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OXFORD CITY COUNCIL

To:	**Cabinet**
Date:	**11 September 2019**
Report of:	**Head of Financial Services**
Title of Report:	**Treasury Management Annual Report 2018/2019**

Summary and Recommendations	
Purpose of report:	The report sets out the Council's Treasury Management activity and performance for the financial year 2018/2019
Key decision:	No
Executive Board Member:	Councillor Ed Turner
Corporate Priority:	An Efficient and Effective Council.
Policy Framework:	Treasury Management Strategy.
Recommendation: That the Cabinet resolves to:	
1. **Note** the report	

Appendices
None

Executive Summary

1. The Council held investments of £96.2 million as at 31st March 2019. Net interest earned during the year, including from loans to companies and external borrowing, was £3.12 million against a target of £2.91 million, excluding any one-off or exceptional items.
2. The average rate of return on the Council's investments in 2018/19 was 1.15% compared to 1.17% in 2017/18. The Council's performance target for the year was 0.6% above base rate, equating to 1.10% for April-Jul 2018 and 1.35% for August 2018-March 2019. Although there was an increase in the base rate during the year, this was not reflected in investment returns as the market reduced its rates due to perceived economic and political risks.

3. At 1 April 2018, the Council had £0.17 million outstanding with the failed Icelandic Banks. Nothing was received in the year and the viability of the remaining balance was low. This balance was written off to revenue in 2018/19. Writing off the balances does not stop the Council continuing to take any actions it could to get the funds returned. The write-off is just an "accounting treatment" of the monies owing. Further information can be found in paragraphs 25-28.

4. The Council was owed £1.17 million relating to land at Barton Park as at 1 April 2018. Information that became available during 2018/19 identified that the Council is now extremely unlikely to receive payment for this debt under the Barton Oxford LLP agreement. This debt was therefore fully impaired in 2018/19. The impairment, however, due to its capital nature, is reversed out of revenue meaning that there is an impact on the level of capital resources available in the future but no direct impact on the level of general fund balances.

5. The Council held £198.5 million of fixed rate Public Works Loan Board (PWLB) debt as at 31 March 2019. The debt was borrowed in March 2012 to fund the buy-out of the Housing Revenue Account (HRA). All of the debt relates to Housing and the maturity profile ranges from 4 to 40 years. Interest paid on the debt in 2018/19 was £6.47 million.

Background

6. The primary principle governing the Council's investment decisions is the Security of the investment, with Liquidity and Yield being secondary considerations.

7. The Council has a statutory duty to set, monitor and report on its prudential indicators in accordance with the Prudential Code, which aims to ensure that the capital investment plans of authorities are affordable, prudent and sustainable.

8. When considering whether to borrow, the Council's Debt Strategy requires a number of factors to be considered. These include:

   - prevailing interest rates
   - the profile of the Council's debt portfolio
   - the type of asset being financed
   - the availability of cash balances to finance capital expenditure.

9. The Council fully complied with its Treasury Management Strategy in relation to both debt and investment management in 2018/19.

10. The prudential indicators detailed in the body of this report compare the Council's outturn position against the target set for 2018/19.

Financing the Capital Programme 2018/19

11. Table 1 below shows actual capital expenditure and financing compared to the original budget.

Table 1

Capital Expenditure	2018/19 Original Budget £'000	2018/19 Actual £'000	Variation £'000
Non-HRA Capital Expenditure	65,836	28,944	-36,892
HRA Capital Expenditure	19,390	13,589	-5,801
Total Capital Expenditure	**85,226**	**42,533**	**-42,693**
Resourced by:			
Developer Contributions	3,139	3,170	31
Capital Receipts	19,374	19,592	218
Capital Grants and contributions	1,811	2,635	824
Major Repairs Reserve	13,958	7,216	-6,742
Prudential Borrowing	35,082	4,180	-30,902
Revenue	11,862	5,740	-6,122
Total Capital Resources	**85,226**	**42,533**	**-42,693**

Much of the variation to the original budget relates to slippage in the programme the resources for which will be moved into funding the expenditure in future years.

The Council's Overall Borrowing Need

12. The Council's underlying need to borrow, or Capital Financing Requirement (CFR), is the measurement and control of the Council's overall debt position. It represents all prior years' net capital expenditure which has not been financed by other means, i.e. revenue, capital receipts, grants etc.

