



Audit & Governance Committee
20 May 2019

2018/19 Treasury Management Outturn Report

Purpose of the report:

This report summarises the Council's treasury management activities during 2018/19, as required to ensure compliance with the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve a treasury management annual report after the end of each financial year.

Recommendations

It is recommended that the committee:

1. Note the content of the Treasury Management Annual Report for 2018/19; and
2. Adopt the Treasury Management Risk register, attached as Annex 2.

Background:

- 1 Treasury Management is defined as the management of the organisation's cash flows, banking, money market and capital market transactions, the effective management of the risk associated with those activities, and the pursuit of optimum performance consistent with those risks.
- 2 The Authority's treasury management strategy and Prudential Indicators for 2018/19 were approved by Council in February 2018. The Authority has continued its policy of borrowing money on a short term basis, and made temporary deposits of cash. While this does lead to lower interest costs in the short term, the Council remains exposed to financial risks including the 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 Authority's treasury management strategy.
- 3 An economic commentary is included in annex 1, outlining the main influences and changes in the UK and European economy during the year. The significant move during the year have been the Bank of England's Monetary Policy Committee (MPC) increasing the Bank Rate by 0.23% to 0.75% in August 2018. Inflation continued to rise, in line with the Bank's forecast in February Inflation Report, to 1.9%, which remains within the 2% target. A further 0.25% rise could be on the horizon later this year if inflation continues this trajectory.

- 4 Treasury Management will always operate with a degree of risks, due to its exposure to outside influences. The updated Risk Register shown in Annex 2 presents the principal risks faced by the Council in its treasury management function and the actions undertaken to mitigate these risks.

Treasury Management Annual Report 2018/19

- 5 On 31st March 2019, the Authority had net borrowing of £635m arising from its revenue and capital income and expenditure, an increase of £70m since 31 March 2018. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), which represents the amount of capital expenditure that is not funded from capital receipts, government grants, third party contributions or revenue.
- 6 Net borrowing has increased due to a rise in the CFR as new capital expenditure was higher than the financing applied, including minimum revenue provision.
- 7 The Treasury Strategy for 2018/19, approved by Council in February 2018, continued the policy of internal borrowing, which maintains borrowing and investments below their underlying levels, in order to reduce risk and keep interest costs low.
- 8 The Council also manages cash on behalf of Surrey Police and Crime Commissioner, the balance of which was £13.7m as at 31 March 2019. The Council accounts for this as short term borrowing. The treasury management position as at 31st March 2018 and the year-on-year change in show in table 1 below.

Table 1: Treasury Management Summary

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m
Long-term borrowing	397	-	397
Short-term borrowing	193	62	255
Surrey Police	18	(4)	14
Total borrowing	608	58	666
Short-term investments			
Cash and cash equivalents	43	(12)	31
Total investments	(43)	12	(31)
Net borrowing	565	70	635

Borrowing Activity

- 9 At 31 March 2019, the Authority held £666m of loans, an increase of £58m on the previous year. The year-end borrowing position and the year-on-year change in show in table 2 below.

Table 2: Borrowing Position

	31.3.18 Balance £m	2017/18 Movement £m	31.3.19 Balance £m	31.3.19 Rate* %
Public Works Loan Board	387		387	4.10
Banks (fixed-term)	10		10	5.0
Local authorities (short-term)	193	62	255	0.84
Surrey Police & Crime Commissioner	18	(4)	14	0.68
Total borrowing	608	58	666	

*Weighted average maturity

- 10** The Authority's primary consideration when borrowing money is to balance low interest charges and cost certainty over the period, while allowing enough flexibility to renegotiate a portion of the debt portfolio based upon changing strategic needs.
- 11** In furtherance of these objectives, no new long term borrowing was undertaken in 2018/19, with all new debt being dated shorter than 365 days. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

Investment Activity

- 12** The Authority holds invested funds, representing income received in advance of expenditure.
- 13** Both the CIPFA Code and government guidance require the Authority 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 Authority'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.
- 14** In furtherance of these objectives, and given the continuing risk and low returns from short-term unsecured bank investments, the Authority has kept its cash balances and investments low throughout 2018/19 and invested funds principally in Money Market Funds to ensure liquidity. During the year, the Authority's investment balance ranged between £0.6m and £113m. The year-end investment position and the year-on-year change in show in table 3 below:

Table 3: Investment Position (Treasury Investments)

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m	31.3.19 Rate* %
Banks & building societies (unsecured)	0	0	0	0
Government (incl. local authorities)	0	0	0	0
Money Market Funds	43	(12)	31	0.63
Total investments	43	(12)	31	0.63

*Weighted average maturity

- 15 The weighted average return on all investments the Council received in the year to 31 March 2019 was 0.63%. This compares favourably against the 0.51% average 7-day London Interbank Bid Rate (LIBID) for the same period.

Financial Implications

- 16 The outturn for interest paid, interest received and the minimum revenue provision are outlined in table 4 below.

