London Borough of Barnet

Annual Treasury Management Out-turn Review 2018/19

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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 (Council 6th March 2018)
- a mid-year (minimum) treasury update report (Performance and Contract Management Committee 18 December 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.

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 either the Policy and Resources Committee or the Performance and Contract Management Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 23th October 2018 in order to support members' scrutiny role.

2. Summary

<u>Debt</u>

Additional short-term borrowing of £45 million was taken in the year. The average annualised interest on the additional borrowing was 0.95%. Gross debt increased by £44.5 million to £364.6 million. Capital expenditure requiring funding by debt / internal balances was £88.3 million, below the TMSS projection of £176.8 million.

<u>Investments</u>

Investment balances declined to £65.4 million compared with £95.5 million at the start of the year.

<u>TMSS Limits</u>

There were no breaches of limits during the year to 31 March 2019.

3. The Economy and Interest Rates

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. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

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.

4. Overall Treasury Position as at 31 March 2019

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

TABLE 1	31 March 2018 Principal £'000	Rate/ Return %	Average Life	31 March 2019 Principal £'000	Rate/ Return %	Average Life
debt	304,080	**3.86**	**26.5 yrs**	349,080	**3.48**	**22.2 yrs**
Other long-term liabilities	15,974			15,489		
Total debt	***320,054***			***364,569***		
CFR	***459,166***			***547,459***		
Over / (under) borrowing	***-139,112***			***-182,890***		
Total investments	***95,500***	***0.52***	***47 days***	***65,350***	***0.71***	***47 days***
Net debt	**224,554**			**299,219**		

Note: Investments exclude loan to Saracen, which had a year-end balance of £156,000 earning 6%.

5. The Strategy for 2018/19

During 2018-19, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), 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.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, due to the scale of the capital programme in the year, short-term borrowing of £45 million was taken in preference to longer term debt. This was replaced by longer term borrowing in 2019-20 as PWLB rates declined sharply to below 2% of 50-year debt.

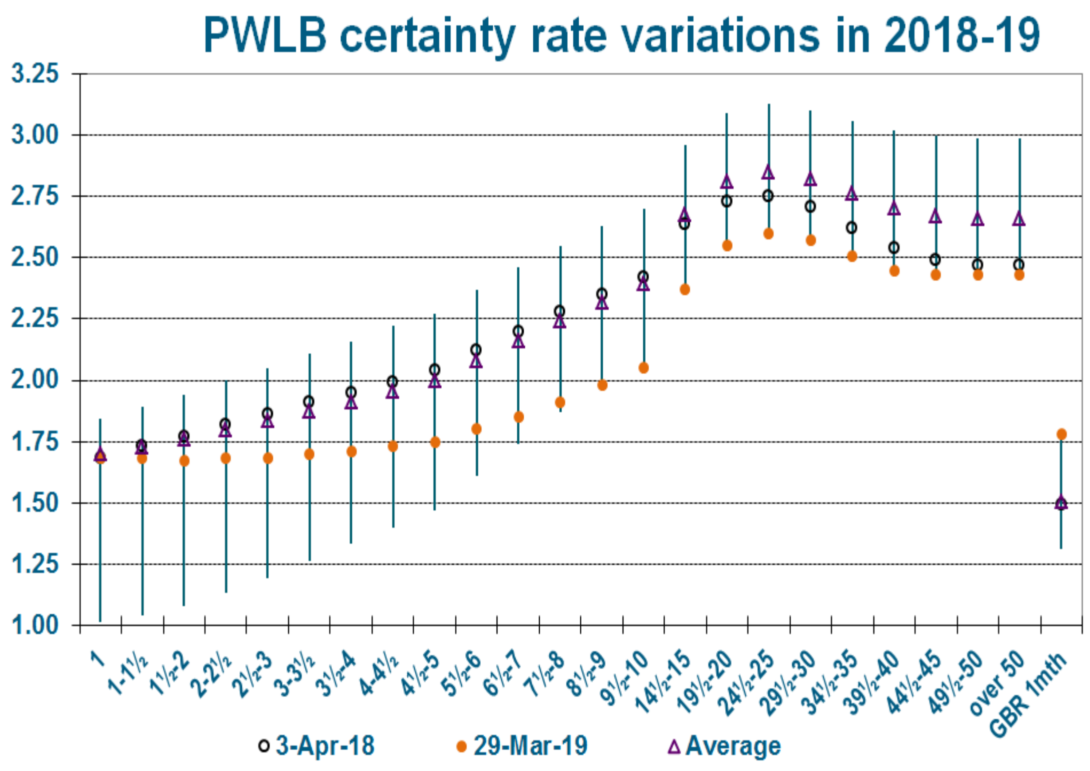
6. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The table below summarises the opening, projected and closing capital positions.

	31-Mar-18 Actual	31-Mar-19 Budget	31-Mar-19 Actual
CFR General Fund (£'000)	258,532	458,978	346,825
CFR HRA (£'000)	200,634	225,460	200,634
Total CFR (£'000)	459,166	684,438	547,459

7. Borrowing Rates in 2018/19

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.



