MEETING:	**AUDIT AND GOVERNANCE COMMITTEE**
DATE:	**29 JULY 2019**
TITLE:	**TREASURY MANAGEMENT 2018/19**
PURPOSE:	**CIPFA's Code of Practice requires that a report on the results of the Council's actual treasury management is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
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Executive Summary

During the 2018/19 financial year the Council's borrowing remained within the limits originally set and total interest received on deposits was £330,614 which was above the budgeted level of £130,000. There were no defaults by banks in which the Council had deposited money.

1. Introduction and Background

CIPFA's revised Code of Practice on Treasury Management was adopted by the Council on 1st March 2011 and the Council fully complies with its requirements. The Code requires that I report on the results of the Council's actual treasury management results in the previous financial year against that which was expected. It is considered that the Audit Committee is the appropriate body to consider this report.

This report compares the actual performance for the Financial year 2018/19 against the strategy which was established in February 2019 and was approved by the full Council on 8 March 2018 and can be accessed at Item 11 on https://democratiaeth.cyngor.gwynedd.gov.uk/ielistdocuments.aspx?cid=130&mid=2409&ver=4&

The report includes:

- the external and local context;
- the borrowing requirement and debt management;
- investment activity;
- compliance with Prudential Indicators.

The report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Welsh Government's Investment Guidance.

The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy.

2. External Context

Economic background: After spiking at over $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

After rising to 0.6% in the third calendar quarter from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

With the 29th March 2019, the original EU 'exit day' now been and gone, having failed to pass a number of meaningful votes in Parliament, including shooting down Theresa May's deal for the third time, MPs voted by a majority of one (313 to 312) to force the prime minister to ask for an extension to the Brexit process beyond 12th April in order to avoid a no-deal scenario. Recent talks between the Conservative and Labour parties to try to reach common ground on a deal which may pass a vote by MPs have yet to yield any positive results. The EU must grant any extension and its leaders have been clear that the terms of the deal are not up for further negotiation. The ongoing uncertainty continues to weigh on sterling and UK markets.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with EU. The EU itself appeared to be show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

Financial markets

December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

Credit background

Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities.

In February, Fitch put the UK AA sovereign long-term rating on Rating Watch Negative as a result of Brexit uncertainty, following this move with the same treatment for UK banks and a number of government-related entities.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

Local Context

At 31 March 2019 the Council had net borrowing of £91m arising from its revenue and capital activities, an increase against £74m in 2018. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The movements are summarised in the table below.

The Council has a decreasing CFR over the next 2 years and a reducing level of investments and therefore may need to borrow over the forecast period.

Balance Sheet Summary

	31.3.18 Actual £m	**2018/19 Movement £m**	**31.3.19 Actual £m**
CFR	177	1	178
Less: Other debt liabilities	(2)	0	(2)
Borrowing CFR	**175**	**1**	**176**
Less: Usable reserves	(59)	(15)	(74)
Less: Working capital	(46)	19	(27)
Net borrowing	**70**	**6**	**76**

The Authority's strategy was to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 31st March 2019 and the year-on-year change in show in the table below.

Treasury management summary

	31.3.18 Balance £m	**31.3.18 Rate %**	**31.3.19 Balance £m**	**31.3.19 Rate %**
Long-term borrowing	(107,810)	5.6	(105,924)	5.6
Short-term borrowing	(10,865)	0.5	(2,770)	8.5
Total borrowing	**(118,675)**	**5.2**	**(108,694)**	**5.6**
Long-term investments	17	4.0	17	4.0
Short-term investments	35,028	0.4	19,567	0.8
Cash and cash equivalents	12,403	0.4	14,686	0.8
Total investments	**47,448**	**0.4**	**34,270**	**0.8**
Net borrowing	**71,227**	**5.2**	**74,424**	**4.8**

Note: the figures in the table are from the balance sheet in the Authority's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments

3. Borrowing Activity in 2018/19

At 31st March 2019, the Council held £107.8m of loans, a decrease of £10.0m on the previous year.

The year-end borrowing position and the year-on-year change are summarised in the table below.

