Part I
Release to Press

Meeting:	**EXECUTIVE / AUDIT COMMITTEE / COUNCIL**	**Agenda Item:**
Portfolio Area:	Resources	
Date:	**10 September / 11 September / 16 October**	

ANNUAL TREASURY MANAGEMENT REVIEW OF 2018/19 INCLUDING PRUDENTIAL CODE

NON-KEY DECISION

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1 PURPOSE

1.1 To review the operation of the 2018/19 Treasury Management and Investment Strategy.

2 RECOMMENDATIONS

2.1 **Audit Committee & Executive**
That subject to any comments the 2018/19 Annual Treasury Management Review is recommended to Council for approval.

2.2 **Audit Committee & Executive**
That subject to any comments the updated MRP Policy is recommended to Council for approval.

2.3 **Council**
That subject to any comments from the Audit Committee and the Executive, the 2018/19 Annual Treasury Management Review and updated MRP Policy be approved.

3 BACKGROUND

3.1 Regulatory requirement

3.1.1 The 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).

3.1.2 During 2018/19 the minimum reporting requirements were that the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 28/02/2018)
- a mid-year treasury update report (Council 18/12/2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

3.1.3 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.

3.1.4 This 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 Committee and the Executive before they were reported to the Council.

3.2 **The Economy and Interest rates in 2018/19 and current position**

3.2.1 After weak economic growth of 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to 0.7% in quarter 3, before returning to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was expected by the forecasters. The annual growth in Quarter 4 came in at 1.4% and the UK was the third fastest growing country in the G7 in quarter 4. However, since then, the economy shrank in the second calendar quarter of 2019 and since a technical recession is defined as two successive quarters of contraction, that means another similar three months of growth (i.e. showing negative growth), between now and the end of September would tip the UK into the technical definition of its first recession since the financial crisis.

3.2.2 In August 2018 the Monetary Policy Committee (MPC) raised UK Bank Rate from 0.5% to 0.75%, and have abstained from any further increases since then. No further action from the MPC is expected until the uncertainties over Brexit are clear. The MPC has been having increasing concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses) in the three months to December before falling to 3.4% in the three months to March. However despite strong pay growth, Bank of England inflationary target at 2%, and with the government announcing, (albeit unfinanced) pay awards above inflation for some public sector workers, commentators, such as, Senior UK economist Ruth Gregory, predicts that falls in household energy bill will push inflation down below target by the end of the year.

3.2.3 CPI inflation itself has been falling since it peaked at 3.1% in November 2017, reaching a low of 1.8% in January 2019 before rising marginally to 1.9% in February. In the February 2019, Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%. Looking forward, the Bank of England's assumptions based on an orderly BREXIT sees inflation fall in the 3rd quarter of 2020 to 1.9% and then slowly rise by 2022 to 2.4%.

3.2.4 **Brexit**. The current "flextension" from the EU provides until 31st October for the UK to agree a deal. However, if something can be agreed beforehand, then the UK is free to leave at that point. Markets and commentators, though, still suggest that there is little near term prospect of any consensus being formed. This uncertain view is enhanced by the current Conservative Party leadership, which continues to stress that the UK will leave on the 31 October. As such, there remain numerous potential options, including (but not limited to) some form of "deal", "disorderly" / "orderly" no-deal Brexit, second referendum and even a General Election. If there were a disorderly exit, the Bank of England may look to cut interest rates to support growth. Due to this uncertainty there are heightened levels of market volatility, with little expectation for this to be resolved any time soon.

3.2.5 **PWLB borrowing rates.** Since PWLB rates peaked during October 2018, rates have been on a general downward trend, though longer term rates did spike upwards again during December, and, (apart from the one 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 Federal Open Market Committee (Fed) in America increased the US Bank Rate four times in 2018, making nine increases in all in this cycle, to reach 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.

3.2.6 By December 2018, financial markets considered that the Fed had gone too far with interest rates, 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 the short term. The issue for market forecasters now, is how many cuts in the US Bank Rate will there 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 could be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen as shown in the table below.

