Allerdale Borough Council

Audit Committee – 12 September 2019
Council – 25 September 2019

Treasury Management Annual Review 2018-19

The Reason for the Decision	To inform members of the performance of the Council's treasury management (TM) activities during 2018-19, the effects of TM decisions and transactions executed in the past year and of compliance with its Treasury Management Policy.
Recommendations	That the contents of this report be noted.
Financial / Resource Implications	None
Legal / Governance Implications	The CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) requires the Council to report on specific aspects of its treasury management activities after the year end.
Community Safety Implications	None
Health and Safety and Risk Management Implications	The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured.
Equality Duty considered / Impact Assessment completed	N/A
Wards Affected	None directly
The contribution this decision would make to the Council's priorities	None directly
Is this a Key Decision	No
Portfolio Holder	Councillor M. Johnson
Lead Officer	Barry Lennox, Financial Services Manager Ext: 2586 email: barry.lennox@allerdale.gov.uk

Report Implications

Community Safety	N	Employment (external to the Council)	N
Financial	N	Employment (internal)	N
Legal	Y	Partnership	N
Social Inclusion	N	Asset Management	N
Equality Duty	N	Health and Safety	N

1.0 Introduction

1.1 Regulations issued under the Local Government Act 2003 require the Council to produce an annual report on its treasury management activities and prudential and treasury indicators for the financial year. This report satisfies this obligation and the associated reporting requirements of the CIPFA Code of Practice on Treasury Management (the TM Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 During 2018-19 the minimum reporting requirements - set out in the Council's Treasury Management Strategy Statement (TMSS) and Investment Strategy - were that Council should receive the following reports:

- an annual Treasury Management Strategy Statement and Investment Strategy in advance of the year (Council 7 March 2018)
- a mid-year treasury update report (Council 5 December 2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

1.3 The regulatory environment places responsibility on members for the review and scrutiny of the Council's treasury management policies and activities. This report is important in that respect, as it provides:

- details of the Council's treasury activities during the financial year and its overall treasury position at 31 March 2019
- evidence of compliance with the treasury policies previously approved by members.

1.4 To enable the Audit Committee to fulfil its responsibilities for ensuring effective scrutiny of the treasury management strategy and policies, the Council's Treasury Management Practices (TMPs) require treasury management reports - including the annual report - to be submitted to the Audit Committee prior to their consideration by Council.

1.5 This report summarises the following:

- Economic background (section 2)
- Overall treasury position at 31 March 2019 (section 3)
- Borrowing requirement (section 4)
- Borrowing rates (section 5)

- Borrowing strategy for 2018-19 (section 6)
- Borrowing activity during 2018-19 (section 7)
- Investment rates (section 8)
- Investment Strategy for 2018-19 (section 9)
- Investment outturn for 2018-19 (section 10)
- Prudential and Treasury Indicators (section 11 and Appendix A).

2.0 Economic Background

U.K.

2.1 After weak economic growth of only 0.1% in quarter 1 (Jan to March) of 2018, reflecting, at least in part, to the temporary impact of adverse weather, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given the uncertainties over Brexit, this weak growth in the final quarter was not out of line with expectations. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing country in the G7 in quarter 4. Boosted by companies in the UK and the European Union building stocks ahead of the original March Brexit deadline, growth in quarter 1 of 2019 was unexpectedly strong at 0.5% (1.8% y/y).

2.2 Following a flow of generally positive economic statistics, the Monetary Policy Committee took the decision on 2 August 2018 to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. Since then, uncertainties over Brexit have increased, UK and global economic growth has been subdued and inflation has fallen back close to the Bank of England's 2% target. The MPC have consequently abstained from any further increases and any further action from the MPC is unlikely until the uncertainties over Brexit clear. If there were a disorderly exit, it is possible that the Bank Rate would be cut to support growth, but this is by no means certain.

2.3 The uncertainties about the nature of EU withdrawal mean the UK economy could follow a wide range of paths over coming years. In response, the appropriate path of monetary policy will depend on the balance of the effects of Brexit on demand, supply and the exchange rate, with the Bank of England stressing that the monetary policy response to Brexit, whatever form it takes, will not be automatic and could be in either direction.

2.4 Employment growth has been stronger than expected, despite relatively soft activity growth and Brexit uncertainties. Although productivity growth has remained weak, the labour market nevertheless remains tight. Wage growth picked up during 2018 and has been growing at its strongest sustained pace since 2008. Wage inflation peaked at a new post financial crisis high of 3.5%, (excluding bonuses) in the three months to December before falling marginally to 3.4% more recently. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. In the three months to March 2019, the unemployment rate fell to

3.8%, its lowest rate since 1975. In the same period UK employment rate was estimated at 76.1%, higher than for a year earlier (75.6%) and the joint- highest figure on record.

2.5 CPI inflation has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February and March. CPI subsequently rose slightly to 2.1% in April before falling back again to 2.0% in May and June and is likely to remain around this level over the next two years. However, if there was a no deal Brexit, it could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

2.6 The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.5%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

Brexit.

2.7 The UK is currently due to leave the EU on 31 October regardless of whether or not a deal has been agreed with the EU. However, it is unclear if there will be majority support in the Commons for any withdrawal option. If there was a stalemate in the Commons, then that would increase the chances of a general election in 2019.This could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

European Union

2.8 The European Central Bank (ECB) provided massive monetary stimulus in 2016 and 2017 to encourage growth in the Eurozone. That produced strong annual growth in 2017 of 2.3%. However, since then the ECB has been reducing its monetary stimulus measures and growth has been weakening - to 0.4% in quarters 1 and 2 of 2018, and then slowed further to 0.2% in quarters 3 and 4; it is likely to be only 0.1% to 0.2% in quarter 1 of 2019. The annual rate of growth for 2018 was 1.8% but is expected to fall to possibly around half that rate in 2019.

2.9 The ECB ended its programme of quantitative easing purchases of debt in December 2018. This means the central banks in the US, UK and EU have all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in growth, together with inflation falling well under the upper limit of its target range of 0% to 2%, has prompted the ECB to take new measures to stimulate growth. With its refinancing rate already at 0% and the deposit rate at -0.4%, it has probably reached the limit of cutting rates.

2.10 At its March 2019 meeting, the ECB stated that it expects to leave interest rates at their present levels “at least through the end of 2019”, but that is of little help to boosting growth in the near term. Consequently, it also announced a third round of Targeted Longer-Term Refinancing Operations (TLTROs); this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending and they will be capped at 30% of a bank's eligible loans.

U.S.

2.11 President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the rate of growth; this rose from 2.2%, (annualised rate) in quarter 1 of 2018 to 4.2% in quarter 2, 3.5% in quarter 3 and then back to 2.2% in quarter 4. The annual rate came in at 2.9% for 2018, just below President Trump's target of 3%. Growth in quarter 1 of 2019 was a strong 3.1% but current expectations are for this to weaken considerably in quarter 2.

