Agenda Item No:	**8**	Fenland CAMBRIDGESHIRE
Committee:	**Corporate Governance Committee**	
Date:	**18 June 2019**	
Report Title:	**Treasury Management Annual Review 2018/19**	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2018/19. This report will be considered by Cabinet on 27 June 2019 and Council on 18 July 2019.

2 Key issues

- Outstanding loans and finance lease liabilities of £8,362,760 and temporary investments of £20,200,000 as at 31 March 2019.
- The average rate on the long term external debt portfolio was 5.99% at 31 March 2019.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/19) currently attracting excessive premiums it was not financially advantageous for the Council to comply with the Gross borrowing and Capital Financing Prudential Indicator in 2018/19. This is consistent with the strategy approved by Council in February 2018.
- No new borrowing was undertaken and the authorised limit was not breached during 2018/19.
- The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- Amount received from external investments £176,672 (compared with an estimate of £170,000).
- Overall interest rate achieved from investments 0.73% (7 day LIBID uncompounded rate for 2018/19 0.51%).

3 Recommendations

- It is recommended that members note the report.

Wards Affected	All
Portfolio Holder(s)	Cllr Chris Boden, Leader & Portfolio Holder, Finance
Report Originator(s)	Peter Catchpole, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Peter Catchpole, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper(s)	Treasury Management and Annual Investment Strategy 2018/19

Report:

1 Introduction

1.1 The Council is required through 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 Chartered Institute of Public Finance and 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 Council should receive the following reports:

- an annual Treasury Strategy in advance of the year (Council 22/02/2018);
- a mid-year treasury update report (Council 15/11/2018);
- 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 provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

1.4 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 Corporate Governance Committee before they were reported to Council.

2 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.

	2017/18 Actual £000	2018/19 Estimate £000	2018/19 Actual £000
Capital expenditure	**1,880**	**3,743**	**2,968**
Financed In Year	1,880	2,765	2,371
Unfinanced capital expenditure	**0**	**978**	**597**

3 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).

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 (See Appendix A).

3.3

	31 March 2018 Actual £000	31 March 2019 Estimate £000	31 March 2019 Actual £000
CFR opening balance	981	765	766
Capital expenditure (internal borrowing)	0	978	597
Less finance lease repayments	(215)	(151)	(151)
CFR Closing balance	**766**	**1,592**	**1,212**
Gross Debt	**8,514**	**8,363**	**8,363**

3.4 The CFR includes finance leases. A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle) for the lease duration (typically 7 years). The annual lease payment is made up of a capital and interest repayment.

3.5 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan.

3.6 As a result of the Council's long term PWLB debt portfolio (£4.5m at 31/03/19) currently attracting excessive premiums (£3.034m), if it were prematurely repaid, it is not financially advantageous for the Council to comply with this prudential indicator. This is consistent with the strategy approved by Council in February 2018.

3.7 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.

3.8 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.

