COTSWOLD DISTRICT COUNCIL

TREASURY MANAGEMENT OUTTURN REPORT

2018/2019

1. Introduction

In February 2011 the Authority adopted 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.

This report fulfils the Authority's legal obligation to have regard to the CIPFA Code

The Authority's treasury management strategy for 2018/19 was approved at Full Council on the 20th February 2018. The Authority has invested substantial sums of money and is therefore 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.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

2. Economic commentary

After spiking at over $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.The UK economy showed signs of slowing with latest estimates showing GDP, helped by an improving global economy, grew by 1.8% in calendar 2017, the same level as in 2016. This was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, but it also reflected the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

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 GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

With the 29th March 2019, the original EU 'exit day' now been and gone, having failed to pass a number of meaningful votes in Parliament, including shooting down Theresa May's deal for the third time, MPs voted by a majority of one (313 to 312) to force the prime minister to ask for an extension to the Brexit process beyond 12th April in order to avoid a no-deal scenario. Recent talks between the Conservative and Labour parties to try to reach common ground on a deal which may pass a vote by MPs have yet to yield any positive results. The EU must grant any extension and its leaders have been clear that the terms of the deal are not up for further negotiation. The ongoing uncertainty continues to weigh on sterling and UK markets.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with EU. The EU itself appeared to be show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

3. Financial markets

December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the New Year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-

year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

4. Credit background:

Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities.

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.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

5. Local Context

On 31st March 2019, the Authority had net investments of £32.075m arising from its revenue and capital income and expenditure. 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 Table 1 below.

Table 1: Balance Sheet Summary

	31.3.18 Actual £m	2018/19 Movement £m	31.3.19 Actual £m
General Fund CFR	0	0	0
Less: External borrowing	2.001	2.001	0
Less: Usable reserves	24.741	3.149	27.890
Less: Working capital	3.510	0.675	4.185
Net Investments	**26.250**	**5.825**	**32.075**

The Council's strategy was to diverse investments into more pooled funds in order to reduce risk and increase returns. The treasury management position as at 31st March 2019 and the year-on-year change is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.18 Balance £m	2018/19 Movement £m	31.3.19 Balance £m	31.3.19 Rate %
Short-term borrowing	2.000	(2.000)	0	
Total borrowing	**2.000**	**(2.000)**	**0**	
Long-term investments	4.570	7.731	12.301	2.02%
Short-term investments	21.000	(7.810)	13.190	0.91%
Cash and cash equivalents	2.680	4.032	6.712	0.62%
Total investments	**28.250**	**3.953**	**32.203**	**1.26%**
Net investments	**26.250**	**5.953**	**32.203**	

6. Investment Activity

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19, the Authority's investment balance ranged between £24.765 and £43.800 million due to timing differences between income and expenditure. The year-end investment position and the year-on-year change in show in table 4 below.

Table 4: 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)	18.000	(9.967)	8.033	0.93%
Government (incl. local authorities)	5.005	0.005	5.010	1.02%
Money Market Funds/Call	2.671	4.041	6.712	0.62%
Pooled Funds	2.574	9.874	12.448	2.71%
Total investments	**28.250**	**3.953**	**32.203**	**1.26%**

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.

In furtherance of these objectives, and given the increasing risk and low returns from short-term unsecured bank investments, the Council diversified into higher yielding asset classes during 2018/19. £10m was invested across a number of pooled funds As a result, investment risk was lowered, and returns on all pooled funds have significantly increased the revenue returns compared with fixed term deposits.

Table 5: Current Pooled Funds

Fund Manager	Investment	31st March 2018	31st March 2019	Dividends Received 2018/19	2018/19 Gain/(Loss)	Gain/(Loss) v Original Investment
	£	£	£	£	£	£
CCLA Property	500,000	509,148	511,537	22,154	2,389	11,537
CCLA Property	2,000,000	0	1,872,848	74,554	(127,152)	(127,152)
Schroders	1,000,000	0	930,978	47,183	(69,022)	(69,022)
M&G UK Income	2,000,000	0	1,932,672	49,104	(67,328)	(67,328)
Investec Div Income	2,000,000	0	2,027,051	22,550	27,051	27,051
Threadneedle Bond	2,000,000	0	2,026,591	5,069	26,591	26,591
CCLA Div	1,000,000	0	998,850	23,558	(1,150)	(1,150)
Total –current funds	**10,500,000**	**509,148**	**10,300,527**	**244,172**	**(208,621)**	**(199,473)**

A decision was made to open up different pooled funds during 2018/19 after taking advice from Arlingclose and receiving member's approval. The funds earned £244k but the capital values fell as asset classes had a turbulent time in late 2018. In respect to the CCLA Property Fund loss – this is entirely fees paid up front. However the returns on dividends amounted to a 2.32% for the financial year.

The nature of these funds is that values can fluctuate from one year to another. Their performance and suitability in meeting the Authority's investment objectives are monitored and discussed with Arlingclose on a regular basis.

7. Financial Implications

The outturn for investment income received in 2018/19 was £458,494 which equates to a 1.26% return (17/18 – 0.58%) on an average investment portfolio of £36.5 million against a budgeted £341,270 on an average investment portfolio of £36.5 million at an average interest rate of 1.16%.

Net investments made an actual surplus of £117,224 for the 2018/19 financial year.

8. Local Authority Regulatory Changes

CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code were incorporated into Treasury Management Strategies from the 2019/2020 financial year. The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. The Code also expands on the process and governance issues of capital expenditure and investment decisions.

In the 2017 Treasury Management Code the definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is be identified and reported.

9. Compliance Report

The Chief Finance Officer 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 is demonstrated in table 7 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	31.3.19 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied
Borrowing	0	4.5	6.5	✓

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 was never above the operational boundary during 2018/19.

10. Treasury Management Indicators

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

10.1. Security

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.3.19 Actual	2018/19 Target	Complied
Portfolio average credit	A	A-	✓

10.2. 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 incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2018/19	2019/20	2020/21
Actual principal invested beyond year end	£12.5m	£10.5m	£10.5m
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied	✓	✓	✓