Resources and Fire & Rescue Overview and Scrutiny Committee

26 September 2019

Treasury Management Outturn 2018/19

Recommendation

That the committee considers and comments on Treasury Management outturn in respect of 2018/19.

1 Introduction

1.1 The treasury management outturn was reported to Cabinet in July and at that meeting an invitation was extended to this committee to explore this area of activity. This report sets out the treasury management outturn as reported to Cabinet for the committee to consider.

1.2 Warwickshire County Council complies with the requirements of The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice (COP) on Treasury Management (Revised) 2009. The primary requirements of the Code are the:

- creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- production of an Annual Treasury Management Strategy Report for the year ahead, a midyear review report (as a minimum) and an annual review report of the previous year.
- delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices, and for the execution and administration of treasury management decisions.

1.3 Under the CIPFA Code, it is necessary to report on the outturn of the annual treasury management activity for the authority, and to provide a monitoring report during the year.

1.4 Treasury management in the context of this report is defined as:

"The management of the local 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." *(CIPFA Code of Practice)*.

2 Investments

2.1 The Council has an investment portfolio consisting of reserves and cash arising from daily receipts being in excess of payments on a short term basis.

2.2 Security and liquidity of cash was prioritised above the requirement to maximise returns. The Council adopted a cautious approach to lending to financial institutions, and continuously monitored credit quality information regarding the institutions on the Council's approved Lending List.

2.3 The Council's investment portfolio at the end the financial year 2018/19 was as follows:

Table 1: Investment Position at 31 March 2019

	Invested at 31st March 2018	Additions (Withdrawals)	Invested at 31st March 2019
In house deposits	25.036	142.487	167.523
Money Market/External Funds	240.280	- 66.827	173.453
Total Treasury Management Investments	**265.316**	**75.660**	**340.976**
Cash	18.970	- 0.917	18.053
Total Cash and Cash Equivalents and Short Term Investments	**284.286**	**74.743**	**359.029**

2.4 Balances overall have increased to £359m. This is partly an intentional outcome of a prudent Minimum Revenue Provision approach, where cash is set aside (£12.4m this year) annually in advance of needing to make loan repayments – and significant loan repayments (£30m) are due over the next couple of years. In addition, reserves have been increased as a result of a revenue underspend of £17.6m and a capital underspend leading to unused capital receipts and grants totalling £23m. These unused funds will be used to finance future spending. The capital underspend has meant that it was not necessary to increase borrowing during the year. Further capital and revenue grants of £23m were received in advance, for example grants from government for the 2019/20 financial year.

2.5 The mix of in house and externally managed funds has changed as a result of action to reduce concentration risk in money market funds. Appendix A illustrates the deposits making up the £359m of cash held at the year end. This includes reference to £18m of cash.

2.6 The performance of the Council's internally and external managed investments (weighted) versus the benchmark is set out in Table 2:

Table 2: Investment Performance to 31 March 2019

	Average Interest rate year to date	Target rate: Average YTD 7 day LIBID	Variance
	%	%	%
In house deposits	0.68	0.51	0.17
Money Market/External Funds	1.08	0.51	0.57
Total	**0.98**	**0.51**	**0.47**

2.7 The investment environment in 2018/19 continued to be a challenging one for investors, however the average return achieved of 0.98% is an improvement on the previous year which was 0.87%. The increase in the bank rate and an increase in the proportion of funds being placed in longer dated deposits that provide higher returns have contributed towards this.

2.8 Appendix B illustrates the mix of treasury management investment returns from the different deposits held at the end of the year. Returns vary from 0.51% to 4.36% however risk also varies with return. This analysis excludes cash balances which are not investments and long term investments that are not held for treasury management purposes.

2.9 The interest earned on the Council's investments was as follows:

Table 3: Interest Earned to March 2019

	Year to date Gross £m	Costs £m	Year to date Net £m
In house deposits	0.582	n/a	0.582
Money Market/External Funds	2.859	0.394	2.465
Total	**3.441**	**0.394**	**3.047**

2.9 Externally managed funds incur management fees which are noted in Table 3. Internally managed funds do not present fees in the same way, either county council cash is lent to other institutions (e.g. other local authorities) who pay fees as the borrower, or are invested in deposit funds that present net returns rather than gross returns with costs.

