

## **Report to Cabinet**

**Subject:** Annual Treasury Activity Report 2018/19  
**Date:** 24 May 2019  
**Author:** Deputy Chief Executive and Director of Finance

### **Wards Affected**

All

### **Purpose**

To inform Members of the outturn in respect of the 2018/19 Prudential Code Indicators, and to advise Members of the outturn on treasury activity, both as required by the Treasury Management Strategy.

### **Key Decision**

This is not a key decision.

### **Recommendation:**

That:

1. Members approve the Annual Treasury Activity Report and refer it to Full Council for approval as required by the regulations.

### **Background**

- 1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury review of its 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 For 2018/19 the minimum reporting requirements were that the Full Council should receive the following reports:

- An Annual Treasury Management Strategy Statement (TMSS) in advance of the year. This was considered by Cabinet on 15 February 2018 and subsequently approved by Full Council on 5 March 2018.
  - A Mid-Year Treasury Update report (In accordance with best practice, Members will note that, as in previous years and in accordance with best practice, quarterly monitoring reports for treasury activity have been provided, and that this exceeds the minimum requirements).
  - 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. The Annual Treasury Activity Report provides details of the outturn position for treasury activities during the year, and highlights compliance with the Council's policies, previously approved by Members.
- 1.4 The Council has complied with the requirement under the Code to give prior scrutiny to all the above treasury management reports by submitting them to Cabinet before they are reported to Full Council.
- 1.5 Member training on treasury management issues is undertaken by the Chief Financial Officer as it is needed in order to support Members' scrutiny role. In addition, the Council's treasury advisers, Link Asset Services (LAS) periodically deliver more detailed training sessions for Members.

## **Proposal**

### **2.1 Summary of the economy and interest rates during 2018/19**

- 2.1.1 Economic growth was weak at only 0.1% in Q1 of 2018 but picked up to 0.4% in Q2 and 0.7% in Q3, before slowing to 0.2 % in the final quarter. Given the uncertainty over Brexit, this return to weaker growth in the final quarter was expected, although some recovery is anticipated going forward. Annual growth in 2018 was 1.4% year on year.
- 2.1.2 The Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, but has so far refrained from more increases. It is unlikely that there will be any further action from the MPC until uncertainty around Brexit is resolved. If there was to be a disorderly Brexit, it is likely that Bank Rate would be cut to support growth; however the MPC also has concerns over the trend in wage inflation, which peaked at a new post financial crisis high of 3.5% in the three months to January. Hiring by British employers was at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy. The unemployment rate fell to 3.9%, its

lowest rate since 1975, and correspondingly, the total level of vacancies rose to a new high.

- 2.1.3 CPI inflation was on a falling trend, reaching 1.8% in January before rising marginally to 1.9% in February. However, in the February Bank of England Inflation Report, the latest forecast for both the two and three year time horizons remained marginally above the MPC's target of 2%. The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power improves in this scenario. The UK economy is services sector driven; therefore an increase in household spending power is likely to feed through into providing support to the overall rate of economic growth in the coming months.
- 2.1.4 The Conservative minority government was unable to achieve a majority in the Commons over its Brexit deal, and both the initial exit date of 29 March and the subsequent short extension to 12 April were missed. The further EU extension now expires on 31 October 2019, and it appears unlikely that there will be a Commons majority in support of a disorderly Brexit, or revoking article 50, (cancelling Brexit). There will need to be a long delay if there is still no majority for any form of Brexit, and if this were to happen, the chance of a general election in 2019 would increase, and this could result in the potential loosening of monetary policy.
- 2.1.5 In the US, President Trump's easing of fiscal policy fuelled a temporary boost in consumption which generated an upturn in the rate of growth. The Federal Reserve (The Fed) increased rates by another 0.25% in December, the fifth rise in 2018 and the ninth in the upward cycle. The Fed now acknowledges that a change in direction may be required and action may be taken to cut rates over the next two years.
- 2.1.6 Growth in the Eurozone has been weak in 2018 and is expected to fall further in 2019, The European Central Bank (ECB), like the UK and USA central banks, ended its programme of quantitative easing, ie the expansion of liquidity supporting world financial markets by purchases of debt.