13. The CFR can be reduced by:

- The application of additional capital resources, such as unapplied capital receipts; or
- By charging a Minimum Revenue Provision (MRP), or a Voluntary Revenue Provision (VRP)

14. Table 2 below shows the Council's CFR as at 31 March 2019, this is a key prudential indicator, and shows that actual borrowing is below the CFR:

Table 2

CFR	**31 March 2018**	**31 March 2019**	**Variation**
	Estimate	**Actual**	
	£'000	**£'000**	**£'000**
Opening Balance	238,792	223,143	-15,649
Prudential Borrowing	35,082	4,180	-30,902
Minimum Revenue Provision	-63	-110	-47
CFR Closing Balance	**273,811**	**227,213**	**-46,598**
Consisting of:			
External Borrowing	198,528	198,528	0
Internal Borrowing	-75,283	-28,685	46,598

No new external debt was taken out during 2018/19 and as at 31 March 2019 the Council's total external debt was £198.5 million. This is below the CFR and indicates that the Council continues to borrow internally from its cash balances.

Treasury Position at 31 March 2019

15. Whilst the Council's gauge of its underlying need to borrow is the CFR, the treasury function manages the Council's actual need to borrow by either:

- Borrowing to the CFR;
- Choosing to utilise temporary cash flow funds, instead of borrowing (known as "under borrowing");
- Borrowing for future increases in the CFR (borrowing in advance of need*)*

16. The Council's treasury position as at the 31 March 2019 for both debt and investments, compared with the previous year is set out in Table 3 below:

Table 3

Treasury Position	31 March 2018		31 March 2019	
	Principal	Average Rate	Principal	Average Rate
	£'000	%	£'000	%
Borrowing				
Fixed Interest Rate Debt	198,528	3.15	198,528	3.15
Total Debt	**198,528**	**3.15**	**198,528**	**3.15**
Investments				
Fixed Interest Investments	61,000	0.63	70,000	0.97
Call Accounts	7,000	0.80	2,500	0.70
Variable Interest Investments	2,960	0.46	13,670	0.65
Property Funds	10,000	4.50	10,000	4.12
Total Investments	**80,960**	**1.17**	**96,170**	**1.15**
Net Position	**117,568**		**102,358**	

17. Overall, the Council earned a weighted average return of 1.15% on its investment which is below the target of 0.6% above base rate, which equated to 1.225% as at 31 March 2019.

18. The Council failed to achieve its target as the base rate rise that occurred in the latter half of the financial year wasn't reflected in the interest rates offered due to uncertainty in the market mainly due to Brexit.

Prudential Indicators and Compliance Issues

19. Some of the prudential indicators provide an overview, others a specific limit on treasury activity. These are detailed below:

20. ***Net Borrowing and the CFR*** – In order to ensure that borrowing levels are prudent, the Council's external borrowing (net of investments) over the medium-term must only be for a capital purpose, and not exceed the CFR except in the short-term. In the short term the Council can borrow for cash flow purposes. Table 4 below highlights the Council's net borrowing position against the CFR, and shows that it is significantly below the limit, due to the level of internal borrowing that has been undertaken.

Table 4

Net Borrowing & CFR	31 March 2018 Actual £'000	31 March 2019 Actual £'000
Total Debt	198,528	198,528
Total Investment	80,960	96,170
Net Borrowing Position	**117,568**	**102,358**
CFR	**223,143**	**227,213**
Under Borrowing plus Investments	**105,575**	**124,855**

21. In the current climate, internal borrowing is preferable to borrowing externally as the interest rate payable on an external loan is much higher than that which can be earnt on investments. Therefore, forfeiting interest receivable on investments is more economical than paying additional interest charges for new external debt. If the net borrowing position, interest rate position and/or CFR changed significantly, the prospect of taking on additional debt would be reviewed.

22. ***The Authorised Limit*** – The Authorised Limit is the ‘affordable borrowing limit’ required by S3 of the Local Government Act 2003. The Council does not have the power to borrow above this level unless it explicitly agrees to do so. Table 5 below demonstrates that during 2018/19 the Council’s gross borrowing was within its Authorised Limit. The Authorised Limit allows for some headroom above the Council’s projected CFR.

Table 5

Authorised Limit compared to Actual Borrowing	31 March 2018		31 March 2019	
	Limit £'000	Actual £'000	Limit £'000	Actual £'000
Authorised Borrowing Limit	338,199	198,528	372,118	198,528

23. ***The Operational Boundary Limit*** – the Operational Boundary Limit is the expected borrowing position of the Council during the year. It is possible to exceed the Operational Boundary Limit, for a short period of time, providing that the Authorised Borrowing Limit is not breached. Table 6 below shows the limits for the last two financial years. Actual borrowing remained unchanged at £198.5m hence the limits were not breached during either period.

