APPENDIX A

Annual Treasury Management Report 2018/19

as at 4/6/19 - LT

1. Introduction and Background

This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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).

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 - February 2018)
- a mid year (minimum) treasury update report (Council – December 2018)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition, the Cabinet and Scrutiny (Audit and Value for Money Council Services) Committee has received quarterly treasury management updates as part of the overall financial reporting during the course of the year.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is 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.

This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny of treasury management reports by the Scrutiny (Audit and Value for Money Council Services) Committee before they were reported to the full Council.

2. This Annual Treasury Report Covers

- the council's treasury position as at 31 March 2019;
- the strategy for 2018/19 – a summary;
- Borrowing and Investments outturn
- the economy and interest rates in 2018/19;
- compliance with treasury limits and prudential indicators;
- Other treasury related issues.

3. Treasury Position as at 31 March 2019

The council’s debt and investment portfolio is organized by the financial management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks with all treasury management activities. Procedures and controls to achieve these objectives are well established through member reporting detailed in the introduction, and through officer activity detailed in the council’s treasury management practices.

The council’s treasury portfolio position (excluding borrowing from finance leases) and the average interest rates on the portfolio as at the beginning and end of the year were as follows:

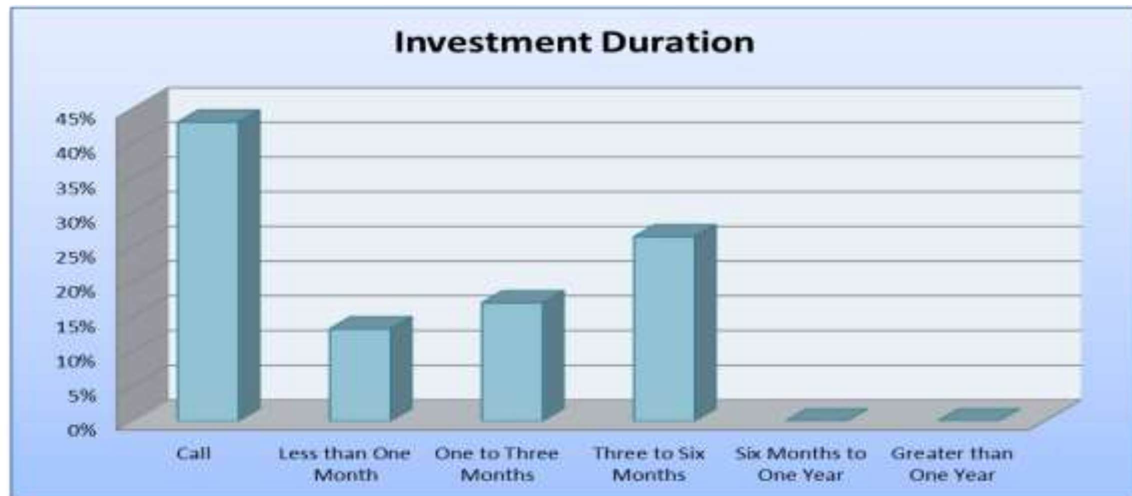
2017/18 Principal	Average Rate		2018/19 Principal	Average Rate
		Borrowing		
£6.4m		- PWLB	£6.3m	
£5.0m		- Market and other	£5.0m	
£11.4m	**5.4%**	**Total Borrowing**	**£11.3m**	**5.4%**
		Investments		
£22.7m	**0.5%**	Core Deposits*	£26.4m	**0.7%**
£0.3m		Cash and Bank	(£0.7)m	
£23.0m		**Total Investments**	**£25.7m**	

**excludes Icelandic deposits*

The maturity structure of the **borrowing** was as follows:-

2017/18 Principal		2018/19 Principal
£0.6m	Under 1 Year	**£0.6m**
£0m	Maturing in 1-2 Years	**£0m**
£0.2m	Maturing in 2-5 Years	**£0.2m**
£6.9m	Maturing in 5-10 Years	**£6.8m**
£3.7m	Maturing in 10-15 Years	**£3.7m**
£0m	Maturing in excess of 15 Years	**£0m**
£11.4m	**Total**	**£11.3m**

The maturity structure of the **investments at 31st March** was as follows:-



4. The Strategy for 2018-19 - Summary

The Treasury Management Strategy Statement and Annual Investment Strategy for 2018/19 was approved by the Council on 26th February 2018.

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. Market investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the Monetary Policy Committee (MPC) would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018.

