Annexes B & C to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Appendix 1

Treasury Management Annual Report 2018/19

Cardiff Council

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Introduction

1. Treasury management activities are the management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2. The Council carries out its treasury management activities in accordance with a code developed for public services and updated in 2017 by the Chartered Institute of Public Finance and Accountancy (CIPFA).

3. On 25th February 2010, Council approved policies and adopted the four clauses of the treasury management code which are replicated in **Annexe A** for information. Council received a report in February 2018 on the Council's Treasury Management Strategy for 2018/19 and a mid-year review in November 2018.

4. This report provides members with an annual report for the Council's Treasury Management activities for 2018/19. It covers:-

   - the economic background to treasury activities
   - treasury investment strategy and outturn for 2018/19
   - borrowing strategy and outturn for 2018/19
   - debt rescheduling
   - compliance with treasury limits and prudential indicators
   - treasury management issues for 2018/19

5. Council requires the scrutiny of the accounting, audit and commercial issues of its Treasury Management Strategy and practices to be undertaken by the Council's Audit Committee. A number of reports were submitted to the Committee to note and review during the year, with each committee receiving a report on the position and performance of treasury investments and borrowing. Member training has also been undertaken to support Members' scrutiny role.

Economic Background

6. Economic growth remained low in 2018/19, with growth of 0.4% in the first quarter of the financial year and 0.5% in the last quarter. However, whilst there are concerns over increases in wage inflation, price inflation as measured by CPI has been on a falling trend since November 2017. This is good news for consumers as it increases their spending power, potentially feeding through into economic growth in the coming months. However uncertainty over Brexit could inhibit growth in the short term.

7. Bank rate was increased from 0.5% to 0.75% in August 2018 which allowed the Council a slight increase in return on investment balances. Further changes are unlikely while until the outcome of Brexit is unclear. Borrowing rates continued their downward trend during the latter half of the year as Brexit uncertainties as well as trade and international political issues intensified. Weak growth in Europe also has resulted in additional demand for government bonds, reducing borrowing rates.

Investments and Outturn

8. The Council's treasury investments include those arising from its own temporary cash balances as well as balances held from activities of Joint Committees for which it is the accountable body.

9. The management of the day-to-day cash requirements of the Council is undertaken in-house with credit advice from Link Asset Services, the Council's Treasury Management advisors. This may involve temporary borrowing pending receipt of income or the temporary lending of surplus funds. Investment balances fluctuate daily and arise from a number of sources including differences in timing of revenue and capital cash flows, reserves, provisions and other balances held for future use.

10. The Council invests with institutions approved by Council as part of its Treasury Management Strategy in February 2018 and in accordance with investment guidelines established by the Welsh Government. As part of the Markets and Financial Instruments Directive II, the Council elected for 'professional' status. The categories, names, periods and size limits on the Council's approved investment list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers and monitored closely in conjunction with the Council's treasury advisors.

11. At 31 March 2019, investments stood at £93.3 million, with a short term investment strategy employed for most of the year. The Council's choice of investments maintained an approach of security, where the amount invested is that repayable. **Annexe B** shows with whom these investments were held.

12. A selection of performance indicators and benchmarking charts in relation to investments is included in **Annexe C.** The main areas to highlight at 31 March 2019 are as follows:-

    - Counterparty exposure against the maximum allowed directly with an organisation. This shows that at 31 March 2019 no exposure limits set were breached. This was also the case during the course of the year.
    - Investments held with different institutions as a percentage of the total shows that investments are diversified over a number of organisations and this was a strategy applied where possible during the course of the year.
    - The geographic spread of investments as determined by the country of origin of relevant organisations. All investments are in sterling and countries are rated AA and above as per our approved criteria.

13. Using historic data adjusted for current financial market conditions, the probability of any default is low at circa 0.02% of the investments outstanding, £14,000.

14. All investments held at 31 March 2019 are deemed recoverable. Accordingly, no impairment losses are reflected in the Council's 2018/19 Statement of Accounts arising from the Council's treasury management activities.

15. The overall level of interest receivable from treasury investments totalled £682,000 in 2018/19. The average returns achieved compared to industry benchmarks are shown in the table below.

	Return on Investment 2017/18		**Return on Investment 2018/19**	
	Benchmark 7day / 3month (%)	**Achieved (%)**	**Benchmark 7day / 3month (%)**	**Achieved (%)**
In-house	0.22/ 0.29	0.44	0.51/ 0.68	0.76

16. The benchmarks are the average of the 7 day London Interbank Bid Rate (LIBID) and 3 month LIBID respectively. These represent the average rate during the course of the year for investments for those periods. Performance exceeded benchmarks, due to availability of notice accounts offering higher deposit rates and undertaking longer term deposits where appropriate.

