

**CABINET**

**15 AUGUST 2019**

**COUNCIL**

**10 SEPTEMBER 2019**

**REPORT OF THE PORTFOLIO HOLDER FOR ASSETS AND FINANCE**

**ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL  
PRUDENTIAL INDICATORS 2018/19**

**PURPOSE**

The Annual Treasury report is a requirement of the Council's reporting procedures. It covers the Treasury activity for 2018/19, and the actual Prudential Indicators for 2018/19.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes in accordance with Regulations issued under the Local Government Act 2003. It also provides an opportunity to review the approved Treasury Management Strategy for the current year and enables Members to consider and approve any issues identified that require amendment.

**RECOMMENDATIONS**

**That Cabinet ask Council to;**

- 1. Approve the actual 2018/19 Prudential and Treasury Indicators within the report and shown at Appendix 1; and**
- 2. Accept the Annual Treasury Management Report for 2018/19.**

**EXECUTIVE SUMMARY**

This report covers Treasury operations for the year ended 31<sup>st</sup> March 2019 and summarises:

- the Council's Treasury position as at 31<sup>st</sup> March 2019; and
- Performance Measurement

The key points raised for 2018/19 are

1. The Council's Capital Expenditure and Financing 2018/19
2. The Council's Overall Borrowing Need
3. Treasury Position as at 31<sup>st</sup> March 2019
4. The Strategy for 2018/19
5. Borrowing Outturn for 2018/19

6. Investment Outturn for 2018/19
7. Performance Measurement
8. The Economy and Interest Rates
9. Other Issues

The Treasury Function has achieved the following favourable results:

- The Council has complied with the professional codes, statutes and guidance;
- There are no issues to report regarding non-compliance with the approved prudential indicators;
- The Council maintained an average investment balance externally invested of £66.3m and achieved an average return of 0.82% (budgeted at £54.2m and an average return of 0.50%).
- This result compares favourably with the Council's own Benchmarks of the average 7 day and the 3 month LIBID rates for 2018/19 of 0.50% and 0.68%;
- The closing weighted average internal rate on borrowing is 4.05% (4.05% for 2017/18);
- The Treasury Management Function has achieved an outturn investment income of £547k compared to a budget of £176k as a result of both investment balances and average interest rates being higher than budgeted.
- We also received an additional £108k in dividends from our property fund investments, due to investment being made earlier than budgeted. The net value of the investments had fallen by £49k as at 31<sup>st</sup> March 2019 after entry fees of £77k.

During 2018/19 the Council complied with its legislative and regulatory requirements.

The Executive Director Finance confirms that there was no overall increase in borrowing within the year and the Authorised Limit was not breached.

At 31<sup>st</sup> March 2019, the Council's external debt was £63.060m (£63.060m at 31<sup>st</sup> March 2018) and its external investments totalled £64.92m (£60.77m at 31<sup>st</sup> March 2018) – including interest credited but excluding impaired investments.

## **RESOURCE IMPLICATIONS**

There are no financial implications or staffing implications arising directly from the report.

## **LEGAL/RISK IMPLICATIONS**

The Council is aware of the risks of passive management of the Treasury Portfolio and with the support of Link Asset Services, the Council's current Treasury advisers, has proactively managed its debt and investments during the year.

## **SUSTAINABILITY IMPLICATIONS**

None

## **REPORT AUTHOR**

If Members would like further information or clarification prior to the meeting please contact Stefan Garner, telephone 01827 709242 or email [stefan-garner@tamworth.gov.uk](mailto:stefan-garner@tamworth.gov.uk)

## **LIST OF BACKGROUND PAPERS**

- Local Government Act 2003;
- Statutory Instruments: 2003 No 3146 & 2007 No 573;
- CIPFA Code of Practice on Treasury Management in Public Services;
- Treasury Management Strategy 2018/19 (Council 27<sup>th</sup> February 2018);
- Treasury Management Mid-Year Review 2018/19 (Council 11<sup>th</sup> December 2018);
- Treasury Outturn Report 2017/18 (Council 11<sup>th</sup> September 2018);
- CIPFA Treasury Benchmarking Club Report 2018;
- Treasury Management Strategy 2017/18 (Council 21<sup>st</sup> February 2017).