Table one: PWLB borrowing rates			
Rates* as at:	**Apr-18**	**Apr-19**	**Aug-19**
Years	**Rate %**	**Rate %**	**Rate %**
5	1.89	1.63	1.15
10	2.28	1.95	1.32
15	2.52	2.28	1.64
20	2.61	2.46	1.86
25	2.64	2.52	1.93

* rates include a 0.2% reduction for certainty rate available to Stevenage BC

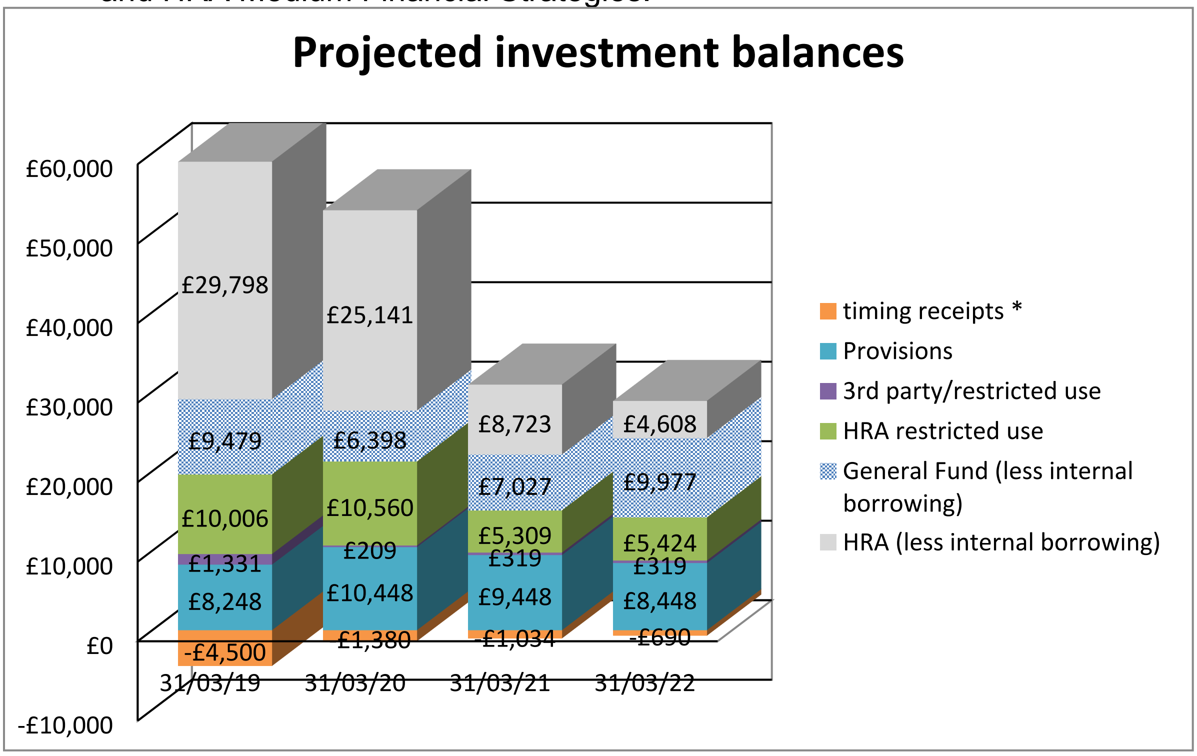
4 OVERALL TREASURY POSITION AS AT 31 MARCH 2019

4.1 As at 31 March 2018 and 2019 the Council's treasury position was as follows:

Table two: Treasury Position						
	2017/18			2018/19		
	31 March 2018 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 March 2019 Principal £'000s	Rate / Return %	Average Life (Yrs)
Total Borrowing	**208,487**	**3.38**	**15.81**	**205,482**	**3.37**	**15.03**
Capital Financing Requirement	221,877			221,940		
Over/(under) borrowing	(13,390)			(16,458)		
Investments Portfolio (see para 5.8)	**62,380**	**0.58**		**54,135**	**0.86**	

4.2 Investment balances have fallen at the end of the year as General Fund and HRA balances were used to support revenue spend in accordance with the planned draw down of these resources in the Medium Term Financial Strategies. The remaining balances include restricted use funds that can only be used to finance capital spend, money set aside as provisions and monies held on behalf of others including council tax and business rates provisions and advance payments.

4.3 The following chart shows the projected use and resulting reduction in cash balances held over the next four years in accordance with the General Fund and HRA Medium Financial Strategies.



Note: the negative value re the timing of receipts reflects the increase in debtors (LEP loan and Housing Benefit subsidy) owed to the Council as at the 31 March 2019 temporarily reducing cash balances.

