**Audit Committee**

**31 July 2019**

**Treasury Management Outturn 2018/19**

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**Report of the Corporate Director of Resources**

## Electoral division(s) affected:

Countywide

## Purpose of the Report

1 To provide Audit Committee with information on the treasury management outturn position for 2018/19.

## Executive summary

2 The attached report was presented at Cabinet on 10 July 2019.

3 The report presents:

(a) a summary of the Council's treasury position, borrowing activity, investment activity, treasury management and prudential indicators

## Recommendation(s)

4 Audit Committee is recommended to:

(a) Note the contents of the report



| | | |
|---|---|---|
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## Appendix 1: Implications

### Legal Implications

None.

### Finance

The report details the council's cash management, loans and investment activity during 2018/98. The report also provides the overall financing of the council's capital expenditure, along with borrowing and investment income returns.

### Consultation

None.

### Equality and Diversity / Public Sector Equality Duty

None.

### Human Rights

None.

### Crime and Disorder

None.

### Staffing

None.

### Accommodation

None.

### Risk

None.

### Procurement

None.

**Cabinet**

**10 July 2019**

**Treasury Management Outturn 2018/19**

**Report of Corporate Management Team**
**John Hewitt, Corporate Director of Resources**
**Councillor Alan Napier, Cabinet Portfolio Holder for Finance**

## Electoral division(s) affected:

None.

## Purpose of the Report

1 To provide information on the treasury management outturn position for 2018/19.

## Executive Summary

2 This report provides a summary of the Council's treasury position, borrowing activity, investment activity, treasury management and prudential indicators.

3 The Council held £311 million in borrowing and £245 million of investments at 31 March 2019. During 2018/19 borrowing of £30 million was taken out from the PWLB at rates of between 2.29% to 2.37%. Furthermore, future borrowing of £60m has been agreed to be taken out during the periods 2020 to 2022 in four separate loans at interest rates of between 2.7% to 2.8%. This has enabled the Council to make savings against the cost of carrying the loans if they had been taken out immediately at the prevailing PWLB rates.

4 Investments have been undertaken in line with both the CIPFA Code and government guidance which require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

5 During the year ending 31 March 2019 the Council has complied with Treasury Management Indicators relating to interest rate exposure, maturity structure of borrowing and sums invested for more than one year. The Council has also complied with Prudential Code Indicators

which relate to the capital programme and how much the Council can afford to borrow.

**Recommendation**

6 Cabinet is asked to note the contents of the report.

**Background**

7 Treasury management is defined as ‘the management of the local authority’s investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks’.

8 The council operates a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, with a main aim of providing sufficient liquidity, ahead of the achievement of the best possible investment returns.

9 The second main function of the treasury management service is to arrange the funding of the council’s capital programme. The capital programme provides a guide to the borrowing need of the council and there needs to be longer term cash flow planning to ensure capital spending requirements can be met. The management of longer term cash may involve arranging long or short term loans, utilising longer term cash flow surpluses and occasionally debt restructuring to meet council risk or cost objectives.

10 The council adopts the latest CIPFA Code of Practice on Treasury Management (the Code) which is regarded as best practice in ensuring adequate monitoring of the Council’s capital expenditure plans and its Prudential Indicators (PIs). This requires that Members agree the following reports, as a minimum:

(a) An annual Treasury Management Strategy in advance of the year (reported to the County Council on 21 February 2018 for the 2018/19 financial year);

(b) a mid-year Treasury Management Review report (reported to the County Council on 5 December 2018);

(c) an annual review following the end of the year describing the activity compared to the strategy (this report);

11 This report provides a summary of the following:

(a) summary treasury position;

(b) borrowing activity;

(c) investment activity;

(d) treasury management indicators;

(e) prudential indicators.

## Summary Treasury Position

12 The council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security for investments, and to manage risks within all treasury management activities.

