Appendix A

Annual Treasury Management Review 2018/19

English Local Authorities
April 2019

Annual Treasury Management Review 2018/19

1. Introduction

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).

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 to Full Council 7th February 2018
- a mid-year treasury update report to Corporate Committee 28th November 2018
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, this Council has received quarterly treasury management update reports as part of the Members' Newsletter.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Budget and Strategic Planning Working Group before they were reported to the full Council.

2. The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2017/18 Actual £m	2018/19 Budget £m	2018/19 Actual £m
Capital expenditure	1,261	1,013	993
Financed in year	1,261	1,013	993
Unfinanced capital expenditure	**0**	**0**	**0**
HRA	2017/18 Actual £m	2018/19 Budget £m	2018/19 Actual £m
Capital expenditure	2,751	7,354	2,485
Financed in year	2,751	7,354	2,485
Unfinanced capital expenditure	**0**	**0**	**0**

3. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2017/18) plus the estimates of any additional capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2018/19. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2018 Actual	31 March 2019 Budget	31 March 2019 Actual
CFR General Fund (£m)	0.113	0.101	0.101
CFR HRA (£m)	31.484	31.484	31.484
Total CFR	**31.597**	**31.585**	**31.585**
Gross borrowing position	31.526	31.514	31.514
(Under) / over funding of CFR	(0.071)	(0.071)	(0.071)

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2018/19 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2018/19
Authorised limit	£46.000m
Maximum gross borrowing position during the year	£31.514m
Operational boundary	£36.479m
Average gross borrowing position	£31.514m
Financing costs as a proportion of net revenue stream: General Fund HRA	 -3.80% 30.49%

4. Treasury Position as at 31 March 2019

At the beginning and the end of 2018/19 the Council's treasury, excluding borrowing by PFI and finance leases (note Melton has no PFI's and only 1 finance lease), position was as follows:

DEBT PORTFOLIO	31 March 2018 Principal £m	Rate/ Return	Average Life (Years)	31 March 2019 Principal £m	Rate/ Return	Average Life (Years)
Total debt (PWLB)	31.413	3.72%	32	31.413	3.72%	*32*
CFR	31.484			31.484		
Over / (under) borrowing	(0.71)			(0.71)		
Total investments	20.100	1.00%	*£18.1m Under 1 year, £2m over 1 year*	20.711	1.20%	*£18.7m Under 1 year, £2m over 1 year*
Net debt	**11.313**			**10.773**		

The maturity structure of the debt portfolio was as follows:

	31 March 2018 Actual £m	31 March 2019 Actual £m
Under 5 years	0	0
5 years and within 10 years	4.098	4.098
10 years and within 20 years	0.600	0.600
20 years and within 30 years	10.000	10.000
30 years and within 40 years	10.840	10.840
40 years and within 50 years	5.875	5.875

