Appendix A

Annual Treasury Management Review 2018/19

Pendle Borough Council

July2019

Annual Treasury Management Review 2018/19

1. Introduction

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).

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,
- a mid-year (minimum) treasury update report, and
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The Council's Accounts and Audit Committee has received quarterly treasury management update reports throughout the year. Practical guidance updated by CIPFA was presented to the Accounts and Audit Committee in July 2018.

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.

2. 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.

£m	2017/18 Actual £m	2018/19 Budget £m	2018/19 Actual £m
Capital expenditure			
Financed in year	9.2	10.9	2.7

3. 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.

	31 March 2018 Actual £m	31 March 2019 Budget £m	31 March 2019 Actual £m
CFR General Fund (£m)	21.0	27.5	20.0
Gross borrowing position	19.4	27.2	20.4
(Under) / over funding of CFR	(1.6)	(0.3)	0.4

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	£30.5m
Maximum gross borrowing position during the year	£20.4m
Operational boundary	£28.5m
Average gross borrowing position	£20.4m
Financing costs as a proportion of net revenue stream	7.24%

4. Treasury Position as at 31 March 2019

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

DEBT PORTFOLIO	31 March 2018 Principal £m	Rate/ Return	Average Life yrs	31 March 2019 Principal £m	Rate/ Return	Average Life yrs
Fixed rate funding:						
PWLB	£19.4	3.18%		£20.4	3.11%	
Total debt	**£19.4**			**£20.4**		
CFR	**£21.0**			**£20.0**		
Over / (under) borrowing	**(£1.6)**			**0.4**		
Total investments	**£14.0**	**0.46%**	**All<1yr**	**£16.0**	**0.76%**	**All<1yr**
Net debt	**£5.4**			**£4.4**		

The maturity structure of the debt portfolio was as follows:-

	31 March 2018 Actual £m	2018/19 original limits %	31 March 2019 Actual £m	2018/19 Actual limits %
Under 12 months	£1.0	20%	£1.0	4.9%
12 months and within 24 months	£1.0	30%	nil	nil
24 months and within 5 years	£3.0	40%	£3.0	14.7%
5 years and within 10 years	£3.5	60%	£3.5	17.2%
10 years and above	£10.4	100%	£12.9	63.2%

INVESTMENT PORTFOLIO	Actual 31.3.18 £m	Actual 31.3.18 %	Actual 31.3.19 £m	Actual 31.3.19 %
Treasury investments				
Banks	5.5	39.2	3.0	18.7
Building Societies - rated	2.5	17.9	3.5	21.9
Local authorities	6.0	42.9	9.5	59.4
DMADF (H M Treasury)	0.0	0.0	0.0	0.0
TOTAL TREASURY INVESTMENTS	14.0	100%	16.0	100%

The Council does not hold non-treasury investments.

The maturity structure of the investment portfolio was as follows:-

	2017/18 Actual £m	2018/19 Budget £m	31 March 2019 Actual £m
Investments All investments under 1 year*	14	15	16

