AUDIT & ACCOUNTS COMMITTEE
24 JULY 2019

TREASURY MANAGEMENT OUTTURN REPORT 2018/19

1. Purpose of Report

1.1. The purpose of this report is to give Members the opportunity to review the annual Treasury Outturn report which will be presented to Council on 15th October 2019 (copy attached at **Appendix A**).

2. Introduction

2.1. In January 2010 the Council formally adopted the CIPFA Code of Practice on Treasury Management which requires that the Council receives regular reports on its treasury management activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

2.2. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Audit and Accounts Committee and for the execution and administration of treasury management decisions to the section 151 officer, who will act in accordance with the Council's policies and practices.

2.3. The Treasury Strategy and Prudential Indicators for 2018/19 were approved by Council on 8th March 2018 and the Outturn report is the last report for the financial year, required by the Code. It has been prepared on the basis of the draft final accounts which appear elsewhere on the agenda. If there are significant changes resulting from the audit of the accounts they will be reported at the next meeting of this Committee.

2.4. The report in section 6 details that there were no breaches of the approved prudential indicators during 2018/19.

3. RECOMMENDATION

That the Treasury Outturn position for 2018/19 be considered.

Background Papers

Nil

For further information please contact Andrew Snape on extn. 5532

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APPENDIX A

ANNUAL TREASURY REPORT 2018/19

1. Background

1.1. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ('the Code') which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. Scrutiny of treasury policy, strategy and activity is delegated to the Audit and Accounts Committee.

1.2. Treasury management is defined as: 'The management of the local authority's investments and cash flows, 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.'

1.3. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management strategy.

2. Economic Background

2.1. 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, 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. With the 29th March 2019, the original EU 'exit day' now been and gone, having failed to pass a number of meaningful votes in Parliament, including shooting down Theresa May's deal for the third time, MPs voted by a majority of one (313 to 312) to force the prime minister to ask for an extension to the Brexit process beyond 12th April in order to avoid a no-deal scenario. Recent talks between the Conservative and Labour parties to try to reach common ground on a deal which may pass a vote by MPs have yet to yield any positive results. The EU must grant any extension and its leaders have been clear that the terms of the deal are not up for further negotiation. The ongoing uncertainty continues to weigh on sterling and UK markets.

2.4. 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 a gathering level of broader based economic uncertainty. The US continues to be set on a path of 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 EU. The EU itself appeared to be show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from 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.

2.6 **Financial markets:** December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

2.7 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.

2.8 Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

2.9 **Credit background:** Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

2.10 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.

2.11 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.

2.12 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. At 31/03/2019 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £129m, while usable reserves and working capital which are the underlying resources available for investment were £53.4m**.**

3.2. At 31/03/2019, the Council had £95m of borrowing and £41m of investments. The Council's current strategy is to maintain borrowing below the underlying level indicated by the CFR, and to use internal resources to cover the gap. This is referred to as internal borrowing.

3.3. The Council has an increasing CFR over the next 2 years of £8.57m, due to the borrowing requirement of £15.6m (GF £5.4m / HRA £10.2m) for financing the capital programme over the forecast period, if reserve levels permit internal borrowing will be considered. The CFR requirement reduces when minimum revenue provisions are made and the repayment of debt, over the forecast period there are four loans due for repayment with a combined total value of £6.0m.

4. Borrowing Strategy

4.1. Borrowing Activity in 2018/19

	Balance 1/4/18 £000	**New Borrowing £000**	**Debt Maturing £000**	**Balance 31/3/19 £000**
CFR	124,681			129,821
Short Term Borrowing	3,293	14,914	13,224	4,983
Long Term Borrowing	86,103	5,000	1,022	90,081
Total Borrowing	**89,396**	**19,914**	**14,246**	**95,064**
Other Long Term Liabilities	224	0	0	224
Total External Debt	**89,620**	**19,914**	**14,246**	**95,288**
Increase/(Decrease) in Borrowing £000				5,668

4.2. The Council'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. The Council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, it was decided to take a combination of medium-term borrowing and long-term borrowing maturity loans. The Council borrowed £5m medium/longer-term fixed rate loans, details of which are below. These loans provide some longer-term certainty and stability to the debt portfolio.