5 TREASURY MANAGEMENT STRATEGY 2018/19

5.1 The original 2018/19 Treasury Management strategy had projected Bank Rate rises from 0.50% to 0.75% in the 3rd quarter of 18/19 (and to 1.00% in the 3rd quarter of 2019/20), and gradual rises in medium and longer term fixed borrowing rates during 2018/19. The returns achievable on the Council's investments were expected to be modest, based on both the low bank of England base rate and the risk appetite of the TM Strategy. Bank rates are unexpected to rise in the near future as stated in paragraph 3.2.3.

5.2 The impact of the European Union (EU) Referendum decision to leave the EU and the implications of this for the UK economy were uncertain when the strategy was set, and it was thought that further updates of the Strategy may be required once these were known. Updates were given in the two reports to Council, but no changes were needed to the Strategy.

5.3 As a result of the MiFIDII legislation, the Council elected to professional client status to allow uninterrupted advice and opportunities for investment/debt products. The necessary quantitative and qualitative tests were satisfied for the Council to be classified as such, plus the minimum total investment portfolio of £10million was included in the TM Strategy.

5.4 Professional status enabled the Council to maintain its existing relationships with financial institutions and ability to use financial instruments which are not available to retail clients, so these were able to remain part of the TM Strategy.

5.5 The Council's Capital Expenditure and Financing 2018/19.

5.5.1 In 2018/19 the Council spent £30,423,335 on capital projects (General Fund and Housing Revenue Account). The capital programme was funded from existing capital resources and an increase in internal borrowing (General Fund £0.155M, HRA £1.81Million). No external loans were taken out during 2018/19 to fund existing borrowing requirements from previous years. Table three details capital expenditure and financing used in 2018/19.

Table three : 2018/19 Capital Expenditure and Financing				
	2018/19 Original Estimate £'000	2018/19 Quarter 3 Revised Working Budget £'000	2018/19 Actual £'000	2018/19 Variance Actual to Quarter 3 Revised Working Budget £'000
Capital Expenditure:				
General Fund Capital Expenditure	21,708	11,615	8,057	(3,558)
HRA Capital Expenditure	31,355	22,617	22,366	(251)
Total Capital Expenditure	**53,063**	**34,232**	**30,423**	**(3,809)**
Resources Available for Capital Expenditure:				
Capital Receipts	(10,020)	(6,685)	(6,061)	624
Capital Grants /Contributions	(5,325)	(5,134)	(3,133)	2,001
Capital Reserves	(1,803)	(672)	(761)	(89)
Revenue contributions	(8,211)	(6,898)	(7,379)	(481)
Major Repairs Reserve	(20,067)	(12,837)	(11,124)	1,713
Total Resources Available	**(45,426)**	**(32,226)**	**(28,458)**	**3,768**
Capital Expenditure Requiring Borrowing	**7,637**	**2,006**	**1,965**	**(41)**

5.5.2 The Treasury Management review of 2018/19 and Prudential Indicators have been updated to reflect changes to capital budgets which have been approved throughout the year. The actual capital expenditure for 2018/19 was reported to the Executive on 11 July 2019.

5.6 **The Council's overall need to borrow and Capital Financing Requirement**

5.6.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt it needs to/has taken out to fund the programme (and includes both internal and external borrowing). The CFR is then reduced as debt repayments are made and Minimum Revenue Provisions (MRP – see also para 5.7) are made. A separate CFR is calculated for the General Fund and Housing Revenue Account and any transfers of assets (such as land or buildings) will impact on each fund's CFR. The CFR will go up on the fund "receiving" the assets and go down (by the same amount) on the fund "giving" the asset. The government has consulted on the option to transfer assets at zero value however no outcome of the consultation has been published.