Borrowing and Outturn

17. Long term borrowing is undertaken to finance the Council's capital programme. The main sources of borrowing are currently the Public Works Loan Board (PWLB) and the Money Markets.

18. At 31 March 2019, the Council had £721.9 million of external borrowing. This was predominantly fixed interest rate borrowing payable on maturity.

31 March 2018			**31 March 2019**	
£m	**Rate (%)**		**£m**	**Rate (%)**
631.8		Public Works Loan Board	660.9	
51.0		Market (Lender Option Borrower Option)	51.0	
4.6		Welsh Government	4.5	
5.9		Other	5.5	
693.3	**4.64**	**Total External Debt**	**721.9**	**4.53**

19. Total interest payable on external debt during 2018/19 was £32.2 million of which £11.7 million was payable by the Housing Revenue Account (HRA). In total £38.0 million was set aside from General Fund and HRA revenue budgets in line with the Councils approved policy on provision for debt repayment.

20. Extracts from the borrowing strategy approved by Council in February 2018 are shown below.

The Council's Borrowing Strategy for 2018/19 and the capital financing revenue budgets included in the MTFP will consider all options to meet the long-term aims of: • *promoting revenue cost stability to aid financial planning and avoid a stop-start approach to service delivery, although it is recognised that this may have a financial impact* • *pooling borrowing and investments to ensure the whole Council shares the risks and rewards of treasury activities* • *ensuring borrowing plans are aligned to known capital expenditure spending plans and financial reserve levels and are also consistent with the prudent provision for the repayment of any capital expenditure paid for by borrowing* • *achieving a balanced maturity profile* • *having regard to the effects on current and future Council Tax and Rent Payers.*

<u>External verses internal borrowing</u> *Whilst interest rates for borrowing are greater than interest rates the Council receives for investments (the cost of carry), it makes financial sense to use any internal cash balances held in the short-term to pay for capital expenditure and minimise costs (Internal Borrowing), rather than undertake external borrowing. However, there is a risk that the Council may have to borrow at higher rates when it does actually need to borrow in future and so this position is kept under continuous review.*
In the short term, using internal borrowing to meet the CFR is deemed manageable. However, based on the current forecasts of capital expenditure plans and high level analysis of the sustainability of internal borrowing from the Council's balance sheet position for future years, external borrowing will be required to be undertaken in the very short term.

21. During 2018/19 borrowing of £32.9 million was undertaken. This comprised borrowing of £32.4 million from PWLB at an average rate of 2.43% with an average maturity of 43 years, and £565,000 of interest free loans from Salix for specific capital schemes. Together with the natural maturity of £4.3 million of primarily PWLB loans, the overall effect of these transactions during the year was to reduce the average rate on the Council's borrowing to 4.53% at 31 March 2019.

22. As part of its loan portfolio, the Council has six Lender Option Borrower Option (LOBO) loans totalling £51 million. These are where the lender can request a change in the rate of interest payable by the Council on pre-determined dates. The Council at this point has the option to repay the loan. Apart from the option to increase rates these loans are comparable to PWLB and have no other complications such as variation in interest rates or complex terms.

23. Interest rates on the LOBO's held range between 3.81% and 4.35% which are not unreasonable and are below the Council's average rate of interest payable. Details of the loans are shown in the table below.

24. None of the LOBO's had to be repaid during 2018/19. £24 million of the LOBO loans are subject to the lender having the right to change the rate of interest payable during the next financial year. The Council has the right to refuse the change, triggering early repayment and the need to re-finance. This is a manageable refinancing risk as LOBO's form a relatively low proportion of the Council's overall borrowing at 7.06%.

£m	Rate	Potential Repayment Date	Option Frequency	Full Term Maturity
6	4.28%	21/05/2019	6 months	21/11/2041
6	4.35%	21/05/2019	6 months	21/11/2041
6	4.06%	21/05/2019	6 months	23/05/2067
6	4.08%	01/09/2019	6 months	23/05/2067
22	3.81%	21/11/2020	5 years	23/11/2065
5	4.10%	16/01/2023	5 years	17/01/2078

25. In accordance with the strategy, the Council has been undertaking internal borrowing which is when it uses temporary cash balances it holds in the short term instead of undertaking external borrowing. This is confirmed by a comparison of the Council's external level of debt and Capital Financing Requirement at 31 March 2019 as shown later in this report.