2.12 The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.4% in February, a decade high point. More recently however, the strong growth in employment numbers recorded during 2018 has faded, indicating that the US economy is cooling, while inflationary pressures are also weakening. CPI inflation overall fell to 1.5% in February, a two and a half year low, and looks to be likely to stay around that number in 2019 i.e. below the Federal Reserve's target of 2%.

2.13 The Federal Reserve increased rates by a further 0.25% in December to between 2.25% and 2.50%, the fourth increase in 2018 and the ninth in the upward swing cycle. However, since then, market expectations have swung to expecting the Federal Reserve to cut rates over the next two years by 1.0% - 1.25% in total to counter the expected downturn in growth.

Asia

2.14 Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus. Medium term risks are also increasing especially as a result of credit intensive growth. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

2.15 The trade war between the US and China on tariffs is also a major concern not only to financial markets and China itself, but also for world growth, as any downturn in China will spill over into impacting countries supplying raw materials to China.

2.16 Japan has been struggling to stimulate significant GDP growth and to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

3.0 Overall Treasury Position at 31 March 2019

3.1 The Council's treasury position at the beginning and end of 2018-19 was as follows:

Table 1: Overall treasury position

	31.3.18 Principal £'000	Rate/ Return[1] %	Av. Life Years	31.3.19 Principal £'000	Rate/ Return[1] %	Av. Life Years
PWLB loans	15,380	5.42	25	15,067	5.45	24.6
Other borrowing	85	0.00	< 1	85	0.00	< 1
Total debt	**15,465**	5.39		**15,152**	5.39	
Short-term investments	7,133	0.36	< 1	6,313	0.69	< 1
Long-term investments[2]	11	5.26	-	11	7.5	-
Bank overdraft less cash	(1,805)		-	(1,909)		-
Total investments	**5,339**	0.37	-	**4,415**	0.70	-

[1] weighted average rate on borrowing/investments at 31 March (for illustrative purposes only)

[2] Not including 'policy investments' falling outside of the Councils Treasury Management and Investment Strategies

3.2 The Council's treasury management debt and investment position is organised in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the introduction and through officer activity detailed in the Council's Treasury Management Practices.

4.0 The Borrowing Requirement

4.1 The Council's underlying need to borrow to finance capital expenditure is measured by the Capital Financing Requirement (CFR). The CFR represents the historic cost of capital expenditure that has yet to be financed by setting aside resources (grants, contributions, capital receipts and revenue financing).

4.2 Capital expenditure that is not financed when incurred, through the application of capital grants, contributions, capital receipts or a direct charge to revenue will increase the capital financing requirement. It will also give rise to a requirement to make an annual charge to the general fund known as the minimum revenue provision (MRP). Charging the minimum revenue provision or a voluntary revenue provision (in addition to the MRP) against the general fund will reduce the CFR.

4.3 The Council's Treasury Management Strategy Statement for 2018-19 included an expected net increase in the CFR of £4.817m during 2018-19 and a closing CFR at 31 March 2019 of £25.46m. This increase was based on the 2018-19 capital budget approved by Council in March 2018 and the revised capital budget for 2017-18 approved in November 2017. The estimated increase in the

CFR during 2018-19 and the closing CFR balance at 31 March 2019 were later revised to £5.397m and £24.314m respectively. These revisions reflect:

- the 2017-18 capital outturn position and approved budget carry forwards incorporated into the 2018-19 revised capital budget. This reduced the opening CFR at 1 April 2018 by £1.726m and added £1.676m to the expected increase in 2018-19.
- capital expenditure growth and savings bids of £3.306m, funded from borrowing, included in the revised 2018-19 capital budget
- reprofiling of previously approved expenditure, funded from borrowing between financial years; This included £5.022m transferred from 2018-19 to 2019-20 as part of the 2018-19 revised budget process and the transfer of £620k, approved by Council in January 2019, from 2019-20 to 2018-19.

4.4 Details of actual borrowing transactions undertaken in 2018-19 are summarised in section 7.

4.5 At 31 March 2019 the Council's capital financing requirement stood at £22.741m compared to £18.917m at 31 March 2018. The increase of £3.824m over the course of 2018-19 reflects:

- an increase of £4.495m relating to unfinanced capital expenditure incurred during the year
- a reduction of £671k resulting from amounts set aside from revenue (the minimum revenue provision), calculated in accordance with the approved MRP Policy Statement for 2018-19.

Table 2: Capital Financing Requirement

	31.3.18 Estimate £000	31.3.18 Actual £000	31.3.19 Approved Estimate £000	31.3.19 Updated Estimate[1] £000	31.3.19 Actual £000
CFR at 31 March	20,643	18,917	25,460	24,314	22,741

[1] reported in mid-year review based on revised capital budget

4.6 The variance of £1.573m between the actual and updated estimate of the CFR at 31 March 2019 comprises:

- £1.327m relating to the unfinanced portion of approved 2018-19 capital budget carry forwards (i.e. the amount funded from borrowing) of £2.444m
- £0.246m reduction in unfunded capital expenditure associated with the reported net underspend (after budget carry-forwards) of £0.105m.

4.7 Capital budget carry-forwards of £2.444m were approved as part of the 2018-19 Capital Outturn report presented to the Council's Executive on 28 June 2019. These carry-forwards relate to the re-profiling of previously approved budget expenditure from 2018-19 to 2019-20 on the following capital schemes:

- Reedlands Road Development - carry forward £1.112m (£0.443m unfinanced)
- Public Toilets Review Works - carry forward £0.109m (£0.075m unfinanced)
- Healthy Homes - carry forward £0.142m (£0.142m unfinanced)
- Mandatory Disabled facilities Grant carry forward £0.102m (£0 unfinanced)
- Brow-Top enhancement scheme - carry forward £0.133m (£0.133m unfinanced)
- Highfield Community Centre - carry forward £0.101m (£0.101m unfinanced)
- RCV Vehicles and wheeled bins - carry forward £0.136m (£0.136 unfinanced)
- Flood resilience schemes - carry forward £0.185m (£0.185m unfinanced)
- Other schemes - carry forward £0.424 (£0.112m unfinanced).

5.0 Public Works Loan Board (PWLB) Borrowing Rates in 2018-19

5.1 Interest rate forecasts provided by the Authority's Treasury advisors (Link Asset Services) 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. Table 3 shows the PWLB borrowing rate forecasts included in the TMSS and the updated forecast included in the Mid- year review issued following the quarterly Bank of England Inflation Report and the decisions and forward guidance issued by the Banks Monetary Policy Committee (MPC) at its meeting on 2 August.

