Audit, Governance & Standards Committee	30th July 2019

Treasury Management Annual Review 2018/19

Final Decision-Maker	Audit, Governance & Standards Committee
Lead Head of Service	Chris Hartgrove, Interim Head of Finance
Lead Officer and Report Author	John Owen, Finance Manager
Classification	Public
Wards affected	All Wards

Executive Summary

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code requires that authorities report on the performance of the treasury management function at least twice a year (at mid-year and year-end).

Council has delegated the role of considering these reports to the Audit, Governance and Standards Committee.

This report sets out the activities of the Treasury Management function for 2018/19 financial year.

This report makes the following recommendations to this Committee:

1. That the review of the financial year 2018/19 in accordance with CIPFA's Code of Practice on Treasury Management along with the prudential and treasury indicators be noted.
2. That no amendments to the current treasury management procedures are necessary as a result of the review of activities in 2018/19.

Timetable	
Meeting	***Date***
Audit, Governance & Standards Committee	30th July 2019

Treasury Management Annual Review 2018/19

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The Treasury Management Function ensures the safeguarding of Council finances and the liquidity of funds when liabilities become due to support the strategic plan objectives.	Interim Head of Finance
Cross Cutting Objectives	The report recommendations support the achievements of all the cross cutting objectives as stated above.	Interim Head of Finance
Risk Management	Covered in the risk section of this report.	Interim Head of Finance
Financial	This report relates to the financial activities of the council in respect of treasury management and specific financial implications are therefore detailed within the body of the report.	Section 151 Officer & Finance Team
Staffing	None.	Interim Head of Finance
Legal	The legal implications are detailed within the body of the report which is compliant with statutory and legal regulations such as the CIPFA Code of Practice on Treasury Management in Local Authorities.	Team Leader (Corporate Governance), MKLS
Privacy and Data Protection	None.	Policy and Information Team
Equalities	The recommendations do not propose a change in service therefore will not require an equalities impact assessment.	Equalities and Corporate Policy Officer
Public Health	We recognise that the recommendations will not negatively impact on population health or that of individuals.	Public Health Officer
Crime and Disorder	None	Interim Head of Finance
Procurement	None	Interim Head of Finance Section 151 Officer

2. INTRODUCTION AND BACKGROUND

2.1 This report sets out the activities of the Treasury Management function for the 2018/19 financial year in accordance with CIPFA's Code of Practice on Treasury Management in Local Authorities. It also sets this in the context of the economic environment over the past 12 months.

2.2 The Authority has 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.

2.3 The Authority's Treasury Management Strategy for 2018/19 was approved by full Council on 7th March 2018. The key elements of the Strategy are:

- to utilise cash balances rather than loan debt to finance the capital programme in the short term, due to lower investment returns and high counterparty risk in the current economic climate;

- to further diversify its portfolio, as far as is operationally feasible, ensuring that a combination of secured and unsecured investments are considered. Greater use of Local Authority investments will be sought due to the high security of the borrower which enables investment over a longer period where funds are not required immediately.

2.4 <u>Economic Overview of 2018/19</u>

2.4.1 During financial year 2018/19 the following developments took place:

- After weak economic growth of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% year on year confirming that the UK was the third fastest growing country in the G7 in quarter 4.

- After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, they have abstained from any further increases. It is unlikely that any further action will be seen from the MPC until the uncertainties over Brexit clear.

- The number of people in work increased by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975.

- CPI inflation has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, 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%.

2.5 Treasury Investment Activity

2.5.1 The CIPFA Code and Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles. The Council has adhered to these principles during 2018/19.

2.5.2 The Authority has held invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19 the Authority's investment balances have ranged between £15m and £43m. The average investment balance for the year was £28.4m. The Council held investments totalling £15.014m as at 31st March 2018. A full list of these can be found within **Appendix I**.