## **APPENDICES**

**Appendix 1 – Prudential and Treasury Indicators**

**Appendix 2 – Borrowing and Investment Rates**

## Annual Treasury Management Review 2018/19

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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 complied with:

- an annual treasury strategy in advance of the year (Council 27<sup>th</sup> February 2018)
- a mid-year (minimum) treasury update report (Council 11<sup>th</sup> December 2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Cabinet has received quarterly Treasury management updates as part of the Financial Healthcheck Reports.

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 provide scrutiny of all of the above Treasury Management Reports to the Audit and Governance Committee. Member training on Treasury Management issues was provided in February 2018, and will be provided as and when required in order to support members' scrutiny role.

During 2018/19, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows.

Prudential & Treasury Indicators	2017/18 Actual £m	2018/19 Estimate £m	2018/19 Actual £m
Capital Expenditure			
Non HRA	1.545	12.932	<b>10.515</b>
HRA	7.655	30.396	<b>9.266</b>
<b>Total</b>	9.200	43.328	<b>19.781</b>
Capital Financing Requirement			
Non HRA	0.885	2.547	<b>0.828</b>
HRA	68.041	75.255	<b>68.041</b>
<b>Total</b>	68.926	77.802	<b>68.869</b>
Gross Borrowing			
External Debt	63.060	63.060	<b>63.060</b>
Investments			
Longer than 1 year	-	-	<b>3.820</b>
Less than 1 year	60.805	54.198	<b>64.941</b>
<b>Total</b>	60.805	54.198	<b>68.761</b>
<b>Net Borrowing</b>	2.255	8.862	<b>(5.701)</b>

It should be noted that **£40.283m** of Capital scheme spend has been re-profiled into 2019/20 (also including re-profiling from previous years) which has increased investment balances.

The Executive Director Finance confirms that there was no overall increase in borrowing in year and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2018/19 continued the challenging investment environment of previous years, namely low investment returns.

### 1. The Council's Capital Expenditure and Financing 2018/19

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 internal funds, the capital expenditure would 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.

General Fund	2017/18 Actual £m	2018/19 Estimate £m	2018/19 Actual £m
Capital Expenditure	1.545	12.932	<b>10.515</b>
Financed in year	1.545	11.166	<b>10.515</b>
<b>Unfinanced capital expenditure</b>	-	1.766	-
HRA	2017/18 Actual £m	2018/19 Estimate £m	2018/19 Actual £m
Capital Expenditure	7.655	30.396	<b>9.266</b>
Financed in year	7.655	23.182	<b>9.266</b>
<b>Unfinanced capital expenditure</b>	-	7.214	-

## 2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2018/19 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWL] or the money markets), or utilising temporary cash resources within the Council.

**Reducing the CFR** – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

the application of additional capital financing resources (such as unapplied capital receipts); or

charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2018/19 MRP Policy (as required by MHCLG Guidance) was approved as part of the Treasury Management Strategy Report for 2018/19 on 27th February 2018.

The Council's CFR for General Fund and the HRA for the year are shown below, and represent a key prudential indicator.

CFR: General Fund	31st March 2018 Actual £m	31st March 2019 Budget £m	31st March 2019 Actual £m
Opening balance	0.943	0.885	<b>0.885</b>
Add unfinanced capital expenditure (as above)	-	1.766	-
Less MRP/VRP	(0.058)	(0.104)	<b>(0.057)</b>
Less PFI & finance lease repayments	-	-	-
<b>Closing balance</b>	0.885	2.547	<b>0.828</b>

CFR: HRA	31st March 2018 Actual £m	31st March 2019 Budget £m	31st March 2019 Actual £m
Opening balance	68.041	68.041	<b>68.041</b>
Add unfinanced capital expenditure (as above)	-	7.214	-
Less MRP/VRP	-	-	-
Less PFI & finance lease repayments	-	-	-
<b>Closing balance</b>	68.041	75.255	<b>68.041</b>

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

**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.

Gross borrowing and the CFR	31st March 2018 Actual £m	31st March 2019 Budget £m	31st March 2019 Actual £m
Gross borrowing position	63.060	63.060	63.060
CFR	68.926	77.802	68.869

**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.

Borrowing Limits	GF £m	HRA £m	Total £m
Authorised limit	5.547	79.407	84.954
Maximum gross borrowing position	-	63.060	63.060
Operational boundary	-	63.060	63.060
Average gross borrowing position	-	63.060	63.060
Budgeted financing costs as a proportion of net revenue stream %	(2.55)	39.71	37.16
Actual financing costs as a proportion of net revenue stream %	(6.16)	29.17	23.02