Debt Rescheduling

26. No debt rescheduling or early repayment of debt was undertaken during 2018/19. The main obstacle remains the level of premium (penalty) that would be chargeable on early repayment by the PWLB. The premium payable on the balance of PWLB loans at 31 March 2019, which are eligible for early repayment (£439 million) is £360 million. This premium is payable primarily because:-

- Interest rates on loans of equivalent maturities compared to those held are currently lower
- A penalty rate or lower early repayment rate was introduced by HM Treasury in November 2007, which increased the cost of premiums and reduced flexibility of Local Authorities to make savings. This has been a significant thorn in the ability of local authorities to manage debt more effectively.

27. The Council has also offered the opportunity for early repayment of LOBO loans but any required premiums payable are unviable. Whilst the cost of premiums can be spread over future years, options for restructuring that have been considered previously, but result in an adverse Net Present Value (NPV). Whilst there may have been short terms savings, these were outweighed by potentially longer term costs and not deemed cost effective.

Compliance with treasury limits and prudential indicators

28. During the financial year the Council operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy. The actual outturn is shown in the following paragraphs and compared to the original estimates contained in the 2018/19 Budget Report. Future year's figures are taken from the Budget Report for 2019/20 and will be updated in the Budget Report for 2020/21.

Capital Expenditure

29. The "Prudential Code" requires the Council to estimate the capital expenditure that it plans to incur over the Medium Term. The actual capital expenditure incurred in 2018/19 and estimates of capital expenditure for the current and future years as set out in the Budget Report of February 2019 are as follows:-

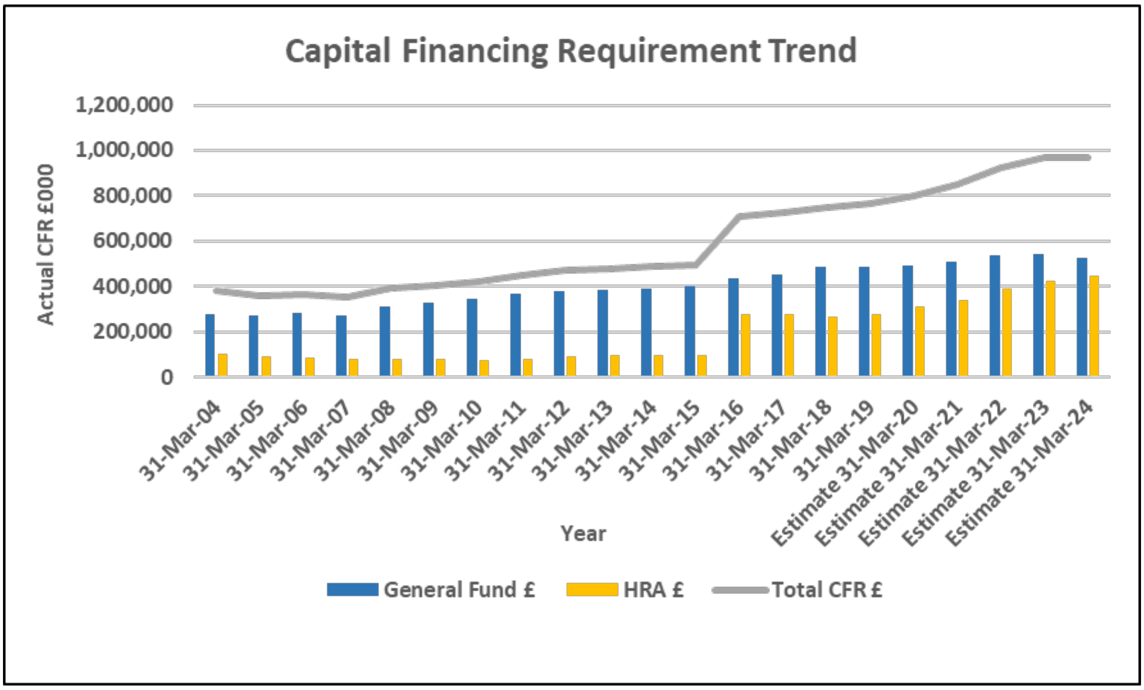
Capital Expenditure							
	2018/19 Actual £m	**2018/19 Original Estimate £m**	**2019/20 Estimate Month 4 £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
General Fund	104	100	71	112	172	120	26
HRA	39	42	45	65	80	69	54
Total	**143**	**142**	**116**	**177**	**252**	**189**	**80**

Capital Financing Requirement (CFR) – The Borrowing Requirement (Excluding Landfill Provision)

30. Where capital expenditure has been incurred without a resource to pay for it immediately i.e. when proposed to be paid for by supported or unsupported borrowing, this will increase what is termed the Council's Capital Financing Requirement (CFR) which is the Council's underlying need to borrow. The Council is required to make a prudent provision for the repayment of historic capital expenditure from its revenue budget. This reduces the CFR. Calculation of the CFR is summarised in the table below and results in the need to borrow money.