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. Due to this uncertainty, a low risk approach was adopted with investment balances generally being kept shorter and some balances being placed with UK Government Treasury Bills.

Market investment rates were little changed during August to October but rose sharply after the Monetary Policy Committee (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 market 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.

In line with the strategy, 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.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. Our strategy to continue to reduce the underlying need to borrow is not only delivering savings to the revenue budget, but also means that when some existing borrowing matures it will not need to be replaced.

The capital financing requirement was forecast to continue to fall, with no new expenditure from borrowing planned and both statutory and voluntary reductions reducing the cost of borrowing to the revenue budget.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Finance Team therefore monitored interest rates in financial markets and adopted a pragmatic approach.

5. Borrowing Outturn for 2018/19

5.1 Capital Financing Requirement

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the council's debt position. The CFR results from the capital activity of the council and what resources have been used to pay for the capital spend. It represents unfinanced capital expenditure as at the year end.

The council's CFR is not allowed to rise indefinitely. Statutory controls are in place that require the authority to make an annual revenue charge, called the Minimum Revenue Provision (MRP) to reduce the CFR. This is effectively a repayment of non-housing borrowing.

The Council's 2018/19 MRP policy (as required by MHCLG guidance) was approved as part of the Treasury Management Strategy Statement for 2018/19.
The CFR position is set out in the table below:-

CFR	2018/19 Actual £'000	2017/18 Actual £'000
Opening Balance	**16,896**	**18,595**
Add unfinanced capital expenditure	**-**	**-**
Less MRP	**(402)**	**(417)**
Less Voluntary Debt Repayment	**(125)**	**(729)**
Less finance lease repayments	**(523)**	**(511)**
Change in long term debtors	**(22)**	**(42)**
Closing Balance	**15,824**	**16,896**

This is higher than had originally been anticipated, due to the timing of capital receipts (£3.8m) that have been committed towards reducing the underlying need to borrow. This was reported earlier in the year and the MTFS for 2019/20 has been adjusted to reflect this. Accordingly, the mid-year update estimated that the CFR would be £15.9m as at 31st March 2019.

Overall the CFR has reduced by £1m, which is largely as a result of in year statutory repayments and the decision to repay £0.1m (part of approved £3.8m) of underlying debt from future capital receipts in order to deliver savings to the revenue budget.

The Council's borrowing activity is constrained by affordability, and prudential indicators including the CFR, operational boundary and the authorised limit.

5.2 The Authorised Limit and Operational Boundary

The authorised limit is the "affordable borrowing limit" required by Section 3 of the Local Government Act 2003. 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.

The operational boundary level is set at £17.5m to allow some headroom. Periods where the actual position is either above or below the boundary are acceptable subject to the authorised limit not being breached.

2017/18 £'000	Borrowing Limits and Boundaries	2018/19 £'000
21,500	Authorised Limit	**19,500**
18,500	Operational Boundary	**17,500**
12,779	Gross Borrowing at 31st March (inc, Finance Leases)	**12,194**
11,401	Gross Borrowing at 31st March (excl. Finance leases)	**11,340**
16,896	Capital Financing Requirement	**15,824**

5.3 Short-term Borrowing

It was anticipated that only very limited short-term borrowing would be required to cover temporary cash flow deficits; interest payable would therefore be minimal. This has been the case, with only one occasion for a total of 16 days when short term borrowing was necessary.

5.4 Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. There has not been any restructuring undertaken during 2018/19.

6. Investments Outturn 2018/19

6.1 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 in February 2018. The policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit agencies supplemented by additional market data (such as credit outlooks, credit default swaps, bank share prices).

