NOT CONFIDENTIAL – For public release **Item No. 14**

COUNCIL
26 September 2019

Report of the Head of Resources

TREASURY MANAGEMENT ANNUAL REPORT FOR 2018/19

PURPOSE OF REPORT

This report seeks approval for the Treasury Management Annual Report for 2018/19. The report compares actual treasury management performance for 2018/19 to the estimates within the treasury management strategy that was approved in March 2018.

RECOMMENDATION

That the Treasury Management Annual Report for 2018/19 be approved.

WARDS AFFECTED

All

STRATEGIC LINK

Treasury Management contributes to the Council's overall financial position and, therefore, the above recommendation contributes to all of the Council's Corporate Plan Priorities

---

1. REPORT

1.1 TREASURY MANAGEMENT ANNUAL REPORT

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities after the end of each financial year.

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

The Authority's treasury management strategy for 2018/19 was approved at a meeting of the Authority on 5th March 2018. The Authority has 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.

1.2 REPORTING REQUIREMENTS

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

The Treasury Strategy The first, and most important, report covers:

- The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- An investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report - (This Report) This report provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

In addition to the above, the 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24th January 2019.

Scrutiny
The above reports are adequately scrutinised by the Corporate Leadership Team before being recommended to the Council.

1.3 EXTERNAL CONTEXT

1.3.1. Economic background

The Bank of England increased the Bank Rate by 0.25% to 0.75% in August 2018, no changes to monetary policy have been made since.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by broader based economic uncertainty. The US continues with protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with the EU. The EU itself appeared to be show signs of a slowdown in economic growth with the major economies, Germany and France, both suffering downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

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 2019 - 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.

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.

1.4 LOCAL CONTEXT

On 31st March 2019, the Authority had net investments of £13.935m arising from its revenue and capital income and expenditure. 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 £'000	**31.3.19 Actual £'000**
General Fund CFR	6,369	5,898
Less: Other debt liabilities *	527	151
Borrowing CFR	**5,842**	**5,747**
Actual borrowing	5,450	5,540
Under borrowing	**392**	**297**
Usable reserves	(17,352)	(19,311)
Working capital requirement	8,803	5,079
Total Investments	**(8,157)**	**(13,935)**

* Finance leases form part of the Authority's total debt

The Authority pursued its strategy of keeping borrowing below its underlying level, sometimes known as under borrowing or internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position as at 31st March 2019 and the change during the year is shown below.

Table 2: Treasury Management Summary

	31.3.18 Balance £'000	**2018/19 Movement £'000**	**31.3.19 Balance £'000**	**31.3.19 Rate %**
Long-term borrowing	5,601	(151)	5,450	4.1
Short-term borrowing	376	(225)	151	
Total borrowing	**5,977**	**(376)**	**5,601**	
Long Term Investments	0	931	931	(2.71)
Short-term investments	0	1,999	1,999	0.76
Cash and cash equivalents	8,157	2,848	11,005	0.74
Total investments	**8,157**	**5,778**	**13,935**	**0.51**
Net investments	**2,180**	**5,402**	**8,334**	

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

1.5 BORROWING STRATEGY

At 31st March 2019, the Authority held £5.5m of loans from the Public Works Loan Board, the same as the previous year, as part of its strategy for funding previous years' capital programmes.

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.

In keeping with these objectives, no new borrowing was undertaken in 2018/19.

The "cost of carry" analysis performed by the Authority's treasury management advisor Arlingclose did not indicate any value in borrowing in advance for future years' planned expenditure and therefore none was taken.

Other Debt Activity

After £0.376m repayment of prior years' finance leases liabilities, total debt other than borrowing stood at £0.151m on 31st March 2019, taking total debt to £5.601m. The Council incurred interest on its borrowing of £232,000 during 2018/19.

1.6 INVESTMENT ACTIVITY

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19, the Authority's investment balance ranged between £6.4m and £21m due to timing differences between income and expenditure. These investments generated £133,000 of income in 2018/19. The year-end investment position is shown in table 3 below.

Table 3: Investments at 31st March 2019

Investment Held	Amount £'000	Rate %
Lloyds Bank	4,504	0.65
Cooperative Rabobank	1,000	0.83
Eastleigh Borough Council	1,000	0.78
Bromsgrove District Council	2,500	0.55
Gosport Borough Council	1,500	0.85
Treasury Bill - UK Government	2,500	0.69
CCLA Property Fund*	931	-2.71
Total	13,935	

* Returns quoted for the CCLA Property fund include initial losses on the purchase of shares. On an income only basis the fund currently returns 4.15%. The value of the fund can fluctuate but has consistently grown over the previous 5 years. At the time of writing the value of the Council's investment was £972,000.

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 investments before seeking the highest 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.

Given the increasing risk from short-term unsecured bank investments, the Authority has diversified into more secure classes as shown above. £1m that is available for longer-term investment was moved from bank and building society deposits into pooled property funds. As a result, investment risk was diversified. The average rate of income return was 0.51% compared with 0.43% in 2017-18

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking below.

