

REPORT TO: Audit and Governance Committee

MEETING DATE: 18 June 2019

BY: Depute Chief Executive (Resources and People Services)

SUBJECT: Annual Treasury Management Review 2018/19

1 PURPOSE

- 1.1 To update the Committee on Treasury Management Activity during 2018/19.

2 RECOMMENDATIONS

- 2.1 The Committee is asked to note the report.

3 BACKGROUND

- 3.1 The Council is required by regulations issued under the Local Government Scotland Act 2003 to produce an Annual Treasury Management Review.
- 3.2 The attached review updates members on the Treasury Management activity during 2018/19, based on the draft unaudited accounts at the time of finalising this report. Members will be kept informed should there be any significant changes to these figures arising prior to the finalisation of the 2018/19 financial accounts.

4 POLICY IMPLICATIONS

- 4.1 There are no direct policy implications associated with this report; however the council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 INTEGRATED IMPACT ASSESSMENT

- 5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

6 RESOURCE IMPLICATIONS

- 6.1 Financial – There are no direct financial implications associated with this report however the Council’s Treasury Management activity clearly has a significant impact on the management of the Council’s financial resources.
- 6.2 Personnel - none
- 6.3 Other - none

7 BACKGROUND PAPERS

- 7.1 Treasury Management Strategy 2018/19 to 2020/21 – East Lothian Council 27 February 2018.

Treasury Management Mid-Year Review 2018/19 – Audit & Governance 27 November 2018.

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DATE	10 June 2019



Annual Treasury Management Review 2018/19



ABBREVIATIONS USED IN THIS REPORT

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.

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

HRA: housing revenue account.

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).

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.

PPP: Private Public Partnership – 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.

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.

Annual Treasury Management Review 2018/19

1. Introduction

This Council is required by regulations issued under the Local Government in Scotland 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 members of the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 27/02/2018)
- a mid-year (minimum) treasury update report (Audit and Governance 27/11/2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee with the annual strategy approved by Council.

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.) with expenditure in excess of these resources giving 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.

	2017/18 Actual £m	2018/19 Budget £m	2018/19 Actual £m
General Services			
Capital expenditure	32.954	45.097	37.519
Financed in year	(25.927)	(24.127)	(16.223)
Net borrowing need in year	7.027	20.970	21.296
HRA			
Capital expenditure	21.302	24.364	22.410
Financed in year	(8.517)	(5.735)	(10.926)
Net borrowing need in year	12.785	18.629	11.484

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 allows the Council some flexibility to borrow in advance of its immediate capital needs. 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
General Services			
CFR	212.919	221.522	222.242
External borrowing position	194.567	201.551	195.535
(Under) / over funding of CFR	(18.352)	(19.970)	(26.707)
HRA			
CFR	178.877	196.403	187.430
External borrowing position	163.459	178.697	164.906
(Under) / over funding of CFR	(15.417)	(17.706)	(22.524)

The authorised limit - the Council has kept within its authorised external borrowing limit as shown by Table 2 in Appendix 1.

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.

