Title of meeting:	Governance and Audit and Standards Committee Cabinet City Council
Date of meeting:	Governance and Audit and Standards Committee 26 July 2019 Cabinet 9 September 2019 City Council 13 October 2019
Subject:	Treasury Management Outturn Report 2018/19
Report by:	Director of Finance and Information Technology (Section 151 Officer)
Wards affected:	All
Key decision:	No
Full Council decision:	Yes

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1. Executive Summary

The Chartered Institute of Public Finance & Accountancy's (CIPFA) Prudential Code of Practice requires local authorities to calculate prudential indicators before the start of and after each financial year. The CIPFA Code of Practice on Treasury Management also requires the Section 151 Officer to prepare an annual report on the outturn of the previous year. This information is shown in Appendix A of the report.

2. Purpose of Report

To inform members and the wider community of the Council's treasury management activities in 2018/19 and of the Council's treasury management position as at 31 March 2019.

3. Recommendations

It is recommended that the actual prudential and treasury management indicators based on the unaudited* accounts, as shown in Appendix B, be noted (an explanation of the prudential and treasury management indicators is contained in Appendix C).

* Since this report was written the Council's auditors have issued an unqualified audit opinion on the Council's accounts and the prudential and treasury management indicators are therefore confirmed.

4. Background

The Local Government Act 2003 requires local authorities to have regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities.

5. Reasons for Recommendations

The net cost of Treasury Management activities and the risks associated with those activities have a significant effect on the Council's overall finances.

6. Equality Impact Assessment

The contents of this report do not have any relevant equalities impact and therefore an equalities assessment is not required.

7. Legal implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance & Information Technology (Section 151 Officer) comments

All financial considerations are contained within the body of the report and the attached appendices

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Signed by Director of Finance & Information Technology (Section 151 Officer)

Appendices:

Appendix A: Treasury Management Outturn Report
Appendix B: Prudential and Treasury Management Indicators
Appendix C: Explanation of Prudential and Treasury Management Indicators
Appendix D: Public Works Loans Board (PWLB) Interest Rates
Appendix E: Debt maturity Pattern
Appendix F: Investment Rates - Bank Rate v. London Interbank Bid (LIBID) Rates
Appendix G: Investment Maturity Pattern

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

	Title of document	**Location**
1	Information pertaining to the treasury management outturn	Financial Services
2		

APPENDIX A

TREASURY MANAGEMENT OUTTURN REPORT

1. GOVERNANCE

Treasury management activities were performed within the Prudential Indicators approved by the City Council.

Treasury management activities are also governed by the Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council.

2. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

On 31 March 2019 the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £656m and gross investments of £417m giving rise to a net debt of £239m. The current high level of investments has arisen from the Council's earmarked reserves and borrowing in advance of need to take advantage of low borrowing rates thus securing cheap funding for the Council's capital program. The current high level of investments does increase the Council's exposure to credit risk, ie. the risk that an approved borrower defaults on the Council's investment. In the interim period when investments are high in advance of capital expenditure being incurred, there is also a short term risk that the rates (and therefore the cost) at which money has been borrowed will be greater than the rates at which those loans can be invested. Current borrowing rates are 1.22% higher than investment rates. Securing low cost long term funding for the capital program will provide longer term savings through reduced borrowing costs.

3. BORROWING ACTIVITY

The Council has established a net loans requirement in its Capital Strategy for 2019/20. This is the Council's underlying need to borrow to fund the approved capital program after taking account of cash backed reserves which could be used to internally fund capital expenditure financed from borrowing for a limited period. This identified that the Council will need to borrow £46m within the next 3 years.

