

BRIDGEND COUNTY BOROUGH COUNCIL

INFORMATION REPORT TO CABINET

17 SEPTEMBER 2019

REPORT OF THE INTERIM HEAD OF FINANCE AND SECTION 151 OFFICER

ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2018-19

1. Purpose of the Report

1.1 The purpose of the report is to:-

- Comply with the requirement of the Chartered Institute of Public Finance and Accountancy 'Treasury Management in the Public Services: Code of Practice' (the Code) to report an overview of treasury activities for the preceding financial year;
- Report on the actual Treasury Management and Prudential indicators for 2018-19.

2. Connection to Corporate Improvement Objectives/Other Corporate Priorities

2.1 This report assists in the achievement of the following corporate priority:

- Smarter use of resources – ensuring that all its resources (financial, physical, human and technological) are used as effectively and efficiently as possible and support the development of resources throughout the community that can help deliver the Council's priorities.

2.2 The Annual Treasury Management Outturn Report is integral to the delivery of the Corporate Improvement Objectives as the allocation of resources determines the extent to which the Corporate Objectives can be delivered.

3. Background

3.1 The Council's Treasury Management activities are regulated by the Local Government Act 2003 which provides the powers to borrow and invest as well as providing controls and limits on this activity. The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 as amended, develops the controls and powers within the Act. This requires the Council to undertake any borrowing activity with regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities and to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services.

3.2 The Council is required to operate the overall treasury function with regard to the Code and this was formally adopted by the Council in February 2012. This includes a requirement for the Council to approve a Treasury Management

Strategy (TMS) before the start of each financial year which sets out the Council's and Chief Financial Officer's responsibilities, delegation and reporting arrangements. Council approved the TMS 2018-19 on 28 February 2018. CIPFA published new editions of Treasury Management in the Public Services: Code of Practice and the Prudential Code for Capital Finance in Local Authorities in late December 2017. The TMS 2018-19 and this report however have been produced using the 2011 Codes due to the late publication of the 2017 Codes as they were not implemented until the TMS 2019-20.

- 3.3 The Welsh Government (WG) issued revised Guidance on Local Authority Investments in April 2010, which requires the Council to approve an Investment Strategy prior to the start of each financial year and this is included in the TMS.
- 3.4 Under regulation 21 of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003, local authorities are required to charge Minimum Revenue Provision (MRP) to their revenue account for each financial year to account for the principal cost of their debt in that financial year. Council approved a revised MRP policy for 2018-19 on 19 September 2018 and the revised MRP policy for 2018-19 amended the method of calculating a prudent annual amount to charge to revenue to repay capital financing costs. The revision of the MRP Policy 2018-19 for calculating MRP on capital expenditure funded from supported borrowing resulted in a change from a 4% reducing balance method to a straight-line method over 45 years.
- 3.5 Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the WG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, or as equity investments and loans to the Council's subsidiaries. Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with the TMS. The Council's existing non-treasury investments relate to investment properties and the balance at 31 March 2019 was £4.635 million.

4. Current Situation/Proposal

4.1 External Debt and Investment Position 2018-19

- 4.1.1 The Council's external debt and investment position for 1 April 2018 to 31 March 2019 is shown in Table 1 below; more detail is provided in section 4.4 the Borrowing Strategy and Outturn and section 4.5 the Investment Strategy and Outturn.
- 4.1.2 It should be noted that the accounting practice to be followed by the Council requires financial instruments in the accounts (debt and investments) to be measured in a method compliant with International Financial Reporting Standards (IFRS). The figures shown in Table 1 and throughout the report are based on the actual amounts borrowed and invested and so may differ from

those in the Statement of Accounts which include accrued interest or other different accounting adjustments.

