Agenda Item:

Meeting of:	**Cabinet**
Date of Meeting:	**Monday, 15 July 2019**
Relevant Scrutiny Committee:	Corporate Performance and Resources
Report Title:	Annual Treasury Management Report 2018/19
Purpose of Report:	To present to Cabinet the annual review report on Treasury Management 2018/19.
Report Owner:	Report of the Leader
Responsible Officer:	Carys Lord, Head of Finance/Section 151 Officer
Elected Member and Officer Consultation:	Carys Lord, Head of Finance/Section 151 Officer
Policy Framework:	This is a matter for Executive decision by Cabinet and approval by Council

Executive Summary:

The Council's borrowing requirement increased by £411k in 2018/19 giving a Total Capital Financing Requirement of £198.37M at 31st March 2019. At the same date the Council held £155.145M of Gross Borrowing. The Council was therefore under borrowed by £43.225M as at 31st March 2019.

The Council's External Borrowing was well within the Authorised Limit and Operational Boundary set for 2018/19.

The Council held Loans from PWLB (£146.447M), Concessionary Loans from WG (£2.6M), Market Loans (£6M) and a Temporary Loan (£0.100M) at 31st March 2019. No new external loans were taken out in year and the Council continued to finance new Capital Expenditure (£1.980M) from internal borrowing.

The Council held investments of £89.1M at 31st March 2019 and the majority of this was invested with Local Authorities (£81M) with an annual return of 0.666%. The overall return on investments in 2018/19 was £552K at a rate of 0.6335%.

Recommendations

1. That Cabinet accepts the annual report on Treasury Management 2018/19 and that the report be referred to Council for approval.

Reasons for Recommendations

1. To accept and refer the report to Council

1. Background

1.1 In March 2018 the Council adopted the CIPFA Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which together with the Welsh Government (WG) revised guide on Local Government Investments (April 2010), require the Council to receive and approve as a minimum three main treasury reports each year. These are a Treasury Management and Investment Strategy to be presented before the start of each year, a mid year report and an annual outturn report to be presented at the end of each financial year.

1.2 This annual outturn Treasury Management report covers.

The economy/interest rates in 2018/19;
The strategy for 2018/19;
Compliance with treasury limits and prudential indicators;
The borrowing outturn for 2018/19, and
Investment outturn for 2018/19

The UK Economy 2018/-19

1.3 The following information has been prepared by the Authority's Treasury Management advisors and sets out the changing conditions under which Treasury Management operations were undertaken.

1.4 After weak economic growth of only 0.2% in quarter one of 2018, 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 all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in quarter 4 came in at 1.4% year on year confirming that the UK was the third fastest growing economy in the G7 in quarter 4.

1.5 The Monetary Policy Committee (MPC) raised the Bank Rate from 0.5% to 0.75% in August 2018. Any further action from the MPC is unlikely until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth.

1.6 The MPC has been having increasing concerns over the trend in wage inflation which peaked at a post financial crisis high of 3.5% (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January.

1.7 The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9%, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

1.8 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. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

1.9 The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving. 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.

1.10 The government has so far been unable to muster a majority in the Commons over its Brexit deal, therefore the European Union (EU) has set a new deadline of October 31st 2019 for the UK to exit. Any new deal will need to be negotiated with the EU by the new Prime Minister and be supported by the House of Commons. It appears unlikely that there would be a Commons majority which would support a disorderly Brexit or revoking article 50, (cancelling Brexit). There would also need to be a long delay if there is no majority for any form of Brexit. If that were to happen, then it increases the chances of a general election in 2019, which could result in a potential loosening of monetary policy.

Other Economies 2018-19

1.11 The US economy grew by 2.9% in 2018 following a massive easing of fiscal policy. Strong growth in employment numbers fuelled wage inflation to 3.4% whereas CPI inflation fell to 1.5% in February 2019 below the target rate of 2%. This resulted in a series of base rate hikes to 2.25%-2.50%. However, the Federal Reserve now appears to be edging towards a change of direction, admitting there may be a need to cut rates over the next two years. Financial markets are now predicting two cuts of 25 basis points by the end of 2020.

1.12 The Eurozone economy grew by 1.8% in 2018 following massive monetary stimulus in 2016 and 2017 by the European Central Bank (ECB). This is expected to fall to possibly around half that rate in 2019 as the cycle of stimulus was ended in December 2018. The downturn in growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth.

1.13 With its refinancing rate already at 0.0% and the deposit rate at -0.4%, the ECB has probably reached the limit of cutting rates. At its March 2019 meeting it said 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.

1.14 In China economic growth has been weakening over successive years and despite repeated rounds of central bank stimulus, medium term risks are increasing. 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.

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

Treasury Management Strategy 2018/19

1.16 The Section 151 Officer continued to adopt a cautious approach with respect to Treasury Management operations. The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return. This being the case, the Authority placed the majority of funds available for investment purposes with other local authorities. These investments attract a slightly more favourable rate of return than investing with the UK government, but still give priority to the security of funds invested.

