APPENDIX A

TREASURY MANAGEMENT POSITION FOR THE THIRD QUARTER OF 2018/19

A1. SUMMARY OF TREASURY MANAGEMENT INDICTORS

The Council's debt at 31st December was as follows:

Prudential Indicator	**Limit** £m	**Actual** £m
Authorised Limit - the maximum amount of borrowing permitted by the Council	660	620
Operational Boundary - the maximum amount of borrowing that is expected	645	620

The maturity structure of the Council's fixed rate borrowing was

	Under 1 Year	**1 to 2 Years**	**3 to 5 Years**	**6 to 10 Years**	**11 to 20 Years**	**21 to 30 Years**	**31 to 40 Years**	**41 to 50 Years**
Minimum proportion of loans maturing	0%	0%	0%	0%	0%	0%	0%	0%
Maximum proportion of loans maturing	10%	10%	10%	20%	30%	30%	30%	40%
Actual proportion of loans maturing	1%	1%	4%	7%	24%	7%	29%	27%

The maturity structure of the Council's variable rate borrowing was

	Under 1 Year	**1 to 2 Years**	**3 to 5 Years**	**6 to 10 Years**	**11 to 20 Years**	**21 to 30 Years**	**31 to 40 Years**	**41 to 50 Years**
Minimum proportion of loans maturing	0%	0%	0%	0%	0%	0%	0%	0%
Maximum proportion of loans maturing	10%	10%	10%	20%	30%	30%	30%	10%
Actual proportion of loans maturing	2%	2%	7%	12%	25%	27%	25%	0%

Surplus cash invested for periods longer than 365 days at 31st December 2018 was:

	Limit £m	**Quarter 3 Actual** £m
Maturing after 31/3/2019	158	147
Maturing after 31/3/2020	133	105
Maturing after 31/3/2021	110	27

The Council's interest rate exposures at 31st December 2018 were:

	Limit £m	**Actual** £m
Fixed Interest - Net Borrowing	454	320
Variable Interest - Net Lending	(289)	(150)

A2. GOVERNANCE

The Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council on 20th March 2018 provides the framework within which treasury management activities are undertaken.

There have been no breaches of these policies during 2018/19 up to the period ending 31st December 2018.

A3. BORROWING ACTIVITY

After the August increase in Bank Base Rate to 0.75%, the first above 0.5% since the financial crash, the Monetary Policy Committee (MPC) has since then put any further action on hold, probably until such time as the uncertainty of Brexit clears and there is some degree of certainty of what the UK will be heading into. It is particularly unlikely that the MPC would increase Bank Base Rate in February 2019 ahead of the deadline in March for Brexit, if no agreement on Brexit has been reached by then. If there is an agreement on a reasonable form of Brexit the Councils treasury management consultants, Link Asset Services, think that the MPC of the Bank of England could return to increasing Bank Base Rate in May 2019 but then hold fire again until February 2020. In the event of a disorderly Brexit, cuts in Bank Base Rate could well be the next move.

The Council has not undertaken any new borrowing during 2018/19.

The Council's gross borrowing at 31st December 2018 of £620m is within the Council's Authorised Limit (the maximum amount of borrowing approved by City Council) of £660m and also within the Council's Operational Boundary (the limit beyond which borrowing is not expected to exceed) of £645m.

The Council plans for gross borrowing to have a reasonably even maturity profile. This is to ensure that the Council does not need to replace large amounts of maturing borrowing when interest rates could be unfavourable.

The actual maturity profile of the Council's borrowing is within the limits contained within the Council's Treasury Management Policy (see paragraph A1).

Early Redemption of Borrowing

With the exception of two loans all the Council's borrowings to finance capital expenditure are fixed rate and fixed term loans. This reduces interest rate risk and provides a high degree of budget certainty.

The Council's borrowing portfolio is kept under review to identify if and when it would be financially beneficial to repay any specific loans early. Repaying borrowing early invariably results in a premium (early repayment charges) by the PWLB that are sufficiently large to make early repayment of borrowing financially unattractive to the Council.

No debt rescheduling or early repayment of debt has been undertaken during 2018/19 as it has not have been financially advantageous for the Council to do so.

Overall Interest on Borrowing

The Council's overall borrowing position at 30th September 2018 is summarised in the table below.

	Principal	**Average Interest Rate**	**Interest Paid in Year to Date**
Borrowings	£556m	3.37%	£9.4m
Finance Leases	£1m	10.21%	£0.1m
Private Finance Initiative (PFI) Schemes	£66m	9.70%	£3.2m
Overall Position	**£623m**	**4.07%**	**£12.7m**

The Council's overall borrowing position at 31st December 2018 is sumarised in the table below.

	Principal	**Average Interest Rate**	**Interest Paid in Year to Date**
Borrowings	£554m	3.37%	£14.0m
Finance Leases	£1m	10.21%	£0.1m
Private Finance Initiative (PFI) Schemes	£65m	9.70%	£4.8m
Overall Position	**£620m**	**4.07%**	**£18.9m**

During quarter 3, borrowing totaling £2m has matured and has been repaid to the PWLB, and PFI liabilities totaling £1m have been repaid.

