South Derbyshire District Council

Treasury Management Annual Report 2018/19

Introduction

The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management annual report after the end of each financial year.

This report fulfils the Authority's legal obligation to have regard to the CIPFA Code.

The Authority's treasury management strategy for 2018/19 was approved at a meeting on 15th February 2018. The Authority 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 Authority's treasury management strategy.

External Context (as supplied by the Council's Treasury Management Advisors)

Economic commentary (as at 8th April 2019)

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 March 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 of 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 2018, 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 rejecting the Prime Minister'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

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

On 31st March 2019, the Authority had net borrowing of £19.45m arising from its revenue and capital income and expenditure, a decrease on 2018 of £10.4m. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). Actual CFR versus budgeted CFR is summarised below.

Capital Financing Requirement (CFR)	Actual £'000	Budget £'000
CFR balance b/fwd April 2018	67,239	67,239
Less Minimum Revenue Provision (MRP)	-206	-206
Less Voluntary Revenue Provision (VRP)	-131	-131
CFR balance c/fwd 31st March 2019	**66,902**	**66,902**
General Fund CFR	5,318	5,318
HRA CFR	61,584	61,584
Total CFR	**66,902**	**66,902**

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 is shown in the following table.

Net Borrowing	April 18 B/fwd (£'000)	Movement (£'000)	March 19 C/fwd (£'000)	Average Rate (%)
Long-term Borrowing:				
Fixed	47,423	0	47,423	3.19%
Variable	10,000	0	10,000	0.86%
Short-term Borrowing	28	0	28	0.00%
Total Borrowing	**57,451**	**0**	**57,451**	
Long-term Investments	1,000	1,000	2,000	4.26%
Short-term investments	23,500	10,000	33,500	0.71%
Cash and Cash Equivalents	3,092	-592	2,500	0.55%
Total Investments	**27,592**	**10,408**	**38,000**	
Net Borrowing	**29,859**	**-10,408**	**19,451**	

The net borrowing of the Council reduced during 2018/19 due to an increase in investments. Lower expenditure and budget savings in year resulted in larger cash balances to invest which is reflected above.

Borrowing Activity

At 31st March 2019, the Authority held £57.4m of loans. These loans were taken out by the Authority in 2011/12 for the purpose of HRA self-financing. The following table shows the maturity dates of the loans and rate of interest payable.

Loan Profile	Type	Value (£'000)	Rate at 31st March 2019 (%)	Maturity
Public Works Loan Board	Variable	10,000	0.92	2021/22
Public Works Loan Board	Fixed	10,000	2.70	2023/24
Public Works Loan Board	Fixed	10,000	3.01	2026/27
Public Works Loan Board	Fixed	10,000	3.30	2031/32
Public Works Loan Board	Fixed	10,000	3.44	2036/37
Public Works Loan Board	Fixed	7,423	3.50	2041/42
		57,423		

The Council's chief 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 flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

For the majority of the year the "cost of carry" analysis performed by the Authority's treasury management advisor Arlingclose did not indicate value in borrowing in advance for future years' planned expenditure and therefore none was taken.

The Council was not required to undertake any temporary borrowing during 2018/19 but does hold money on deposit for 2 Parish Councils which is classed as temporary as it can be recalled on immediate notice.

Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19, the Authority's investment balance ranged between £28m and £50m due to timing differences between income and expenditure. The year-end investment position is show below.

Investment Profile	Type	Value (£'000)	Average Rate (%)
Local Authorities	Fixed Rate	25,000	0.67
Banks (unsecured)	Variable Rate	2,500	0.55
Money Market Funds	Variable Rate	8,500	0.74
CCLA Property Fund	Variable Rate	2,000	4.26
		38,000	

Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

In furtherance of these objectives, and given the increasing risk and falling returns from short-term unsecured bank investments, the Authority has undertaken greater detailed cash flow forecasting which has enabled it to enter into longer-term deposits with other Local Authorities, therefore securing a higher rate of return.

In recent years the Authority has diversified into the CCLA Property Fund and Money Market Funds which both offer a higher yield. During the year a further £1m was deposited into the CCLA Property Fund, and up to £10m was invested in Money Market Funds at any one time. As a result, investment risk was marginally increased but funds have still remained secure and the average rate of return has increased.

Financial Implications

The outturn for debt interest paid in 2018/19 was £1.59 million at an average interest rate of 2.81% against a budgeted interest charge of £1.80 million at an average interest rate of 3.13%.

Lower interest costs have been achieved due to the variable element of the loans. The rate of interest budgeted was 3% but the average rate charged was only 0.86%

The outturn for interest income received in 2018/19 was £302,092 against a budget of £45,000. The average interest rate achieved was 0.66%.

Interest received in year was greater than budgeted due to higher levels of cash for investment plus a change in the investment portfolio. The CCLA Property Fund and Money Market investments have increased the average rate of return achieved.

Performance Report

The main indicator the Council uses to measure its return on investments to average, over the year, is the Average 7-Day Money Market Rate. This is a standard measure of performance. Performance in recent years is shown in the following table.

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
7 Day Rate (Target)	0.62%	0.51%	0.47%	0.50%	0.50%	0.36%	0.35%	0.65%
Actual Rate	0.74%	0.31%	0.33%	0.31%	0.32%	0.25%	0.39%	0.66%

Compliance Report

The Chief Finance Officer is pleased to report that all treasury management activities undertaken during 2018/19 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in the table below.

Debt Limits	Actual Debt 18/19 £'000	Operational Boundary £'000	Authorised Limit £'000
HRA	57,423	57,423	66,853
General Fund	0	5,000	5,653

The Operational Boundary represents the expected external debt outstanding in the year. The limit on the General Fund of £5m is a provision for temporary borrowing and is included as a contingency should cash flow become negative during year. The HRA's Operational Boundary represents the current borrowing undertaken due to self-financing.

The Authorised Limit is the Borrowing Cap for the Council. It represents the CFR on the General Fund and the former debt cap set by the Government on the HRA for self-financing. In his Autumn 2018 Budget Statement, the Chancellor confirmed the abolition of the HRA Debt Cap with effect from 29th October 2018. However to ensure affordability the Chief Finance Officer has retained the former limit.

The Council invests surplus funds in accordance with an approved policy and associated counterparty list. Below is a table showing the maximum investments during 2018/19 within each category on the Counterparty list and that the Council were fully compliant with the policy.

Investment Limits	Maximum Investment during 18/19 £m	Maximum invested per Counterparty £m	Limit	Maximum Term	Complied
Debt Management Office	£11m	£11m	£20m in total	364 days	✓
Other Local Authorities	£28m	£5m	£5m per Authority	364 days	✓
Money Market funds	£10m	£2m	£10m total, £2m per fund	60 days	✓
CCLA Property Fund	£2m	£2m	£2m	Indefinite period	✓
Named Counterparties (HSBC/Lloyds/BOS/Standard Chartered /Close Bros/Santander)	£2m	£2m	£2m per Bank	6 months	✓
Named Counterparties (Barclays/Goldman Sachs/RBS/NatWest/Ulster)	£2m	£2m	£2m per Bank	100 days	✓
Named Counterparties (Nationwide/Coventry)	0	0	5% of total deposits	6 months	✓
Named Counterparties (Leeds)	0	0	5% of total deposits	100 days	✓
Foreign Counterparties	0	0	AAA rated - £1m per Bank	1 month	✓
Independent Building Societies	0	0	£1m per Society	100 days	✓