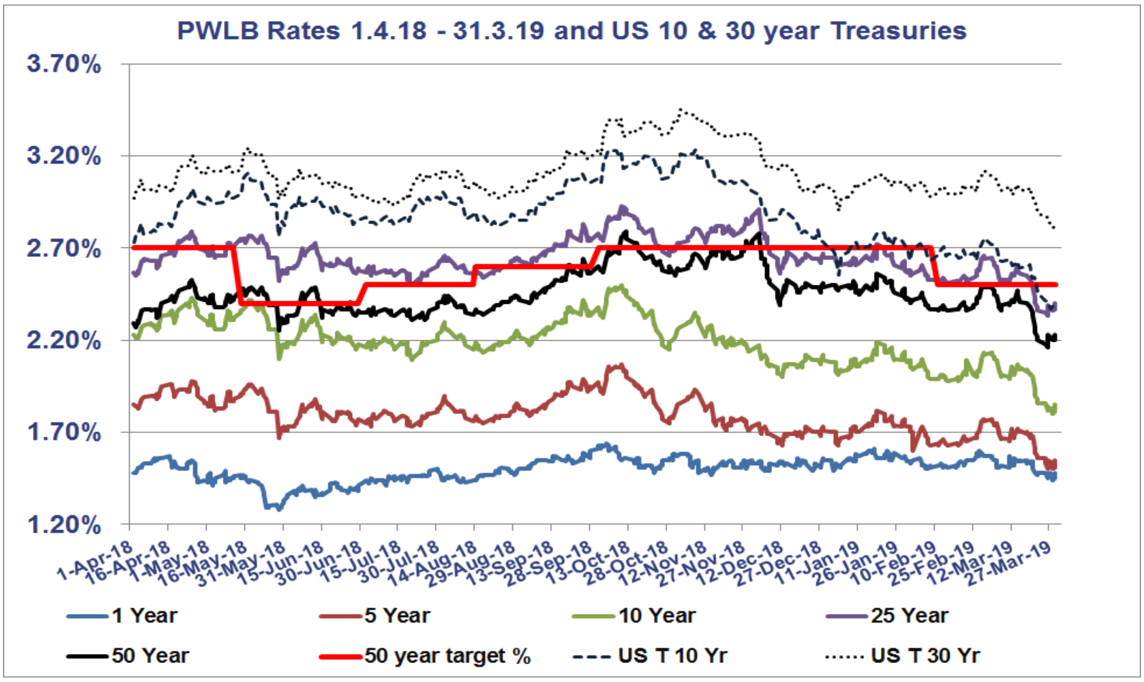
Table 3: Forecast interest rates 2018-2021

Quarter ending	PWLB Borrowing Rates[1]							
	5 year %		10 year %		25 year %		50 year %	
	TMSS	Mid- Yr	TMSS	Mid- Yr	TMSS	Mid- Yr	TMSS	Mid- Yr
Mar 2018	1.60	-	2.20	-	2.90	-	2.60	-
Jun 2018	1.60	-	2.30	-	3.00	-	2.70	-
Sep 2018	1.70	-	2.40	-	3.00	-	2.80	-
Dec 2018	1.80	2.00	2.40	2.50	3.10	2.90	2.90	2.70
Mar 2019	1.80	2.10	2.50	2.50	3.10	3.00	2.90	2.80
Jun 2019	1.90	2.20	2.60	2.60	3.20	3.10	3.00	2.90
Sept 2019	1.90	2.20	2.60	2.70	3.20	3.10	3.00	2.90
Dec 2019	2.00	2.30	2.70	2.70	3.30	3.20	3.10	3.00
Mar 2020	2.10	2.30	2.70	2.80	3.40	3.20	3.20	3.10
Jun 2020	2.10	2.40	2.80	2.90	3.50	3.30	3.30	3.10
Sept 2020	2.20	2.50	2.90	2.90	3.50	3.40	3.30	3.20
Dec 2020	2.30	2.50	2.90	3.00	3.60	3.50	3.40	3.30
Mar 2021	2.30	2.60	3.00	3.10	3.60	3.50	3.40	3.30

[1]Certainty rates are calculated by subtracting 0.2% from the standard new loan rates. Certainty rates apply to authorities who have provided MHCLG with required information on their plans for long-term borrowing and associated capital spending.

5.2 The graphs and tables below and in appendix B show, for a selection of maturity periods, the high and low points for PWLB certainty maturity rates, the average rates, spreads and individual rates at the start and the end of the financial year.

Graph 1: PWLB borrowing rates 2018-19



5.3 The graph above shows that whilst PWLB rates were on a rising trend during the latter half of the second quarter, there was little consistent trend in rates during the first six months of the financial year. After peaking in 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.

5.4 At 31 March 2019 the 50 year PWLB certainty rate for new loans stood at 2.23% (fixed) compared to 2.27% at 1 April. The 25-year rate ended the year at 2.4% compared to 2.55% at 3 April 2018. This compares with updated forecasts included in the Mid-year report for 50 and 25 year maturities at the end of 2018-19 of 2.9% and 2.7% respectively.

5.5 Over the course of the year there was a significant level of correlation between movements in US Treasury yields and UK gilt yields (which determine PWLB rates). The US Federal Reserve (the Fed.) increased the Federal Reserve 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, by December 2018 financial markets had reached the view that the Fed had gone too far and discounted expectations of further increases.

5.6 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. This trend has continued into the 2019-20 financial year with PWLB rates on a general falling trend during most of the first quarter. This fall has been largely caused by a fall in US Treasury yields as investors have become increasingly concerned that the US economy is heading towards a sharp fall in GDP growth.

6.0 Borrowing Strategy for 2018-19

6.1 In recent years, the Council has maintained an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement - CFR), has not been fully funded with loan debt. By utilising cash supporting the Council's reserves and favourable in-year cash flows, the Council has been able to avoid the need to borrow up to the level of the CFR.

6.2 This has allowed the Council to minimise borrowing costs and reduce treasury risk by postponing borrowing and reducing its external investment balances. The policy of avoiding new borrowing by utilising cash balances has served the Council well and is considered prudent in light of low investment returns and the ongoing counterparty risk cosiderations which have endured since the 2008 financial crisis.

6.3 The borrowing strategy adopted in 2018-19 was for the Council to continue with this policy to the extent permitted by its liquidity requirements and the effective management of its interest rate exposures. In managing interest rate exposures, interest rates were closely monitored throughout the year and a pragmatic strategy adopted based upon the following principles:

- if it had been felt that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowing would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
- if it had been felt that there was a significant risk of a much sharper rise in long and short term rates than expected (e.g. due to an acceleration in the start date and the rate of increase in central rates in the US and UK; a greater tha expected increase in global economic activity or a sudden increase in inflation risks), then the portfolio position would have been re-appraised with the most likely action being to draw down fixed rate funding whilst interest rates were lower than they were projected to be in the next few years.

7.0 Borrowing Activity in 2018-19

7.1 A summary of borrowing transactions undertaken during 2018-19 is included in the following table (table 3).

Table 3: External borrowing activity during 2018-19

	01-Apr-18 £'000	New Borrowing £'000	Borrowing Repaid £'000	Other Movements £'000	31-Mar-19 £'000
Long-term					
PWLB – fixed rates	15,380	0	(313)	0	15,067
Short-term					
Local Bonds	31	0	0	0	31
Trust Funds	54	0	0	0	54
	15,465	**0**	**(313)**	**0**	**15,152**

7.2 The Council did not undertake any new borrowing, premature repayments or rescheduling of existing borrowing during 2018-19.