Table 1: External debt and investment position 1 April 2018 to 31 March 2019

	Principal as at 01-04-18 £m	Average Rate %	Principal as at 31-03-19 £m	Average Rate %
External long term borrowing:				
Public Works Loan Board	77.62	4.70	77.62	4.70
Lender's Option Borrower's Option	19.25	4.65	19.25	4.65
Total External borrowing	96.87	4.69	96.87	4.69
Other Long Term Liabilities (LTL)				
Private Finance Initiative (PFI)*	17.64		17.00	
Other LTL	3.38		0.88	
Total Other Long Term Liabilities	21.02		17.88	
Total Gross External Debt	117.89		114.75	
Treasury investments:				
Banks	7.40	0.58	5.40	0.86
Building Societies	2.00	0.54	1.00	0.90
Local Authorities	21.00	0.64	21.00	0.96
Total treasury investments	30.40	0.62	27.40	0.94
Net Debt	87.49		87.35	

* (PFI) arrangement for the provision of a Secondary School in Maesteg 15 years remaining term

4.1.3 The £19.25 million in Table 1 above relates to Lender's Option Borrower's Option (LOBO) loans which have a maturity date of 2054, however these may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, with the lender exercising their option to increase rates at one of the bi-annual trigger points (the trigger dates being July and January) and, therefore, the Council being given the option to accept the increase or to repay the loan without incurring a penalty. The next trigger point is January 2020 and although the Council understands that the lender is unlikely to exercise this option in the current low interest rate environment, an element of refinancing risk remains and the Council would take the option to repay these loans at no cost if it has the opportunity to do so in the future. The current average interest rate for these LOBO's is 4.65% compared to the Public Works Loan Board (PWLB) average interest rate of 4.70%.

4.1.4 The other long term liabilities figure of £17.88 million at 31 March 2019 includes £17.00 million for the Council's Private Finance Initiative (PFI) arrangement for the provision of a Secondary School in Maesteg with fifteen years remaining term. £0.69 million of the £17.00 million is included as current liabilities in the Council's balance sheet in the Statement of Accounts.

4.1.5 Favourable cash flows have provided surplus funds for investment and the balance on investments at 31 March 2019 was £27.40 million (average interest rate 0.94%). This was a decrease from the start of the financial year where investments were £30.40 million (average interest rate 0.62%). Table 2 in section 4.5 details the movement of the investments during 2018-19 by counterparty types and shows the average balances, investment income received, duration and rates for the year.

4.1.6 The treasury management function has been reviewed by the Council's External Auditors, the Wales Audit Office, during the 2018-19 annual audit and there were no adjustments relating to treasury management. In addition to the external audit work, the Internal Audit section undertook an audit of the treasury management function during 2018-19 and the audit identified that "based on an assessment of the strengths and weakness of the areas examined, and through testing it has been concluded that the effectiveness of the internal control environment is considered to be sound and therefore substantial assurance can be placed upon the management of risks".

4.1.7 The Council's treasury management advisors are Arlingclose. Their contract runs from 1 September 2016 for four years following a tender process and the contract will be reviewed annually and either party may at any time terminate this agreement on 3 months prior written notice. The current services provided to the Council include:-

- advice and guidance on relevant policies, strategies and reports
- advice on investment decisions
- notification of credit ratings and changes
- other information on credit quality
- advice on debt management decisions
- accounting advice
- reports on treasury performance
- forecasts of interest rates
- training courses.

4.2 Treasury Risk Management 2018-19

4.2.1 The TMS sets out the parameters for the management of risks associated with Financial Instruments. The Council also produces Treasury Management Practices specifying the practical arrangements to be followed to manage these risks. The Council's overall treasury risk management procedures focus on the unpredictability of financial markets and putting in place measures to minimise these risks.

4.2.2 The Council has an integrated TMS where borrowing and investments are managed in accordance with best professional practice. The Council borrows money either to meet short term cash flow needs or to fund capital schemes approved within the capital programme. Therefore any actual loans taken out are not associated with particular items of expenditure or assets. The Council is exposed to financial risks including the potential loss of invested funds and the

revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's TMS.

4.2.3 The Council's activities expose it to a variety of financial risks, the key risks are:-

- Credit risk (i.e. security) – the possibility that other parties might fail to pay amounts due to the Council;
- Liquidity risk – the possibility that the Council might not have funds available to meet its commitments to make payments;
- Market risk - the possibility that financial loss might arise for the Council as a result of changes in such measures as interest rates movements.

4.2.4 The Council's primary objective for the management of its investments is to give priority to the security and liquidity of its funds before seeking the best rate of return so not all the options available to the Council were utilised during 2018-19. The majority of the Council's surplus funds during 2018-19 were therefore kept in the form of short-term investments and were all placed with counterparties satisfying the appropriate credit criteria and spread over a number of counterparties. This was deemed a much safer option even though it may be at the expense of extra basis points in interest and more detail is provided below in section 4.5.