Since Public Works Loans Board (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 (See Appendix D). In March £34.5m was borrowed for the following reasons:

- The PWLB Certainty Rate (the rate that the PWLB charges the Council for borrowing) was less than 2.50% which the Bank of England has suggested will be the neutral base rate in the long term, ie. the rate at which monetary policy is neither accommodating or constraining the economy;
- The PWLB Certainty Rate was less than the Council's treasury management advisors, Link Asset Services, target borrowing rate;

- Link Asset Services had forecast that the rate that the PWLB would lend to local authorities would increase by 0.10% by June 2019 and continue to gradually increase for at least the next 3 years;
- Borrowing in March 2019 was forecast to have a lower cost in real terms, taking account of the time value of money, than borrowing in 3 years' time.

Consequently the following loans were taken from the PWLB in March:

- £23m on 12 March at 2.39% for 50 years repayable at maturity
- £11.5m on 25 March at 2.24% for 46 years repayable at maturity

The Council borrowed £2.1m interest free from Salix repayable over 5 years to fund energy efficiency projects including the replacement of street lighting with LED lamps. Salix is a not-for-profit organisation that is funded by the Government to promote energy efficiency within the public sector.

The Council's gross debt at 31 March 2019 of £656m is within the Council's authorised limit (the maximum amount of borrowing permitted by the Council) of £724m and the Council's operational boundary (the maximum amount of borrowing that is expected) of £706m. The Council aims to have a reasonably even maturity profile so that the Council does not have to replace a large amount of borrowing in any particular year when interest rates might be high. The maturity profile of the Council's borrowing (Appendix E) is within the limits contained in the Council's Treasury Management Policy.

4. INVESTMENT ACTIVITY

Size of Cash Investment Portfolio

The Council's cash investment portfolio has decreased by £2.0m from £418.7m at 31 March 2018 to £416.7m at 31 March 2019.

Interest rates

Bank Rate and London Interbank Bid (LIBID) investment rates for 2018/19 are shown in Appendix F.

Interest rates offered on investments remained generally 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 Monetary Policy Committee of the Bank of England (MPC) would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018.

It was expected that the MPC would not raise the 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 investing longer term 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.

Treasury Management Strategy

During the year investments were made to meet the objectives of the Treasury Management Strategy approved by the City Council on 20 March 2018. These were to:

- Ensure the security of lending
- To maintain £10m in instant access accounts
- To make funds available to the Council's subsidiaries
- To make funds available for the regeneration of Hampshire
- To optimise the return on surplus funds
- To manage the Council's investment maturity profile to ensure that no single month exposes the authority to a substantial re-investment requirement when interest rates may be relatively low

The Council has numerous investment objectives which can conflict with each other and a balance has to be struck.

Security of Lending

None of the City Council's investments has defaulted. However, £2.8m was lent to Victory Services Energy Limited (VESL) which now faces an uncertain future. Because of this uncertainty a £2.8m provision has been made to cover the resulting loss if VESL does default.

Maintaining £10m in Instant Access Accounts

At 31 March 2019 £29.9m was invested in instant access accounts (£29.7m at 31 March 2018).

To Make Funds Available to the Council's Subsidiaries

At 31 March 2019 £2.8m had been lent to VESL. No other surplus cash had been lent to subsidiary companies. £6.5m had been lent to Portico (formerly MMD) for capital purposes, but this was done through the capital program rather than through the Treasury Management Policy.

To Make Funds Available for the Regeneration of Hampshire

It was intended to fulfill this objective by providing secured loans to Hampshire Community Bnk (HCB) which would then on lend the Council's funds to small and medium sized businesses in Hampshire. However, at 31 March 2019 a funding arrangement had not been agreed with HCB and no funds had been lent.

To Optimise the Return on Surplus Funds

The average return on the Council's cash investments during 2018/19 before providing for defaults was 1.12%. This compares with 0.90% during 2017/18. This was largely achieved by lengthening the weighted average duration of the investment portfolio by 81 days from 217 days at 31 March 2018 to 298 days at 31 March 2019. However, after taking account of the provision made for the investment in VESL, the average return falls to 0.47%.

