TELFORD & WREKIN COUNCIL

AUDIT COMMITTEE – 23 JULY 2019

TREASURY MANAGEMENT - 2018/19 ANNUAL REPORT AND 2019/20 UPDATE

REPORT OF THE ASSISTANT DIRECTOR:FINANCE & HR (CHIEF FINANCIAL OFFICER)

PART A) – SUMMARY REPORT

1. SUMMARY OF MAIN PROPOSALS

The report updates members on the outcome of Treasury Management activities for 2018/19 and details the position for 2019/20 to date.

1.1 2018/19 Treasury Outturn

The treasury portfolio ended the year with net indebtedness of £251.2m (borrowing: £266.9m less investments: £15.7m (excluding NuPlace Share capital). Base rate was increased from 0.50% to 0.75% on 2 August 2018 and remained there for the rest of 2018/19. It is predicted to remain at this rate for the foreseeable future.

The borrowing strategy for 2018/19 was to borrow temporarily to take advantage of low interest rates where possible and review opportunities for new longer term borrowing as appropriate. Maintaining high levels of very cheap temporary borrowing has contributed to surplus treasury management returns of more than £17m since 2015/16 which has reduced the impact of Government cuts and therefore helped to protect front line services.

Borrowing was £10.2m higher at 31 March 2019 compared to 31 March 2018, investments were £4.2m lower (excluding NuPlace share capital). The net increase in net indebtedness was due to capital expenditure, including income generating schemes such as NuPlace and the Property Investment Portfolio, and various highways schemes which have increased the value of Council assets. Short term borrowing was used during the year at favourable interest rates generating a significant benefit for the Council's budget. Following advice from Arlingclose, the Council's external treasury advisors, some longer, fixed term borrowing has also been taken to manage exposure to interest rate fluctuations.

The investment strategy for 2018/19 was to gain maximum benefit with security of capital being the key consideration. The average return on investments for the year was 0.49% against a benchmark of 0.41%.

Overall, treasury delivered a net over-achievement of £3.161m against the budget set for 2018/19. The majority of the saving relates to the benefit of low interest rates on the levels of temporary borrowing we held during the year.

1.2 **2019/20 Update**

The strategy for 2019/20 remains consistent with that of the previous year. Investment opportunities will be reviewed as they arise and we will seek to gain maximum benefit within the agreed risk parameters. There are currently no long term investments, which reduces counter-party risk and also reduces net interest costs as longer-term borrowing costs tend to be greater than we are able to earn on new investments.

Based on the capital programme, borrowing will be required during the year and consideration will be given to the maturity profile of current debt, interest rates and refinancing risks as well as the source, which is primarily expected to be the Public Works Loans Board.

Total borrowing was £266.9m at 31 March 2019 and has increased slightly to £273.4m as at 31 May 2019. Investments were £16.6m at 31 May 2019.

2. RECOMMENDATIONS

Audit Committee Members are asked to:-

2.1 note the contents of the report

2.2 note the performance against Prudential Indicators.

3. *SUMMARY IMPACT ASSESSMENT*

COMMUNITY IMPACT	Do these proposals contribute to specific priority plan objectives?	
	Yes/~~No~~	Efficient Community Focussed Council
	Will the proposals impact on specific groups of people?	
	~~Yes~~/No	
TARGET COMPLETION / DELIVERY DATE	Part of ongoing Treasury Management Activities within the Treasury Management Strategy and Policy approved by Council.	
FINANCIAL/VALUE FOR MONEY IMPACT	Yes/~~No~~	Where appropriate these are detailed in the body of the report**.**
LEGAL ISSUES	Yes/~~No~~	The AD: Finance & HR (Section 151 Officer), has responsibility for the administration of the financial affairs of the Council. In providing this report the Section 151 Officer is meeting one of the responsibilities of the post contained within the Council's Constitution at Part 2, Article 12, paragraph 12.04(f) which states "The Chief financial Officer will contribute to the promotion and maintenance of high standards of governance, audit, probity and propriety, risk management and the approval of the statement of accounts through provision of support to the Audit Committee**.**"

OTHER IMPACTS, RISKS AND OPPORTUNITIES	Yes/~~No~~	The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.
IMPACT ON SPECIFIC WARDS	~~Yes~~/No	

4. **PREVIOUS MINUTES**
Council 28 February 2019
Audit Committee 29 January 2019
Audit Committee 24 July 2018
Council 1 March 2018
Audit Committee 30 January 2018

PART B) – ADDITIONAL INFORMATION

5. **BACKGROUND**

5.1 Treasury Management in local government is regulated by the CIPFA Treasury Management in Public Services: Code of Practice (the Code). This Council has adopted the Code and fully complies with its requirements. The primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement, which states the policies and objectives of its treasury management activities. The Authority's treasury management strategy for 2018/19 was approved at Full Council on 1st March 2018.

