**Annexe B**

# TREASURY MANAGEMENT ANNUAL REPORT 2018/19

## 1 INTRODUCTION

1.1 This Council is required by 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 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 the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council Feb 2018)
- a mid-year (minimum) treasury update report (Council Feb 2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

## 2 SUPPORTING INFORMATION

**<u>Current Treasury Position</u>**

2.1 At the beginning and the end of 2018/19 the Council's treasury position (excluding borrowing by PFI and finance leases) was as follows:

*Table 1 – Treasury Position 31/03/19*

| Treasury Position | At 31 March 2019 | | At 31 March 2018 | |
|---|---|---|---|---|
| | Principal | Average Rate | Principal | Average Rate |
| Fixed Interest Borrowing | | | | |
| Short Term Market Loans | £35.000m | 0.97% | £30.000m | 0.57% |
| Long-Term PWLB | £80.000m | 2.30% | £70.000m | 2.32% |
| Variable Interest Borrowing | - | | - | |
| **Total Borrowing** | **£115.000m** | | **£100.000m** | |
| Fixed Interest Investments | - | | - | |
| Variable Interest Investments (MMF) | £14.850m | 0.61% | £16.994m | 0.29% |
| **Total Investments** | **£14.850m** | | **£16.994m** | |
| **Net borrowing position** | **£100.150m** | | **£83.006m** | |

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## Capital Expenditure and Financing

2.2 The Council undertakes capital expenditure on long term assets. These activities may either be funded immediately through capital receipts or capital grants or contributions, or if insufficient financing is available financed through borrowing. The actual capital expenditure forms one of the required prudential indicators and the table below shows how this was financed in 2017/18. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources, and is shown below in Table 2.

*Table 2 Financing of Capital Programme 2017/18*

| | **£'000** |
|---|---:|
| **Expenditure** | |
| Capital Programme | **63,475** |
| | |
| **Financed by** | |
| Capital Receipts | 7,048 |
| Community Infrastructure Levy | 8,480 |
| Government Grants/Contributions | 11,908 |
| S106 Contributions | 3,328 |
| Capital Financing Requirement | 32,711 |
| **Total** | **63,475** |
| | |

## The Strategy for 2018/19

### Investment Strategy and control of interest rate risk

2.3 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.

2.4 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. 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.

2.5 This authority does not have sufficient cash balances to be able to place deposits for more than a month so as to earn higher rates from longer deposits. However, when Bank Rate went up in August, its investment returns also improved from deposits held in Money Market Funds.

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**Borrowing Strategy and control of interest rate risk**

2.6 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. However, this was kept under review to avoid incurring higher borrowing costs in the future when the authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

2.7 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 risks

- if it had been felt that there was a significant risk of a sharp fall in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
- 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.

2.8 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 around 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.

**<u>Investment Outturn</u>**

2.9 the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council. 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, bank share prices etc.).

2.10 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties. Given the net borrowing position of the Council investments are managed through the use of AAA Money Market Funds (MMF) offering immediate liquidity and the highest security whilst offering a yield equivalent to 7-day rates. The Council also invests in in MMF that offers a slightly higher return with the proviso that funds are available on a +1 day basis – i.e. funds withdrawn today will be received tomorrow – this has enabled the Council to increase its investment yield without adding any security or liquidity risk. The average rate on investments was 0.61% on an average balance of £19.8m, representing a 10 basis points out-performance on the 7-Day LIBID benchmark (0.51%).

**Borrowing Outturn**

2.11 The following loans were entered into during the year.

*Table 3 – Borrowing undertaken in year*

| **Lender** | **Principal** | **Type** | **Interest Rate** | **Maturity** |
|---|---|---|---|---|
| PWLB | £10m | Fixed | 2.14% | 10 Years |
| Derby CC | £5m | Fixed | 0.60% | 184 days |
| St Helens Council | £5m | Fixed | 0.90% | 273 days |
| Durham CC | £5m | Fixed | 0.90% | 245 days |
| Somerset CC | £3m | Fixed | 0.95% | 182 days |
| South Derbyshire | £2m | Fixed | 0.90% | 182 days |
| Somerset CC | £5m | Fixed | 1.00% | 181 days |
| Barnsley MBC | £5m | Fixed | 1.00% | 182 days |
| Greater London Authority | £4m | Fixed | 1.07% | 273 days |
| London Borough of Brent | £4m | Fixed | 1.00% | 270 days |
| Rugby Council | £2m | Fixed | 1.03% | 273 days |

**Net Treasury Outturn**

2.12 The Council budget for net borrowing costs of £4.4m – reflects the borrowing costs for the Council's Commercial Property Investment Strategy and the impact of the significant Capital Programmes in 2016/17 and 2017/18 (namely the Coral Reef Refurb and Binfield Learning Village) alongside the 2018/19 Capital Programme and the use of reserves to balance the revenue budget. In order to minimise costs, internally generated cash flows were used before borrowing which resulted in lower borrowing costs than envisaged.

