2018-2019 Annual Treasury Management Report

Appendix 1

Contents

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1. Introduction

1.1. The council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management report including a review of activities and the actual Prudential and Treasury Indicators for 2018/19.This report meets the requirements of both the Chartered Institute of Public Finance and Accounting (CIPFA) Code of Practice in Treasury management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2. The report includes:

- Capital Activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing requirement, CFR);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Review of debt and investment activity.

1.3. During 2018/19 the Council complied with its legislative and regulatory requirements. Detailed reports have been presented to Overview and Scrutiny Committee, Cabinet and Council throughout the year as part of the Quarterly Corporate Financial Reports.

1.4. There were no breaches of any indicators or limits during the year.

1.5. Table 1 below provides a summary of the key data for 2018/19:

Table 1: Capital Expenditure, Capital Financing Requirement and Cash Resources

	2017/18 Actual £000	2018/19 Feb 18 estimate £000	2018/19 Feb 19 estimate £000	2018/19 Actual £000
Capital expenditure	6,596	4,028	7,502	4,030
Capital Financing Requirement (CFR)	17,995	18,557	18,468	18,354
External debt	12,800	12,800	12,800	12,800
Total Investments (inc. call accounts)	18,912	19,031	17,819	20,329

2. Capital Expenditure and Financing 2018/19

2.1. The Council incurs 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;
- Un-financed capital expenditure which leads to an increase in the Council's CFR. This increases the Minimum Revenue Provision (MRP see 2.6) charged to the revenue account to ensure that resources are set aside to pay for the asset over its useful life.

2.2. Table 2 below shows the actual capital expenditure and how this was financed.

Table 2: Capital expenditure and financing.

	2017/18 Actual £000	2018/19 Feb 18 estimate £000	2018/19 Feb 19 estimate £000	2018/19 Actual £000
Capital expenditure	**6,596**	**4,028**	**7,502**	**4,030**
Resourced by:				
· Capital receipts	1,537	328	1,836	887
· Capital grants	2,198	832	1,974	1,334
· Revenue Reserves	1,593	1,945	2,477	877
Unfinanced capital expenditure	**1,268**	**923**	**1,215**	**932**

2.3. Explanations of the variances are included within the out-turn report to Council on 23 July 2019. The main reason for the in-year variances in capital expenditure are due to the addition and subsequent re-phasing of spend relating to the Kendal Flood Relief ERDF scheme to 2019/20 onwards.

2.4. The CFR represents the Council's underlying need to borrow for capital expenditure. It increases when the Council incurs capital expenditure and reduces as resources are applied to capital expenditure.

2.5. The CFR is the cumulative unfinanced capital expenditure which has not yet been 'paid for'. It can be understood in terms of an outstanding 'mortgage' balance on the Council's non-current assets.

2.6. There are statutory controls in place to ensure that the cost of capital assets is charged to revenue over the life of the assets. This is the annual MRP charge.

2.7. 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 minimum revenue charge each year through a Voluntary Revenue Provision (VRP)

2.8. The Council's 2018/19 MRP Policy (as required by MHCLG guidance) was approved as part of the Treasury Management Strategy Report for 2018/19 on 27th February 2018.

2.9. The Council's CFR for the year is shown in Table 3, and represents a key prudential indicator.

Table3: CFR Movement

CFR	2017/18 Actual £000	2018/19 Feb 18 estimate £000	2018/19 Feb 19 estimate £000	2018/19 Actual £000
Opening balance	17,176	18,373	17,992	17,995
Add unfinanced capital expenditure (as above)	1,268	923	1,215	932
Less MRP	(449)	(739)	(739)	(573)
Closing balance	17,995	18,557	18,468	18,354

3. Borrowing

3.1. A key prudential indicator is to compare the level of gross debt against the CFR. Gross debt should not exceed the CFR in the medium term in order to remain prudent and to ensure revenue activities are not being funded by borrowing. Table 4 highlights the Council's gross borrowing position against the CFR and shows that the Council has complied with this prudential indicator.

Table 4: Gross Debt v CFR

	31 March 2018 £000	31 March 2019 £000
Gross Debt	12,800	12,800
CFR	18,814	18,354
Over / (under) borrowing	(6,014)	(5,554)

3.2. During 2018-19, the council maintained an under-borrowed position of £5.6m. This means that the capital borrowing need, the 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 and minimising counterparty risk on placing investments also needed to be considered.

3.3. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However this was, and will continue to be, kept under review to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure.

