Chorley Council

| Report of | Meeting | Date |
|---|---|---|
| Chief Finance Officer | Governance Committee | 24 July 2019 |

# TREASURY MANAGEMENT ANNUAL REPORT 2018/19 AND JUNE QUARTER MONITORING 2019/20

## PURPOSE OF REPORT

1. To report on Treasury Management performance and compliance with Prudential Indicators for the financial year ended 31 March 2019.

2. To present monitoring figures for the quarter ended 30 June 2019, including updated interest rate forecasts from Link Asset Services.

## RECOMMENDATION(S)

3. That the report be noted.

## EXECUTIVE SUMMARY OF REPORT

4. This report advises on compliance with Prudential and Treasury Indicators in 2018/19. The return on investments for the year was 0.61%, which exceeded the benchmark of 0.57%. Details of borrowing and investments as at 31 March 2019 are presented.

5. Borrowings and investments as at 30 June 2019 are also presented, and Link Asset Services have provided updated interest rate forecasts for 2019/20 and subsequent financial years.

| **Confidential report**<br>Please bold as appropriate | Yes | **No** |
|---|---|---|

## CORPORATE PRIORITIES

6. This report relates to the following Strategic Objectives:

| | | | |
|---|---|---|---|
| Involving residents in improving their local area and equality of access for all | | A strong local economy | |
| Clean, safe and healthy communities | | An ambitious council that does more to meet the needs of residents and the local area | √ |

## BACKGROUND

7. The Treasury Strategy for 2018/19 to 2020/21 was approved by Council on 27 February 2018. The strategy included prudential and treasury indicators, the treasury management strategy, annual investment strategy (including the list of approved investment counterparties), and the annual Minimum Revenue Provision (MRP) Policy.

8. A mid-year review of Treasury Management activity was presented to Governance Committee on 21 November 2018. This recommended the addition of LVNAV Money Market Funds (MMFs) to the list of approved investment counterparties. The original list included only included Constant Net Asset Value (CNAV) MMFs, which were all converting to LVNAV status as a requirement of EU MMF reforms.

9. On 26 February 2019 Council approved the Treasury Strategy for 2019/20 to 2021/22, which included revised prudential and treasury indicators for 2018/19. Where relevant, comparisons with 2018/19 indicators in this outturn report are to those approved most recently.

10. A glossary of technical terms used in this report is presented as Appendix J.

## THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING

11. Capital Expenditure and Financing 2018/19

The Council undertakes capital expenditure on long-term activities. 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; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure for 2018/19.

| Table 1 - Capital Expenditure | 2018/19 Estimate £000 | 2018/19 Revised £000 | 2018/19 Actual £000 | 2018/19 Variance £000 |
|---|---|---|---|---|
| Corporate | 122 | 0 | 0 | 0 |
| Customer & Digital | 0 | 2,439 | 1,576 | (863) |
| Early Intervention & Support | 696 | 1,004 | 936 | (68) |
| Policy & Governance | 441 | 347 | 159 | (188) |
| Business Development & Growth | 24,792 | 27,400 | 22,211 | (5,189) |
| **Capital Expenditure Total** | **26,051** | **31,190** | **24,882** | **(6,308)** |

Additional analysis of the schemes included in the 2018/19 Capital programme was presented to Executive Cabinet on 20 June 2019 in the report "Provisional Revenue and Capital Outturn 2018/19".

Financing of the capital expenditure is shown in the following table.

| Table 2 - Capital Financing | 2018/19 Estimate £000 | 2018/19 Revised £000 | 2018/19 Actual £000 | 2018/19 Variance £000 |
|---|---|---|---|---|
| Capital expenditure from Table 1 | 26,051 | 31,190 | 24,882 | (6,308) |
| Capital Receipts | (491) | (645) | (576) | 69 |
| Grants & Contributions | (13,148) | (16,799) | (13,896) | 2,903 |
| Revenue and Reserves | (2,197) | (2,857) | (2,092) | 765 |
| **Net financing needed for year** | **10,215** | **10,889** | **8,318** | **(2,571)** |

**THE COUNCIL'S OVERALL BORROWING NEED**

12. Capital Financing Requirement 2018/19

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the unfinanced capital expenditure in 2018/19 plus prior years' unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activity is to address the funding requirement for this borrowing need. Depending on the capital expenditure programme, the Council's cash position is organised to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board (PWLB), or the money markets), or utilising temporary cash resources within the Council.

