Appendix 3

Gravesham Borough Council

Report to:	Finance and Audit Committee
Date:	11 June 2019
Reporting officer:	Director (Corporate Services)
Subject:	Annual Treasury Management Review 2018-19

Purpose and summary of report:

To report on treasury management acitivity during 2018-19 in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA's) revised code on Treasury Management (2017).

Recommendations:

1. The Finance and Audit Committee note the contents of this report.
2. The Finance and Audit Committee recommends to the Full Council that:
   1) The revised authorised limits and operational boundary figures, as set out in this report are agreed.

1. INTRODUCTION

1.1 The 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).

1.2 In accordance with reporting requirements for each financial year, Full Council received the following reports for 2018-19:

- an annual treasury strategy in advance of the year (Council 6 March 2018)
- a mid-year (minimum) treasury update report (Council 18 December 2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report, which will be received by Council on 25 June 2019 through consideration of the Minutes of this meeting of the Finance & Audit Committee).

1.3 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.

1.4 The report also provides confirmation that the Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Finance and Audit Committee before they were reported to the Full Council.

2. THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING

2.1 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.

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2017/18 Actual £m	2018/19 Revised Budget £m*[1]	2018/19 Actual £m*[1]
Capital Expenditure - GF	4.400	17.721	13.351
Capital Expenditure - HRA	12.657	13.383	10.783
Capital Expenditure – GF Housing	0.695	1.515	0.821
Total Capital Expenditure	17.752	32.619	24.955
Financed in Year	15.571	19.267	12.520
Unfinanced Capital Expenditure	2.181	13.352	12.435

*[1] based on the Provisional Outturn Report 2018/19

3. THE COUNCIL'S OVERALL BORROWING NEED

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

3.2 **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. The table below highlights the Council's gross borrowing position (external debt plus finance lease) against the CFR. The Council has complied with this prudential indicator.

	31 March 2018 Actual £m	31 March 2019 Revised Budget £m*2	31 March 2019 Actual £m*2
CFR General Fund (£m)	20.167	126.725	125.808
CFR HRA (£m)	88.665	84.564	84.564
Total CFR	108.832	211.289	210.372
Gross Borrowing Position	98.093	187.537	187.537
Under / over funding of CFR	10.739	23.752	22.835

*2 based on the Provisional Outturn Report 2018/19

3.3 There has been a significant increase in the CFR during 2018/19. This is as a result of entering into the agreement with Reef to redevelop the St George's Shopping Centre. The agreement is a finance lease which has resulted in an increase in the CFR at the end of 2018/19 of £93.63m. This will be reduced over a 50 year period through an MRP charge (Minimum Revenue Provision charge - statutory annual minimum revenue charge to reduce the total outstanding CFR).

3.4 **The authorised limit** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. This effectively relates to the setting of a maximum sum pertaining to debt financing, consisting of external borrowing and any long term liabilities of the council. Once this has been set, the Council does not have the power to borrow above this level. The authorised limit can be amended with Full Council approval.

3.5 **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. The operational boundary limit can be amended with Full Council approval.

3.6 The original authorised limit and operational boundary for 2018/19 and future years were set prior to the agreement made with Reef Estates for the redevelopment of the St George's Shopping Centre. The authorised limit and operational boundary therefore did not reflect the impact of this agreement. Once the agreement was put in place, both the authorised limit and the operational boundary for 2018/19 and future years should have been increased to reflect the impact of the deal, however this was not the case. Therefore it is necessary to seek retrospective approval to amend the authorised limit and operational boundary for 2018/19 and future years.

3.7 The revised authorised limits and operational boundary figures against those agreed by the Finance and Audit Committee in February 2019 are detailed in the table below.