3.4. Included in the prudential code are a number of other indicators for debt, the levels for which are shown in Table 5

Table 5: Summary of Debt and Debt Indicators

	2018/19 £000
Gross Debt	12,800
Authorised limit	24,600
Operational boundary	18,600
Estimate of Financing Costs : Net revenue stream (Feb 18 estimate)	9.40%
Estimate of Financing Costs : Net revenue stream (Feb 19 estimate)	8.91%
Actual of Financing Costs : Net revenue stream	6.59%

3.5. The Authorised limit; is the “affordable borrowing limit” required by section 3 of the Local Government Act 2003. This is the level of debt that while not desirable, could be afforded in the short term, but is not sustainable in the longer term. Once set the Council does not have the power to borrow above the authorised limit.

3.6. The Operational Boundary; is the limit beyond which external debt is not normally expected to exceed. This is set at a level consistent with the borrowing need (CFR) plus an allowance for unexpected expenditure.

3.7. As demonstrated in Table 5 the council has maintained gross borrowing within both its authorised limit and operational boundary for 2018/19.

3.8. The ratio of financing costs to net revenue stream identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income). This shows the percentage amount of the net revenue stream which is spent before the Council provides any services. For 2018/19 the actual was 6.59%, which came in below estimates for the year.

3.9. In addition to the previously mentioned indicators for debt it is also important to be aware of the maturity structure of borrowing and limits places on fixed and variable rate debt. These are shown in Table 6 below.

Table 6 Maturity Structure of Debt and Limits on Fixed and Variable rate debt.

	31/03/2018 Actual	31/03/2019 Approved	31/03/2019 Actual
Fixed Interest Borrowings:	**%**	**%**	**%**
Under 12 months	0	Up to 25%	0
12 Months to 2 Years	0	Up to 25%	0
2 - 5 Years	0	Up to 25%	0
5 to 10 years	0	Up to 100%	0
10 to 20 years	0	Up to 100%	0
20 to 30 Years	6.25%	Up to 100%	6.25%
30 to 40 Years	46.87%	Up to 100%	46.87%
40 years plus	46.88%	Up to 100%	46.88%
	100%		**100%**
Limits on Borrowing at	**£m**	**£m**	**£m**
Fixed rate	12.8	24.6	12.8
Variable rate (maturing<1 year)	0	0	0

4. Investments

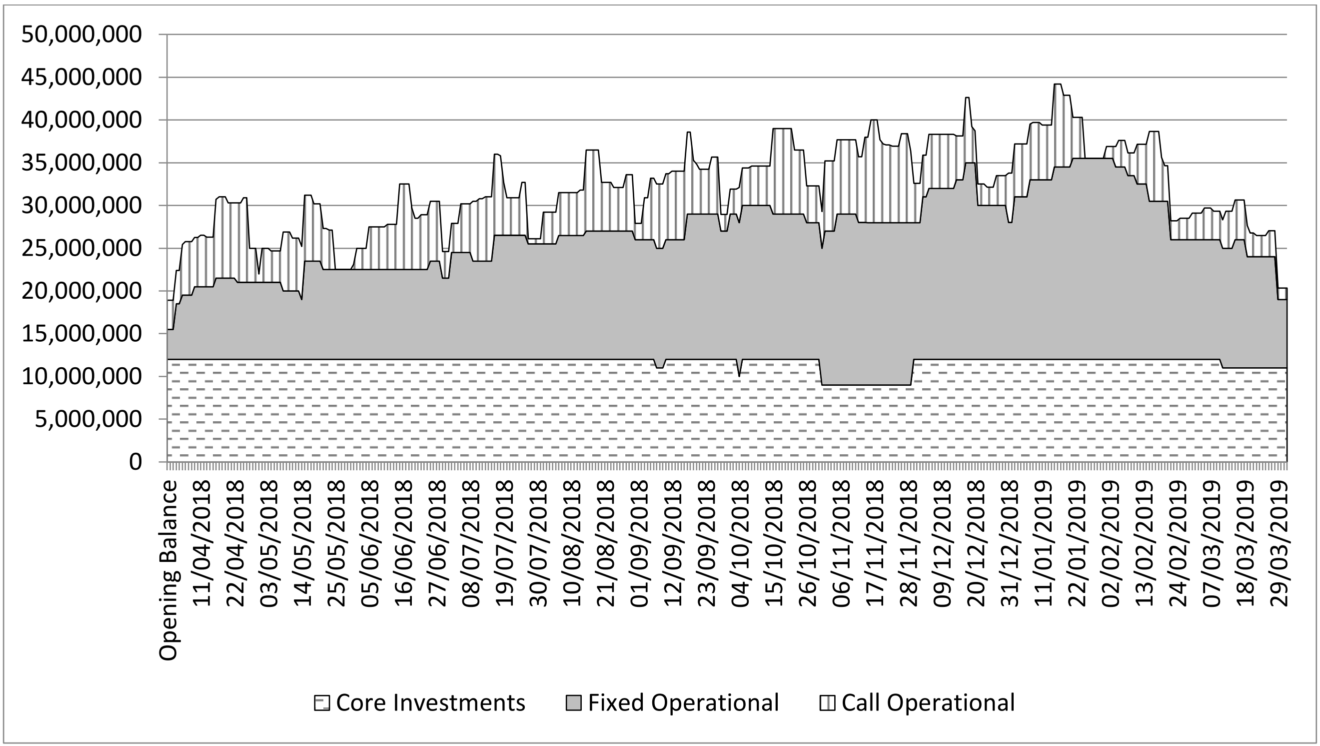
4.1. The Council's investments are all managed in house by the Council's finance team, with the objective to manage risk to ensure the security of investments and maintain adequate liquidity for revenue and capital activities. Procedures and controls to achieve this are well established both through member reporting and officer activity detailed in the Council's Treasury Management Practices.