2.10 The Council also received income from longer term investments that are held for service reasons rather than treasury management purposes, including for example the University of Warwick Science Park and Educaterers Ltd. Long

term investments total £2m, and the total interest earned by the Council when including these additional funds was £3.5m.

2.11 The costs in Table 3 relate to the direct fees of fund managers. In addition to these costs there are costs of managing the treasury management service and tax advice which bring total costs associated with income earned to £0.5m.

2.12 Most of the deposits simply provide a return and the deposit value is static. However two funds are of a nature where the deposit itself has a value which can rise or fall, presenting an opportunity for higher returns but with higher risk. These are the CCLA Property Fund and the Threadneedle Social Bond Fund. The changes in the underlying asset value of these investments are not reflected in investment returns above but would be realised upon selling. The movements in asset value during 2018/19 are illustrated in Appendix C. The property fund has increased in value, the social bond fund reduced in value and then returned close to its initial value.

2.13 Further information about funds held (duration and Fitch rating) is summarised in Appendix D. This information focuses on treasury management investment returns and so excludes cash balances which are not investments, and long term investments which are not held for treasury management purposes.

2.14 Table 4 details our consultant's view on interest rates. With continued uncertainty over the final terms of Brexit, the base rate and money market rates are likely to remain at low levels until mid-2020. The impact of this is the continuation of low returns on cash deposits and money market funds. Further commentary on the wider economic environment from our external advisers (Link) is provided at Appendix E. Note that this commentary relates to what was known at the time of the outturn but some events, in particular in relation to Brexit have moved on since then.

Table 4: Interest Rate Forecast

	Present – May 2019 %	**Jun 2019 – Feb 2020 %**	**Mar 2020 – Aug 2020 %**	**Sep 2020 – May 2021 %**	**Jun 2021 to Feb 2022 %**	**Mar 2022 onwards %**
Interest Rate Forecast	0.50	0.75	1.00	1.25	1.50	1.75

Source: Link Asset Services

2.15 The Council does not currently hold any variable rate debt and so is not exposed to interest rate risk on debt. However increasing rates mean that the duration of cash investments needs to be short enough that they are not locked into rates that are then left behind as better rates become available, with this risk being balanced against the fact that longer dated investments get higher returns.

3 Debt Financing

3.1 The authority had borrowing held with the Public Works Loans Board (PWLB) of £352m of principal, and the total balance outstanding at the 31st March 2019 was £359.9m after including accrued interest. The weighted average interest payable on the loans during 2018/19 was 4.85%. Total interest payable for the year was £17.054m.

3.2 During the financial year, the authority had no maturing debt. The County did not undertake any new long term borrowing in 2018/19 and borrowing remained within the prudential limits. The profile of when debt was taken out and when it is due to mature is set out in Appendix F.

3.3 A review of PWLB debt was undertaken, driven by the relatively high rates being paid compared to what is currently available. It was not appropriate to refinance this debt due to the early redemption fees put in place by HM Treasury to protect from the loss of income that would result if local authorities did refinance to lower rates. This position will be kept under review.

4 Compliance with Treasury Limits and Prudential Indicators

4.1 During 2018/19, the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Treasury Management Strategy. Full details of the Prudential Indicators set for 2019/20 are shown in Appendix G. Explanations of the terminology employed is set out in Appendix H**.**

5 Sensitivity Analysis

5.1 For the purposes of disclosure on Market Risk a sensitivity analysis has been carried out to show the impact of a change in interest rates of + 1% on the debt portfolio.

5.2 The following table shows the results of the sensitivity analysis:

	Actual	+1% increase in Base Rate	
	F.V. at 31.03.2019 £m	F.V. at 31.03.2019 £m	Difference £m
Debt (new borrowing)	550.224	468.153	**82.071**
Debt (early repayment)	648.788	543.447	**105.341**

5.3 The above table demonstrates how as interest rates rise the fair value of a given level of debt reduces. The early repayment figures are higher than the new borrowing figures, and this illustrates the early redemption penalties for Public Works Loan Board debt.