13 At the beginning and end point 2018/19 the council's treasury position (excluding borrowing by finance leases) was as follows:

| | **31.03.18** £ million | **Rate /Return** % | **Average Life** years | **31.03.19** £ million | **Rate /Return** % | **Average Life** years |
|---|---|---|---|---|---|---|
| **Total Debt** | 291 | 3.88 | 17.61 | 311 | 3.75 | 17.99 |
| **Total Investments** | 172 | 0.56 | 0.3 | 245 | 0.97 | 0.32 |
| **Net Debt** | 119 | | | 66 | | |

14 As at 31 March 2019, the council held £311 million in borrowing and £245 million in investments.

## Borrowing Activity

15 At 31 March 2019, the council held £310.605 million of loans, an increase of £19.992 million from the start of the year. The borrowing position and the change since the start of the year is shown in the following table:

| | 31.3.18 Balance £ million | In-year Movement £ million | 31.3.19 Balance £ million | Average Rate % | 31.3.19 Average Life years |
|---|---|---|---|---|---|
| Public Works Loan Board | 238.979 | 19.998 | 258.977 | 3.62% | 17.85 |
| Private Sector | 51.420 | (0.008) | 51.428 | 4.41% | 27.20 |
| Pension Fund | 0.214 | (0.014) | 0.200 | 8.01% | 8.93 |
| **Total borrowing** | **290.613** | **19.992** | **310.605** | | |

16 The council's chief objective when borrowing has been to strike an appropriate risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

17 To take advantage of historically low rates of interest, new borrowing of £30 million was raised in 2018/19 with details in the following table.

| Lender | Principal £ million | Interest Rate % | Start Date | Length |
|---|---|---|---|---|
| PWLB | 10.00 | 2.31 | 31/05/2018 | 40 years |
| PWLB | 10.00 | 2.37 | 22/03/2019 | 40 years |
| PWLB | 10.00 | 2.29 | 25/03/2019 | 40 years |
| **Total** | **30.00** | | | |

18 The key maturity during the year was a £10 million PWLB loan that was taken out in October 2011 at 2.72% and matured in September 2018.

19 Affordability and the "cost of carry", the gap between the interest rate on borrowings and the interest rate achieved on investments, continued to be important influences on the Council's borrowing strategy. During the year the council's Treasury Management advisors, Link Asset Services, identified that there was a strong possibility that interest rates would have increased by the time the Council next needed to undertake significant borrowing to support the capital programme. An appraisal was undertaken to compare the potential borrowing alternatives that were identified:

(a) to secure future borrowing at fixed, historically low, rates with no cost of carry anticipated;

(b) taking out PWLB loans at current rates and incurring costs of carry until they were needed.

20 The conclusion was that securing future borrowing at the following fixed rates was identified as the preferred option:

| Loan Number | Deferred Period | Rate | Amount | Start Date | End Date |
|---|---|---|---|---|---|
| Loan 1 | 1.5 years | 2.733% | £20m | 13/02/2020 | 13/02/2070 |
| Loan 2 | 2.5 years | 2.773% | £15m | 15/02/2021 | 15/02/2071 |
| Loan 3 | 3 years | 2.793% | £15m | 13/08/2021 | 13/08/2071 |
| Loan 4 | 3.5 years | 2.807% | £10m | 15/02/2022 | 15/02/2072 |

21 This enabled the council to make savings against the cost of carrying the loans if they had been taken out immediately at the prevailing PWLB rates and secure a £750,000 MTFP saving in 2019/20 against the borrowing costs budget.

22 No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

## Other Debt Activity / Long Term Liabilities

23 Although not classed as borrowing, the Council also raised £4.599 million of capital finance for replacement fleet vehicles and equipment via finance leases during the year to 31 March 2019.

24 Total debt other than borrowing stood at £81.058 million on 31 March 2019, taking total debt to £391.663 million.

## Investment Activity

25 The council has held significant funds invested representing funds received in advance of expenditure plus balances and reserves held. During 2018/19, investment balances ranged between £172 million and £282 million.