Maintaining an Even Investment Maturity Profile

The maturity profile of the Council's investments is shown on Appendix G.

No more than 13% of the investment portfolio matures in any single month.

5. REVENUE COSTS OF TREASURY MANAGEMENT ACTIVITIES IN 2018/19

Expenditure on treasury management activities in both the General Fund and the HRA against the revised budget is shown below.

	Revised Estimate 2018/19 £000	Actual 2018/19 £000	Variance +/- £000
Interest Payable:			
PWLB	17,418	17,405	(13)
Other Long Term Loans	1,129	1,001	(128)
HCC Transferred Debt	379	359	(20)
Interest on Finance Lease	189	189	0
Interest on Service Concession Arrangements (including PFIs)	6,364	6,364	0
Interest Payable to External Organisations	7	7	0
Premiums and Discounts on Early Redemption of Debt	85	85	0
	25,571	**25,410**	**(161)**
Deduct			
Investment Income:			
Interest on Investments	(2,457)	(4,674)	(2,217)
Impairment of Investments		2,753	2,753
Other interest receivable	(1,309)	(1,365)	(56)
	21,805	**22,124**	**319**
Provision for Repayment of Debt	3,841	4,118	277
Debt Management Costs	498	547	49
	26,144	**26,789**	**645**

Net treasury management costs were £0.6m, or 2.5% above the revised budget (£0.8m, or 3.1% below the revised budget in 2017/18).

Interest payable was £0.2m below the revised estimate. This was mostly due to less contingent interest being payable than had been anticipated on the loan from Canada Life which is subject to retail price index (RPI) increases.

Interest income was £0.5m below the revised estimate. Although interest on investments was £2.2m more than the revised estimate, this was offset by making a £2.8m provision for the investment in VESL.

The provision for the repayment of debt was £0.3m more than the revised estimate. This is because the provision for the repayment of debt on recently capital completed schemes was greater than had been anticipated.

APPENDIX B

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

1. Capital financing requirement	**Original Estimate £'000**	**Actual £'000**
General Fund	467,446	453,626
Housing Revenue Account (HRA)	177,260	173,068
Total	644,706	626,694

2. Authorised Limit	**Limit £'000**	**Actual £'000**
Long Term Borrowing	658,069	589,521
Other Long Term Liabilities	66,151	66,151
Total	724,220	655,672

3. Operational Boundary	**Limit £'000**	**Actual £'000**
Long Term Borrowing	640,093	589,521
Other Long Term Liabilities	66,151	66,151
Total	706,244	655,672

4. Ratio of financing costs to net revenue stream	**Original Estimate**	**Actual**
General Fund	10.9%	10.3%
Housing Revenue Account (HRA)	7.2%	7.4%
Total		

5. Interest rate exposures	**Limit £'000**	**Actual £'000**
Fixed rate (net borrowing)	454,000	394,068
Variable rate (net investments)	289,000	218,489

6. Maturity Structure of Fixed Rate Borrowing	**Lower Limit**	**Upper Limit**	**Actual**
Under 12 months	0%	10%	1%
12 months and within 24 months	0%	10%	1%
24 months and within 5 years	0%	10%	4%
5 years and within 10 years	0%	20%	6%
10 years and within 20 years	0%	30%	23%
20 years and within 30 years	0%	30%	7%
30 years and within 40 years	0%	40%	28%
Over 40 years	0%	40%	30%

7. Principal sums invested over 365 days	**Limit £'000**	**Actual £'000**
Maturing after 31/3/2019	264,000	155,590
Maturing after 31/3/2020	205,000	115,150
Maturing after 31/3/2021	144,000	63,250
Maturing after 31/3/2022	117,000	10,000

APPENDIX C

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

1. ACTUAL CAPITAL FINANCING REQUIREMENT

This represents the underlying requirement to borrow for capital expenditure. It takes the total value of the City Council's fixed assets and determines the amount that has yet to be repaid or provided for within the Council's accounts.