5.2 A requirement of the Council's Treasury Management Practices is the reporting to the Council of both the expected treasury activity for the forthcoming financial year (the annual treasury strategy statement) and subsequently the results of the Council's treasury management activities in that year (this annual treasury report).

5.3 The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

6. **2018/19**

6.1 The annual report is covered in paragraphs 6-15 and deals with: -
- 2018/19 Portfolio position;
- the borrowing strategy for 2018/19;
- the borrowing outturn for 2018/19;
- compliance with treasury limits;
- investments strategy for 2018/19;
- investments outturn for 2018/19;
- debt rescheduling;
- Shropshire Council debt
- overall outturn position
- leasing

7. 2018/19 PORTFOLIO POSITION

7.1 The Council's treasury management position at the beginning and the end of the year was as follows: -

	31 March 2019		31 March 2018	
	Principal £m	**Rate %**	**Principal £m**	**Rate %**
Borrowing	266.924	2.41	256.702	2.22
Investments (excluding NuPlace share capital)	15.685	0.51	19.937	0.25
Net Indebtedness (ex NuPlace)	**(251.239)**		**(236.765)**	
Investment in NuPlace	11.600		8.950	
Net Indebtedness	**(239.639)**		**(227.815)**	

There was continued use of temporary borrowing through 2018/19, temporary borrowing was £75.1m at 31 March 2019 (including £7.7m PWLB maturing in 2019/20). £5.1m of PWLB loans were repaid during the year and new PWLB borrowing of £65m was raised. Alongside this £20m of LOBOs (Lenders Option Borrowers Option) loans were redeemed which reduced the Council's exposure to interest rate changes. The capital programme was funded from a combination of borrowing, capital receipts, grants and other external contributions; as expected, this has resulted in an increase in net indebtedness during the year. Prudential borrowing increased in 2018/19 due to planned capital expenditure approved as part of the capital programme. Investments at 31/3/19 included £11.6m share capital in NuPlace.

The Adopted Treasury Strategy was to:-

- Monitor borrowing opportunities determined by the prevailing markets.
- Only investing short term to meet cashflow requirements.
- Reduce the volatility of investment returns while maintaining adequate flexibility in arrangements.
- To achieve optimum return on investments commensurate with proper levels of security and liquidity.

8. COUNCILS RESPONSE TO ECONOMIC CLIMATE

8.1 **Economic background:** 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 2018, 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, original EU 'exit day' now been and gone, the prime minister was forced to ask for an extension to the Brexit process beyond 12th April in order to avoid a no-deal scenario and the date of 31 October has now been agreed with the EU. The resignation of Theresa May has created greater short-term uncertainty and there is the possibility of exiting the EU on 31 October without a deal. These ongoing uncertainties continue 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 the EU. The EU itself appeared to 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. 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 ring fencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ring fenced) and investment banking (non-ring fenced) 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.

9. <u>BORROWING 2018/19</u>

9.1 Original Economic Projections

The Expectation for Interest Rates – When the budget was set for 2018/19 the "average" City view anticipated that Bank Rate would remain at 0.50% during 2018/19 following the rise from the historic low of 0.25%. The Monetary Policy Committee (MPC) re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

9.2 Outturn 2018/19

Bank Rate rose to 0.75% in August 2018. Rhetoric from the Bank of England has shown it has a bias towards higher interest rates but has been reluctant to push rate expectations too strongly due to the uncertainty surrounding Brexit. Arlingclose expects the base rate to remain at 0.75% for the foreseeable future, although this is dependent on the outcome of Brexit. The markets forecast an even slower rise over the same period. Brexit and its timing complicate the outlook and the economy faces a challenging period as it exits the EU.

Borrowing and Investment Rates in 2018/19
The overnight investment rate increased in August in line with the Bank Rate.

Treasury Borrowing and Rescheduling
The borrowing strategy for the current year was to borrow temporarily to take advantage of low interest rates where possible and review opportunities for new longer term borrowing as appropriate.

During the year we borrowed new PWLB loans totalling £65.0m at the discounted certainty rate and we had maturities totalling £5.1m. These new loans were a mixture of Equal Instalments of Principal, Annuity and Maturity loans.

PWLB Repayments & Discounts
No loans were repaid early or rescheduled during the year.
An analysis of the maturity structure of our debt is shown below. The maturing in less than 1 year includes £7.703m of PWLB loans.