The CFR is not matched in full by external borrowing, so the Council is said to have under borrowed by using its own cash balances to finance capital expenditure. There is some loss of interest as a result, but had external loans been taken the interest payable would have been at a higher rate. Use of the Council's own cash helps to achieve savings in net interest.

The Council's underlying borrowing need is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can be borrowed and repaid, but this does not change the CFR.

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

The 2018/19 MRP Policy (as required by MHCLG Guidance) was approved by Council as part of the Treasury Strategy 2018/19 to 2020/21 on 27 February 2018.
The Council's CFR for the year is shown in Table 3 below, and represents a key prudential indicator. It includes financing by means of a finance lease for leisure related capital investment, which increases the Council's borrowing need.

| Table 3 - Capital Financing Requirement | 2018/19 Estimate £000 | 2018/19 Revised £000 | 2018/19 Actual £000 | 2018/19 Variance £000 |
|---|---|---|---|---|
| Opening CFR | 43,231 | 41,506 | 41,507 | 1 |
| Net financing need for the year (Table 2) | 10,215 | 10,889 | 8,318 | (2,571) |
| Less MRP/VRP | (594) | (516) | (542) | (26) |
| **Closing CFR** | **52,852** | **51,879** | **49,283** | **(2,596)** |

See also Note 36 Capital Expenditure and Financing in the Statement of Accounts 2018/19.

13. The CFR and Gross Debt

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

**Gross borrowing and the CFR**. In order to ensure that borrowing levels are prudent over the medium term and are only for capital purposes, the Council ensures that its gross external borrowing does not, except in the short term, exceed the total of the CFR in the preceding year (2017/18) plus the estimates of any additional CFR 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 would allow the Council some flexibility to borrow in advance of its immediate capital needs, but this was not required in 2018/19.

Table 4 shows the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

| Table 4 - Portfolio Position | 2018/19 Estimate £000 | 2018/19 Revised £000 | 2018/19 Actual £000 | 2018/19 Variance £000 |
|---|---|---|---|---|
| Debt at 1 April | 20,252 | 15,252 | 15,252 | 0 |
| Other long-term liabilities (OLTL) | 16 | 15 | 15 | 0 |
| Total gross debt 1 April | 20,268 | 15,267 | 15,267 | 0 |
| Change in Debt | 10,953 | 9,627 | 5,738 | (3,889) |
| Change in OLTL | 0 | 0 | 0 | 0 |
| Change in gross debt | 10,953 | 9,627 | 5,738 | (3,889) |
| Gross debt 31 March | 31,221 | 24,894 | 21,005 | (3,889) |
| Capital Financing Requirement (Table 3) | 52,852 | 51,879 | 49,283 | (2,596) |
| **Under / (over) borrowing** | **21,631** | **26,985** | **28,278** | **1,293** |

An analysis of external borrowing as at 31 March 2019 is presented in Appendix A. The figures for short-term borrowing include accrued interest payable to lenders, so that the external borrowing matches the total shown in the Balance Sheet in the Statement of Accounts 2018/19.

**The authorised limit**. This 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 revised limit set for 2018/19 by Council on 26 February 2019 was £27.894m and actual gross debt shown in Table 4 was £21.005m. The Council has maintained gross borrowing within its authorised limit.

**The operational boundary**. This 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. The revised operational boundary set for 2018/19 was £24.894m and actual gross debt at 31 March 2019 was £21.005m.