4.2.5 The counterparty limits were constantly reviewed and, where market conditions dictated, the counterparty limit was dropped below those detailed in the Investment Strategy. No breaches of the Council's counterparty criteria occurred during 2018-19 and the Council does not expect any losses from non-performance by any of its counterparties in relation to deposits. A risk of irrecoverability applies to all of the Council's deposits, but there was no evidence at 31 March 2019 that this was likely to happen. The pie chart in section 4.5 below summarises the credit risk exposures of the Council's investment portfolio by credit rating, based on the lowest long term rating.

4.3 External Context 2018-19

4.3.1 The interest rate views, incorporated in the Council's TMS 2018-19, were based upon officers' views supported by a selection of City forecasts provided by Arlingclose. When the TMS 2018-19 was prepared in January 2018 it was forecast that the Bank Rate would remain at 0.50% during 2018-19.

4.3.2 The Bank Rate started the financial year at 0.50% and remained at that rate until 2 August 2018 when the Bank of England's Monetary Policy Committee (MPC) increased the rate by 0.25% to 0.75%. The Bank Rate remained at 0.75% for the remainder of 2018-19.

4.4 Borrowing Strategy and Outturn 2018-19

4.4.1 Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the

debt portfolio. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council took a cautious approach to its treasury strategy. With short-term interest rates currently lower than long term rates, it is likely to be more cost effective in the short term to use internal resources or take out short term loans instead. Short term and variable rate loans expose the Council to the risk of short term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates as shown in the treasury management indicators in section 4.9 below. However, with long term rates forecast to rise in the coming years, any such short term savings will need to be balanced against the potential longer-term costs. The Council's treasury management advisors will assist the Council with this 'cost of carry' and breakeven analysis.

- 4.4.2 The Council's primary objective for the management of its debt is to ensure its long term affordability. The majority of its loans have therefore been taken from the Public Works Loan Board (PWLB) at long term fixed rates of interest and the last time the Council took out long term borrowing was £5 million from the PWLB in March 2012. The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and were therefore unattractive for debt rescheduling activity so no rescheduling activity was undertaken in 2018-19 as a consequence. However, in conjunction with Arlingclose, the loan portfolio will continue to be reviewed for any potential savings as a result of any loan rescheduling. For cash-flow purposes on two occasions short term borrowing was taken in 2018-19 totalling £3 million and repaid within a few weeks and there was none outstanding at 31 March 2019.
- 4.4.3 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This is known as Internal Borrowing. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

4.5 Investment Strategy & Outturn 2018-19

- 4.5.1 Both the CIPFA Code and the WG 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, balancing the risk of incurring losses from defaults against receiving unsuitably low investment income.
- 4.5.2 The Annual Investment Strategy incorporated in the Council's TMS 2018-19 includes the credit ratings defined for each category of investments, the prudential use of non-specified investments and the liquidity of investments. The Council's investments have historically been placed in short term bank and building society unsecured deposits and with local and central government, however, investments may be made with any public or private sector organisations that meet the minimum credit criteria specified in the Investment

Strategy and any new instruments used will be in full consultation with Arlingclose.

- 4.5.3 As previously reported, the Council opened a Money Market Fund (MMF) in 2017-18 which is an approved financial instrument in the TMS and provides instant access to the funds. During 2018-19, additional MMFs were set up (all approved by Arlingclose) as well as a web based portal (at no cost to the Council) to simplify and introduce efficiencies to all aspects of MMFs, from account maintenance through to trading and reporting. These MMFs offer same-day liquidity and very low or no volatility and are a good alternative to instant access bank accounts. There was no balance outstanding in MMFs at 31 March 2019.
- 4.5.4 Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's to ensure that this lies within the Council's agreed minimum credit rating. **Appendix B** shows the equivalence table for these published credit ratings and explains the different investment grades. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. In the current climate, relying mainly on credit ratings is considered to be inappropriate and the Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard is therefore given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments are made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.
- 4.5.5 On a day to day basis, the Council typically has surplus cash balances arising from the cash flow e.g. timing differences between grants being received and making various payments. These are invested on the market via brokers, direct with the institution or held in deposit accounts or a money market fund with instant access. The Council usually invests for a range of periods dependent on cash flow requirements and the interest rates on offer having regard to the Investment Strategy.
- 4.5.6 Occasionally, investments are placed with the UK Debt Management Office (DMO - Executive Agency of UK Government) but only for very short term deposits and only as a last resort as the interest rates offered by this facility are lower than some other counterparties, but this is commensurate with the high level of security and reduced risk offered. It provides another option when examining potential investments and ensures compliance with the Council's investment objective that security takes priority over yield. There were no deposits outstanding with the DMO at 31 March 2019.
- 4.5.7 The Council's primary objective for the management of its investment portfolio is to give priority to the security and liquidity of its funds before seeking the best rate of return. As shown in Tables 2 and 3 below, the majority of investments in 2018-19 were held as short term investments with UK Local Authorities,