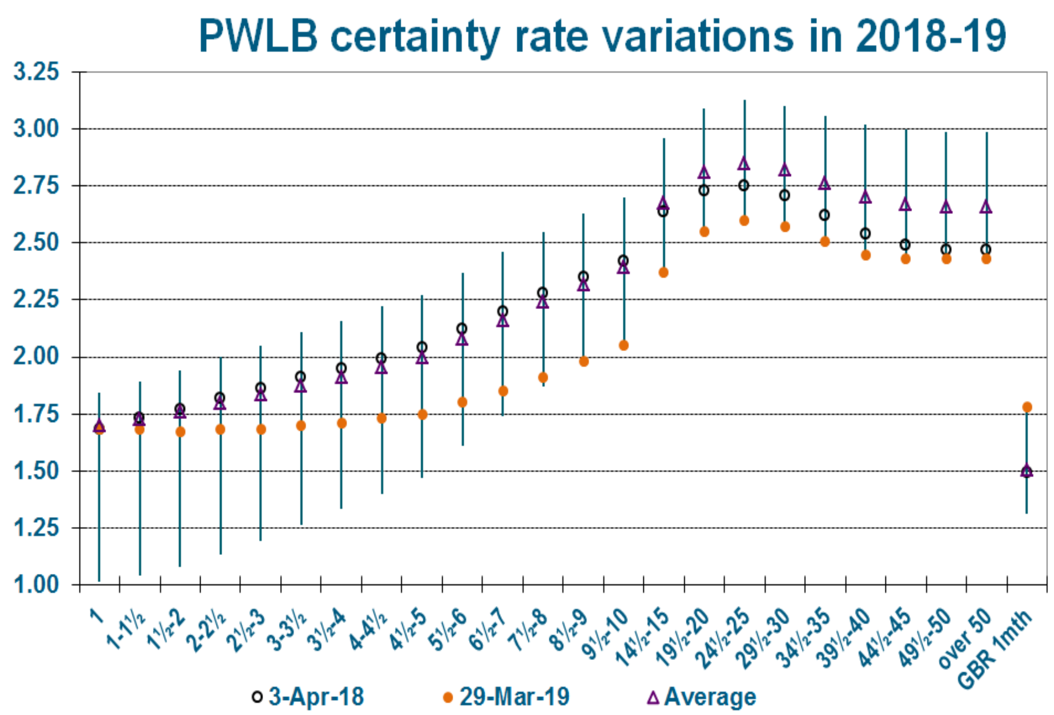
5.6.2 Cash balances (£54.135M as at 31 March 2019) enable the Council to use internal borrowing in line with its Capital Strategy and Treasury Management Strategy. This position is kept under review taking into account future cash balances and forecast borrowing rates. Members should note that these cash balances relate in part to the restricted use right to buy "one for one" receipts

(£10.0million) and provisions (£9.6million) for future liabilities (see also para 5.8.4) and as seen in the chart at paragraph 4.3 these balances are forecast to significantly fall over the next four years.

5.6.3 As at the 31 March 2019 the Council had total external borrowing of £205,482,582. The debt repayment profile is shown in the following table:

Table four Maturity of Debt Portfolio for 2017/18 and 2018/19		
Time to maturity	**31 March 2018 Actual £'000's**	**31 March 2019 Actual £'000's**
Maturing within one year	3,004	263
1 year or more and less than 2 years	263	263
2 years or more and less than 5 years	790	526
5 years or more and less than 10 years	18,956	28,556
10 years or more	185,474	175,874
Total	**208,487**	**205,482**

5.6.4 During 2018/19, shorter term PWLB rates were most volatile, and reached their higher levels towards the end of the year, whereas medium and longer term PWLB rates were at their lowest levels towards the end of the year. The graph below (and table one paragraph 3.2.6) shows the overall position for 2018/19.



5.6.5 The General Fund had external borrowing of £2,808,582, all of which was with the Public Works Loan Board (PWLB). The HRA had external borrowing of £202,674,000 all held with the PWLB, of which £7,763,000 relates to pre 2012 decent homes programme and the remainder £194,911,000 to self- finance the payment made to central government in 2012.

5.6.6 In October 2018, the then Prime Minister Theresa May announced a policy change of the abolition of the HRA debt cap. The Chancellor announced in the Budget that the applicable date was 29 October 2018.

5.6.7 The HRA's operational debt limit, which had been capped by government at £217,685,000, can now be set by the Council. The new limit will be set on the basis of prudence, affordability and sustainability. Opportunities arising from the lifting of the debt cap will be considered as part of the updated HRA business plan presented to Members and subsequent Treasury management reports and indicators will be updated accordingly.