2.5.3 Investment income for the year totalled £220k which exceeded the budget for 2018/19 of £100k. This was due to the fact that investment rates had risen slightly after the base rate rise and there were larger than expected sums available for investment. The average rate for investments for the year was 0.78%.

2.5.4 Nearly all investments during 2018/19 have been short term due to the evolving capital programme and the decision to use the Council's cash to fund these projects prior to borrowing. The exception is £2m of core cash invested with a local authority in May 2018 for a period of 2 years for an increase in yield with a highly secure organisation.

2.5.5 All investments during the year have been within the agreed limits of the Treasury Management Strategy 2018/19.

2.6 Non-Treasury Investments Activity

2.6.1 Investments which are outside the normal treasury function, i.e. investing surplus cash as a result of its day to day activities, are classed as non-treasury investments.

2.6.2 The Council made property purchases and regeneration works within the borough which are not classed as commercial but with the intention of supporting the local community, housing and regeneration objectives rather than for generating profits.

2.6.3 The Council has provided two service loans which were made to support local public services to other organisations. The two service loans are to Kent Savers for £25,000, paid in 2017/18, which is repayable in 2022/23 at an interest rate of 1% and to One Maidstone for £60,000 (BID loan) interest free repayable over 5 years.

2.6.4 A loan to Cobtree Manor Estates Trust has been agreed for £320,000 at an interest rate of 3% over 5 years which will be payable to the Trust in 2019/20.

2.7 Borrowing Activity

2.7.1 During 2018/19, the Council maintained an under-borrowed position, in other words, 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 is prudent as it reduces the cost of carry (ie the difference between interest payable and interest receivable) and minimises counterparty risk on placing investments.

2.7.2 As at 31st March 2019, the Authority did not hold any external debt. The Council's only borrowing requirements for 2018/19 have been for short term purposes where the cheapest options to borrow were sought within the market. Details of these borrowings are as follows:

Lender	Amount £m	Rate (%)	Start	End
Rhondda Cynon Taff Superannuation Fund	2.5	0.35	22/05/2018	29/05/2018
Rhondda Cynon Taff General Account	2.6	0.35	25/05/2018	29/05/2018
Rhondda Cynon Taff General Account	3.94	0.35	22/06/2018	26/06/2018
Rhondda Cynon Taff General Account	3.5	0.35	26/06/2018	27/06/2018
Newport City Council	2.5	0.45	23/07/2018	27/07/2018

Total cost of this borrowing was £575.

2.7.3 The Council is expected to borrow externally in 2019/20 to fund the current capital programme which, with rates being very low and possibly even lower in future due to the uncertainty of Brexit, may be an opportune time to take advantage of debt. The Director of Finance & Business Improvement monitors interest rates to ensure when will be the most prudent time and if borrowing should be long or short term to minimise the risk of refinancing.

2.8 Prudential and Treasury Indicators

2.8.1 The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the indicators that must be set and monitored each year.

2.8.2 The Council has operated within its Prudential and Treasury Indicators set out in the Treasury Management Strategy 2018/19 and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators can be found in **Appendix II**.

2.8.3 All limits have been complied with during the year.

2.9 <u>Compliance Report</u>

2.9.1 The Director of Finance & Business Improvement 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.

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3. AVAILABLE OPTIONS

3.1 The Audit, Governance and Standards Committee agrees that no amendments to the current procedures are necessary as a result of the review of activities in 2018/19.

3.2 The Audit, Governance and Standards Committee proposes changes to the current procedures as a result of the review of activities in 2018/19.

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4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

4.1 The Audit, Governance and Standards Committee agrees that no amendments to the current strategy for 2018/19 are necessary as a result of the review of activities in 2018/19 as there is no justification to make any changes.

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5. RISK

5.1 Detailed risk management policies are included within the Treasury Management Practices to which the Council adheres to. A brief description of these risks along with the Council's actions to mitigate these risks are as follows:

- **<u>Liquidity Risk</u>** - Liquidity risk is the risk that cash may not be available when it is required. The Council has sufficient standby facilities to ensure that there is always sufficient liquidity to deal with unexpected occurrences. The Council also has an overdraft facility with Lloyds Bank of £500,000 plus the option of short term borrowing.

