BLACKBURN with DARWEN BOROUGH COUNCIL

REPORT to :	Audit & Governance Committee
LEAD OFFICER:	Director of Finance and Customer Services
DATE:	25th June 2019

WARD/S AFFECTED: All

Treasury Management Annual Report 2018/19

1. PURPOSE

1.1 To formally report the Treasury outturn for 2018/19, as also reflected in the 2018/19 Outturn Corporate Monitoring Report (13th June Executive Board).

2. RECOMMENDATIONS

2.1 Audit and Governance Committee is recommended to note the Outturn position for 2018/19.

3. BACKGROUND

3.1 In February 2018 the Council agreed a Treasury Management Strategy and Minimum Revenue Provision (MRP) Policy for 2018/19.

3.2 The CIPFA Treasury Management Code required the Council to approve a Treasury Management Strategy (including various Treasury Management indicators) before the start of each financial year, and to consider the outturn after each year end. This report is to update Audit and Governance Committee on the overall outturn position for 2018/19.

4. KEY ISSUES AND RISKS

<u>4.1 Treasury Priorities</u>

The Council has operated within CIPFA and statutory guidance and requirements in respect of Treasury Management practice. The approved Treasury Management Policy Statement, together with the more detailed Treasury Management Practices and each year's Annual Strategy have all emphasised the importance of security and liquidity over yield.

5. 2018/19 OUTTURN

5.1 Original Strategy for 2018/19

5.1.1 The Strategy for 2018/19 was approved by Council on 26th February 2018. The main aspects of the strategy are outlined below :

- With short-term interest rates expected to continue to be lower than long-term rates it was acknowledged, for another year, that it may continue to be more cost effective not to borrow and instead reduce the level of investments.
- Long-term borrowing would be taken if it became apparent that there was a risk of significantly increased interest rates.
- Any balances over and above those required to maintain basic liquidity could be invested either in the medium term (out to a year) or the longer term (over a year), though it was recognised that long term investment was unlikely. Priority was given to security of funds and liquidity (accessibility) over yield (or return).
- The limits to investment by reference to amount, duration and credit rating were largely unchanged from those applying in previous years

5.2 Economic Review 2018/19

5.2.1 After rising to 0.6% in the third calendar quarter, from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual growth continues to remain below trend, and business investment levels remained weak as a result of uncertainty over Brexit.

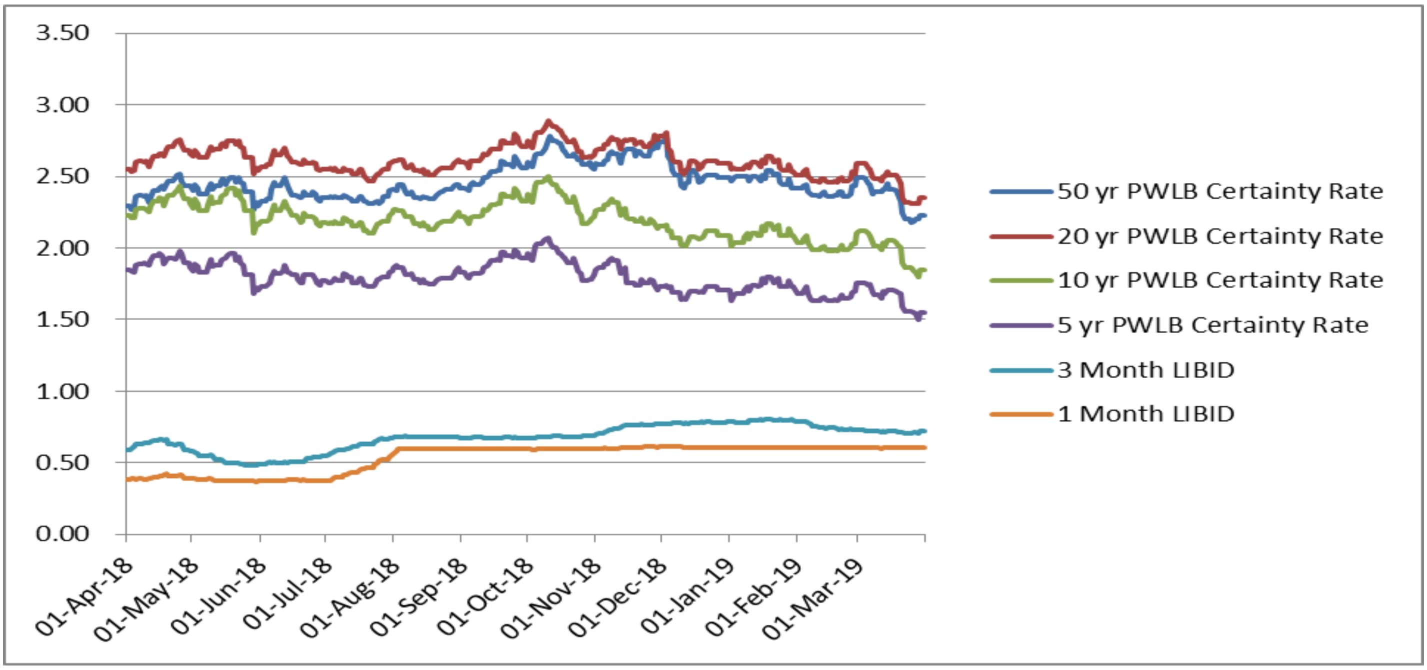
5.2.2 Oil price fluctuations impacted on inflation levels, but by the end of the year, the UK CPI (Consumer Price Inflation) index was at 1.9% (year on year), which was broadly in line with Bank of England expectations. Unemployment remained low, while wage rises began to outstrip price inflation.

