REVIEW OF TREASURY MANAGEMENT ACTIVITY 2018/19

REPORT OF: Peter Stuart, Head of Corporate Resources

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Wards Affected: All

Key Decision No

PURPOSE OF REPORT

1. The report sets out the Council's treasury management activity for the year ended 31 March 2019.

SUMMARY

2. All transactions are in order and the performance of the service has been in keeping with the requirements of the Service Level Agreement (SLA) with our shared services provider.

RECOMMENDATIONS

3. The Committee is requested to note the contents of the report.

BACKGROUND

4. The Treasury Management function of this Council has been provided by Adur and Worthing Councils as a shared service since October 2010. This has enabled the cost of the service to be reduced whilst giving access to specialist advice and the administration skills of a larger authority. The SLA was extended for a further three years from 18th October 2016 and is currently under negotiation for further extension.

5. The 2018-19 Treasury Management Annual Report produced by the Group Accountant (Strategic Finance) is attached as Appendices 1 to 2. Members should note that this report format and level of detail is similar to that presented to the other authorities in the shared service and whilst it may appear to contain much in the way of industry knowledge, it would reward careful reading by those with an interest.
For those Members seeking a summary, paragraph 11.2 of Appendix 1 sets out the key points:

   "The actual outturn performance for investment income was higher than the budgeted estimate due to the increase in Base Rate and the higher than forecast average investment balance. The shared service will continue to monitor the market carefully for the best possible interest rates."

6. The Group Accountant would welcome questions and queries from Members using the contact details above.

POLICY CONTEXT

7. The presentation of this report fulfils the requirements under the Council's treasury management policy to produce an annual report by 31st August 2019 after the year end. Providing transparency and approval of the strategies contained in this report is an important part of the Council's statutory role. Treasury Management has become increasingly topical given the nature of the world's financial markets in recent years, and Members are expected to have a basic understanding of how the Council uses its reserves and cash flows which are in the stewardship of the Head of Corporate Resources.

OTHER OPTIONS CONSIDERED

8. None – this report is statutorily required by regulations issued under the Local Government Act 2003.

FINANCIAL IMPLICATIONS

9. This report has no quantifiable financial implications. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget but are not required to support the provision of services.

RISK MANAGEMENT IMPLICATIONS

10. This report has no specific implications for the risk profile of the Council.

EQUALITY & CUSTOMER SERVICE IMPLICATIONS

11. None

BACKGROUND PAPERS

- Treasury Management Strategy Statement & Annual Investment Strategy 2018/19 to 2020/21 (Council on 28th March 2018), and Review of Treasury Management Activity 1 April – 30 September 2018 (Audit Committee 20th November 2018).
- The CIPFA code of Practice on Treasury Management (the code).
- CIPFA Prudential code for Capital Finance in Local Authorities (the Prudential Code)
- Link Asset Services report template (May 2019)

APPENDIX 1

1. SUMMARY

1.1 This report summarises the operation of the treasury management service for the financial year 2018/19. The presentation of this report fulfils the requirements under the Council's treasury management policy.

2. INTRODUCTION AND BACKGROUND

2.1 Treasury management is defined as:

"The management of the local authority's cash flows and investments, 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"

2.2 The 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).

2.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report therefore provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

2.4 For 2018/19 the minimum reporting requirements were that the Council should receive the following reports, which incorporate a variety of policies, estimates and actuals:

- The Annual Treasury Management Strategy Statement and Annual Investment Strategy approved by full Council in advance of the year (Council – 28th March 2018)
- The mid-year treasury management operations update report (Audit Committee – 20th November 2018)
- An annual review (this report) to be presented to the Audit Committee following the end of the year, describing the activity compared to the strategy.

2.5 The Council 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 was undertaken on 6th June 2018 in order to support member's scrutiny role.

3. OVERALL TREASURY POSITION AS AT 31 MARCH 2019

3.1 *The following commentary has been supplied by* ***Link Asset Services Ltd****, the professional consultants for the Council's shared treasury management services provider. The context is significant as it describes the backdrop against which treasury management activity has been undertaken during the year.*

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. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

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. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

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.

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.

3.2 The Council's position at the beginning and end of the year was as follows:-

	Principal at 31.03.18 £m	**Average Rate of Return**	**Average Life in Years**	**Principal at 31.03.19 £m**	**Average Rate of Return**	**Average Life in Years**
Borrowing						
PWLB	(0.698)	4.55%	5	(0.571)	4.55%	4
Other Borrowing	(12.000)	0.87%	2.31	(13.000)	1.00%	1.27
Finance lease	0.000			(2.541)		
TOTAL BORROWING	**(12.698)**			**(16.112)**		
CFR	**25.357**			**27.948**		
(Over)/under borrowing	**12.659**			**11.836**		
Investments:						
Local Authority Property Fund	5.851	4.30%	n/a	5.942	4.30%	n/a
In-house:						
Long Term	4.000	0.98%	1.17	0.025	n/a	n/a
Short Term	27.550	1.01%	< 1 year	25.210	0.99%	< 1 year
TOTAL INVESTMENTS	**37.401**			**31.177**		
NET INVESTMENTS	**24.703**			**15.065**		

3.3 The Council's debt comprises one loan from the Public Works Loan Board (PWLB), which matures on 1 March 2023 and loans with other local authorities, totalling £13m, £6m of which was a temporary loan repaid on 1st April 2019, with the rest payable in 2020. The local authority loans are at rates lower than those available from the PWLB, ranging from 0.90% to 1.1%, and they will be repaid using capital receipts and maturing investments.

