

Report to: **Audit Committee**
Date: **25 July 2019**
Title: **Annual Treasury Management Report 2018/19**
Portfolio Area: **Cllr H Bastone – Support Services**
Wards Affected: **ALL**
Urgent Decision: **N** Approval and clearance obtained: **Y**

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Recommendations:

That the Audit Committee:

- 1. Approves the actual 2018/19 prudential and treasury indicators in this report.**
- 2. Notes the Annual Treasury Management report for 2018/19.**

1. Executive summary

- 1.1 Income from investments this year was £327,234 which is £204,234 higher than the budget of £123,000 at an average return of 0.84%. The comparable performance indicator (Benchmark) is the average 7-day LIBID rate which was 0.51%. Therefore the Council achieved 0.33% return on investments over the benchmark for 18/19.

2. Background

- 2.1 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).

- 2.2 Treasury management is defined as:

“The management of the local authority’s 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 ”

- 2.3 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 (Minute C74/17)
- A mid-year (minimum) treasury update report (Minute A42/18)
- An annual review following the end of the year describing the activity compared to the strategy (this report)

- 2.4 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.

- 2.5 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 Committee before they were reported to the full Council. Member training on treasury management issues will be undertaken during 2019/20 in order to support Members’ scrutiny role.

3. The Economy and Interest Rates

- 3.1 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.
- 3.2 After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, it is of little surprise that they have abstained from any further increases since then. Any further action from the MPC is unlikely until the uncertainties over Brexit are clear. If there was a disorderly exit, it is likely that Bank Rate would be cut to support growth.
- 3.4 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%.

4. Overall Treasury Position as at 31 March 2019

- 4.1 At the beginning and the end of 2018/19 the Council's treasury position was as follows:

Investments	31 March 2018 Principal	Rate/Return for 2017/18	31 March 2019 Principal	Rate/Return for 2018/19
	£	%	£	%
Short term - fixed	22,600,000	0.32	14,500,000	0.84%
Money Market Funds	20,140,000	0.26	11,320,000	0.65%
Heritable Bank	22,483	-	22,483	-
CCLA – Local Authority Property Fund	-	-	468,213	4.26%
CCLA – Diversified Income Fund	-	-	1,008,489	3.25%
Total	42,762,483		27,319,185	

- 4.2 The following is a list of our investments at 31 March 2019.

Fixed Term Deposits

Counterparty	Fixed to	£	Interest Rate
Barclays Bank plc	07/05/2019	2,500,000	1.00%
Nationwide BS	09/04/2019	5,000,000	1.00%
Nationwide BS	19/06/2019	1,000,000	0.72%
Lloyds TSB Bank Plc	04/07/2019	5,000,000	0.77%
Lloyds TSB Bank Plc	02/08/2019	1,000,000	0.85%

Money Market Funds

Amount	Investment	Interest rate
£6,000,000	Ignis Sterling Liquidity	0.65%
£4,820,000	LGIM Sterling Liquidity Fund	0.64%
£500,000	BlackRock	0.65%

CCLA Funds

Amount	Investment	Dividend Yield
£468,213	CCLA – Property Fund	4.26%
£1,008,489	CCLA – Diversified Income Fund	3.25%

4.3 At Council in March 2018, it was approved (Minute C74/17 and E72/17) that a sum of £500,000 be used to invest in CCLA's (CCLA Investment Management Limited) Local Authorities Property Fund and a sum of £1 million be used to invest in CCLA's Diversified Income Fund, with the investments being placed in April and May 2019.

4.4 The investments were made with a view to a long term commitment. The bid market values as at 31 March 2019 for the Council's investments were £468,213 (Local Authorities Property Fund) and £1,008,489 (Diversified Income Fund).

5. The Strategy for 2018/19

Investment strategy and control of interest rate risk

5.1 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.

- 5.2 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.
- 5.3 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.
- 5.4 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.
- 5.5 The Treasury Management Strategy Report for 2018/19 was approved by the Council on 29 March 2018 (Minute – C74/17).

The Borrowing Requirement and Debt

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

	31-Mar-18 Actual	31-Mar-19 Budget	31-Mar-19 Actual
CFR General Fund (£m)	646	5,797	6,291

- 5.7 During 2018/19 the Council undertook prudential borrowing totaling £5.49 million for the leisure investment. This reflects the increase in the actual Capital Financing Requirement for 2018/19.