Borrowing Position

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m	31.3.19 Rate %	31.3.19 WAM* years
Public Works Loan Board	91.6	(0.0)	91.6	5.86	19
Banks (fixed-term)	26.2	(10.0)	16.2	4.23	59
Total borrowing	**117.8**	**(10.0)**	**107.8**	**5.62**	**26**

*Weighted average maturity

The Council's main objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with a secondary objective of flexibility to renegotiate loans should the Council's long-term plans change.

Further to these objectives, no new long-term borrowing was undertaken in 2018/19, with existing loans maturing without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregoing investment income) and reduce overall treasury risk.

The "cost of carry" analysis performed by Arlingclose (the Council's treasury management advisor) did not indicate any value in long-term borrowing in advance for future years' planned expenditure and therefore none was taken.

The short-term loan taken last year to ensure sufficient cash was available during the period from January to March 2018 rather than taking on long-term borrowing, was repaid in 2018/19.

4. Treasury Investment Position

The Council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19 the Council's investment balances have ranged between £17.6million and £79.4 million.

The Welsh Government's Investment Guidance gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Investment Position

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m	31.3.19 Rate %	31.3.19 WAM* days
Banks & building societies (unsecured)	11.3	0.9	12.2	0.5	85
Covered bonds (secured)	2.0	(2.0)	0.0	0	0
Government (incl. local authorities)	25.0	(25.0)	0.0	0	0
Money Market Funds	9.2	3.2	12.4	0.7	5
Property Funds	0.0	10.0	10.0	1.0	365+
Total investments	**47.5**	**(12.9)**	**34.6**	**0.7**	**137**

*Weighted average maturity

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Investment Benchmarking

	Credit Score	Credit Rating	Bail-in Exposure	WAM* (days)	Rate of Return
31.03.2018	3.96	AA-	43%	48	0.55%
30.06.2018	3.85	AA-	42%	52	0.69%
30.09.2018	4.21	AA-	53%	43	0.69%
31.12.2018	5.19	A+	62%	47	0.70%
31.03.2019	**4.96**	**A+**	**92%**	**41**	**2.13%**
Similar LAs	**3.93**	**AA-**	**38%**	**125**	**0.97%**
All LAs	**4.02**	**AA-**	**55%**	**29**	**1.45%**

*Weighted average maturity

During the year the exposure to 'bail-in' has increased and the credit score has also increased from 4 to 5. This is due to investment in property funds.

In February 2019 £10m of the Council's cash was invested in externally managed strategic pooled property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds will generate an additional return of income return which will be used to support services from next year onwards and the capital growth in the longer term.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the medium-term and the Council's latest cash flow forecasts, investment in these funds has been maintained.

Readiness for Brexit

With little by way of political clarity as to the exact date on whether there would be an agreed deal prior to leaving the EU and to be prepared for the outside chance of a particularly disruptive Brexit (such as last-minute no-deal) on 29th March, the Authority ensured there were enough accounts open at UK-domiciled banks and Money Market Funds to hold sufficient liquidity over the year end and that its account with the Debt Management Account Deposit Facility (DMADF) remained available for use in an emergency.

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

Treasury Performance

The outturn for debt interest paid in 2018/19 was £6.0 million on an average debt portfolio of £106.8 million at an average interest rate of 5.6%.

The average cash balances were £44.7m during the year. The UK Bank Rate had been between 0.25% and 0.5% since March 2009 until August 2018 when it was raised to 0.75%. Short-term money market rates have remained at relatively low levels. New deposits were made at an average rate of 0.78%. Investments in Money Market Funds generated an average rate of 0.65%.

The Council's budgeted investment income for the year was £0.13m. The Council's investment income outturn for the year was £0.33m.

Compliance Report

The Head of Finance is pleased to report that all treasury management activities undertaken during 2018/19 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in the table below.