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

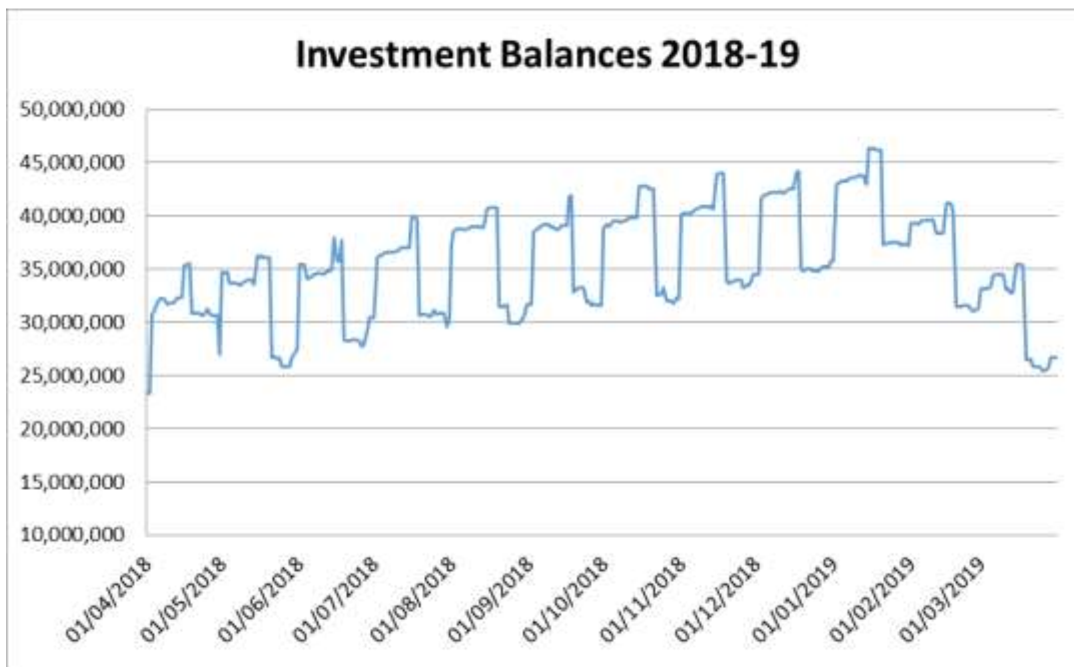
6.2 Investments as at 31st March 2019

The Council's core investments as at 31st March amounted to £26.4m (excluding Icelandic deposits). These balances were, in the main, held within AAA rated Money Market Funds (£10.8m) and fixed term deposits and call accounts amounting to £7.1m have also been placed with a few UK Banks. With the remainder relating to UK Government Treasury Bills (£8.5m). This strategy reflects a continuation of the council's relatively low risk appetite in relation to its investments – particularly in light of the current uncertainty in relation to Brexit.

The Council's Investments as at 31st March 2019 were as follows:

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date
Call Accounts and Money Market Funds				
RBS SIBA	630,673	0.01%		Call
Federated MMF	4,000,000	0.78%		Call
Insight MMF	3,175,000	0.76%		Call
Aberdeen MMF	3,575,000	0.73%		Call
Fixed Deposits:				
Bank of Scotland	500,000	1.00%	06/07/2018	08/07/2019
Bank of Scotland	1,500,000	1.05%	28/09/2018	27/09/2019
Bank of Scotland	500,000	1.00%	08/11/2018	08/05/2019
Lloyds	1,000,000	1.00%	01/06/2018	03/06/2019
UK Treasury Bill	509,000	0.72%	08/10/2018	08/04/2019
UK Treasury Bill	1,000,000	0.72%	05/11/2018	07/05/2019
UK Treasury Bill	1,000,000	0.73%	19/11/2018	20/05/2019
UK Treasury Bill	1,000,000	0.74%	10/12/2018	10/06/2019
UK Treasury Bill	1,000,000	0.73%	14/01/2019	15/07/2019
UK Treasury Bill	1,000,000	0.72%	14/01/2019	15/04/2019
UK Treasury Bill	1,015,000	0.75%	25/02/2019	27/08/2019
UK Treasury Bill	2,000,000	0.77%	04/03/2019	02/09/2019
National Westminster RFB	1,000,000	0.91%	02/10/2018	02/04/2019
National Westminster RFB	1,000,000	0.91%	24/10/2018	26/04/2019
National Westminster RFB	1,000,000	1.04%	17/09/2018	16/09/2019

The chart below illustrates the movement in the level of investments held by the Council throughout the year, with the peak being £46.4m in January and the average being £35.4m.



6.3 Investment Rates

The following table illustrates the rate of return generated by the Council's Investments for 2018/19, which compares favourably with the benchmark returns:

	Average Rate Year to 31/03/19
ESBC	0.72%
3 Month LIBID Rate	0.67%
6 Month LIBID Rate	0.73%
Base Rate	0.67%
Budget	0.50%

**LIBID = London Inter Bank Deposit Rate

The ESBC average return for the year exceeds the base rate and is consistent with other benchmarks.

7. The Economy and Interest Rates

UK. After weak economic growth of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing country in the G7 in quarter 4.

After the Monetary Policy (MPC) Committee raised Bank Rate from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

As for CPI inflation itself, this has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC’s target of 2%.