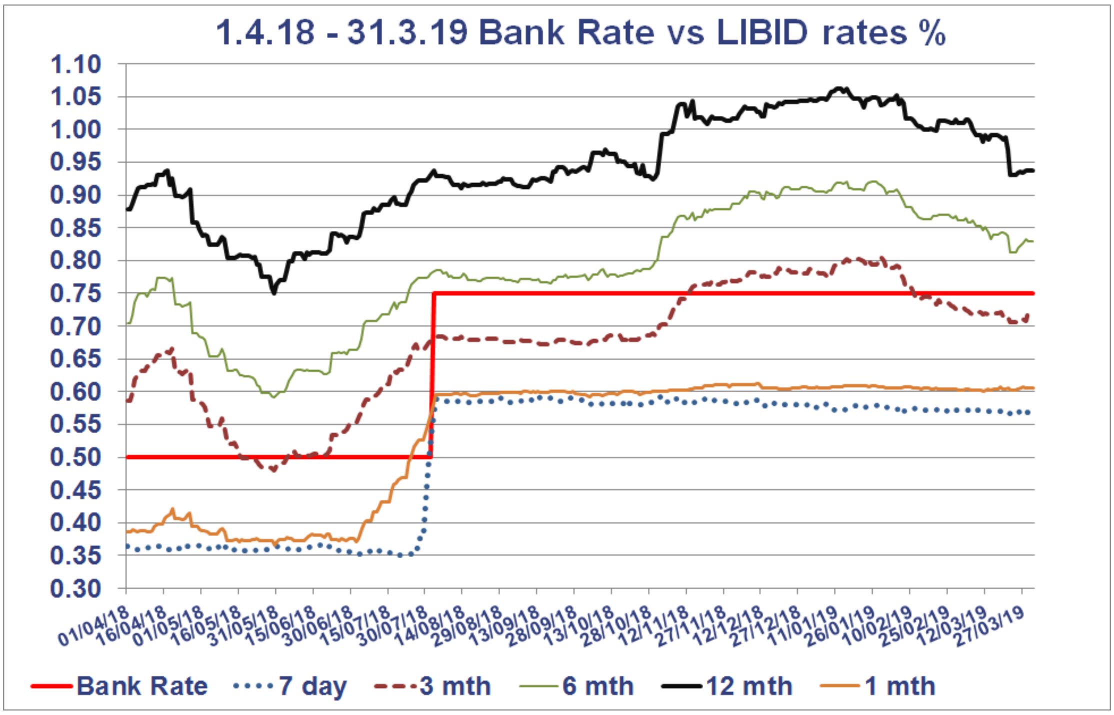
8. Borrowing Outturn for 2018/19

New short term borrowing of £45 million with a maturity of six months was taken during the year. The value of debt increased by this amount to £349.1 million at the end of the year. In addition, there was £15.489 million of PFI liabilities as at 31 March 2019.

The TMSS forecast closing gross borrowing of £495.5 million, derived from £176.8 million of debt funded capital expenditure. The value of capital expenditure funded by internal cash during the year was considerably lower at £88.3 million.

9. Investment Rates in 2018/19

Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 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.



10. Investment Outturn for 2018/19

Investment Policy – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 6 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, and the Council had retained sufficient cash balances to meet all its obligations on time.

Investments held by the Council - the Council maintained an average balance of £72.5 million of internally managed funds. The internally managed funds earned an average rate of return of 0.71%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.51%.

Appendix 1: Prudential and treasury indicators

The table below compares the prudential indicators set out at the start of 2017-18 with those achieved at 31st March 2019

1. PRUDENTIAL INDICATORS	2017/18	2018/19	2018/19
	actual	original	actual
	£'000	£'000	£'000
Capital Expenditure			
Non - HRA	115,514	312,598	209,316
HRA (applies only to housing authorities)	49,378	80,312	33,047
TOTAL	164,892	392,910	242,363
Financing of Capital Expenditure			
Capital receipts	32,706	84,570	18,286
Capital grants	60,886	45,837	68,879
Capital reserves	7,598	48,458	29,315
Revenue	40,187	37,215	37,590
Total	141,377	216,080	154,070
Net Financing Need for the Year	23,515	176,830	88,293
Ratio of financing costs to net revenue stream			
Non - HRA (ex PFI)	4.54%	5.94%	5.80%
HRA	11.77%	12.73%	12.61%
Gross borrowing as at 31 March			
Non - HRA	120,553	283,522	120,553
HRA	199,501	220,518	199,501
Total	320,054	504,040	320,054
CFR			
Non – HRA	258,532	458,979	346,825
HRA	200,634	225,466	200,634
TOTAL	459,166	684,445	547,459

NB: Ratio of 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. The increase between 2017/18 and 2018/19 is due to higher MRP charges in the later year.

2. TREASURY MANAGEMENT INDICATORS	2017/18	2018/19	2018/19
	actual	TMSS limits	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	304,080	598,029	349,080
other long-term liabilities	15,974	31,034	15,489
TOTAL	320,054	629,063	364,569
Operational Boundary for external debt -			
borrowing	304,080	598,029	349,080
other long-term liabilities	15,974	16,034	15,489
TOTAL	320,054	614,063	364,569
HRA Debt Limit			
HRA debt Cap	240,643	240,043	240,643
HRA CFR	200,634	228,145	200,634
HRA headroom	40,009	11,898	40,009
Upper limit for fixed interest rate exposure	100%	100%	100%
Upper limit for variable rate exposure	0%	30%	0%
Upper limit for total principal sums invested for over 364 days	nil	25,000	nil

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 is acceptable subject to the authorised limit not being breached.

3. Maturity Profile of Debt	31-Mar-18	2018/19	31-Mar-19
	actual	TMSS Upper limits	actual
Under 12 months	0%	50%	12.89%
12 months and within 24 months	0%	50%	0%
24 months and within 5 years	0%	75%	0%
5 years and within 10 years	0.7%	75%	6.45%
10 years and within 60 years	92.6%	100%	80.66%