Subject: **2018/19 TREASURY MANAGEMENT OUTTURN REPORT**

Report to: Policy and Resources 11 June 2019
Full Council 11 July 2019

Report by: Finance Director (Section 151 Officer)

SUBJECT MATTER/RECOMMENDATIONS

This report presents the treasury management activity for the 2018/19 financial year and includes:

1. The overall treasury position for 2018/19
2. The borrowing requirement and debt for 2018/19
3. The borrowing outturn for 2018/19

Recommendations:

Members are asked to recommend that Council approves the Treasury Management outturn report and indicators for 2018/19.

1. INTRODUCTION AND BACKGROUND

1.1 The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management annual report after then end of each financial year.

1.2 This report fulfils the Authority's legal obligation to have regard to the CIPFA Code.

1.3 The Authority's treasury management strategy for 2018/19 was approved at a meeting on 20th February 2018. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

2. NATIONAL CONTEXT AND ECONOMIC COMMENTRY

2.1 Economic background: UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

2.2 After rising to 0.6% in the third calendar quarter from 0.4% in the second, the fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

2.3 Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

2.4 The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities.

2.5 In February, Fitch put the UK AA sovereign long-term rating on Rating Watch Negative as a result of Brexit uncertainty, following this move with the same treatment for UK banks and a number of government-related entities.

2.6 There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

3. LOCAL CONTEXT

3.1 On 31st March 2019, the Authority had net borrowing of £102m arising from its revenue and capital income and expenditure, an increase on 2018 of £6.5m. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary	**31.3.18 Actual £m**	**2018/19 Movement £m**	**31.3.19 Actual £m**
General Fund CFR	£50.200	£707	£50.907
HRA CFR	£80.717	£1.360	£82.077
Total CFR	**£130.917**	**£2.067**	**£132.984**
Less: Other debt liabilities*	(£1.010)	£112	(£0.898)
Borrowing CFR	**£129.907**	**£2.179**	**£132.086**
Less: Long term investments	(£2.000)	(£2.700)	(£4.700)
Less: Usable reserves	(26.139)	(£2.774)	(£28.913)
Less: Working capital	(6.605)	£9.824	£3.219
Net borrowing	**£95.163**	**£6.529**	**£101.692**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

3.2 The increase in CFR reflects the use of borrowing to finance the capital expenditure in 2018/19. Also there has been an increase in usable reserves, including £1.2m in the HRA and £0.3m in the Capital Receipts reserve; and an increase in working capital due to the timing of receipts and payments.

3.3 The Authority's strategy was to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position at 31st March 2019 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary	**31.3.18 Balance £m**	**2018/19 Movement £m**	**31.3.19 Balance £m**	**31.3.19 Rate %**
Long-term borrowing	£81.388	£27.459	£108.847	3.15% - 4.95%
Short-term borrowing	£28.504	(£15.500)	£13.004	0.98% - 4.44%
Total borrowing	**£109.892**	**£11.959**	**£121.851**	
Long-term investments	£2.000	£2.700	£4.700	6%
Cash and cash equivalents	£12.729	£2.730	£15.459	N/A
Total investments	**£14.729**	**£5.430**	**£20.159**	
Net borrowing	**£95.163**	**£6.529**	**£101.692**	

Note: the figures in the table are from the balance sheet in the Authority's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

3.4 The increase in net borrowing in table 2 has translated into a rise in investment balances due to the Authority's internal borrowing policy. The £27m increase in long term borrowing has arisen from utilising the low cost Local Authority lending market to increase our liquidity resilience. Short term borrowing includes a £0.5m loan at 11% interest which was taken out in December 1983 and was repaid in December 2018. Long term investments increased by £2.7m from the Authority funding its trading company.

4. BORROWING ACTIVITY

4.1 At 31st March 2019 the Authority held £122m of loans, an increase of £12m on the previous year, as part of its strategy for improving liquidity resilience. The year-end borrowing position and the year-on-year change show in table 3 below.

