ANNUAL TREASURY MANAGEMENT REVIEW 2018-19

Meeting	**Council – 10 October 2019**
Report Author	**Tim Willis, Deputy Chief Executive and Section 151 Officer**
Portfolio Holder	**Cllr David Saunders, Cabinet Member for Financial Services and Estates**
Status	**For Decision**
Classification:	**Unrestricted**
Key Decision	**No**
Reasons for Key *(if appropriate)*	**N/A**
Previously Considered by	**Governance and Audit Committee - 24 July 2019** **Cabinet - 19 September 2019**
Ward:	**N/A**

Executive Summary:

This report summarises treasury management activity and prudential/ treasury indicators for 2018-19.

Recommendation(s):

That council:

- Notes the actual 2018-19 prudential and treasury indicators in this report.
- Approves the Annual Treasury Management report for 2018-19.

CORPORATE IMPLICATIONS	
Financial and Value for Money	The financial implications are highlighted in this report.
Legal	Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the council's finances. For this council, this is the Deputy Chief Executive and this report is helping to carry out that function.
Corporate	Failure to undertake this process will impact on the council's compliance with the Treasury Management Code of Practice.

Equalities Act 2010 & Public Sector Equality Duty	There are no equity and equalities implications arising directly from this report, but the council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these. It is important to be aware of the council's responsibility under the Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by council.

CORPORATE PRIORITIES (tick those relevant)✓	
A clean and welcoming Environment	
Promoting inward investment and job creation	
Supporting neighbourhoods	

CORPORATE VALUES (tick those relevant)✓	
Delivering value for money	✓
Supporting the Workforce	
Promoting open communications	

1.0 Introduction and Background

1.1 This council is required by regulations issued under the Local Government Finance 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 Chartered Institute of Public Finance & Accountancy (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 that the full council should receive the following reports:

- an annual treasury strategy in advance of the year (council 08-02-2018)
- a mid-year treasury update report (council 07-02-2019)
- 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. 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 members.

1.4 This 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 Governance and Audit Committee before they were reported to the full council. Member training on treasury management issues was last undertaken on 21-09-2015 in order to support members' scrutiny role, and further training will be arranged following the local elections in May 2019. The council's external treasury management advisor is Link Asset Services (Link).

1.5 The council's 2018-19 accounts have not yet been audited and hence the figures in this report are subject to change.

2.0 The Council's Capital Expenditure and Financing

2.1 The council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£000	2017-18 Actual	2018-19 Budget	2018-19 Actual
Capital expenditure - GF	6,234	13,512	9,945
Capital expenditure - HRA	4,492	7,408	5,435
Capital expenditure - Total	**10,726**	**20,920**	**15,380**
Financed by:			
Capital receipts	2,250	4,816	3,182
Capital grants	3,582	6,368	3,517
Revenue and reserves	3,484	5,104	4,639
Borrowing	1,410	4,632	4,042
Total	**10,726**	**20,920**	**15,380**

2.2 Full details of capital expenditure and explanations of variances from budget will be reported within the Financial and Performance Monitoring Outturn Report to Cabinet in September.

3.0 The council's Overall Borrowing Need

3.1 The council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge for the council's debt position and represents the 2018-19 and historic net capital expenditure which has not yet been charged to revenue. The process for charging the capital expenditure to revenue is a statutory requirement and is called the Minimum Revenue Provision (MRP)*. The council has the option to charge more than the statutory MRP each year through Voluntary Revenue Provision (VRP). The council's CFR for the year is shown below, and represents a key prudential indicator. The total CFR can also be reduced by the application of additional capital resources (such as unapplied capital receipts).

*In effect this is the amount required to be set aside for the eventual loan repayment

3.2 **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 (2017-18) plus the estimates of any additional capital financing requirement for the current (2018-19) and next two financial years. This essentially means that the council is not borrowing to support revenue expenditure. This indicator allowed the council some flexibility to borrow in advance of its immediate capital needs in 2018-19. The table below highlights the Council's gross borrowing position against the CFR. The council has complied with this prudential indicator.

£000	31 March 2018 Actual	31 March 2019 Budget	31 March 2019 Actual
CFR GF	23,812	27,086	26,497
CFR HRA	20,787	20,786	20,786
Total CFR	44,599	47,872	47,283
Gross borrowing position	31,086	35,133	30,456
Underfunding of CFR	13,513	12,739	16,827

3.3 **The authorised limit** - 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 table below demonstrates that during 2018-19 the Council has maintained gross borrowing within its authorised limit.

3.4 **The operational boundary** – 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.

