

Briefing Report	ITEM NO.
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REPORT OF THE LEAD MEMBER FOR FINANCE AND SUPPORT SERVICES

TO COUNCIL ON 20th NOVEMBER 2019

TITLE: TREASURY MANAGEMENT ANNUAL REPORT 2018/19

RECOMMENDATIONS: City Mayor and Members are requested to consider the outturn position and performance of Treasury Management

EXECUTIVE SUMMARY:

This report provides details of treasury management activity in 2018/19. The key highlights are:

- The continuing policy of financing borrowing requirements by utilising a series of short term loans from other local authorities in order to take advantage of historically low interest rates currently available and using PWLB loans to finance increases in the CFR.
 - The investment rate of return has exceeded the benchmark target. Interest on investments was also higher than budgeted, although primarily because the level of investments was higher than forecast.
 - All treasury management activity was within the performance boundaries set in the approved strategy for the year.
 - The Council redeemed early a £50m inverse LOBO loan. After accounting for the premium, a net annual saving of £0.4m will be made to the General Fund.
 - The overall level of capital financing costs was contained within budget provision as a result of the borrowing strategy adopted.
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BACKGROUND DOCUMENTS:

Various working papers in the Finance Division including:-

- T.M. strategy 2018/19 reported to Council on 28 February 2018.
 - Revisions to the strategy reported to council at the mid-year update reported to council on the 21 November 2018
 - T.M.P's 1 to 12 and supporting schedules
 - T.M. Code of Practice (CIPFA)
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KEY DECISION: YES / NO

DETAILS:

TREASURY MANAGEMENT ANNUAL REPORT 2018/19

1. Introduction

1.1 The council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities following year end. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 During 2018/19 the minimum reporting requirements were fulfilled in line with the approved Treasury Management Strategy and the following reports were received:

- an annual treasury strategy statement in advance of the year was received at Council 28 February 2018
- a mid-year treasury update report was received at Council on 21 November 2018
- an annual review following the end of the year describing the activity compared to the strategy to be received at Council on 18 September (this report).

1.3 The regulatory environment places responsibility on the City Mayor and 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 Council.

1.4 The council uses Link Asset Services as its external treasury management advisors but recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

1.5 This annual report provides a review of 2018/19 and covers the following major areas:

- the council's treasury position as at 31 March 2019
- the outturn for 2018/19
- compliance with treasury limits
- investment strategy and outturn for 2018/19

2. The Economy and Interest Rates

2.1 The UK economy's growth in 2018/19 ended weak at 0.2% even after being particularly strong in quarter 3. This was as to be expected given all the uncertainties over Brexit.

2.2 The Monetary Policy Committee (MPC) raised Bank Rate from 0.5% to 0.75% in August 2018. No further increases are likely until the uncertainties over Brexit clear. If there were to be a disorderly exit, it is likely that Bank Rate would be cut to support growth.

2.3 CPI inflation has been on a falling trend, reaching a low of 1.8% in January 2019, at which level it remained until the end of the 2018/19 financial year. However, in the August 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% reaching 2.4% by 2022.

3. Overall Treasury Position as at 31 March 2019

3.1 At the beginning and the end of 2018/19 the Council's treasury position (excluding borrowing by PFI and finance leases and transferred debt) was as follows:

TABLE 1	31 March 2018 Principal £m	Rate/ Return	31 March 2019 Principal £m	Rate/ Return
Total debt	432.3	3.76	448.6	3.68
CFR excluding PFI liability	434.8		462.3	
Over / (under) borrowing	-2.5		-13.7	
Total debt	432.3	3.76	448.6	3.68
Total investments	70.65	0.68	65.73	0.82
Net debt	361.6		382.8	

4 The strategy for 2018/19

4.1 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%. This duly happened at the MPC meeting on 2 August 2018. Prior to August, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year. Following the rate rise, value was sought by placing longer term investments when cash balances were sufficient to allow this.

5. The Borrowing Requirement and Debt

5.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The capital financing requirement for 2017/18 was restated as part of the preparation of the 2018/19 statement of accounts, to take into account the repayment of a capital loan.