26 As at 31 March 2019 the Council held investments totalling £245.370 million. The following table provides a breakdown of these investments split by the type of financial institution and maturity period.

| Financial Institution | 0-3 months | 3-6 months | 6-12 months | 12-24 months | Total |
|---|---|---|---|---|---|
| | £ million | | | | |
| Banks | 29.381 | 26.063 | 47.769 | 8.664 | 111.877 |
| Building Societies | - | - | - | - | - |
| Central Government | 0.867 | - | - | - | 0.867 |
| Other Local Authorities | 4.332 | 59.929 | 68.365 | - | 132.626 |
| Money Market Funds | - | - | - | - | - |
| **Total** | **34.580** | **85.992** | **116.135** | **8.664** | **245.370** |
| **% of total** | **14%** | **35%** | **47%** | **4%** | |

27 The council's investment policy is governed by Ministry of Housing, Communities and Local Government (MHCLG) guidance, which has been implemented in the annual investment strategy approved by the council on 21 February 2018. Both the CIPFA Code and government guidance require the council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

28 All of the council's investment activity has remained within the benchmarks for managing investment risk which were included in the Annual Treasury Management Strategy. The following table compares the actual position as at 31 March 2019 against the previously agreed benchmarks.

| Investment Risk | Measured by | Benchmark | Actual position 31.03.2019 |
|---|---|---|---|
| Security | % of historic risk of default | 0.08% | 0.014% |
| Liquidity | Weighted average life to maturity at execution | 6 months (183 days) average<br>9 months (274 days) maximum | 238 days average |
| Yield | Internal returns above the 7 day LIBID rate (average) | 0.507% | 0.838% |

## Treasury Management Indicators

29 There are three debt related treasury activity limits which are designed to manage risk and reduce the impact of an adverse movement in interest rates.

**Interest Rate Exposures**: This indicator is set to control the council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principle invested was:

| | 31.3.19 Actual | 31.3.19 Actual | 2018/19 Limit | Complied |
|---|---|---|---|---|
| Upper limit on fixed interest rate exposure | £271.1m | 87.3% | 100% | ✔ |
| Upper limit on variable interest rate exposure | £39.5m | 12.7% | 70% | ✔ |

**Maturity Structure of Borrowing:** This indicator is set to control the council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

| | Lower Limit | Upper Limit | 31.3.19 Actual | Complied |
|---|---|---|---|---|
| Under 12 months | 0% | 20% | 4% | ✔ |
| 12 months to 2 years | 0% | 40% | 3% | ✔ |
| 2 years to 5 years | 0% | 60% | 10% | ✔ |
| 5 years to 10 years | 0% | 80% | 23% | ✔ |
| 10 years and above | 0% | 100% | 60% | ✔ |

**Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments:

| | Limit | As at 31.3.19 | Complied |
|---|---|---|---|
| Actual principal invested beyond one year | £75m | £10m | ✔ |

## Prudential Code Indicators

30 The Local Government Act 2003 requires the council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

31 The objective of the Prudential Code is to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

**Capital Expenditure:** The table below summarises capital expenditure incurred and how the expenditure was financed:

| Capital Expenditure | 2018/19 Estimate £ Million | 2018/19 Actual £ Million | Difference £ Million |
|---|---|---|---|
| **Capital Programme** | **103.819** | **91.258** | **(12.561)** |
| **Financed by:** | | | |
| Capital receipts | 13.206 | 9.391 | (3.815) |
| Capital grants | 65.745 | 52.183 | (13.562) |
| Revenue and reserves | 24.868 | 22.116 | (2.752) |
| **Net borrowing financing need for the year** | **0.000** | **7.568** | **7.568** |