Borrowing strategy and control of interest rate risk

- 5.9 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.
- 5.10 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash

balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

5.11 The policy of avoiding new borrowing by utilising spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

5.12 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Strategic Finance Lead (S.151 Officer) therefore monitored interest rates in financial markets and adopted a pragmatic approach to changing circumstances:

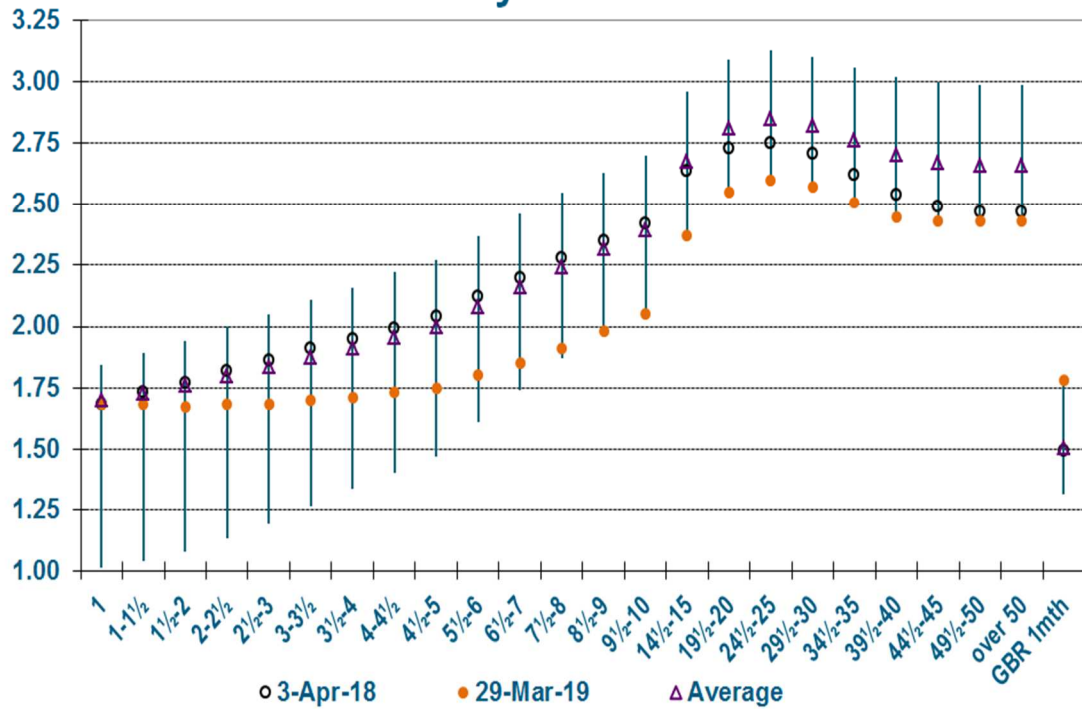
- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration 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 will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

5.13 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 2.1.18													
	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%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

5.14 PWLB borrowing rates - the graph below shows, 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.

PWLB certainty rate variations in 2018-19



	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%

6. Borrowing Outturn for 2018/19

6.1 Details of the loans outstanding at 31 March 2019 are shown below:

Lender	Purpose	Maturity	Interest Rate %	Principal held at 31 March 2018 £'000	Principal held at 31 March 2019 £'000
PWLB – 15 maturity loans	Commercial Property – Heron Road	5-19 Years	2.41*	-	5,490
Total				-	5,490

*Average interest rate

Repayments

6.2 During 2018/19 the Council repaid interest of £117,016 at an average rate of 2.41%.

Borrowing in advance of need

6.3 The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Debt rescheduling

6.4 No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Investment Outturn for 2018/19

7.1 **Investment Policy** – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 29 March 2018 (Minute – C74/17). 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.).

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

7.3 Income from investments this year was £327,234 which is £204,234 higher than the budget of £123,000 at an average return of 0.84%. The comparable performance indicator (Benchmark) is the average 7-day LIBID rate which was 0.51%. Therefore the Council achieved 0.33% return on investments over the benchmark for 18/19.

8. Other Issues 2018/19

Revised CIPFA Code

8.1 The 2018/19 Code of Practice on Local Authority Accounting has adopted IFRS 9 Financial Instruments. As a result of the implementation of IFRS 9, the Council's Draft Accounts reflect an irrevocable election to designate the CCLA investments as fair value through other comprehensive income. These investments are eligible for the election because they meet the definition of equity instruments in paragraph 11 of IAS32 and are neither held for trading (the Council holds these investments as long term strategic investment) nor contingent consideration recognised by an acquirer in a business combination to which IFRS3 applies. They are not considered to be puttable instruments because the Council does not have a contractual right to put the instrument back to the issuer for cash.