### 3. Treasury Position as at 31<sup>st</sup> March 2019

The Council’s debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council’s Treasury Management Practices. At the beginning and the end of 2018/19 the Council’s treasury (excluding borrowing by finance leases) position was as follows:

General Fund	31st March 2018 Principal £m	Rate/ Return %	Average Life yrs	31st March 2019 Principal £m	Rate/ Return %	Average Life yrs
<b>Total debt</b>	-	-	-	-	-	-
<b>CFR</b>	<b>0.885</b>	-	-	<b>0.828</b>	-	-
<b>Over / (under) borrowing</b>	<b>(0.885)</b>	-	-	<b>(0.828)</b>	-	-
Investments:						
- in house	32.334	0.54	-	36.209	0.82	-
<b>Total investments</b>	<b>32.334</b>	<b>0.54</b>	-	<b>36.209</b>	<b>0.82</b>	-

HRA	31st March 2018 Principal £m	Rate/ Return %	Average Life yrs	31st March 2019 Principal £m	Rate/ Return %	Average Life yrs
Fixed rate funding:						
-PWLB	63.060	4.05	36.74	63.060	4.05	35.74
<b>Total debt</b>	<b>63.060</b>	<b>4.05</b>	<b>36.74</b>	<b>63.060</b>	<b>4.05</b>	<b>35.74</b>
<b>CFR</b>	<b>68.041</b>	-	-	<b>68.041</b>	-	-
<b>Over / (under) borrowing</b>	<b>(4.981)</b>	-	-	<b>(4.981)</b>	-	-
Investments:						
- in house	28.471	0.54	-	28.732	0.82	-
<b>Total investments</b>	<b>28.471</b>	<b>0.540</b>	-	<b>28.732</b>	<b>0.82</b>	-

## Maturity Structures

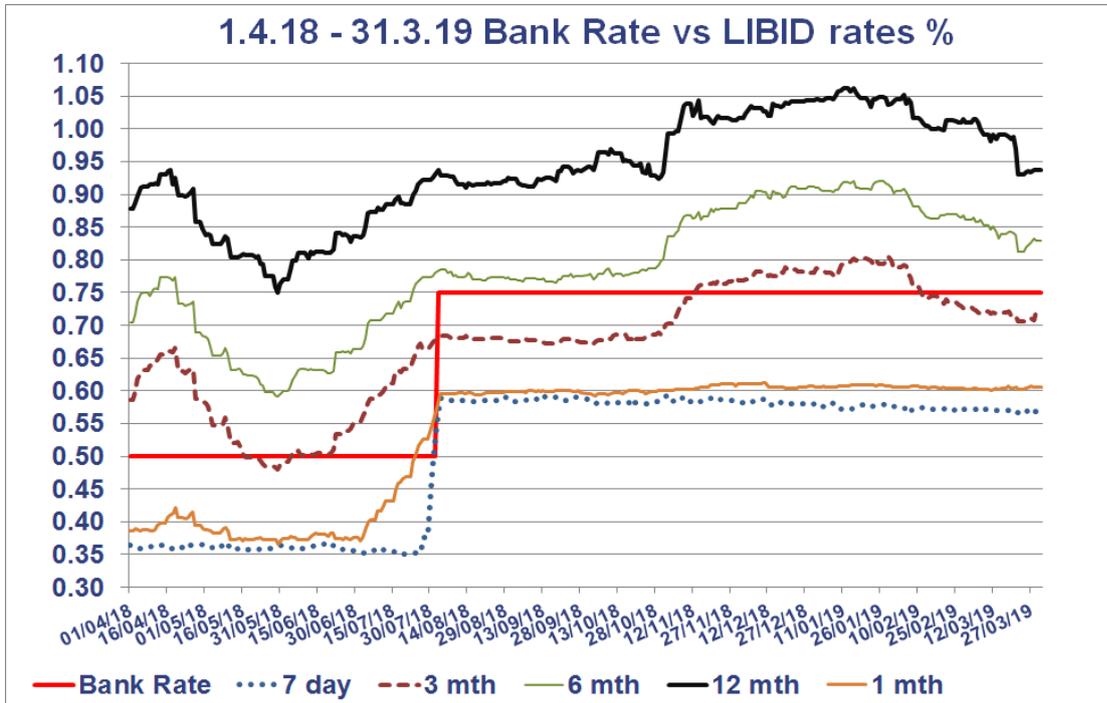
The maturity structure of the debt portfolio was as follows:

