Report to: **Policy and Resources Committee, 31st July 2019**

Report of: **Head of Finance**

Subject: TREASURY MANAGEMENT ANNUAL REPORT – 2018/19

1. Recommendation

1.1 That Policy and Resources Committee note the details included within the Treasury Management Annual Report for 2018/19; and

1.2 That the Treasury Management Annual Report for 2018/19 is referred to full Council for information, in accordance with the CIPFA Treasury Management Code.

2. Background

2.1 In February 2010 the Council formally 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 treasury management semi-annual and annual reports.

2.2 The Council's treasury management strategy for 2018/19 was approved by the Policy and Resources Committee on 12th December 2017. The Authority has borrowed and 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 remains central to the Council's treasury management strategy.

2.3 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 edition (the CIPFA code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. The report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3. The Council's Treasury Management Performance in 2018/19

INVESTMENTS

3.1 The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The Council invests its short-term core cash for a range of periods from overnight to 365 days, dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

3.2 The Council currently invests in four types of instrument - Fixed Term Deposits, Instant Access Deposits, Certificates of Deposit and Money Market Funds. On advice from our treasury advisors we do not currently invest with Building Societies. The Council plans to continue to invest mainly in Money Market Funds and with other Local Authorities during 2019/20 as these both offer high levels of security and provide competitive rates of return. The Council diversified its portfolio at the end of April 2018 by placing a £3m longer-term investment with the CCLA Property Fund with a recommended time horizon of greater than 5 years.

3.3 The Council's average investment for the year was £1.9m per transaction (2017/18: £1.9m). The annual return earned on short-term investments was 0.71% (2017/18: 0.54%) which is approximately 0.07% below the benchmark average 3 month LIBOR (London Inter Bank Offer Rate) for the year which was 0.78%. The bank base rate began the year at 0.50% and then rose to 0.75% in August 2018. The longer-term Property Fund investment achieved an annual return of 4.07%.

3.4 The Council achieved £117,361 of interest from its short-term investments in 2018/19 (2017/18: £87,280) and £111,816 from its long-term investment (2017/18: nil).

3.5 It should be noted that the return on investments has been severely suppressed for the past ten years. For comparison, in 2007/08 the interest rate was in excess of 5% and the interest earned was £727,000. This is in main due to the economic crash of 2008/09 and the effect of the government scheme called 'Funding for Lending' launched in July 2012 and ending early last year. This caused a flood of cheap credit to be made available to banks which then resulted in investment rates falling further. These rates continued at very low levels during 2018/19 as banks continued to strengthen their balance sheet positions in response to the European banking regulation Basel III causing their appetite for cash to remain low. Further background on the economic conditions in 2018/19 is contained in **Appendix 1**.

3.6 **Tables 1 to 5** below provide further details on our investments and our lending portfolio as at 31st March 2019. Further detail on performance against budget can be found within the Q4 Financial Monitoring report 2018/19.

Table 1: Summary of Interest Received 2018/19

	Interest Received £
Short Term investment interest received in year (cash)	72,254
Short-Term investment interest to be received in 19/20 relating to 18/19 (accrual)	45,107
Total Short-Term investment interest received	**117,361**
Long-Term investment interest received	111,816
Total investment interest received	**229,177**

Table 2: Investment Balances 2018/19

	Investment Balances
Total Investment balance as at 1st April 2018	10.8
Short-Term periodic investments made in year	59.8
Short-Term investments matured in year	(56.2)
Total Short-Term investments as at 31st March 2019	**14.4**
Long-Term investments made in year	3.0
Total investment balance as at 31st March 2019	**17.4**

Table 3: External Lending Investment Portfolio as at 31st March 2019

Borrower	Issue Date	Maturity Date	Investment £m	Interest Rate
Lancashire County Council	01/10/18	01/04/19	2.0	0.90%
Santander UK	28/03/19	04/04/19	1.9	0.40%
HSBC	29/03/19	04/04/19	1.7	0.60%
Blackpool Borough Council	24/09/18	24/04/19	2.0	0.65%
Eastleigh Borough Council	09/05/18	08/05/19	2.0	0.85%
Federated Investors	07/11/18	17/06/19	2.8	0.78%
Cherwell District Council	09/07/18	08/07/19	2.0	0.81%
Sub-Total			**14.4**	
CCLA Property Fund	28/04/18	TBC	3.0	4.07%
Total			**17.4**	