7.3 Scheduled loan repayments of £313k were made during the year to March 2019.

7.4 The Council's 2018-19 Budget and Treasury Management Strategy Statement anticipated additional PWLB borrowing during 2018-19 of up to £5.4m to fund the Council's capital programme. As a result of the changes included in the Council's revised 2018-19 capital programme, including the impact of the re-profiling of expenditure funded from borrowing between financial years and the later reprofiling change approved in January 2018, anticipated (maximum) external borrowing requirements for 2018-19 was subsequently revised upwards to £5.8m.

7.5 As noted above, the Council's policy is to use internal borrowing to avoid or postpone the timing of any new borrowing in circumstances where it considered prudent to do so, having regard to its liquidity requirements and the effective management of interest rate exposures.

7.6 During 2018-19, the reported underspend against the 2018-19 capital budget, coupled with the timing of capital expenditure during the year and other positive in year cash flows, has enabled the Council to continue with the policy and to meet its liquidity requirements by utilising cash from reserves, revenue balances and favourable in year cash flows without the need to borrow externally.

7.7 As a consequence, during 2018-19 the Council has maintained an under borrowed position level, increasing the level of under borrowing from £3.97m at 1 April 2018 to £7.59m at 31 March 2019.

7.8 By utilising internal borrowing to meet capital funding requirements and deferring the draw-down of new external (PWLB) borrowing the Authority has been able to secure:

- non recurring savings - included in the 2018-19 revised budget - of £133k against the original budget for interest costs
- a favourable outturn variance in interest payable - compared to the revised budget - of £20k.

7.9 Further information regarding the movement in the CFR and the level of under borrowing is set out in Appendix A (Prudential indicators).

7.10 At 31 March 2019, the Council's PWLB loan portfolio consisted of fixed rate:

- maturity loans totalling £8.0m (31 March 2018: £8m)
- annuity loans of £1.627m (31 March 2018: £1.70m)
- EIP loans of £5.44m (31March 2018: £5.68m).

7.11 Interest rates applying to individual loans within the Council's PWLB loan portfolio range from 2.44% to 9.5%. At 31 March 2019, the weighted average rate of interest payable on the Council's PWLB loan portfolio stood at 5.45% (31 March 2018: 5.42%). Whilst this remains above current rates applicable to new PWLB borrowing (see Appendix B) - reflecting the historic nature of the Council's PWLB loans portfolio - no rescheduling was done during the year as the average 1% differential, between PWLB new borrowing rates and premature redemption rates, made rescheduling unviable.

7.12 At 31 March 2019, the 'fair value' of the Council's PWLB loans portfolio – measured using PWLB premature repayment rates – was £29.605m (31 March 2018: £29.598m) .The difference of £14.538m – between this and the principal outstanding (£15.067) – reflects the premium that would be payable to repay those loans prematurely (£14.337m), plus interest accrued from the previous scheduled repayment date (£0.201m).

7.13 At 31 March 2019, the weighted average life of the Council's PWLB loan portfolio was approximately 25 years (31 March 2017: 25 years). The weighted average time to maturity of these loans was 29 years (31 March 2018: 30 years).

8.0 Investment Rates in 2018-19

8.1 Deposit rates continued into the start of 2018-19 at previous depressed levels and despite increases over the year have, in line with expectations, remained low throughout 2018-19. As a consequence a cost of carry remained throughout the year on any new long-term borrowing that was not immediately used to finance capital expenditure as this would have caused a temporary increase in cash balances and would have incurred a revenue cost reflecting the difference between (higher) borrowing costs and investment returns.

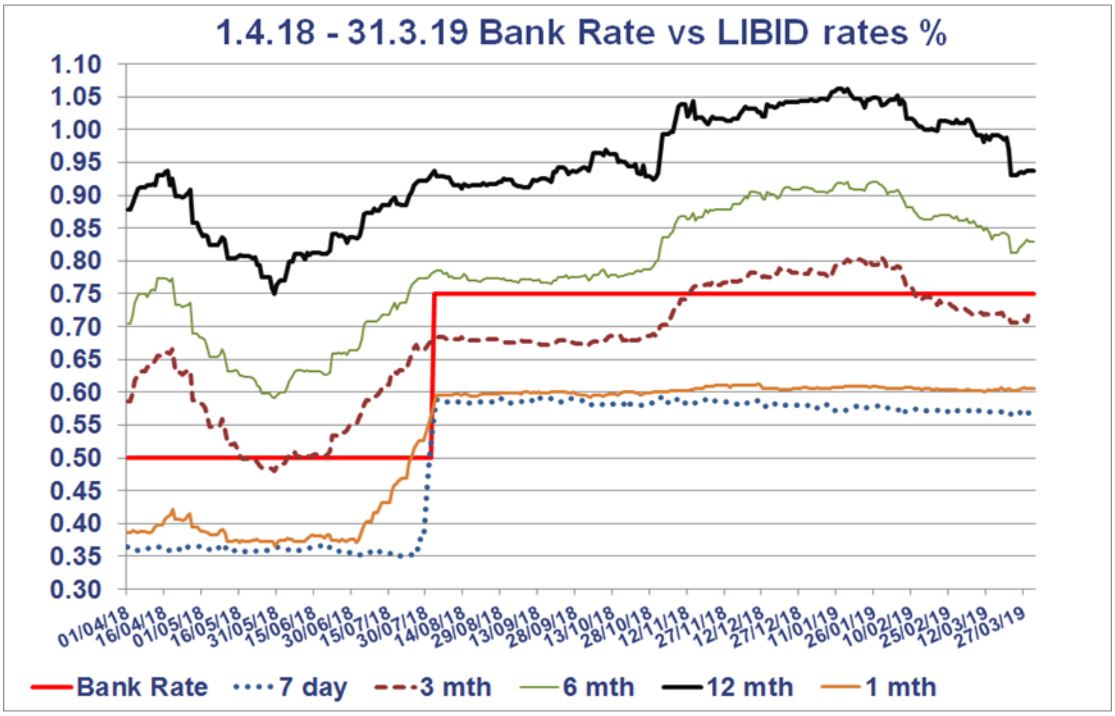
8.2 The expectation for interest rates within the 2018-19 Treasury Management Strategy was that Bank Rate would rise from 0.50% to 0.75% in or around the third quarter (Oct to Dec). However the Strategy also emphasised that with so many external influences weighing on the UK (not least the uncertainties over what form Brexit will eventually take), economic and interest rate forecasting remained difficult. As a consequence interest forecasts were liable to further changes depending on how economic data and developments in financial markets unfolded over time. However, the Bank of England has continued to stress that any future increases in the Bank Rate are expected to be gradual and to a limited extent.

8.3 In its February Inflation Report (issued after publication of the Authority's 2018-19 Treasury Strategy) the Bank signalled that should the economy evolve broadly in line with its forecasts, monetary policy would need to be tightened earlier and by a greater extent over the forecast period than anticipated at the time of the November Report, in order to return inflation sustainably to the target. In response the Council's treasury advisors added one further 25bp rise in the bank rate in May 2018.