5.6.8 The Council's CFR is one of the key prudential indicators and is shown in the following table.

Table Five : Capital Financing Requirement 2017/18 and 2018/19			
CFR Calculation	**31-Mar-18 (£'000)**	**31-Mar-19 (£'000)**	**Movement in Year (£'000)**
Opening Balance	**223,275**	**221,877**	
Closing Capital Financing Requirement (General Fund)	15,624	15,121	(503)
Closing Capital Financing Requirement (Housing Revenue Account)	206,253	206,820	567
Closing Balance	**221,877**	**221,941**	
Increase/ (Decrease)	**(1,398)**	**64**	**64**

5.6.9 The CFR for the HRA has increased by £566,753 as a repayment of £1,241,000 was made in year, offset by £1,810,558 new internal borrowing for Decent Homes. There were no asset transfers between the General Fund and HRA in 2018/19.

5.6.10 The General Fund's CFR has decreased by £503,167 - due to;

- the Minimum Revenue Provision (MRP) payment made in year of £661,090 (see also para 5.7)
- less, short term borrowing for Housing GF development of £155,118

5.6.11 Borrowing originally forecast for Investment Properties was not taken in 2018/19.

5.7 **Minimum Revenue Provision (MRP)**

5.7.1 The Prudential Code, by which the Council has to make its borrowing decisions, requires the Council to demonstrate that borrowing is required and affordable. The MRP is a statutory requirement to ensure borrowing is affordable for the General Fund and does not apply to the HRA (the HRA affordability is determined in the HRA Business Plan (see also para 5.5.5)). The Council is required to make an annual MRP based on its policy approved by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement (regardless of whether that borrowing was internal or external) and the life of the asset for which the borrowing was required.

5.7.2 The MRP charged to the General Fund in 2018/19 was £661,090, of which £335,058 is effectively funded from regeneration assets and £35,120 funded from investment property with the remainder (£290,912) a net cost to the General Fund.

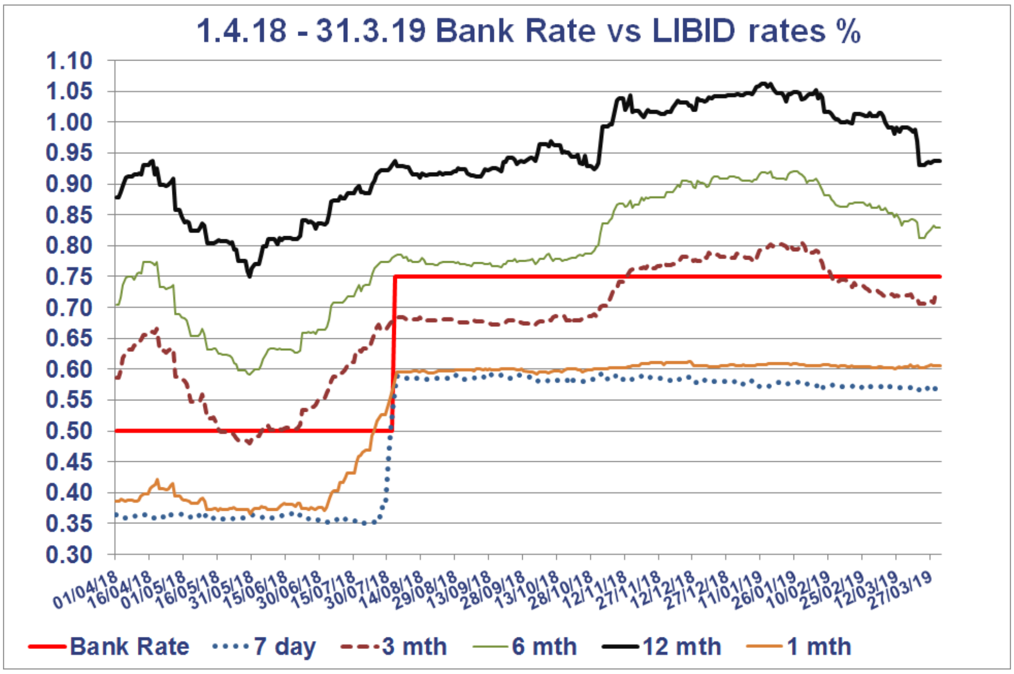
5.7.3 Officers recommend that the MRP calculations should be reviewed in light of the investment being made and resulting extension to the useful life of the asset. (See also para 6.2 and Appendix C.)

