Bath & North East Somerset Council		
MEETING	**Cabinet**	
MEETING DATE:	**10 July 2019**	EXECUTIVE FORWARD PLAN REFERENCE: E 3119
TITLE:	**Treasury Management Outturn Report 2018/19**	
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council's Investment Position at 31st March 2019
Appendix 3 – Average monthly rate of return for 2018/19
Appendix 4 – The Council's External Borrowing Position at 31st March 2019
Appendix 5 – Arlingclose's Economic & Market Review Q4 of 2018/19
Appendix 6 – Interest & Capital Financing Budget Monitoring 2018/19
Appendix 7 – Summary Guide to Credit Ratings

1 THE ISSUE

1.1 In February 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan for 2018/19.

2 RECOMMENDATION

The Cabinet agrees that;

2.1 The Treasury Management Report to 31st March 2019, prepared in accordance with the CIPFA Treasury Code of Practice, is noted.

2.2 The Treasury Management Indicators to 31st March 2019 are noted.

3 THE REPORT

Summary

3.1 The average rate of investment return for the 2018/19 is 0.73%, which is 0.17% above the benchmark rate.

3.2 The Council's Prudential Indicators for 2018/19 were agreed by Council in February 2018 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

3.3 The Council's investment position as at 31st March 2019 is given in **Appendix 2**. The balance of deposits as at 31st December 2018 and 31st March 2019 are also set out in the pie charts in this appendix.

3.4 Gross interest earned on investments totalled £329k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.73%, which was 0.17% above the benchmark rate of average 7 day LIBID +0.05% (0.56%).

Summary of Borrowings

3.5 The Council's external borrowing as at 31st March 2018 totalled £226.1 million and is detailed in Appendix 4. PWLB annuity borrowing for £20million was arranged during the final quarter to maintain appropriate cashflow balances, in particular reflecting an investment property purchase.

3.6 The Council's Capital Financing Requirement (CFR) as at 31st March 2019 was £300.7 million. This represents the Council's underlying need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

3.7 The CFR represents the underlying need to borrow and the difference from the current borrowing of £226.1 million, represents re-investment of the internal balances of reserves, reducing the in-year borrowing costs in excess of the potential investment returns.

3.8 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2019 apportioned to Bath & North East Somerset Council is £11.9m. Since this borrowing is managed by an external body and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 5.5.

3.9 The borrowing portfolio as at 31st March 2019 is shown in **Appendix 4**.

Strategic & Tactical Decisions

3.10 As shown in the charts at **Appendix 2**, the investment portfolio is diversified across Money Market Funds, highly rated UK and Foreign Banks and a UK Building Society. The Council uses AAA rated Money Market funds to maintain very short term liquidity and had overall investments of £39.7m invested as at 31st March 2019

3.11 The Council does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Council's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

3.12 The Council's average investment return is above the budgeted level of 0.45%.

Future Strategic & Tactical Issues

3.13 Our treasury management advisors economic and market review for the fourth quarter 2018/19 is included in **Appendix 5**.

3.14 With GDP Growth rising to 0.6% in the third calendar quarter from 0.4% in the second, the fourth quarter economic growth slowed to 0.2% with weaker expansion in production, construction and services dragging on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August 2018, no further changes to monetary policy have been made since.

3.15 The benefits of the Council's current policy of internal borrowing are monitored regularly against the likelihood that long term borrowing rates are forecast to rise in future years. The focus remains on the rate of increase and the medium-term peak.

3.16 The borrowing that has taken place in 2018/19 is therefore driven by a need to maintain an appropriate working cash balance rather than any immediate changes to interest rates.

Budget Implications

3.17 A breakdown of the revenue budget showing interest and capital financing and the year end position based on the period April to March is included in **Appendix 6**. An overall underspend is £741k is reported towards the Council's net revenue outturn, mainly related to the re-phasing of capital spend leading to lower than forecast borrowing costs and minimum revenue provision (MRP) requirement. (Overall Outturn is reported elsewhere on the Agenda). This is partly offset by lower internal income related to service charges for funding debt costs in relation to the re-phased capital projects.