2.13 Furthermore higher than anticipated cash balances at the beginning of the year enabled the Council to pre-pay pension contributions enabling the Council to once again take benefit from the discount offered by the Pension Authority. This generated additional savings of £300k. The Council also formalised the loan with Downshire Homes Limited (DHL) – moving from the previously agreed 1-Year rate to a longer term 25-Year rate that provided DHL and the Council with greater certainty. This had not been previously built into the original budget and added another £400k of income.

2.14 In addition to this as a result of higher than anticipated capital income (particularly CIL) and a more delayed cash-outflow on the major capital schemes, the level of borrowing is below that estimated in the budget. In particular the Council gained significant additional income from the inclusion in the Business Rates Pilot and the one-off settlement with HMRC with regard to VAT on leisure income. Taken together with maximising the use of grants and other internal cash flow the actual level of borrowing costs in 2018/19 was £3.3m less than anticipated.

2.15 Approximately £1.5m will be of an ongoing nature and was offered up as a saving as part of the 2019/20 Budget round. Further savings may accrue as interest rates continue to be held at significantly low levels and the Council benefits from a further (unexpected) year within the Business Rates Pilot and the continued housing development in the Borough generates higher than anticipated CIL and S106 contributions

**Compliance with Treasury Limits**

2.16 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement.

2.17 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR) and is set out below. The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources This includes PFI and finance lease schemes on the balance sheet, which increases the Council's borrowing need however no borrowing is actually required against these schemes as a borrowing facility is included in the contract.

| | **2018/19** |
|---|---|
| | £'000 |
| **Opening Capital Financing Requirement** | 187,029 |
| | |
| **Capital Investment** | |
| Gross Capital Expenditure | 63,475 |
| | |
| **Sources of Finance** | |
| Capital Receipts | -7,048 |
| Government Grants and Other Contributions | |
| CIL | -8,480 |
| Grants and contributions | -11,908 |
| S106 | -3,328 |
| Waste PFI Donated Asset Account | -89 |
| MRP | -1,798 |
| | -32,651 |
| **Closing Capital Financing Requirement** | **217,853** |

1.1 The outturn for the remaining Prudential Indicators are as follows

| **Authorised limit** | **2018/19 Estimate** | **2018/19 Out-turn** |
|---|---|---|
| Borrowing | £250m | £250m |
| Other long term liabilities | £16m | £16m |
| Total | £266m | £266m |

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| **Operational Boundary** | **2018/19 Estimate** | **2018/19 Out-turn** |
|---|---|---|
| Borrowing | £235m | £235m |
| Other long term liabilities | £15m | £15m |
| Total | £250m | £250m |

The Council has complied with all of the relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

**Annexe E**

## Virements between Departments

| Total | Explanation |
|---|---|
| **£'000** | |
| | **Central** |
| -190 | A final review of the DSB budgets has taken place between the Delivery and Central directorates to align budgets to the correct directorate following the restructure. As such, a virement of £0.190m is to be made into Delivery from Central to reflect the current staffing structures in place. |
| -31 | Revenue contribution for the purchase of software relating to the Agresso financial system. |
| | **Delivery** |
| 190 | A final review of the DSB budgets has taken place between the Delivery and Central directorates to align budgets to the correct directorate following the restructure. As such, a virement of £0.190m is to be made into Delivery from Central to reflect the current staffing structures in place. |
| -322 | Following the purchase of a commercial properties in Southampton, a budget for associated rental income has been transferred into Resources from Council Wide Items. |
| 454 | Centralisation of the Business Intelligence Team into Delivery |
| 20 | Funding for Home to School Transport provisions agreed under exceptional circumstances will be transferred to the Delivery Directorate where transportation is arranged, in order to increase efficiency by removing the need for expenditure transfers between Directorates. |
| | **People** |
| -454 | Centralisation of the Business Intelligence Team into Delivery |
| -20 | Funding for Home to School Transport provisions agreed under exceptional circumstances will be transferred to the Delivery Directorate where transportation is arranged, in order to increase efficiency by removing the need for expenditure transfers between Directorates. |
| | **Non-Departmental / Council Wide** |
| 322 | Following the purchase of a commercial property in Northampton, a budget for associated rental income has been transferred into Delivery from Council Wide Items. |
| 31 | Revenue contribution for the purchase of software relating to the Agresso financial system. |
| **0** | **Total Virements** |