6.0 Financial Implications

6.1 The financial implications of the Treasury Management outturn are set out in the body of the report.

Background Papers
None

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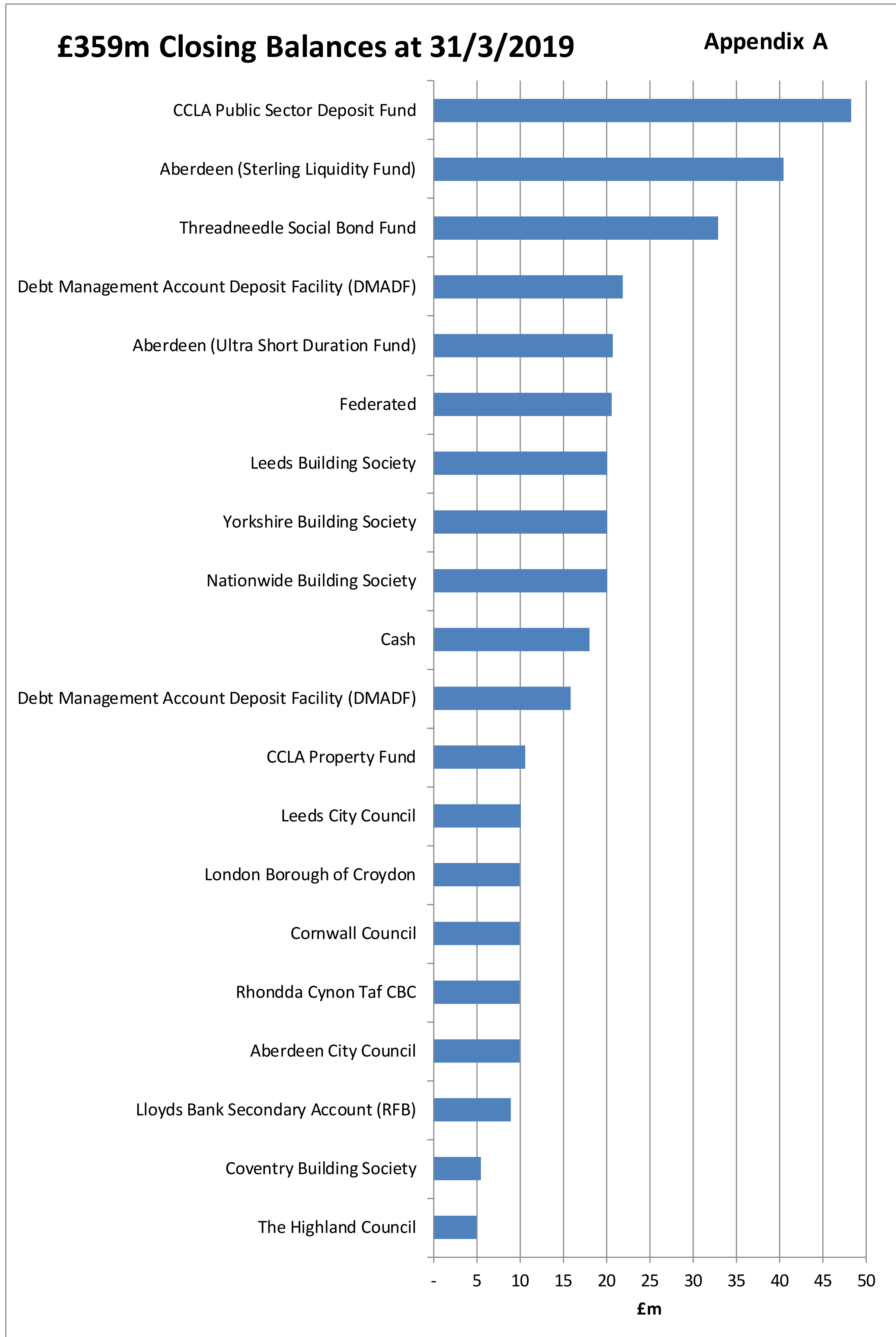