5.2.3 The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate to 0.75% in August 2018. There were no significant changes to monetary policy across the year, as a steady level of Quantitative Easing was maintained

5.2.4 Gilt yields – reflecting the cost of UK government borrowing – were again volatile, with significant dips in the cost of borrowing in mid-December 18, early January and again in late March 2019.

5.2.5 The pattern of interest rates over the year is summarised in the chart below. Local government long term borrowing costs are set by the Public Works Loans Board (PWLB) - these directly mirror gilt yields. Nominal investment rates, measured through the London Inter-Bank Bid Rate (LIBID), are also shown.

Interest Rate Movements in 2018/19 –



5.3 Treasury Management Performance 2018/19

5.3.1 By 31st March 2019, the Council had net borrowing of almost £173 M, arising from its revenue and capital income and expenditure, down £4 M from the previous year.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in the table below.

Balance Sheet Summary	31 March 2018 £M	2018/19 Movement £M	31 March 2019 £M
General Fund CFR	299.9	-2.3	297.6
Less CFR re Debt -			
managed by Lancashire County Council (LCC)	-16.0	0.4	-15.6
re Private Finance Initiative (PFI) arrangements	-69.9	0.2	-69.7
Loans/Borrowing CFR	**214.0**	**-1.7**	**212.3**
Less Usable Reserves	-41.0	0.9	-40.1
Less Working Capital	3.6	-3.0	0.6
Net Borrowing	**176.6**	**-3.8**	**172.8**

The overall decrease in **net borrowing** occurred primarily because of the unwinding of part of the pre-payment of the Local Government Pension deficit lump sum in April 2017 (which has led to net budget savings).

5.3.2 Under the Council's Minimum Revenue Provision (MRP) Policy,

(a) the MRP charge to the accounts in respect of both PFI debt and debt managed by LCC has been less than the actual debt repaid, and
(b) the MRP charge to the accounts in respect of the Council's own capital spend financed from borrowing has been reduced.

This has resulted in the Council's CFR being higher than it otherwise would have been, and increases borrowing (interest) costs in the short run – though by less than the MRP savings achieved.