Authorised Limit	**2018/19 Revised £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Previously agreed Authorised Limit				
Debt (including HRA Settlement)	117.700	124.100	124.900	122.600
Other Long Term Liabilities	1.600	1.600	1.600	1.600
Commercial activities / non-financial investments	20.000	35.000	35.000	35.000
Total	**139.300**	**160.700**	**161.500**	**159.200**
Revised Authorised Limit				
Debt (including HRA Settlement)	117.700	124.100	124.900	122.600
Other Long Term Liabilities	98.000	97.800	97.600	97.320
Commercial activities / non-financial investments	20.000	35.000	35.000	35.000
Total	**235.700**	**256.900**	**257.500**	**254.920**

Operational Boundary	**2018/19 Revised £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Previously agreed Operational Boundary				
Debt (including HRA Settlement)	116.200	122.600	123.400	121.100
Other Long Term Liabilities	1.500	1.500	1.500	1.500
Commercial activities / non-financial investments	15.000	30.000	30.000	30.000
Total	**132.700**	**154.100**	**154.900**	**152.600**
Revised Operational Boundary				
Debt (including HRA Settlement)	117.700	124.100	124.900	122.600
Other Long Term Liabilities	96.500	96.300	96.100	95.820
Commercial activities / non-financial investments	20.000	30.000	30.000	30.000
Total	**234.200**	**250.400**	**251.000**	**248.420**

3.8 **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 (revised)	235.700
Maximum gross boundary position during the year	192.454
Operational boundary (revised)	222.700
Average gross borrowing position	199.770
Financing costs as a proportion of net revenue stream	20.39%

4. TREASURY POSITION AS AT 31 MARCH 2019

4.1 The Council's treasury position (excluding the St George's Shopping Centre finance lease) at the beginning and the end of 2018-19 was as follows:

	31 March 2018 Principal £m	Rate/ Return	31 March 2019 Principal £m	Rate/ Return	Average Life yrs
PWLB Loans	90.082		85.900		
Stock Loans	8.000		8.000		
Short Term Loans	0.011		0.012		
Total Debt	**98.093**	**3.17%**	**93.912**	**3.23%**	**5.79**
Capital Financing Requirement (CFR)	108.832	-	116.746	-	-
Over/ (Under) borrowing	(10.739)	-	(22.834)	-	-
Total Investments	**31.100**	**-**	**46.229**	**-**	**-**
Net Debt (Total Debt minus Total Investments)	66.993	-	47.683	-	-

4.2 The maturity structure of the debt portfolio was as follows:

	31 March 2018 Actual £m	31 March 2018 Actual %	2018/19 original limits %	31 March 2019 Actual £m	March 2019 Actual %
Under 12 months	4.193	4.27	50	4.831	5.14
12 to 24 months	4.819	4.91	50	13.418	14.29
24 months to 5 years	28.363	28.91	75	23.315	24.83
5 to 10 years	49.554	50.53	75	52.348	55.74
More than 10 years	11.164	11.38	100	0.000	0.00

Investment Portfolio	Actual 31 March 2018 £m	Actual 31 March 2018 %	Actual 31 March 2019 £m	Actual 31 March 2019 %
Treasury Investments				
Fixed Term Investments	3.000	9.65	8.000	17.31
Certificate of Deposits	7.450	23.95	9.000	19.47
Notice Accounts	0.000	0.00	5.000	10.82
Money Market Funds	0.569	1.83	4.296	9.29
Total managed in house	**11.019**	**-**	**26.296**	**-**
Property Funds	9.746	31.34	10.543	22.81
Multi Asset Funds	10.335	33.23	9.390	20.30
Total managed externally	**20.081**	**-**	**19.933**	**-**
Total Treasury Investments	**31.100**	**100.00**	**46.229**	**100.00**