Table 4: Investment Position (Treasury Investments)

	Budget £m	Outturn £m	Variance £m
Interest Paid	6.6	4.2	(2.4)
Interest Received	(0.3)	(0.7)	(0.4)
MRP	18.4	15.1	(3.3)

- 17 The amount required to be set aside for the future repayment of external borrowing is known as the Minimum Revenue Provision. This amount is calculated with reference to the Council's balance sheet as at the end of the previous financial year. The amount required to be set aside for 2018/19 was £3.3 less than expected when the budget was set. This was due to underspends in the general capital programme for 2017/18.
- 18 The variance of £2.4m on interest payable relates mainly to the contribution from the investment strategy. These are made to cover the cost of borrowing for these investments. Due to additional investment the contribution has been higher than expected, which has been accentuated by the Council's continued short term borrowing strategy resulting in the contribution being in excess of the actual costs incurred. In addition, there was a further underspend of £1m in relation to amounts held within this budget to cover the potential costs of interest rate rises.

Compliance Report

- 19 The Executive Director of Finance is pleased to report that all treasury management activities undertaken during 2018/19 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits, the authorised limit and operational boundary for external debt, is demonstrated in table 4 below.

Table 5: Debt Limits

	2018/19 Maximum £m	31.3.19 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied
Borrowing	711	666	1,059	1,643	✓

- 20 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt did not exceed the operational boundary in any period in 2018/19.

Table 6: Investment Limits

	2018/19 Maximum £m	31.3.19 Actual £m	2018/19 Limit	Complied
UK Central Government			Unlimited	✓
Money Market Funds	113	31	£100m	✓
Any group of pooled funds under the same management			£25m	✓
Any group of organisations under the same ownership	0	0	£20m	✓
Any single organisation, except the UK Central Government			£20m	✓
Unsecured investments with Building Societies	0	0	£10m	✓

Treasury Management Indicators

- 21 The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Council analyses the investment portfolio against historic default rates to assess the maximum exposure to default. The table below shows that by ensuring all of the Council's investments are in AAA rated funds, based on the historic default rates of these funds, the Council has reduced its exposure to security risk.

Table 7 – Historic Debt Rates

	Amount	Historical experience of default	Adjustment for market conditions	Estimated maximum exposure to default
	£000s	%	%	£000s
	31/03/2019	31/03/2019	31/03/2019	31/03/2019
	(a)	(b)	(c)	(a x c)
Deposits with banks and financial institutions				
Local Authorities	0	0.00%	0.00%	0
AAA rated counterparties	30,700	0.00%	0.00%	0
AA rated counterparties	0	0.02%	0.02%	0
A rated counterparties	0	0.05%	0.05%	0
Other counterparties				
Total	30,700			0

Liquidity: The Council manages its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments. The Council maintains a bank overdraft of £100,000, utilises overnight access Money Market Funds and accesses short term borrowing to meet cash flow requirements. The Local Authority market provides readily available funds.

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

	31.3.19 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate exposure:			
• Fixed long term borrowing	100%	100%	✓
• Fixed short term borrowing			
• Fixed short term investments			
Upper limit on variable interest rate exposure	0%	25%	✓

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

	31.3.19 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	40%	50%	0%	✓
12 months and within 24 months	0%	50%	0%	✓
24 months and within 5 years	2%	50%	0%	✓
5 years and within 10 years	0%	75%	0%	✓
10 years and above	58%	100%	25%	✓

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of interest rate changes.

	2018/19
Actual principal invested for >364 days	0
Limit on principal invested beyond year end	35%
Complied	✓

Other Non-Treasury Holdings and Activity

- 22** Although not classed as treasury management activities, the 2018 CIPFA Code requires the Authority to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and/or regeneration as well as commercial investments which are made mainly for financial reasons.
- 23** The Authority holds the following non-treasury investments:
- £136m of directly owned property
 - £234m of loans to Halsey Garton Ltd (property investment)
 - £3m of loans to other local businesses & subsidiaries
 - £93m of equity investments.
- 24** Such loans and investments have been approved in accordance with the Council's agreed processes. A register of such investments is maintained and performance information is reported to the Investment Board or the Shareholder Board, in accordance with their Terms of Reference.
- 25** These non-treasury investments generated £5.7m of investment income for the Authority after taking account of direct costs and interest payable.

Implications

- Financial**
- 26** The financial implications of this report are discussed at paragraph 16-18 and are included in the outturn report to Cabinet.

Equalities

27 There are no direct equalities implications of this report.

Risk management

The risk management arrangements in relation to treasury management are discussed in paragraph 21. Annex 2 presents the revised Risk Register.

What happens next

- i. The treasury team will continue to monitor the UK and overseas banking sector and will continue to update this Committee as appropriate.
- ii. In line with the requirements of CIPFA's Code of Practice on Treasury management, this committee will receive a half yearly report on the Council's treasury management activities in December 2019, and a full year report for 2019/20 in May 2020.

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Sources/background papers:

Capital Budget, Prudential Indicators & Treasury Management Strategy 2018/19
CIPFA Code of Practice for Treasury Management
CIPFA Prudential Code