Table 4: Investment Limits

	2018/19 Max. amount placed per Institute	**31.03.19 Actual per Institute**	**2018/19 Limit per Institute**	**Complied**
DMO or UK Treasury Bills	Not used	Nil	No limit	√
Corporate Bonds	Not used	Nil	£3m	√
UK Local Authority	£2m	£2.0m x 4	£3m	√
Term Deposits with Banks	£1.5m	Nil	£3m	√
Certificates of Deposit with Banks	£2m	Nil	£3m	√
Call and Notice Accounts with Banks	£2.5m	£1.7m, £1.9m	£3m	√
Banks nationalised or part-nationalised by UK Government	Not used	Nil	£3m	√
Floating Rates Notes with Banks	Not used	Nil	£3m	√
Money Market Funds	£2.8m	£2.8m	£3m	√

Property Funds	£3m	£3m	£5m	√

The Head of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Strategy.

Table 5: Investment Benchmarking

	Credit Score	Credit Rating	Bail-in exposure	Weighted Average Maturity (days)	Average Rate of Return %
Worcester City 31.03.2018	5.12	A+	100%	42	0.49%
Worcester City 31.03.2019	4.13	AA-	44%	24	1.27%
Similar LAs	4.13	AA-	53%	86	1.75%
All LAs	4.20	AA-	55%	29	1.45%

3.7 As can be seen from the table above, the Council has been able to reduce credit risk and bank bail-in exposure within the past year by focusing its investments more towards other Local Authorities and AAA-rated Money Market Funds rather than High Street banks.

3.8 In addition, £3m of the Council's investments are now held in an externally-managed strategic pooled Property Fund where short-term security and liquidity are lesser considerations and the objectives instead are regular revenue income and long-term price stability. This has enabled the Council to raise its average rate of return more in line with similar LAs. Because this fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. Investments such as these are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a five-year period total returns will exceed cash interest rates.

3.9 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), 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 our account with the Debt Management Account Deposit Facility (DMADF) remained available for use in an emergency.

EXTERNAL BORROWING

3.10 As at 31st March 2019 the Council's external loans are a £5m Lender Option Borrower Option (LOBO) loan and £2.294m of Public Works Loans Board (PWLB) loans. The LOBO was taken on for a period of 50 years from the 3rd December 2004.

3.11 The Council has approved a strategy for the replacement of the LOBO loan in the event that the lender exercises their option and increases the interest rate. The agreed action, in this event, is to replace the loan with a shorter dated loan and keep the rate as low as possible bearing in mind the Financing Requirement contained in the Council's Treasury Management Strategy (Prudential Borrowing Limits).

3.12 The interest payable in 2018/19 on existing loans was £340k (2017/18: £359k). This decrease was due to the maturity of two small PWLB loans part way through the year. The lender of our £5m LOBO loan did not exercise their right to increase the rate from the current 4.50% at any point during the year and the likelihood of this occurring remains extremely low in the current interest rate environment.

3.13 The Council did not raise any new external borrowing during 2018/19. The Council's approval for the building of Perdiswell Swimming Pool was for funding of £10.4m which included external borrowing of £6.2m. To date the Council's financial position has not necessitated taking this external borrowing out due to holding sufficient levels of reserves, provisions and working capital (known as internal borrowing). This is the most prudent approach and the Council will only consider externally borrowing and incurring interest costs when absolutely necessary.

3.14 The long-term interest rates on offer are monitored on a daily basis and should further spend be committed with regard to the recently approved Property Development Fund then appropriate external borrowing may be enacted to ensure that the Council secures funding at a competitive rate.