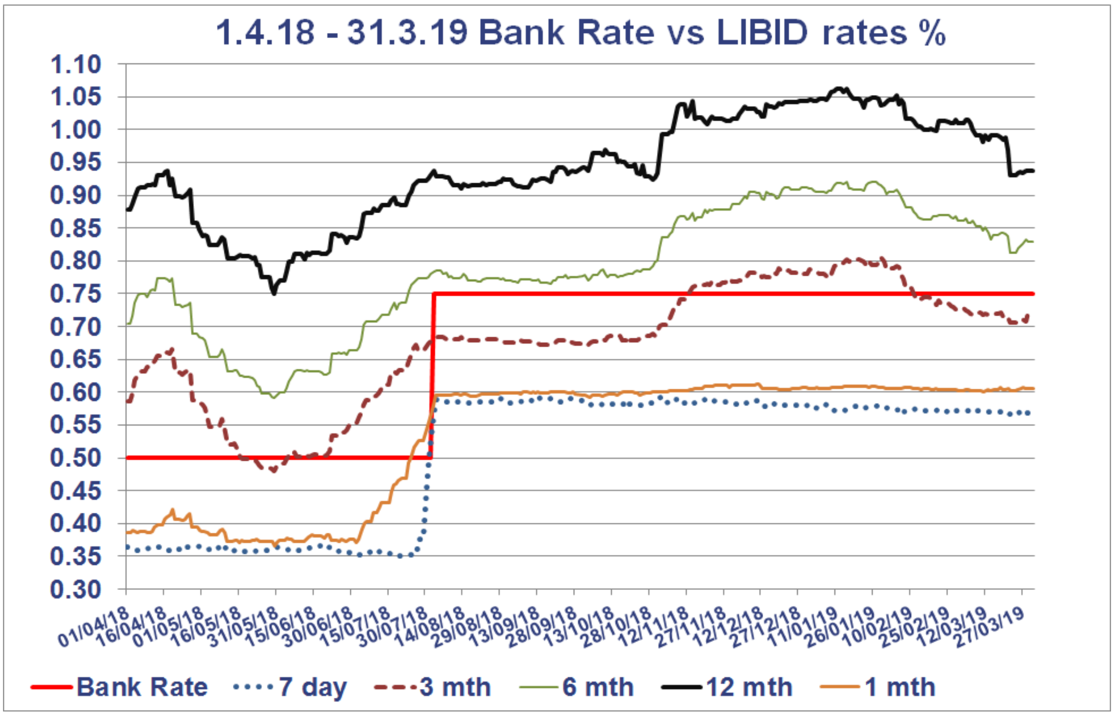
INVESTMENT PORTFOLIO	Actual 31.3.18 £000	Actual 31.3.18 %	Actual 31.3.19 £000	Actual 31.3.19 %
Treasury investments				
Banks	11,000	55%	14,000	67%
Building Societies - rated	5,000	25%	0	0%
Money Market Funds	2,100	10%	4,710	23%
Total managed in house	**18,100**	**90%**	**18,710**	**90%**
Property funds	2,000	10%	2,000	10%
Total managed externally	**2,000**	**10%**	**2,000**	**10%**
TOTAL TREASURY INVESTMENTS	**20,100**	**100%**	**20,710**	**100%**

The maturity structure of the investment portfolio was as follows:

	2017/18 Actual £000	2018/19 Budget £000	31 March 2019 Actual £000
Investments			
Longer than 1 year	2,000	2,000	2,000
Up to 1 year	18,100	10,233	18,710
Total	20,100	12,233	20,710

5. The strategy for 2018/19

5.1 Investment strategy and control of interest rate risk



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. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

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. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

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.

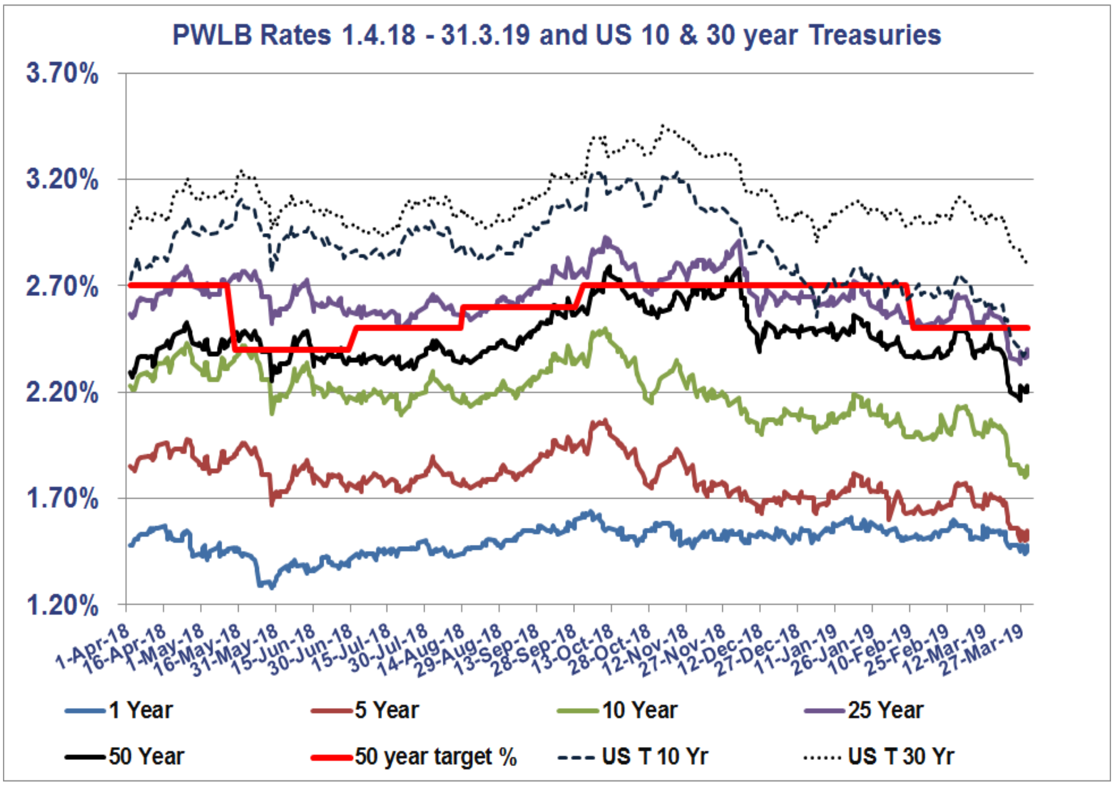
Continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