**Annexe E**

## Departmental Virements over £50,000

| Debit | Credit | Explanation |
|---|---|---|
| **£'000** | **£'000** | |
| | | **Central** |
| | | The Devolved Staffing Budgets (DSB) have then been realigned to reflect in year staff turnover and amendments to staffing structures |
| | -13 | **Director: Finance** |
| 2 | | **Chief Executive** |
| | | **Director: Organisational Development, Transformation & HR** |
| 12 | | Human Resources |
| 23 | | Organisational Development |
| | -12 | Performance & Partnerships |
| | -16 | Communications |
| | | **Director: Place, Planning & Regeneration** |
| | -36 | Town Centre Regeneration |
| 67 | | Parks Open Space & Countryside |
| 129 | | Director (MVF) |
| | -155 | Head of Planning |
| | -56 | Building Control & Land Charges |
| | -24 | Monitoring Streetworks |
| | -7 | Transport Engineering |
| 86 | | Development & Adoptions |
| **319** | **-319** | **Total** |
| | | **Delivery** |
| | | The Devolved Staffing Budgets (DSB) have then been realigned to reflect in-year staff turnover and amendments to staffing structures. |
| 82 | | Executive Director: Delivery |
| | -29 | Business Intelligence |
| | -91 | Democratic & Registration |
| 70 | | Property |
| | -180 | Contract Services |
| 44 | | Customer Experience |
| | -8 | ICT |
| 112 | | Legal |
| **308** | **-308** | **Total** |

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## Departmental Virements over £50,000

| Debit | Credit | Explanation |
|---|---|---|
| **£'000** | **£'000** | |
| | | **People** |
| | | The devolved staffing budgets have been reviewed and reset to reflect requirements for the year. A small number of virements are required that balance to a net nil effect. |
| | -55 | Office Services |
| 55 | | Early Years, Childcare and Play |
| | | Transformation Programme savings have been held in holding accounts pending the development of workstreams and the realisation of savings. As part of the year end process, Transformation related savings achieved in individual services are transferred to the central holding codes. |
| 35 | | Departmental Management Team |
| | -1 | School Improvement, Music and Governor Services |
| | -6 | Education Welfare and Support |
| | -54 | Education Psychology |
| | -4 | Advice for 13-19 year olds |
| 60 | | Early Years, Childcare and Play |
| 30 | | Performance and Governance |
| | -57 | Extended services and support to families |
| | -3 | Youth Service |
| | | **Schools Budget** |
| | | The approved Scheme for Local Management of Schools sets out criteria under which school budgets will be adjusted to take account of changing circumstances. These can be in respect of local policy decisions or in order to comply with relevant legislation. |
| 3,734 | | Funds Delegated to Schools |
| | -8 | School Grant Income |
| | -134 | De-delegated Budgets |
| | -212 | Other School Services |
| 4 | | Funds Delegated to Special Schools |
| | -4 | Post 16 SEN and other grants |
| | -1,537 | Maintained Schools & Academies |
| 19 | | Education out of School |
| | -1,460 | EY Free Entitlement |
| | -402 | DSG |
| | | The transfer of schools to an academy status results in the Education and Skills Funding Agency (ESFA) directly funding relevant schools, rather than the council. There have also been changes to funding allocations to the council to support high needs pupils. The ESFA recoup and adjust relevant income from the council requiring resultant budget adjustments. |
| | -20,469 | Funds Delegated to Schools |
| | -345 | De-delegated Budgets |
| 18 | | Other School Services |
| 328 | | NMSS & Colleges |
| 20,468 | | DSG |
| **24,751** | **-24,751** | **Total** |
| | | |
| **25,378** | **-25,378** | **Grand Total** |