	Opening Capital Financing Requirement (CFR)
+	Capital expenditure incurred in year
-	Grants, contributions, reserves and receipts used to pay for capital expenditure
-	Prudent Minimum Revenue Provision & Voluntary Repayment
=	*Closing Capital Financing Requirement (CFR)*

31. The historic trend in the CFR is shown below, with the increase in 2015/16 reflecting the Housing Revenue Account subsidy buyout as reported previously.



32. The CFR as at 01 April 2018 was £751 million. The actual CFR as at 31 March 2019, estimates for current and future years (estimated in the February 2019 budget) are shown in the table below and exclude non cash backed provisions in relation to Landfill after care provision:-

Capital Financing Requirement (Excludes landfill provision)							
	31.03.2019 Actual £m	**31.03.2019 Original Estimate £m**	**31.03.2020 Estimate £m**	**31.03.2021 Estimate £m**	**31.03.2022 Estimate £m**	**31.03.2023 Estimate £m**	**31.03.2024 Estimate £m**
General Fund	488	500	483	509	538	543	524
HRA	279	295	304	342	387	426	447
Total CFR	**767**	**795**	**787**	**851**	**925**	**969**	**971**
External Debt	**722**						
Over / (Under) Borrowing	**(45)**						

33. By comparing the CFR at 31 March 2019 (£767 million) and the level of external debt at the same point in time (£722 million), it can be seen that the Council is temporarily using circa £45 million of internal cash balances to finance the Capital Programme at 31 March 2019 (£58 million at 31 March 2018).

34. As set out in the February 2019 Budget Report, the CFR is forecast to increase over the next five years due to capital programme investment in existing assets, new housing,

21st century schools and invest to save schemes. Forecasts will be updated in the 2020/21 Budget Report.

35. The Housing Revenue Account CFR at 31 March 2019 is £279 million. As part of the Housing Finance Reform voluntary agreement with Welsh Government and HM Treasury in 2015/16, a debt cap of £316 million was introduced, however this has now been removed following national removal of the Cap.

Actual External Debt

36. The Code requires the Council to indicate its actual external debt at 31 March 2019 for information purposes. This was £722 million as shown in the earlier paragraphs.

Affordable Borrowing Limit

37. The Council has a statutory duty under section 3 of the Local Government Act 2003 and supporting regulations to determine and keep under review how much it can afford to borrow and to enter into credit arrangements (the “Affordable Borrowing Limit”). This cannot be breached without Council approval. Council must have regard to the Prudential Code when setting this limit which is intended to ensure that total capital investment remains within sustainable limits and that the impact upon future council tax/rent levels is affordable.

38. During 2018/19 the Council remained within the authorised limit of £863 million set for that year.

Operational Boundary

39. The operational boundary is the estimated level of external borrowing and is subject to the timing of borrowing decisions. The boundary was originally estimated at £795 million to match the forecast for the CFR when setting the 2018/19 budget. The actual level of external debt equalled £722 million reflecting the strategy to utilise internal borrowing in the short term.

Maturity Structure of Fixed Rate Borrowing

40. The maturity structure remains within the limits below approved as part of the 2018/19 strategy below. These limits are set to avoid having large amounts of debt maturing in a short space of time, thus being exposed to significant liquidity risk and interest rate risk.

	31-Mar-18		Upper limit	31-Mar-19			
				Loans to Maturity		Loans if LOBO's Paid Early	
	%	£m	%	%	£m	%	£m
Under 12 months	0.7	4.5	10	0.6	4.2	3.9	28.2
12 months and within 24 months	0.5	3.3	10	0.2	1.2	0.2	1.2
24 months and within 5 years	1.9	12.9	15	2.1	15.5	5.9	42.5
5 years and within 10 years	5.1	35.4	20	5.8	42.0	5.8	42.0
10 years and within 20 years	22.4	155.5	30	22.3	161.0	22.3	161.0
20 years and within 30 years	23.9	166.0	35	23.3	168.0	21.6	156.0
30 years and within 40 years	30.4	210.7	35	29.4	212.7	29.5	212.7
40 years and within 50 years	14.4	100.0	35	15.6	112.3	10.8	78.3
50 years and within 60 years	0.7	5.0	15	0.7	5.0	0.0	0.0

41. The maturity profile of the Council's borrowing as at 31 March 2019 is also shown in a chart in **Annexe D**. Unless the Council's LOBO loans are repaid early, very little debt matures within the next 10 years. In the medium to long term, efforts will be made to restructure loans maturing in 2056/57 and to review LOBO maturities in order to reduce refinancing risk. Benchmarking undertaken has demonstrated that the Council's maturity profile is not inconsistent with other local authorities where information is available.