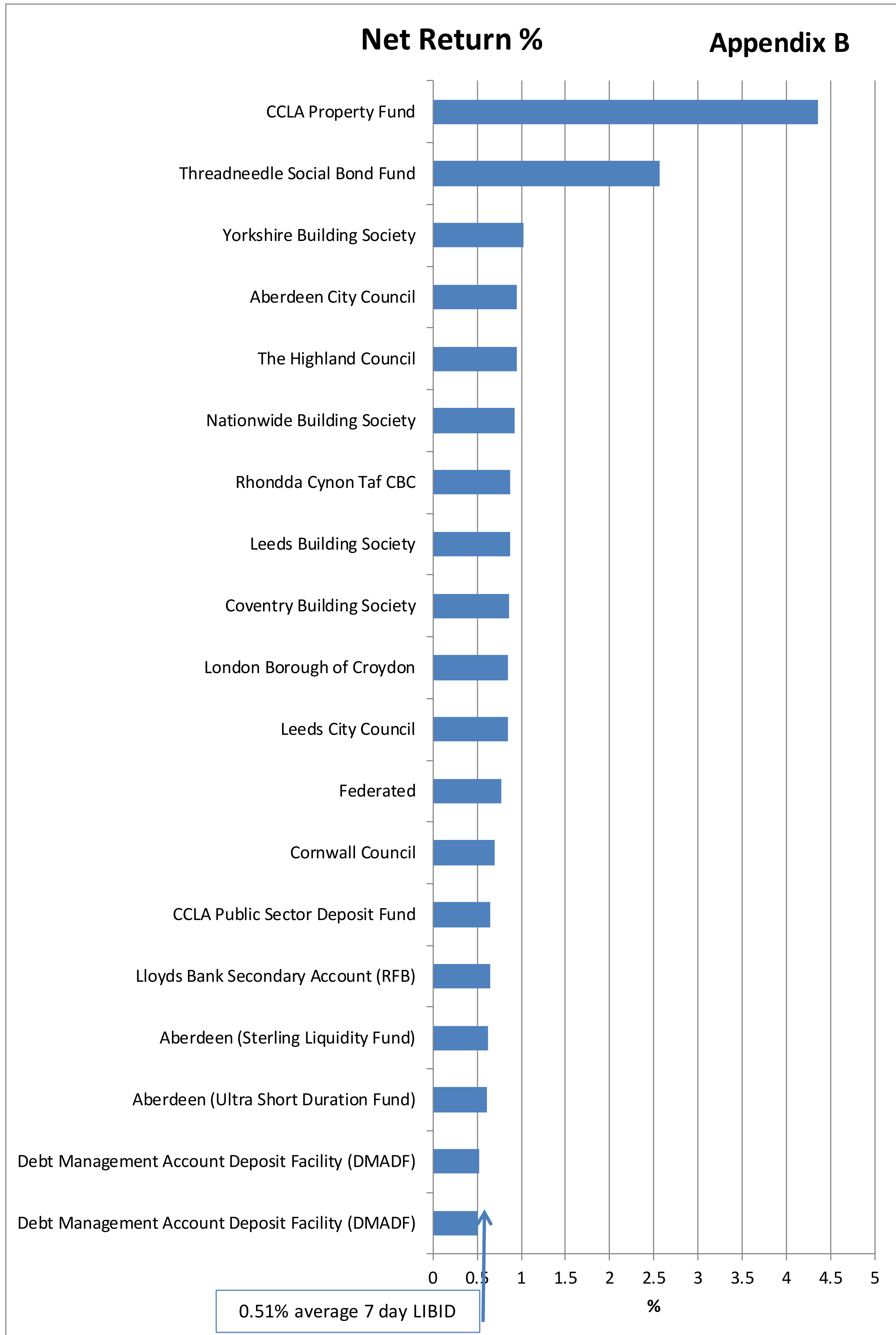
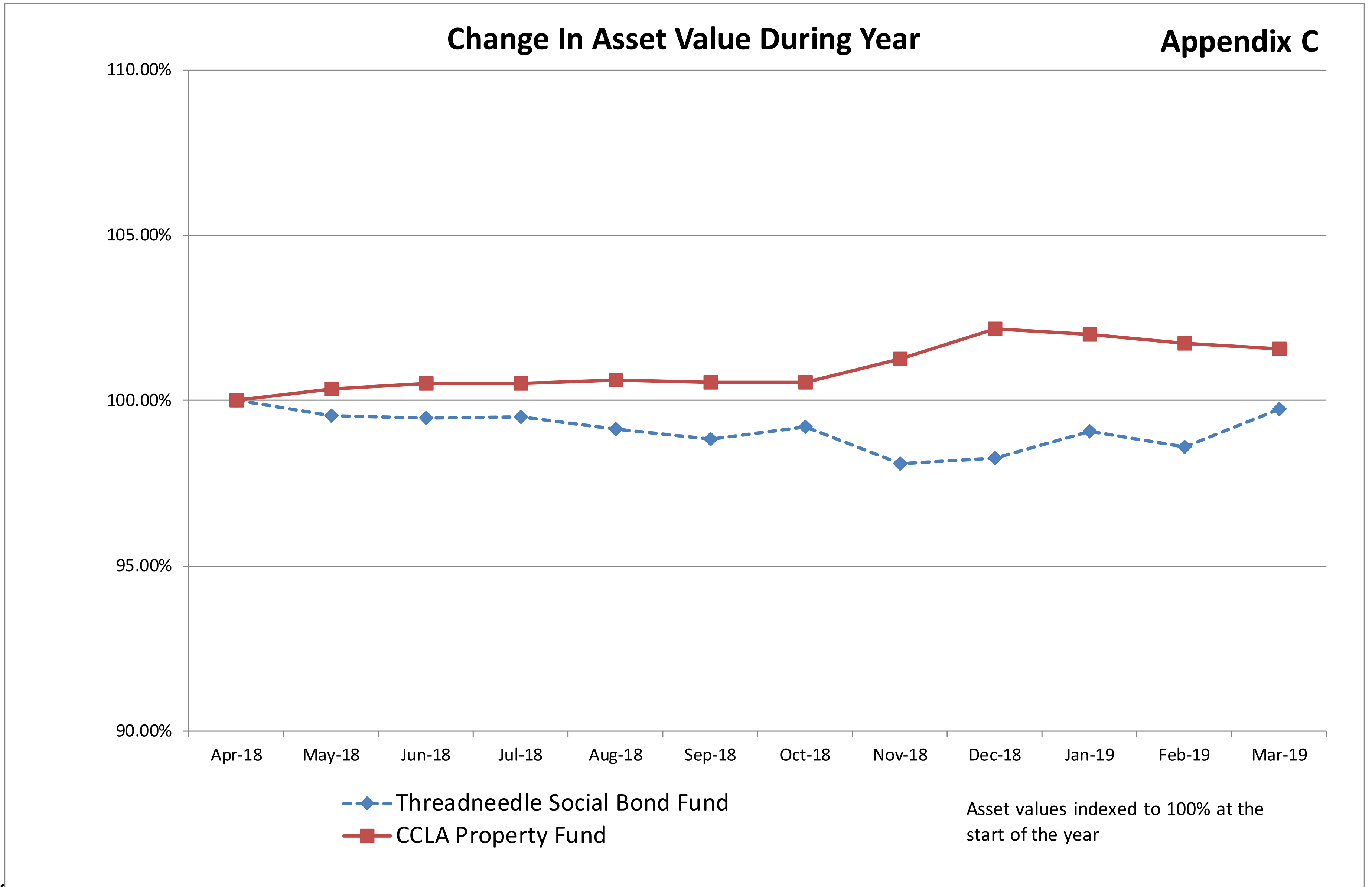
The report was circulated to the following members prior to publication:
Local Member(s): none
Other members: none