**Maximum duration for qualifying investments is 364 days as per the approved AIS.*

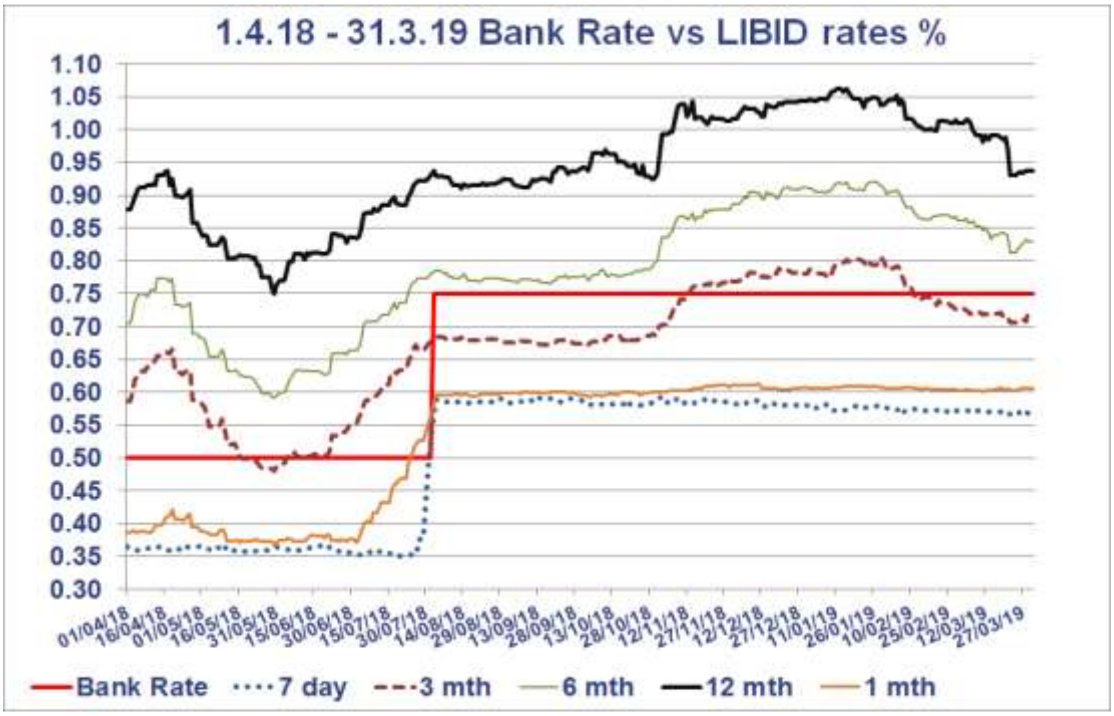
5. The strategy for 2018/19

The expectation for interest rates within the Treasury Management strategy for 2018/19 anticipated small growth in interest rate rises from Q4 2018/19 and gradual rises in fixed term borrowing rates during the year.

Uncertainty surrounding the UK's negotiation from the EU continued to dominate headlines and future forecasts. The Council's strategy maintained a cautious approach, focussing on Security, Liquidity and Yield (SLY) in a low counterparty risk environment, resulting in relatively low returns compared to borrowing rates.

The delayed departure date enabled the credit rating agencies to maintain their risk assessments of those counterparties included on the Councils approved list. These assessments and other market data support the creditworthiness policy of the Council's Annual Investment Strategy. The outcome of the final Brexit deal could result in a review of these rating factors and have implications for future strategy and creditworthiness policy.

5.1 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. The Council's staggered maturity profile enabled value to be achieved, placing maturing investments after 2nd 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 1st 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.

5.2 Borrowing strategy and control of interest rate risk

During 2018/19, the Council maintained an over-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was over funded with loan debt. A cost of carry remained during the year on new long-term borrowing that was not immediately used to finance capital expenditure, causing a temporary increase in cash balances; this incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns - but is set in the context of the financial outlook (see below) and the timing of anticipated Capital Expenditure (slippage).

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 Chief Financial Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following:-

- It was 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, so the portfolio position was re-appraised. A proportion of the budgeted fixed rate funding was drawn whilst interest rates were lower than they were projected to be in the next few years (Medium Term Financial Plan position – MTFP).

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	12.2.18												
	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%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB Rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

Since PWLB rates peaked during October 2018, most PWLB rates have been on a general downward trend, though longer term rates did spike upwards again during December, and, (apart from the 1 year rate), reached lows for the year at the end of March. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields - which determine PWLB rates. The Fed in America increased the Fed Rate four times in 2018, making nine increases in all in this cycle, to reach 2.25% – 2.50% in December. However, it had been giving forward guidance that rates could go up to nearly 3.50%. These rate increases and guidance caused Treasury yields to also move up. However financial markets considered by December 2018, that the Fed had gone too far, and discounted its expectations of further increases. Since then, the Fed has also come round to the view that there are probably going to be no more increases in this cycle. The issue now is how many cuts in the Fed Rate there will be and how soon, in order to support economic growth in the US. But weak growth now also looks to be the outlook for China and the EU so this will mean that world growth as a whole will be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

6. Borrowing Outturn for 2018/19

Treasury Borrowing – the following loans were taken during the year:

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£1m	Fixed interest rate	2.78%	25 years
PWLB	£1m	Fixed interest rate	2.64%	45 years

Borrowing in advance of need
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.

The Council borrowed where it was considered optimal to do so in order to finance capital expenditure which would be incurred within the time frame of the forward approved Capital Financing Requirement estimates. In taking this decision, the Council carefully considered achieving best value, the risk of having to borrow at higher rates at a later date, the carrying cost of the difference between interest paid on such debt and interest received from investing funds which would be surplus until used, and that the Council could ensure the security of such funds placed on temporary investment.

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

Repayments
The Council was due to make a £1m loan repayment on 31 March 2018 but as this date fell on a bank holiday, it was not repaid until 3 April 2018.

7. Investment Outturn for 2018/19

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 22nd March 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, however, with one exception, and the Council had no liquidity difficulties.

A £2.0m investment was made with a Local Authority which was within the £3.0m limit per counterparty. A second investment was made for 5 months for another £2.0m which then exceeded the limit for that period. Following an assessment of risk, the decision to maintain the counterparty relationship was taken and sums were not recalled. Principal and interest were repaid on 15th March 2019 as originally agreed when the transaction was executed. The controls within the process were reviewed and strengthened. This incident was reported to Internal Audit and the Accounts and Audit Committee.

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 (£m)	31 March 2018	31 March 2019
Balances	**1.0**	**1.0**
Earmarked reserves	**7.2**	**6.4**
Provisions	**1.6**	**2.1**
Usable capital receipts	**2.6**	**2.0**
Total	**12.4**	**11.5**

Investments held by the Council - The Council maintained an average balance of £17m of internally managed funds. The internally managed funds earned an average rate of return of 0.73%. Comparable performance indicators are the average 7-day LIBID rate which was 0.51% or the 3-month LIBID rate which was 0.68%. This compares with a revised budget assumption of £15m investment balances earning an average rate of 0.60%.