8.4 However, at the start of 2018-19, UK GDP growth had proved disappointingly weak in the first few months of 2018. As a consequence the expectation for the timing of this increase was pushed back from May to August 2018.

8.5 Between April and July 2018 the 7-day LIBID rate remained broadly stable before increasing sharply in August, as a result of the increase in Bank Rate on 2 August 2018 (Graph 2). Over the course of the first six months of 2018-19 the 7-day LIBID fluctuated between a high of 0.59% (14 September 2018) and a low of 0.35% (19 July 2018). The average 7-day rate for the six months to September was 0.43%. This compares with an average of 0.11% for the corresponding period last year.

Graph 2: Investment Rates in 2018-19



8.6 Following the sharp rise in August, the 7-day rate has remained broadly stable over the second half of 2018-19, fluctuating between a high of 0.59% (1/11/18) and a low of 0.57% (25/3/19). The average for the second half year was 0.58% (2017-18: 0.32%).The average 7-day LIBID rate for 2018-19 was 0.51% (2017-18: 0.22%).

8.7 Investment rates for terms of three months and longer fell during April and May after expectations collapsed that the MPC would raise Bank Rate at its May meeting. Rates reached lows at the end of May before rising steadily over the period May to August in anticipation that the MPC would raise the Bank Rate in August. However, in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019, it was not expected that the MPC would raise Bank Rate again during 2018-19 after August.

8.8 Investment rates for maturities of 3 months and longer were consequently little changed during August to October. Rates did however rise 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, has seen investment rates falling back again during the final quarter of the financial year.

9.0 Investment strategy

9.1 The Council's investment policy is set having regard to the MHCLG's Guidance on Local Government Investments ('MHCLG Investment Guidance') (third edition) issued in February 2018 and CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes ('the Treasury Management Code'). The primary objectives of the Council's treasury investment activity are to ensure:

- first, the security of principal sums invested (i.e. to protect the capital sum invested from loss)
- second, that appropriate levels of liquidity are maintained – (i.e. ensuring funds invested are available to meet expenditure when needed).

9.2 The policy for 2018-19 was set out in the Treasury Management Strategy Statement and Investment Strategy approved by Council on 7 March 2018. The contents of this policy include:

- procedures for determining the counterparties with whom investments may be placed, including the use of credit ratings and other sources of information to assess credit and counterparty risk
- the types of investment instruments that may be used
- limits on the amount that may be invested with any single institution or group of institutions
- limits on the maximum period for which funds may be prudently committed.

9.3 In the current economic climate and in light of the Council's forecast liquidity requirements over the next 12-18 months, the investment strategy for 2018-19 considered it appropriate to keep investment terms short and to retain the current upper limit on investment maturities of 12 months all new investments.

9.4 Continued uncertainty in the aftermath of the 2008 financial crisis 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.

10 Investment Outturn for 2018-19

10.1 Investment activity during the year - excluding 'policy investments' falling outside of the Councils Treasury Management and Investment Strategies - is summarised in the following table:

Table 4: Investment activity during 2018-19

	Credit Rating	1 April 2018 £'000	Investments Made £'000	Investments Repaid £'000	31 March 2019 £'000
Specified Investments					
Call Accounts	AA-	822	16,743	(17,137)	428
Call Accounts	A / A-	796	28,273	(28,472)	597
Term Accounts (DMO)	A	0	1,200	(1,200)	0
Money Market Funds	AAA	5,515	52,586	(52,813)	5,288
Non Specified Investments					
Equity Shares	Not rated	11	0	0	11
		7,144	**98,802**	**(99,622)**	**6,324**

10.2 Investment activity during the year complied with the Council's approved strategy and the Council had no liquidity difficulties. In keeping with MHCLG's guidance on local authority investments, the Council maintained a sufficient level of liquidity through the use of money market funds, call and fixed term deposits with HM Government's Debt Management Account Deposit Facility-(DMO). All (specified) investments made during 2018-19 had a maximum maturity not exceeding 365 days (from the date of acquisition).

10.3 During 2018-19 the Council maintained an average short-term investment balance of internally managed funds of £15.6m (2017-18: £13.2m). These funds earned an average rate of return of approximately 0.58% (2017-18: 0.24%). This compares favourably with the Council's benchmark return (the average 7- day LIBID rate) over the year of 0.52% (2017-18: 0.21%). The amount of interest and dividends earned on investments (long-term and short-term) during 2018-19 was £90,668 (2017-18: £32,137), compared to a revised budget for 2018-19 of £32,000.

Credit Risk

10.4 The Council's prime policy objective of its investment activity is to ensure the security of principal sums invested.

10.5 Ensuring the security of principal sums invested is achieved through active management of the Council's credit risk exposures. This includes placing restrictions and limits on:

- the counterparties with whom investments may be placed based on the creditworthiness of the counterparty
- the types of investment instruments that may be used
- the amount invested with any single institution or group of institutions on the Council's list of approved counterparties
- the duration of individual investment instruments depending on the financial standing (creditworthiness) of the counterparty.

10.6 Whilst published credit ratings remain the primary means of assessing the credit worthiness of counterparties, the Council continues to make use of other sources of information on credit risk before making investment decisions. This information includes:

- ratings outlooks (indicating the likely direction of an issuer's rating over the medium term)
- credit watches and watchlists (indicating that downgrading or upgrading of the credit rating could be imminent)
- sovereign ratings and support mechanisms
- credit default swap (CDS) spreads (indicating perceived market sentiment regarding the credit risk associated with a particular institution and an early warning of potential creditworthiness problems which may only belatedly lead to actual changes in credit ratings).

10.7 In accordance with the Council's Annual Investment Strategy, counterparties used during 2018-19 were restricted to financial institutions and other bodies with a minimum long-term rating across all three of the main credit ratings agencies (Fitch, Moody's and Standard & Poor's) of A- or equivalent (AA+ or equivalent for non-UK sovereigns).

10.8 None of the investments made by the Authority during 2018-19 were with counterparties holding a credit rating below the Council's minimum credit rating threshold.

10.9 With the exception of funds placed with HM Treasury's Debt Management Office (DMO), the maximum amount that may be placed with any institution or group of institutions that are part of the same banking group is £4m. For funds placed with the DMO's Account Deposit Facility the current limit is £12m. There were no breaches of these counterparty exposure limits during the financial year.

11 Prudential Indicators.

11.1 The Local Government Act 2003 requires the Council to determine and keep under review, limits on how much money it can afford to borrow by way of loans and other forms of credit (for example finance leases). The process the Council must follow in setting these limits (the 'Authorised Limit for External Debt') is set out in the Prudential Code for Capital Finance in Local Authorities, to which the Council is required to 'have regard to' under provisions contained in the 2003 Act.