£359m Closing Balances at 31/3/2019
Appendix A
CCLA Public Sector Deposit Fund
Aberdeen (Sterling Liquidity Fund)
Threadneedle Social Bond Fund
Debt Management Account Deposit Facility (DMADF)
Aberdeen (Ultra Short Duration Fund)
Federated
Leeds Building Society
Yorkshire Building Society
Nationwide Building Society
Cash
Debt Management Account Deposit Facility (DMADF)
CCLA Property Fund
Leeds City Council
London Borough of Croydon
Cornwall Council
Rhondda Cynon Taf CBC
Aberdeen City Council
Lloyds Bank Secondary Account (RFB)
Coventry Building Society
The Highland Council
-
5
10
15
20
25
30
35
40
45
50
£m


Net Return %
Appendix B
CCLA Property Fund
Threadneedle Social Bond Fund
Yorkshire Building Society
Aberdeen City Council
The Highland Council
Nationwide Building Society
Rhondda Cynon Taf CBC
Leeds Building Society
Coventry Building Society
London Borough of Croydon
Leeds City Council
Federated
Cornwall Council
CCLA Public Sector Deposit Fund
Lloyds Bank Secondary Account (RFB)
Aberdeen (Sterling Liquidity Fund)
Aberdeen (Ultra Short Duration Fund)
Debt Management Account Deposit Facility (DMADF)
Debt Management Account Deposit Facility (DMADF)
0
0.5
1
1.5
2
2.5
3
3.5
4
4.5
5
%
0.51% average 7 day LIBID


