CYNGOR SIR *POWYS* COUNTY COUNCIL

CABINET
30th July 2019

REPORT BY: **Cllr. Aled Davies**
Portfolio Holder for Finance
SUBJECT: **Treasury Management Review 2018/19**

REPORT FOR: **Approval**

1. Introduction:

1.1 The Council's Treasury Management Policy, as per the CIPFA Code of Practice, requires an annual report on Treasury Management activity to be approved by Cabinet by 30th September each year.

1.2 Treasury Management in this context is defined as:
"The management of the authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. The Council's Overall Borrowing Need:

2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represent's the current year's unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP) to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

2.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This can be sourced through external borrowing or utilising temporary cash resources within the Council.

3. Strategy for 2018/19:

3.1 At the start of 2018/19 the Authority had an estimated Capital Financing Requirement of £324.5m, projected to rise by £114.7m during the course of the following five years to £439.2m. The Authority's external borrowing at 1st April 2018 stood at £251.4m. In relation to the CFR figure of £324.5m, this equated to the Authority being under borrowed by £73.1m.

3.2 During 2018-19, the Council maintained an under-borrowed position. This meant that the capital borrowing need (CFR) 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. A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure. This is because it caused a temporary increase in cash balances which would have incurred a revenue cost of the difference between (higher) borrowing costs and (lower) investment returns.

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.

3.3 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. It was expected that the MPC would not 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.

Investment rates changed little 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.

This authority did not have sufficient cash balances to be able to place deposits for more than a month in order to earn higher rates from longer deposits.

3.4 The Capital Programme for 2018/19 incorporated £17.9m of prudential borrowing at start of year so there was the possibility the Authority would need to externally borrow during the year. The agreed strategy for this at the start of the year, based on interest rate forecasts and discussions with Link (the Authority's advisors), was to set a benchmark of 2.0% for 5 year borrowing, 2.5% for 10 year borrowing, 2.9% for 25 year borrowing and 2.7% for 50 year borrowing. This remained largely unchanged during the year.

3.5 In light of the continuing stress on the world banking system, enhanced priority was given to the security and liquidity of investments.

The strategy for investments therefore was:

a) to ensure the security of the Authority's funds
b) to ensure the Authority had sufficient liquidity to meet its cashflow requirements
c) to achieve the optimum yield after ensuring a) and b) above.

4. Treasury Position:

4.1 The major issue for Treasury Management in 2018/19, alongside reducing cash balances, was the continuing challenging environment of previous years i.e. low investment returns and continuing counterparty risk which meant giving heightened preference to security and liquidity of investments. This resulted in the investment portfolio being in short-term investment instruments with lower rates of return but higher security and liquidity.

4.2 In order to balance the impact of the loss in investment income the Authority was mindful of the possibility of making premature repayments of debt if circumstances were conducive to this.

Net borrowing increased by £48.874M in the year. This increase arose as follows:

	£000s
Increase in PWLB debt	47,879
Decrease in LOBO debt	(5,000)
Increase in Market debt	10,000
Decrease in Temporary Borrowing	(5,000)
Increase in Investments	(6,005)
	41,874

4.3 The table below summarises the borrowing and investment transactions during the year:

	Balance 01-04-18	Borrowing	Investments	Repayments	Balance 31-03-19
	£000's	£000's	£000's	£000's	£000's
PWLB *	181,359	47,900	N/A	(21)	229,238
LOBOs *	40,000	Nil	N/A	(5,000)	25,000
Market Loans	25,000	10,000	N/A	Nil	45,000
Temporary Borrowing	5,000	39,475	N/A	(44,475)	Nil
Total	251,359	97,375	N/A	(49,496)	299,238
Temporary Investments	(2,955)	N/A	(270,280)	264,275	(8,960)
Long Term Investments	Nil	N/A	Nil	Nil	Nil
Net Borrowing	248,404	97,375	(270,280)	214,779	290,278

Note: * Public Works Loan Board / Lender's Option Borrower's Option
(2 LOBOs are now fixed so moved to Market Loans categorisation)

4.4 A summary of the economy for 2018/19 is at Appendix A.

5. Debt Rescheduling/Repayment:

5.1 No rescheduling was carried out during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

6. Performance Measurement:

6.1 Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide.
In this context, the overall average rate of interest on all debt in 2018/19 was 4.02%.