The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.5%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

Brexit. The government has so far been unable to muster a majority in the Commons over its Brexit deal. It appears unlikely that there would be a Commons majority which would support a disorderly Brexit or revoking article 50, (cancelling Brexit). There would also need to be a long delay if there is no majority for any form of Brexit. If that were to happen, then it increases the

chances of a general election in 2019; this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the strong rate of growth; this rose from 2.2%, (annualised rate) in quarter 1 of 2018 to 4.2% in quarter 2, 3.5% in quarter 3 and then back to 2.2% in quarter 4. The annual rate came in at 2.9% for 2018, just below President Trump's aim for 3% growth. The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.4% in February, a decade high point. However, CPI inflation overall fell to 1.5% in February, a two and a half year low, and looks to be likely to stay around that number in 2019 i.e. below the Fed's target of 2%. The Fed increased rates another 0.25% in December to between 2.25% and 2.50%, this being the fourth increase in 2018 and the ninth in the upward swing cycle. However, the Fed now appears to be edging towards a change of direction and admitting there may be a need to switch to taking action to cut rates over the next two years. Financial markets are now predicting two cuts of 25 bps by the end of 2020.

EUROZONE. The annual rate of growth for 2018 was 1.8% but is expected to fall to possibly around half that rate in 2019. The European Central Bank (ECB) completely ended its programme of quantitative easing purchases of debt in December 2018, which means that the central banks in the US, UK and EU have all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. With its refinancing rate already at 0.0% and the deposit rate at -0.4%, it has probably reached the limit of cutting rates. At its March 2019 meeting it said that it expects to leave interest rates at their present levels "at least through the end of 2019", but that is of little help to boosting growth in the near term. Consequently, it also announced a third round of TLTROs; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Equity markets are currently concerned about the synchronised general weakening of growth in the major economies of the world: they fear there could even be a recession looming up in the US, though this fear is probably overdone.

8. Compliance with Treasury Limits

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators *is shown in Appendix 1.*

9. Other Treasury Matters

a) Icelandic Bank Defaults

This authority currently has the following investments outstanding in Icelandic banks:

Borrower - Icelandic Exposure	Principal (£)	Interest Rate	Start Date	Maturity Date
Singer	285,000	5.41%		08/10/2008

The administrators for Kaupthing, Singer and Friedlander Ltd made one dividend payment during the financial year, with total dividend payments to date of 85.75%. The administration process has now been extended to October 2021.

Appendix 1: Prudential Indicators

PRUDENTIAL INDICATOR	2017/18	2018/19	2018/19
	£'000	£'000	£'000
	Actual outturn	**Original Estimate**	**Actual outturn**
Capital Expenditure **(a)**	**1,832**	**2,479**	**541**
Ratio of financing costs to net revenue stream	**14.07%**	**11.59%**	**12.50%**
Capital Financing Requirement as at 31 March (excluding finance leases) **(b)**	**15,518**	**11,455**	**14,970**
Capital Financing Requirement as at 31 March (including finance leases) **(b)**	**916,896**	**12,303**	**15,824**
External Debt	**12,779**	**12,125**	**12,194**

(a) The original estimate assumed the Leisure spend would take place during 2018/19. It also reflects the timing of capital spend/commitments in relation to grant awards.

(b) The outturn is higher than the original estimate (but close to the mid-year estimate) due to the timing of the capital receipts committed towards the repayment of debt.

PRUDENTIAL INDICATOR	2017/18	2018/19	2018/19
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
	Actual Outturn	**Original**	**Actual Outturn**
Authorised Limit for external debt -			
Borrowing	18,500	16,500	**16,500**
other long term liabilities*	3,000	3,000	**3,000**
TOTAL	**21,500**	**19,500**	**19,500**
Operational Boundary for external debt -			
Borrowing	16,500	15,500	**15,500**
other long term liabilities*	2,000	2,000	**2,000**
TOTAL	**18,500**	**17,500**	**17,500**
Upper limit for fixed rate exposure	9,000	9,000	**9,000**
Upper limit for variable rate exposure	4,000	4,000	**4,000**
Upper limit for total principal sums invested for over 1 year	5,000	5,000	**5,000**

*This provides an allowance for on-balance sheet finance leases, as set out in previous reports.

Maturity structure of fixed rate borrowing during 2018/19	upper limit	lower limit
under 12 months	85%	0%
12 months and within 24 months	85%	0%
24 months and within 5 years	85%	0%
5 years and within 10 years	90%	0%
10 years and above	90%	0%