4 STATUTORY CONSIDERATIONS

4.1 This report is for information only.

5 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

5.1 The financial implications are contained within the body of the report.

6 RISK MANAGEMENT

6.1 A risk assessment related to the issue and recommendations has been undertaken, in compliance with the Council's decision making risk management guidance.

6.2 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

6.3 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

6.4 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year.

7 CLIMATE CHANGE

7.1 This is a technical report for information only and does not directly link to climate change policy.

8 OTHER OPTIONS CONSIDERED

8.1 None

9 CONSULTATION

9.1 Consultation has been carried out with the Cabinet Member for Resources, Section 151 Finance Officer and Monitoring Officer.

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Background papers	*2018/19 Treasury Management & Investment Strategy*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2018/19 Prudential Indicator	Actual as at 31st March 2019
	£'000	£'000
Borrowing	434,000	226,125
Other long term liabilities	2,000	0
Cumulative Total	**436,000**	**226,125**

2. Operational limit for external debt
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2018/19 Prudential Indicator	Actual as at 31st March 2019
	£'000	£'000
Borrowing	403,000	226,125
Other long term liabilities	2,000	0
Cumulative Total	**405,000**	**226,125**

3. Upper limit for fixed interest rate exposure
This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2018/19 Prudential Indicator	Actual as at 31st March 2019
	£'000	£'000
Fixed interest rate exposure	**403,000**	**206,125***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the Lender exercise this option to increase the rate).

4. Upper limit for variable interest rate exposure
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2018/19 Prudential Indicator	Actual as at 31st March 2019
	£'000	£'000
Variable interest rate exposure	**246,000**	**20,000**

5. Upper limit for total principal sums invested for over 364 days

This is the maximum amount of total investments which can be over 364 days. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

	2018/19 Prudential Indicator	**Actual as at 31st March 2019**
	£'000	£'000
Investments over 364 days	**50,000**	**0**

6. Maturity Structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk.

	Upper Limit	**Lower Limit**	**Actual as at 31st March 2019**
	%	%	%
Under 12 months	50	Nil	13.3*
12 months and within 24 months	75	Nil	0
24 months and within 5 years	75	Nil	0
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	86.7

* The CIPFA Treasury management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date (which are at 6 monthly intervals for the £20m of LOBO's). However, the Council would only consider repaying these loans if the Lenders exercised their options to alter the interest rate.

7. Average Credit Rating

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**.

	2018/19 Prudential Indicator	**Actual as at 31st March 2019**
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AA**

APPENDIX 2
March
The Council's Investment position at 31st March 2019
The term of investments is as follows:

Term Remaining as at 31st March 2019	Balance at 31st March 2019
	£'000's
Notice (instant access funds)	14,720
Up to 1 month	
1 month to 3 months	10,000
Over 3 months	15,000
Total	**39,720**

The investment figure is made up as follows:

	Balance at 31st March 2019
	£'000's
B&NES Council	35,966
Schools	3,754
Total	**39,720**

The Council had a total average net positive balance of £45.1m during the period April 2018 to March 2018.