8.2 This election means there is no impact on the revenue budget. Any gains or losses on the valuation of the CCLA investments will therefore be transferred to a Financial Instruments Revaluation Reserve until they are realised.

9. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	Statutory powers are provided by the Local Government Act 1972 Section 151 and the Local Government Act 2003
Financial Implications to include reference to value for money	Y	Income from Treasury Management activities amounted to £327,234 in 2018/19. Consideration of the Annual Treasury Report forms an essential component of the Council's systems for public accountability. It also provides a platform for future investment planning.
Risk	Y	The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate

		<p>performance. The yield risk is regarding the volatility of interest rates/inflation.</p> <p>The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines.</p> <p>The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and Members.</p>
Supporting Corporate Strategy		The income from treasury management supports all the Council's corporate strategy themes.
Comprehensive Impact Assessment Implications		
Equality and Diversity	N	None directly arising from this report.
Safeguarding	N	None directly arising from this report.
Community Safety, Crime and Disorder	N	None directly arising from this report.
Health, Safety and Wellbeing	N	None directly arising from this report.
Other implications	N	None directly arising from this report.

Supporting Information

Appendices:

Appendix A – Lending list as at 29 March 2019

Appendix B - Prudential and Treasury Indicators 2018/19

Background Papers:

Annual treasury strategy in advance of the year (Council 29 March 2019 – C74/17)

A mid-year treasury update report (Audit Committee 31 January 2019 – A42/18)

APPENDIX A

Counterparty as at 29th Mar 2019		Fitch Rating				Moody's Ratings				S&P Ratings		Suggested Duration		
		Long Term	Short Term	Viability	Support	Long Term	Short Term	Long Term	Short Term					
United Kingdom														
AAA Rated and Government Backed Securities	Collateralised LA Deposit*											Y - 60 mths		
	Debt Management Office											Y - 60 mths		
	Multilateral Development Banks											Y - 60 mths		
	Supranationals											Y - 60 mths		
	UK Gilts											Y - 60 mths		
Banks	Abbey National Treasury Services	NW	A	F1		1	SB	Aa3		P-1			R - 6 mths	
	Bank of Scotland PLC (RFB)	NW	A+	F1	a	5	SB	Aa3		P-1	SB	A+	A-1	O - 12 mths
	Barclays Bank PLC (NRFB)	NW	A+	F1	a	5	SB	A2		P-1	SB	A	A-1	R - 6 mths
	Barclays Bank UK PLC (RFB)	NW	A+	F1	a	1	SB	A1		P-1	SB	A	A-1	R - 6 mths
	Close Brothers Ltd	NW	A	F1	a	5	SB	Aa3		P-1				R - 6 mths
	Goldman Sachs International Bank	SB	A	F1		1	NO	A1		P-1	SB	A+	A-1	R - 6 mths
	Handelsbanken Plc	SB	AA	F1+		1					SB	AA-	A-1+	O - 12 mths
	HSBC Bank PLC (NRFB)	NW	AA-	F1+	a+	1	SB	Aa3		P-1	SB	AA-	A-1+	O - 12 mths
	HSBC UK Bank Plc (RFB)	NW	AA-	F1+	a	1					SB	AA-	A-1+	O - 12 mths
	Lloyds Bank Corporate Markets Plc (NRFB)	NW	A	F1		1	SB	A1		P-1	SB	A	A-1	R - 6 mths
	Lloyds Bank Plc (RFB)	NW	A+	F1	a	5	SB	Aa3		P-1	SB	A+	A-1	O - 12 mths
	NatWest Markets Plc (NRFB)	NW	A	F1	WD	1	PO	Baa2		P-2	PO	BBB+	A-2	G - 100 days
	Santander UK PLC	NW	A+	F1	a	2	PO	Aa3		P-1	SB	A	A-1	R - 6 mths
	Standard Chartered Bank	SB	A+	F1	a	5	SB	A1		P-1	SB	A	A-1	R - 6 mths
Sumitomo Mitsui Banking Corporation	SB	A	F1		1	SB	A1		P-1	PO	A	A-1	R - 6 mths	
Building Societies	Coventry Building Society	NW	A	F1	a	5	SB	A2		P-1				R - 6 mths
	Leeds Building Society	NW	A-	F1	a-	5	SB	A3		P-2				G - 100 days
	Nationwide Building Society	NW	A	F1	a	5	NO	Aa3		P-1	PO	A	A-1	R - 6 mths
	Skipton Building Society	NW	A-	F1	a-	5	PO	Baa1		P-2				G - 100 days
	Yorkshire Building Society	NW	A-	F1	a-	5	SB	A3		P-2				G - 100 days
Nationalised and Part Nationalised Banks	National Westminster Bank PLC (RFB)	NW	A+	F1	a	5	PO	A1		P-1	PO	A-	A-2	B - 12 mths
	Royal Bank of Scotland Group Plc (RFB)	NW	A+	F1	a	5	PO	A1		P-1	PO	A-	A-2	B - 12 mths

