Dorset Council

Audit and Governance Committee

Treasury Management Annual Report 2018/19

Date of Meeting: 17 September 2019

Portfolio Holder: Cllr Tony Ferrari

Local Member(s): Not applicable

Director: Aidan Dunn, Executive Director Corporate Development

Executive Summary:

This report summarises the treasury management performance and position information for Dorset Council's six predecessor authorities for the year ended 31 March 2019.

Treasury management at the six authorities was conducted within the framework of CIPFA's Treasury Management Code of Practice. In adopting the code, recommended best practice is for members to approve an annual treasury management strategy report, and to then receive a mid-year update on progress against the strategy and a year-end review of actual performance against the strategy (this report).

Total capital expenditure in 2018/19 for all six authorities was £72.1m, compared to a combined estimate of £61.6m when the respective treasury management strategies were approved. This was primarily because of higher than expected slippage of projects within the Dorset County Council capital programme.

The combined Capital Financing Requirement (CFR) (or borrowing need) for all six authorities at 31 March 2019 was £364.4m, compared to a combined estimate of £369.5m when the respective strategies were approved. Again, this is largely the result of slippage in the unfinanced element of the capital programme.

Total actual external borrowing and other financing liabilities of the six predecessor authorities at 31 March 2019 was £265.1m, and the total interest payable on this borrowing was £11.9m. The difference between the CFR and actual borrowing was approximately £100m, financed temporarily by 'internal borrowing' – effectively reserves have temporarily offset the need to borrow.

The total cash, cash equivalents, and investments for all six authorities at 31 March 2019 was £147.5m, of which £14.8m was invested for longer than one year. The total interest and investment income for all six authorities for the year was approximately £5.8m.

Equalities Impact Assessment:

This report does not deal with any new strategies or polices that would trigger an impact assessment.

Budget:

All treasury management budget implications are reported as part of the corporate budget outturn report, alongside the asset management reports that include the progress of the capital programme.

Risk Assessment:

This report is for information. However, treasury management is an inherently risky area of activity and a number of controls are embedded in its operation. The key treasury management risks are highlighted as part of the treasury management strategy approved by Council as part of the budget setting process. This report highlights any variances from this strategy and draws out any specific risks which have arisen.

Current Risk: HIGH
Residual Risk MEDIUM

Climate Implications:

Not applicable.

Other Implications:

Not applicable.

Recommendation:

That the Committee note and comment upon the report.

Reason for Recommendation:

To better inform members of treasury management activity, in accordance with the corporate requirement to ensure money and resources are used wisely.

Appendices:

Appendix 1 – Treasury Management Outturn Summary 2018/19

Background Papers:

Treasury management strategy statements 2018/19 (for each predecessor authority)
Statements of accounts 2018/19 (for each predecessor authority)

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1. Introduction

1.1 Local authorities operate a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The role of treasury management is to ensure this cash flow is adequately planned, with surplus monies invested with low risk counterparties, ensuring adequate liquidity initially before then considering optimising investment return.

1.2 The second main function of the treasury management service is the funding of capital plans. These capital plans provide a guide to the borrowing needs of councils, essentially longer-term cash flow planning to ensure capital spending requirements can be met. This management of longer-term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. Also, on occasion, any debt previously drawn may be restructured to meet risk or cost objectives.

1.3 Accordingly, treasury management is defined by CIPFA as:
"The management of the local authority'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."

1.4 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the TM Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code), and the obligation under the Local Government Act 2003 to have regard to the TM Code.

1.5 The TM Code recommends that local authorities produce for each financial year as a minimum:

- An annual treasury strategy in advance of the year;
- A mid-year treasury update report, and;
- An annual review following the end of the year describing the activity compared to the strategy (this report).

1.6 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn positions for 2018/19 for treasury activities, and highlights compliance with the predecessor councils' policies previously agreed by members of those councils.

1.7 The key outturn and comparator figures for the treasury management activities of the councils are summarised in Appendix 1. All figures are sourced from either the treasury management strategies or the final accounts for each of the predecessor authorities.

2. Treasury Management Advisers

2.1 Treasury management advisers provide a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;

- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments; and
- Credit ratings-market information service comprising the tmain credit rating agencies.

2.2 Whilst advisers provide support to the internal treasury function, under current market rules and the TM Code, the final decision on treasury matters remains with councils.

2.3 The six predecessor authorities all used treasury management advisers. Dorset County Council and Purbeck District Council both used Link Asset Services (formerly Capita Asset Services). East Dorset District Council, North Dorset District Council, West Dorset District Council and Weymouth and Portland Borough Council all used Arlingclose. Following a selection process, Arlingclose have been appointed as treasury management advisers to Dorset Council.

3. Economic Background and Interest Rate Forecasts

3.1 Part of the service provided by treasury management advisers is to help clients formulate a view on likely changes to interest rates.