Duration	31st March 2018 Actual £m	2018/19 original limits %	31st March 2019 Actual £m
Under 12 months	-	20	-
12 months and within 24 months	-	20	-
24 months and within 5 years	-	25	-
5 years and within 10 years	-	75	-
10 years and within 20 years	5	100	<b>5</b>
20 years and within 30 years	-		-
30 years and within 40 years	30		<b>39</b>
40 years and within 50 years	28		<b>19</b>

All investments held by the Council were invested for up to one year, with the exception of £3.8m invested in property funds, which are held for the longer-term, 5 – 10 years.

#### 4. The Strategy for 2018/19

##### 4.1 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 2nd August 2018. During this period, investment decisions were influenced by anticipation that rates would be higher later in the year.

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 where cash balances were sufficient to allow this.

Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1st 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.

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.

## **4.2 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.

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 and incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

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 the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Executive Director Finance 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 sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
- 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.

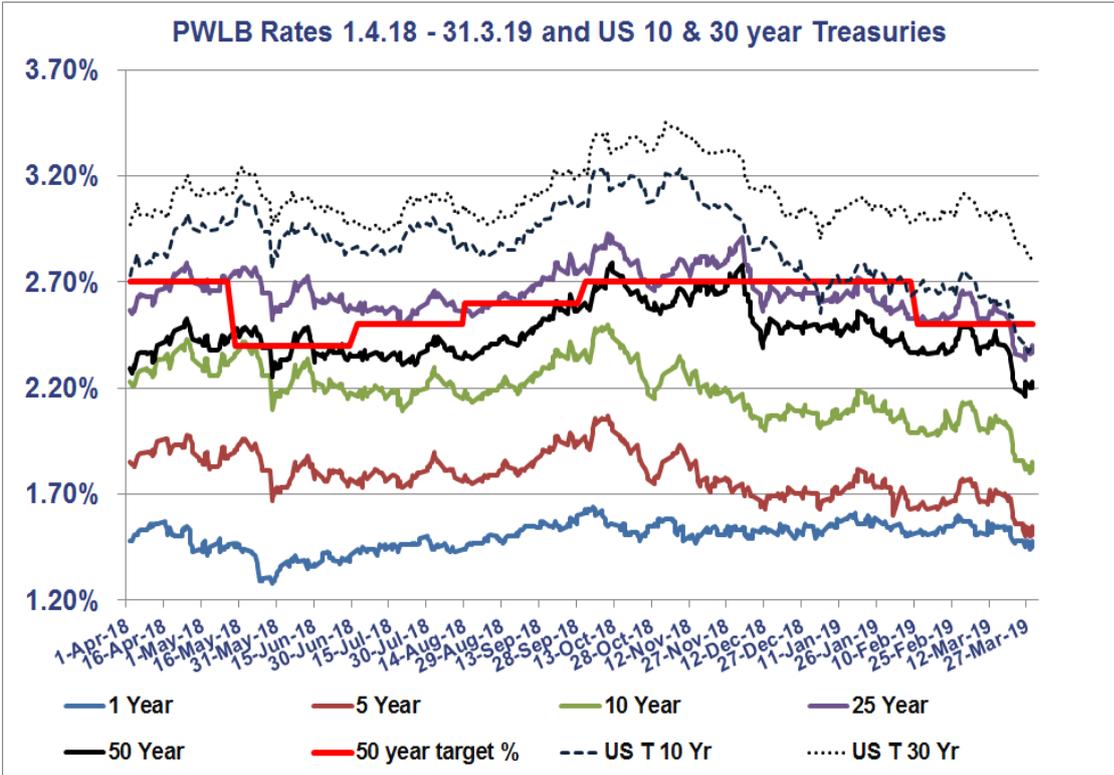
Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

### **PWLB Borrowing Rates**

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.