Table 3: Borrowing Position	**31.3.18 Balance £m**	**2018/19 Movement £m**	**31.3.19 Balance £m**	**31.3.19 Rate %**	**31.3.19 Maturity years**
Public Works Loan Board	£71.388	£0	£71.388	3.15%-4.40%	10-40 years
Banks (LOBO)	£3.000	£0	£3.000	4.95%	1-2 years
Banks (fixed-term)	£7.500	(£500)	£7.000	3.35%-3.98%	<1-60 years
Local authorities (long-term)	£0.00	£27.375	£27.375	1.25%-4.44%	>1 year
Local authorities (short-term)	£28.004	(£14.916)	£13.088	0.98%-4.44%	<1 year
Total borrowing	**£109.892**	**£11.959**	**£121.851**		

4.2 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

4.3 In furtherance of these objectives, new loans totalling £39m were borrowed in 2018/19 to repay £30m existing short term borrowing and create liquidity. This strategy enabled the Authority to reduce net borrowing costs by exploiting the Local authority lending market.

4.4 New borrowing of £39m from Local Authorities in the year was for between 1 and 3 years and at interest rates of between 0.98% and 1.45%. Loans repaid to Local Authorities in the year of £28m were from between 1 and 6 months at interest rates of between 0.77% and 0.95%.

4.5 LOBO loans: The Authority continues to hold £3m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option to increase the rate during 2018/19.

5. INVESTMENT ACTIVITY

5.1 The Authority holds a level of invested funds, representing income received in advance of expenditure plus balances and reserves held and money borrowed in advance of need. During 2018/19, the Authority's investment balances ranged between £12m and £36m, averaging £22m due to timing differences between income and expenditure. The year-end position and the year-on-year change is shown in table 4 below.

Table 4: Treasury Investment Position	**31.3.18 Balance £m**	**2018/19 Movement £**	**31.3.19 Balance £m**	**31.3.19 Rate %**
Banks & building societies (unsecured)	£5.244	£0.465	£5.709	0.00% - 0.60%
Government (Inc. local authorities)	£0	£7.780	£7.780	0.50% - 1.00%
Money Market Funds	£8.945	£1.200	£9.065	0.61% - 0.86%
Total investments	**£14.189**	**£8.365**	**£22.554**	

5.2 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.3 In furtherance of these objectives and given the increasing risk and low returns from short-term unsecured bank investments, the Authority diversified into more secure and/or higher yielding asset classes during 2018/19. £14m that is available for longer-term investment was moved from bank and building society deposits into Local Authorities and Money Market Funds. As a result, investment risk was lowered, while the average rate of return has increased to between 0.31% and 1.00%. The progression of credit risk and return metrics for the Authorities investments managed in-house are shown in the extracts from Arlingclose's quarterly investment benchmarking in table 5 below.

Table 5: Investment Benchmarking	Balance £m	Short term/Money Market Funds			
		Fitch	Moody's	S&P	Arlingclose Limit £000
Barclays Bank Plc*	£1.000	F1	P-1	A-1	N/A
Goldman Sachs Liquid Reserve	£2.000	AAA mmf	Aaa-mmf	AAAm	£060.9
DWS Deutsche Managed	£1.565	AAA mmf	Aaa-mmf	AAAm	£028.2
Aberdeen Liquidity Funds	£2.500	AAA mmf	Aaa-mmf	AAAm	£138.2
CCLA Public Sector Deposit Fund	£1.000	AAA mmf	-	-	£002.2
Insight Liquidity Fund	£2.000	AAA mmf	-	AAAm	£115.4
Total	**£10.065**				

*The 2018/19 TMSS set the limit per institution at £3m with which the Authority complied. The above table does not include investments with the DMO £4.780 and local authorities £3.00m the total investments as at 31st March 2019 was £17.845m.

6. FINANCIAL IMPLICATIONS

6.1 The outturn for debt interest paid in 2018/19 was £3.449m on an average debt portfolio of £115.871m against a budgeted interest cost of £3.277m resulting in an average interest rate of 2.98%. The outturn for treasury investment income received in 2018/19 was £0.123m on an average investment portfolio of £15m at an average interest rate of 0.66%. Interest is allocated between the General Fund (45%) and the Housing Revenue Account (55%).

6.2 Readiness for Brexit: With little by way of political clarity as to the exact date on whether there would be an agreed deal prior to leaving the EU and to be prepared for the outside chance of a particularly disruptive Brexit (such as last-minute no-deal) on 29th March, the Authority ensured there were enough accounts open at UK-domiciled banks and Money Market Funds to hold sufficient liquidity over the year end and that its account with the Debt Management Account Deposit Facility (DMADF) remained available for use in an emergency.

6.3 The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long-term borrowing was maintained.

6.4 Other Non-Treasury Holdings and Activity – Although not classed as treasury management activities the definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

6.5 At the balance sheet date of 31 March 2019, the Authority also holds £53m of investments in directly owned property, loans to homeowners and local bodies and investments in a trading subsidiary. This represents an increase of £4.5m on the previous year due to new investment in its subsidiary of £2m and commercial property £1m as a result of asset reclassification.