5.2 Borrowing strategy and control of interest rate risk

In the light of the investment position identified in paragraph 5.1 above, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk. However, as anticipated no new borrowing during 2018-19.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View 2.1.18													
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%



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 round 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. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

6. Borrowing Outturn

There were no borrowing requirements during 2018/19.

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Investment Outturn

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 7 February 2018. 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.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Investments held by the Council

- The internally managed funds (excluding the property fund) earned an average rate of return of 1.03%.
- The comparable performance indicator is the average 7-day LIBID rate, which was 0.51%.
- Including the property fund the return was 1.32%
- The Council maintained an average balance of £22.3m of internally managed funds.
- This compares with a budget assumption of £12.2m investment balances earning an average rate of 1.25%.
- The Property Fund earned a return of £85k (4.2435% average rate of return).
- Total investment income was £294,941 compared to an original budget of £153,300 and a revised budget of £193,300.

The anticipated level of investments in 2018/19 was forecast in the February 2018. Since then the level of investments have been higher than predicted due to an underspend on the capital programme in both 2017/18 and 2018/19 and a higher level of reserves.

8. Other Issues

a) IFRS 9

The implementation of IFRS9 introduced two new considerations for Financial Instruments with regard to the Statement of accounts:

- Expected credit loss model. Assets held as Financial Instruments should be reviewed to assess whether there is evidence to suggest that their value on the balance sheet should be reduced. The Authority's assets were reviewed when the Statement of Accounts was produced and no material credit losses were identified.
- The CCLA Property Fund investment previously valued under the available for sale category was also reviewed in line with IFRS9, and was changed to **Fair Value through the Profit and Loss (FVPL),** such that changes in the valuation of the fund are now charged/credited to "Surplus or Deficit on Provision of Services".

b) MHCLG Mandatory Statutory Override

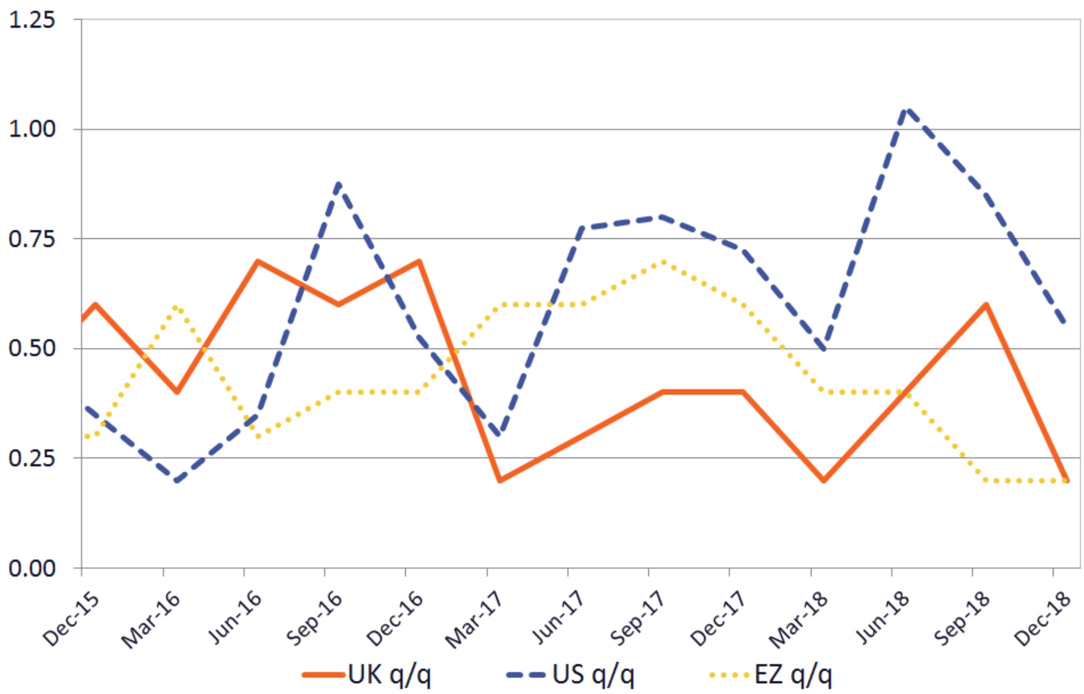
Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds , including the CCLA Property Fund. This will be effective from 1 April 2018. The statutory override applies for five years from this date, to allow authorities time to adjust their portfolio of investments.

Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

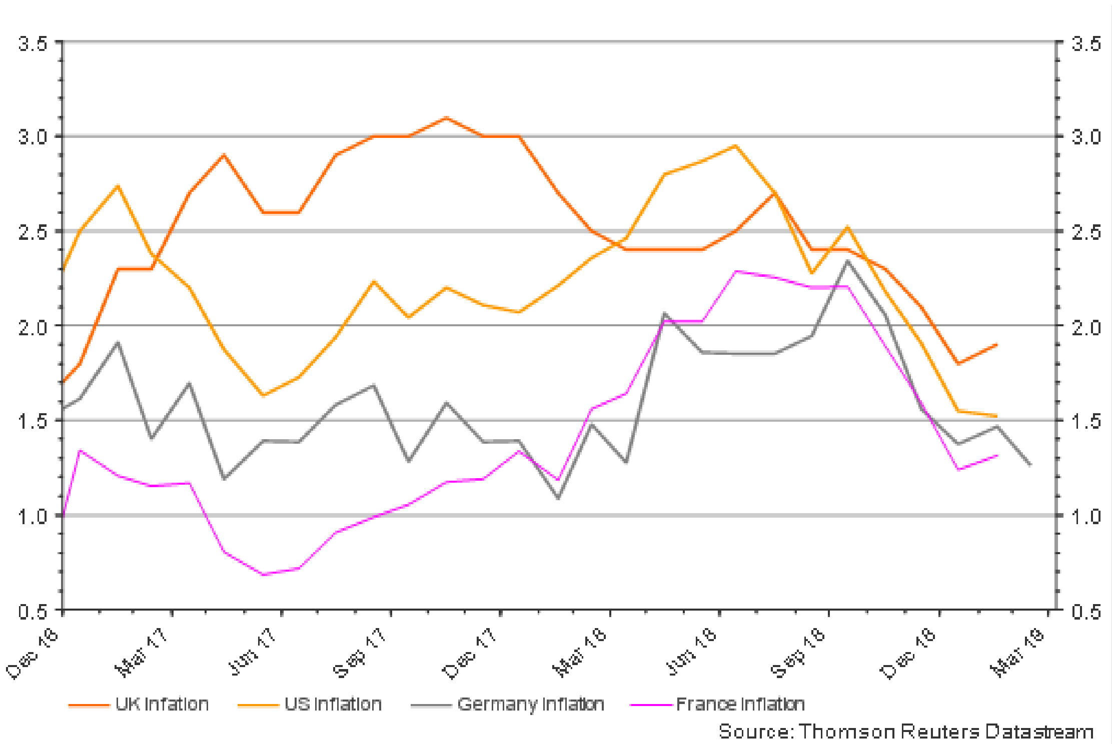
The effect of this Statutory Override means that there will be no impact on the General Fund of changes in the valuation of the CCLA Property Fund until 2023-24.