Under/Over Borrowing

The extent to which the Council is "under" or "over" borrowed is determined by comparing the actual value of long term borrowing outstanding with the value of capital expenditure that has been incurred and was financed by borrowing (after deducting Minimum Revenue Provision that has been made in respect of that capital expenditure).

If the Council has borrowed less than it requires to fund the total value of capital expenditure to be funded from borrowing the Council is "under borrowed" and if the value of borrowing is greater than the value of capital expenditure incurred which is to be financed from borrowing it is "over borrowed".

The Council last undertook long term borrowing during 2016/17. Some of these borrowings have not yet been used to finance capital expenditure, already approved within the capital programme and the council is therefore currently "over borrowed". In 2016/17 a total of £94m was borrowed from the Public Works Loans Board at a weighted average interest rate of 2.37% per annum and £73m was borrowed from Canada Life at an equivalent interest rate of 0.65% per annum[1]. The weighted average interest rate payable on the total borrowing undertaken in 2016/17 is therefore 1.62%.

It is some of this borrowing that has not yet been applied to finance capital expenditure approved but not yet expended within the Capital Programme (primarily investment properties). At 31st March 2018 the Council was "over Borrowed" by £55m. This surplus cash was invested in accordance with the treasury management policy which was yielding an average investment return of 1.11%. The interest payable on this over borrowing net of interest received from investing the surplus cash is termed the "cost of carry". The cost of carry is calculated as being the difference between the weighted interest payable by the Council on the 2016/17 borrowing and the average return being achieved from the investment of surplus cash arising from the over borrowing (i.e. 1.62% less 1.11% (1.07% at 30th September). The Council is not expecting to be significantly over borrowed as at 31st March 2019.

Borrowing in advance of need has enabled the council to secure lower interest rates on long term debt than it would have otherwise have been able to do if it had waited to take the borrowing later when interest rates are starting to rise.

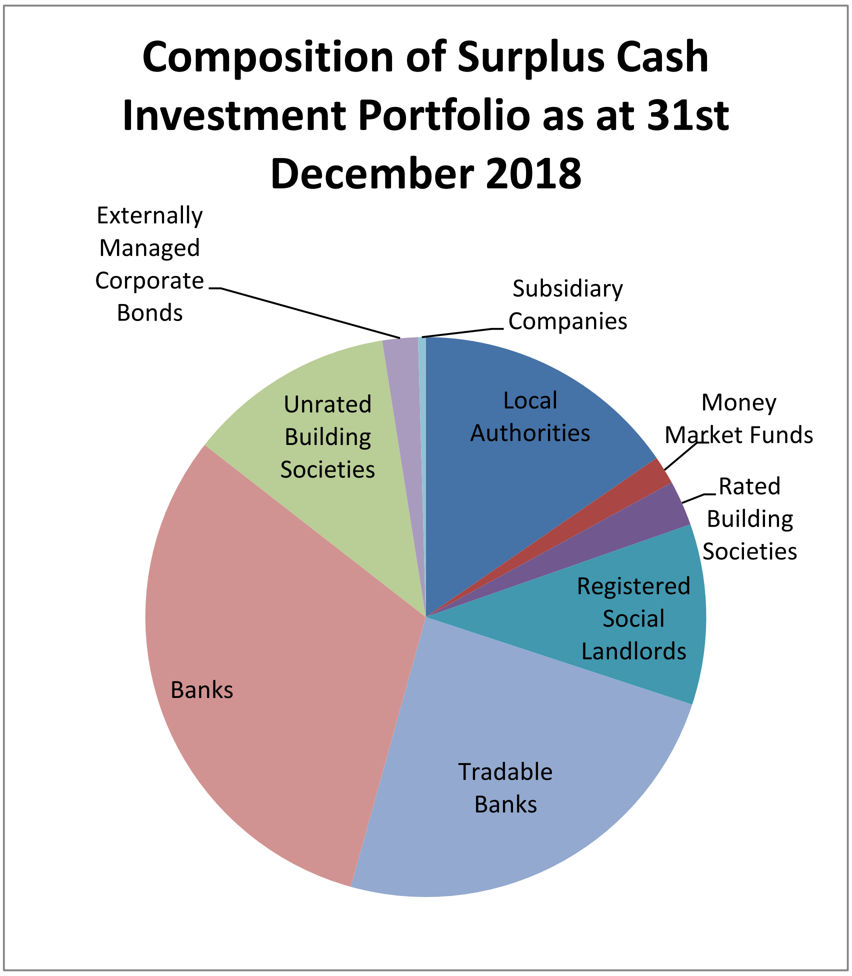
A4. INVESTMENT ACTIVITY

Investment rates have followed a rising trend since June 2018. Appendix B shows the actual market rates available for the first three quarters of 2018/19. Bank base rate is not forecast to rise again this financial year and then to only rise slowly thereafter.