Change In Asset Value During Year
Appendix C
110.00%
105.00%
100.00%
95.00%
90.00%
Apr-18
May-18
Jun-18
Jul-18
Aug-18
Sep-18
Oct-18
Nov-18
Dec-18
Jan-19
Feb-19
Mar-19
Threadneedle Social Bond Fund
CCLA Property Fund
Asset values indexed to 100% at the start of the year

Cash Funds Summary **Appendix D**

Internally Managed Funds	Total £m	Net % Rate	Duration (days From 31/3/2019) Note 1	Duration (total days from inception) Note 2	Fitch Long Term Credit Rating
Lloyds Bank Secondary Account (RFB)	9.0	0.65	same day	same day	A+
Leeds Building Society	20.1	0.87	12	182	A-
Leeds City Council	10.0	0.85	37	183	A-
Yorkshire Building Society	20.1	1.02	138	273	A-
Cornwall Council	10.0	0.70	3	90	AA
London Borough of Croydon	10.0	0.85	127	214	AA
Coventry Building Society	5.5	0.86	47	128	A
The Highland Council	5.0	0.95	198	273	AA
Rhondda Cynon Taf CBC	10.0	0.88	114	181	AA
Nationwide Building Society	20.0	0.92	61	120	A
Aberdeen City Council	10.0	0.95	127	181	AA
Debt Management Account Deposit Facility (DMADF)	21.9	0.51	8	28	AA
Debt Management Account Deposit Facility (DMADF)	15.8	0.52	25	29	AA
	167.5				

Externally Managed Funds	At 31 March 2019 £m	Net Return %	Duration (Days From 31/3/2019)	Duration (total days from inception)	Fitch Long Term Credit Rating
CCLA Public Sector Deposit Fund	48.2	0.65	same day	same day	AAA
Aberdeen (Sterling Liquidity Fund)	40.4	0.62	same day	same day	AAA
Aberdeen (Ultra Short Duration Fund)	20.7	0.61	next day	next day	AAA
Federated	20.6	0.78	next day	next day	AAA
Threadneedle Social Bond Fund	32.9	2.56	4 days	4 days	
CCLA Property Fund (Note 3)	10.7	4.36	up to 30 days	up to 30 days	
Total	**173.5**				

Note 1 - This records the duration from the end of the year to give an indicaiton of overall liquidity at one point in time.
Note 2 - This records the overall duration of each asset to give an indication of how long cash is placed for in each fund.
Note 3 - The CCLA Property Fund has a monthly dealing date so the maximum wait would be 30 days.

Fees

Internally managed funds do not have gross fees - a net return on investment is received.
Externally managed funds have fees in the range 0.1% to 0.65%, but the returns quoted above are net of fees.

Appendix E

The Economy and Interest Rates

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 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** 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, (8.4.19), been unable to muster a majority in the Commons over its Brexit deal. The EU has set a deadline of April 12 for the House of Commons to propose what form of Brexit it would support. If another form of Brexit, other than the proposed deal, does get a majority by April 12, then it is likely there will need to be a long delay to Brexit to allow time for negotiations with the EU. 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.