3.9 Neither the authorised limit or operational boundary were breached during 2018/19.

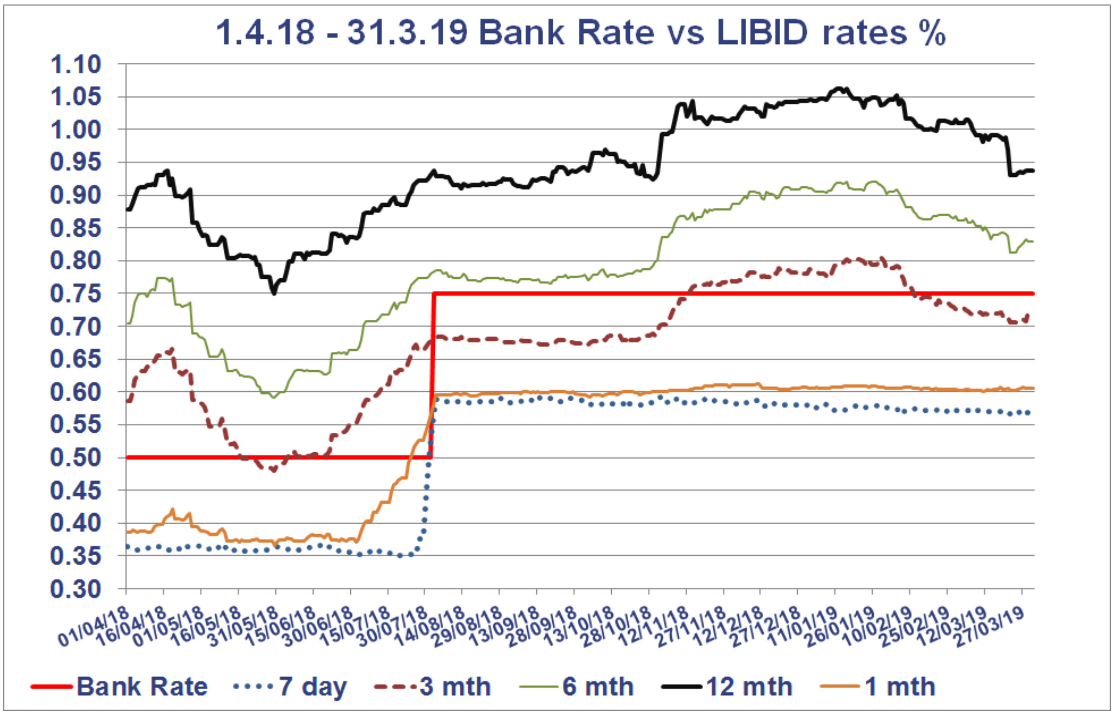
4 Overall Treasury Position as at 31 March 2019

4.1 At the beginning and end of 2018/19 the Council's treasury position was as follows.

	31 March 2019 Principal £000	Rate / Return	Average Life years	**31 March 2018 Principal £000**	Rate / Return	Average Life years
Fixed rate funding						
• PWLB	**4,500**	7.29%	11.40 yrs	**4,500**	7.29%	12.40 yrs
• LOBO	**3,300**	*4.70%*	34.96 yrs	**3,300**	4.70%	35.96 yrs
• Finance Leases	**563**	3.61%	3.56 yrs	**714**	3.25%	4.56 yrs
Total debt	**8,363**			**8,514**		
Investments	**(20,200)**	0.73%		**(19,500)**	0.41%	
Net debt /(Investments)	**(11,837)**			**(10,986)**		

4.2 All investments held at 31 March 2019 are fixed term or callable deposits due for repayment within the next twelve months.

5 The Strategy for 2018/19



Investment Strategy

5.1 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.

5.2 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.

5.3 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.

5.4 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.

Borrowing Strategy

5.5 The Council was ‘over borrowed’ during 2018/19; the Council’s gross debt exceeded its CFR, as has been the case since 2007 when the Council decided not to repay £7.8m of PWLB debt, following the Council’s stock transfer.