	31-Mar-18 Actual £m	31-Mar-18 Restated £m	31-Mar-19 Budget £m	31-Mar-19 Actual £m
CFR General Fund (£m)	620.0	617.4	685.4	642.1
CFR HRA (£m) (if applicable)	1.5	1.5	1.5	1.5
Total CFR	621.5	618.9	686.9	643.6

5.2 Over the year the capital financing requirement increased by £24.7m. This reflected an increase in the CFR due to unsupported borrowing of £63.0m that was partly offset by

the Minimum Revenue Provision (MRP) set aside £24.5m, capital receipts set aside of £13.5m and other debt repayments of £0.3m.

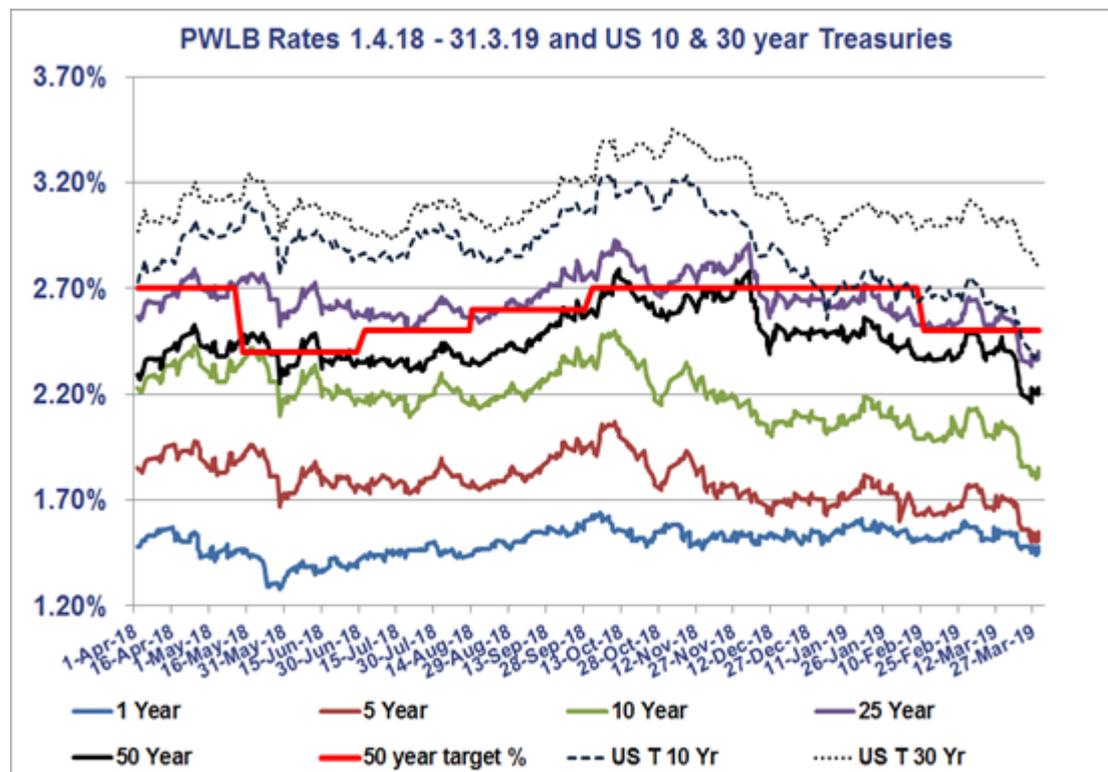
- 5.3 As indicated within the table above whilst the CFR has increased compared to last year, it is lower than that originally budgeted due to reprofiling of spend on the capital programme to 2019/20.
 - 5.4 The Council's gross borrowing for the year was £627.6m as detailed in appendix 1 (this includes PFI liabilities). This was less than the CFR and resulted in the Council being under-borrowed by £16m.
6. Performance for 2018/19
- 6.1 The Council's performance indicators were set out in the annual Treasury Management Strategy Statement. The 2018/19 indicators were revised at the council meeting in November 2018 when the Treasury management strategy mid-year review update was approved, in line with best practice the indicators were revised to reflect changes to the capital expenditure forecast, the strategy should be updated as new information becomes available.
 - 6.2 The treasury management activities carried out in the year were all within the performance boundaries, indicating that the Council's activities were prudent and sustainable. Full details are shown in appendix 1.