## 2.2 The overall treasury position 31 March 2019

The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security of investment, and to manage risks within all treasury management activities. At the beginning and end of 2018/19, the treasury position was as follows:

Treasury position:	1 April 2018 £000s	31 March 2019 £000s
Total external debt	6,812	8,812
Capital Financing Requirement (CFR)	11,262	10,221
<b>Over/(under) borrowing to CFR</b>	<b>(4,450)</b>	<b>(1,409)</b>
Total external debt	6,812	8,812
Total investments	(8,290)	(13,490)
<b>Net debt/(investment)</b>	<b>(1,478)</b>	<b>(4,678)</b>

## 2.3 The treasury strategy for 2018/19

2.3.1 The expectation within the treasury strategy for 2018/19 (the TMSS) was that the Monetary Policy Committee (MPC) would increase Bank Rate to 0.75% in November 2018, and would then be unlikely to raise the rate further during the Brexit negotiation period, with the next rise coming in November 2019 - unless strong domestically generated inflation was to emerge. Medium and longer term fixed rates were expected to rise only gradually during the year, and variable or short term rates were expected to be the cheaper form of borrowing over the period. Investment returns were expected to remain low in 2018/19 and continued uncertainty in the aftermath of the financial crisis would promote 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, although care would be needed to ensure that borrowing was not postponed to a point where undertaking it at higher rates would be unavoidable.

2.3.2 In the event, the MPC raised Bank Rate to 0.75% in August 2018 and it remained at this level for the remainder of the year.

2.3.3 PWLB rates peaked in October 2018 and since then most rates have been on a general downward trend.

## 2.4 The Council's Borrowing Requirement

The Council's underlying need to borrow for capital expenditure is termed the capital financing requirement (CFR), and is a gauge of the Council's indebtedness.

The CFR results from the Council's capital activity, and the resources it uses to pay for that capital spending, and represents unfinanced expenditure that has not yet been paid for from revenue or other resources.

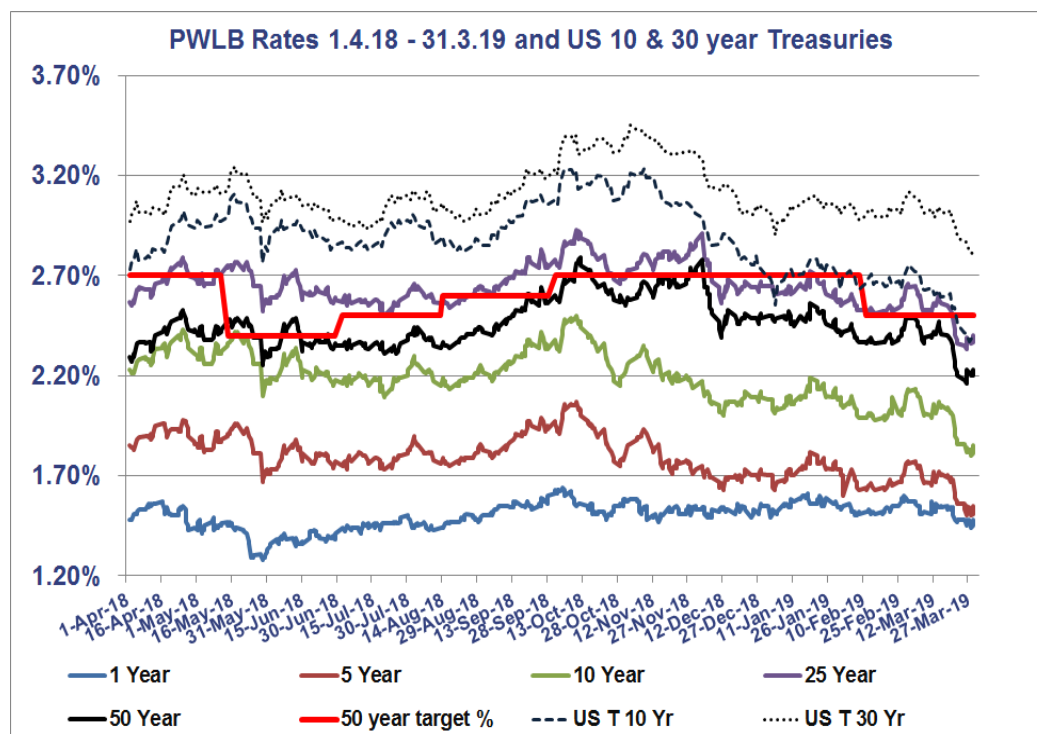
CFR:	1 April 2018 (Actual) £000s	31 March 2019 (Orig. Est) £000s	31 March 2019 (Actual) £000s
Capital Financing Requirement	11,262	15,086	10,221