Key		Duration
SB	Stable Outlook	Yellow - Y 60 Months
NO	Negative Outlook	Blue - B 12 Months
NW	Negative Watch	Orange - O 12 Months
PO	Positive Outlook	Red - R 6 Months
PW	Positive Watch	Green - G 100 Days
EO	Evolving Outlook	
EW	Evolving Watch	

APPENDIX B

PRUDENTIAL AND TREASURY INDICATORS 2018/19

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Capital Expenditure

This prudential Indicator is a summary of the Council's capital expenditure.

	2017/18 Actual £000	2018/19 Estimate £000	2018/19 Actual £000
General Fund services	4,179	7,492	8,286
Capital investments*	0	0	0
TOTAL	4,179	7,492	8,286

*Capital investments relate to areas such as capital expenditure on investment properties.

The table below summarises the financing of the Council's capital programme.

	2017/18 Actual £000	2018/19 Estimate £000	2018/19 Actual £000
External sources	1,079	700	1,067
Own resources	2,356	1,855	1,574
Debt (including internal borrowing)	744	4,937	5,645
TOTAL	4,179	7,492	8,286

NB. Please note that the estimate for 2018/19 represents the approved capital programme for that year. However, actual capital spend includes not only expenditure on projects within that capital programme, but also expenditure on schemes carried forward from previous capital programmes.

The Council's Borrowing Need (the Capital Financing Requirement)

The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

	2017/18 Actual £000	2018/19 Estimate £000	2018/19 Actual £000
General Fund services	646	5,797	6,291
Capital investments	0	0	0
TOTAL CFR	646	5,797	6,291

The Council's Gross Debt and the Capital Financing Requirement

Statutory guidance states that debt should remain below the capital financing requirement, except in the short-term.

	2017/18 Actual £000	2018/19 Estimate £000	2018/19 Actual £000
Debt	0	4,937	5,490
Capital Financing Requirement	646	5,797	6,291

AFFORDABILITY PRUDENTIAL INDICATORS

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans.

These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

The financing costs were increased in the 2018/19 estimate to reflect the proposals within the commercial property acquisition strategy, and therefore increased this indicator. These proposals will now take place in 2019/20 and 2020/21 onwards.

	2017/18 Actual	2018/19 Estimate	2018/19 Actual
Financing costs (£m)	(140,882)	87,040	(210,218)
Proportion of net revenue stream	(1.7%)	1.0%	(2.3%)

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

The Operational Boundary – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	2017/18	2018/19
	£	£
Borrowing	5,000,000	9,000,000
Other long term liabilities	-	-
Total	5,000,000	9,000,000

The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

Authorised limit	2017/18	2018/19
	£	£
Borrowing	10,000,000	14,000,000
Other long term liabilities	-	-
Total	10,000,000	14,000,000

The Council's current level of borrowing as at 31 March 2019 was £5.49 million.

The maturity analysis of fixed rate borrowing is as follows, with the maximum and minimum limits for fixed interest rates maturing in each period:

Refinancing rate risk indicator	Approved minimum limits	Approved maximum limits	Actual 31 March 2018		Actual 31 March 2019	
	%	%	£million	%	£million	%
Less than 1 year	0%	10%	0	0	0	0
Between 1 and 2 years	0%	10%	0	0	0	0
Between 2 and 5 years	0%	30%	0	0	0	0
Between 5 and 10 years	0%	50%	0	0	2.160	39.3%
More than 10 years	0%	100%	0	0	3.330	60.7%
Total			0	0	5.490	100.0%