Long-dated Loans borrowed	Amount £000	Rate %	Period (Years)
PWLB Maturity Loan 1	3,000	2.04	10
PWLB Maturity Loan 2	1,000	2.34	15
PWLB Maturity Loan 3	1,000	2.53	30

4.4. **LOBOs**: The Council holds £3.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of the £3.5m of LOBOS had options during the year, none of which were exercised by the lender.

4.5. **Debt Rescheduling**: The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

5. <u>Investment Activity</u>

5.1. Investment Activity in 2018/19

	Balance 1/4/8 £000	New Investments £000	Investments Redeemed £000	Balance 31/3/19 £000
Short Term Investments	24,472	141,593	124,695	41,370
Long Term Investments	0	0	0	0
Total Investments	**24,472**	**141,593**	**124,695**	**41,370**
Increase/(Decrease) in Investments £000				16,898

5.2. Both the CIPFA Code and government guidance require the Council 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 Council'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. During 2018/19 the Council's investment balances have ranged between £22.6 and £51.1 million.

5.3. Security of capital remained the Council's main objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2018/19.

5.4. Counterparty credit quality is assessed and monitored by Arlingclose, the Council's treasury advisors, with reference to credit ratings; credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. Arlingclose provide recommendations for suitable counterparties and maximum investment periods.

5.5. 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 Council 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.

5.6. Also, during the financial year 2018/19 there was the introduction of International Financial Reporting Standard (IFRS) 9 – Financial Instruments. The new standard presented revised guidance on the classification and measurement of financial assets, including a new expected credit loss model for calculating impairment.

6. Compliance with Prudential Indicators

6.1. The Council can confirm that it has complied with its Prudential Indicators for 2018/19, which were set on 8 March 2018 as part of the Council's Treasury Management Strategy Statement.

6.2. **Interest Rate Exposure:** These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates for both borrowing and investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Approved Limit for 2018/19 %	**Maximum during 2018/19 £m**
Fixed Rate		
Borrowing	100%	91%
Investments	75%	44%
Compliance with Limit		*Yes*
Variable Rate		
Borrowing	20%	9%
Investments	100%	56%
Compliance with Limit		*Yes*

6.3. **Maturity Structure of Fixed Rate Borrowing.** This indicator is to limit large concentrations of fixed rate debt and control the Council's exposure to refinancing risk.

	Upper Limit %	**Fixed Rate Borrowing 31/03/19 £m**	**Fixed Rate Borrowing 31/3/19 %**	**Compliance?**
Under 12 months	15%	7.007	7.4%	Yes
12 months to 2 years	15%	4.000	4.2%	Yes
2 years to 5 years	30%	16.976	17.9%	Yes
5 years to 10 years	100%	24.060	25.3%	Yes
10 years and above	100%	43.021	45.2%	Yes

6.4. **Principal Sums Invested for over 364 Days.** All investments were made on a short-term basis and there were no investments for more than 364 days.

6.5. **Authorised Limit and Operational Boundary for External Debt.** The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The s151 Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2018/19; borrowing at its peak was £96.1m.

	Approved Operational Boundary 2018/19 £m	**Authorised Limit 2018/19 £m**	**Actual External Debt 31/03/19 £m**
Borrowing	128.3	128.3	95.1
Other Long Term Liabilities	0.4	0.6	0.2
Total	**128.7**	**128.9**	**95.3**

6.6. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary of the treasury management activity during 2018/19. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

6.7. The Council also confirms that during 2018/19 it complied with its Treasury Management Policy Statement and Treasury Management Practices.