5.8 **Cash Balances and Investment rates**

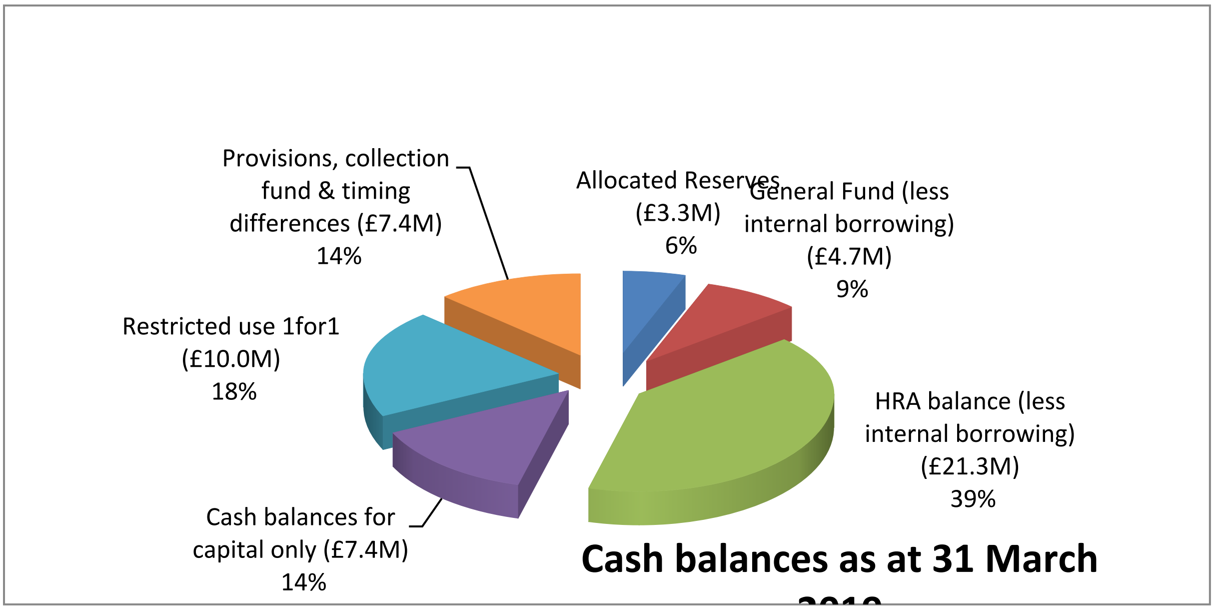
5.8.1 During the year the average cash balance was £68Million, earning interest of £585,017 and achieving an average interest rate of 0.86%. The comparable rate was 0.51% (average 7-day LIBID rate). This compares with an original budget assumption of £305,300 based on average investment rate of 0.7%, however higher cash balances and better than anticipated rates resulted in more investment interest.

5.8.2 During 2018/19 UK Base Rate was increased to 0.75% at the Monetary Policy Committee (MPC) meeting on 2nd August 2018, and remained at that rate during the rest of 2018/19. 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 UK 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. Value was therefore sought by placing longer term investments after 2 August as cash balances were sufficient to allow this. There continued to be a gap between investing (0.86%) and borrowing rates (2.6% - 25yr PWLB rate March 2019), which meant it was still prudent to maintain the treasury strategy of postponing external borrowing. This policy avoided the cost of holding higher levels of investments and reduces counterparty risk, by using internal borrowing while cash balances allow. (See also section 5.6 and chart at paragraph 4.3).