5.3.3 The following table summarises debt and investments at the start and end of the year:

	31 Mar 2018 Principal (£ M)	Rate / Return	Avg Life (Yrs)	31 Mar 2019 Principal (£ M)	Rate / Return	Avg Life (Yrs)
Fixed rate funding:						
Public Works Loans Board	104.5	4.20%	22.7	138.0	3.61%	16.6
Market Debt (Long Term)	10.3	4.47%	36.7	5.3	4.50%	36.0
Market Debt (Short Term)	85.0	0.57%		41.0	0.95%	
	199.8			**184.3**		
Variable rate funding:						
Public Works Loans Board	0.0			0.0		
Market	10.5	5.24%	17.5	13.0	4.48%	27.1
	10.5			**13.0**		
Loans taken by Blackburn with Darwen Borough Council	**210.3**			**197.3**		
Debt from PFI arrangements	66.8			65.1		
Debt managed by LCC	15.4	2.0%		14.7	2.0%	
Total debt	**292.5**			**277.1**		
Total investments	**33.7**	**0.52%**		**24.5**	**0.73%**	

For the first time in a number of years, a significant tranche of long term borrowing was taken, in early December 2018 (when long term borrowing rates were low), to rebalance the overall debt portfolio away from an excessive reliance on short term borrowing.

In summary, the key changes to the Council's overall debt position across the year were:

a) A reduction in the level of short term borrowing, from £85M to £41M,
b) Repayment of a £2.5M money market loan
c) Principal repayments of £1.6M on PWLB EIP (Equal Instalment of Principal) loans
d) Taking on £35M of PWLB EIP debt, across four new loans -

7th Dec 2018	£10 M	10 years	1.74%
10th Dec 2018	£10 M	15 years	1.88%
12th Dec 2018	£5 M	12 years	1.73%
13th Dec 2018	£10 M	17 years	1.92%

e) Repayments of part of the outstanding PFI debt recognised on the balance sheet for Building Schools for the Future (BSF), and of debt managed by LCC.

No debt rescheduling was undertaken, because the premiums payable on early repayment of PWLB debt made it uneconomic to do so.

5.3.4 Short term loans were taken for a range of durations at various points across the year. Investments continued to be maintained to ensure sufficient resources to cover day to day cash flow needs, and would be higher when the timing of short term loans taken was not aligned to the immediate cash flow requirements of the Council.

Across the year, the Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change.

Overall, investment balances are still much lower than they would have been if long term borrowing had been taken to cover the Council's CFR position. The degree to which long term debt was less than CFR fell, by over £30M, to around £56M, as a result of the new PWLB loans taken.

The deliberate strategy of taking short term loans continued to reduce the interest earned on balances, but delivered large savings on borrowing costs.

5.3.5 In summary, the outturn position in respect of interest costs and income, and MRP charges, was as follows:

Outturn 2017/18 £'000		**Original Budget 2018/19** £'000	**Outturn 2018/19** £'000
5,438	Interest paid on borrowing – long term debt	5,186	5,378
278	Interest paid on borrowing – short term debt	480	539
315	Interest paid on debt managed by LCC	366	333
6,420	PFI interest paid	6,240	6,230
(91)	Interest – treasury/other minor elements	(80)	(256)
(156)	Interest & dividends from BSF investments	(113)	(1,170)
5,734	MRP on Council borrowing	5,678	5,670
141	MRP – PFI debt	153	153
340	MRP – debt managed by LCC	340	340

5.3.6 Interest paid on borrowing in 2018/19 was around £0.25M up on the Original Estimate, reflecting both higher short term interest rates and the decision to take on new long term debt in year. There was still a significant element of interest paid on short term borrowing – the element relating to short term debt went up from around £278,000 to around £539,000.

PFI interest charges did not add to the "bottom line" faced by the Council Taxpayer, as grants covered their cost.

5.3.7 The average investment balance over the year was up, at £37M (£28M in 2017/18), as a result of the high levels held in the last quarter of the year following the PWLB loans taken in December. (see Weekly Balances **Appendix 1**).

Overall, interest and dividends received rose significantly to £1.4M in 2018/19 (£0.25M in 2017/18). The most significant variation was in relation to the Council's BSF PFI holding. While "routine" PFI holding receipts were similar, at £0.15M (£0.16M in 2017/18), **a one off windfall of over £1M** was generated for the council by the restructuring of one of the BSF PFI debt frameworks.

Investment interest rates increased a little but remained low across 2018/19. Funds have continued to be invested for short periods, and sometimes with the government's Debt Management Office, to manage risk – this also contributed to the relatively low returns. Interest earned on treasury cash investments increased, from £0.08M to £0.24M, and the average rate of return rose to 0.63% (against 0.25% in 2017/18).