**Capital Financing Requirement (CFR):** The CFR is a measure of the Council's underlying borrowing need for a capital purpose. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). The actual outturn position compared to the original estimate in February 2018 is set out in the following table:

| | 2018/19 Estimate £ Million | 2018/19 Actual £ Million | Difference £ Million |
|---|---|---|---|
| **Capital Financing Requirement** | **484.786** | **457.660** | **(27.126)** |

**Actual Debt:** The council's actual debt at 31 March 2019 compared to the original estimate in February 2018 is as follows:

| | Revised Estimate £ Million | Final Outturn £ Million | Difference £ Million |
|---|---|---|---|
| Borrowing | 295.597 | 310.605 | 15.008 |
| Finance leases* | 46.670 | 42.712 | (3.958) |
| PFI liabilities | 38.182 | 38.346 | 0.164 |
| **Total Debt** | **380.449** | **391.663** | **11.214** |

*The opening position for finance leases has been adjusted to reflect the Councils long term lease interest in properties at Freemans' Reach, for the sum of £32.989 million.

**Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the council should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence. The actual outturn position compared to the original estimate in February 2018 is set out in the following table:

| | **2018/19 Estimate £ Million** | **2018/19 Actual £ Million** | **Difference £ Million** |
|---|---|---|---|
| Total debt | 380.449 | 391.663 | 11.214 |
| Capital financing requirement | 484.786 | 457.660 | (27.126) |
| **Headroom (Under borrowed)** | **104.337** | **65.997** | **(38.340)** |

**Operational Boundary:** This is the limit beyond which external borrowing is not normally expected to exceed. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

| | **2018/19 Estimate £ Million** | **2018/19 Actual £ Million** | **Complied** |
|---|---|---|---|
| Borrowing | 432.000 | 310.605 | ✔ |
| Other long term liabilities* | 86.000 | 81.058 | ✔ |
| **Total** | **518.000** | **391.663** | ✔ |

*The opening position for other long term liabilities has been adjusted to reflect the Councils long term lease interest in properties at Freemans' Reach, for the sum of £32.989 million.

**Authorised Limit for external borrowing**: This represents a control on the maximum level of borrowing and is a statutory limit determined under section 3 (1) of the Local Government Act 2003. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

| | **2018/19 Estimate £ Million** | **2018/19 Actual £ Million** | **Complied** |
|---|---|---|---|
| Borrowing | 482.000 | 310.605 | ✔ |
| Other long term liabilities* | 91.000 | 81.058 | ✔ |
| **Total** | **573.000** | **391.663** | ✔ |

*The opening position for other long term liabilities has been adjusted to reflect the Councils long term lease interest in properties at Freemans' Reach, for the sum of £32.989 million.

**Actual and estimates of the ratio of financing costs to 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 Estimate % | 2018/19 Actual % | Difference % |
|---|---|---|---|
| Ratio of financing costs to net revenue stream | 7.67 | 7.52 | (0.15) |

## Conclusion

32 The council has complied with its Treasury Management Strategy 2018/19 for its full year activity covering the period to 31 March 2019.

## Background Papers

- 21 February 2018 – County Council – Appendix 11: Durham County Council 2018/19 Annual Treasury Management Strategy as part of the Medium Term Financial Plan, 2018/19 to 2021/22 and Revenue and Capital Budget 2018/19.

- 8 December 2018 – County Council – Mid Year Treasury Management Review 2018/19.

| | | | |
|---|---|---|---|
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| | **Azhar Rafiq** | **Tel:** | **03000 263480** |

## Appendix 1: Implications

### Legal Implications
None

### Finance
The report details the council’s cash management, loans and investment activity during 2018/98. The report also provides the overall financing of the council’s capital expenditure, along with borrowing and investment income returns.

### Consultation
None

### Equality and Diversity / Public Sector Equality Duty
None

### Human Rights
None

### Crime and Disorder
None

### Staffing
None

### Accommodation
None

### Risk
None

### Procurement
None