The 2018/19 variance is due to slippage and savings on the 2017/18 capital programme both of which reduced the borrowing requirement in that year, and to amendments to the capital programme during 2018/19, including the slippage of schemes to 2019/20.

## 2.5 Borrowing rates in 2018/19

PWLB rates peaked in October 2018 and have since been on a general downward trend, albeit that longer term rates spiked up again in December.

The graph below has been provided by the Council's treasury advisers.



For illustration, the table below shows the LAS forecasts for interest rates as at 31 March 2019.

Link Asset Services Interest Rate View												
	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
10yr PWLB Rate	2.30%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.00%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%

## 2.6 The borrowing outturn for 2018/19

- 2.6.1 Two new loans, each of £1m, were raised during 2018/19 at exceptionally favourable 50-year rates of 2.46% and 2.33% respectively. No loans were redeemed during the year.

The Council has embarked upon a commercialisation programme aimed at the generation of funding to replace Revenue Support Grant, which was withdrawn at the end of 2018/19. Significant additional borrowing may be required to support this commercial programme, which will be supported by individual business case assessments to demonstrate that each project generates a return sufficient to cover any borrowing costs. Advice will be taken from LAS with regard to the amount and timing of any additional borrowing, and should conditions become advantageous, some further borrowing in advance of need will also be considered by the Chief Financial Officer.

- 2.6.2 Total outstanding debt at 31 March 2019 was £8.812m. All loans held are repayable on maturity, and are at fixed rates.

- 2.6.3 There was no rescheduling of PWLB debt undertaken during the year, as the average 1% differential between PWLB new borrowing rates and premature repayment rates made such action unviable.

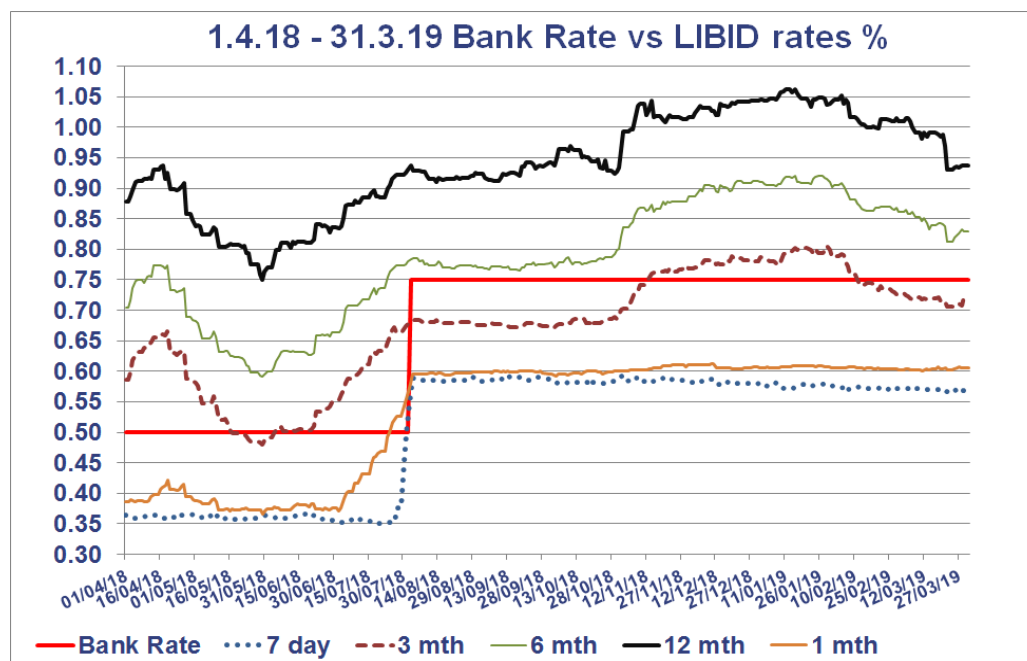
- 2.6.4 No temporary loans were arranged for cashflow purposes during 2018/19.