11.2 In addition to the Authorised Limit, CIPFA's Prudential and Treasury Management Codes and accompanying the sector guidance, include a number of other key treasury management indicators designed to ensure the Council operates its treasury activities within well-defined limits. These include:

- setting an operational boundary for external debt based on the expectations of the most likely maximum external debt for the year
- ensuring that gross debt does not, except in the short term, exceed the Capital Financing Requirement (CFR) - the undeylying need to borrow for capital purposes - at the end of the preceding year plus the estimates of any additional CFR for current and the following two financial years
- placing upper limits on the total of principal sums invested for periods of more than 365 days
- placing upper and lower limits on the maturity structure of borrowings.

11.3 The Council's Authorised Borrowing Limit (the statutory limit on borrowing under the Local Government Act 2003), Operational Boundary (the limit beyond which external debt is not expected to exceed) and other indicators and limits required by CIPFA's Prudential and Treasury Management Codes, were set out in the Council's Treasury Management Strategy Statement and Investment Strategy for 2018-19 and approved by members on 7 March 2018.

11.4 During 2018-19 the Council complied with the limits established by the Prudential and Treasury indicators included in its Treasury Management & Investment Strategy for 2018-19. Further information relating to the Prudential and treasury indicators for 2018-19 are set out in Appendix A.

Appendix A: Prudential and treasury indicators

1 Indicators required by the Prudential Code

1.1 The Prudential Code requires local authorities to self-regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans, by setting estimates and limits and by publishing actuals for a range of prudential indicators. It also requires them to ensure their treasury management practices are in accordance with good practice.

1.2 The prudential and treasury indicators required by the Prudential Code and the Treasury Management Code and accompanying sector guidance are designed to support and record local decision making. They are not designed to be comparative performance indicators and should not be used for this purpose.

1.3 The Council's performance compared to the limits and estimates set out in the Council's 2018-19 Treasury Management Strategy Statement and 2018-19 Mid-year Treasury Update Report are summarised in the following sections.

2 Actual capital expenditure

2.1 Table A shows the actual capital expenditure incurred during 2018-19.

Table A: Actual capital expenditure

	2017/18 Actual £000	2018/19 Approved £000	2018/19 Revised estimate[1] £000	2018/19 Actual[2] £000
General Fund Capital Expenditure	2,790	14,593	9,590	7,747
Financed by:				
Capital receipts	3	0	177	102
Capital grants & contributions	1,668	9,043	2,872	2,080
Revenue	253	20	473	1,070
Total expenditure financed in year	1,924	9,063	3,522	3,252
Unfinanced capital expenditure:				
Supported borrowing	0	0	0	0
Unsupported borrowing	866	5,530	6,068	4,495
Total financed & unfinanced	2,790	14,593	9,590	7,747

[1] 2018-19 revised capital budget (including revisions approved by Council in January 2019); [2] including capital expenditure of £706k financed from the revenue budget

2.2 Capital expenditure is defined in section 16 of the Local Government Act 2003 and includes all expenditure that falls to be capitalised in accordance with proper practices together with any items capitalised in accordance with regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended), or by virtue of a capitalisation direction issued under section 16(2) of the 2003 Act.

2.3 The variance of £2.549m between the capital outturn position (£7.041m) and the 2018-19 revised estimate (£9.590m) comprises:

- budget carry forwards of £2.444m
- net variance (underspend) of £105k.

2.4 Approved budget carry forwards of £2.444m reflect changes to the expected timing of expenditure on individual schemes (rather than the overall amount of expenditure) and subsequent budget revisions to reflect the re-profiling of expenditure across the 2018-19 and 2019-20 financial years. Further details relating to the capital outturn position for 2018-19 can be found in the Capital Outturn report considered by the Council's Executive on 28 June 2019. The net variance on the capital budget after accounting for budget carry-forwards was £105k.

3 Actual Capital Financing Requirement

3.1 The Capital Financing Requirement (CFR) is a measure of an authority's underlying need to borrow for capital purposes. It represents the historic cost of capital expenditure that has yet to be financed by setting aside resources (grants, contributions, capital receipts and revenue financing). It does not necessarily correspond with an authority's actual borrowing position which is determined in accordance with an authority's treasury management strategy and practices. Table B shows the Council's actual capital financing requirement at 31 March 2019.

Table B: Capital financing requirement

	2017/18 Actual £000	2018/19 Approved estimate £000	2018/19 Revised estimate[1] £000	2018/19 Actual £000
CFR at 1 April	18,674	20,643	18,917	18,917
CFR at 31 March	18,917	25,460	24,314	22,741
Movement in CFR	243	4,817	5,397	3,824
Movement represented by:				
Unfinanced expenditure	866	5,530	6,068	4,495
Less MRP	(623)	(713)	(671)	(671)
Less Voluntary set aside	0	0	0	0
Movement in CFR	243	4,817	5,397	3,824

[1] Updated to reflect 2018-19 revised capital budget (including revisions approved by Council in January 2019)

4 Gross debt and the capital financing requirement (CFR)

4.1 A fundamental provision of the Prudential Code and a key indicator of prudence is that, over the medium term, debt will only be for a capital purpose. In order to ensure this is the case, gross external debt should not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.2 This requirement allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes. Gross debt refers to the sum of borrowing and other long-term liabilities (credit arrangements). Table C compares the Council's gross debt and CFR.

Table C: Gross debt & the CFR

	2017/18 Actual at 31.3.18 £000	**2018/19 Approved (max) £000**	**2087/19 Revised estimate[1] £000**	**2018/19 Actual at 31.3.19 £000**
PWLB	15,380	22,749	20,259	15,067
Other borrowing	85	85	85	85
Total debt	**15,465**	**22,834**	**20,344**	**15,152**
CFR at 1 April	18,674	20,643	18,917	18,917
Add: Unfinanced capital expenditure	866	5,530	6,068	4,495
Less: MRP	(623)	(713)	(671)	(671)
CFR at 31 March	**18,917**	**25,460**	**24,314**	**22,741**
(Under)/Over borrowing	(3,452)	(2,626)	(3,970)	(7,589)

[1] based on the maturity profile of the Council's loan portfolio at 30.9.18

4.3 At 31 March 2019, the Council was under-borrowed against its capital financing requirement by £7.589m. This compares with an under-borrowed position at 31 March 2018 of £3.452m. The increase of £4.137m during 2018/19 is represented by:

- an increase in the CFR of £4.495m as a result of unfinanced capital expenditure incurred during the year, less
- a reduction in the CFR of £0.671m reflecting amounts set aside from revenue in 2018-19 (the minimum revenue provision) to repay debt, plus
- scheduled repayments of external (PWLB) borrowing of £0.313m.

5. Authorised limit for external debt

5.1 The Authorised Borrowing Limit represents the statutory limit on borrowing determined under section 3 of the Local Government Act 2003 (Affordable Limit). It imposes an upper limit on the Council's gross external debt (excluding investments), separately identifying borrowing (external loans) from other long-term liabilities (for example finance lease liabilities). Breach of the Affordable Borrowing Limit is prohibited by section 2(1) (a) of the Local Government Act 2003.