7. Borrowing Rates in 2018/19

7.1 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											
	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	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60

7.2 Since PWLB rates peaked during October 2018, most PWLB rates have been on a general downward trend and reached lows at the year end. PWLB rates are determined by UK gilt yields that are influenced by US Treasury yields. Treasury yields have fallen sharply during 2019 and gilt yields / PWLB rates have also fallen as a result of these and an expectation that world growth will be weak.



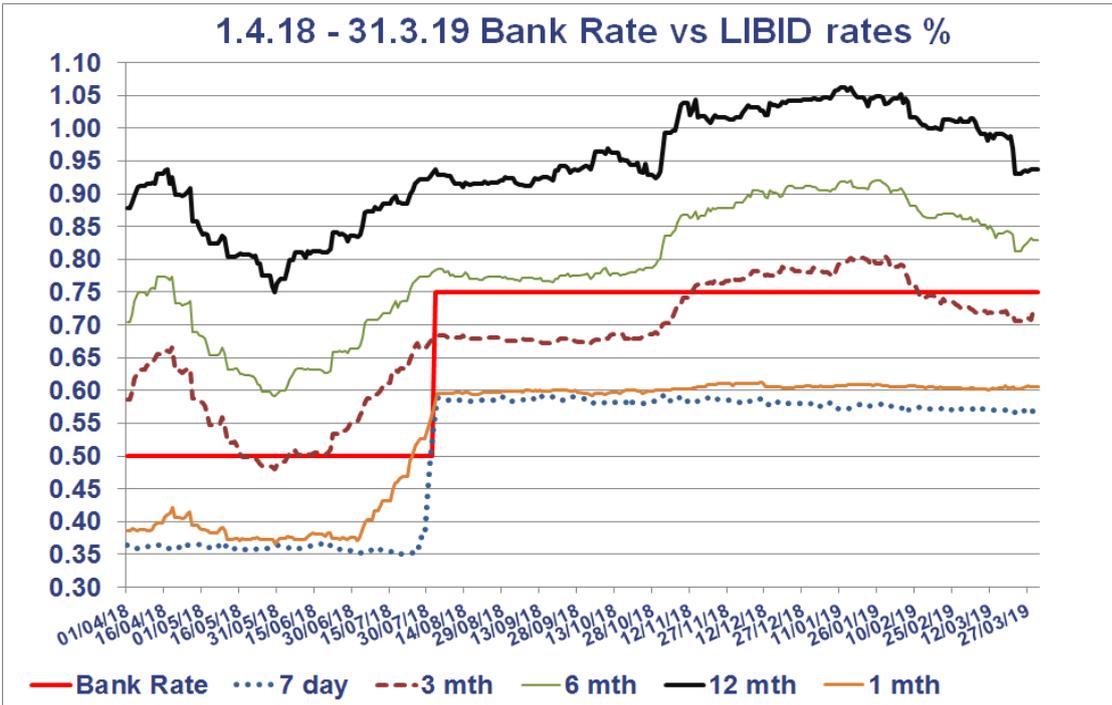
8. Borrowing Outturn for 2018/19

8.1 The Council borrowed £107.6m of PWLB borrowing. This long term borrowing was used to partially repay some temporary borrowing due to mature and also take advantage of interest rates by fixing it over the longer term than using temporary borrowing. In taking this decision the Council carefully considered achieving best value including forecast increases in interest rates.

- 8.2 The council continued to renew the remainder of its temporary borrowing. At the start of the year temporary borrowing was £135.5m, at the end of the year it was £108.3m. During the year 75 temporary loans matured and 67 new loans were taken.
- 8.3 On 16/11/2018 the Council accepted the proposed option to redeem a £50m inverse LOBO loan. This resulted in a premium of £21.3m. Net annual savings of £0.4m will be made to the General Fund after accounting for the premium.
- 8.4 The weighted average interest rate on the council's whole portfolio of loans during 2018/19 was 3.68%.

9. Investment Rates in 2018/19

- 9.1 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 mounting 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.
- 9.2 With the market generally, 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.



10. Investment Outturn for 2018/19

- 10.1 Investment Policy – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 28 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.).

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

10.3 Investments held by the Council - the Council maintained an average balance of £60.1m of internally managed funds. The internally managed funds earned an average rate of return of 0.82% (£54.7m at 0.67% for 2017/18). The comparable performance indicator is the average 7-day LIBID rate, which was 0.51%. This compares with a budget assumption of £25m of investment balances being available earning an average rate of 0.75% and £10m of investment balances being available earning a fixed rate of 1.9% over 10 months. Total investment income was £0.490m compared to an original budget of £0.346m.