## 2.7 Investment rates in 2018/19

Deposit rates remained low in 2018/19. Rates rose gently in the first half of the year in anticipation of the expected Bank Rate rise, and this was duly delivered by the MPC in August. Investments were kept short during this period in anticipation of the higher rates. The expectation was that there would be no further rate rises during the year and indeed Bank Rate

ended the year at 0.75%. Investment rates did rise after the November MPC meeting, after warnings of building inflationary pressures; however weak growth plus increasing concerns around Brexit resulted in these falling back again.

The graph below has been provided by the Council's treasury advisers.



## 2.8 Investment outturn for 2018/19

- 2.8.1 The Council's investment policy is governed by MHCLG guidance and implemented by the Annual Investment Strategy, which formed part of the TMSS approved by Council on 5 March 2018. This policy sets out the approach for selecting investment counterparties. For 2018/19 the Chief Financial Officer adopted the Link Asset Services (LAS) credit rating methodology, a sophisticated modelling approach utilising credit ratings from all three of the main rating agencies to give a suggested maximum duration for investments. Accordingly it does not place undue reliance on any one agency's ratings. The methodology subsequently applies an "overlay" to take account of positive and negative credit watches and/or credit outlook information, which may increase or decrease the suggested duration of investments. It then applies a second overlay based on the credit default swap spreads for institutions, the monitoring of which has been shown to give an early warning of likely changes in credit ratings. The methodology also incorporates sovereign ratings to ensure selection of counterparties from only the most creditworthy countries. The current Treasury Strategy permits the use of any UK counterparties, subject to their individual credit ratings under the LAS methodology. It also permits

the use of counterparties from other countries with a minimum sovereign rating of AA. For information, at 31 March 2019 the UK had a rating of AA.

- 2.8.2 Whilst credit ratings advice is taken from the treasury advisers, the ultimate decision on what is prudent and manageable for the Council is taken by the Chief Financial Officer under the approved scheme of delegation.
- 2.8.3 No changes to the TMSS for 2018/19 approved by Council on 5 March 2018 were made during the year.
- 2.8.4 The Council's investment priorities in 2018/19 remained the security of capital and good liquidity. Whilst the Council always seeks to obtain the optimum return (yield) on its investments, this is at all times commensurate with proper levels of security and liquidity. In the current economic climate it has remained appropriate either to keep investments short-term to cover cashflow needs, or to take advantage of fixed periods up to twelve months with a small number of selected counterparties.
- 2.8.5 During 2018/19, significant use was made of two money market funds, achieving equated returns of around 0.65% and 0.63% respectively. These funds are AAA rated investment vehicles which allows the pooling of many billions of pounds worth of assets nationally into highly diversified funds, thus reducing the Council's risk.
- 2.8.6 An investment of £1m was made in the CCLA Local Authority Property Fund (LAPF) on 30 November 2017. This is a local government investment scheme approved by the Treasury under the Trustee Investments Act 1961 (section 11). Dividends are currently averaging around 4% per annum and are treated as revenue income. The investment has allowed the Council to introduce a property element into its investment portfolio without the risks associated with the direct purchase of assets. The main risk around Property Funds is the preservation of the capital sum however evidence from recent years shows that over time the property market has been a positive long-term investment and it is accordingly anticipated that this investment will be held for at least five years to minimise any risk.
- 2.8.7 The property fund investment purchased a number of units, determined by the unit price on the entry date. This valued the initial investment of £1m at £936,770, setting the implied entry fee at £63,230, or 6.32%. The certified value of the property fund investment at 31 March 2019 was £971,092. Following changes to accounting arrangements, all movements in the valuation of pooled investment funds must be charged to the Comprehensive Income and Expenditure account (CIES), however a