The capital financing requirement is increased each year by any new borrowing and reduced by any provision for the repayment of debt. Broadly, the higher the capital financing requirement, the higher the amount that is required to be set aside for the repayment of debt in the following year.

2. AUTHORISED LIMIT

The authorised limit for external debt is the maximum amount of debt which the authority may legally have outstanding at any time. The authorised limit includes headroom to enable the Council to take advantage of unexpected movements in interest rates and to accommodate any short-term debt or unusual cash movements that could arise during the year.

3. OPERATIONAL BOUNDARY

The Operational Boundary is based on the probable external debt during the course of the year. It is not a limit, but acts as a warning mechanism to prevent the authorised limit (above) being breached.

4. RATIO OF FINANCING COSTS TO NET REVENUE STREAM 2018/19

This ratio reflects the annual cost of financing net debt as a proportion of the total revenue financing received. It therefore represents the proportion of the City Council's expenditure that is largely fixed and committed to repaying debt. The higher the ratio, the lower the flexibility there is to shift resources to priority areas and/or reduce expenditure to meet funding shortfalls.

For the General Fund, this is the annual cost of financing debt as a proportion of total income received from General Government Grants, Non Domestic Rates and Council Tax.

The ratio of Housing Revenue Account (HRA) financing costs to net revenue stream is the annual cost of financing capital expenditure, as a proportion of total gross income received including housing rents and charges.

5. 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.

Variable interest rates expose the Council to the benefits and dis-benefits of interest rate movements and can give rise to budget variances.

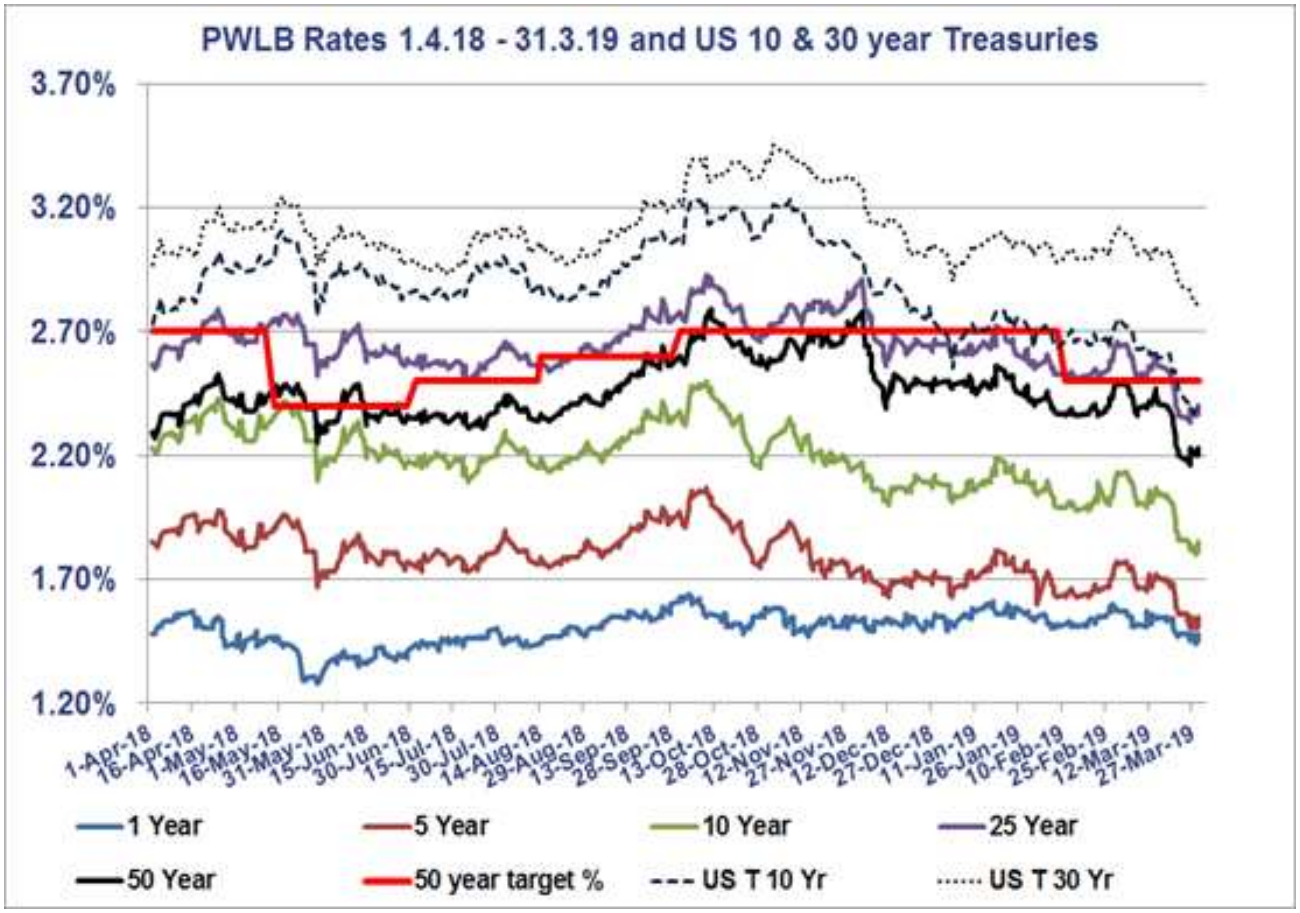
6. MATURITY STRUCTURE OF FIXED RATE BORROWING

