Audit, Governance and Standards Committee

24 July 2019

Treasury Management Annual Report 2018-2019

Head of Investment, Risk and Commercial Finance - Resources

Purpose

To inform the Committee of the Council's Treasury Management activities and performance for 2018 -19.

FOR INFORMATION

Key Points

A. The Council's debt management strategy continues to be prudent, whilst maintaining long-term stability of the debt portfolio.

B. The Council's investment objective, to invest prudently and have regard to the security and liquidity of investments before yield was maintained by following the Council's counterparty policy as set out in its Treasury Management Annual Strategy Report for 2018/19.

Context

1. The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM code) requires that authorities report on the performance of the treasury management function at least twice a year (mid-year and at year-end). The Authority's Treasury Management Strategy for 2018/19 was approved by full Council on 27 February 2018, and the mid-year position was reported to the 21 November 2018 meeting of this Committee.

2. The authority has borrowed and 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. This report covers treasury activity and the associated monitoring and control of risk.

3. Although the responsibility for treasury management decisions remains with the Council at all times, Treasury Management is a complex and technical area, therefore we employ treasury management advisors to provide specialist skills and resources.

4. Following a joint procurement exercise carried out by the Sutton and Kingston Shared Finance Service, Link Asset Services were awarded a joint contract for treasury management advice, effective from 1 April 2018.

5. **THE UK ECONOMY and INTEREST RATES** - Investment returns remained low during 2018/19. 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 Bank Rate to rise from 0.50% to 0.75% 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 Monetary Policy

Committee (MPC) would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018.

6. 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.

7. Investment rates were little changed during August to October, but rose sharply, after the MPC meeting of 1 November was unexpectedly hawkish about the Committee's 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.

8. Since Public Works Loan Board (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.

9. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields -which determine PWLB rates. The Federal Reserve central bank (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.

10. However financial markets considered by December 2018, that the Fed had gone too far, and discounted its expectations of further increases. Treasury yields therefore fell sharply during Q1 2019 and gilt yields / PWLB rates also fell.

DEBT MANAGEMENT 2018 -19

11. The Council's specific objective in relation to debt set out in the 2018/19 Treasury Management Annual Strategy Report, was to achieve the lowest level of interest paid on the Council's debt as prudently possible, while at the same time minimising the potential volatility of the average rate of interest.

12. The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 1 April 2018 was £338m. However for 2018/19, the Council's strategy was to maintain an under-borrowed position, as the "cost of carry" (the difference between the cost of new long term debt and the return from the proceeds temporarily held as investments) was significant. As borrowing is often for longer dated periods, the cost of carry needs to be considered against a backdrop of uncertainty and affordability constraints in the Council's wider financial position.

13. **Internal Borrowing** - The Council's internal resources (reserves, balances and cash flow) were therefore used in lieu of external borrowing. By essentially lending its own surplus funds to itself, the Council is able to minimise borrowing costs and reduce overall treasury risk by reducing both external debt and cash investments. Borrowing options and the timing of any

future borrowing in 2019/20 will continue to be assessed in conjunction with the Council's treasury advisor.

14. **Public Works Loan Board (PWLB)** - If required, the PWLB is able to meet all of a local authority's needs for long-term borrowing. The PWLB is prepared to lend to authorities who act prudently and comply with all relevant legislation.

15. By providing advance information on long-term borrowing and associated capital spending plans, local authorities can qualify for borrowing at the 'PWLB Certainty Rate' (0.20% below the PWLB standard rate). The Council has qualified for borrowing at the 'Certainty Rate' for rolling 12 month periods since November 2014 when the Certainty Rate was introduced.