3.2 In early 2018, when the predecessor authorities were finalising their strategy statements for 2018/19, Arlingclose forecast interest rates to remain broadly constant over the year but with some volatility, particularly driven by the progress of EU exit negotiations. Link forecast one 0.25% increase in Bank Rate during the year, with investment returns and borrowing rates increasing marginally too, but cautioned that the balance of risks to the UK economy was to the downside, highlighting in particular uncertainties in relation to Brexit.

3.3 UK economic growth in the first half of 2018/19 was modest but sufficiently robust for the Bank of England's Monetary Policy Committee (MPC) to unanimously vote in August 2018 to increase Bank Rate from 0.5% to 0.75%. Some MPC members had expressed concerns about a build-up of inflationary pressures and the MPC indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on target. However, expectations of further increases over the remainder of the year (and into 2019/20) subsided as Brexit uncertainties continued, and concerns grew about the risk of a global economic slowdown.

3.4. The following table gives Arlingclose's most recent forecast for UK Bank Rate, short term investment returns (LIBID) and borrowing rates from the Public Works Loans Board (PWLB):

	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-21	Mar-21	Jun-21
BANK RATE	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
3 month LIBID	0.95%	1.00%	1.15%	1.25%	1.35%	1.35%	1.35%	1.35%
6 month LIBID	1.00%	1.05%	1.20%	1.30%	1.40%	1.40%	1.40%	1.40%
12 month LIBID	1.15%	1.25%	1.40%	1.45%	1.55%	1.55%	1.55%	1.55%
5 Yr PWLB	0.85%	0.95%	1.05%	1.10%	1.10%	1.10%	1.10%	1.10%
10 Yr PWLB	1.05%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.50%
20 Yr PWLB	1.55%	1.60%	1.75%	1.80%	1.90%	1.95%	1.95%	1.95%
50 Yr PWLB	1.50%	1.55%	1.70%	1.75%	1.85%	1.90%	1.90%	1.90%

4. Capital Expenditure

4.1 Total capital expenditure in 2018/19 for all six predecessor authorities was £72.1m, compared to a combined estimate of £61.6m when the respective strategies were approved.

	DCC	EDDC	NDDC	PDC	WDDC	W&PBC	Total
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Capital Expenditure:							
Estimate	64,341	3,457	42	1,010	1,401	1,856	72,107
Actual	53,806	1,770	168	1,857	3,157	853	61,611
Under / (Over) Spend	10,535	1,687	- 126	- 847	- 1,756	1,003	10,496

4.2 The underspend was driven largely by higher than expected slippage of projects within the Dorset County Council capital programme, with funding carried forward into 2019/20 to enable those projects to be completed.

5. Capital Financing Requirement (CFR)

5.1 Councils' capital expenditure on long-term assets may either be financed immediately through the application of capital or revenue resources, including capital receipts from asset sales, capital grants received from central government or from revenue budgets, and has no impact on borrowing need. If insufficient financing is available, or a decision is made not to apply resources, capital expenditure will give rise to a borrowing need.

5.2 The Capital Financing Requirement (CFR) is the cumulative unfinanced element of the capital programme and is made up of a council's underlying need to borrow in addition to any Private Finance Initiative (PFI) and finance lease liabilities it may have.

5.3 In 2002, the Government changed the way in which it helped councils to fund their capital spend. Rather than paying councils capital grants the Government gave revenue grants to cover the costs of principal repayment and the interest costs of borrowing. This funding was included as part of the revenue support grant (RSG) funding formula. As part of the 2010 grant changes this part of the funding formula has been removed.

5.4 Part of a council's treasury activity is to address the funding requirements for this borrowing need, and the cash position must be managed to ensure that there is sufficient cash available to meet capital plans and resulting cash flow requirements. Borrowing may be sourced through external bodies, such as the government through the Public Works Loans Board (PWLB) or the money markets, or by temporarily utilising cash resources from within the council ('internal borrowing').

5.5 A council's borrowing need, and therefore CFR, cannot increase indefinitely, and statutory controls require the Council to make an annual charge to the Income and Expenditure account over the life of the assets that are being financed by the borrowing requirement. This charge is known as the Minimum Revenue Provision (MRP) and is effectively a repayment of the borrowing need.

5.6 It is important to stress that the borrowing need or requirement is not the same as the actual amount of borrowing held by a council. The decisions on the level of borrowing are taken as part of the treasury management operations of a council, subject to overriding limits in the treasury management strategy agreed by members annually.

5.7 The CFR can also be reduced by the application of additional capital financing resources (such as unapplied capital receipts or government grants); or by charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision.

5.8 The total CFR for all six predecessor authorities at 31 March 2019 was £364.4m, compared to a combined estimate of £369.5m when the respective strategies were approved.