<u>Ratio of financing costs to net revenue stream</u>

42. This indicator identifies the percentage of the net revenue stream that is subsumed each year in servicing debt. Financing costs include, interest payable on borrowing and receivable on treasury investments, prudent revenue budget provision for repayment of capital expenditure paid for by borrowing and re-imbursement of borrowing costs from directorates in respect of Invest to Save/Earn schemes.

43. For the General Fund, net revenue stream is the sum of non-specific WG Grants and Council Tax, whilst for the HRA it is the amount to be met from rent payers.

Ratio of financing costs to Net Revenue Stream							
	2018/19 Original Estimate %	**2018/19** Actual %	**2019/20** Estimate %	**2020/21** Estimate %	**2021/22** Estimate %	**2022/23** Estimate %	**2023/24** Estimate %
General Fund – **Net** Capital Financing Budget	5.76	5.69	5.59	5.71	6.04	5.90	5.70
General Fund – **Gross** Capital Financing Budget	7.53	7.65	7.50	7.82	8.40	8.52	8.41
HRA	31.53	31.21	33.14	35.72	36.75	36.26	37.44

44. Whilst the net indicator is required by the Prudential Code, it has a number of limitations:

- it does not take into account the fact that some of the Council's revenue budget cannot be directly influenced such as schools delegated budgets, fire levy and Council Tax Reduction Scheme payments
- it is impacted by transfers in and out of the settlement.
- it includes investment income which is unpredictable, particularly in future years.
- it does not reflect capital financing costs for schemes where additional borrowing is undertaken to be repaid from within directorate budgets.

45. Although there may be short term implications, invest to save/earn schemes are intended to be net neutral on the capital financing budget. However there are risks that the level of income, savings or capital receipts anticipated from such schemes will not materialise and would have a detrimental long term consequence on the Revenue budget. This requires careful monitoring when considering future levels of additional borrowing.

46. Accordingly an additional local indicator is calculated for the general fund to support decision making and is shown in the table below for the period up to 2023/24. These indicators, which will be updated in the budget proposals report for 2020/21, show capital financing costs of the Council as a percentage of its controllable budget, excluding treasury investment income:

Capital Financing Costs as percentage of Controllable Budget									
	2011/12 Actual %	2018/19 Original Estimate %	2018/19 Actual %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	Difference 11/12-23/24 %
Net	13.47	13.87	13.99	13.75	14.59	15.95	15.90	15.56	15.52
Gross	15.17	18.07	18.66	18.38	19.88	22.08	22.83	22.81	50.36

47. An increasing percentage indicates that a greater proportion of the controllable budget is required for capital financing costs which are committed in the long term. The requirement to meet these additional costs can only come from future savings or from increases in Council Tax. This clearly limits the scope for additional borrowing in future

years and reduces the Council's overall flexibility when making decisions on the allocation of revenue resources. The percentages take into account the impact on the controllable base budget of the significant level of savings having to be found in 2019/20 and over the medium term.

Principal Invested for over 364 days

48. An upper limit for principal invested over 364 days was set at £60 million and this was not breached during the year, primarily due to the strategy adopted of minimising the period for which investments were made during 2018/19.

Treasury Management issues for 2019/20

49. Whilst this report is primarily backward looking, in relation to Treasury Activities for 2018/19, some key issues for 2019/20 are:

- The timing of external borrowing given uncertainty over Brexit and the Council's longer term need to borrow
- WG consultation to update investment guidance for local authorities.

50. In accordance with the Council's Treasury Management Policy, Council will receive a further update on Treasury Management issues as part of the 2019/20 Mid-Year Treasury Management report in November 2019.

Christopher Lee
Corporate Director Resources
3 September 2019

The following Annexes are attached:-
Annexe A – Treasury Management Policy and Four Clauses of Treasury Management
Annexe B – Investments at 31 March 2019
Annexe C – Investment charts at 31 March 2019
Annexe D – Maturity analysis of debt as at 31 March 2019