4.3 All internally managed investments were for up to one year.

5. THE INVESTMENT STRATEGY AND CONTROL OF INTEREST RATE RISK FOR 2018/19

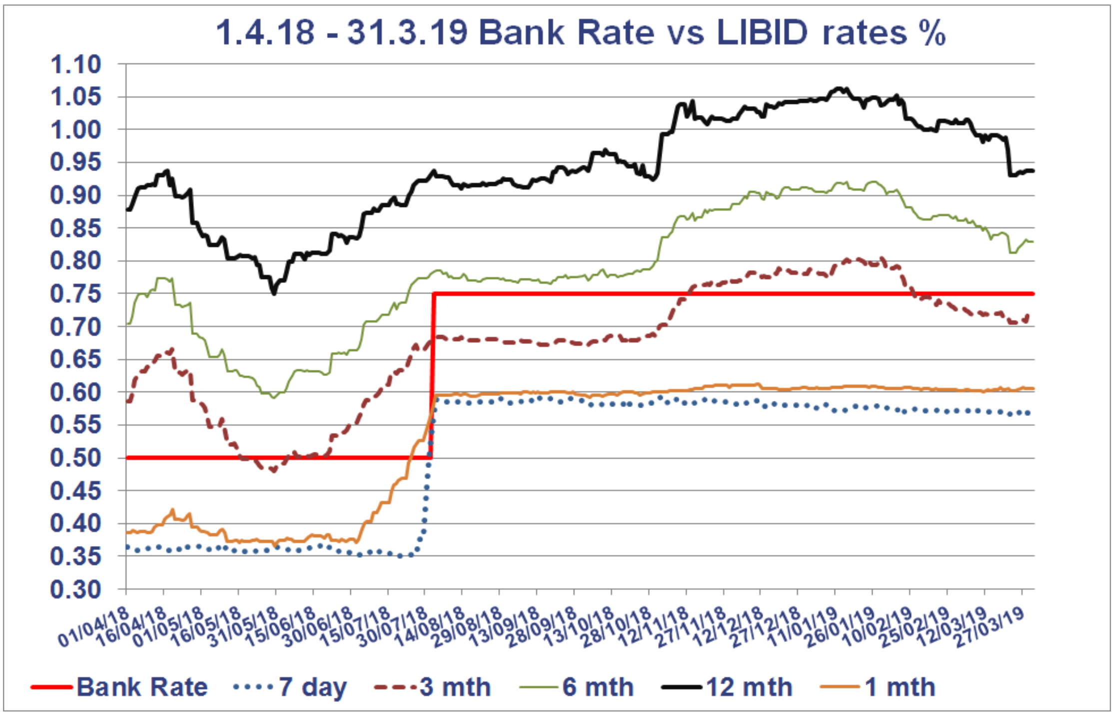
5.1 Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, 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 which happened at the MPC meeting on 2 August 2018. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

5.2 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. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

5.3 Investment rose sharply after the MPC meeting of 1 November, however, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

5.4 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.

5.5 The graph below shows the London Interbank Bid Rate (LIBID - the rate at which banks borrow from one another) against the Bank of England Base Rate for 2018/19.



6. BORROWING STRATEGY AND CONTROL OF INTEREST RATE RISK RATES IN 2018-19

6.1 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.