**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 revenue stream (council tax, business rates, and various Government grants).

| Table 5 - Ratio of Financing Costs to Net Revenue Stream | 2018/19 Estimate % | 2018/19 Actual % | 2018/19 Variance % |
|---|---|---|---|
| Ratio | 8.86 | 6.83 | (2.03) |

The actual ratio was lower than estimated in 2018/19 because net financing costs were lower than estimated and the revenue stream was higher.

## TREASURY POSITION AS AT 31 MARCH 2019

14. Treasury management debt and investment position

The Council's treasury management debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security for investments, and to manage risks within all treasury management activities. Gross debt is shown in Table 4, and Investments (including Cash and Cash equivalents but excluding accrued interest) are shown in Table 6.

| Table 6 - Year-End Resources 2018/19 | 2018/19 Estimate £000 | 2018/19 Revised £000 | 2018/19 Actual £000 | 2018/19 Variance £000 |
|---|---|---|---|---|
| Core Funds/Working Balances | (22,631) | (27,985) | (31,126) | (3,141) |
| Under/(over) borrowing (Table 4) | 21,631 | 26,985 | 28,278 | 1,293 |
| **Investments** | **(1,000)** | **(1,000)** | **(2,848)** | **(1,848)** |

A detailed analysis of Short Term Investments and Cash and Cash Equivalents is presented as Appendix B. Accrued interest is shown so that figures match those in the Balance Sheet and notes in the Statement of Accounts 2018/19. The maximum balance invested with each counterparty complied with the limit approved by the Council. Appendix C presents the approved counterparty limits for 2018/19.

Council approved a maximum of £4m should be invested with UK local authorities for more than 365 days and up to two years. No sums were invested for more than 365 days.

| Table 7 - Maximum Principal Sums Invested > 365 Days | 2018/19 Estimate £000 | 2018/19 Revised £000 | 2018/19 Actual £000 | 2018/19 Variance £000 |
|---|---|---|---|---|
| UK Government | 0 | 0 | 0 | 0 |
| UK Local Authorities ** | 4,000 | 4,000 | 0 | (4,000) |
| UK Banks & Building Societies | 0 | 0 | 0 | 0 |
| Non-UK Banks | 0 | 0 | 0 | 0 |
| **Total** | **4,000** | **4,000** | **0** | **(4,000)** |

** Maximum of £2 million per local authority

## INVESTMENT PERFORMANCE 2018/19

15. Review of Performance

Investment returns remained low during 2018/19. When the treasury management strategy for 2018/19 was approved, the expectation 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 the anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018.

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. The Council has continued to achieve budget savings by maintaining a position of under borrowing, which means that it has used its own cash balances to finance capital expenditure rather than taking external loans.

**Investment Policy**. The Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by Council for 2018/19. 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 ratings outlooks, credit default swaps, banks share prices etc.). Link Asset Services, the Council's treasury advisors, provide suggested investment durations for the approved counterparties. During 2018/19 cash was not invested in term deposits. To manage the Council's cash flow, balances were held only in highly liquid accounts, specifically in call accounts and MMFs.

Investment performance in 2018/19 is presented in Table 8.

| **Table 8 - Investment Performance 2018/19** | **Average Daily Investment £000** | **Interest 2018/19 £** | **Average Rate %** |
|---|---|---|---|
| Fixed Term Deposits | 0 | 0 | n/a |
| Notice Accounts | 0 | 0 | n/a |
| Call Accounts | 2,011 | 11,380 | 0.57 |
| Money Market Funds | 4,828 | 30,393 | 0.63 |
| Debt Management Office DMADF | 0 | 0 | n/a |
| **Total** | **6,839** | **41,773** | **0.61** |

The average return of 0.61% in 2018/19 compares to the 0.26% achieved in 2017/18, and reflects the gradual increase in interest rates.

The average 7-day LIBID for 2018/19 was 0.50%. The target to exceed for 2018/19 was 7-day LIBID plus 15%, which was 0.57%. This was achieved.