banks of high credit quality and in MMFs. Favourable cash flows have provided positive cash balances for investment and the balance on investments at 31 March 2019 was £27.40 million made up of £4 million long term investments, £20 million short term investments and £3.40 million Cash and Cash Equivalents. Table 2 below details these investments by counterparty type and Table 3 summarises these investments based on the maturity profile (remaining duration from 31 March 2019) and counterparty type.

Table 2: Investments Profile 2018-19

Investment Counterparty Category	Balance 01 April 2018	Investments Raised	Investments Repaid	Balance 31 March 2019	Investment Income Received 2018-19 **	Average Original Duration of the Investment	Weighted Average Investment Balance 2018-19	Weighted Average Interest Rate 2018-19
	(A)	(B)	(C)	(A+B-C)	**			
	£m	£m	£m	£m	£'000	Days	£m	%
Government - DMO	-	80.10	80.10	-	2.90	4	0.78	0.37
Local Authorities	21.00	139.10	139.10	21.00	201.49	125	28.73	0.74
Building Societies	2.00	7.00	8.00	1.00	13.03	97	1.33	0.65
Banks (Fixed Maturity)	5.00	10.00	11.00	4.00	40.01	205	5.35	0.75
Banks Instant Access/Notice Period Accounts*	2.40	100.23	101.23	1.40	32.32	n/a	6.10	0.68
Money Market Fund (Instant Access)*	-	65.65	65.65	-	39.58	n/a	6.86	0.73
Total/Average	30.40	402.08	405.08	27.40	329.33	108	49.15	0.72

* An average duration is not shown as there is no original duration as instant access or notice period and money is added and withdrawn to/from these accounts as required by cash-flow

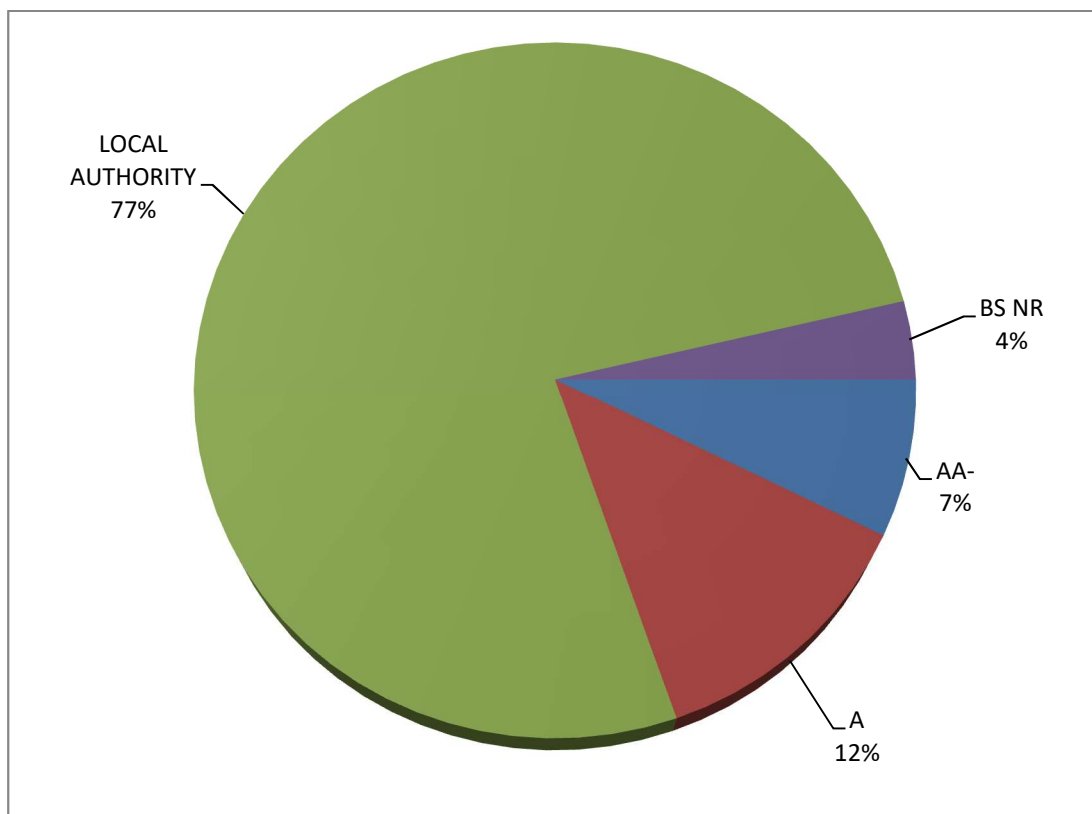
** Received in the Council's bank account not investment income earned

