

NORTH DEVON COUNCIL

REPORT TO: STRATEGY AND RESOURCES
Date: 1ST JULY 2019
TOPIC: ANNUAL TREASURY MANAGEMENT REPORT 2018/19
REPORT BY: CHIEF FINANCIAL OFFICER

1. INTRODUCTION

- 1.1 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is 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.

2. RECOMMENDATIONS

2.1 The Committee is asked to recommend to full Council that:

- The annual treasury management report for 2018/19 be noted;
- The actual 2018/19 prudential and treasury indicators be approved.
- The Section 151 Officer be delegated authority to update the Treasury Management Policy and Practices to reflect the recent changes to committee structure and overdraft arrangements

3. REASONS FOR RECOMMENDATIONS

- 3.1 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).
- 3.2 During 2018/19 the minimum reporting requirements were that the full Council should receive the following reports:
- an annual treasury strategy in advance of the year (Council 21/02/2018)
 - a mid year treasury update report (Council 16/01/2019)
 - an annual review following the end of the year describing the activity compared to the strategy (this report)

This Council confirms that it has complied with the requirements under the Code to give prior scrutiny to all the above treasury management reports by the Overview and Scrutiny Committee and now the Policy Development Committee before they were reported to the full Council.

4. REPORT

4.1 The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£000	2017/18 Actual	2018/19 Estimate	2018/19 Actual
Capital expenditure	2,454	5,242	4,298
Financed in year	3,410	5,645	4,092
Unfinanced capital expenditure	(956)	(403)	206

4.2 The Council's Overall Borrowing Need

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

Gross borrowing and the CFR - 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 capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2018/19. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

£000	31 March 2018 Actual	31 March 2019 Estimate	31 March 2019 Actual
Total CFR	5,009	4,847	4,711
Gross borrowing position	2,000	1,250	1,250
Over / (under) funding of CFR	(3,009)	(3,597)	(3,461)

- *Estimates from the Mid-Year Treasury Management Report*

The authorised limit - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2018/19 the Council has maintained gross borrowing within its authorised limit.

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 over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2018/19
Authorised limit	£10.5m
Maximum gross borrowing position during the year	£2m
Operational boundary	£5.25m
Average gross borrowing position	£1.33m
Financing costs as a proportion of net revenue stream	2.87%

4.3 Treasury Position as at 31st March 2019

At the beginning and the end of 2018/19 the Council’s treasury position was as follows:

DEBT PORTFOLIO	31/03/18 Principal £000	Rate/ Return	31/03/19 Principal £000	Rate/ Return
Total debt	£2,000	2.02%	£1,250	2.03%
CFR	£5,009		£4,711	
Over / (under) borrowing	(£3,009)		(£3,461)	
Total investments	£10,735	0.34%	£9,849	0.57%
Net debt/(investments)	(£8,735)		(£8,599)	

The maturity structure of the debt portfolio was as follows:

	31 March 2018 actual	2018/19 original limits	31 March 2019 actual
Under 12 months	£0.75m (37.5%)	50%	£0m
12 months and within 24 months	£0m	60%	£0.75m (60%)
24 months and within 5 years	£0.75m (37.5%)	100%	£0m
5 years and within 10 years	£0.5m (25%)	100%	£0.50m (40%)
10 years and above	£0m	50%	£0m

INVESTMENT PORTFOLIO	Actual 31.3.18 £000	Actual 31.3.19 £000
Treasury investments		
Banks	9,560	8,560
TOTAL TREASURY INVESTMENTS	9,560	8,560

All investments were for maturities less than one year

During 2018/19, the Council made no material non-treasury investments in property with a view of generating an income stream.

4.4 The Strategy for 2018/19

Investment strategy and control of interest rate risk - Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

It was not expected that the MPC would raise Bank Rate again during 2018-19 after August in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 November was unexpectedly hawkish about their perception of building inflationary pressures, particularly from rising wages. However, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

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

Borrowing strategy and control of interest rate risk - During 2018-19, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review 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 the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Section 151 Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

- 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 borrowings 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 initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts 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.

Link Asset Services Interest Rate View 7.11.17														
	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB Rate	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

4.5 Borrowing Outturn

£0.75m of PWLB borrowing matured in May 2018, due to cash flow balances and investment concerns (both counterparty risk and low investment returns) no new external borrowing was undertaken during the year. Total external borrowing as at 31st March 2019 reduced to £1.25m.

The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

No debt rescheduling was done during the year as it was not a viable option.

4.6 Investment Outturn

Investment Policy – the Council's investment policy is governed by HMCLG guidance, which was implemented in the annual investment strategy approved by the Council on 21st February 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.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£000)	31 March 2018	31 March 2019
General Fund Balance	1,161	1,161
Earmarked reserves	5,246	5,230
Provisions	865	990
Usable capital receipts/grants	1,987	2,389
Total	9,259	9,770

Investments held by the Council - the Council maintained an average balance of £16.3m of internally managed funds. The internally managed funds earned £91,803 interest at an average rate of return of 0.57%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.51%. This compares with a budget assumption of £60,000 investment interest.

5. RESOURCE IMPLICATIONS

5.1 As detailed in the report.

6. CONSTITUTIONAL CONTEXT

Article or Appendix and paragraph	Referred or delegated power?
Part 4 Financial Procedure Rules (Article 13.8)	Delegated
Article 4.4	

7. STATEMENT OF CONFIDENTIALITY

7.1 This report contains no confidential information under the provisions of Schedule 12A of 1972 Act.

8. BACKGROUND PAPERS

8.1 Background papers will be available for inspection and will be kept by the author of the report.

9. STATEMENT OF INTERNAL ADVICE

9.1 The author (below) confirms that advice has been taken from all appropriate Councillors and Officers.

Author: Jon Triggs, Head of Resources

Date: 8th June 2019

Reference: T:\Technical\Adam\Treasury Management\ TM Annual Report 2018 19.doc