Debt Limits

	2018/19 Maximum	31.3.19 Actual	2018/19 Operational Boundary	2018/19 Authorised Limit	Complied
Borrowing	£108m	£108m	£178m	£188m	✓
PFI and Finance Leases	£1.8m	£1.7m	£2m	£2m	✓
Total debt	**109.8**	**109.7**	£180m	£190m	✓

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Investment Limits

	2018/19 Maximum	31.3.19 Actual	2019/20 Limit	Complied
Any single organisation, except UK Government	£6m each	£5m and below	£8m each	✓
Any group of funds under the same ownership	£6m per group	£5m and below	£8m per group	✓
Foreign countries	£6m per country	£2m and below	£8m per country	✓
Unsecured investments with Building Societies	£6m in total	£2m in total	£8m in total	✓
Money Market Funds	£30m in total	£10m in total	£40m in total	✓

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators:

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the time-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment and taking the arithmetic average, weighted by the length of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.3.19 Actual	**2018/19 Target**	**Complied**
Portfolio average credit score	4.96	a score of 7 or lower	✓

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	31.3.19 Actual	**2018/19 Target**	**Complied**
Total cash available within 3 months	£36.6m	£10m	✓

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed was:

	31.3.19 Actual	**2018/19 Target**	**Complied**
Upper limit on fixed interest rate exposure	100%	100%	✓
Upper limit on variable interest rate exposure	0	50%	✓

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	31.3.19 Actual	**Upper Limit**	**Lower Limit**	**Complied**
Under 12 months	2.0%	25%	0%	✓
12 months and within 24 months	1.5%	25%	0%	✓
24 months and within 5 years	3.9%	50%	0%	✓
5 years and within 10 years	15.0%	75%	0%	✓
10 years and within 20 years	32.0%	100%	0%	✓
20 years and within 30 years	5.3%	100%	0%	✓
30 years and within 40 years	25.3%	100%	0%	✓
40 years and above	15.0%	100%	0%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2018/19	**2019/20**	**2020/21**
Actual principal invested beyond year end	£10.0m	£0	£0
Limit on principal invested beyond year end	£40m	£20m	£10m
Complied	✓	✓	✓

Appendix 1

Prudential Indicators 2018/19

The Local Government Act 2003 requires the Council to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

This report compares the approved indicators with the outturn position for 2018/19. Actual figures have been taken from or prepared on a basis consistent with, the Council's statement of accounts.

Estimates of Capital Expenditure: The Council's capital expenditure and financing may be summarised as follows:

Capital Expenditure and Financing	2018/19 Estimate £m	2018/19 Actual £m	Difference £m
General Fund Expenditure	**14.8**	**22.8**	**8.0**
Capital receipts	0.3	0.2	(0.1)
Government Grants	3.5	10.5	7.0
Revenue contributions	6.1	4.2	(1.9)
Supported borrowing	4.1	4.1	0.0
Prudential borrowing	0.8	3.8	3.0
Total Financing	**14.8**	**22.8**	**8.0**

Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31/03/19 Estimate £m	31/03/19 Actual £m	Difference £m
General Fund	178.9	177.7	1.2

There was no change in the CFR as capital expenditure financed by debt was the same as the resources put aside for debt repayment.

Actual Debt: The Council's actual debt at 31 March 2019 was as follows:

Debt	31/03/19 Estimate £m	31/03/19 Actual £m	Difference £m
Borrowing	108.7	108.7	0
Finance leases	0.0	1.7	1.7
Total Debt	**108.7**	**110.4**	**1.7**

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt and CFR	31/03/19 Estimate £m	31/03/19 Actual £m	Difference £m
Total debt	108.7	110.4	1.7
CFR	175.0	177.7	2.7
Headroom	**66.3**	**67.3**	**1.0**

Total debt remained below the CFR during the year.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary and Total Debt	31/03/19 Boundary £m	31/03/19 Actual Debt £m	Difference £m
Borrowing	**175**	**110.4**	**64.6**
Other long-term liabilities	**0**	**1.7**	**(1.7)**
Total Debt	**175**	**112.1**	**62.9**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Boundary and Total Debt	**31/03/19 Boundary £m**	**31/03/19 Actual Debt £m**	**Difference £m**
Borrowing	**195**	**110.4**	**84.6**
Other long-term liabilities	**0**	**1.7**	**(1.7)**
Total Debt	**195**	**112.1**	**82.9**

Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**31/03/19 Estimate %**	**31/03/19 Actual %**	**Difference %**
Total	**5.91**	**5.20**	**0.71**

APPENDIX 2

Credit Score Analysis

Scoring:

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit

The Council aimed to achieve a score of 7 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating threshold of A- for investment counterparties.