6.2 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

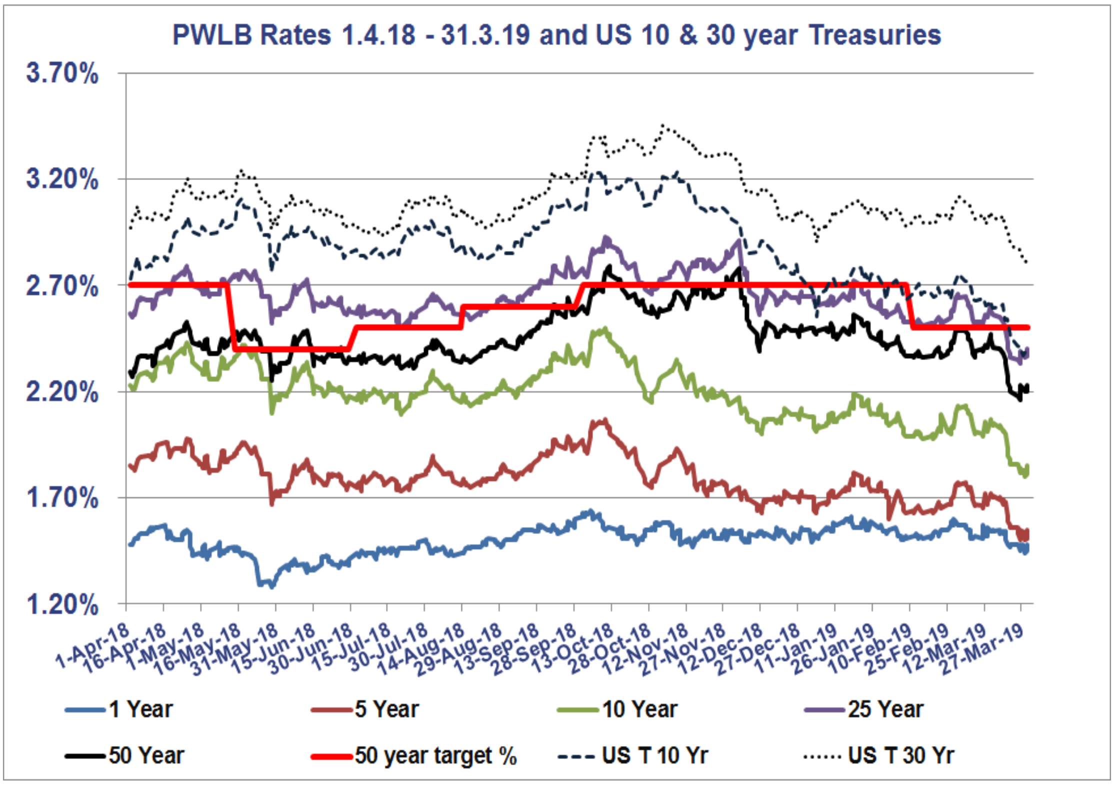
6.3 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

6.4 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Corporate Services therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles 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%



6.5 Public Works Loan Board (PWLB - part of HM Treasury which provides loans to local authorities to finance capital expenditure) 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.

7. BORROWING OUTTURN FOR 2018-19

7.1 No external borrowing was undertaken during 2018-19.

7.2 No rescheduling of debts was carried out during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7.3 On 28 March 2019, a further loan the Council had taken on as a result of HRA self-financing matured. Loan principal totalling £4,101,000 was repaid. The Council has made a voluntary contribution of Minimum Revenue Provision (MRP) equal to the loan principal in order to reduce the CFR accordingly.

8. INVESTMENT OUTTURN FOR 2018-19

8.1 **Investment Policy** - the Council's investment policy is governed by Ministry of Housing, Communities & Local Government (MHCLG) investment guidance, which has been implemented in the annual investment strategy approved by the Council on 6 March 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.).

8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

8.3 **Investments held by the Council** – the Council maintained an average balance of £32.067m of internally managed funds during the year. The internally managed funds earned an average rate of return of 0.760%. The 3 month LIBID rate which is used as the most appropriate comparative performance indicator was 0.676%. Despite the continued low investment yields offered by financial markets, the average rate of return exceeded by 0.084%.

8.4 **Property Funds** – As at 31 March 2019 the Council achieved an average income rate of return on its investments and capital growth as follows:

Property Funds	Average Income Return %	Capital Growth %
Lothbury	4.07	0.31
Hermes	3.50	3.82
CCLA	4.94	1.59
Total	4.05	1.68

8.5 **Multi-Asset Funds** – As at 31 March 2019 the Council achieved an estimated average income rate of return on its investments and capital loss as follows:

Multi Asset Funds	Average Income Return %	Capital (Loss) %
JP Morgan	3.35	(3.01)
Jupiter	5.26	(8.73)
Aberdeen	5.23	(6.22)
Total	4.28	(5.37)

8.6 The Multi Asset funds continue to be a volatile and the loss experienced as at 31 March 2019 reflects the fall in the value of equities over the past few months. It is important to remember that these are long term investments, the value of which can go up as well as down. Since the 31 March 2019, the value of these investments has increased but officers continue to monitor the position carefully.