The Council aims to have a reasonably even debt maturity profile so that it is not unduly exposed to refinancing risk in any particular year when interest rates may be high. The maturity structure of fixed rate borrowing matters less in future years as inflation will reduce the real value of the sums to be repaid.

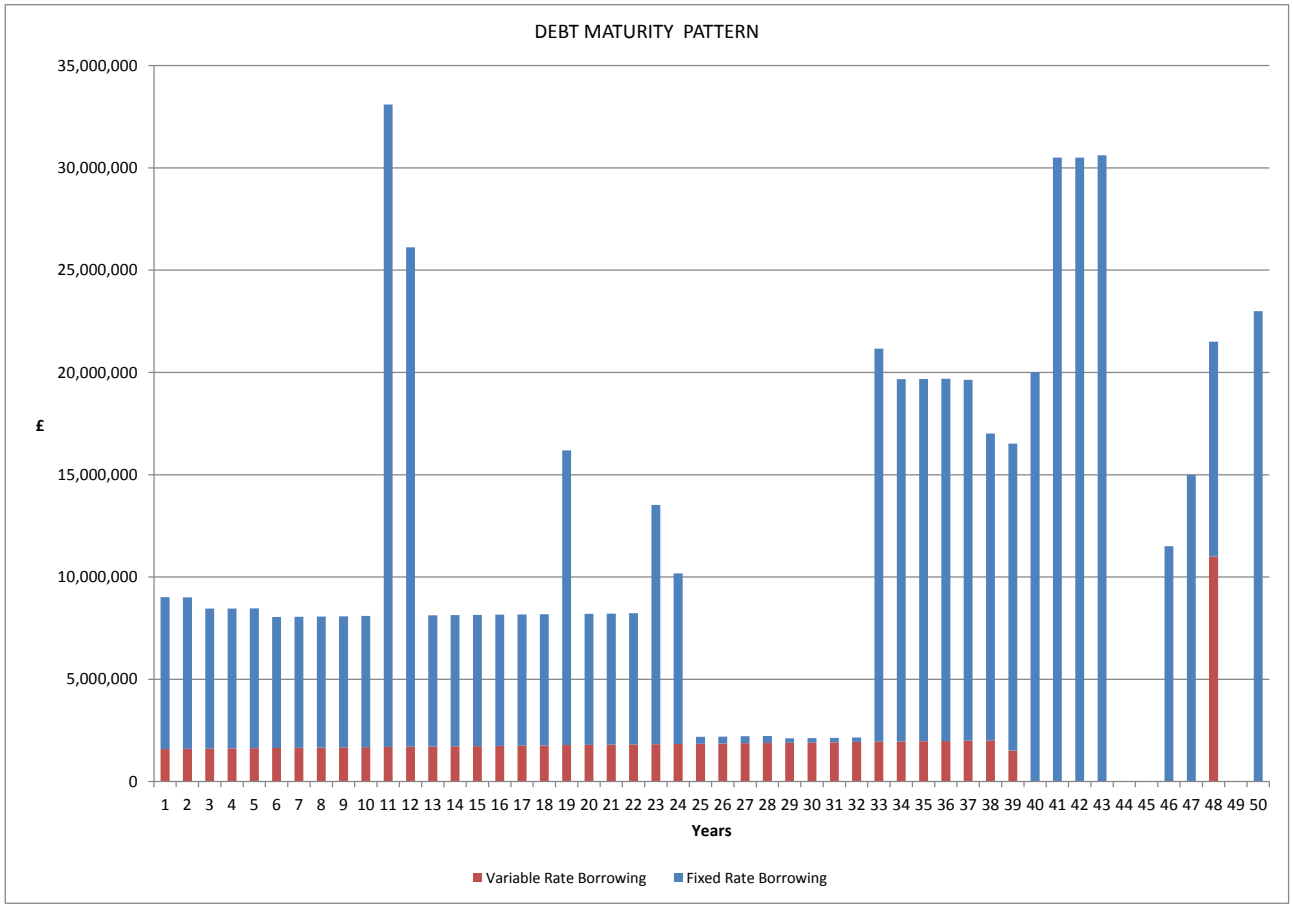
7. PRINCIPAL SUMS INVESTED FOR OVER 365 DAYS