1.17 Funds not placed with other local authorities were placed in the 'Debt Management Account Deposit Facility' (DMADF) as these deposits are guaranteed by the British Government. However, these deposits attract a lower return than those available from placement of funds with either local authorities or commercial banks.

1.18 The Council's primary objective for the management of its debt is to ensure its long term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board at long term fixed rates of interest. In 2018/19 the Council continued to finance its capital expenditure from internal resources. The potential reduction of the Councils investments balances at times of elevated credit risk and poor investment returns was still considered the most prudent option available to the Authority throughout 2018/19.

1.19 Council approved the Treasury Management Strategy for 2018/19 at its meeting on the 28th February 2018, minute no. 743.

1.20 The Section 151 Officer advises that all treasury management activity undertaken during the financial year complied with the amended approved strategy, the CIPFA Code of Practice, and the relevant legislative provisions.

2. Key Issues for Consideration

The Council's Capital Expenditure and Financing

2.1 The Council undertakes Capital Expenditure on long term assets. These activities may either be financed immediately through capital or revenue resources e.g.

capital receipts, capital grants etc. Alternatively the activities can give rise to a borrowing need which would create an increase in the Council's Capital Financing Requirement (CFR).

2.2 The table below shows the Council's capital expenditure and how it is financed.

In Year Movement in Capital Financing Requirement	2018/19	2018/19	2018/19
	General Fund	HRA	Total
	£M	£M	£M
Total Capital Expenditure	31.938	11.444	43.382
Financed in Year	(30.966)	(12.005)	(42.971)
Movement in Capital Finance Requirement/Unfinanced Capital Expenditure*	0.972	(0.561)	0.411

*This is capital expenditure that will be funded by an increase in the Council's borrowing requirement.

The Council's Overall Borrowing Need

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

Gross Borrowing and the CFR

2.4 In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its Gross External Borrowing does not (except in the short term) exceed the total of the Capital Financing Requirement in the preceding year (2017/18) plus the estimates of any additional CFR for the current year (2018/19) and the next two financial years. The Council has complied with this prudential indicator in 2018/19.

2.5 The table below highlights the Council's Gross Borrowing position against the CFR.

	31 March 2018	31 March 2019	31 March 2019
	Actual	Budget	Actual
	£M	£M	£M
CFR General Fund	123.156	124.654	124.125
CFR HRA	74.805	76.468	74.245
Total CFR	197.961	201.122	198.370
Gross Borrowing Position	(155.365)	(154.645)	(155.145)
Under/(Over) Borrowing of CFR	42.596	46.477	43.225

2.6 The Authorised Limit

The Authorised Limit is the affordable borrowing limit required by Section 3 of the Local Government Act 2003. Once it has been set, the Council does not have the power to borrow above this level.

2.7 The Operational Boundary

The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or above the boundary is acceptable subject to the Authorised Limit not being breached.

2.8 Actual Financing Costs as a Proportion of Net Revenue Stream

This indicator identifies the trend in the cost of capital, (borrowing and long term obligation costs net of investment income), against the net revenue stream.

2.9 The Council's performance against the above indicators in 2018/19 is set out in the table below.

	2018/19
Authorised Limit	£200.854M
Maximum Gross Borrowing Position in Year	£155.365M
Operational Boundary	£185.812M
Average Gross Borrowing Position	£154.935M

2.10 Financing Costs as a proportion of Net Revenue Stream

	2017/18	2018/19
	£M	£M
Upper Limit for Fixed Interest Rate Exposure	149.265	149.045
Upper Limit for Variable Rate Exposure expressed as an absolute value	0	0

2.11 Financing Costs as a proportion of Net Revenue Stream

	Non HRA (Council Tax)	HRA (Rents)
2018/19 Budget	3.53%	23.16%
2018/19 Actual	3.45%	22.53%

Treasury Position

2.12 At the beginning and the end of 2018/19 the Council's treasury position was as follows.

Debt Portfolio	31st March 2018		31st March 2019	
	Principal	Rate of Return	Principal	Rate of Return
	£M		£M	
Fixed Rate Funding				
PWLB	147.165	4.74%	146.445	4.72%
Concessionary Loans	2.100	0%	2.600	0%
Variable Rate Funding				
Market Loans	6.000	5.32%	6.000	5.32%
Temporary Loan	0.100	0.35%	0.100	0.51%
Total Debt	155.365		155.145	
CFR	(197.960)		(198.370)	
Over/(Under) Borrowing	(42.596)		(43.225)	

Movement in Net Debt

	31st March 2018	31st March 2019
Total Debt	155.365	155.145
Total Investments	(66.900)	(89.100)
Net Debt	88.465	66.045

Maturity Structure of the Debt Portfolio

2.13 The Maturity Structure of the Debt Portfolio is set out below.

	2018/19 Original Limits	2018/19 Actual*	2018/19 Actual
	%	£M	%
Less than one year	20%	1.335	0.86%
Between one and two years	20%	0.793	0.51%
Between two and five years	30%	25.841	16.66%
Between five and ten years	40%	32.307	20.82%
Between ten and twenty years	100%	55.885	36.02%
Between twenty and thirty years	100%	26.534	17.10%
Between thirty and forty years	100%	12.450	8.03%
Between forty and fifty years	100%	0	0%
Total		155.145	100%

*Principal only

Borrowing Outturn 2018/19

2.14 During 2018/19 £5,401,735 of additional internal funds was used in the financing of capital expenditure. An average rate of interest was charged to reflect the use of capital resources. The total charges for interest and principal including for prudential borrowing during the year 2018/19 were £7,791,642 and £4,971,374 respectively.