Lenders Option Borrowers Option Redemption
The Authority continues to hold £25m of Lenders Option Borrowers Option loans, as at 31/03/2019, where the lender has the option to propose an increase in the interest rate as at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year and current expectations are that calls in the foreseeable future are unlikely.

Banks have been reluctant to review these loans, however Arlingclose were able to negotiate terms relating to £20m of the Council's LOBOs in July 2018 which provided value to the Council in terms of savings and reduces the interest rate risk exposure in the overall borrowing portfolio.

Analysis of Debt Maturity as at 31st March

	2019 £'000	%	**2018 £'000**	%
Maturing in less than 1 year	75,101	28.1	102,176	39.8
Maturing in 1-2 years	7,226	2.7	5,098	2.0
Maturing in 2-5 years	20,318	7.6	12,793	5.0
Maturing in 5-10 years	30,115	11.3	18,741	7.3
Maturing in more than 10 years*	134,164	50.3	117,894	45.9
	266,924	100.0	**256,702**	100.0

* this includes £25m LOBO (Lenders Option Borrowers Option) loans that are potentially callable at certain points before the maturity date.

Debt Performance
As highlighted in section 7 the average debt portfolio rate has risen over the course of the year from 2.22% to 2.41%. This is due to the reduction in use of temporary borrowing being undertaken in 2018/19 (£67.4m as at 31/03/2019 compared to £97.1m as at 31/03/2018).

10. COMPLIANCE WITH TREASURY LIMITS

10.1 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

11. INVESTMENTS 2018/19

11.1 Strategy

The authority currently manages the majority of its investments in-house and invests within the institutions complying with its counterparty limits and credit rating requirements. All investments are short term related to cash flows in order to minimise counterparty risk and to minimise overall treasury management costs. Investments include £4.980m in Money Market Funds (MMFs) which provide greater diversification of credit risk and achieve a slightly higher return than our call accounts.

Investment Strategy - The agreed short term investment strategy for 2018/19 was to achieve optimum return on investments commensurate with proper levels of security and liquidity.

The Council has continued to maintain short duration and relatively low level of investments during 2018/19. This reduces exposure to investment risk.

We have closely followed investment guidance issued by our Treasury Advisors in relation to credit ratings, financial standing and duration and take advice on borrowing strategies and options.

11.2 Outturn 2018/19

Detailed below are the results of the investment strategy undertaken by the Council, based on the average investment during the year.

	Average Investment	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark Return *
Investments	£26.149m	0.49%	0.49%	0.41%

*DMO Overnight rate

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

12. SHROPSHIRE COUNCIL DEBT

12.1 The Council makes an annual contribution (£1.309m in 2018/19) towards Shropshire Council costs on pre disaggregation debt (i.e. pre unitary inception) - interest paid averaged 5.17% last year. The rate of interest paid on this is managed by Shropshire and is considerably higher than the rate payable by Telford & Wrekin Council on its borrowing.

13. OVERALL OUTTURN FOR 2018/19

13.1 The net overall position is summarised in the table below. The sound overall position has resulted from a mix of cash flow benefits plus pro-active treasury management activities. The budget reflected the position when the budget was set, the underspend has been achieved through active management of borrowing and the low interest rates prevailing for the year. Overall a net saving of £3.161m was made against budget for the year which is summarised below:

Summary of Outturn Position

	Estimate £m	**Outturn £m**	**Variance £m**
Interest Received	(0.175)	(0.148)	0.027
Debt Management & Recharges	0.048	0.149	0.101
MRP including saving from change of policy re PFI	(1.629)	(1.714)	(0.085)
Capitalisation of Interest	(0.206)	(0.074)	0.132
Shropshire County Council	1.331	1.304	(0.027)
Interest Paid	8.232	4.923	(3.309)
Net Position	**7.601**	**4.440**	**(3.161)**

14. LEASING

14.1 Each year the Council arranges operating leases for assets such as vehicles, computers and equipment. This helps spread the cost over a number of years in line with the anticipated life of the equipment.

Only one leasing drawdown was completed for 2018/19 and this was in September, which was reported in the last update to members in January.

15. 2019/20 UPDATE

The remainder of this report deals with the current financial year based largely on information to 31 May 2019.

15.1 **Strategy**
The strategy for 2019/20 was approved by Full Council 28th February 2019. The strategy is to continue to keep investments as short term, where possible, to reduce the need to borrow thus reducing investment exposure and maximising overall returns to the revenue account. We will review investment opportunities if they arise and also review borrowing opportunities as we progress through the year and look to take advantage of advantageous interest rates where appropriate. 2019/20 and 2020/21 will see the Council continue to invest in significant regeneration projects including highways and building homes and commercial property for rent as part of the approved Housing Investment Programme. In order to comply with MiFID II the Council will maintain a minimum investment balance of £10m.