Investing long term at fixed rates provides certainty of income and reduces the risk of interest rates falling.

APPENDIX D


PWLB Rates 1.4.18 - 31.3.19 and US 10 & 30 year Treasuries
3.70%
3.20%
2.70%
2.20%
1.70%
1.20%
1-Apr-18
16-Apr-18
1-May-18
16-May-18
31-May-18
15-Jun-18
30-Jun-18
15-Jul-18
30-Jul-18
14-Aug-18
29-Aug-18
13-Sep-18
28-Sep-18
13-Oct-18
28-Oct-18
12-Nov-18
27-Nov-18
12-Dec-18
27-Dec-18
11-Jan-19
26-Jan-19
10-Feb-19
25-Feb-19
12-Mar-19
27-Mar-19
1 Year
5 Year
10 Year
25 Year
50 Year
50 year target %
US T 10 Yr
US T 30 Yr

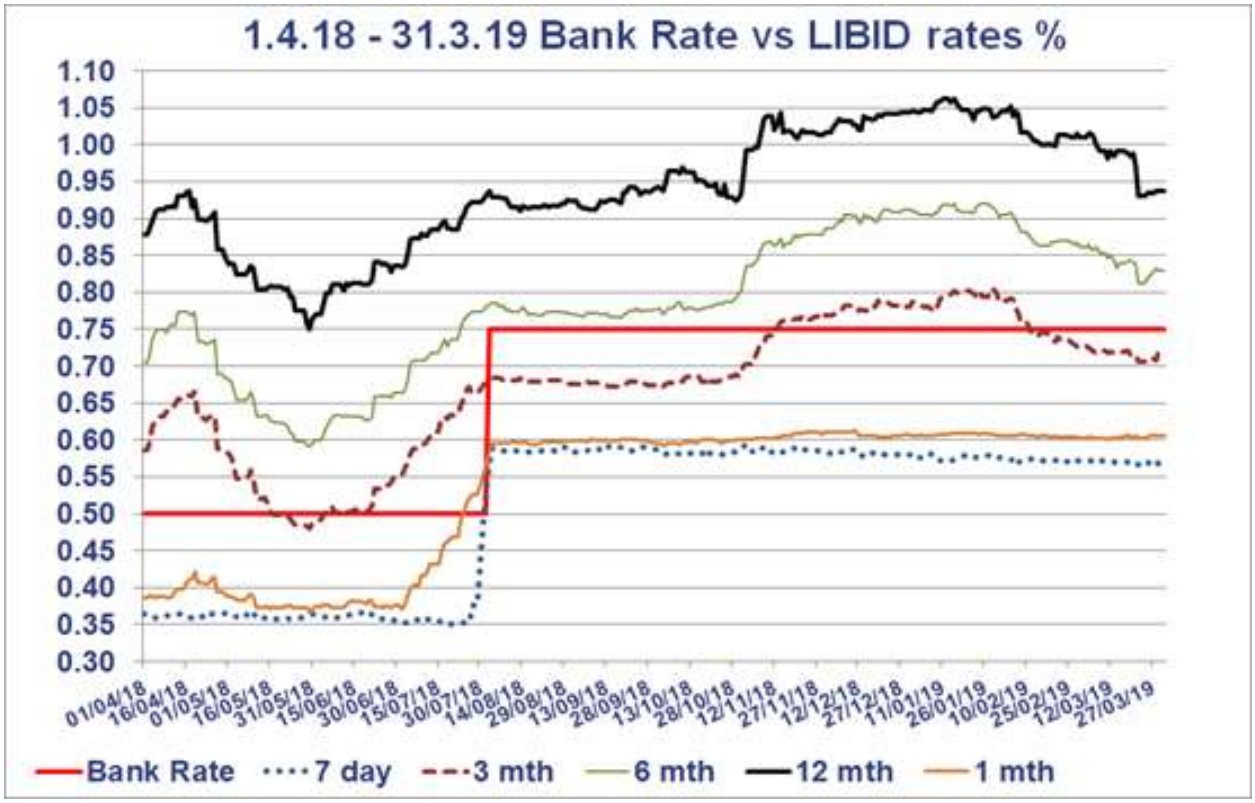
APPENDIX E



Years 11 and 12

In 2013 the Council successfully applied to the Government to borrow £43m from the PWLB at a discounted "Project Rate" to finance the development of Tipner, Horsey Island and Dunsbury Hill. As a consequence of this £25m was borrowed in 2014/15 and £18m was borrowed in 2015/16 for 15 years repayable at maturity in line with the financing requirements of this project.