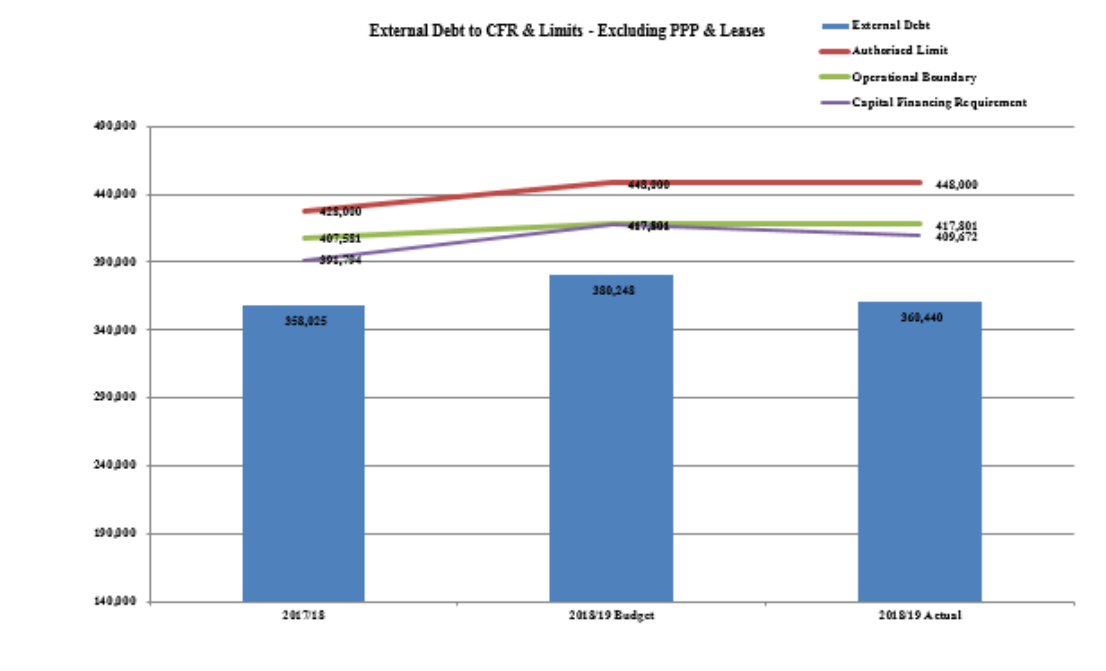
Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

4. Treasury Position as at 31 March 2019

At the beginning and the end of 2018/19 the Council's treasury, (excluding borrowing by PPP and finance leases), position was as follows:

	31 March 2018 Principal £m	31 March 2019 Principal £m
CFR	392	409
Over / (under) borrowing	(34)	(49)
Total external debt	358	360
Total investments	(9)	(9)
Net debt	348	351

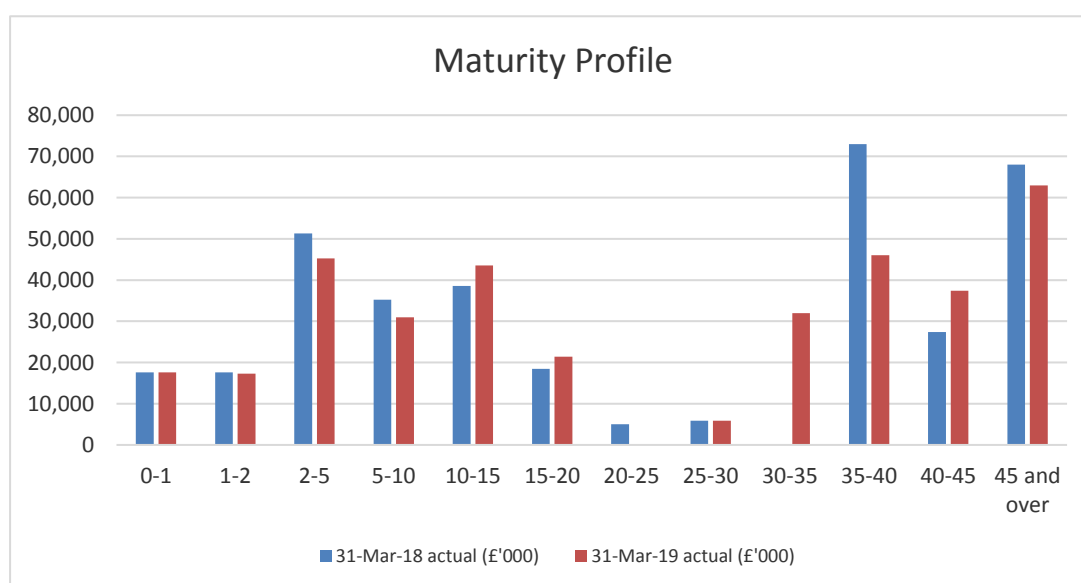
The graph below highlights the level of External Debt against approved boundary limits



As at 31st March 2018 the average interest rate for all external debt was 4% and the average life across all loans outstanding was 24.6 years. As at 31st March 2019 the average interest rate for all external debt was 4% and the average life across all loans was 25 years.