16. **External Debt Position**

Sector	Balance on 31 March 2018	New Debt	Debt Maturing	Balance on 31 March 2019
	£m	£m	£m	£m
PWLB – Long Term[1]	211.69	-	0.77	210.91
Banks – Long Term	61.00	-	-	61.00
Short Term Borrowing[2]	5.00	4.50	8.00	1.50
Other - GLA[3]	20.00	6.62	-	26.62
TOTAL	**297.69**	**11.12**	**8.77**	**300.04**

[1] includes £115.5m borrowed in March 2012 for HRA self-financing settlement
[2] to maintain adequate liquidity - £1.5m repaid April 2018
[3] interest free - provided to facilitate Cambridge Road Estate regeneration

17. During the financial year the average rate of interest paid was 4.00% (£10.9m interest paid).

18. **LOBOs:** The Council holds £46m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which RBK has the option either to accept the new rate or to repay the loan at no additional cost. No options on these loans were exercised by the lender during 2018/19.

19. **Debt Rescheduling:** Treasury Management officers are continuously aware of the need to keep debt servicing costs to a minimum. Officers monitor interest rates in order to identify any opportunities for completing debt restructuring exercises or for premature repayment of debt. Debt restructuring involves early repayment and re-borrowing of loans. This can involve paying a premium or receiving a discount, but is intended to reduce the overall interest burden, since the replacement loans are borrowed at lower interest rates.

20. The premium charge for early repayment of PWLB debt remained relatively expensive for loans in the Council's debt portfolio and therefore unattractive. No debt rescheduling or premature debt repayment was undertaken as a consequence.

INVESTMENT ACTIVITY

21. Investment of the Council's cash balances is governed by Guidance on Local Government Investments issued by CLG. The key intention of the guidance is

that councils invest prudently, and that priority is given first of all to security (protecting the investment from loss), and then liquidity (keeping the money readily available for expenditure when needed) before yield.

22. The guidance requires certain investment policy parameters to be set within the Treasury Management Annual Investment Strategy Report. The Strategy Report sets out the Council's criteria for choosing counterparties and limiting exposure to the risk of loss by setting maximum maturity and monetary exposure limits.

23. **Investment Activity in 2018/19 -** RBK managed significant funds, representing income received in advance plus balances and reserves held. During the year investments totalling £410m were placed, the total sum of maturities was £409m. The amount of deposits outstanding at 31 March 2019 was £35.6m. The Council maintained an average investment balance of £45.3m and earned an average rate of return of 0.82% (£0.37m interest receivable). The movement in the Council's investments during 2018/19 is categorised as follows:

Sector	**Balance 31 Mar 2018**	**Investments Made**	**Investments Repaid**	**Balance 31 Mar 2019**
	£m	**£m**	**£m**	**£m**
Banks (fixed term)	-	5.00	2.50	2.50
Building Socs. (fixed)	-	5.00	5.00	-
Call Accounts	2.49	9.56	3.50	8.55
Local Authorities	-	13.00	3.00	10.00
Money Market Funds	19.00	369.65	388.65	-
Pooled Funds	5.00	-	-	5.00
Sub total	**26.49**	**402.21**	**402.65**	**26.05**
Achieving for Children[1]	6.29	7.65	5.98	7.96
Other[2]	1.50	0.10	-	1.60
TOTAL	**34.28**	**409.96**	**408.63**	**35.61**

[1] As joint owners of AfC Community Interest Company, RBK, the LB Richmond and the RB of Windsor & Maidenhead provide AfC with a revolving credit facility.
[2] Chessington School (formerly Chessington Community College)

24. **Credit and Counterparty Risk Update -** Credit risk arises from deposits with banks and financial institutions. The Council's maximum exposure to credit risk in relation to its investments cannot be assessed generally as the risk of any institution failing to make interest payments or repay the principal sum will be specific to each individual institution. Recent experience has shown that it is rare for such entities to be unable to meet their commitments. A risk of non-recovery applies to all of the Council's deposits, but the Council does not expect any losses from default by any of its counterparties in relation to deposits. The table below summarises the credit risk exposures of the Council's investment portfolio by credit rating (excluding AfC, Chessington School) :

Credit Rating	31 March 2018	30 Sept 2018	31 March 2019
	£m	£m	£m

AAA	19.00	17.17	-
AA+	-	-	-
AA	5.00	-	15.00
AA-	-	-	-
A+	-	-	-
A	2.49	10.51	11.05
A-	-	-	-
BBB+	-	-	-
Unrated	-	-	-
Total (excl AfC/Chessington School)	**26.49**	**27.68**	**26.05**
Value Weighted Avg	AA+	AA	AA-

PERFORMANCE INDICATORS

25. The Council's performance over the year measured against the performance indicators set out in the 2018/19 Treasury Management Annual Strategy Report was as follows:

a) Borrowing – average rate of borrowing compared to average available.