statutory override is in place for a period of five years to ensure that the impact of these on the General Fund are neutralised. Accordingly the difference of £28,908 between the £1m investment and the certified 31 March 2019 value of £971,092 is held in the Pooled Investment Funds Adjustment Account.

- 2.8.8 Investment interest of £144,620 (including dividends of £41,056 on the property fund) was generated in the year, representing an equated rate of 1.00%. This outperforms the benchmark average 7 day LIBID rate, which ended the year at 0.51%, and in cash terms represents additional income to the General Fund of £70,900. This was achieved as a result of positive investment management, together with the 4.1% dividend on the Property Fund. Performance in respect of the longer average 3 month LIBID rate, which ended the year at 0.67%, still represents additional income of £47,700.
- 2.8.9 Investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties. The investment counterparty limit of £3m (£4m for money market funds) was not exceeded during the year.

2.8.10 The Treasury Activity Report for the year ended 31 March 2019 is attached at Appendix 1 in accordance with the TMSS.

## 2.9 Compliance with Prudential and treasury indicators

- 2.9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Prudential and Treasury Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS) approved by Council on 5 March 2018.
- 2.9.2 During the financial year 2018/19 the Council has at all times operated within the Prudential and Treasury Management Indicators set out in the Council's TMSS, and in compliance with the Council's Treasury Management Practices. A summary of the outturn position at 31 March in respect of each of the 2018/19 Prudential and Treasury Management Indicators is shown at Appendix 2.

### a) Prudential Indicators:

#### i) Capital Expenditure

Capital expenditure for 2018/19 totalled £3,992,775. This differs to the approved indicator of £8,374,000 due to the inclusion of approved carry forward requests from 2017/18, and to the approved variations to the

capital programme during 2018/19, which include the slippage of schemes to 2019/20.

ii) Capital Financing Requirement (CFR)

The CFR represents the Council's underlying need to borrow and totalled £10,221,460 at 31 March 2019. This is lower than the approved indicator of £15,086,500 due to savings on the capital programme, additional capital receipts, and slippage of schemes to 2019/20.

iii) Ratio of Financing Costs to Net Revenue Stream

The outturn of 7.85% differs to the approved indicator of 7.49% due to increased revenue contributions to capital expenditure, offset by a reduction in MRP arising from the savings and slippage on the capital programme in 2017/18; reduced PWLB interest payable; and additional investment interest receivable.

iv) Maximum gross debt

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for 2018/19 and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. Gross debt at 31 March 2019 was £8.812m which was well within the approved indicator.

(b) Treasury Management Indicators:

The Treasury Management indicators are based on limits, beyond which activities should not pass without management action, and the Council has operated within these limits at all times during 2018/19. They include two key indicators of affordability and four key indicators of prudence and Appendix 2 demonstrates the outturn position compared to each limit.

Affordability

i) Operational boundary for external debt

This is the limit above which external debt is not "normally" expected to pass. In most cases this would be a similar figure to the CFR but may be lower or higher depending on the level of actual debt. The Operational Boundary has not been exceeded during 2018/19.

ii) Authorised limit for external debt

This limit represents a control on the "maximum" level of borrowing and is

the statutory limit determined under s3(1) of the Local Government Act 2003. It represents the limit beyond which external debt is prohibited.

The Authorised limit must be set, and revised if necessary, by Full Council. It reflects a level of external debt which, whilst neither desirable nor sustainable in the longer term, could be afforded in the short term. The Government retains an option to control either the total of all Councils' plans, or a specific Council, although this power has not yet been exercised. The Authorised Limit has not been exceeded during 2018/19.

