Cherwell District Council

Accounts, Audit & Risk Committee

31 July 2019

2018/19 Treasury Management Annual Report

Report of the Executive Director: Finance (Interim)

This report is public

Purpose of report

This report presents information on treasury management performance and compliance with treasury management policy during 2018/19 as required by the Treasury Management Code of Practice.

1.0 Recommendations

The meeting is recommended:

1.1 To note the contents of this report in line with the Treasury Management Strategy.

2.0 Introduction

2.1 In 2012 the Council 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 full Council 26 February 2018. The Council 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. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

2.4 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments.

The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 25 February 2019.

3.0 External Context – see Appendix 1

3.1 A detailed economic commentary provided by our Treasury advisers, Arlingclose, as at 31 March 2019 can be found at Appendix 1.

4.0 Local Context

4.1 On 31 March 2019, the Council had net borrowing of £95.7m (2018 £92.4m) arising from its revenue and capital income and expenditure. 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 are summarised in Table 1 below:

Table 1: Balance Sheet Summary

	31.3.19 Actual £m
General Fund CFR / Borrowing CFR	**146.2**
Less: Usable reserves	(21.4)
Less: Working capital	(28.7)
Net borrowing / (investments)	**95.7**

4.2 The Council's strategy was to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

4.3 The treasury management position as at 31 March 2019 and the year-on-year change is shown in table 2 below.

Table 2: Treasury Management Summary

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m	2018/19 Rate %
Long-term borrowing	-21.0	-47.0	-68.0	2.02
Short-term borrowing	-90.5	47.5	-43.0	0.85
Total borrowing	**-111.5**	**0.5**	**-111.0**	**1.39**
Long-term investments	0	0	0	-
Short-term investments	7.0	-1.0	6.0	0.45
Cash and cash equivalents	12.1	-2.8	9.3	0.61
Total investments	**19.1**	**-3.8**	**15.3**	**0.50**
Net (borrowing) / investments	**-92.4**	**-3.3**	**-95.7**	

Note: the figures in the table are principle amounts and do not include accrued interest, therefore differ from those shown in the statement of accounts.

5.0 Borrowing Activity

5.1 At 31 March 2019, the Council held £111m of loans as part of its strategy for funding previous and current years' capital programmes. The year-end borrowing position and the year-on-year change is shown 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 WAM* years
Public Works Loan Board	21.0	20.0	41.0	2.21	15.5
Local authorities (long-term)	0	27.0	27.0	1.28	2.0
Local authorities (short-term)	90.5	-47.5	43.0	1.11	0.8
Total borrowing	**111.5**	**-0.5**	**111.0**	**1.54**	**5.1**

*Weighted average maturity

5.2 The Council'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 Council's long-term plans change being a secondary objective.

5.3 In keeping with these objectives, new borrowing was kept to a minimum in 2018/19. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.4 The Council has an increasing CFR due to the capital programme and an estimated borrowing requirement which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, it was decided to take a higher proportion of medium/longer-term fixed rate loans, to provide some certainty and stability to the debt portfolio.

6.0 Treasury Investment Activity

6.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19, the Council's investment balance ranged between £7.3m and £39.5 million due to timing differences between income and expenditure. The year-end investment position and the year-on-year change is shown in table 4 below.

Table 4: Investment Position (Treasury Investments)

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m	31.3.19 Rate %
Banks & building societies	2.6	0.9	3.5	0.98
UK Government	7.0	-4.0	3.0	0.50
Money Market Funds	9.5	-0.7	8.8	0.75
Total investments	**19.1**	**-3.8**	**15.3**	**0.74**

6.2 Both the CIPFA Code and government guidance require the Council 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 Council'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.

6.3 As only a relatively low level of investment balances is held, and invested for shorter durations, the interest rates achieved are lower than could otherwise be expected. The type of investments during the year is constantly monitored and adjusted to reflect market conditions and cashflow requirements.

7.0 Financial Implications

7.1 The outturn for debt interest paid in 2018/19 was £1.325m on an average debt portfolio of £95.3m at an average interest rate of 1.39%, against a budgeted £2.074m debt interest payable.

7.2 The outturn for treasury investment income received in 2018/19 was £90.9k on an average credit portfolio of £18.2m at an average interest rate of 0.50%, against a budgeted £42k investment income receivable.

8.0 Non-Treasury Investments

8.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

8.2 These non-treasury investments are not financially motivated, and contribute to the Council's service delivery and regeneration objectives.