Table 3: Investments Outstanding Maturity Profile 31 March 2019

Counterparty Category	Instant Access	Deposits Maturing Within 1 Month	Deposits Maturing Within 2-3 Months	Deposits Maturing Within 4-6 Months	Deposits Maturing Within 7-12 Months	Deposits Maturing Within 1-2 Years	Total
	£m	£m	£m	£m	£m	£m	£m
Local Authorities	-	2.00	2.00	8.00	5.00	4.00	21.00
Banks	1.40	2.00	2.00	-	-	-	5.40
Building Society	-	-	1.00	-	-	-	1.00
Total	1.40	4.00	5.00	8.00	5.00	4.00	27.40

4.5.8 The Council defines high credit quality as organisations and securities having a credit rating of A- or higher. The pie chart below summarises the above table by credit ratings and shows the £27.40 million investments at 31 March 2019 by percentage outstanding. Most local authorities do not have credit ratings and the £1m investment with an unrated building society (shown as 'BS NR' below) was an approved counterparty by Arlingclose whilst the remainder of the Council's investments all had a credit rating of A or above.

Pie Chart: Investments Outstanding Credit Ratings Profile 31 March 2019



Performance Measurement

4.6.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year and the ones set in the TMS 2018-19 are shown below. These are distinct historic indicators as opposed to the Treasury Management and Prudential Indicators (shown in section 4.9 below and Appendix A) which are predominantly forward looking. One debt performance indicator is the average portfolio rate of interest compared to an appropriate average available such as the average PWLB Debt for Welsh and UK Local Authorities.

4.6.2 The average long term borrowing rate for 2018-19 and at 31 March 2019 was 4.69% (the same rate as at 31 March 2018) and 80% of this was made up of PWLB loans with an average rate of 4.70% (the same rate as at 31 March 2018). Comparable performance indicators are shown below:-

Bridgend CBC Average Rate of PWLB Debt 31-03-19 %	All Welsh Local Authorities* Average Rate for outstanding PWLB Debt 31-03-19 %	All Wales, England & Scotland Local Authorities* Average Rate for outstanding PWLB Debt 31-03-19 %
4.70	4.47	3.86
	+0.23	+0.84

*excluding Parish, Town and Community Councils

4.6.3 The average rate on investments for 2018-19 was 0.72% and at 31 March 2019 was 0.94% (compared to 0.49% for 2017-18 and 0.62% at 31 March 2018). Comparable performance indicators for benchmarking purposes set in the TMS 2018-19 were the average one month London Inter Bank Bid (LIBID) rate and the average Bank Rate. The tables below show that the investments average interest rate for 2018-19 and the actual rate as at 31 March 2019 compared favourably against these two benchmarking rates:-

Bridgend CBC Average Rate of Return on Investments 2018-19 %	Average 1 month LIBID (London Inter-Bank Bid rate) 2018-19 %	Average Bank Rate 2018-19 %
0.72	0.53	0.67%
	+0.19	+0.05
Bridgend CBC Average Rate of Return on Investments 31-03-19 %	1 month LIBID (London Inter-Bank Bid rate) 31-03-19 %	Bank Rate 31-03-19 %
0.94	0.61	0.75
	+0.33	+0.19