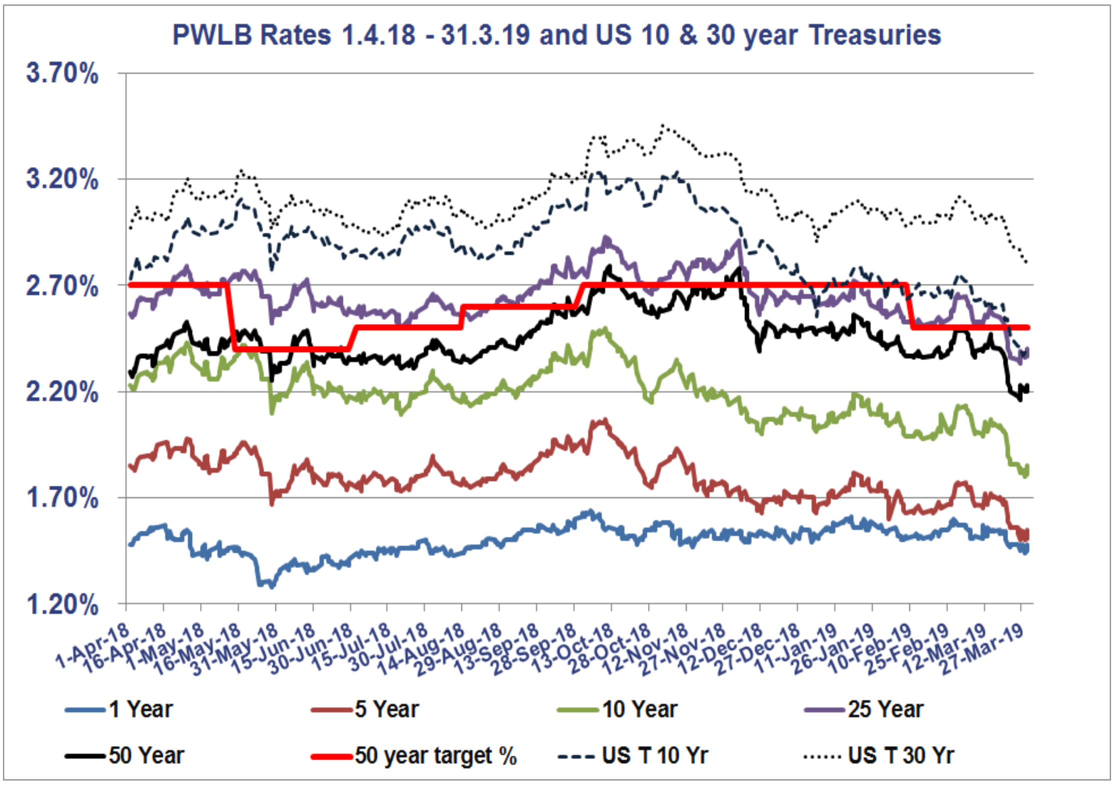
5.6 Therefore, as opposed to taking on additional loan debt to fund capital expenditure in 2018/19, the Council followed a strategy of using cash, supporting the Council’s reserves, balances and cash flow as an interim measure. The strategy was prudent as investment returns were low and to reduce counterparty risk on placing investments

5.7 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.

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

5.9 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.

	Dec-17	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%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%



5.10 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 has also come round to the view that there are probably going to be no more increases in this cycle. The issue now is 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 looks to be the outlook for China and the EU so this will mean that world growth as a whole will be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

6 Borrowing Outturn

6.1 No long term or temporary borrowing was required during 2018/19. The approach during the year was to use cash balances to finance new capital expenditure, so as to run down cash balances that were earning low investment returns and to minimise counterparty risk incurred on investments.

6.2 No rescheduling was completed during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates and the penalty position which can arise from early repayment of debt, made rescheduling unviable.

7 Investment Outturn

7.1 The Council's investment policy is governed by the Ministry of Housing, Communities and Local Government investment guidance, which has been implemented in the annual investment strategy approved by Council on 22 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 and bank share price).

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

7.3 The Council maintained an average balance of £22.945m of internally managed funds. The internally managed funds earned an average rate of return of 0.73% (£176,672). The comparable performance indicator is the average 7-day LIBID rate, which was 0.51%.

8 Prudential and Treasury Indicators

8.1 During 2018/19 the Council complied with its legislative and regulatory requirements with the exception of gross borrowing (see paragraph 3.6 above).

Appendix A - Prudential Indicators

	Prudential Indicators	2017/18 Actual £000	2018/19 Estimate £000	**2018/19 Actual £000**
1	**Capital Expenditure**	1,880	3,743	**2,968**
2	**Ratio of Financing Costs to Net Revenue Stream (external interest – investment income)**	3.38%	3.71%	**3.66%**
3	**Gross Borrowing and the Capital Financing Requirement**			
	Gross Debt	8,514	8,363	**8,363**
	CFR	766	1,592	**1,212**

	Treasury Management Indicators	2017/18 Actual £000	2018/19 Estimate £000	**2018/19 Actual £000**
4	**Authorised Limit for External Debt**			
	Borrowing	15,000	15,000	**15,000**
	Other Long Term Liabilities	2,000	2,000	**2,000**
	Total	17,000	17,000	**17,000**
5	**Operational Boundary for External debt**			
	Borrowing	10,000	10,000	**10,000**
	Other Long Term Liabilities	2,000	2,000	**2,000**
	Total	12,000	12,000	**12,000**
6	**Actual External debt (as at 31 March)**			
	Borrowing	7,800	7,800	**7,800**
	Other Long Term Liabilities	714	563	**563**
	Total	8,514	8,363	**8,363**