Appendix A1

Annual Treasury Management Review
2018/19

East Cambridgeshire District Council
April 2019

Annual Treasury Management Review 2018/19

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 Full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 22/02/2018)
- a mid-year (minimum) treasury update report (Council 21/02/2019)
- 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 the former Resources and Finance Committee and the Finance and Assets Committee (with regard to this report) before they were reported to the Full Council.

2. The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. 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 and how this was financed.

£m	2017/18 Actual	2018/19 Budget	2018/19 Actual
Capital expenditure	**16.232**	**9.672**	**3.479**
Financed in year	5.068	8.063	2.417
Unfinanced capital expenditure	**11.164**	**1.609**	**1.062**

3. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2017/18) plus the estimates of any additional capital financing requirement 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 allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2018/19. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2018 Actual	31 March 2019 Budget	31 March 2019 Actual
CFR General Fund (£m)	13.524	16.452	14.486
Gross external borrowing position	0	5.000	0
Under / over funding of CFR	13.524	11.452	14.486

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 are acceptable subject to the authorised limit not being breached.

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 net revenue stream.

	2018/19
Authorised limit for external debt	£12.0m
Maximum gross external borrowing position during the year	£0.0m
Operational boundary	£5.0m
Average gross borrowing position	£0.0m
Financing costs as a proportion of net revenue stream	0.0%

4. Treasury Position as at 31 March 2019

At the beginning and the end of 2018/19 the Council's treasury position was as follows:

INVESTMENT PORTFOLIO	Actual 31.3.18 £000	Actual 31.3.18 %	Actual 31.3.19 £000	Actual 31.3.19 %
Treasury investments				
Banks	300	6.2%	261	4.2%
Money Markets	4,550	93.8%	5,930	95.8%
TOTAL TREASURY INVESTMENTS	4,850	100%	6,191	100%

Non Treasury investments				
Loan to ECTC	3,205	100%	4,620	100%
TOTAL NON TREASURY INVESTMENTS	3,205	100%	4,620	100%

Treasury investments	4,850	60.2%	6,191	57.3%
Non Treasury investments	3,205	39.8%	4,620	42.7%
TOTAL OF ALL INVESTMENTS	8,055	100%	10,811	100%

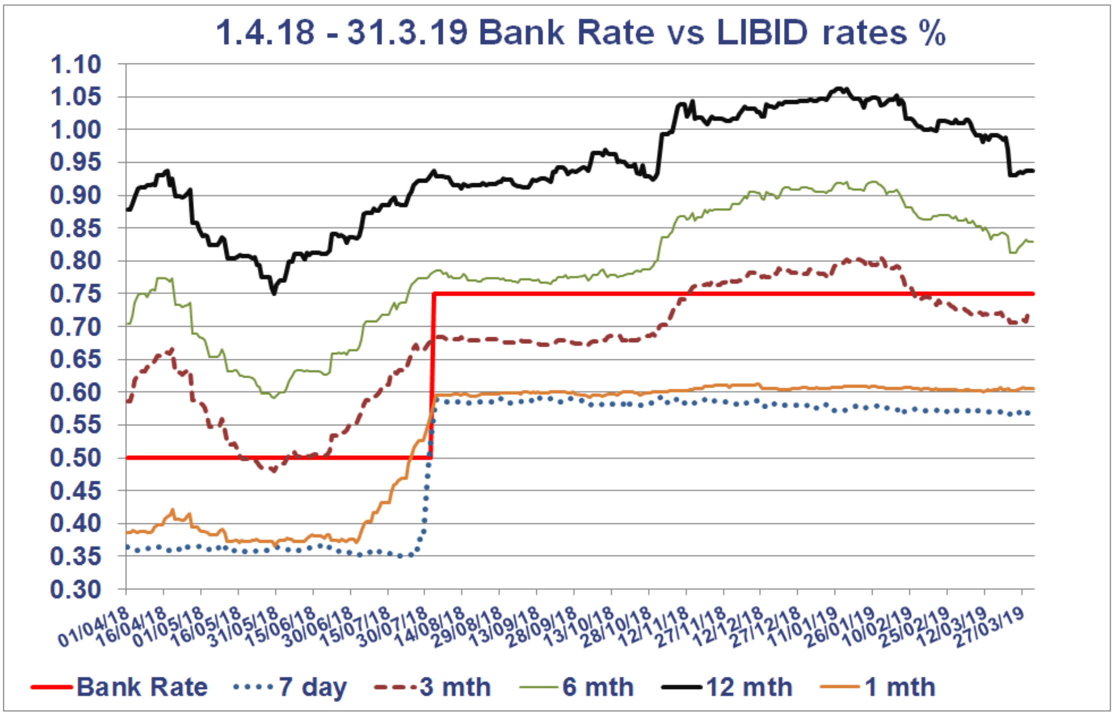
The maturity structure of the investment portfolio was as follows:

All treasury investments are in cash and as such we have instant access to them.