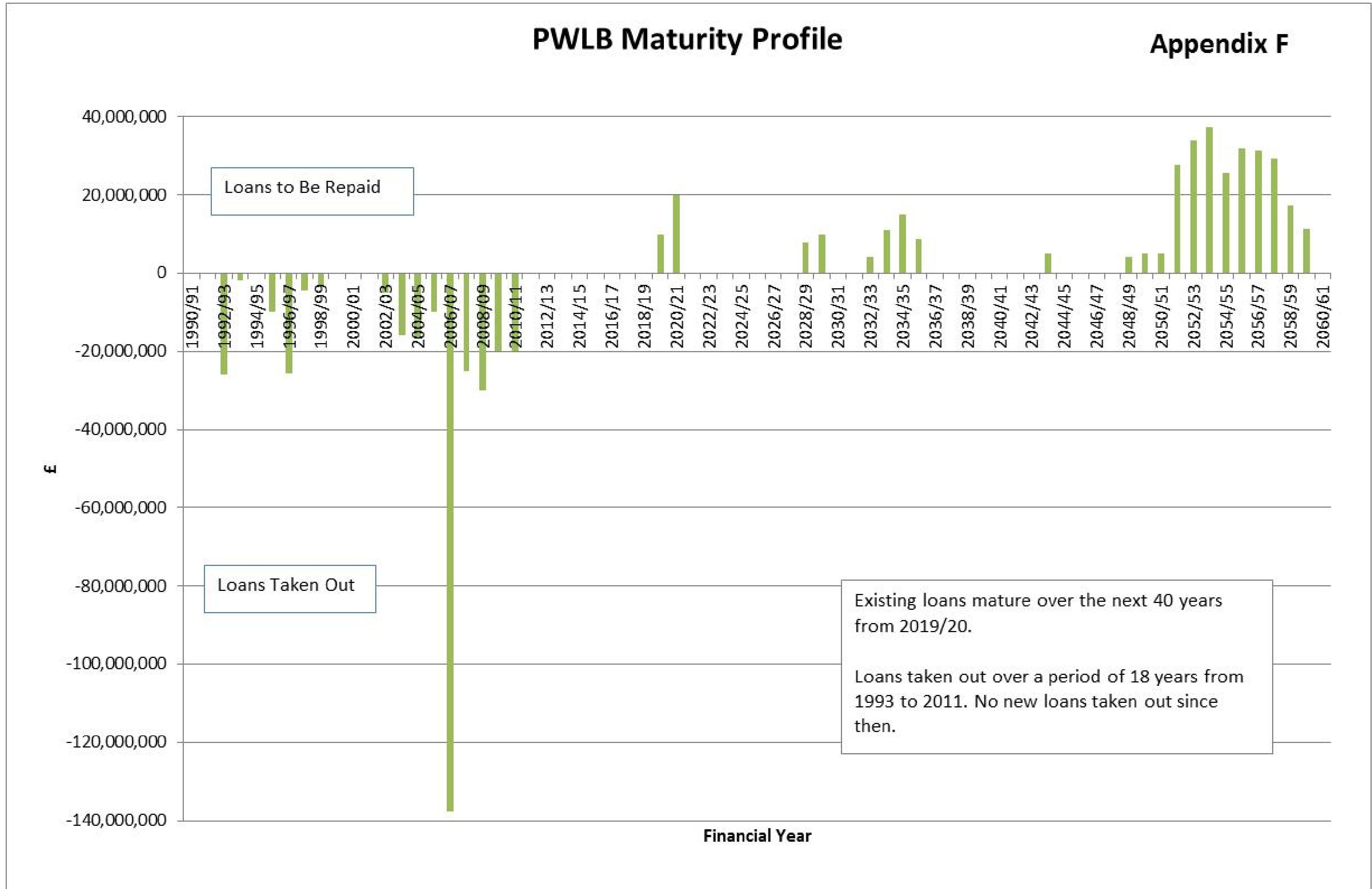
USA. President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the strong rate of growth; this rose from 2.2%, (annualised rate) in quarter 1 of 2018 to 4.2% in quarter 2, 3.5% in quarter 3 and then back to 2.2% in quarter 4. The annual rate came in at 2.9% for 2018, just below President Trump's 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 Eurozone 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 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 - 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. 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 Targeted Longer Term Refinancing Options; 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 Targeted Longer Term Refinancing Options 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 up in the US, though this fear is probably overdone.


PWLB Maturity Profile
Appendix F
Loans to Be Repaid
Loans Taken Out
Existing loans mature over the next 40 years from 2019/20.
Loans taken out over a period of 18 years from 1993 to 2011. No new loans taken out since then.
40,000,000
20,000,000
0
-20,000,000
-40,000,000
-60,000,000
-80,000,000
-100,000,000
-120,000,000
-140,000,000
£
Financial Year
1990/91
1992/93
1994/95
1996/97
1998/99
2000/01
2002/03
2004/05
2006/07
2008/09
2010/11
2012/13
2014/15
2016/17
2018/19
2020/21
2022/23
2024/25
2026/27
2028/29
2030/31
2032/33
2034/35
2036/37
2038/39
2040/41
2042/43
2044/45
2046/47
2048/49
2050/51
2052/53
2054/55
2056/57
2058/59
2060/61