Appendix 1: Prudential and treasury indicators

In order to ensure that over the medium term debt will only be used for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years.

1. PRUDENTIAL INDICATORS	2017/18	2018/19	2018/19
Extract from budget setting report	**actual**	**original**	**actual**
	£'000	**£'000**	**£'000**
Capital Expenditure			
General	£9,223	£10,940	£2,712
Ratio of financing costs to net revenue stream			
General	7.94%	11.47%	7.24%
Gross borrowing requirement General Fund			
brought forward 1 April	£15,406	£23,659	£20,965
carried forward 31 March	£20,965	£27,271	£20,404
in year borrowing requirement	£5,559	£3,612	(£561)
Gross debt	£19,359	£27,159	£20,359
CFR			
TOTAL	**£20,965**	**£27,483**	**£20,404**

2. TREASURY MANAGEMENT INDICATORS	2017/18	2018/19	2018/19
	actual	original	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£28,000	£30,000	£30,000
other long term liabilities	£500	£500	£500
TOTAL	£28,500	£30,500	£30,500
Operational Boundary for external debt -			
borrowing	£26,000	£28,000	£28,000
other long term liabilities	£500	£500	£500
TOTAL	£26,500	£28,500	£28,500
Actual external debt	£19,359	£27,271	£20,359

Maturity structure of fixed rate borrowing during 2018/19	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	60%	0%
10 years and above	100%	0%

The authorised limit is the aggregate of gross borrowing (i.e. before investment) and other long term liabilities such as transferred debt.

The operational boundary is based on the authorised limit but without the additional headroom.

The authorised limit and operational boundary separately identify borrowing from other long-term liabilities.

GLOSSARY OF TERMS

ALMO: an Arm's Length Management Organisation is a not-for-profit company that provides housing services on behalf of a local authority. Usually an ALMO is set up by the authority to manage and improve all or part of its housing stock.

LAS: Link Asset Services, Treasury solutions – the council's treasury management advisers.

CE: Capital Economics - is the economics consultancy that provides Link Asset Services, Treasury solutions, with independent economic forecasts, briefings and research.

CFR: capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

CPI: consumer price index – the official measure of inflation adopted as a common standard by countries in the EU. It is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

ECB: European Central Bank - the central bank for the Eurozone
EU: European Union
EZ: Eurozone -those countries in the EU which use the euro as their currency

Fed: the Federal Reserve System, often referred to simply as "the Fed," is the central bank of the United States. It was created by the Congress to provide the nation with a stable monetary and financial system.

FOMC: the Federal Open Market Committee – this is the branch of the Federal Reserve Board which determines monetary policy in the USA by setting interest rates and determining quantitative easing policy. It is composed of 12 members--the seven members of the Board of Governors and five of the 12 Reserve Bank presidents.

GDP: gross domestic product – a measure of the growth and total size of the economy.

G7: the group of seven countries that form an informal bloc of industrialised democracies--the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom--that meets annually to discuss issues such as global economic governance, international security, and energy policy.

Gilts: gilts are bonds issued by the UK Government to borrow money on the financial markets. Interest paid by the Government on gilts is called a coupon and is at a rate that is fixed for the duration until maturity of the gilt, (unless a gilt is index linked to inflation); while the coupon rate is fixed, the yields will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.

HRA: housing revenue account.

IMF: International Monetary Fund - the lender of last resort for national governments which get into financial difficulties.

LIBID: the London Interbank Bid Rate is the rate bid by banks on deposits i.e., the rate at which a bank is willing to borrow from other banks. It is the "other end" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend).

MHCLG: the Ministry of Housing, Communities and Local Government -the Government department that directs local authorities in England.

MPC: the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

MRP: minimum revenue provision -a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).

PFI: Private Finance Initiative – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

PWLB: Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

QE: quantitative easing – is an unconventional form of monetary policy where a central bank creates new money electronically to buy financial assets, such as government bonds, (but may also include corporate bonds). This process aims to stimulate economic growth through increased private sector spending in the economy and also aims to return inflation to target. These purchases increase the supply of liquidity to the economy; this policy is employed when lowering interest rates has failed to stimulate economic growth to an acceptable level and to lift inflation to target. Once QE has achieved its objectives of stimulating growth and inflation, QE will be reversed by selling the bonds the central bank had previously purchased, or by not replacing debt that it held which matures. The aim of this reversal is to ensure that inflation does not exceed its target once the economy recovers from a sustained period of depressed growth and inflation. Economic growth, and increases in inflation, may threaten to gather too much momentum if action is not taken to 'cool' the economy.

RPI: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – CPI. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

VRP: a voluntary revenue provision to repay debt, in the annual budget, which is additional to the annual MRP charge, (see above definition).