BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM** **6**

Resources Committee **19 June 2019**

Report of S151 Officer

TREASURY MANAGEMENT OUTTURN - ANNUAL REPORT 2018-19

1 Purpose of Report

The purpose of this report is to present the annual report of treasury management activity for 2018-19. The treasury management function contributes towards the council's overall objective of the efficient use of resources.

2 Executive Summary

To inform members of the outturn position in respect of the application of the treasury management strategy for 2018-19.

3 Appendices

1. Prudential Indicators for the year 2018-19
2. Economic Overview

4 The Committee Is invited to RECOMMEND to:

4.1 APPROVE the Treasury Management outturn position, as detailed in the report.

5 Background

5.1 This council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2018-19. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

5.2 During 2018-19 the minimum reporting requirements were that the Members should receive the following reports:

- an annual treasury strategy in advance of the year (Resources 21 March 2018)
- a mid-year treasury update report (Resources 31 October 2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

5.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the council's policies previously approved by members.

5.4 This council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Resources Committee before they were reported to the full Council.

5.5 The council's investment policy is governed by Ministry of Housing, Communities and Local Government (MHCLG) guidance, which was implemented in the annual investment strategy approved by the council on 17 April 2018. The Credit Worthiness policy was reviewed and approved by council on 17 April 2018. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

5.6 The council has complied fully with the requirements of its approved Treasury Management Strategy during the period, including use of approved counterparties and investment limits. The council had no liquidity difficulties.

5.7 The council maintained an average balance of £24m of internally managed funds, which is a combination of short and long term investments. These investments earned an average rate of return of 1% which compares with a budget assumption of £26.3m investment balances earning an average rate of 0.74%.

6 Discussion

Investments

6.1 At 31 March 2019 the Council held the following investments.

Money Market transactions:

Short term investments for periods of less than 1 year:

Investments	Range of Interest Rates Receivable %	Total Investment at 31 March 2018 £'000	Total Investment at 31 March 2019 £'000
Building Societies	0.73% -1.25%	16,068	18,077
Banks	0.65% - 0.95%	4,516	11,866
Other Local Authorities	0.75%	1,000	1,001
Total		**21,584**	**30,944**
Bank Balance	0.65%	1,432	2,515
Total cash available for Investment	0.65-1.25%	**23,016**	**33,459**

The year on year variance for money market investments is therefore an increase of £9.360m. This is due to a significant capital receipt in March 2019, offset slightly by increased S106 capital expenditure. The Council did not hold any long term money market investments at 31 March 2019.

6.2 The average rate of interest earned on investments during the year was 0.86% (2017-18 0.70%).

6.3 **Investment Trusts:**

At the 31 March 2019 the Council held long term investments of share capital in the Aberdeen Diversified Income and Growth Trust (previously known as Black Rock Income Strategies Trust) investment with the following comparative values:

	31 March 2018 £000	31 March 2019 £000
Purchase Price	157	157
Market Value	295	290

6.4 The authority's statutory accounts are required to disclose the fair value of investments. The difference in the value of the Aberdeen Diversified Income and Growth Trust Investment, when compared to the historical cost, amounted to a decrease in value of £5k (in 2017-18 there was an increase of £7.5k), due to a reduction in the share price to £1.16. The decrease in value (£7.5k) has been debited from the Available for Sale Financial Instruments Reserve.

Borrowing

6.5 The authority became debt free in December 2002; consequently the authority has no outstanding borrowings.

Interest Received

6.6 Details of interest received during 2018-19 compared with the estimate are as follows:

	2018-19 Original Estimate £	2018-19 Actual £	Variance Original Est. to Actual £
Amount received;			
Investment income	180,000	206,687	26,687
Dividends	13,000	13,175	175
Other (incl. bank interest)	0	20,576	20,576
Total	**193,000**	**240,438**	**47,438**

Future Prospects

6.7 Clearly, future prospects for generating investment income to support the annual revenue budget continue to be dependent on the level of balances and future movement in the level of interest rates. The uncertainties which are inherent to both of these serve to highlight the continuing need for robust treasury management skills internally and external professional advice to assist in achieving future maximum investment returns.

6.8 Investment returns have recovered a little from the exceptionally low levels reached in the aftermath of the financial crisis, but nonetheless remained low during 2018/19, with a gently rising trend in the second half of the year, following the rise in the Bank of England base rate to 0.75% in August 2018. However, banks and building societies continue to be cash rich and therefore do not need as much investment as previously required and thus the interest rates that are being offered are remaining at a relatively low level. The interest rate forecasts within the Council's Investment Strategy are based upon the Base Rate rising to 1% by the end of 2019/20 and by a further 0.25% in each of the following years reaching 1.5% by the end of 2021/22.

7 Legal Powers

Local Government Act 2003.

8 Financial and Value For Money Implications

As shown in the report.

9 Risk Analysis

Nature of risk	**Consequences if realised**	**Likelihood of occurrence**	**Control measures**
Losses on invested funds	Potentially significant to the Council	Unlikely	Treasury management strategy
Fluctuations in interest rates	Beneficial if interest rates rise, adverse when interest rates fall	Investment income rates continue to be at relatively low levels	Use of external advisors to determine best strategy

10 Implications for Resources

As shown in the report.

11 Implications for Stronger and Safer Communities

No direct implications.

12 Implications for Equalities

No direct implications.