Prudential Indicators — Appendix G

(1). AFFORDABILITY PRUDENTIAL INDICATORS	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual	Actual	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Capital Expenditure	78,344	84,077	230,593	55,489	7,261
	%	%	%	%	%
Ratio of financing costs to net revenue stream	7.10	6.99	6.78	7.66	7.57
Gross borrowing requirement	£'000	£'000	£'000	£'000	£'000
Gross Debt	362,274	362,274	352,274	332,274	332,275
Capital Financing Requirement as at 31 March	313,947	301,581	407,734	392,611	377,098
Under/(Over) Borrowing	(48,327)	(60,693)	55,460	60,337	44,823
	£'000	£'000	£'000	£'000	£'000
In year Capital Financing Requirement	(2,746)	(12,367)	106,154	(15,123)	(15,513)
	£'000	£'000	£'000	£'000	£'000
Capital Financing Requirement as at 31 March	313,947	301,581	407,734	392,611	377,098

PRUDENTIAL INDICATOR (2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2017/18	2018/19	2019/20	2020/21	2021/22
	Approved	Approved	estimate	estimate	estimate
Authorised limit for external debt -	£'000	£'000	£'000	£'000	£'000
Borrowing	549,049	516,818	547,273	541,125	498,510
other long term liabilities	12,000	12,000	12,000	12,000	12,000
TOTAL	**561,049**	**528,818**	**559,273**	**553,125**	**510,510**
Operational boundary for external debt -	£'000	£'000	£'000	£'000	£'000
Borrowing	457,540	430,681	456,061	450,938	415,425
other long term liabilities	10,000	10,000	10,000	10,000	10,000
TOTAL	**467,540**	**440,681**	**466,061**	**460,938**	**425,425**
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / fixed term investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
Net principal re fixed rate borrowing / fixed term investments	25%	25%	25%	25%	25%
Upper limit for total principal sums invested for over 365 days	£'000	£'000	£'000	£'000	£'000
(per maturity date)	£0	£60,000	£60,000	£60,000	£60,000

Maturity structure of new fixed rate borrowing during year	upper limit	upper limit	lower limit
under 12 months	20%	20%	0%
12 months and within 24 months	20%	20%	0%
24 months and within 5 years	60%	60%	0%
5 years and within 10 years	100%	100%	0%
10 years and above	100%	100%	0%

Maturity structure of new variable rate borrowing during year	upper limit	upper limit	lower limit
under 12 months	20%	20%	0%
12 months and within 24 months	20%	20%	0%
24 months and within 5 years	60%	60%	0%
5 years and within 10 years	100%	100%	0%
10 years and above	100%	100%	0%

Note – The top line capital expenditure figures represent currently approved capital expenditure and hence they tail off in future years. However as new capital expenditure plans are developed and approved the actual capital spent in future years will be higher than is set out here.

Prudential Indicators Glossary

Ratio of financing costs to net revenue stream

The ratio of financing costs to net revenue stream shows the estimated annual revenue costs of borrowing, less net interest receivable on investments, plus repayments of capital, as a proportion of annual income from council taxpayers and central government. The estimates of financing costs include current and future commitments based on the capital programme.

Gross Borrowing

Gross borrowing refers to the Authority's total external borrowing and other long term liabilities versus the Capital Financing Requirement.

Actual and Estimated Capital Expenditure

Actual and estimates of capital expenditure for the current and future years.

Capital Financing Requirement

The Capital Financing Requirement (CFR) represents capital expenditure financed by external debt and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR measures the Authority's underlying need to borrow externally for a capital purpose. The Authority has a treasury management strategy which accords with the CIPFA Code of Practice for Treasury Management in the Public Services.

Authorised Limit

In respect of its external debt, the Authority approves authorised limits for its total external debt gross of investments. These limits separately identify borrowing from other long-term liabilities such as finance leases. Authorised Limits are consistent with the Authority's current commitments, service plans, proposals for capital expenditure and associated financing, cash flow and accord with the approved Treasury Management Policy statement and practices. The Authorised Limit is based on the estimate of most likely prudent, but not necessarily the worst case scenario and provides sufficient additional headroom over and above the Operational Boundary.

Operational Boundary

The Operational Boundary for external debt is based on the same estimates as the authorised limit but reflects the Head of Finance's estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements, and equates to the

maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in-year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified.

Limits on Interest Rate Exposure

This means that the Authority will manage fixed and variable interest rate exposure within the ranges. This provides flexibility to take advantage of any favourable movements in interest rates.