The maturity structure of the debt portfolio was as follows:

	31 March 2018 Actual £m	31 March 2019 Actual £m	Paid or New Loan £m	Nearing maturity date £m
Under 12 months	17.57	17.60	(17.57)	17.60
12 months and within 24 months	17.60	17.27		(0.33)
24 months and within 5 years	51.29	45.30		(5.99)
5 years and within 10 years	35.24	31.00		(4.24)
10 years and within 15 years	38.59	43.54	10.00	(5.05)
15 years and within 20 years	18.44	21.43		2.99
20 years and within 25 years	5.00	-		(5.00)
25 years and within 30 years	5.90	5.90		-
30 years and within 35 years	-	32.00	5.00	27.00
35 years and within 40 years	73.00	46.00		(27.00)
40 years and within 45 years	27.40	37.40		10.00
45 years and over	68.00	63.00	5.00	(10.00)
Total	358.02	360.44	2.43	(0.01)



5. The strategy for 2018/19

5.1 Investment strategy and control of interest rate risk

The Council's investment priorities are security first, liquidity second and then return. The Council adopts a prudent approach to managing risk and followed the approved 2018/19 Strategy where investments were only considered where the type of investment and exposure to risk was low or very low. Limits were set for fixed and variable interest rate exposure which were not exceeded during the year.

Investment returns remained low during 2018/19. The treasury management strategy for 2018/19 estimated that bank rate interest would rise from 0.50% to 0.75% and a rate rise was agreed at the MPC meeting on 2 August 2018. During this period, our investments were short term. Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 November predicted inflationary pressures, particularly from rising wages. Weak GDP growth data after December along with increasing concerns regarding Brexit resulted in investment rates falling back again.

5.2 Borrowing strategy and control of interest rate risk

During 2018-19 the Council continued to maintain an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) was not fully funded by external borrowing as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This was a prudent strategy as investment returns were low and minimising of counterparty risk on investments must be considered.

The policy of avoiding new borrowing where possible by close monitoring of cash balances is kept under continual 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 and/or the refinancing of maturing debt.

The interest rate forecasts predicted 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%

PWLB rates peaked during October 2018 and most PWLB rates have been on a general downward trend and (apart from the 1 year rate) reached lows for the year towards the end of March. The table below shows the PWLB rates at the start and end of the year, highs and lows during 2018/19 with dates and the average rate during the year.

	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2018	1.48%	1.85%	2.23%	2.57%	2.29%
29/03/2019	1.48%	1.55%	1.85%	2.40%	2.23%
Low	1.28%	1.50%	1.80%	2.33%	2.16%
Date	29/05/2018	26/03/2019	28/03/2019	26/03/2019	26/03/2019
High	1.64%	2.07%	2.50%	2.93%	2.79%
Date	04/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018
Average	1.50%	1.80%	2.20%	2.66%	2.47%

6. Borrowing Activity during 2018/19

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

Lender	Principal	Type	Interest Rate	Maturity	Date
PWLB	£10m	Fixed interest rate	2.22%	13 years	12/03/2019
PWLB	£ 5m	Fixed interest rate	2.45%	33 years	12/03/2019
PWLB	£ 5m	Fixed interest rate	2.36%	49 years	12/03/2019

This compares with a budget assumption of borrowing at an interest rate of 2.80%.

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.

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 following loans were repaid in full during the year:-

Lender	Principal	Type	Interest Rate	Maturity	Date
PWLB	£ 5m	Fixed interest rate	3.86%	8 years	24/09/2018
PWLB	£10m	Fixed interest rate	3.89%	8 years	24/09/2018

Instalments of £2.60m were also paid on 8 loans which are payable as an Annuity or EIP (equal instalments of principal) basis rather than on maturity.