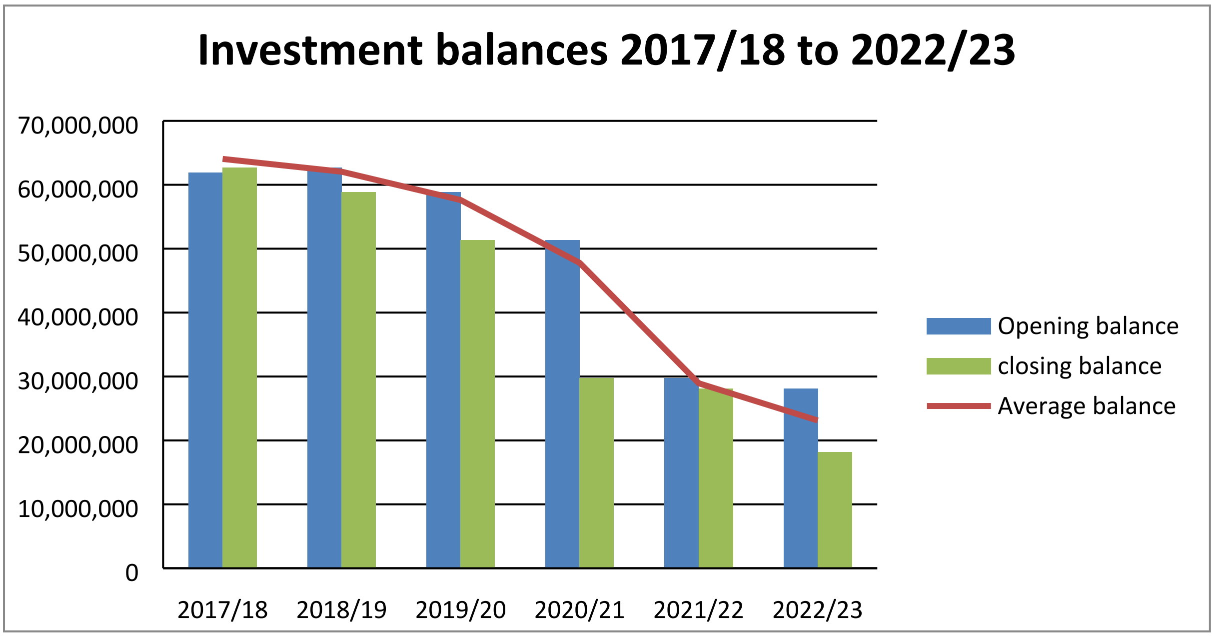
5.8.3 The following chart shows UK Bank Rate and LIBID (London Interbank Bid) rates in 2018/19.



5.8.4 As at 31 March 2019 cash balances were £54.135Million and included one for one right to buy receipts, ring fenced for HRA new social housing schemes (£10.0Million), provisions and reserves held for specific purposes. The apportionment of cash balances at year end is shown in the following chart.



5.8.5 The restrictive use of a proportion of these receipts plus the planned use of resources in line with the Council's capital and revenue strategies means that these resources are not available for new expenditure. The following chart shows the historic level of cash balances and the projected reduction following the planned use of reserves to 2022/23.



5.8.6 Further to the lifting of the HRA debt cap and opportunities to use external borrowing instead of revenue contributions (RCCO) to fund the HRA's capital programme, the forecast investment balances may change subject to approval of the updated HRA business plan. These changes will be incorporated into future Treasury management reports and forecasts provided to Members.

5.8.7 In accordance with the Treasury Management Strategy approved by Council on 28 February 2018, the Council invests it surplus cash balances. The 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 and counterparty limits dependant on level of cash balances held.

5.8.8 There were no breaches to this policy in 2018/19 with the investment activity during the year conforming to the approved strategy. The Council had no liquidity difficulties and no funds were placed with the Debt Management Office (DMO) during 2018/19, demonstrating that counterparty limits and availability for placing funds approved in the TM Strategy were working effectively.

5.9 **Other Prudential Indicators**

5.9.1 The treasury management indicators for 2018/19 onwards have been updated based on the updated Capital Strategy approved by Council in February 2019 and subsequently updated in the 3rd and 4th quarter capital updates reported to Executive and Council in March and July 2019.

5.9.2 The **net borrowing position** for the Council as at 31 March 2019 was **£151.347Million** (total external borrowings/loans of £205.482Million less total investments held of £54.135Million).

5.9.3 The **operational boundary** and **authorised limit** refers to the borrowing limits within which the treasury team operate. A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. **There were no breaches of either limit in 2018/19.**

5.9.4 The **ratio of financing costs** to net revenue stream is equal to General Fund interest costs divided by the General Fund net revenue income from Council tax, Revenue Support Grant and retained business rates. The 2018/19 indicator is **6.45%.**

5.9.5 The full list of treasury prudential indicators is shown in Appendix A and has been updated for the 2018/19 outturn position and the revised 2019/20 capital programme.

6 OTHER ISSUES

6.1 IFRS 9

6.1.1 Risk management needs to take account of the 2018/19 Accounting Code of Practice proposals for the valuation of investments. Key considerations include:

- Expected credit loss model. Whilst this should not be material for vanilla treasury investments such as bank deposits, this is likely to be problematic for some funds e.g. property funds, (and also for non-treasury management investments dealt with in the capital strategy e.g. longer dated service investments, loans to third parties or loans to subsidiaries).
- The valuation of investments previously valued under the available for sale category e.g. equity related to the “commercialism” agenda, property funds, equity funds and similar, will be changed to Fair Value through the Profit and Loss (FVPL).

