Appendix A

Treasury Management Outturn Report 2018/19

Introduction

The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code). Treasury risk management at the Authority is conducted within the framework of the CIPFA Code, which requires the Authority 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 Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The Authority's treasury management strategy for 2018/19 was approved at a meeting on 21st February 2019. 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 remain central to the Authority's treasury management strategy.

External Context

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 rejecting 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.

Local Context

On 31st March 2018, the Authority had net borrowing of £102m 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

	31.03.18 Actual £m	**2018/19 Movement £m**	**31.3.19 Actual £m**
General Fund CFR	55	4	59
HRA CFR	86	-2	84
Total CFR	**141**	**2**	**143**
Less: Other debt liabilities *	-5	0	-5
Borrowing CFR	**136**	**2**	**138**
Less: Usable reserves	-25	-1	-26
Less: Working capital	-4	-6	-10
Net borrowing	**107**	**-5**	**102**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 31st March 2019 and the change during the year 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	31.3.19 Rate %
Long-term borrowing	96.5	0.5	97	2.82
Short-term borrowing	23.5	-4.5	19	0.75
Total borrowing	**120**	**-4**	**116**	
Short-term investments	11.5	0.5	12	0.45
Cash and cash equivalents	2	0	2	0
Total investments	**13.5**	**0.5**	**14**	
Net borrowing	**106.5**	**-4.5**	**102**	

Borrowing Strategy during the year

At 31st March 2019 the Authority held £116m of loans, (a decrease of £4.5m from 31st March 2018, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised 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 Weighted Average Rate %
Public Works Loan Board	86.5	-2	84.5	3.05
Phoenix Life Ltd	10	0	10	2.86
Local authorities (long-term)	0	2.5	2.5	1.25
Local authorities (short-term)	23.5	-4.5	19	0.93
Total borrowing	**120**	**-4**	**116**	

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

In keeping with these objectives, new borrowing was kept to a minimum of £21.5m, while £25.5m of existing loans were allowed to mature without replacement. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

With short-term interest rates remaining much lower than long-term rates, the Authority considered it to be more cost effective in the near term to use internal resources or short-term loans instead. The net movement in short-term loans is shown in table 3 above.

The Authority has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Authority's borrowing need based on realistic projections, it was decided to take a combination of short and long-term borrowing

Other Debt Activity

After £0.121m repayment of prior years' Private Finance Initiative liabilities, total debt other than borrowing stood at £4.619m on 31st March 2019, taking total debt to £107m.

Treasury Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £7.5m and £22.5 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m	31.3.19 Weighted Average Rate %
Banks & building societies (unsecured)	1	-1	0	0.00
Government (incl. local authorities)	9.5	1.5	11	0.84
Money Market Funds	1	0	1	0.74
Total investments	**11.5**	**0.5**	**12**	

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority'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.

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) on 29th March, the Authority ensured there were enough accounts open at UK-domiciled banks and Money Market Funds to hold sufficient liquidity over the year end and that its account with the Debt Management Account Deposit Facility (DMADF) remained available for use in an emergency.

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority 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.

At 31st March 2019, the Authority held £50m of such investments in loans to subsidiaries. This represents an increase of £3m on the previous year due to additional investment in Aspire CRP Ltd.

These investments generated £1.9m of investment income for the Authority after taking account of direct costs, representing a rate of return of 4%.

Compliance

The Director of Finance and Corporate Services reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy with the exception of the upper limit on fixed interest rate exposure, this is explained in more detailed on the following page and in table 7.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 5 below.

Table 5: Debt Limits

	2018/19 Maximum £m	**31.3.19 Actual £m**	**2018/19 Operational Boundary £m**	**2018/19 Authorised Limit £m**	**Complied**
Borrowing	120	116	116	244	✓
PFI	5	5	6	6	✓
TOTAL	**125**	**121**	**122**	**250**	✓

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 was above the operational boundary for periods totalling 37 days during 2018/19.

Investment limits are set each year in the Treasury Management Strategy and provide the parameters for investments, table 6 details the counterparties, time limits and the amounts the Council can invest in each one.

Table 6: Investment Limits

	2018/19 Maximum £m	31.3.19 Actual £m	2018/19 Limit £m	Complied
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard and Poor's is A- and above except the UK Central Government	0	0	1	✓
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard and Poor's is BBB+ except the UK Central Government	0	0	1	✓
UK Central Government	10	2	Unlimited	✓
UK Local Authorities including Police and Fire per authority	6	6	6	✓
UK Building Societies without credit ratings	0	0	1	✓
Saffron Building Society	0	0	0.5	✓
Money Market Funds, per fund	1	1	3	✓

Treasury Management Indicators

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

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk.

Fixed rate investments and borrowings 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. As can be seen from table 7 the upper limit on fixed rate investments was exceeded by £6,000 due to additional longer term borrowing for the investment in the development of Aspire (CRP) Ltd (£2.5m over 18 months).

The upper limit is set in the original 2018/19 Strategy and is based on our expected borrowing requirement and the associated estimated interest for the financial year ahead; this is not a statutory limit.

The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed was:

Table 7 – Interest Rate Exposure

	31.3.19 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate exposure	2,862	2,856	x
Upper limit on variable interest rate exposure	80	80	✓

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Table 8 – Borrowing Structure

	31.3.19 Actual	Upper Limit %	Complied
Under 12 months	15	20	✓
12 months and within 24 months	3	20	✓
24 months and within 5 years	6	60	✓
5 years and within 10 years	13	100	✓
10 years and within 20 years	36	100	✓
20 years and above	27	100	✓

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

Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Authority'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:

Table 9 – Investment Risk

	2018/19	2019/20	2020/21
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied	✓	✓	✓