APPENDIX F


1.4.18 - 31.3.19 Bank Rate vs LIBID rates %
1.10
1.05
1.00
0.95
0.90
0.85
0.80
0.75
0.70
0.65
0.60
0.55
0.50
0.45
0.40
0.35
0.30
01/04/18
16/04/18
01/05/18
16/05/18
31/05/18
15/06/18
30/06/18
15/07/18
30/07/18
14/08/18
29/08/18
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28/09/18
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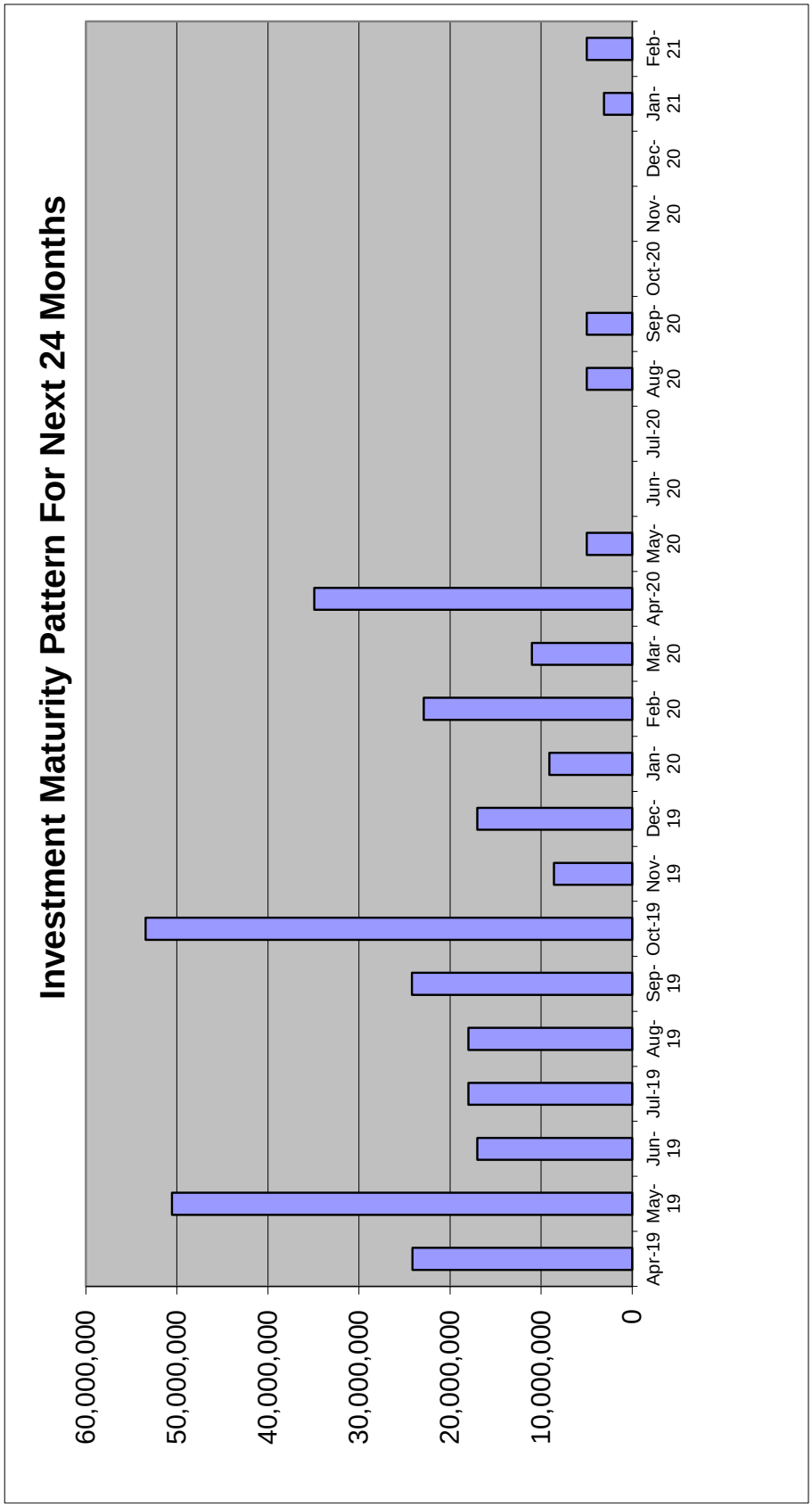
12/11/18
27/11/18
12/12/18
27/12/18
11/01/19
26/01/19
10/02/19
25/02/19
12/03/19
27/03/19
Bank Rate
7 day
3 mth
6 mth
12 mth
1 mth

APPENDIX G


Investment Maturity Pattern For Next 24 Months
60,000,000
50,000,000
40,000,000
30,000,000
20,000,000
10,000,000
0
Apr-19
May-19
Jun-19
Jul-19
Aug-19
Sep-19
Oct-19
Nov-19
Dec-19
Jan-20
Feb-20
Mar-20
Apr-20
May-20
Jun-20
Jul-20
Aug-20
Sep-20
Oct-20
Nov-20
Dec-20
Jan-21
Feb-21