8.7 **Property Acquisitions** – The purchase of commercial properties and land acquisition is not deemed a Treasury Management investment but a Service Investment. However there is a direct impact upon Treasury Management on the basis that any such purchase reduces the level of investable cash balances. Treasury officers will continue to liaise closely with Legal and Property to ensure that cash is available at the appropriate time to facilitate the further purchase of commercial properties and land as set out in the 2019/20 Capital Programme.

8.8 **MiFID II –** On 3 January 2018 new EU legislation came into force that impacted upon the Council's treasury management activity. MiFID II (Markets in Financial Instruments Directive) was aimed at increasing investor protection by creating a more efficient, risk-aware and transparent market for investment services and activities. This legislation required the FCA to treat all local authorities as Retail Clients but did allow local authorities to opt up to an Elective Professional Client status if they met certain pre-determined criteria. The Council was not obliged to opt up but by not doing so could have precluded the Council from dealing with certain institutions or funds. The Council opted up to Elective Professional Client status with all the institutions that required it to do so and has ensured that during 2018/19 it has continued to comply with the requirements of the institutions to maintain Elective Professional Client status.

9. BACKGROUND PAPERS

9.1 There are no Background Papers pertaining to this Report.

Prudential and treasury indicators Appendix A

1. PRUDENTIAL INDICATORS	2017-18	2018-19	2018-19
	Actual	**Revised**	**Actual**
	£m	**£m**	**£m**
Capital Expenditure			
Non - HRA	£5,095	£19.236	£14.172
HRA	£12,657	£13,383	£10.783
TOTAL	£17,752	£32.619	£24.955
Ratio of financing costs to net revenue stream (This is the proportion of annual debt financing costs as a percentage of the council's annual budget requirement)			
Non - HRA	3.67%		6.42%
HRA	23.43%		26.07%
Gross borrowing requirement (inc finance lease)			
brought forward 1 April	£101.677	£98.082	£98.093
carried forward 31 March	£98.093	£93.912	£187.537
in year borrowing requirement	(£3.584)	(£4.170)	£89.444
Gross Debt	£98.093	£93.912	£187.537
Capital Financing Requirement (CFR) as at 31 March (This is the amount of capital spending that has not been financed by capital receipts, capital grants of contributions from revenue)			
Non – HRA	£20.167	£126.725	£125.808
HRA (applies only to housing authorities)	£88.665	£84.564	£84.564
TOTAL	£108.832	£211.289	£210.372
Annual change in Cap. Financing Requirement			
Non – HRA	(£0.208)	£106.558	£105.641
HRA (applies only to housing authorities)	(£3.504)	(£4.101)	(£4.101)
TOTAL	(£3.712)	£102.457	£101.540
Incremental impact of capital investment decisions	**£ p**		**£ p**
Increase in council tax (band D) per annum *	£8.62		£9.67
Increase in average housing rent per week	N/A		N/A

2. TREASURY MANAGEMENT INDICATORS	2017/18	2018/19	2018/19
	Actual	Revised	Actual
	£'000	£'000	£'000
Authorised Limit for external debt (This is the maximum amount of borrowing which the council is permitted to undertake on a temporary basis to manage cash flow demands)			
borrowing	£126,500	£137.700	£137.700
other long term liabilities	£1,600	£1,600	£98.000
TOTAL	£128,100	£139.300	£235.700
Operational Boundary for external debt (This is the maximum amount of borrowing which the council is permitted to undertake on a day to day basis and must not be breached other than for temporary cash flow demand purposes)			
borrowing	£125,000	£131.200	£126.200
other long term liabilities	£1,500	£1,500	£96.500
TOTAL	£126,500	£132.700	£222.700
Actual external debt	£98.093	£93.912	£93.912
Upper limit for fixed interest rate exposure			
Net interest re fixed rate borrowing / investments	100 %	100 %	100 %
Upper limit for variable rate exposure			
Net interest re variable rate borrowing / investments	25 %	25 %	25 %
Upper limit for total principal sums invested for over 364 days	£10,000	£10,000	£10,000

Maturity structure of fixed rate borrowing during 2017/18	Lower limit	Upper limit
under 12 months	0%	50%
12 months and within 24 months	0%	50%
24 months and within 5 years	0%	75%
5 years and within 10 years	0%	75%
10 years and within 15 years	0%	100%
15 years and within 20 years	0%	100%
Greater than 20 years	0%	100%

Note: The figures shown in the tables above reflect the position as at the date of reporting. They are subject to change during the final accounts process.