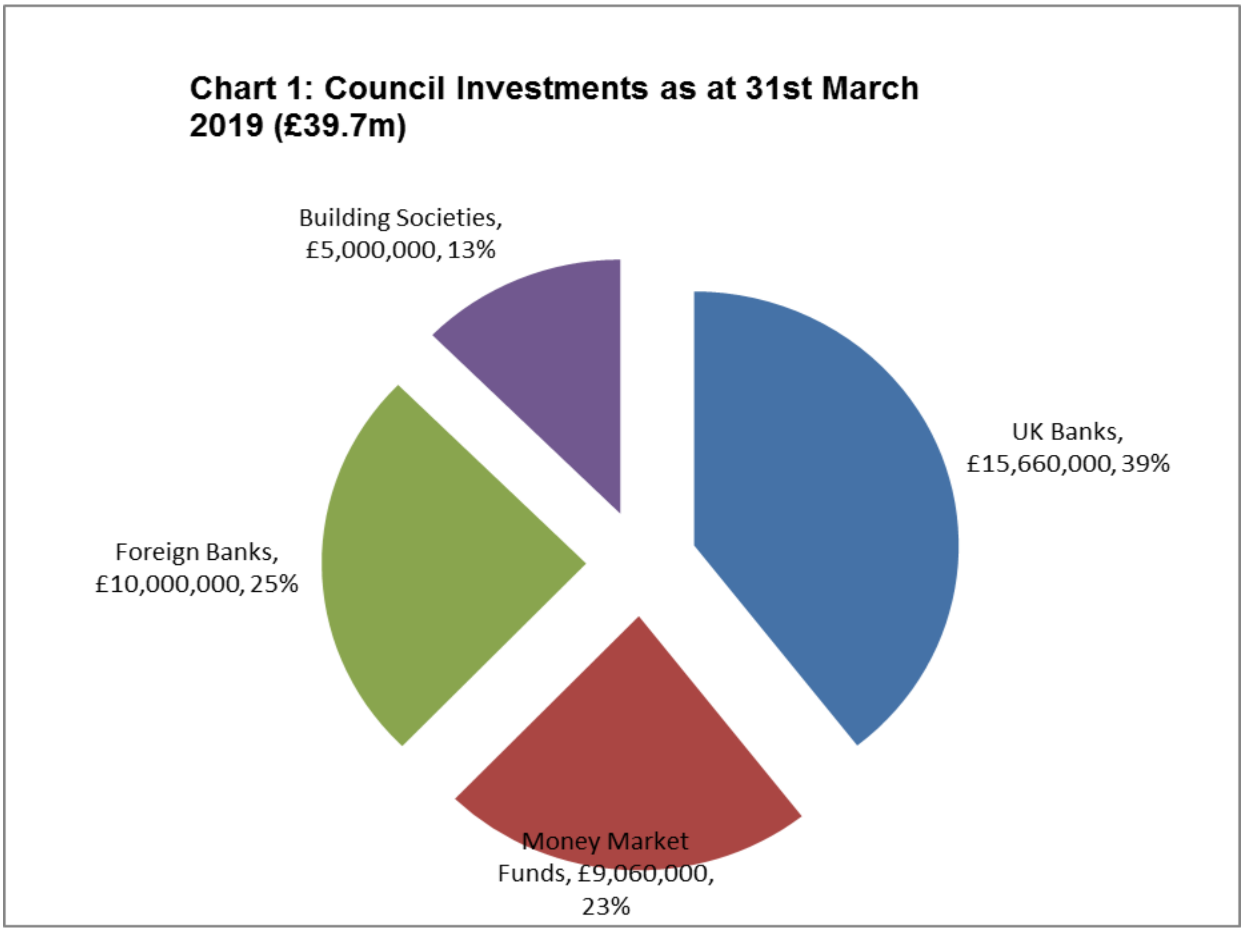


Chart 1: Council Investments as at 31st March 2019 (£39.7m)
Building Societies, £5,000,000, 13%
UK Banks, £15,660,000, 39%
Foreign Banks, £10,000,000, 25%
Money Market Funds, £9,060,000, 23%

