For Publication

Bedfordshire Fire and Rescue Authority
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Item No. 10

REPORT AUTHOR: **ASSISTANT CHIEF OFFICER/FRA TREASURER**

SUBJECT: **TREASURY MANAGEMENT – ANNUAL REPORT FOR 2018/19**

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Background Papers:

Treasury Management Strategy 2018/19, as detailed in the Budget Book 2018/19.

Implications (tick ✓):

LEGAL		FINANCIAL	✓
HUMAN RESOURCES		EQUALITY IMPACT	
ENVIRONMENTAL		POLICY	
ORGANISATIONAL RISK	✓	OTHER (please specify)	

Any implications affecting this report are noted at the end of the report.

PURPOSE:

To consider the Authority's Annual Report for Treasury Management for 2018/19.

RECOMMENDATION:

That Members consider the report.

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1. Introduction

This Authority 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 that the full Authority should receive the following reports:

- an annual treasury strategy in advance of the year
- a mid-year (minimum) treasury update report
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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 Authorities policies previously approved by members.

This Authority confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Corporate Services Policy and Challenge Group before they were reported to the full authority. Training can be provided to Members by our Treasury Advisor's, Link Asset Services, in 2019 at the FRA's request.

2. The Authorities Capital Expenditure and Financing

The Authority 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 Authorities 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.

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

Capital Expenditure by Service	**2017/18 Actual £'000**	**2018/19 Budget £'000**	**2018/19 Actual £'000**
As per Budget Book	1,292	1,253	1,291

3. The Authorities Overall Borrowing Need

The Authorities underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

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 Authority 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 Authority is not borrowing to support revenue expenditure. This indicator allowed the Authority some flexibility to borrow in advance of its immediate capital needs in 2018/19.

The table below highlights the Authorities gross borrowing position against the CFR. The Authority has complied with this prudential indicator.

	31 March 2018 Actual £'000	31 March 2019 Budget £'000	31 March 2019 Actual £'000
Prudential Indicator – Capital Financing Requirement			
Borrowing	9,987	9,987	9,987
Other long term liabilities	6	0	0
Total Debt	9,993	9,987	9,987
TOTAL CFR	8,890	8,398	8,398
Under/(over) borrowing	(1,167)	(1,589)	(1,589)

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 Authority does not have the power to borrow above this level. The table below demonstrates that during 2018/19 the Authority has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Authority 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.

	2018/19 £’000
Authorised Limit	11,893
Maximum gross borrowing position during the year	9,993
Operational Boundary	9,993
Average gross borrowing position	9,987
Financing costs as a proportion of net revenue stream	**2.39%**

4. Treasury Position as at 31 March 2019

At the beginning and the end of 2018/19 the Authorities treasury position was as follows:

	31 March 2018 Principal £'000	**Rate/Return**	**Average Life yrs**	**31 March 2019 Principal £'000**	**Rate/Return**	**Average Life yrs**
Fixed rate funding:						
PWLB	9,987	4.27%	39	9,987	4.27%	38
Other long term liabilities	6			0		
Total debt	**9,993**	4.27%	39	9,987	4.27%	38
CFR* (year end position)	**8,890**			**8,398**		
Over/(under) borrowing	**1,103**			**1,589**		
Total investments	**13,496**	**0.73%**		**14,496**	**0.94%**	
Net debt	**(3,503)**			**(4,509)**		

The maturity structure of the debt portfolio was as follows:

	31 March 2018 Actual £'000	**2018/19 Original limits £'000**	**31 March 2019 Actual £'000**
Under 12 months	0	0	0
12 months to 2 years	0	0	0
2 years to 5 years	0	0	0
5 years to 10 years	0	0	0
10 years and above	9,987	9,987	9,987

Investment Portfolio	Actual 31 March 18 £'000	Actual 31 March 18 %	Actual 31 March 19 £'000	Actual 31 March 19 %
Treasury Investments				
UK banks	5,996	44%	11,246	78%
Foreign bank (via Links)	7,500	56%	3,250	22%
Total	**13,496**	**100%**	**14,496**	**100%**

5. The strategy for 2018/19

5.1 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 2 August 2018. During this period, investments were, therefore, kept shorter term in 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 after 2 August 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 1 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.

5.2 Borrowing strategy and control of interest rate risk

During 2018-19, the Authority maintained an over-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), has been exceeded by loan debt and leasing liabilities. The strategy for the CFR and the under/over borrowed position going forward will be discussed at the next meeting with our Treasury advisors.

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.

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.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks *(please adapt this outline to what you actually did in the year):*

- 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.

	End Q2 2019	End Q3 2019	End Q4 2019	End Q1 2020	End Q2 2020	End Q3 2020	End Q4 2020	End Q1 2021
Bank Rate	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%
5yr PWLB rate	1.80%	1.90%	2.00%	2.10%	2.20%	2.20%	2.30%	2.40%
10yr PWLB rate	2.20%	2.30%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%
25yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.30%
50yr PWLB rate	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.10%

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.

6. Borrowing Outturn

6.1 It was anticipated at the beginning of 2018/19 that the Authority would have surplus funds available for short-term investment, either within its Special Interest Bearing Account (SIBA) at its bankers or through the money market. As at the 31st March 2019 the SIBA account is paying a rate of 0.20% up to £999,999 and 0.30% for funds over £1M.

6.2 The Authority's call-account with Barclays Bank has been used during 2018/19. As at the 31st March 2019 the Barclays account is paying a rate of 0.45%.

6.3 This Authority had also placed surplus funds into a 120-Day Interest account with Santander at a rate of 0.70%. This rate increased to 0.95% as of 1st September and remained that as at 31st March 2019.

6.4 This Authority had also placed surplus funds into a 180-Day Interest account with Santander at a rate of 0.90%. This rate increased to 1.00% as of 1st September and remained that as at 31st March 2019.

6.5 The Authority has invested funds with three foreign banks, Sumitomo Mitsui BC Europe, Goldman Sachs and Qatar during 2018/19, via our Treasury Agents, Link Asset Services. The Sumitomo Mitsui BC Europe investment was a fixed term investment for six months at a rate of 0.85% and has since matured in October 2018 (£3M). The Goldman Sachs Bank investments are fixed term investments for six months at a rate of 0.85% and 0.845% and both have since matured in February 2019 (£2M and £1M). The Qatar National Bank investments are fixed term investments for six months at a rate of 1.23% and 1.32%. These will mature in early 2019/20, April and May.

6.6 During 2018/19 the Authority did not use Money Market Funds for short-term investments.

6.7 Borrowing has not been undertaken in 2018/19 to finance the Capital Programme. The funding for the 2018/19 Capital Programme was through Grant and revenue contributions.

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

7. Investment Outturn

Investment Policy – the Authorities investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by Members on 28 March 2019. 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 Authority had no liquidity difficulties.

Resources – the Authorities cash balances comprise revenue and capital resources and cash flow monies. The Authorities core cash resources comprised as follows:

Balance Sheet Resources (£m)	**31 March 2018** **£'000**	**31 March 2019** **£'000**
Balances	2,600	2,600
Earmarked reserves	12,448	12,669
Grants and other Contributions unapplied	199	189
Usable capital receipts	697	644
Total	**15,944**	**16,102**

Investments held by the Authority

- the Authority maintained an average balance of £14M of internally managed funds
- The internally managed funds earned an average rate of return of 0.99%
- The comparable performance indicator is the average Local Authority 7 Day Rate which was 0.5068%
- Total investment income was £148,315 compared to a budget of £90,400

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