7. Investment Activity for 2018/19

Investment Policy

The Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the annual investment strategy approved by the Council on 27 February 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, and the Council had no liquidity difficulties.

Investments held by the Council

During the first 6 months of 2018/19 and in accordance with the approved strategy 2 short term investments were made and repaid. During this period and during the remaining 6 months any surplus cash balances were held in the Council's bank account, which is an interest bearing account.

Date of Lending	Borrower	Amount	Interest rate	Date repaid
09/05/18	Telford & Wrekin Council	£ 5m	0.57%	10/09/18
21/06/18	North Lanarkshire Council	£ 5m	0.50%	21/09/18

The Council also has the following loans to third parties which fall under the scope of the Council's approved Investment Strategy

	Loan balance at 31 March 2018 £m	Loan balance at 31 March 2019 £m
East Lothian Housing Association	9.429	9.198
Dunbar Fisherman's Association	0.020	-

Under the new accounting standard IFRS9 effective from 1st April 2018, an expected credit loss for all loans to third parties must be obtained and recognised in the Council's Income and Expenditure account within Surplus/Deficit on Provision of Services this was £78k for 17/18 and reduced to £72k for 18/19.

Investments held by fund managers

The Council uses Investec as external fund managers to invest cash balances on behalf of the 4 Common Good Funds and ELC Charitable Trusts. The performance of the managers against the benchmark return was:

	Investments held 31 March 2018 £m	Investments held 31 March 2019 £m	Return	Benchmark
Charitable Trusts	3.296	3.393	6.8%	7.0%
Common Good Funds	3.325	3.425	6.8%	7.0%
Total	6.621	6.818	£0.207m	

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2017/18	2018/19	2018/19
	Actual £m	Budget £m	Actual £m
Capital Expenditure			
General Services	32.954	45.097	37.519
HRA	21.302	24.364	22.410
TOTAL	54.256	69.461	59.928
Ratio of financing costs to net revenue stream			
General Services	8.41%	8.77%	8.32%
HRA	32.16%	33.75%	29.91%
Gross borrowing requirement - General Services			
brought forward 1 April	217.559	212.809	212.918
carried forward 31 March	212.918	221.522	222.242
in year borrowing requirement	(4.641)	8.713	9.324
Gross borrowing requirement - HRA			
brought forward 1 April	169.092	181.171	178.877
carried forward 31 March	178.877	191.264	187.430
in year borrowing requirement	9.785	10.093	8.553
CFR			
General Services	212.918	221.522	222.242
HRA	178.877	191.264	187.430
TOTAL	391.795	412.786	409.672
Annual Change in Capital Financing Requirement			
General Services	(4.641)	8.713	9.324
HRA	9.785	10.093	8.553
TOTAL	5.144	18.806	17.877
Annual Impact of Capital Investment Decisions			
General Services – Debt per Band D Equivalent	£4,513	£4,574	£4,625
HRA – Debt per dwelling	£20,565	£22,334	£21,445

	2017/18	2018/19	2018/19
2. TREASURY MANAGEMENT INDICATORS	Actual	Budget	Actual
	£m	£m	£m
Authorised Limit for External Debt -			
Borrowing	427	448	438
Other long term liabilities	40	39	39
Total	467	487	477
Operational Boundary for External Debt -			
Borrowing	391.794	417.924	409.672
Other long term liabilities	39.723	38.245	38.244
Total	431.517	456.169	447.916
Actual External Debt	358.025	380.248	360.440
3. LOANS FUND			
General Services			
Opening balance	218	213	213
Add advances	7	21	21
Less repayments	(12)	(12)	(12)
Closing balance	213	222	222
HRA			
Opening balance	169	181	179
Add advances	13	19	11
Less repayments	(3)	(3)	(3)
Closing balance	179	197	187
Total			
Opening balance	387	394	392
Add advances	20	40	32
Less repayments	(15)	(15)	(15)
Closing balance	392	419	409