8.3 However, they do generate additional investment income for the Council, at a higher rate of return of than earned on treasury investments, reflecting the longer term nature and/or additional risks to the Council of holding such investments.

8.4 As at 31 March 2019 the Council held the following non-treasury investments:

- Graven Hill equity £21.7m
- Graven Hill loans £38.8m
- Crown House equity £1.1m
- Crown House loans £8.0m
- Silverstone Heritage loan £1.0m
- Other external loans (total) £0.3m

8.5 The total interest earned on the above loans in 2018/19 was £3.3m.

9.0 Performance Report

9.1 The Council measures the financial performance of its treasury management activities in terms of its impact on the revenue budget, as shown in table 5 below.

Table 5: Performance

	Actual £k	Budget £k	Over/ Under	Actual %	Budget %	Over/under %
Total debt interest payable	(2,074)	(1,325)	749	1.39	1.66	0.27
Total investment interest receivable	42	90	48	0.50	0.35	0.15
GRAND TOTAL	**(2,032)**	**(1,235)**	**797**	**n/a**	**n/a**	**n/a**

10.0 Compliance Report

10.1 The Executive Director of Finance (Interim) is pleased to report that all treasury management activities undertaken during 2018/19 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

10.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

Table 6: Debt Limits

	2018/19 Maximum £m	31.3.19 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied
Borrowing / Total debt	116.5	111.0	205	225	✓

10.3 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 did not exceed the operational boundary during 2018/19.

Table 7: Investment Limits

	2018/19 Maximum £m	31.3.19 Actual £m	2018/19 Limit £m	Complied
Any single organisation, except the UK Central Government	6.6	4.7	10	✓
Any group of organisations under the same ownership	6.6	4.7	10	✓
Any group of pooled funds under the same management	6.6	4.7	10	✓
Negotiable instruments held in a broker's nominee account	0	0	10	✓
Foreign countries	0	0	10	✓

Registered Providers	0	0	10	✓
Unsecured investments with Building Societies	0	0	10	✓
Loans to unrated corporates	0	0	10	✓
Money Market Funds (total)	11.6	8.8	15	✓

11.0 Treasury Management Indicators

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

11.2 **Interest Rate Exposures**: This indicator is set to control the Council’s exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of principal borrowed was:

	31.3.19 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate exposure	66%	100%	✓
Upper limit on variable interest rate exposure	34%	100%	✓

11.3 Fixed rate investments 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.

11.4 **Maturity Structure of Borrowing**: This indicator is set to control the Council’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	39%	100%	0%	✓
12 months and within 24 months	24%	100%	0%	✓
24 months and within 5 years	-	100%	0%	✓
5 years and within 10 years	28%	100%	0%	✓
10 years and above	9%	100%	0%	✓

11.5 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.

11.6 **Principal Sums Invested for Periods Longer than 364 days**: The purpose of this indicator is to control the Council’s exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2018/19 £m	2019/20 £m	2020/21 £m
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	5	5	5
Complied	✓	✓	✓

12.0 Conclusion and Reasons for Recommendations

12.1 The annual treasury report is a requirement of the Council's reporting procedures. It covers the treasury activity during 2018/19, including performance against budget and compliance with Indicators.

13.0 Alternative Options and Reasons for Rejection

13.1 This report illustrates the Council's Treasury performance for 2018/19 against budget and includes the Annual Treasury Report for 2018/19.

The following options have been identified. The approach in the recommendations is believed to be the best way forward:

Option One To review current performance levels, and consider any actions arising.

Option Two To approve or reject the recommendations above or request that Officers provide additional information.

14.0 Implications

Financial and Resource Implications

14.1 There are no specific financial effects arising directly from this report.

Comments checked by:
Dominic Oakeshott, Assistant Director - Finance (Interim)
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Legal Implications

14.2 There are no legal implications arising directly from any outcome of this report.

Comments checked by:
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Risk management

14.3 There are no risk implications arising directly from any outcome of this report. All projects maintain their own risk registers and these are monitored corporately.

Comments checked by:
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15.0 Decision Information

Wards Affected

All

Links to Corporate Plan and Policy Framework

All

Lead Councillor

Councillor Tony Ilott – Lead Member for Financial Management and Governance

Document Information

Appendix No	Title
Appendix 1	Arlingclose economic background report
Background Papers	
None	
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Appendix 1

External Context (provided by Arlingclose – April 2019)

Economic background: After spiking at over $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/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%.

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.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

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: December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

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. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which 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. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

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.