3.5 **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.

£000	2018-19
Authorised limit	£87,000
Maximum gross borrowing position during the year	£31,086
Operational boundary	£77,000
Average gross borrowing position	£30,711
Financing costs as a proportion of net revenue stream - GF	6.1%
Financing costs as a proportion of net revenue stream -HRA	5.2%

4.0 Treasury Position as at 31 March 2019

4.1 At the beginning and the end of 2018-19 the council's treasury (excluding borrowing by private finance initiatives (PFI) and finance leases) position was as follows:

Table 1 - Overall Treasury Position as at 31 March 2019

	31 March 2018 Principal £'000	Rate/ Return	Average Life Years	31 March 2019 Principal £'000	Rate/ Return	Average Life Years
GF debt	11,046	3.15%	13.9	10,416	3.22%	13.8
HRA debt	20,040	4.03%	8.1	20,040	4.03%	7.3
Total debt (all fixed rate)	**31,086**	**3.71%**	**10.2**	**30,456**	**3.75%**	**9.5**
GF CFR	23,812			26,497		
HRA CFR	20,787			20,786		
Total CFR	**44,599**			**47,283**		
Under-borrowing	**(13,513)**			**(16,827)**		
Total investments	**40,882**	**0.36%**		**41,673**	**0.69%**	
Net debt / (investment)	**(9,796)**			**(11,217)**		

4.2 All of the debt is from PWLB apart from the following GF loans (as at 31 March 2019):

Market: £4,500k principal at 4.19% with an average life of 0.5 years.
Salix: £30k principal at 0.00% with an average life of 1.5 years.

4.3 The maturity structure of the debt portfolio was as follows:

£000	31 March 2018 actual	2018-19 upper limits	31 March 2019 actual
Under 1 year	5,131	15,228	9,932
1 year to under 2 years	5,432	15,228	631
2 years to under 5 years	5,144	15,228	4,772
5 years to under 10 years	3,006	16,751	2,835
10 years to under 20 years	6,453	15,228	8,366
20 years to under 30 years	3,000	15,228	1,000
30 years to under 40 years	1,920	15,228	1,920
40 years to under 50 years	1,000	15,228	1,000
50 years and above	0	15,228	0
Total debt	31,086		30,456

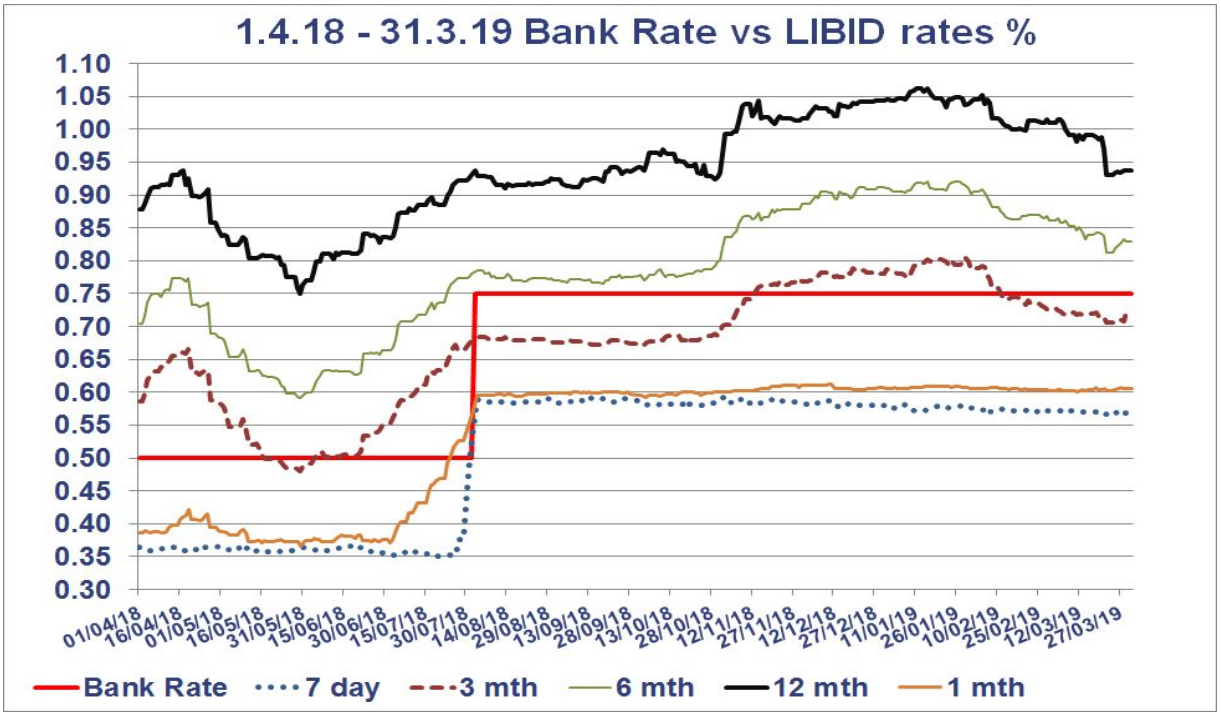
4.4 The composition of the investment portfolio was as follows:

