Date	Rate
N Yorkshire CC	4.0	09/03/2018	20/04/2018	0.85%
Middlesbrough BC	7.0	14/03/2018	15/05/2018	0.70%
N Yorkshire CC	5.0	30/05/2017	29/05/2018	0.45%
London Bor Brent	5.0	15/05/2018	15/08/2018	0.55%
Vale of Glamorgan CC	3.0	19/02/2018	20/08/2018	0.70%
N Yorkshire CC	4.0	20/04/2018	22/10/2018	0.80%
Derbyshire CC	5.0	15/08/2018	15/11/2018	0.80%
Barnsley Met Council	3.0	20/08/2018	20/11/2018	0.75%
Lewes DC	2.0	22/10/2018	23/01/2019	0.70%
Liverpool City Council	1.0	07/11/2018	07/02/2019	0.75%
Cheshire East BC	5.0	23/11/2018	12/02/2019	0.82%
Lewes DC	3.0	03/12/2018	01/03/2019	0.75%
Lewes DC	3.0	01/03/2019	13/03/2019	0.65%
E Northamptonshire DC	2.0	15/05/2018	14/05/2019	0.90%
Barnsley Met Council	3.0	20/11/2018	20/05/2019	0.95%
Greater Manchester Council	5.0	29/05/2018	23/05/2019	0.80%
East Riding of Yorkshire Council	2.0	22/10/2018	17/10/2019	1.00%
Epping Forest District Council	3.0	21/02/2019	21/08/2019	0.98%
Portsmouth City Council	7.0	13/03/2019	13/12/2019	1.07%

Long Term Loans taken during 2018-19

Lender - Long Term Debt	£m	Start Date	End Date	Rate
PWLB Maturity	2.0	03/04/2018	24/03/2068	2.28%
PWLB Maturity	2.0	31/05/2018	24/03/2068	2.25%
PWLB EIP	4.0	04/02/2019	24/09/2033	1.89%
PWLB EIP	4.0	12/02/2019	24/09/2033	1.82%
PWLB EIP	5.0	19/03/2019	24/09/2033	1.88%
PWLB EIP	3.0	26/03/2019	24/09/2033	1.70%

Maturity loans – repayment is due in full at maturity.
EIP loans – loans are repaid over the term of the loan in equal instalments paid half yearly.

The long term borrowing interest rates vary between 1.70% and 2.28% compared with a budget assumption of borrowing at an interest rate of 2.5%.