Treasury Management Outturn Report 2018/19

Introduction

The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve a treasury management annual report after the end of each financial year.

This report fulfils the Councils legal obligation to have regard to the CIPFA Code.

The Council's treasury management strategy for 2018/19 was approved at a meeting of the Authority on 22nd February 2018. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

External Context

Economic commentary 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.

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.

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.

Financial markets: 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.

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. World trade growth 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.

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.

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.

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.

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.

Local Context

On 31st March 2019, the Authority had net borrowing of £82m arising from its revenue and capital income and expenditure, a decrease on 2018 of £3.2m. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors and the year-on-year change are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.18 Actual £000	**2018/19 Movement £000**	**31.3.19 Actual £000**
General Fund CFR	15,143	(232)	14,911
HRA CFR	132,343	(1,985)	130,358
Total	**147,486**	**(2,217)**	**145,269**
Less: Usable reserves	(51,440)	664	(50,776)
Less: Working capital	(11,103)	(1,601)	(12,704)
Net borrowing	**84,943**	**(3,154)**	**81,789**

Net borrowing has decreased due to a fall in the CFR as new capital expenditure was lower than the financing applied including minimum revenue provision; together with a rise in working capital due to the timing of receipts and payments.

The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 31st March 2019 and the year-on-year change in show in table 2 below.

Table 2: Treasury Management Summary

	31.3.18 Balance £000	**2018/19 Movement £000**	**31.3.19 Balance £000**	**31.3.19 Rate %**
Long-term borrowing	131,303	(1,967)	129,336	
Short-term borrowing	0	0	0	
Total borrowing	**131,303**	**(1,967)**	**129,336**	**3.73**
Long-term investments	0	0	0	
Short-term investments	20,238	(7,324)	27,562	

Cash and cash equivalents	26,122	6,137	19,985	
Total investments	**46,360**	**(1,187)**	**47,547**	**0.85**
Net borrowing	**84,943**	**(3,154)**	**81,789**	

Borrowing Activity

At 31st March 2019, the Authority held £129m of loans, a decrease of £2m on the previous year, as part of its strategy for funding previous years' capital programmes. The year-end borrowing position and the year-on-year change in show in table 3 below.

Table 3: Borrowing Position

	31.3.18 Balance £m	**2018/19 Movement £m**	**31.3.19 Balance £m**	**31.3.19 Rate %**	**31.3.19 Average maturity years**
Public Works Loan Board	131,302	(1,966)	129,336	3.73	28 years
Local Authorities (short term)	0	0	0		
Other	1	1	0		
Total borrowing	**131,303**	**(1,967)**	**129,336**		

The Authority'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.

In furtherance of these objectives, no new external borrowing was undertaken in 2018/19, while existing loans were allowed to mature without replacement. This strategy enabled the Authority to reduce net borrowing costs and reduce overall treasury risk.

The “cost of carry” analysis performed by the Authority’s treasury management advisor Arlingclose did not indicate any value in borrowing in advance for future years’ planned expenditure and therefore none was taken.

Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19, the Authority’s investment balance ranged between £44m and £61m million due to timing differences between income and expenditure. The year-end investment position and the year-on-year change in show in table 4 below.

Table 4: Investment Position

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m	31.3.19 Rate %	31.3.19 Average maturity years
Banks & building societies (unsecured)	12.0	(3.0)	9.0	0.95	<1 year
Government (incl. local authorities)	13.2	5.8	19.0	0.87	<1 year
Money Market Funds	21.1	(1.6)	19.5	0.76	<1year
Total investments	**46.3**	**1.2**	**47.5**		

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority’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.

In furtherance of these objectives, the Authority continued to increase deposits into more secure asset classes during 2018/19, particularly deposits with other Local Authorities. As a result investment risk was lowered.

Other Non-Treasury Holdings and Activity

Although not classed as treasury management activities, the 2017 CIPFA Code now requires the Authority to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and regeneration purposes as well as commercial investments which are made mainly for financial reasons. The Authority holds £48m of directly owned investment property and land. This represents an increase of £1m on the previous year due to revaluation gains. The Authority also holds a £200,000 loan to the Derbyshire Building Control Partnership that commenced in March 2018.

Performance Report

The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget, as shown in table 6 below.

Table 6: Performance

	Actual £000	Budget £000	Over/ under
Total investment income	(418)	(355)	(63)
Total debt expense	5,035	5,035	0
GRAND TOTAL	4,617	4,680	(63)

Compliance Report

The Chief Finance Officer is pleased to report that all treasury management activities undertaken during 2018/19 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Table 7: Investment Limits

	2018/19 Maximum	31.3.19 Actual	2018/19 Limit	Complied
Any single organisation	**£5m**	**£5m**	**£5m**	✓

Any group of funds under the same management	**£7.5m**	**£5m**	**£7.5m**	✓
Enhanced Money Market Funds	**£10m**	**£9.6m**	**£10m**	✓

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

Table 8: Debt Limits

	2018/19 Maximum £000	**31.3.19 Actual £000**	**2018/19 Operational Boundary £000**	**2018/19 Authorised Limit £000**	**Complied**
Borrowing	**£131,303**	**£129,336**	**£138,330**	**£147,970**	✓

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt was below the operational boundary for the whole of 2018/19.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed was:

	31.3.19 Actual	**2018/19 Limit**	**Complied**
Upper limit on fixed interest rate exposure	£129m	£135m	✓
Upper limit on variable interest rate exposure	£48m	£60m	✓

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	31.3.19 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	2%	10%	0%	✓
12 months and within 24 months	2%	10%	0%	✓
24 months and within 5 years	6%	10%	0%	✓
5 years and within 10 years	10%	20%	0%	✓
10 years and within 25 years	47%	50%	20%	✓
25 years and above	33%	70%	20%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

	2018/19	2019/20	2020/21
Actual principal invested > 364 days	£0	£0	£0
Limit on principal invested > 364 days	£5m	£3m	£0m
Complied	✓	✓	✓