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%. 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. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

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4.3 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.

4.4 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. THE BORROWING STRATEGY

5.1 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 and minimising counterparty risk on placing investments also needed to be considered.

5.2 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Head of Corporate Resources therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

5.3 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.

5.4

Link Asset Services Interest Rate View 12.2.18													
	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%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB Rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

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

	31 March 2018 Actual	31 March 2019 Strategy	31 March 2018 Actual
CFR (£m)	**25.357**	**5.130**	**27.948**
External Debt	**(12.698)**	**(7.729)**	**(13.571)**
Finance Lease	**0.00**	**0.00**	**(2.541)***
Total Borrowing	**(12.698)**	**(7.729)**	**(16.112)**
(Over)/under borrowing	**12.659**	**(2.599)**	**11.836**

5.6 The table above compares the Gross Debt against the underlying need to borrow (the CFR) thereby highlighting any over or under borrowing. This comparison is one of the Prudential Indicators of affordability under the Prudential Code to show that borrowing levels are prudent over the medium term, and sustained for capital investment purposes – i.e. that the Council is not borrowing to support revenue expenditure.

5.7 The difference between the borrowing budget and the actual is due to a temporary £6m loan taken to cover the purchase of property. It was repaid on 1st April 2019. The difference between the CFR in the strategy and the actual CFR is due to a delayed capital receipt.

5.8 The Authority has a contract with SERCO for the provision of waste collection. The new fleet of vehicles used to provide the service are shown as Property, Plant and Equipment in the Balance Sheet, with a vehicle life of 10 years 4 months which ends 30 July 2028. Accordingly this is recognised as a *Finance Lease.

5.9 Accordingly, the amount of borrowing should not exceed the CFR for 2018/19 (plus any expected changes to the CFR over 2019/20 and 2020/21) except in the short term. This requirement has been fully met in 2018/19 as the gross debt is below the CFR by **£11.836m.**

6 BORROWING OUTTURN for 2018/19

6.1 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.

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

6.3 The following loans were repaid on maturity during the year

Lender	Principal	Type	Interest Rate	Maturity
London Borough of Islington	**£5m**	**Fixed interest rate**	**0.60%**	**19/11/2018**

7 INVESTMENT OUTTURN FOR 2018/19

7.1 **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 **28th March 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.). The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

7.2 **Investments held by the Council** - the Council maintained an average balance of **£37.72m** of internally managed funds, which earned an average rate of return of **0.971%**. The comparable performance indicator is the average 6 month LIBID rate, which was **0.788**%. This compares with a budget assumption of **£27.65m** investment balances earning an average rate of **0.95%**. The Treasury investment returns (excluding returns from the Local Authority Property Fund) included in the reported income of the Council for 2018/19 amount to **£368k £105k** above the budgeted investment estimate. This was due to the higher than projected interest rates available for investments and the higher than forecast average balance.

7.3 **Investment Properties**
As part of the Council's investment strategy, In 2018/19 the main purchases made by the Authority are two industrial estate buildings, 255-269 London Road, Burgess Hill for £6,622,000 and 208-216 London Road, Burgess Hill for £5,271,000.

7.4 **Local Authority Property Fund** – the Council has invested £6m with the Local Authority Property Fund and earned **£257k** in dividend interest in 2018/19.

7.5 **Resources** – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources	31 March 2018	31 March 2019
	£'000s	£'000s
Balances	**6.854**	**3.098**
Earmarked Reserves	**20.714**	**16.840**
Provisions	**1.924**	**2.323**
Usable capital Receipts	**1.323**	**1.061**
Total	**30.815**	**23.322**