5.3.8 The impact of the revised MRP Policy introduced in 2016/17, can be seen in the continuing lower MRP costs in 2018/19, which, at £6.2M, were still significantly lower than they would have been under the previous policy. The final MRP costs at outturn were in line with expectations.

5.3.9 The position with regard to performance against Treasury/Prudential Indicators in 2018/19 is summarised in **Appendix 2**. There was no breach of the Authorised Borrowing Limit, but the Operational Boundary (set for management purposes) was exceeded for a limited period following the new long term borrowing taken in December 2018, until existing short term debt was repaid over succeeding months.

Outturn capital spend was £20M, which is below the £30M anticipated at the start of the year.

5.4 Treasury Management Consultancy

5.4.1 The Council is contracted up to 31st March 2020 to receive treasury management support from Arlingclose Limited. They provide advice and information on the Council's investment and borrowing activities, although responsibility for final decision making remains with the Council and its officers.

5.4.2 Over the period, in providing support to the Council, Arlingclose have reviewed the Council's Treasury management procedures and activities. They have provided member training; ongoing officer training; support for and review of treasury decisions, reports and strategies; feedback on accounting for treasury activities; benchmarking with other authorities; guidance on borrowing and investment opportunities; forecasts of interest rates; and regular updates on credit ratings and other information on credit quality. The quality of the support provided has been of a high standard.

5.5 Counterparty Update

5.6.1 Credit Default Swap (CDS) spreads, an indicator of market confidence in banks, increased (worsened) towards the end of 2018 on the back of Brexit uncertainty, before falling (improving) again in 2019. The process of separating the banks into retail (ringfenced) and investment banking (non-ringfenced) entities concluded.

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

5.6.3 Otherwise, there were minimal other credit rating changes during the period.

6.5 Risk Management

6.5.1 The Council's key priorities for managing its investments are the security and liquidity of its funds, before seeking the best rate of return. Most surplus cash is therefore held as short-term investments with the UK Government, highly rated banks and pooled funds. The Council also holds some investments that entail a slightly higher level of risk, including unrated building society deposits (where risks have been mitigated by limiting the amount and duration of exposure).

6.5.2 The Council's primary objective for the management of its debt is to ensure its long-term affordability. The largest part of its loans is from the Public Works Loan Board at long-term fixed rates of interest.

6.5.3 A combination of short duration investments and long duration debt exposes the Council to the risk of falling investment income during periods of low interest rates. However, the risk of low investment returns is viewed as of lower priority compared to the benefits of optimising the security and liquidity of investments, and the savings made on borrowing costs. Also, though the Council has no long term investments, it is hedged against the investment return risk by its short term debt.

6.5.4 Even though a significant tranche of new longer term debt, the Council is still holding a significant element (around £40M) in short term loans from other local authorities. If the medium to long term cost of debt were to move upwards, it may be necessary to restructure the Council's debt quickly, and cope with an increased cost of borrowing. This issue remains under review, with regular updates from Arlingclose.

7. FINANCIAL IMPLICATIONS

The financial implications arising from the 2018/19 Treasury Outturn have been incorporated into Corporate Budget Monitoring Reports.

8. LEGAL IMPLICATIONS

8.1 Under the Local Government Act 2003, local authorities determine locally their levels of capital investment and associated borrowing. The Prudential Code has been developed to support local authorities in taking these decisions, and the Council is required by Regulation to have regard to the Code when carrying out its duties under Part 1 of the Local Government Act 2003.

8.2 The Department for Communities and Local Government issued Guidance on Local Government Investments, under the Local Government Act 2003, effective from 1st April 2010. Authorities must manage their investments within an approved strategy, setting out what categories of investment they will use and how they will assess and manage the risk of loss of investments.

9. POLICY IMPLICATIONS, RESOURCE IMPLICATIONS, CONSULTATIONS

None

10. STATEMENT OF COMPLIANCE

The recommendations are made further to advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation and an equality analysis and impact assessment has been considered. The recommendations reflect the core principles of good governance set out in the Council's Code of Corporate Governance.

VERSION:	**0.01**

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DATE:	31st May 2019
BACKGROUND PAPER:	Treasury Management strategy for 2018/19 approved at Council 26th February 2018.