Link Asset Services suggested a budgeted investment earnings rate of 0.60% for 2018/19, based on investment durations of up to three months. This was a challenging target, because cash was held only in liquid accounts instead of being placed as term deposits. However, the target rate was exceeded by the smallest of margins.

## MONITORING JUNE QUARTER 2019/20

16. Borrowing and Investments

External borrowing as at 30 June 2019 is presented in Appendix E. Temporary borrowing from another local authority has been repaid. One loan for £2.5m has been taken from PWLB. Further loans will be taken during the year. To finance the capital programme, and these have been budgeted for.

Investments as at 30 June 2019 are presented in Appendix F. Cash balances available to invest fluctuate throughout the year, depending on the timing of receipts and payments. Currently the balance is higher than at 31 March 2019, and it is likely to be higher at points during the remainder of the financial year. However, the tendency is for the balance to reduce by 31 March.

Appendix G presents the counterparty limits for 2019/20. It is unlikely that cash will be invested in anything other than liquid accounts with instant access.

17. Prudential and Treasury Indicators and Investment Counterparty Limits

A report recommending purchase of a major property asset is being presented to the Full Council meeting of 23 July 2019. If the purchase of the asset is approved by Council, it will be necessary to amend a number of Prudential and Treasury Indicators, in particular the Operational Boundary and Authorised Limit to allow funding of the purchase by external borrowing. In addition, it is recommended that investment counterparty limits should be increased temporarily in case the borrowing is taken before payment for the purchase is made. (Borrowing from PWLB is arranged two working days before the cash is received.) This would allow any surplus cash to be placed temporarily with approved counterparties at a higher rate of interest than if placed in the Debt Management Office's Debt Management Account Deposit Facility.

Should the asset purchase be approved by Council, and the Prudential and Treasury Indicators and counterparty limits be revised, these will be circulated for information only. Subsequent treasury monitoring during 2019/20 would be against the revised indicators and limits.

## ADVICE OF LINK ASSET SERVICES

18. Treasury Advisors' review of 2018/19 and forward looking commentaries

Link Asset Services' review of the Economy and Interest Rates in 2018/19 is presented as Appendix D.

A detailed economic commentary on developments during the quarter ended 30 June 2019 is presented as Appendix H.

Appendix I is a detailed commentary on interest rate forecasts. This includes an updated forecast for the rate of return on cash invested for 2019/20 and subsequent years. The suggested rate of 0.75% for 2019/20 will be challenging and is unlikely to be achieved. It exceeds the rate being earned in MMF accounts at present, and is higher than the call account rate. It would only be achievable if cash could be placed in term deposits for six to twelve months, but this is not feasible.

## IMPLICATIONS OF REPORT

19. This report has implications in the following areas and the relevant Directors' comments are included:

| | | | |
|---|---|---|---|
| Finance | √ | Customer Services | |
| Human Resources | | Equality and Diversity | |
| Legal | | Integrated Impact Assessment required? | |
| No significant implications in this area | | Policy and Communications | |

**COMMENTS OF THE STATUTORY FINANCE OFFICER**

20. This report meets statutory reporting requirements. Its statistical content is consistent with the Council's financial accounts for the financial year 2018/19.

**COMMENTS OF THE MONITORING OFFICER**

21. The Monitoring Officer has no comments.

GARY HALL
CHIEF EXECUTIVE & STATUTORY FINANCE OFFICER

| Background Papers | | | |
|---|---|---|---|
| **Document** | **Date** | **File** | **Place of Inspection** |
| Treasury Strategy 2018/19<br>Treasury Strategy 2019/20 | 27/2/18<br>26/2/19 | | Town Hall |

| Report Author | Ext | Date | Doc ID |
|---|---|---|---|
| Michael Jackson | 5490 | 16 July 2019 | Treasury Management Annual Report 2018-19 and June Quarter Monitoring 2019-20.docx |