The Council's surplus cash investments have decreased by £34.5m from £418.7m at 1st April 2018 to £384.2m at 31st December 2018. The Council's budgeted investment return for 2018/19 is £2.3m and performance for the year to date is £1.9m above budget. This is a result of obtaining better interest rates on maturing deposits and higher cash balances than originally anticipated. All Council investments have been in accordance with the Council's Treasury Management Policy approved by Full Council in March 2018 and there are no breaches to report.

[1] 0.65% is the annual interest rate that must be used to calculate an annuity based on a loan advance of £72,919,800 (i.e. the amount of consideration paid by Canada Life to obtain the head lease in respect of land at White Hart Road) for a period of 41 years (the term of the head lease) which results in quarterly pass through payments of £506,549 (i.e. the quarterly rent paid to PCC by Wight Link in respect of land at White Hart Road and subsequently paid by PCC to Canada Life who hold the head lease)

A summary of the Council's surplus cash investment portfolio is shown in the graph below. These investments totaled £384m as at 31st December 2018.



Money Market Funds
Money market funds are instant access investments in AAA rated pooled funds.

Tradable Investments in Banks and Corporates (Commercial Companies)
Some investments in banks and corporates (commercial companies) are tradable. This means that the Council can sell the investments at any time to a third party. This contrasts with bank and building society term deposits which can only be repaid by the bank or building society.

Externally Management Corporate Bond Holdings
The Council has some externally managed corporate bond holdings. These consist of tradable debt issued by commercial companies.

Rated Building Societies
These are building societies with at least two credit ratings from Standard and Poor, Moody's or Fitch.

Unrated Building Societies
These are building societies that do not have at least two credit ratings from Standard and Poor, Moody's or Fitch.

A5. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

The Councils net debt position at 31st December 2018 is summarised in the table below.

	Principal	**Average Interest Rate**	**Interest to 31st December 2018**
Borrowing (including finance leases & private finance initiative (PFI) schemes)	£620m	4.07%	£18.9m
Investments	(384m)	(1.11%)	(£3.6m)
Net Debt	£236m		£15.3m

<u>Source of Surplus Cash Invested In Accordance With the Treasury Management Policy</u>

As at 31st March 2018 the surplus cash invested in accordance with the treasury management policy totaled £419m and was represented by the following items on the Council's balance sheet.

	£m
General Fund Balance & Housing Revenue Account Balance	50
Capital Grants	85
Capital Receipts	13
Earmarked Revenue Reserves	154
Borrowing in Advance of Need	55
Excess of Creditors over Debtors	21
Other	41
Total	**419**

A6. INTEREST RATE EXPOSURES

Fixed interest rates avoid the risk of budget variances caused by interest rate movements, but prevent the Council from benefiting from falling interest rates on its borrowing or rising interest rates on its investments. The Council's net fixed interest rate borrowing at 31st December was £320m which was within the limit set in the Treasury Management Policy of £454m. Variable interest rates expose the Council to the benefits and dis-benefits of interest rate movements and can give rise to budget variances. The Council's net variable interest rate cash investments at 31st December were £150m which was within the limit set in the Treasury Management Policy of £289m.

A7. INVESTMENT PROPERTIES

Investment properties themselves do not form part of the treasury management function but are referred to here for completeness. Further details on the performance of the investment property portfolio were reported to the Cabinet on 9th October 2018.

The Council's policy is to establish and maintain an investment property portfolio with a balanced risk profile and was valued at £114m as at 31st March 2018 with a return against total capital investment (including costs) of 5.85% as reported to the Cabinet on 9th October 2018.

Current Minimum Revenue Provision (MRP) policy relating to investment properties is that, there is no annual set aside of resources as a provision to repay debt relating to these properties. However, the Treasury Management Policy requires that upon the sale of an investment property, the proceeds from the sale are set aside to fully provide for the repayment of the debt that originally financed the investment.

Inevitably there will be cyclical movements in the market value of the investment property portfolio and there is a risk that in the short term the market value of an investment property could fall below the original price for which it was acquired. If this happens the MRP policy requires additional funds to be set aside to ensure there are adequate resources available to repay the debt that was incurred to finance the property. The set aside will be made over the remaining life of the investment property.

To guard against financial shocks on the General Fund arising from property value fluctuations, the Council's policy is to transfer 20% of the annual rental income from investment properties to an earmarked Investment Property Reserve. As at 31st March 2018 the balance on this reserve was £2.07m but will increase further over time.

A8. ALTERNATIVE INVESTMENTS

Alternative investments such as equity funds are subject to significant price volatility and can incur large fees. As a consequence they are most suited as long term investments within a cash investment portfolio. Work is currently being undertaken to forecast the amount of cash that is likely to be available to the Council over the next 30 years and therefore available for investment in accordance with the Treasury Management Policy. This information will be used to inform future Treasury Management Strategies which will be reported to G&A&S for scrutiny and Cabinet and City Council for approval and may result in alternative investment strategies.

APPENDIX B

LIBID rates are London inter-bank bid rates and gove an indication of the rates available in the London money market

Some of the Council's cash is invested for longer than a year for which there is no comparable published LIBID rate