The Council did not draw any new long term loans during the year.

b) Debt – average rate movement year on year.

	2017/18	**2018/19**
Average rate of interest paid	*4.06%*	**4.00%**

c) Investments – returns above the 7 day LIBID rate.

The objective set at the beginning of the financial year for the Council's cash investments, was to achieve an overall return on total deposits above the average 7-day notice London Inter-Bank BID Rate (LIBID). The 7-day LIBID is the set interest rate at which major banks in London are willing to borrow (bid for) funds from each other for different periods. The same rate is commonly used by external cash managers as their benchmark.

The Council's overall return was 0.317% above the target rate (equates to £0.143m).

	Interest Rate	Interest Receivable
RBK	0.824%	£0.373m
Average 7 day LIBID rate	0.507%	£0.230m

ACTIVITY INDICATORS

26. The purpose of the Treasury Management activity indicators shown below is to contain the activity of the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the Council's overall financial position.

27. In measuring a Council's exposure to interest rate changes, CIPFA requires limits to be calculated by combining debt and investments together. These are approved before the start of each year by Budget Council. The tables below show that the Council complied with all the treasury management activity indicators.

28. **Interest Rate Exposures**

	Prudential Limits	Actual at 31 March 2019
	%	%
Upper limit - fixed rates	100	96.1
Upper limit - variable rates	40	3.9

29. **Maturity Structure of fixed borrowing as at 31 March 2019.** The Code of Practice requires the maturity of LOBO loans to be determined by the earliest date on which the lender can require payment (see column 3). LOBO instruments have a fixed initial term (typically one to ten years) and then move to an arrangement whereby the lender can decide at pre-determined intervals to adjust the rate on the loan. At this stage the borrower has the option to repay the loan. However, these loans are expected to continue for much longer due to current market conditions. Column 4 shows the position if the LOBO loans ran to their final maturity date.

Column 1 Duration	Column 2 **Prudential Limits**		Column 3 (Classifies LOBOs at earliest repayment date)	Column 4 (Classifies LOBOs at final maturity date)
	Lower	**Upper**		
Under 12 months	0%	50%	16%	0%
12 months - under 2 years	0%	50%	0%	0%
2 years - under 5 years	0%	50%	2%	2%
5 years - under 10 years	0%	70%	13%	13%
10 years - under 20 years	0%	70%	24%	24%
20 years - under 30 years	0%	70%	9%	18%
30 years - under 40 years	0%	70%	22%	24%
40 years - under 50 years	0%	70%	14%	19%
50 years and above	0%	70%	0%	0%

30. **Maximum principal sums invested >364 days (at year end)**

	LIMIT (£m)	Actual (£m)
12 months to 2 years	50	0
2 to 3 years	50	0
3 years and above	50	0

Timescale

31. As the report is for Members' information, there is no particular timescale for action arising out of it. However, it is good practice for the Committee to review the annual report after the end of the financial year as soon as possible, but before the end of September.

Resource Implications

32. As the report is for Members' information, there are no resource implications arising out of it. However, proper management of the Council's borrowing and investment position in accordance with the approved Treasury Management Strategy contributes significantly to the financial stability of the Council's budget position.

Legal Implications

33. As the report is for Members' information, there are no legal implications arising out of it.

Risk Assessment

34. The effective identification and management of risk are central to the Council's treasury management strategy. Credit and counterparty risk are covered in paragraph 28.

Equalities Impact Assessment

35. As the report is for Members' information, an EQIA is not needed.

Environmental Implications

36. None arising directly from this report.

Background papers – None other than those referred to in this report

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