7.6 Investments held at 31 March 2019 (excluding the Local Authority Property Fund):

Counterparty	Issue Date	Maturity Date	Principal	Current Interest Rate	Long Term Rating
Saffron Building Society	03/04/2018	03/04/2019	£1,000,000	1.0500	*
Goldman Sachs Int Bank	03/04/2018	03/04/2019	£2,000,000	1.2750	A
Lloyds Bank	05/06/2018	05/06/2019	£1,000,000	1.0000	A+
Lloyds Bank	27/06/2018	27/06/2019	£1,000,000	1.0000	A+
Progressive Build Soc	27/09/2018	27/09/2019	£2,000,000	1.0500	*
Newcastle Build Soc	07/11/2018	07/11/2019	£1,000,000	1.1500	*
Saffron Building Society	15/03/2019	16/03/2020	£2,000,000	1.2500	*
Progressive Build Soc	20/04/2017	18/04/2019	£1,000,000	1.0200	*
Nottingham Build Soc	05/09/2017	05/09/2019	£2,000,000	0.9500	BBB+
Nth Lincolnshire Council	09/03/2018	09/04/2019	£1,000,000	0.9800	N/A
National Counties BS	10/04/2018	11/04/2019	£1,000,000	1.0300	*
Principality BS	10/04/2018	11/04/2019	£1,000,000	0.9500	BBB
Nottingham Build Soc	15/05/2018	16/05/2019	£1,000,000	0.9600	BBB+
National Counties BS	15/05/2018	16/05/2019	£1,000,000	0.9600	*
Close Brothers Limited	29/03/2019	30/03/2020	£2,000,000	1.2500	A
CCLA	17/08/2018	01/04/2019	£2,815,000	0.7903	AAA
Invesco STIC	03/04/2018	01/04/2019	£2,385,000	0.7840	AAA
Handelsbanken	15/06/2018	01/04/2019	£10,000	0.5000	AA-
TOTAL			**£25,210,000**		

* - Not on credit list

All investments listed are due to mature within 12 months.

8. MINIMUM REVENUE PROVISIONS (MRP) FOR REPAYMENT OF DEBT

8.1 The Council, in accordance with legislation, makes a provision from revenue to enable the repayment of borrowing that has been undertaken to fund the capital programme. This provision is known as the Minimum Revenue Provision (MRP) and is charged to the General Fund Revenue Account each year. MRP is set aside each year at an amount equivalent to the value of debt repaid in the year.

8.2 For 2018/19 an amount of **£498k** has been set aside in the annual accounts as the MRP for repayment of debt.

9. OTHER ISSUES AND MATTERS

Shared Services Arrangements

9.1 The Council's treasury management services are provided under a shared services arrangement (SSA) performed by the in-house treasury management team formed out of partnership working between Adur District Council and Worthing Borough Council. The treasury management team is based at Worthing Town Hall, but services all three Councils' treasury management operations from this location utilising similar banking arrangements.

The SSA is provided under a Service Level Agreement that was renewed from 18th October 2016, and which defines the respective roles of the client and provider authorities for a period of three years. A new partnership agreement with Adur District Council and Worthing Borough Council is currently being drawn up.

10 Statutory override

Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements 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.

11. CONCLUSION

11.1 This report fulfils the requirements of the CIPFA Codes as well as the Council's own treasury management practices to present an annual outturn report on treasury management activity before 31st August 2019.

11.2 The actual outturn performance for investment income was higher than the budgeted estimate due to the increase in Base Rate and the higher than forecast average investment balance. The shared service will continue to monitor the market carefully for the best possible interest rates. All counterparty lending limits approved at the start of the year were met and all Prudential Limits were adhered to.

COMPLIANCE WITH PRUDENTIAL INDICATORS 2017/18

1. PRUDENTIAL INDICATORS Extract from budget	2017/18 Actual £'000	2018/19 Full year Estimate £'000	2018/19 Actual £'000
Capital Expenditure	3,477	13,533	24,626
Ratio of financing costs to net revenue stream	-0.68%	0.62%	0.50%
Borrowing Outstanding			
Brought forward 1 April	22,819	12,698	12,698
Carried forward 31 March	12,698	7,571	16,111
Net in year borrowing / (repayments)	(10,121)	(5,127)	3,413
Capital Financing Requirement at 31 March	25,357	5,130	27,948
Change in Cap. Financing Requirement	379	(20,227)	2,591

2. TREASURY MANAGEMENT INDICATORS	2017/18 Actual £'000	2018/19 Original £'000	2018/19 Actual £'000
Authorised Limit for external debt -			
Borrowing	30,000	30,000	30,000
Other long term liabilities	1,000	1,000	1,000
Total Authorised Limit for external debt	31,000	31,000	31,000
Operational Boundary for external debt			
Borrowing	28,000	28,000	28,000
Other long term liabilities	1,000	1,000	1,000
Total Operational Boundary for external debt	29,000	29,000	29,000

APPENDIX 2

COMPLIANCE WITH PRUDENTIAL INDICATORS 2018/19

The maturity structure of the debt portfolio was as follows:

	2018/19 upper limits	2018/19 lower limits	31-Mar-19 actual
Under 12 months	50%	0%	40%
12 months and within 24 months	60%	0%	15%
Over 2 Years	80%	0%	45%

The authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The Council did not breach the authorised limit during the year.

The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached. The Council did not breach the operational boundary during the year.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.