5.2 The Authorised Borrowing Limit is set with reference to the Council's capital expenditure plans, capital financing requirement (or underlying borrowing requirement) and the potential need to borrow to meet temporary revenue borrowing requirements pending the receipt of amounts due to the Council.

The Affordable Borrowing Limit also includes headroom over and above the Operational Boundary (see below) to accommodate any unusual or unforeseen cash movements. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table D: Authorised Limit for External Debt

	2018/19 Approved £000	2018/19 Revised £000	31.3.19 Actual £000	2018/19 Actual (max) £000
Borrowing	28,000	28,000	15,152	15,465
Other long-term liabilities	0	0	0	0
Total	28,000	28,000	15,152	15,465

6 Operational boundary for external debt

6.1 The Operational Boundary represents the limit beyond which (gross) external debt is not expected to exceed. It is based on expectations of the maximum external debt of a local authority according to probable events (that is, the most likely (prudent) but not worst case scenario) and is consistent with the maximum level of external debt projected by these estimates. The Operational Boundary links directly to the Council's plans for capital expenditure, estimates of the capital financing requirement and cash flow requirements for the year for all purposes, but without the additional headroom included within the Authorised Limit. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table E: Operational boundary for external debt

	2018/19 Approved £000	2018/19 Revised £000	31.3.19 Actual £000	2018/19 Actual (max) £000
Borrowing	26,000	26,000	15,152	15,465
Other long-term liabilities	0	0	0	0
Total	26,000	26,000	15,152	15,465

7 Estimates of the ratio of financing costs to net revenue stream

7.1 This indicator of affordability highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs (net of interest and investment income).

Table F: Ratio of Financing Costs to Net Revenue Stream

	2017/18 Actual %	2018/19 Approved %	2018/19 Revised %	2018/19 Actual %
Ratio	9.0	11.9	10.5	9.7

7.2 Financing costs comprise the aggregate of:

- interest charged to the General Fund with respect to borrowing
- interest payable under finance leases and other long-term liabilities
- premiums and discounts from debt restructuring charged or credited to the amount to be met from government grants and local taxpayers
- interest and investment income (excluding interest on policy investments falling outside of the Council's Treasury Management and Investment Strategies)
- amounts payable or receivable in respect of financial derivatives
- minimum revenue provision plus any additional voluntary contributions
- any amounts for depreciation/impairment charged to the amount to be met from government grants and local taxpayers.

7.3 Actual figures for Net Revenue Stream are taken from the Council's Comprehensive Income and Expenditure Statement for 'taxation and non-specific grant income and expenditure'.

8.0 Indicators required by the Treasury Management Code

8.1 In addition to the indicators required by the Prudential Code, there are also a number of treasury indicators required by the Treasury Management Code and accompanying sector guidance. These are:

- upper and lower limits to the maturity structure of its borrowing
- upper limits on the total of principal sums invested for periods of more than over 365 days.

8.2 These treasury management indicators specify ranges (rather than targets) designed to limit the Council's exposure to interest rate, liquidity and refinancing risks.

9 Upper and lower limits to the maturity structure of borrowing

9.1 This indicator highlights potential exposures to refinancing risk arising from concentrations of fixed rate debt falling due for refinancing and is designed to facilitate reductions in the Council's exposure to refinancing at times of volatile or high interest rates.

9.2 It is calculated as the amount borrowing maturing in each period as a percentage of total borrowing. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Table G: Lower/upper limits on % of borrowing maturing in each period

	At 31.3.18 Actual %	Lower limit 2018/19 %	Upper limit 2018/19 %	At 31.3.19 Actual %
Under 12 months	2.57	0	20	2.67
12 months to 2 years	2.07	0	20	2.16
2 years to 5 years	6.5	0	20	6.81
5 years to 10 years	12.13	0	30	12.76
10 years to 20 years	19.31	0	40	18.58
20 years to 30 years	5.69	0	40	4.22
30 years to 40 years	51.73	0	80	52.80
40 years to 45 years	0	0	80	0

10 Upper limits to the total of principal sums invested for period of more than 365 days

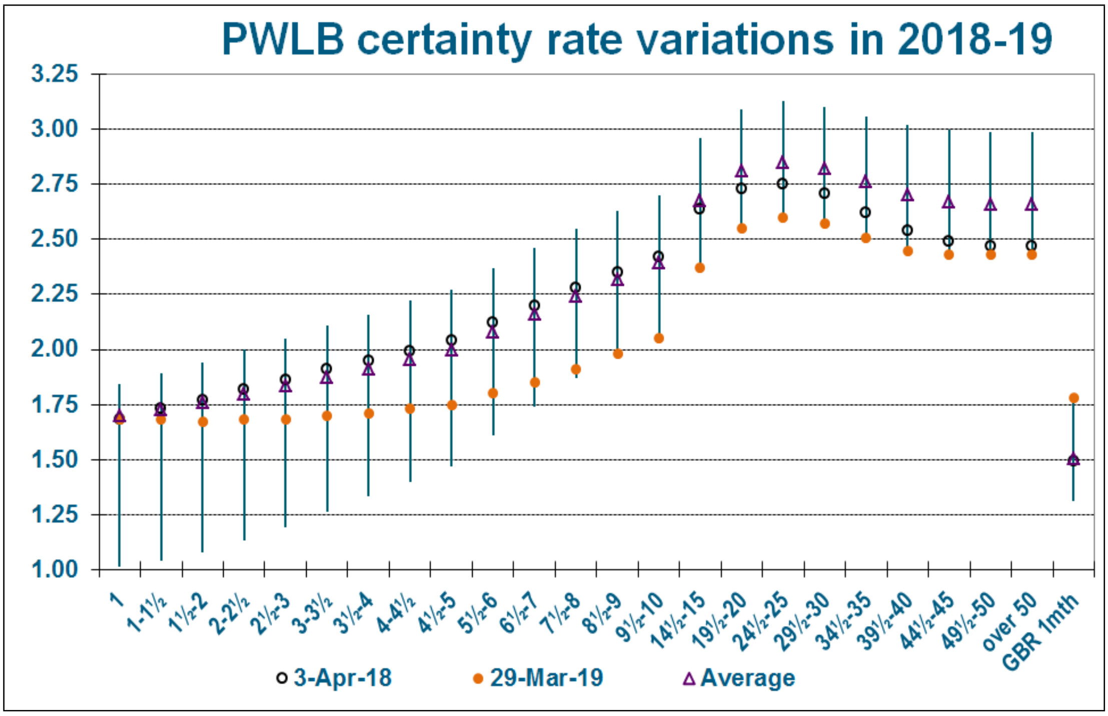
10.1 A local authority that invests, or plans to invest, for periods of more than 365 days is required to set an upper limit for each forward financial year period for the maturing of such investments. The purpose of the limit for principal sums invested for periods longer than 365 days is to contain the authority's exposure to the possibility of loss that might arise as a result of its having to seek early repayment or redemption of principal sums invested.