- **<u>Interest Rate Risk</u>** - Interest rate risk is the risk that unexpected changes in interest rates expose the Council to greater costs or a shortfall in income that has been budgeted for. The Council will seek to minimise this risk by seeking expert advice on forecasts of interest rates from treasury management consultants and agreeing with them its strategy for the coming year for the investment and debt portfolios. It will also determine appropriate limits and trigger points which are set out in the annual Treasury Management Strategy Statement.

- **<u>Exchange Rate Risk</u>** - Exchange rate risk is the risk that unexpected changes in exchange rates expose the Council to greater costs or a shortfall in the income that has been budgeted for. The Council has no exposure to exchange rate risk as it has no powers to enter into loans or investments in foreign currencies for treasury management purposes.

- **Inflation Risk** - Inflation risk is the risk that unexpected changes in inflation expose the Council to greater costs or a shortfall in income than have been budgeted for. Inflation both current and projected will form part of the debt and investment decision-making criteria both within the strategy and operational considerations

- **Credit and Counterparty Risk** - Credit and counter-party risk is the risk of failure by a third party to meet its contractual obligations under an investment, loan or other commitment, especially one due to deterioration in its creditworthiness, which causes the Council an unexpected burden on its capital or revenue resources. Treasury management staff will add or delete counterparties to/from the approved counterparty list in line with the policy on criteria for selection of counterparties. Due to volatility of the financial market, Treasury Management staff will use information from various sources, eg brokers, Treasury Management Consultants and other local Authority experience to determine the creditworthiness of an institution and to decide if funds are at risk and agree the best course of action with the Director of Finance & Business Improvement.

- **Refinancing Risk** - Refinancing risk is the risk that when loans or other forms of capital financing mature, they cannot be refinanced where necessary on terms that reflect the assumptions made in formulating revenue and capital budgets. The Council is currently debt-free, however it will soon be looking to borrow to fund its capital programme in the coming years. In considering the affordability of its capital plans, the Council will consider all the resources currently available/estimated for the future together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the two following years and the impact these will have on council tax. It will also take into account affordability in the longer term beyond this three year period.

- **Legal and Regulatory Risk** - Legal and regulatory risk is the risk that either the Council, or a third party which it is dealing with in its treasury management activities, acts outside of its legal powers or regulatory requirements and as a result the Council incurs loss. The treasury management activities of the Council comply fully with legal statute, guidance, Codes of Practice and the regulations of the Council. The Authority will provide written evidence of its powers and authorities to any counterparty that requests us to do so. Counterparties will also provide their details to the Authority as a matter of course.

- **Fraud, Error and Corruption Risk** - Fraud, error and corruption risk is the risk that the Council may fail to employ adequate systems, procedures and other arrangements which identify and prevent losses through such occurrences. The Council will seek to ensure an adequate division of responsibilities and maintenance at all times of an adequate level of internal checks which minimises such risks along with maintaining records of all treasury management transactions so that there is a full audit trail and evidence of the appropriate checks being carried out. Delegated members of staff have the responsibility for the treasury management function for the Council and the Director of Finance & Business Improvement authorises who these are. The Council also has a Fidelity Guarantee insurance policy with Zurich Insurance which covers against loss of cash through fraud or dishonesty of employees. The treasury management function is subject to review by internal audit on a regular basis.

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6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

6.1 None.

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7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

7.1 If Audit, Governance and Standards Committee agrees that no change in current procedures with Treasury management will be made, then there will be no further action.

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8. REPORT APPENDICES

8.1 The following documents are to be published with this report and form part of the report:

- Appendix I: List of Investments as at 31st March 2019
- Appendix II: Prudential and Treasury Indicators

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9. BACKGROUND PAPERS

9.1 None