### Prudence

- iii) Prior to the 2017 revisions to the Treasury Management Code there was a requirement to set indicators for the Council's maximum exposure to fixed and variable interest rates for net borrowing (ie. external borrowing less investments). This requirement has now been removed in favour of a statement in the TMSS stating how interest rate exposure is managed and monitored by the Council, and this is repeated below:

*The Council has a general preference for fixed rate borrowing in order to minimise uncertainty and ensure stability in the charge to revenue, however it is acknowledged that in certain circumstances, some variable rate borrowing may be prudent, for example if interest rates are expected to fall. The Council's investments are generally for cashflow purposes and accordingly a mix of fixed and variable rates will be used to maximise flexibility and liquidity. Interest rate exposure will be managed and monitored on a daily basis by the Chief Financial Officer.*

Local indicators for the proportions of fixed and variable rate loans, have been retained by the Council for information purposes.

- iv) Maximum new principal sums to be invested during 2018/19 for periods in excess of 365 days - such investments are classified as a "non-specified". This indicator is subject to the overall limit for non-specified investments set in the TMSS. This option has not been used during 2018/19.
- v) Upper limits for the maturity structure of borrowing - set to reduce the Council's exposure to large fixed rate sums falling due for refinancing. These limits have not been exceeded during 2018/19.

## 2.10 Other Issues

### 2.10.1 Revised CIPFA Codes of Practice

As previously noted, revised editions of the Prudential Code and the Treasury Management Code and Cross Sectoral Guidance Notes came into effect for 2018/19, with particular focus on non-treasury (non-financial)

investments, eg. commercial property purchases, which are made primarily to generate income at a higher level than can be attained by treasury investments. The revised Codes acknowledge the drive for income generation and the use of non-treasury investments such as commercial property, but they reiterate the need for risk management - including proportionality in respect of overall resources.

#### 2.10.2 Revised Investment and MRP Guidance

As previously reported, the Ministry of Housing, Communities and Local Government (MHCLG) issued revised Investment Guidance and Minimum Revenue Provision (MRP) Guidance which came into effect for 2018/19. The definition of “investment” has been changed to include expenditure driven activity, eg. commercial property, as well as simple treasury cash. Such activity would represent “non-treasury investments”, ie investments in “non-financial assets”.

The effective definition in the 2010 guidance of short term investment being that repayable “within 12 months” has been removed from the 2018 guidance. A long term investment now is therefore one in excess of 365 days (previously 364 days).

The revised MRP guidance also focused on expenditure on non-financial investments, eg. property, making it clear that the duty to make MRP extends to investment property where its acquisition has been partially or fully funded by an increase in borrowing. The guidance also confirms that borrowing may only be undertaken for strategic purposes and not purely for financial return.

#### 2.10.3 IFRS9

Investments previously categorised under the available for sale category, including property funds, will change under IFRS9 to be classified as assets held at fair value through profits and loss (FVPL), whereby fluctuations in value will impact on the Comprehensive Income and Expenditure Account (CIES). Following a consultation by the MHCLG, the Government has introduced a mandatory statutory override for local authorities to reverse out through the Movement in Reserves Statement (MiRS) all unrealised fair value movements resulting from pooled investment funds. This will be effective from 1 April 2018 for a period of five years. The Council must disclose the net impact of the unrealised fair value in a separate unusable reserve throughout the duration of the override, in order for the Government to keep the override under review and to maintain a form of transparency. This reserve has been named the Pooled Investment Funds Adjustment Account (see 2.8.7 above).

**Alternative Options**

There are no alternative options, this report being a requirement of the Council's Treasury Management Strategy Statement (TMSS).

**Financial Implications**

No specific financial implications are attributable to this report.

**Appendices**

1. Annual Treasury Activity Report 2018/19.
2. Outturn Prudential and Treasury Management Indicators for 2018/19.

**Background Papers**

None identified.

**Reasons for Recommendations**

To comply with the requirements of the Council's Treasury Management Strategy Statement.

**For more information, please contact:**

Alison Ball, Financial Services Manager, on 0115 901 3980.