	DCC	EDDC	NDDC	PDC	WDDC	W&PBC	Total
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Capital Financing Requirement:							
Opening CFR 01.04.2018	340,624	52	-	-	10,080	8,281	359,037
Closing CFR 31.03.2019	346,185	50	-	-	10,005	8,201	364,441
Estimated CFR 31.03.2019	351,303	48	-	-	10,000	8,100	369,451

6. Borrowing and Other External Capital Financing

6.1 Actual borrowing activity is constrained by the CFR, the operational boundary and the authorised limit, and maturity limits, all approved annually in the Treasury Management Strategy.

6.2 In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, a council's external borrowing should not exceed the brought forward CFR for the year plus the expected changes to the CFR from financing the capital programme for the current and next two financial years. This aims to prevent councils from borrowing to support revenue expenditure. It does, however, allow some flexibility over the timing of the borrowing so, if interest rates are favourable, for example, it can borrow in advance of its immediate cash need.

6.3 The 'operational boundary' is the limit beyond which external debt is not normally expected to exceed, based on the CFR plus an allowance for short term borrowing that might be required for cash flow purposes or unexpected calls on capital resources. The 'authorised limit' is based on the operational boundary but includes a margin to allow for unusual or unpredicted demands on cash.

6.4 In addition, 'maturity limits' can help councils to manage refinancing, liquidity and interest rate risks. If a high proportion of borrowing matures in any one year it may place pressure on the cash flow position of a council and force it to refinance these loans at unfavourable rates. By spreading the maturity profile of loans, the council can provide for their repayment in an orderly way.

6.5 In 2018/19, all six predecessor authorities complied with these prudential indicators as set out in their respective treasury management strategies.

6.6 The total borrowing, PFI and other financing liabilities of the six predecessor authorities at 31 March 2019 was £265.1m.

	DCC	EDDC	NDDC	PDC	WDDC	W&PBC	Total
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Capital Financing - actual:							
Short Term Borrowing	30,942	-	-	-	602	372	31,916
Long Term Borrowing	180,020	-	-	-	-	21,086	201,106
Total Borrrowing	**210,962**	**-**	**-**	**-**	**602**	**21,458**	**233,022**
Long Term PFI Liabilities	25,643	-	-	-	-	-	25,643
Obligations under Finance Leases	6,458	-	-	-	-	-	6,458
Total Capital Financing	**243,063**	**-**	**-**	**-**	**602**	**21,458**	**265,123**

6.7 The total interest payable on borrowing for all six predecessor authorities in 2018/19 was £11.9m.

	DCC	EDDC	NDDC	PDC	WDDC	W&PBC	Total
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Interest Payable	7,348	5	40	-	943	3,530	11,866

7. Investments

7.1 The TM Code requires councils to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return. Each predecessor authority invested in accordance with its own investment strategy, agreed by members alongside the treasury management strategy each year.

7.2 Balances available for investment fluctuate throughout the year as part of day to day operations, and cashflows are monitored and projections updated on a daily basis. Liquidity was maintained at adequate levels during the year by all six predecessor authorities, with no concerns over the ability to discharge creditors and other payments as they fell due.

7.3 The total cash, cash equivalents, and investments for all six predecessor authorities at 31 March 2019 was £147.5m. Of this, £14.8m was invested for longer than one year, compared to a combined upper limit of £161.0m.

	DCC	EDDC	NDDC	PDC	WDDC	W&PBC	Total
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Cash and Investments:							
Cash & Cash Equivalents	3,512	19,555	5,068	153	6,257	6,118	40,663
Short Term Investments	-	-	18,652	2,280	40,907	30,145	91,984
Long Term Investments	38	-	-	2,046	6,314	6,432	14,830
Total Cash & Investments	**3,550**	**19,555**	**23,720**	**4,479**	**53,478**	**42,695**	**147,477**

7.4 The total interest and investment income for all six predecessor authorities for the year was approximately £5.8m.

	DCC	EDDC	NDDC	PDC	WDDC	W&PBC	Total
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Interest & Investment Income	- 178	- 124	- 674	- 145	- 2,628	- 2,013	- 5,762

8. Member and Officer Training

8.1 The high level of risk inherent in treasury management means officers need to be adequately experienced and qualified. Officers attend national treasury management events and training courses, and have regular strategy and review meetings with advisers, as well as regular telephone contact.

8.2 A training session for all Dorset Council's elected members will be provided by officers and advisers to further explain the responsibilities that members have in relation to treasury management. Further training will also be provided from time to time.

9. Local Government Reorganisation (disaggregation)

9.1 The creation of two new unitary councils in Dorset has made it necessary to divide Dorset County Council's assets and liabilities as at 31 March 2019 between Dorset Council and Bournemouth, Christchurch and Poole (BCP) Council.

9.2 The principles for this process of disaggregation were agreed as part of preparations for setting up the two new councils. Officers from both councils are currently working through the DCC balance sheet detail to ensure the principles are applied correctly and consistently. This work should be complete by the end of September 2019.

9.3 The results of this exercise will have an impact on Dorset Council's capital financing requirements, and levels of borrowing and investments.

Aidan Dunn
Executive Director Corporate Development
September 2019