	Credit Risk Score **	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return (Total Portfolio) %
31st March 2018	4.52	A+	82%	9	0.43
31st March 2019	3.97	AA-	42%	18	0.51*
Similar LAs	4.13	AA-	53%	86	1.80
All LAs	4.20	AA-	55%	29	1.43

* Includes loss on CCLA fund
** The lower the credit score the lower the risk

Other Non-Treasury Holdings and Activity

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.

The Authority held £1.5m of such investment in directly owned property.

These investments generated £0.097m of investment income for the Authority after taking account of direct costs, representing a rate of return of 6.39% This is higher than the return earned on treasury investments but reflects the additional risks to the Authority of holding such investments.

A register of such investments is held within the council's asset system and is reviewed annually.

1.7 COMPLIANCE REPORT

The Head of Resources is pleased to report that all treasury management activities undertaken during 2018/19 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

Compliance with specific investment limits is demonstrated in table 4 below.

Table 4: Investment Limits

	2018/19 Maximum	31.3.19 Actual	2018/19 Limit	Complied
Banks (£1m per counterparty)	£1m	1m	£1m	✓
Council's own bank (Lloyds)	£5.9m	£4.5m	£6m	✓
Local Authorities (per Authority)	£3m	£2.5	£3m	✓
Money Market Funds (per fund)	£3m	£0m	£3m	✓
UK Government	3m	2.5	Unlimited	✓
Pooled Funds	1m	1m	3m	✓

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 5 below.

Table 5: Debt Limits

Operational Boundary for External Debt: The operational boundary is based on the authority's estimate of prudent levels of external debt.

Authorised Limit for External Debt: The authorised limit is determined in compliance with the Local Government Act 2003 and is the maximum the Authority can legally owe. It provides headroom above the operational boundary for unusual cash movements.

	2018/19 Maximum £000	31.3.19 Actual £000	Operational Boundary £000	Authorised Limit £000	Complied
Borrowing	5,450	5,450	8,000	11,000	✓
PFI & finance leases	151	151	1,000	1,000	✓
Total debt	**5,601**	**5,601**	**9,000**	**12,000**	✓

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.

1.8 TREASURY MANAGEMENT INDICATORS

The Authority measures and manages its exposures to treasury management risks using the following indicators:

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

	31.3.19 Actual	2018/19 Target	Complied
Portfolio Average Credit Rating	AA-	A+	✓

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, without additional borrowing.

	31.3.19 Actual	2018/19 Target	Complied
Total cash available within 3 months	13m	6m	✓
Total sum borrowed without prior notice	0	0	✓

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 amount of net principal borrowed was:

	2018/19 Limit	Complied
Upper limit on fixed interest rate exposure	100%	✓
Upper limit on variable interest rate exposure	30%	✓

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.

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 fixed rate borrowing were:

	Actual	Upper Limit	Complied
Under 12 months	0%	35%	✓
12 months and within 24 months	0%	50%	✓
24 months and within 5 years	0%	65%	✓
5 years and within 10 years	0%	80%	✓
10 years and above	100%	100%	✓

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.

Principal Sums Invested for Periods Longer than 364 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:

	2018/19 Actual	Limit	Complie d
Principal invested beyond year end	£1m	£3m	✓

1.9 PRUDENTIAL INDICATORS

The objectives of the Prudential Code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. In addition to indicators already covered the Prudential Code sets out the following indicators that must be set and monitored each year.

Actual Capital Expenditure: The Authority's Actual capital expenditure and financing may be summarised as follows

Capital Expenditure and Financing	2018/19 Actual	2018/19 Estimate
Total Expenditure	**2,784,490**	3,621,714
Capital Receipts	**908,612**	1,281,463
Capital Grants	**435.757**	453,873
Reserves	**1,440,121**	1,886,378
Total Financing	**2,784,490**	3,621,714

Ratio of Financing Costs to Net Revenue Stream:

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2018/19 Actual %	2018/19 Estimate %
General Fund	6.84	**6.88**

2. RISK ASSESSMENT

2.1 Legal

The report complies with best practice and government guidance on the preparation of the treasury management strategy statement which aims in part, to mitigate financial risk to the Council. The legal risk is therefore low.

2.2 Financial

The Council prioritises security and liquidity ahead of financial return when making investment decisions. In addition, the Council receives advice from an independent advisor who specialises in local authority treasury management. This report is a retrospective look at 2018/19 that demonstrates compliance with the Council's Treasury Management Strategy. The financial risk is therefore considered low.

2.3 Corporate

This strategy sets in place a proposed structure and systems that place security of investments above yield. The risk is therefore assessed as low.

3. OTHER CONSIDERATIONS

In preparing this report the relevance of the following factors has also been considered prevention of crime and disorder, equalities, environmental, climate change, health, human rights, personnel and property.

4. CONTACT INFORMATION

For further information contact:
Karen Henriksen, Head of Resources on 01629 761284 or
Email: karen.henriksen@derbyshiredales.gov.uk

Mark Nash, Financial Services Manager on 01629 761214 or
Email: mark.nash@derbyshiredales.gov.uk

5. BACKGROUND PAPERS

None

6. ATTACHMENTS

None