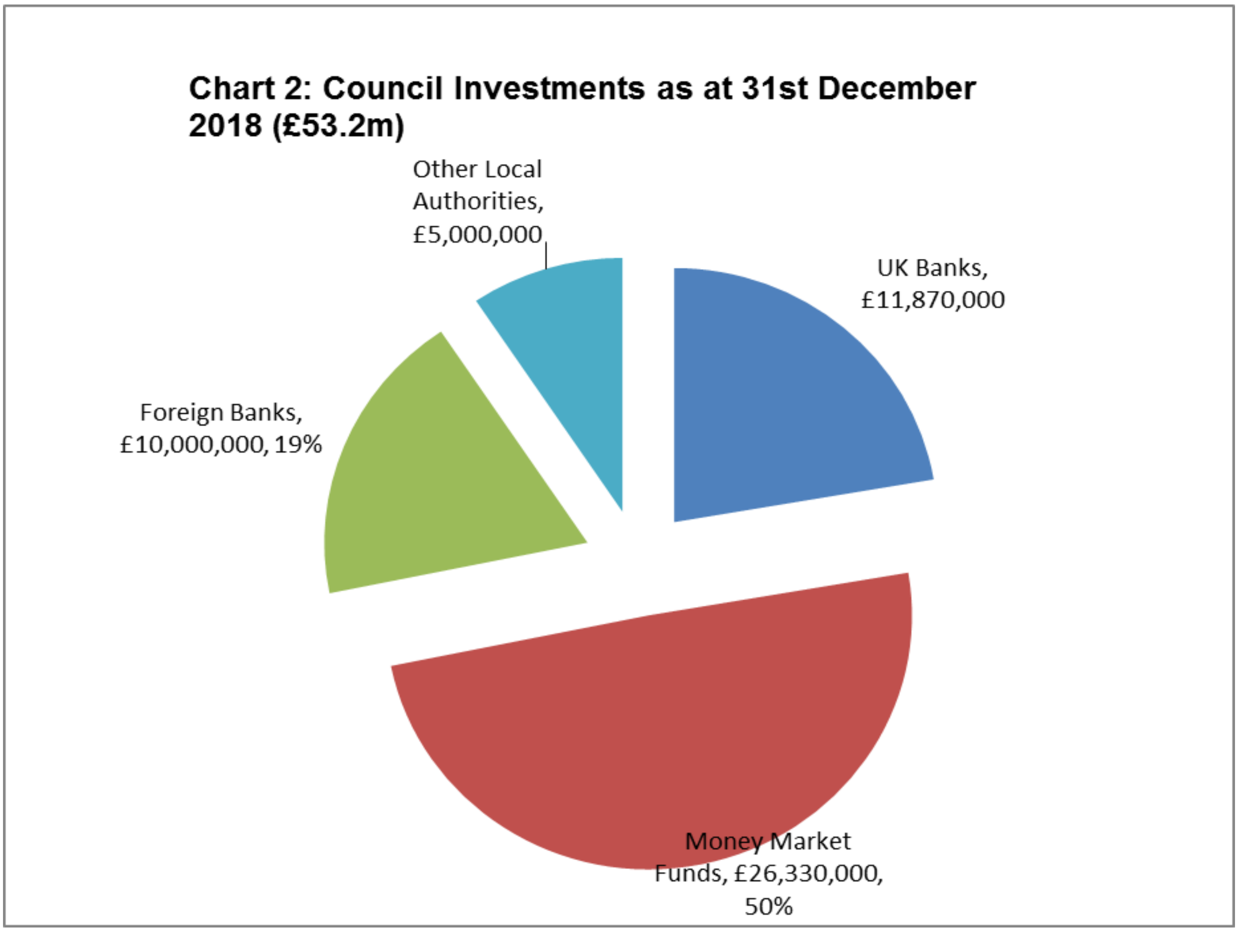


Chart 2: Council Investments as at 31st December 2018 (£53.2m)
Other Local Authorities, £5,000,000
UK Banks, £11,870,000
Foreign Banks, £10,000,000, 19%
Money Market Funds, £26,330,000, 50%

Chart 3: Council Investments per lowest equivalent Long Term credit rating (£39.7m) 31th March 2019