IMPLICATIONS	APPENDIX 1
Legal	AS PER SECTION 1.13B.67 OF THE COUNCIL'S CONSTITUTION, THE CHIEF FINANCE OFFICER HAS DELEGATED RESPONSIBILITY FROM CABINET. "in respect of borrowing and investments to arrange such loans as are legally permitted to meet the Council's borrowing requirements"
Finance and Value for Money	A SUMMARY OF THE PERCEIVED RISKS ASSOCIATED WITH TREASURY MANAGEMENT WERE IDENTIFIED IN THE TREASURY MANAGEMENT STRATEGY APPROVED BY COUNCIL ON 6 MARCH 2018. OFFICERS CONTINUE TO MONITOR THE RISKS ON A DAY TO DAY BASIS AND IDENTIFY MITIGATING ACTIONS TO MINIMISE RISKS. IN ORDER TO ACHIEVE A BALANCED BUDGET, THE AUTHORITY RELIES UPON GENERATING MAXIMUM INTEREST FROM ITS INVESTMENTS WHILST MINIMISING THE EXPOSURE TO RISK. IN ORDER TO ACHIEVE THIS, INVESTMENTS ARE ONLY PLACED WITH INSTITUTIONS WHICH MEET THE CRITERIA SET OUT WITHIN THIS REPORT. INVESTMENT DURATIONS DO NOT EXCEED THOSE AS ADVISED BY CAPITA ASSET SERVICES CREDIT RATINGS WHICH ARE ASSOCIATED WITH THE SPECIFIC INSTITUTIONS. WHERE THE AUTHORITY IS REQUIRED TO BORROW TO MEET THE NEEDS OF THE AUTHORITY, OFFICERS WILL SEEK ADVICE FROM CAPITA ASSET SERVICES ON TIMINGS AND OPTIONS IN ORDER TO ENSURE THE BEST DEAL FOR THE AUTHORITY.
Risk Assessment	The risks associated with Treasury Management and capital expenditure are detailed within this report.
Data Protection Impact Assessment	*A data protection impact assessment (DPIA) should be carried out at the start of any major project involving the use of personal data or if you are making a significant change to an existing process.*
	a. Does the project/change being recommended through this paper involve the processing of personal data or special category data or criminal offence data? A definition of each type of data can be found on the Information Commissioner's Office website via the above links. N/A
	b. If yes to question a, have you completed and attached a DPIA including Data Protection Officer advice? N/A
	c. If no to question b, please seek advice from your nominated DPIA assessor or the Information Governance Team at gdpr@medway.gov.uk. N/A

<table>
<tr><td rowspan="3">Equality Impact Assessment</td><td>a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community? If yes, please explain answer.
N/A</td></tr>
<tr><td>b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality? If yes, please explain answer.
N/A</td></tr>
<tr><td>In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above</td></tr>
<tr><td>Corporate Plan</td><td>Strategic Objective 4 - Sound & self-sufficient council.</td></tr>
<tr><td>Crime and Disorder</td><td>TREASURY MANAGEMENT ACTIVITIES ARE CARRIED OUT IN ACCORDANCE WITH THE TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY WHICH MINIMISES THE RISK OF CRIMINAL ACTIVITIES. THE ARRANGEMENTS TO ENSURE APPROPRIATE GOVERNANCE AROUND CAPITAL EXPENDITURE ARE SET OUT IN THE CAPITAL STRATEGY.</td></tr>
<tr><td>Digital and website implications</td><td>N/A</td></tr>
<tr><td>Safeguarding children and vulnerable adults</td><td>N/A</td></tr>
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