The graph and tables for PWLB rates below and in Appendix 2 show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



**5. Borrowing Outturn for 2018/19**

**Treasury Borrowing**

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

**Borrowing in Advance of Need**

The Council has not borrowed more than, or in advance of, its needs, purely in order to profit from the investment of the extra sums borrowed.

**Rescheduling**

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

**6. Investment Outturn for 2018/19**

**Investment Policy** – the Council’s investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 27th 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 cash flow monies. The Council’s core cash resources comprised the following:

Balance Sheet Resources General Fund	31 <sup>st</sup> March 2018 £m	31 <sup>st</sup> March 2019 £m
Balances	6.918	<b>6.113</b>
Earmarked Reserves	5.888	<b>7.951</b>
Provisions	1.545	<b>1.815</b>
Usable Capital Receipts	17.001	<b>17.656</b>
Capital Grants Unapplied	0.048	<b>0.048</b>
<b>Total GF</b>	<b>31.400</b>	<b>33.583</b>

Balance Sheet Resources HRA	31 <sup>st</sup> March 2018 £m	31 <sup>st</sup> March 2019 £m
Balances	6.824	<b>4.485</b>
Earmarked Reserves	15.572	<b>16.460</b>
Provisions	-	-
Usable Capital Receipts	5.252	<b>5.704</b>
<b>Total HRA</b>	<b>27.648</b>	<b>26.649</b>

<b>Total Authority Resources</b>	<b>59.048</b>	<b>60.232</b>
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**Investments held by the Council** – the Council maintained an average balance of £66.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.82%. The comparable performance indicator is the average 7-day LIBID rate which was 0.50%. This compared with a budget assumption of £54.2m investment balances earning an average rate of 0.50%.

## 7. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table in section 3). The Council’s performance indicators were set out in the Annual Treasury Management Strategy Statement.

This service has set the following local performance indicator:

➤ *Average external interest receivable in excess of 3 month LIBID rate;*

Whilst the assumed benchmark for local authorities is the 7 day LIBID rate, a higher target is set for internal performance.

The actual return of 0.82% compared to the average 3 month LIBID of 0.68% (0.14% above target).

## **CIPFA Benchmarking Club**

The Council is a member of the CIPFA Treasury Management Benchmarking Club which is a means to assess our performance for the year against other members.

## **8. The Economy and Interest Rates**

**UK.** 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 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% y/y 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, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in **wage inflation** which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

As for **CPI inflation** itself, this 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%.

The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.5%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in **household spending power** is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

**Brexit.** The Conservative minority government has so far been unable to muster a majority in the Commons over its Brexit deal. Currently there is a deadline of 31<sup>st</sup> October 2019 for the UK to leave the EU, however uncertainty remains around whether it is feasible for a new deal to be agreed with the EU, and approved by Parliament by the deadline, or whether the UK leaves without a deal, a course of action to which Parliament is unlikely to agree. If there is no majority for any form of Brexit in Parliament, this would increase the chances of a general election, which could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

**USA.** President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the strong rate of growth; this rose from 2.2%, (annualised rate) in quarter 1 of 2018 to 4.2% in quarter 2, 3.5% in quarter 3 and then back to 2.2% in quarter 4. The annual rate came in at 2.9% for 2018, just below President Trump's aim for 3% growth. The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.4% in February, a decade high point. However, CPI inflation overall fell to 1.5% in February, a two and a half year low, and looks to be likely to stay around that number in 2019 i.e. below the Fed's target of 2%. The Fed increased rates another 0.25% in December to between 2.25% and 2.50%, this being the fourth increase in 2018 and the ninth in the upward swing cycle. However, the Fed now appears to be edging towards a change of direction and admitting there may be a need to switch to taking action to cut rates over the next two years. Financial markets are now predicting two cuts of 25 bps by the end of 2020.

**EUROZONE.** The European Central Bank (ECB) provided massive monetary stimulus in 2016 and 2017 to encourage growth in the EZ and that produced strong annual growth in 2017 of 2.3%. However, since then the ECB has been reducing its monetary stimulus measures and growth has been weakening - to 0.4% in quarters 1 and 2 of 2018, and then slowed further to 0.2% in quarters 3 and 4; it is likely to be only 0.1 - 0.2% in quarter 1 of 2019. The annual rate of growth for 2018 was 1.8% but is expected to fall to possibly around half that rate in 2019. The ECB completely ended its programme of quantitative easing purchases of debt in December 2018, which means that the central banks in the US, UK and EU have all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. With its refinancing rate already at 0.0% and the deposit rate at -0.4%, it has probably reached the limit of cutting rates. At its March 2019 meeting it said that it expects to leave interest rates at their present levels "at least through the end of 2019", but that is of little help to boosting growth in the near term. Consequently, it also announced a third round of TLTROs; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will

include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans.

**CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

**JAPAN** - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

**WORLD GROWTH.** Equity markets are currently concerned about the synchronised general weakening of growth in the major economies of the world: they fear there could even be a recession looming up in the US, though this fear is probably overdone.

## 9. Other Issues

### International Financial Reporting Standard (IFRS) 9 – Financial Instruments.

The 2018/19 Accounting Code of Practice introduced changes in way investments are valued and disclosed in the Council's Statement of Accounts. Key considerations are:-

- Expected credit loss model. Whilst not material for vanilla treasury investments such as bank deposits, this does impact our investment in property funds
- The valuation of investments previously valued under the available for sale category e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar, will be changed to **Fair Value through the Profit and Loss (FVPL)**.

Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This is effective from 1st April 2018, and applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

### Investment in Property Funds

Investment in property funds was included within the Commercial Investment and Regeneration Strategy, with the aim of generating improved returns of c.4-5% p.a. (plus asset growth) being long term investments of between 5 – 10 years (minimum) in order to make the necessary returns (after set up costs).

Utilising the capital receipt proceeds of the sale of the Golf Course, a budget of £12m was allocated to long-term investment in a number of property funds. During 2017/18, the Council undertook a Property Fund Manager selection exercise, appointing Link Asset Services to provide support and advice in the identification and selection of suitable UK-focussed property funds. Full details of the selection process

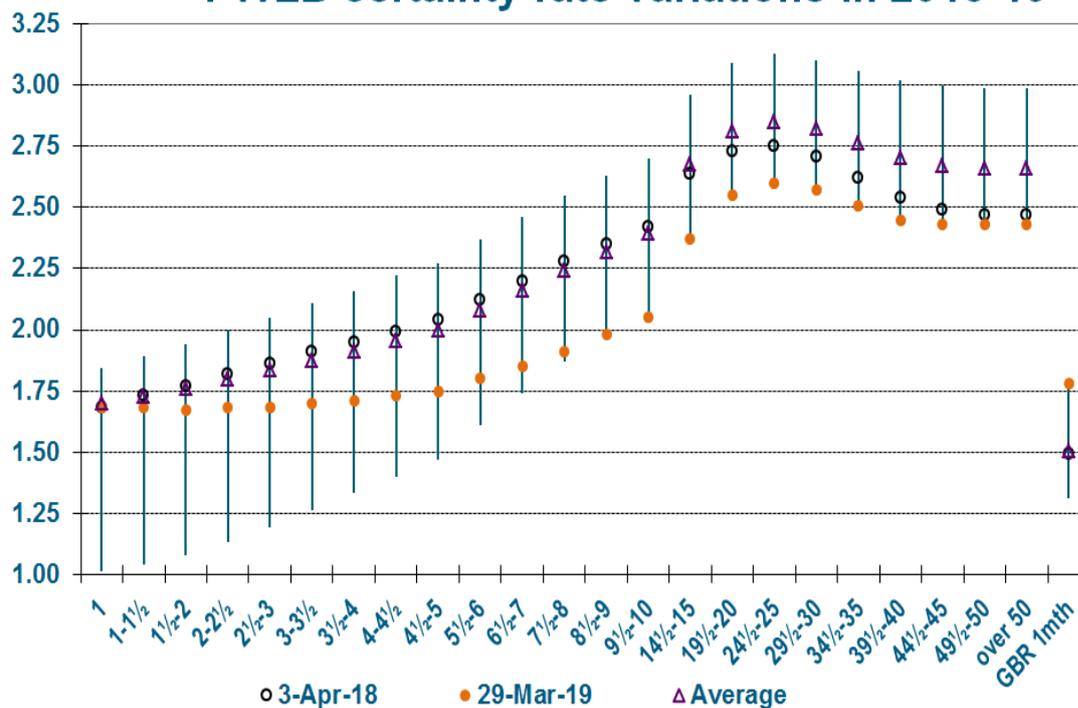
were included in Link Asset Services' report presented to Members 21<sup>st</sup> February 2018.