The loan to East Cambridgeshire Trading Company is due to be repaid on or before 31st March 2021.

5. The strategy for 2018/19

5.1 Investment strategy and control of interest rate risk



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.

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.

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.

This authority does not have sufficient cash balances to be able to place deposits for more than a month, and is therefore unable to earn higher rates from longer deposits. However, when Bank Rate went up in August, its investment returns also improved from deposits for periods up to one month.

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.

5.2 Borrowing strategy and control of interest rate risk

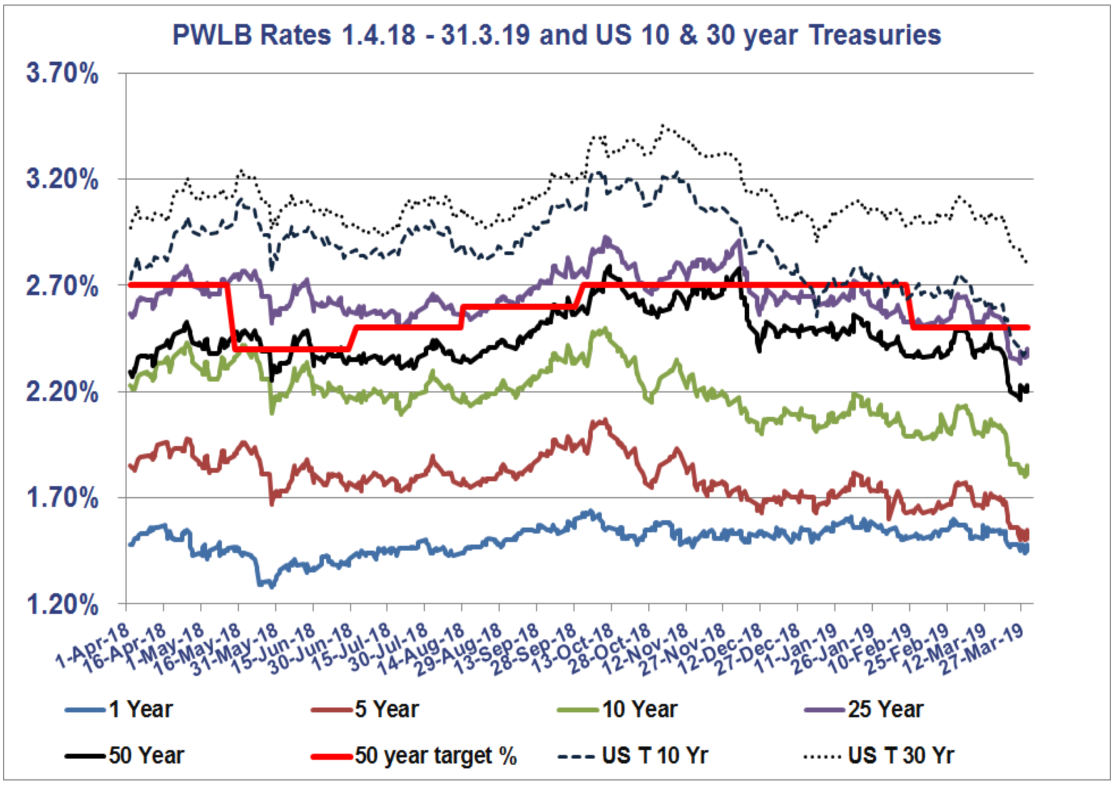
During 2018/19, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

The policy of avoiding new borrowing by running down cash balances, has served well over the past few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or replacing internal borrowing, as Council reserves reduce.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Finance Manager therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principle to manage interest rate risks: if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View				12.2.18									
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB Rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%



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.

6. Investment Outturn

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance, which was implemented in the annual investment strategy approved by the Council on 22nd February 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 no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cashflow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£m)	31 March 2018	31 March 2019
Earmarked reserves	**10.147**	**9.358**
CIL / Section 106	**3.928**	**4.083**
Provisions	**0.769**	**1.362**
Usable capital receipts	**0.669**	**1.102**
Cash / Debtors	**2.504**	**4.772**
Internal Borrowing	**-13.167**	**-14.486**
Total	**4.850**	**6.191**

Investments held by the Council

- The Council maintained an average balance of £9.34 million of internally managed funds.
- Interest of £59,093 was earned on the Council's investments during 2018/19, this compares favourably to the budget of £5,000. (This excludes interest earned on the loan to ECTC.)
- The internally managed funds earned an average rate of return of 0.633%.
- The comparable performance indicator is the average 7-day LIBID rate, which was 0.507%.