	31 March 2018 actual £000	31 March 2018 actual %	31 March 2019 actual £000	31 March 2019 actual %
Banks - Instant Access	3	0.01	3	0.01
Banks - Notice Accounts	0	0.00	4,453	10.68
Banks - Fixed Term Deposits	17,811	43.56	13,414	32.19
Money Market Funds	23,068	56.43	23,803	57.12
Total Treasury Investments	**40,882**	**100.00**	**41,673**	**100.00**

4.5 All investments at both the 2017-18 and 2018-19 year-ends were for under one year.

5.0 The Strategy for 2018-19

5.1 Investment strategy and control of interest rate risk



5.1.1 Investment returns remained low during 2018-19. 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 the increase in Bank Rate from 0.50% to 0.75% 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.

5.1.2 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.

5.1.3 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.

5.1.4 Continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

5.2 Borrowing strategy and control of interest rate risk

5.2.1 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.

5.2.2 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

5.2.3 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

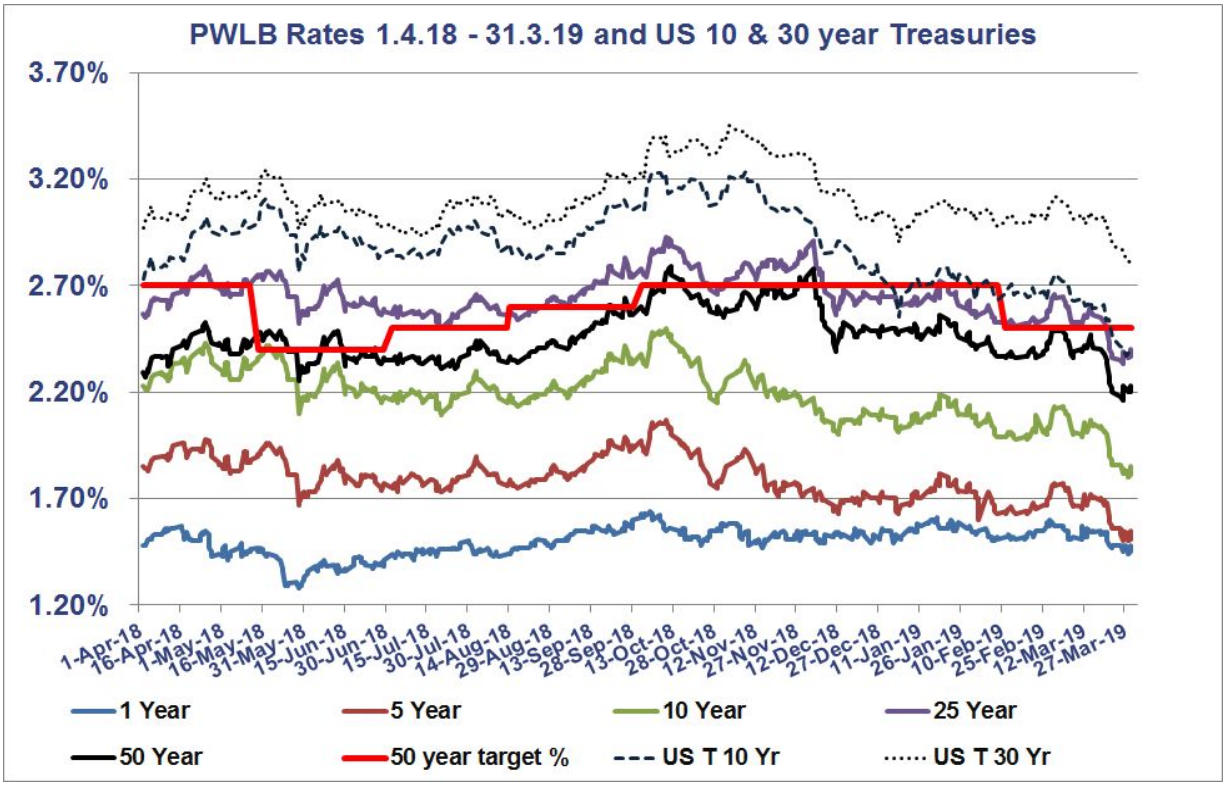
5.2.4 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Section 151 Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