To date, the Council has invested £1.85m with Schroders UK Real Estate Fund and £2m with Threadneedle Property Unit Trust, total investment £3.85m with an estimated return of 4% plus any longer-term capital growth. The MTFs includes budgeted income of £480k pa from 2020/21 arising from investment of the full £12m budgeted, however, due to recent uncertainty around arrangements for Brexit and the associated impact on the economy, it was decided during the year to delay any further investment in property funds until there is more clarity.

<b>1. PRUDENTIAL INDICATORS</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2018/19</b>
<b>Extract from budget and rent setting report</b>	<b>Actual</b>	<b>Original</b>	<b>Actual</b>
<b>Capital Expenditure</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Non - HRA	1.545	12.932	10.515
HRA	7.655	30.396	9.266
<b>TOTAL</b>	<b>9.200</b>	<b>43.328</b>	<b>19.781</b>
<b>Ratio of financing costs to net revenue stream</b>	<b>%</b>	<b>%</b>	<b>%</b>
Non - HRA	(2.84)	(2.55)	(6.16)
HRA	38.19	39.71	29.17
<b>Gross borrowing requirement General Fund</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
brought forward 1 April	-	-	-
carried forward 31 March	-	-	-
in year borrowing requirement	-	1.766	-
<b>Gross borrowing requirement HRA</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
brought forward 1 April	63.060	55.846	63.060
carried forward 31 March	63.060	63.060	63.060
in year borrowing requirement	-	7.214	-
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Gross debt</b>	63.060	63.060	63.060
<b>Capital Financing Requirement</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Non – HRA	0.885	2.547	0.828
HRA	68.041	75.255	68.041
<b>TOTAL</b>	<b>68.926</b>	<b>77.802</b>	<b>68.869</b>
<b>Annual change in Capital Financing Requirement</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Non – HRA	(0.058)	(0.104)	(0.057)
HRA	-	7.214	-
<b>TOTAL</b>	<b>(0.058)</b>	<b>7.110</b>	<b>(0.057)</b>

<b>2. TREASURY MANAGEMENT INDICATORS</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2018/19</b>
	<b>Actual</b>	<b>Original</b>	<b>Actual</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Authorised Limit for external debt - General Fund</b>			
borrowing	4.885	5.547	5.547
other long term liabilities	-	-	-
TOTAL	4.885	5.547	5.547
<b>Authorised Limit for external debt - HRA</b>			
borrowing	79.407	79.407	79.407
other long term liabilities	-	-	-
TOTAL	79.407	79.407	79.407
<b>Operational Boundary for external debt - General Fund</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
borrowing	0.000	0.000	0.000
other long term liabilities	-	-	-
TOTAL	0.000	0.000	0.000
<b>Operational Boundary for external debt - HRA</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
borrowing	65.060	63.060	63.060
other long term liabilities	-	-	-
TOTAL	65.060	63.060	63.060
<b>Actual external debt</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
	63.060	63.060	63.060
<b>Maximum HRA debt limit</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
	79.407	79.407	79.407

### PWLB certainty rate variations in 2018-19



	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2018	1.48%	1.85%	2.23%	2.57%	2.29%
29/03/2019	1.48%	1.55%	1.85%	2.40%	2.23%
Low	1.28%	1.50%	1.80%	2.33%	2.16%
Date	29/05/2018	26/03/2019	28/03/2019	26/03/2019	26/03/2019
High	1.64%	2.07%	2.50%	2.93%	2.79%
Date	04/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018
Average	1.50%	1.80%	2.20%	2.66%	2.47%

### Money market investment rates 2018/19

	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
01/04/2018	0.50	0.36	0.39	0.59	0.70	0.88
31/03/2019	0.75	0.57	0.61	0.72	0.83	0.94
High	0.75	0.59	0.61	0.81	0.92	1.06
High Date	02/08/2018	01/11/2018	10/12/2018	29/01/2019	15/01/2019	11/01/2019
Low	0.50	0.35	0.37	0.48	0.59	0.75
Low Date	01/04/2018	19/07/2018	30/05/2018	30/05/2018	30/05/2018	30/05/2018
Average	0.67	0.51	0.54	0.68	0.79	0.94
Spread	0.25	0.24	0.25	0.33	0.33	0.31