15.2 **Interest Rates**
Base rate began the year at 0.75% and has remained there. The current expectation is that this will continue for the foreseeable future.

15.3 **Prudential Regime**

This Council agreed its required indicators at Council on 28th February 2019. There have been no breaches of the indicators and none have been amended. The Council set itself an Operational limit for external debt of £420m for 2019/20 and an Authorised limit of £440m. Our total borrowing outstanding as at 31/05/19 (including PFI) is £325m which is within both limits.

15.4 **Borrowing**

We have taken two New PWLB loans during in 2019/20 totalling £10m (details below). In total we have £7.7m maturing during 2019/20.

Date	Loan	Period	Amount	Interest Rate
01/04/2019	EIP	25 years	£5m	1.99%
28/05/2019	Annuity	23 years	£5m	1.98%

15.5 **Investments**

The strategy for the year is to gain maximum benefit at minimum risk whilst achieving as a minimum, the overnight deposit rate. For the period to 31 May 2019 some £630m worth of investments have been made in our overnight call accounts or with the Debt Management Office. Rates have ranged from 0.50% to 0.53%. As at 31 May 2019 internal investments stood at £16.553m including Money Market Funds.

Potentially the Council can place up to £15.0m with any Counterparty. At the end of May the greatest exposure with a single counterparty was £3.864m (23.3% of the portfolio) with both Handelsbanken and the DMO. A detailed breakdown of the investment portfolio is shown in Appendix 2.

The Council also has investments in money market funds which gives increased diversification of counter-party risk and slightly higher yield whilst retaining a high degree of liquidity. The amount invested in money market funds at 31st May 2019 is £4.98m. This investment was split equally between 2 funds.

15.6 **Projected Performance 2019/20**

Current projections are that a surplus against budget of around £2m will be achieved if current treasury management performance continues for the remainder of the year. This benefit will be used to help offset pressures being faced in key front line care services for older adults and looked after children.

16. **Background Papers**

CIPFA Code of Practice for Treasury Management in Local Authorities; Fund Manager Valuations; Temporary Borrowing records; PWLB records
Investment records

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PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2017/18 Actual Outturn	2018/19 Original Estimate	2018/19 Actual Outturn
(1). EXTRACT FROM BUDGET SETTING REPORT	**£m**	**£m**	**£m**
Capital Expenditure			
TOTAL	85.5	84.7	57.6
Ratio of financing costs to net revenue stream			
General fund	3.85%	7.45%	4.62%
Net borrowing requirement			
brought forward 1 April	220.0	276.8	256.7
carried forward 31 March	256.7	320.1	266.9
in year borrowing requirement	+36.7	+43.3	+10.2
Capital Financing Requirement as at 31 March			
TOTAL	420.8	467.8	445.2
Annual change in Cap. Financing Requirement			
TOTAL	+53.0	+42.7	+24.4
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum (not cumulative)	0.06	0.74	0.05

PRUDENTIAL INDICATOR	2017/18 final	2018/19 original	2018/19 final
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£m**	**£m**	**£m**
Authorised limit for external debt -			
borrowing	350	440	440
other long term liabilities	61	61	61
TOTAL	**411**	**501**	**501**
Operational boundary for external debt -			
Borrowing	330	420	420
other long term liabilities	60	59	59
TOTAL	**390**	**479**	**479**
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	100	100	100
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments:-	30%	30%	30%
Upper limit for total principal sums invested for over 364 days			
(per maturity date)	95%	95%	95%

Maturity structure of fixed rate borrowing during 2018/19	lower limit	upper limit
under 12 months	0%	70%
12 months and within 24 months	0%	30%
24 months and within 5 years	0%	50%
5 years and within 10 years	0%	75%
10 years and above	25%	100%

Summary of Investments at 31 May 2019

	Sovereign Credit Rating	Individual credit Rating	Total £m	%
Call Accounts				
Lloyds	UK AA	F1 A+ support 5	3.845	23.2
Svenska Handelsbanken	UK AA	F1+ AA support 1	3.864	23.3
Debt Management Office (DMO)	Government		3.864	23.3
Other Investments				
Money Market Funds	N/A	AAA	4.980	30.2
Total			**16.553**	**100.0**

Call Accounts Non UK holding £7.8m (Limit £15m)
Please note. Part of the Money Market Funds are invested in non UK sovereigns. At 31st May 2019 this amounted to 92.2% of the funds.