13 Author and Contact Officer

Tracey Cave, Service Accountant

14 Consultees

Shaun Darcy, Director of Resources, S151 Officer
Eric Symons, Assistant Director, Deputy S151 Officer
Julie O'Connell, Finance Manager

15 Background Papers

The Prudential indicators and Treasury Management Report 2018-19
Resources committee 21 March 2018.
2018-19 Draft Statement of Accounts

Prudential Indicators for the year 2018-19

The Capital Prudential Indicators 2018/18 – 2021/22

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital Expenditure. This Prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Total	3.274	10.393	0.766	0.025

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The Council has no finance leases which effectively include borrowing instruments:

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Total	3.274	10.393	0.766	0.025
Financed by:				
Capital generated in year receipts	13.874	1.250	0.250	0.250
Capital grants	0.712	2.192	-	-
Capital receipts reserves	-11.312	6.951	0.516	-0.225
Revenue	-	-	-	-
Net financing need for the year	-	-	-	-

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life. Given that all historical capital spending, including that for 2018/19, has been fully

funded and that full funding is planned for all future schemes, the Council has a current and projected borrowing need of zero.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

The Council's current overall CFR is zero and this is projected to remain unchanged and therefore no borrowing is anticipated in the foreseeable future.

MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The authority has no current or planned borrowing requirement or finance lease liability that would give rise to the need for MRP, but for completeness the Council is recommended to approve the following MRP Statement:

a) **Should the Council incur capital expenditure which gives rise to a borrowing requirement, then MRP will be provided for based on the estimated life of the assets concerned.**

b) **The Council will make provision in its revenue accounts each year to meet the costs of the Principal element of any outstanding Finance Leases.**

The Use of the Council's Resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Fund balances / reserves	5.730	4.452	3.599	3.245
Capital receipts	28.673	16.275	14.759	14.984
Capital grants unapplied	0.433	-	-	-
Provisions	-	-	-	-
Other	*0.359*	-	-	-
Total core funds	**35.195**	**20.727**	**18.358**	**18.229**
Working capital*	-4.337	-1.500	-1.500	-1.500
Under/over borrowing	-	-	-	-
Expected investments	**30.858**	**19.227**	**16.858**	**16.729**

*Working capital balances shown are estimated year end; these may be higher mid year

Affordability Prudential Indicators

The Prudential Code for Capital Expenditure in Local Authorities requires each Council to set and report against indicators showing:

- the cost of servicing long-term borrowing, including both interest costs and provision for loan repayment, as a percentage of total net service costs, and
- the impact on Council Tax levels of funding additional capital expenditure from borrowing.

The previous sections cover the capital prudential indicators, but the prudential indicators required to assess the affordability of the capital investment plans, are not reported because the Council is debt-free and is projected to remain so for the foreseeable future.

Current Portfolio Position

The Council's treasury portfolio position at 31 March 2019, with forward projections are summarised below. The council is currently debt free and there is no need for borrowing to fund the capital programme for the forseeable future.

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

2017/18 Actual	£m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	External Debt:				
	Debt at 1 April	-	-	-	-
	Expected change in Debt	-	-	-	-
	Other long-term liabilities (OLTL)	-	-	-	-
	Expected change in OLTL	-	-	-	-
	Actual debt 31 March :	-	-	-	-
	The Capital Financing Requirement	-	-	-	-
	Under/(over) borrowing	-	-	-	-
	Total investments at 31 March:				
21,584	Investments	30,858	19,227	16,858	16,729
1,460	Investment change	9,274	-11,631	-2,369	-129
	Net Debt	-	-	-	-

The Director of Resources & Section 151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	0.00	10.00	10.00	10.00
Other long term liabilities	-	-	-	-
Total	0.00	10.00	10.00	10.00

The Authorised Limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council approved the following Authorised Limit at the March 20 Resources Committee.

Authorised Limit £m	**2018/19 Actual**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Debt	0.00	50.00	50.00	50.00
Other long term liabilities	-	0.50	0.50	0.50
Total	0.00	50.50	50.50	50.50

Appendix 2

ECONOMIC OVERVIEW

UK. After weak **economic growth** of only 0.2% in Q1 of 2018, growth picked up to 0.4% in Q2 and to a particularly strong 0.7% in Q3, 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 Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing country in the G7 in Q4.

After the Monetary Policy Committee (MPC) raised **Bank Rate** from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in **wage inflation** which peaked at a new 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. 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. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

As for **CPI inflation** itself, this 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%.

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. The Conservative minority government has so far, been unable to muster a majority in the Commons over its Brexit deal. 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; 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.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the strong rate of growth; this rose from 2.2%, (annualised rate) in Q1 of 2018 to 4.2% in Q2, 3.5% in Q3 and then back to 2.2% in Q4. The annual rate came in at 2.9% for 2018, just below President Trump's aim for 3% growth. 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. However, 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 Fed's target of 2%. The Fed increased rates another 0.25% in December to between 2.25% and 2.50%, this being the fourth increase in 2018 and the ninth in the upward swing cycle. However, the Fed now appears to be edging towards a change of direction and admitting there may be a need to switch to taking action to cut rates over the next two years. Financial markets are now predicting two cuts of 25 bps by the end of 2020.

EUROZONE. The European Central Bank (ECB) provided massive monetary stimulus in 2016 and 2017 to encourage growth in the EZ and 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 Q1 and Q2 of 2018, and then slowed further to 0.2% in Q3 and Q4; it is likely to be only 0.1 - 0.2% in Q1 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. The ECB completely ended its programme of quantitative easing purchases of debt in December 2018, which means that 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%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. With its refinancing rate already at 0.0% and the deposit rate at -0.4%, it 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 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.

CHINA. Economic growth has been weakening over successive years, 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.

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.

WORLD GROWTH. Equity markets are currently concerned about the synchronised general weakening of growth in the major economies of the world: they fear there could even be a recession looming in the US, though this fear is probably overdone.