4.6.4 The Council participates in a benchmarking exercise with Arlingclose. As shown below, the Council's average rate of return on investments was above that of the average rate of return for Arlingclose's Welsh Local Authority Unitary clients internally managed investments, for the majority of the year. The Bank Rate is also shown for information:-

		Bridgend CBC		Arlingclose Welsh Local Authority Unitary Clients	
2018-19	Bank Rate %	Principal £m	Average Rate of Return Investments %	Principal £m	Average Rate of Return Internally Managed Investments * %
30-06-18	0.50	39.30	0.65	29.80	0.69
30-09-18	0.75	34.30	0.81	25.50	0.70
31-12-18	0.75	33.00	0.88	21.70	0.74
31-03-19	0.75	27.40	0.94	25.70	0.77

*Excludes external pooled funds

4.7 Review of the Treasury Management Strategy 2018-19

- 4.7.1 CIPFA's Code of Practice for Treasury Management requires all local authorities to conduct a mid-year review of its treasury management policies, practices and activities. As a result of this review it was not deemed necessary to make any changes to the TMS 2018-19, although Council approved a revised MRP policy for 2018-19 as detailed in paragraph 3.4.

4.8 Reporting Arrangements 2018-19

- 4.8.1 CIPFA's Code of Practice for Treasury Management requires that the Council reports on its treasury management as an annual strategy and plan in advance of the year, a mid-year review and an annual outturn report, to Council. Quarterly monitoring reports are also reported to Cabinet as Information Reports. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the Council's TMS and CIPFA's Standard of Professional Practice on Treasury Management.
- 4.8.2 In addition to the Code of Practice, the Welsh Government has issued Guidance on Local Government Investments which require local authorities to report their Annual Investment Strategy.
- 4.8.3 The Council has complied with its legislative and regulatory requirements during 2018-19. The TMS 2018-19 and the Half Yearly Outturn were reported to Council on 28 February 2018 and 24 October 2018 respectively and this Annual Treasury Management Outturn Report is being reported to Cabinet and Council in September 2019. In addition, quarterly monitoring reports were presented to Cabinet during 2018-19.
- 4.8.4 To ensure effective scrutiny of treasury management in accordance with the TMS, Audit Committee has been nominated to be responsible for ensuring effective scrutiny of the treasury management strategy and policies. During the financial year 2018-19, in addition to the regular treasury management reports to Cabinet and Council, Audit Committee received the Annual Treasury Management Report 2017-18 in June 2018, the Half Year Treasury Management Report 2018-19 in November 2018, the TMS 2019-20 in January 2019 and an Annual Outturn Report 2018-19 in June 2019.

4.9 Treasury Management & Prudential Indicators 2018-19

- 4.9.1 The 2011 Treasury Management Code and Prudential Code require the Council to set and report on a number of Treasury Management and Prudential Indicators. Details are shown in **Appendix A** of the estimated indicators for 2018-19 as detailed in the TMS 2018-19 approved by Council on 28 February 2018 and the actual indicators for 2018-19.

4.9.2 During the financial year 2018-19, the Council operated within the limits and indicators as set out in the agreed TMS 2017-18 and complied with its treasury management practices

5. Effect upon Policy Framework and Procedure Rules

5.1 As required by Financial Procedure Rule 20.3 within the Council's Constitution, all investments and borrowing transactions have been undertaken in accordance with the TMS 2018-19 as approved by Council with due regard to the requirements of the CIPFA's Code of Practice on Treasury Management in the Public Services.

6. Equality Impact Assessment

6.1 There are no equality implications.

7. Well-being of Future Generations (Wales) Act 2015 Implications

7.1 The well-being goals identified in the Act were considered in the preparation of this report. As the report is for noting only and is retrospective in nature it is considered that there will be no significant or unacceptable impacts upon the achievement of well-being goals/objectives as a result of this report.

8. Financial Implications

8.1 The financial implications are reflected within the report.

9. Recommendation

9.1 It is recommended that Cabinet:

- Note the treasury management activities for 2018-19
- Note the actual Treasury Management and Prudential Indicators for 2018-19 against the ones approved in the Treasury Management Strategy 2018-19.

Gill Lewis
Interim Head of Finance & Section 151 Officer
19 August 2019

Contact Officer: Karin Thomas
Loans & Investment Officer
Telephone: 01656 643198
E-mail: Karin.Thomas@bridgend.gov.uk

Background documents:
Treasury Management Strategy 2018-19