Table 6

Operational Boundaries	31 March 2018 £'000	31 March 2019 £'000
Total Operational Borrowing Limit	243,528	274,000

24. ***Actual financing costs as a proportion of net revenue stream*** – this indicator identifies the trend in the net cost of capital against the net revenue stream and is an indicator of affordability. Table 7 below shows that for the General Fund, the ratio is negative as external loans have been repaid and investment income is positive. The HRA ratio has improved slightly after last year's reducing income stream meaning that financing costs as a proportion have also fallen.

Table 7

Actual Finance Costs	2017/18 £'000	2018/19 £'000
Revenue Stream		
General Fund	22,858	25,873
Housing Revenue Account	44,739	45,030
Comparison to Actual Revenue Position		
Financing Costs as a proportion of Net Revenue Stream - General Fund	-6.78%	-7.48%
Financing Costs as a proportion of Net Revenue Stream - HRA	16.93%	16.70%

Icelandic Banks

25. During 2008/09 the Council invested £4.5 million with two of the now failed Icelandic banks: £3.0 million was deposited with Heritable Bank and £1.5 million with Glitnir Bank.

26. As at 31 March 2016, the Council had received approximately £2.94 million of its original Heritable Bank investment. An outstanding balance of £0.06 million remains.

27. As at 31 March 2016, the Council had received approximately £1.39 million of its Glitnir investment. An outstanding balance of £0.11 million remains with the prospect of full recovery uncertain.

28. There have been no further receipts and therefore in 2018/19 the balances have been written down to revenue as the Council now deems these to be irrecoverable

Investment Income

29. Markets are remaining weak as rate increases look less likely due to Brexit and economy pressures, no rate rise now predicted by Link Asset Services (the Council's Treasury advisers) until December 2020 and the rates being offered may even anticipate a rate decrease over next two quarters.

30. The Council manages its investments in-house and invests with institutions listed in the Council's approved counterparty list. The Council invests for a range of periods

from overnight to 364 days, dependant on cash flow requirements, its view on interest rates and duration limits are set out in the Council's Investment Strategy.

31. During 2018/19, the Council maintained an average investment balance of £106 million and received an average return of 1.15%. The upper limit of non-specified investments allowed in the strategy is 25% of the average investment balance for the preceding calendar year. The average balance for 2018 was £106 million giving a limit on non-specified investments of £26.5 million. Only the property funds fell into the non-specified investment category; their original investment value was £10 million which within the non-specified limit at 9.4% of the average investment balance.

32. The Property Funds are classified as Non-specified Investments within the approved Strategy. The current rate of return on the investments is circa 4.05% per annum. The capital value of the Communities, Churches and Local Authorities (CCLA) Fund has increased by 34.37% between April 2013 and March 2019. However, it is important to reiterate that fluctuations in value are to be expected with property fund investments over the short term and that they are a long term investment; as such, any gains and losses in fund value should be considered over the long term.

33. The overall value of the Lothbury property fund investment has increased by 17.39% since inception in August 2014.

34. Actual investment income for 2018/19 was £3.12 million; £0.21m higher than the budget estimate of £2.91 million. The difference is primarily due to reinvestments being arranged at a higher rate than previously assumed following the rate rise and the increased average investment level.

35. Fluctuations in the Council's balances have been managed through a mix of instant access and notice accounts, money market funds and short term deposits (up to 364 days). This approach is in line with the Investment Strategy approved by Council.

Interest Rates since 31 March 2019

36. The Council takes advice from Link Asset Services on the appropriate durations to place investments with counterparties. These durations and also the availability of individual counterparties are subject to change dependent on market conditions and the credit ratings of the individual institutions. This means that the investment portfolio has to be actively managed to ensure both the availability of enough suitable counterparties and that the Council achieves the best interest rates possible within the agreed security and liquidity parameters.

37. There have been no increases in Base Rate since August 2018. Link's current view is that it will only increase to 0.25% over the next 3 years.

38. The Council continues to use money market funds, call accounts and instant access accounts for liquidity purposes, whilst seeking to maximise its returns by arranging longer term deposits where possible. In order to achieve this position, it is vital to maintain a robust cashflow model which is continuously reviewed and updated. However, given the volatile nature of the Council's cashflow requirements, it is not always possible to "lock away" funds for as long as may be desirable and so a strategic approach to investments is fundamental in order to achieve the most practicable yet favourable outcome.

Financial implications

39. These are set out within the body of the report.

Legal issues

40. The Council is required, under the 2003 Local Government Act, to report on its Treasury Management function on an annual basis. This report meets that requirement.

Level of risk

41. There are no risks in connection with the report's recommendations. Risk assessment and management is a key part of Treasury Management activity, especially in the selection of counterparties when investment is being considered. The Council uses external advisers and counterparty credit ratings issued by the rating agencies to assist in this process.

Equalities impact

42. There is no equalities impact assessment relating to this report.

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Background Papers: None

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