6.6 These non-treasury investments generated £2.2 million of investment income for the Authority after taking account of direct costs, representing a rate of return of 4.1%. This is higher than the return earned on treasury investments but reflects the additional risks to the Authority of holding such investments.

6.7 **Performance** Report - The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and is developing further performance measures on this.

6.8 **Compliance Report -** The Finance Director is pleased to report that all treasury management activities undertaken during 2018/19 complied fully with the CIPFA Code of Practice and Treasury Management Strategy 2018/19. The Authority utilised the low-cost Local Authority lending market to increase its liquidity resilience and reduce costs by taking out low rate, short term loans.

6.9 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below, and compliance with the specific investment limits is demonstrated in table 7 below.

Table 6: Debt Limits	**2018/19 Maximum £m**	**31.3.19 Actual £m**	**2018/19 Operational Boundary £m**	**2018/19 Authorised Limit £m**	**Complied?** Yes/No
Borrowing	£125.872	£121.851	£135.000	£140.000	Yes
Long term liabilities, PFI & Finance Leases	£0.898	£0.898	£2.000	£2.000	Yes
Total debt	**£126.770**	**£122.749**	**£137.000**	**£142.000**	Yes

6.10 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt did not exceed the operational boundary during 2018/19.

Table 7: Investment Limits	**2018/19 Maximum**	**31.3.19 Actual**	**2018/19 Limit**	**Complied?** Yes/No
Any single organisation, except the UK Government	£1m	£1m	£2m each	Yes
UK Central Government	Unlimited	£4.780	Unlimited	Yes
UK Central Government Local Authorities	£3m	£3m	£3m (2years)	Yes
Any group of organisations under the same ownership	£1m	£1m	£2m per group	Yes
Loans to subsidiary trading company	£4.7m	£4.7m	Not set	Yes
Money Market Funds	£15m	£9.065m	£3m per fund £10m in total	Yes

6.11 **Treasury Management Indicators -** The Authority measures and manages its exposures to treasury management risks using the following indicators.

6.12 **Liquidity -** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, and the amount it can borrow each quarter without giving prior notice.

Table 8: Liquidity	31.3.19 Actual	2018/19 Target	Complied?
Total cash available without notice	£10.065m	£11.250m	Yes
Total sum borrowed in past 3 months without prior notice	£6m	Not set	

6.13 **Interest Rate Exposures -** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed was:

Table 9: Interest Rate Exposures	31.3.19 Actual	2018/19 Limit	Complied?
Upper limit on fixed interest rate exposure	100%	100%	Yes
Upper limit on variable interest rate exposure	0%	100%	Yes

6.14 Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

6.15 **Maturity Structure of Borrowing -**This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Table 10: Maturity Structure of Borrowing	31.3.18 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	13%	0%	20%	Yes
12 months and within 24 months	19%	0%	40%	Yes
24 months and within 5 years	3%	0%	60%	Yes
5 years and within 10 years	2%	0%	80%	Yes
10 years and above	64%	0%	100%	Yes

6.16 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6.17 **Principal Sums Invested for Periods Longer than 365 days:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 11: Principal Sums Invested for Periods Longer than 365 days	2018/19 £m	2019/20 £m	2019/21 £m
Actual principal invested beyond year end	£7.780m	Nil	Nil
Limit on principal invested beyond year end	£12m	£12m	£12m
Complied	Yes	Yes	Yes

7 RISK IMPLICATIONS

7.1 The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

8. CONCLUSIONS

8.1 The report presents the outturn of the treasury management activity compared to the strategy as approved by Members in February 20th February 2018. The Authority has complied with the Treasury Management Strategy for 2018/19.

9. RECOMMENDATIONS

9.1 Members are asked to recommend that Council approves the Treasury Management outturn report and indicators for 2018/19.

Areas of consideration: e.g. does this report raise any of the following issues and if so how have these been considered/mitigated against?

Area for consideration	**Comment**
Monitoring Officer Consultation:	No
Section 151 Officer Consultation:	Yes
Existing Council Policies:	Yes, Treasury Management Strategy 2018/19
Financial Implications (including VAT and tax):	Yes
Legal Implications (including human rights):	No
Risk Implications:	Yes
Equality Issues/EQIA assessment:	No
Crime & Disorder:	No
Every Child Matters:	No