5.2.5 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 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%



5.2.6 Since PWLB rates peaked during October 2018, most PWLB rates have been on a general downward trend, though longer term rates did spike upwards again during December and (apart from the 1 year rate) reached lows for the year at the end of March. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields - which determine PWLB rates. The Fed in America increased the Fed Rate four times in 2018, making nine increases in all in this cycle, to reach 2.25% – 2.50% in December. However, it had been giving forward guidance that rates could go up to nearly 3.50%. These rate increases and guidance caused Treasury yields to also move up. However financial markets considered by December 2018 that the Fed had gone too far, and discounted its expectations of further increases. Since then, the Fed came round to the view that there are probably going to be no more increases in this cycle and the issue became how many cuts in the Fed Rate there will be and how soon, in order to support economic growth in the US. But weak growth now also looked to be the outlook for China and the EU which meant that world growth as a whole would be weak.

Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

5.3 **Change in strategy during the year** – the strategy adopted in the original Treasury Management Strategy Report for 2018-19 approved by the council on 08-02-18 was not revised during 2018-19.

6.0 Borrowing Outturn for 2018-19

6.1 **Borrowing** – Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

6.2 **Borrowing in advance of need -** 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.

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

6.4 **Repayments** – The council repaid £630k of maturing debt using investment balances, as below:

Lender	Principal £'000	Interest Rate	Repayment Date
Salix	4	0.00%	01-04-18
PWLB	43	3.08%	23-04-18
PWLB	50	2.48%	27-05-18
PWLB	146	1.97%	27-05-18
PWLB	72	1.28%	20-06-18
Salix	4	0.00%	01-10-18
PWLB	43	3.08%	23-10-18
PWLB	50	2.48%	27-11-18
PWLB	146	1.97%	27-11-18
PWLB	72	1.28%	20-12-18
Total	630		

6.5 **Summary of debt transactions** – The average interest rate on the debt portfolio increased from 3.71% to 3.75% during the year. This was due to the repayment of maturing debt as shown above.

7.0 Investment Outturn for 2018-19

7.1 **Investment Policy** – the council's investment policy is governed by the Ministry of Housing, Communities and Local Government (MHCLG) investment guidance, which has been implemented in the annual investment strategy approved by the council on 8 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.).

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

7.3 **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 £000	31 March 2018	31 March 2019
GF Balance	2,011	2,011
Earmarked Reserves	13,021	13,998
HRA Balance	7,753	9,307
Capital Receipts Reserve	9,221	9,437
Major Repairs Reserve	10,019	12,765
Capital Grants Unapplied	43	43
Total Usable Reserves	42,068	47,561

7.4 **Investments held by the council**

- The council maintained an average balance of £47.289m of internally managed funds.
- The internally managed funds earned an average rate of return of 0.69%.
- The comparable performance indicator is the average 7-day London Interbank Bid Rate (LIBID) rate, which was 0.51%.
- This compares with an original budget assumption of £25m investment balances earning an average rate of 0.25%.
- Total investment income was £328k compared to a budget of £63k.

7.5 **Investments held by fund managers** – the council does not use external fund managers.

8.0 Investment risk benchmarking

8.1 The following investment benchmarks were set in the council's 2018-19 annual treasury strategy:

8.2 **Security** - The council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio.

8.3 **Liquidity** – in respect of this area the council seeks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £10m available with a week's notice.
- Weighted average life benchmark is expected to be 0.5 years, with a maximum of 1.0 year.

8.4 **Yield** - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

8.5 The council kept to the above benchmarks during 2018-19.

9.0 Options

9.1 The recommended option (to ensure regulatory compliance as set out in section 1 of this report) is that council:

- Notes the actual 2018-19 prudential and treasury indicators in this report.
- Approves the Annual Treasury Management report for 2018-19.

9.2 Alternatively, council may decide not to do this and provide reason(s) why.

10.0 Disclaimer

10.1 This report is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

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Reporting to:	Madeline Homer, Chief Executive

Annex List

Annex 1	Report Guidance
Annex 2	Abbreviations and Definitions

Corporate Consultation Undertaken

Finance	Chris Blundell, Head of Financial Services
Legal	Tim Howes, Director of Corporate Governance & Monitoring Officer