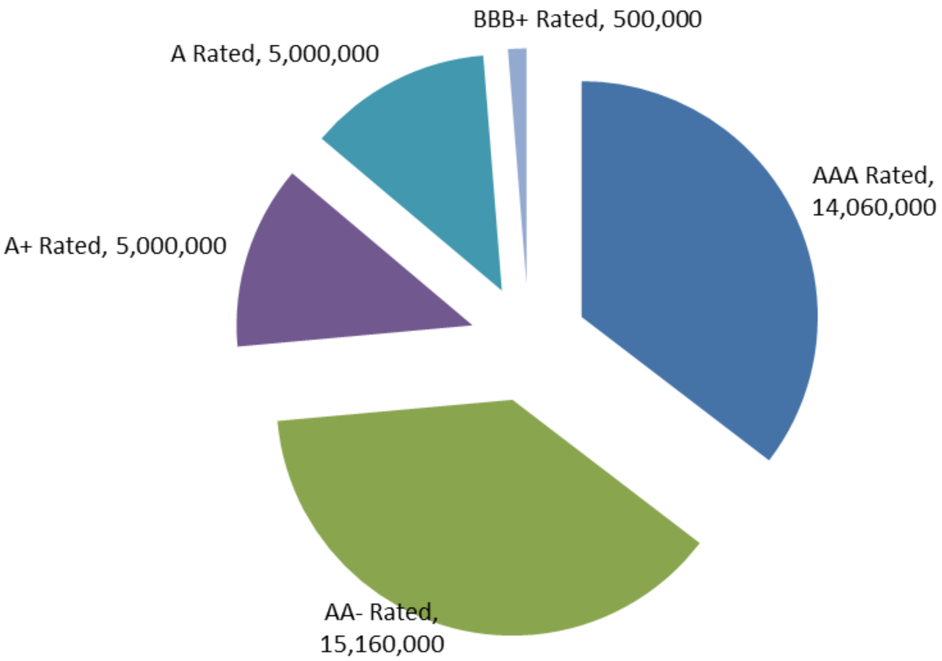
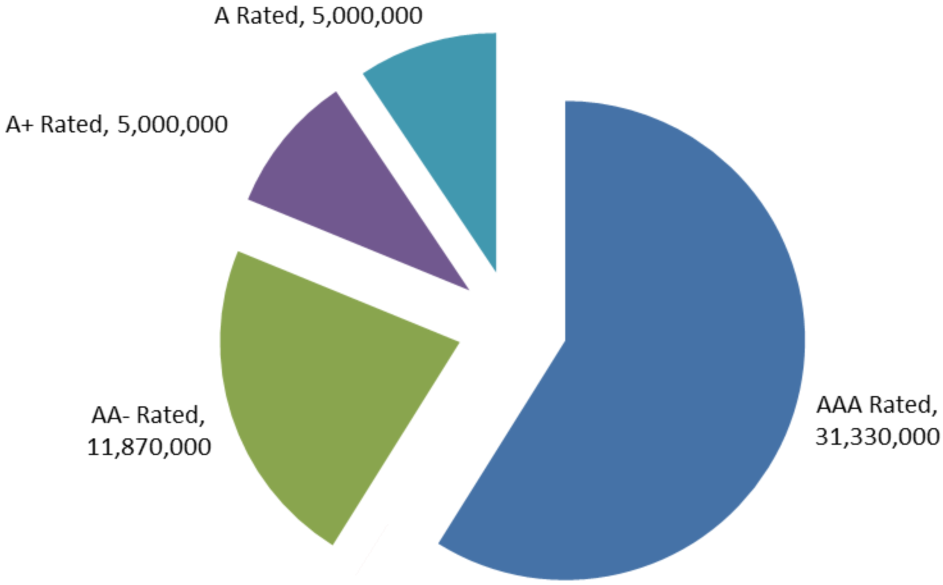


Chart 4: Council Investments per lowest equivalent Long Term credit rating (£53.2m) 31th December 2018



APPENDIX 3
Average rate of return on investments for 2018/19

	April %	May %	June %	July %	Aug %	Sep %
Average rate of interest earned	0.50%	0.60%	0.61%	0.60%	0.71%	0.74%
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.41%	0.41%	0.41%	0.41%	0.63%	0.64%
Performance against Benchmark %	+0.09%	+0.19%	+0.20%	+0.19%	+0.08%	+0.10%

	Oct %	Nov %	Dec %	Jan %	Feb %	Mar %	Average for Period
Average rate of interest earned	0.75%	0.82%	0.81%	0.82%	0.84%	0.83%	0.73%
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.63%	0.64%	0.63%	0.63%	0.62%	0.62%	0.56%
Performance against Benchmark %	+0.12%	+0.16%	+0.18%	+0.19%	+0.22%	+0.21%	+0.17%