	31.03.19 £000's	Average rate for year	31.03.18 £000's	Average rate for year
Total debt	299,238	4.02%	251,359	4.38%
CFR	349,520		313,873	
Over/(under borrowing)	(50,282)		(62,514)	

6.2 The Treasury Management Policy stipulates that the Average Rate on External Investments should be compared with the 3-month uncompounded LIBID rate. This is in preference to the 7-day uncompounded LIBID rate and is in line with Link's advice. It reflects a more realistic neutral investment position for core investments with a medium-term horizon and a rate which is more stable with less fluctuations caused by market liquidity. Historically, the 3-month rate has been slightly higher than the 7-day rate and is, therefore, more challenging for the cash manager.

6.3

Average investments held during 2018/19 £000's	Average rate achieved	3 month LIBID	Average investments held during 2017/18 £000's	Average rate achieved	3 month LIBID
13,355	0.31%	0.67%	11,550	0.36%	0.587%

In 2018/19 the average rate on external investments achieved was 0.31% compared with the 3 month uncompounded LIBID rate of 0.67%. This was as expected due to the reduced and short-term nature of the Council's cash balances available for investment.

7. Summary Statement of Accounts

7.1 The Treasury Management Policy Statement stipulates that a summary Statement of Accounts for Treasury Management be produced at the year end and reported as part of the annual review (see Appendix B).

8. Prudential/Treasury Indicators

8.1 During the year the Authority operated within the treasury limits as approved by Council.

9. Member Training

9.1 The CIPFA Code of Practice states that members charged with governance (all members as the annual strategy requires approval by Full Council) have a personal responsibility to ensure that they have the appropriate skills and training for their role. As such, the Authority provided two members' briefing sessions for treasury management in 2018/19.

10. Treasury Management Policy Statement

10.1 Any major changes to the Treasury Management Policy Statement are reported to Cabinet whilst any minor changes are circulated to members via the members' portal.

Proposal

It is proposed that the Treasury Management Review Report is approved.

Statutory Officers

Chief Finance Officer's comment:
The Head of Financial Services (s151 Officer) notes the report's contents and that, by receiving the report before 30th September, the Cabinet has met the Council's responsibility under the code of practice.

The Solicitor to the Council (Monitoring Officer) has made the following comment: “I have nothing to add to the report”.

Recommendation:				**Reason for Recommendation:**	
The contents of this report are approved.				Statutory requirement	
Person(s) To Action Decision					
Date By When Decision To Be Actioned:					
Relevant Policy (ies):	Financial Regulations, Treasury Management Policy				
Within Policy:	**Y**	**Within Budget:**		**N/A**	
Contact Officer Name:	**Tel:**			**Email:**	
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Background Papers used to prepare Report:

Treasury Management Policy Statement
CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Advisor’s Papers

Appendix A:

UK. 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 Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing country in the G7 in quarter 4.

After the Monetary Policy Committee 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, 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 remains an unknown as it currently remains unlikely that there will be a Commons majority which would support a disorderly Brexit or revoking article 50 (cancelling Brexit). There will also need to be a long delay if there is no majority for any form of Brexit. If that were to happen, it increases the chances of a general election in 2019 and 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.

Appendix B:

Statement of Accounts
Treasury Management

		2018/19	2018/19	2017/18
		Actual	Budget	Actual
		£	**£**	**£**
Employees		175,513	165,000	146,496
Transport	*1	2,140,679	1,266,450	2,002,811
Supplies & Services		201,750	200,000	199,711
Interest Paid	*2	10,711,281	12,699,120	10,398,779
Debt Management Expenses		23,710	6,000	30,947
Gross Expenditure		**13,226,081**	**14,336,570**	**12,778,744**
Interest Received		51,310	0	67,066
Gross Income		**51,310**	**0**	**67,066**
Net Expenditure		**13,174,771**	**12,682,255**	**12,711,678**

Note 1: Employees increase was due to having to cover a maternity leave

Note 2: Transport relates to the cost of leasing/hire across the Authority and is included in the Treasury Management Statement of Accounts as leasing is classed as a Treasury Management activity.

Note 3: Supplies & Services: includes £149k dr/cr card charges, £33k bank charges