Appendix: Graphs

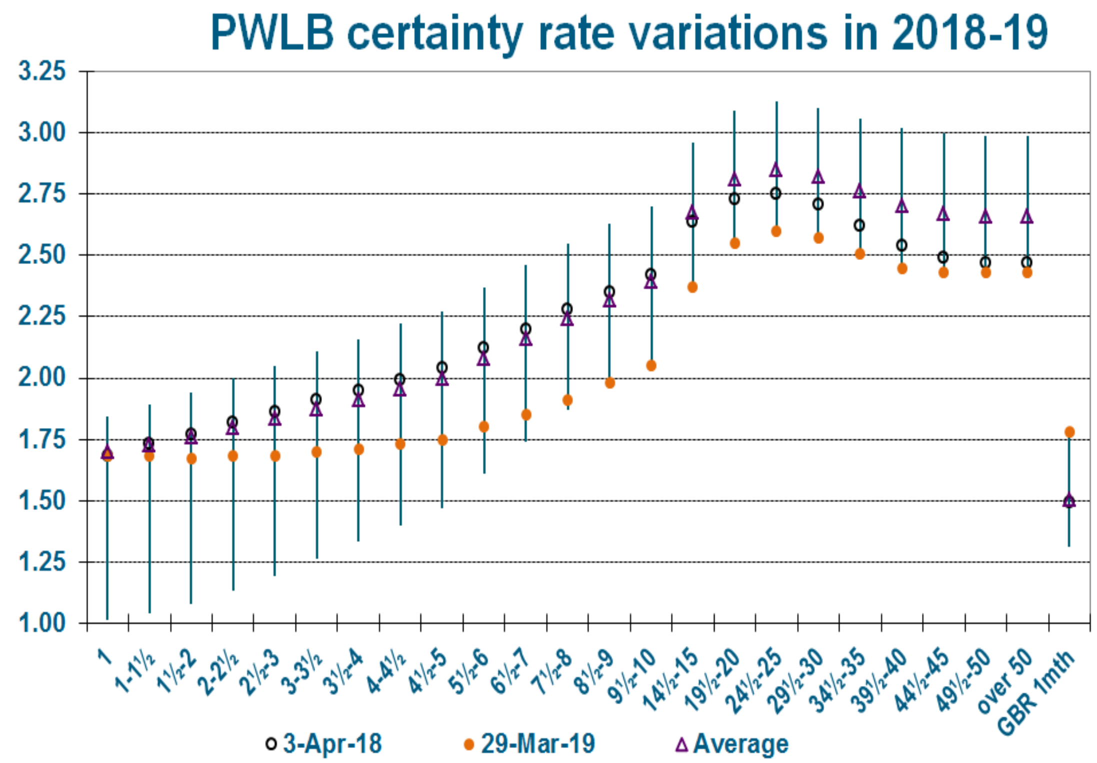
a) UK, US and EZ GDP growth



b) Inflation UK, US, Germany and France



c) PWLB borrowing rates



	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2018	1.48%	1.85%	2.23%	2.57%	2.29%
29/03/2019	1.48%	1.55%	1.85%	2.40%	2.23%
Low	1.28%	1.50%	1.80%	2.33%	2.16%
Date	29/05/2018	26/03/2019	28/03/2019	26/03/2019	26/03/2019
High	1.64%	2.07%	2.50%	2.93%	2.79%
Date	04/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018
Average	1.50%	1.80%	2.20%	2.66%	2.47%

d) Money market investment rates and forecasts 2018/19

	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
01/04/2018	0.50	0.36	0.39	0.59	0.70	0.88
31/03/2019	0.75	0.57	0.61	0.72	0.83	0.94
High	0.75	0.59	0.61	0.81	0.92	1.06
High Date	02/08/2018	01/11/2018	10/12/2018	29/01/2019	15/01/2019	11/01/2019
Low	0.50	0.35	0.37	0.48	0.59	0.75
Low Date	01/04/2018	19/07/2018	30/05/2018	30/05/2018	30/05/2018	30/05/2018
Average	0.67	0.51	0.54	0.68	0.79	0.94
Spread	0.25	0.24	0.25	0.33	0.33	0.31

Link Asset Services Interest Rate View 7.11.17														
	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
3 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.00%	1.20%	1.20%	1.20%
6 Month LIBID	0.50%	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.70%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.60%