APPENDIX 4
Councils External Borrowing at 31st March 2019

Borrowing	Amount (£)	Start	Maturity Date	Interest Rate
LONG TERM				
PWLB	10,000,000	15/10/04	15/10/34	4.75%
PWLB	5,000,000	12/05/10	15/08/35	4.55%
PWLB	5,000,000	12/05/10	15/02/60	4.53%
PWLB	5,000,000	05/08/11	15/02/31	4.86%
PWLB	10,000,000	05/08/11	15/08/29	4.80%
PWLB	15,000,000	05/08/11	15/02/61	4.96%
PWLB	5,300,000	29/01/15	08/04/34	2.62%
PWLB	5,000,000	29/01/15	08/10/64	2.92%
PWLB	18,485,552	20/06/16	20/06/41	2.36%
PWLB	9,302,947	24/02/17	16/02/40	2.28%
PWLB	9,390,197	04/04/17	16/02/43	2.26%
PWLB	7,981,019	08/05/17	15/02/42	2.25%
PWLB	6,896,403	10/08/17	10/04/67	2.64%
PWLB	9,702,041	13/12/17	10/10/42	2.35%
PWLB	9,708,599	06/03/18	10/10/42	2.52%
PWLB	9,777,159	06/03/18	10/10/47	2.62%
PWLB	9,853,265	10/09/18	20/07/43	2.42%
PWLB	9,852,481	06/12/18	20/06/43	2.38%
PWLB	9,950,587	12/12/18	20/06/68	2.59%
PWLB	4,924,955	13/12/18	20/06/43	2.35%
PWLB	20,000,000	11/02/19	11/02/68	2.52%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
Eurohypo Bank*	10,000,000	27/04/05	27/04/55	4.50%
Gloucestershire C C	5,000,000	25/11/14	19/12/19	2.05%
Gloucestershire C C	5,000,000	19/12/14	19/12/19	2.05%
Overall Total	**226,125,204**			

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals. Should the lender use the option to change the rate, then at this point the borrower has the option to repay the loan without penalty.

APPENDIX 5

Economic and market review for April to March 2019

Economic background:
After spiking at over $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

After rising to 0.6% in the third calendar quarter from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

With the 29th March 2019, the original EU 'exit day' now been and gone, having failed to pass a number of meaningful votes in Parliament, including shooting down Theresa May's deal for the third time, MPs voted by a majority of one (313 to 312) to force the prime minister to ask for an extension to the Brexit process beyond 12th April in order to avoid a no-deal scenario. Recent talks between the Conservative and Labour parties to try to reach common ground on a deal which may pass a vote by MPs did not yield any positive results. The EU have granted an extension to 31st October and its leaders have been clear that the terms of the deal are not up for further negotiation. The ongoing uncertainty continues to weigh on sterling and UK markets.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with EU. The EU itself appeared to be show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.
Financial markets: December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

<u>Credit background:</u>
Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities.

In February, Fitch put the UK AA sovereign long-term rating on Rating Watch Negative as a result of Brexit uncertainty, following this move with the same treatment for UK banks and a number of government-related entities.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2018/19 (Apr to March)

April to March 2019	**YEAR END POSITION** **Budgeted Spend or (Income) £'000**	**Actual Spend or (Income) £'000**	**Actual over or (under) spend £'000**	**ADV/FAV**
Interest & Capital Financing				
- Debt Costs	7,647	6,340	(1,307)	FAV
- Internal Repayment of Loan Charges	(10,998)	(9,400)	1,597	ADV
- Ex Avon Debt Costs	1,140	1,143	3	ADV
- Minimum Revenue Provision (MRP)	6,230	5,267	(963)	FAV
- Interest on Balances	(304)	(375)	(71)	FAV
Total	**2,974**	**3716**	**(741)**	**FAV**

APPENDIX 7

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicates an issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.