2.15 For all borrowing excluding loans that are advanced under the Local Government Borrowing Initiative an original estimate of 3.81% has been included in the estimates for 2018/19. The actual rate was 3.92%.

2.16 The Authority internally borrowed for 2 new loans totalling £1.979,735. This new borrowing comprised of a loan to finance the Council's contribution to City Deal in 2018/19 of £1,043,232 at the pool rate of 3.90% and an Affordable Housing loan at 3% in line with revenue stream to be received by Welsh Government.

2.17 Loans borrowed from the Public Works Loan Board (PWLB) are intended to assist local authorities in meeting their longer term borrowing requirements. The Authority did not borrow any new loans from the PWLB during 2018/19, opting to fund from internal resources.

2.18 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this is being kept under review by the Section 151 Officer to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or refinancing maturing debt.

2.19 Market loans represent those non-PWLB loans that are repayable at least 1 year or more from the date they are advanced. The debt is a market loan, £2,000,000 of which will mature on the 8th November 2021 and £4,000,000 will mature on the 23rd February 2054.

2.20 The Concessionary Loans have been advanced to the Council by Welsh Government. Loan 1 (£2,100,000) was advanced on 1st April 2015 and is repayable on 31st March 2025. Loan 2 (£500,000) was advanced on the 28th March 2019 and is repayable on 31st July 2020. Both loans are interest free.

2.21 Temporary Loans represent loans that have no fixed maturity date. Current loans have been borrowed from the Vale of Glamorgan Welsh Church Act Fund. Interest is calculated using the "Average 7 Day Rate". The interest rate payable on the Authority's outstanding temporary loans was 0.51% during 2018/19.

Borrowing in Advance of Need

2.22 The Council is under borrowed at 31st March 2019, and has not borrowed in advance of its needs during 2018/19.

Debt Rescheduling

2.23 The Council did not undertake any rescheduling activities during 2018/19 as the average differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Investment Outturn for 2018/19

2.24 All investment activity during 2018/19 conformed to the approved strategy and the Council did not encounter any liquidity difficulties in year.

Internally Managed Investments

2.25 The Authority manages investments in-house and is able to invest with those institutions which meet the minimum credit rating criteria and are included on the approved lending list as laid out in the investment strategy. The Authority currently invests short term for a range of periods from overnight to 364 days, dependent on its cash flows, its interest rate view and the interest rates/periods on offer.

2.26 Investment movements for 2018/19 (excluding accrued interest) are summarised as follows.

Investment Portfolio	Actual 31st March 2018	Actual Return %	Actual 31st March 2019	Actual Return %
	£M		£M	
Debt Management Account Deposit Facility (DMADF)	6.900	0.145%	8.100	0.406%
Local Authorities	60.000	0.379%	81.000	0.666%
Total	66.900		89.100	

2.27 The continuing market uncertainties resulted in the majority of available funds still being invested cautiously either in Debt Management Account Deposit Facility (DMADF) or with local authorities. The Authority this year favoured deposits with local authorities as these investments attracted a slightly more favourable return without any increase in risk to the principal sums invested.

2.28 Debt Management Account Deposit Facility - The Authority continued to place a portion of all surplus funds in the DMADF which is guaranteed by the British Government. The maturity dates of these investments ranged from overnight to a maximum period of 6 months. The Authority made a return of £43,690 on these investments during 2018/19.

2.29 Local Authorities - During the year deposits were placed with local authorities. The Authority made a return on these investments of £507,893 including accrued interest.

2.30 The overall return on investments for 2018/19 was £551,583 at a rate of 0.6335%.

2.31 The Section 151 Officer will continue to keep the borrowing and investment strategies under review.

3. How do proposals evidence the Five Ways of Working and contribute to our Well-being Objectives?

3.1 The Treasury Management and Investment Strategy ensures that the financial plans of the Council are sustainable into the future and do not adversely impact on future generations.

3.2 The Treasury Management and Investment Strategy underpins the financial management of the Council and its ability to achieve its well being objectives as set out in the Corporate Plan.

4. Resources and Legal Considerations

Financial

4.1 Money is borrowed for capital purposes and interest is charged to revenue accounts.

Employment

4.2 There are no direct employment issues relating to this report.

Legal (Including Equalities)

4.3 Compliance with the Local Government Act 2003 and CIPFA's "Code of Practice for Treasury Management in the Public Services" is mandatory.

5. Background Papers

5.1 CIPFA's Code of Practice for Treasury Management in the Public Services" (2017 Edition), "The Prudential Code" (2017 Edition) and WG guidance on local authority investments.