4. Treasury Management Performance Indicators

4.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

4.2 Performance on our key Treasury Management Performance Indicators for 2018/19 is as follows:

Performance Indicator	**Benchmark/ Budget**	**Outturn**
Average rate of return on short-term investments	0.55% in MTFF	0.71%
Investment management costs per average sum invested	£1.08 per £'000	£1.08 per £'000
Annual cost of borrowing (including minimum revenue provision)	£981,890	£780,677
FTE staff involved in Treasury Management function	0.48 FTE	0.48 FTE

5. Prudential Indicators

5.1 The purpose of the indicators is to provide a framework to support decision making on capital expenditure and treasury investments. The indicators highlight the level of capital expenditure, the impact on borrowing, investment levels, and the overall controls in place to ensure the activity remains affordable, prudent and sustainable. Details of the indicators are included below.

Budgeted and Actual Capital Expenditure

5.2 The budgeted and actual capital expenditure (CapEx) for 2018/19 was as follows:

Actual CapEx 2017/18 £'m	Budget CapEx 2018/19 £'m	Actual CapEx 2018/19 £'m
3.511	7.210	4.073

5.3 The original capital programme budget for 2018/19 was £2.428m. However this was adjusted to reflect in-year additions and re-profiled budgets carried forward from 2017/18 to the value of £4.782m. Further detail on capital expenditure is included in the Q4 Financial Monitoring report 2018/19 and the Statement of Accounts 2018/19.

Ratio of Financing Costs to net revenue stream

5.4 The net revenue stream is the amount of the budget to be met from Formula Grant and Council Tax income (also known as the Budget Requirement). Financing cost is the net of interest payable, interest receivable and minimum revenue provision.

	2017/18 Actuals £000's	2018/19 Budget £000's	2018/19 Actuals £000's	2019/20 Budget £000's
Financing costs (net)	697	603	394	565
Net revenue stream	11,283	11,784	11,716	11,020
Ratio of financing costs to net revenue stream	6.18%	5.12%	3.36%	5.13%

Ratio of Financing Costs to gross expenditure

5.5 Gross expenditure is shown to demonstrate the proportion of our financing costs compared to our total expenditure.

	2017/18 Actuals £000's	2018/19 Budget £000's	2018/19 Actuals £000's	2019/20 Budget £000's
Financing costs (net)	697	603	394	565
Gross expenditure	21,842	22,879	23,859	22,858
Ratio of financing costs to gross expenditure	3.19%	2.64%	1.65%	2.47%

Capital Financing Requirement

5.6 The Capital Financing Requirement is a gauge of the Council's requirement to take on long term borrowing for capital purposes. This is calculated from the draft Balance Sheet for 2018/19, which was approved by the Council's Section 151 officer before the deadline date of 31st May 2019, and which is subject to independent audit. The actual Capital Financing Requirement at 31 March 2019 (again subject to audit) and estimates for future years are:

	2017/18 Actuals £000's	2018/19 PI/Budget £000's	2018/19 Actuals £000's	2019/20 Estimate £000's
Capital Financing Requirement	11,502	11,218	11,230	21,911

The CFR rises significantly in 2019-20 due to the acquisition of a property which is part of the aforementioned £30m Property Development Fund.

Minimum Revenue Provision

5.7 The Minimum Revenue Provision (MRP) represents a charge to Council Tax payer's equivalent to the estimated repayment of prudential borrowing associated with the purchase of capital assets (i.e. reducing the loan principal in instalments).

5.8 The MRP charge for 2018/19 was £440k (2017/18: £472k) against a budget of £438k.

Authorised Limit/Operational Limit for External debt

5.9 The Council approved the Authorised Limit in 2018/19 for external debt at £33.0m. The approved Operational Limit was £27.3m. The Operational Limit is calculated on the same basis as the Authorised Limit, but differs in that it excludes short term borrowing.

5.10 The Council's external debt as at 31st March 2019 is £7.294m which is within the limits set in the Treasury Management Strategy.

Ward(s): **All**
Contact Officer: **Mark Baldwin, Head of Finance**
Tel: 01905 722007
e-mail: mark.baldwin@worcester.gov.uk

Appendix 1

Treasury Management Annual Report
Background information from our Treasury advisors; Arlingclose

Economic Background for 2018/19

I. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year on 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%.

II. 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.

III. 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 a avoid a no-deal scenario. Recent talks between 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.

IV. 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 market 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.

V. In February, Fitch put the UK AA sovereign long-term rating on Rating Watch Negative as a result of Brexit uncertainty, following this move 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 its senior unsecured debt and deposits.