Table H: Upper limit on total principal invested for periods or more than 365 days

	2017/18 Actual £000	2018/19 Approved £000	2018/19 Revised £000	2018/19 Actual £000
Principal sums invested > 364 days	11	20	20	11

[1] Measured at fair value. The nominal value (historic cost) of principal sums investment as 31 March 2019 is £1k

Appendix B



PWLB certainty rates 2018-19

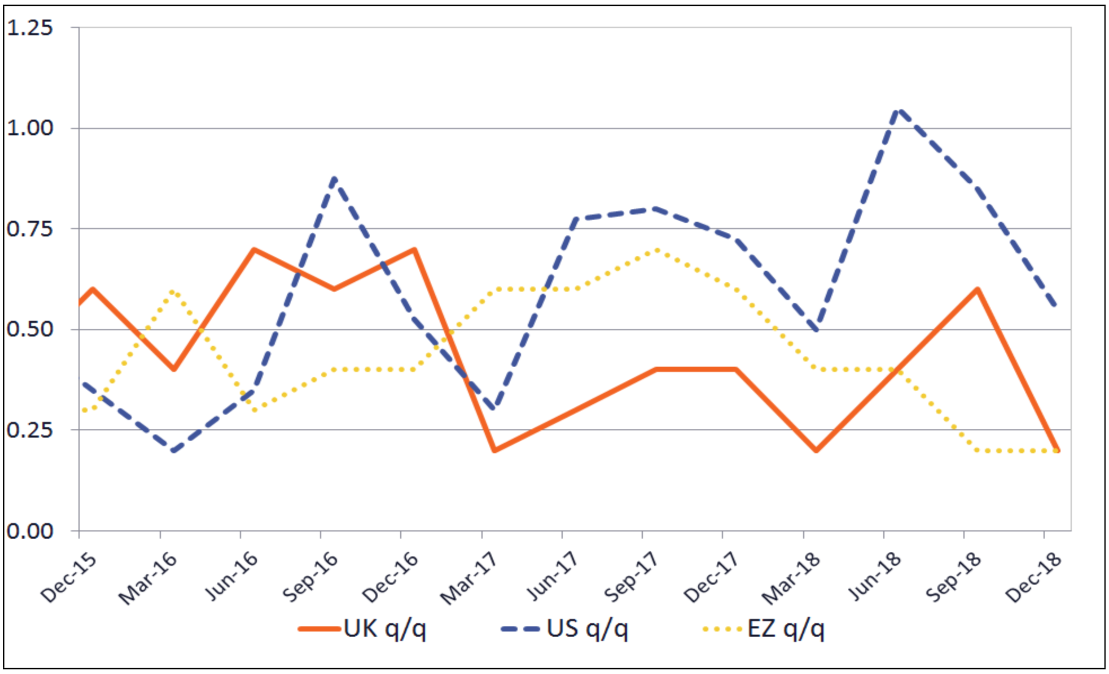
	1-Years %	4½- 5 Years %	9½-10 Years %	24½- 25 Years %	49½ - 50 Years %
At 2.4.18	1.48	1.85	2.23	2.57	2.29
At 29.3.19	1.48	1.55	1.85	2.40	2.23
Low	1.28	1.50	1.80	2.33	2.16
Date	1/6/18	28/3/19	28/3/19	26/3/19	26/3/19
High	1.64	2.07	2.5	2.93	2.79
Date	10/10/18	10/10/18	10/10/18	10/18/18	12/10/18
Average	1.50	1.80	2.19	2.65	2.46

Money market investment rates 2018-19 (LIBID)

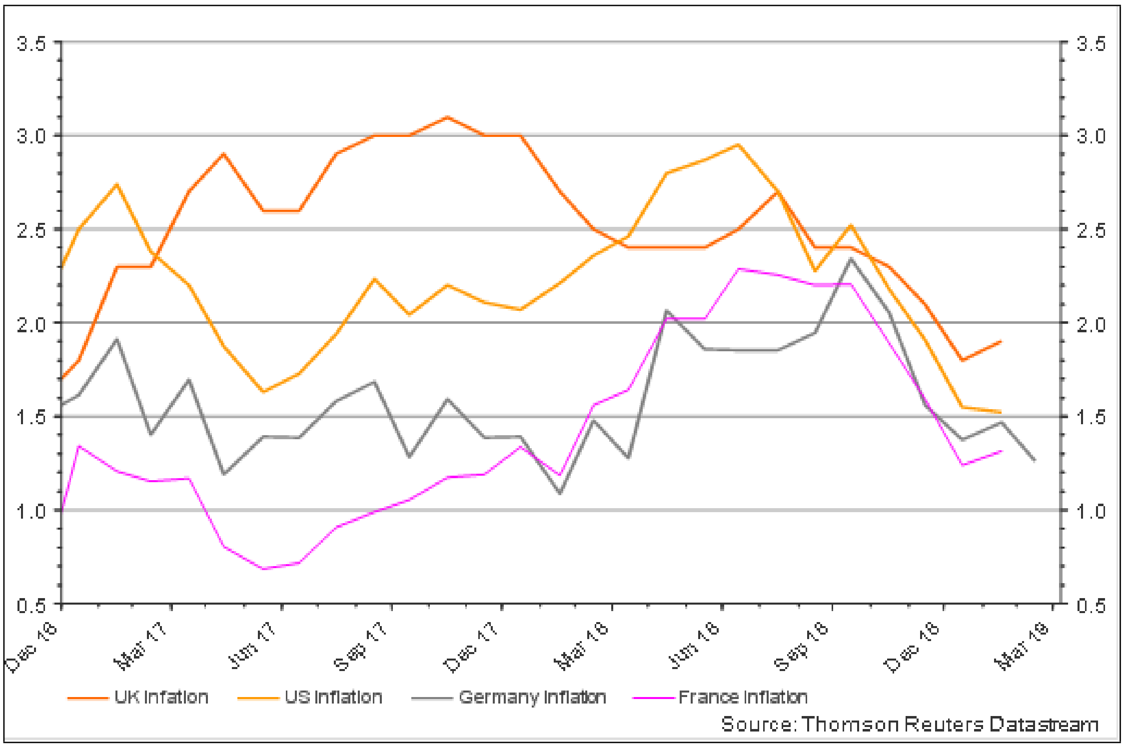
	Bank Rate	7 day	1 month	3 month	6 month	1 year
01/4/2018	0.50%	0.36	0.39	0.59	0.70	0.88
31/3/2019	0.75%	0.57	0.61	0.71	0.83	0.94
High	0.75%	0.59	0.61	0.81	0.92	1.06
Low	0.50%	0.35	0.37	0.48	0.59	0.75
Average	0.67%	0.51	0.54	0.68	0.79	0.94
Spread	0.25%	0.24	0.25	0.33	0.33	0.31
High date	2/8/18	1/11/18	10/12/18	29/1/19	15/1/19	11/1/19
Low date	1/4/18	19/7/18	30/5/18	30/5/18	30/5/18	30/5/18

Appendix C

UK, US and EZ GDP growth



Inflation UK, US, Germany and France



Source: Thomson Reuters Datastream