4.2. At the beginning and end of 2018/19 the Council's investment position was as follows:

Table 7 Investment Position

	31 March 2018 Principal £000	Rate/ Return %	31 March 2019 Principal £000	Rate/ Return %
Call Accounts	3,410	0.25%	1,330	0.65%
Cash Flow (Operational)	3,502	0.37%	7,998	0.70%
Core Cash	12,000	1.11%	11,000	0.74%
Total Investments	**18,912**	**0.80%**	**20,329**	**0.71%**

4.3. Chart 1 shows how investment balances have fluctuated over the course of the year.



4.4. Investment returns remained low during 2018/19 with the Bank of England Base Rate rising only once in 2018/19 to 0.75% in August 2018.

4.5. Overall the Council earned £223k on its investments against a budget of £176k as it benefited from the increase in base rate. However fluctuations in expectations throughout the year lead to the core cash investments, which are invested for longer periods of time, underperforming the bench mark rate.

Table 8 Investment Performance

	Average Annual Return	Benchmark	Variance
Call Accounts	0.65%	0.49%	0.16%
Cash Flow (Operational)	0.70%	0.68%	0.02%
Core Cash	0.74%	0.79%	-0.05%

Non-Treasury Investments

4.6. Some investments are taken out for non-treasury management purposes, and these are held primarily or partially to generate a profit. Examples of this include investment properties and loans supporting service outcomes

4.7. During 2018/19 no new non-treasury investments were made.

4.8. The Council continues to hold 23 investment properties with a fair value of £4.594m. All these properties are within the boundaries of SLDC. After expenses the council earned £0.406m in income, creating a return on investment of 8.85% overall down from 9.3% in 2017/18.

5. The Economy and Interest Rates

5.1. The Bank of England Monetary Policy Committee (MPC) raised the bank rate to 0.75% in August 2018. Further rates have not been forthcoming and are unlikely until uncertainties over Brexit clear.

5.2. CPI inflation has been on a falling trend since peaking at 3.1% in November 2017 and finished at 1.9% in March 2019. The latest inflation report forecasts inflation to be remain marginally over the MPC's Target of 2%. While at the same time wage inflation peaked at a new post financial crisis high of 3.5% (excluding bonuses) in the three months to December.

5.3. The rise in wage inflation and the fall in CPI inflation is good news for consumers as their spending power sees a real terms increase of circa 1.6%.

5.4. Annual Growth for 2018 came in at 1.4% year on year confirming that the UK was the third fastest growing county in the G7.

5.5. Looking forward, there is significant uncertainty as the UK continues to decide on the exit agreement with the EU, to the new deadline of 31st October 2019.

5.6. Elsewhere the US economy grew by 2.9% in 2018, while growth in the EU fell to 1.8% in 2018 from 2.3% in 2017 and is expected to fall further in 2019.

6. Conclusions

6.1. The Council has operated in line with its Treasury and Prudential Indicators and overall investments have performance well earning the council an extra £47k in income. Uncertainty continues over the UK economy and base rates into 2019/20.

6.2. The capital programme out-turn has led to no new borrowing being required as cash reserves have been used to fund capital. The borrowing position will continue to be kept under review.