JOANNE HARDMAN

CHIEF FINANCE OFFICER

Appendix 1

Prudential and Treasury Indicators

Prudential Indicators	2018/19	2018/19
	Revised	Actual
	£m	£m
Capital Expenditure		
Non-HRA	139.9	84.5
HRA	0.0	0.0
Total	139.9	84.5
Gross borrowing requirement		
borrowing	476.1	448.6
other long term liabilities	195.3	179.0
Total	671.4	627.6
Capital financing requirement (CFR)		
Non-HRA	685.4	642.1
HRA	1.5	1.5
Total	686.9	643.6
Annual Change in CFR		
Non-HRA	99.9	24.6
HRA	0.0	0.0
Total change in CFR	99.9	24.6
Debt repayment provision MRP	-34.5	-24.6
Total after MRP	65.4	0.1
Ratio of financing costs to net revenue stream	%	%
Non-HRA	22.5%	20.3%
HRA	0.0%	0.0%

	2018/19	2018/19
	Original	Actual
	£m	£m
Prudential indicator - operational boundary for external debt		
Borrowing	574.3	448.6
Other long term liabilities	195.3	179.0
Total debt (year end position)	769.6	627.6

	2018/19	2018/19
	Original	Actual
	£m	£m
Prudential indicator - Authorised limit for external debt		
Borrowing	626.3	448.6
Other long term liabilities	205.3	179.0
Total debt (year end position)	831.6	627.6

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2018/19) plus the estimates of any additional capital financing requirement for the current (2019/20) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure but allows it some flexibility to borrow in advance of its immediate capital needs.

At the 31 March 2019 gross borrowing of £627.6m was less than the £643.6m capital financing requirement; the council therefore under-borrowed by £16m, satisfying the above.

The operational boundary limits for external debt reflect the estimate of the most likely, prudent, but not worst case, scenario without the additional headroom included within the authorised limit.

Treasury Indicators			Outturn
		2018/19	
Limits on			
Upper Limit on Fixed Interest Rate Exposure		100%	100%
Upper Limit on Variable Interest Rate Exposure		65%	0%
All Years			
Maturity	Upper Limit	Lower	
Under 12 months	75%	0%	32%
12 and within 24	50%	0%	6%
24 months and within 5 years	50%	0%	20%
5 years and within 10 years	50%	0%	5%
10 years and above	100%	25%	37%
Upper Limit for Investments beyond 364 days		£40m	0

In the table above, LOBOs are shown as maturing at the point the next lender option arises, although in practice it is unlikely that LOBO loans will be called over the next few years as the LOBO interest rates already exceed current market rates and the option to change lies with the banks.

KEY COUNCIL POLICIES: Treasury Management Strategy and Budget Strategy.

EQUALITY IMPACT ASSESSMENT AND IMPLICATIONS:

ASSESSMENT OF RISK: Low

The monitoring and control of risk underpins all treasury management activities. The main risks are of adverse or unforeseen fluctuations in interest rates and security of capital sums.

LEGAL IMPLICATIONS Supplied by: Tony Hatton, Principal Solicitor, tel. 219 6323

Regulations issued under the Local Government Act 2003 require the Council to provide a review of its treasury management activities each year for the previous year. Additional requirements are contained within the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities, which are both taken into account for compliance as outlined in the report, which covers particularly the Council's treasury position as at 31 March 2019, compliance with treasury limits and the Council's investment strategy and outturn for 2018/19.

The Act therefore requires the Council to set out its Treasury Management Strategy at the start of each new financial year and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The report highlights the existing policy of borrowing requirements using short-term loans to benefit from low interest rates, and states that all treasury management activity conformed to the Treasury Management Strategy which was approved by Council in February 2018.

FINANCIAL IMPLICATIONS Supplied by: May Sung – Finance Manager Ext. 2851

Financial implications are included within the report.

PROCUREMENT IMPLICATIONS

There are no Procurement Implications in this report.

HR IMPLICATIONS

There are no HR implications arising from this report

OTHER DIRECTORATES CONSULTED:

CONTACT OFFICERS:

May Sung

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WARDS TO WHICH REPORT RELATES: None specifically