6.1.2 Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

These changes have no impact on the valuation of investments held by **Stevenage Borough Council,** and the statutory override has not been needed.

6.2 MRP Policy

An MRP Policy review is being currently being carried out by officers (see Appendix C), and where asset lives on property are expected to exceed the current life used in the MRP calculation an adjustment maybe considered. The policy remains unchanged in that Option 3 Life expectancy is used in calculation of the MRP charge however the estimation of the life expectancy is being reviewed. The maximum life used will be capped at 50 years as permissible under the prudential code.

6.3 **Operational and Authorised Borrowing Limits**

6.3.1 General Fund borrowing limits were increased as part of the Housing wholly owned company (WOC) report which was recently approved by Council. General Fund limits will be further reviewed in the Annual Treasury Management Strategy due to go to Executive and Council in February.

6.3.2 HRA limits will be reviewed as part of the revised HRA Business Plan presented to Members in November and will reflect the removal of the debt cap.

6.4 **Property Funds and Commercial Strategy**

When the TM Strategy was presented at Audit Committee on 1 February 2017, it was resolved that Council be recommended to approve the use of property funds, subject to market conditions and in consultation with the Resources Portfolio holder and the Audit Committee up to a maximum of £3Million. A review of the Commercial Strategy will be presented to Executive in November and will include a review of the Council's risk appetite. The Assistant Director (Finance and Estates) considers that this is an opportunity to review the use of property fund investment options and a further report will be given to the Audit Committee and the Resources Portfolio Holder on property fund investments.

6.5 **Breach of overdraft Limit on 21 May 2018**

As previously reported, on 21 May 2018, a request was made to return funds held by the Council from Amundi, a Money Market Fund (MMF). This fund is held in a Luxembourg bank. Council staff were unaware that it was a bank holiday on that day in Luxembourg, where Amundi's bank is based, which meant that the requested was not processed and funds weren't returned until the next working day. A short term overdraft facility was arranged to ensure Council's obligations were met, which resulted in an interest payment of £3,006. Measures have been out in place to prevent this happening in the future.

6.6 **Queensway Properties (Stevenage) LLP**

As part of the Queensway redevelopment proposals the Council is acting as agent for Aviva in that construction monies are held in a named Stevenage Borough Council bank account. However the sole signatories to that account are Aviva representatives and the Council has no access to these funds. Only Aviva can make payments from this account and the Council does not have authority to invest this money. Therefore, although the monies are in a

Stevenage Borough account they are excluded from Treasury management strategy and are not considered in HSBC counterparty limits. As the redevelopment of Queensway continues monies will be drawn down from this account and when works are complete the account will be closed.

7 IMPLICATIONS

7.1 Financial Implications

7.1.1 This report is of a financial nature and reviews the treasury management function for 2018/19. Any consequential financial impacts identified in the July Capital strategy and 4th quarter revenue budget monitoring report have been incorporated into this report.

7.1.2 During the financial year Officers operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

7.2 Legal Implications

7.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy are intended to ensure that the Council complies with relevant legislation and best practice.

7.3 Equalities and Diversity Implications

7.3.1 The purpose of this report is to review the implementation of the Treasury management policy in 2018/19. Before investments are placed with counter parties the Council has the discretion not to invest with counter parties where there are concerns over sovereign nations' human rights issues.

7.3.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity; sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

7.4 Risk Implications

7.4.1 The current policy of minimising external borrowing only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. Should these conditions change the Council may need to take borrowing at higher rates which would increase revenue costs.

7.5 Policy Implications

7.5.1 This report confirms treasury decisions have been made in accordance with the existing policy.

7.5.2 Extending the asset life of relevant existing assets to 50 years relates to the new MRP Policy recommended for approval as per Appendix C.

BACKGROUND PAPERS

- BD1 Mid year Treasury update (Council 18 December 2018)
- BD2 Treasury Management Strategy including Prudential Code Indicators 2018/19 (Council 28 February 2018)

APPENDICES

- Appendix A Prudential Indicators
- Appendix B Investment and Borrowing Portfolio
- Appendix C MRP Policy