

THE ROYAL BOROUGH OF KENSINGTON AND CHELSEA

**AUDIT AND TRANSPARENCY COMMITTEE – 4 JUNE 2019
COUNCIL MEETING – 26 JUNE 2019**

REPORT BY THE EXECUTIVE DIRECTOR OF RESOURCES AND ASSETS.

ANNUAL TREASURY REPORT 2018/19

The Council's treasury management practices require this report to be made to the Lead Member for Finance and Modernisation and to the Audit and Transparency Committee. The latter is the body identified as being responsible for the scrutiny of treasury management. The report must also be presented to the full Council for information.

FOR INFORMATION

1. Introduction

1.1 This is the Treasury Management outturn report for 2018/19.

2. Background

2.1 The purpose of this report is to present the Council's annual Treasury Management outturn for 2018/19 in accordance with the Code of Practice on Treasury Management 2017, adopted by the Chartered Institute of Public Finance and Accountancy (CIPFA). It is a regulatory requirement for this outturn report to be presented to Council by the 30 September of each year.

2.2 This annual treasury report covers:

- the treasury position as at 31 March 2019;
- the borrowing strategy for 2018/19;
- the borrowing outturn for 2018/19;
- compliance with treasury limits and Prudential Indicators;
- investment strategy for 2018/19; and
- investment outturn for 2018/19.

3. Current Treasury Position

3.1 The Council's debt and investment positions at the beginning and end of the year were as follows:

£m	Principal	Rate	Principal	Rate
	31 March 2018	31 March 2018	31 March 2019	31 March 2019
Fixed Rate Borrowing				
Public Works Loan Board	226.35	4.68%	218.84	4.52%
Total / Weighted Average	226.35	4.68%	218.84	4.52%
Investments				
Fixed Term deposits	119.31	0.47%	83.00	0.96%
Call Account	3.63	0.15%	1.88	0.30%
Money Market Funds	100.00	0.44%	70.30	0.78%
Treasury Bills	0.00	N/A	55.10	0.76%
Total / Weighted Average	222.94	0.45%	210.28	0.84%

3.2 The table below shows the allocation of external interest paid and received during the year compared to the original budget:

Fund	Interest Payable (£M)			Interest Receivable (£M)		
	Budget	Actual	Over/(Under) spend	Budget	Actual	Over/(Under) spend
General Fund	3.68	2.70	(0.98)	(0.30)	(1.53)	(1.23)
Housing Revenue Account	8.21	7.75	(0.46)	(0.03)	(0.10)	(0.07)
Total	11.89	10.45	(1.44)	(0.33)	(1.62)	(1.29)

3.3 In addition to the above the HRA has paid interest totalling £1,306,000 to the general fund for use of general fund cash balances.

4. Treasury Borrowing

4.1 During 2017/18, the Council adopted a strategy of buying properties in the aftermath of the Grenfell Tower Fire. A report reviewing the Council's borrowing strategy was agreed by Council on 25 October 2017. New long-term borrowing totalling £100 million was undertaken in November 2017 through the Public Works Loans Board (PWLB) with interest rates and maturity periods varying respectively from 2.64% to 2.78% and from 20 years to 35 years.

4.2 The Council has an increasing capital financing requirement (CFR) and officers continue to monitor long term interest rates for suitable borrowing opportunities. The 2018/19 Treasury Management Strategy anticipated £10 million of new borrowing during the year, with £7.5 million of PWLB debt being repaid. The £7.5 million loan matured in January 2019 (an HRA loan originally placed at a rate of 9.25%). Cash balances remained relatively stable during 2018/19 and therefore no new external borrowing was required in the financial year. This led to the Council's average cost of borrowing being reduced as the table in paragraph 3.1 shows.

4.3 The following table shows highs and lows of PWLB rates during the financial year at various example maturity periods. These rates have been adjusted for the 0.20% certainty rate discount:

Years	Fixed Rates								1 month variable
	5	10	15	20	25	30	35	50	
03/04/2018	1.84%	2.22%	2.43%	2.53%	2.55%	2.51%	2.42%	2.27%	1.29%
29/03/2019	1.55%	1.85%	2.14%	2.35%	2.40%	2.37%	2.31%	2.23%	1.58%
High	2.07%	2.50%	2.74%	2.89%	2.93%	2.90%	2.86%	2.79%	1.58%
Low	1.50%	1.80%	2.09%	2.28%	2.33%	2.30%	2.24%	2.16%	1.29%
Average	1.80%	2.19%	2.45%	2.61%	2.65%	2.62%	2.56%	2.46%	1.50%
Spread	0.57%	0.70%	0.65%	0.61%	0.60%	0.60%	0.62%	0.63%	0.29%
High date	10/10/2018	10/10/2018	10/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018	12/10/2018	11/09/2018
Low date	28/03/2019	28/03/2019	26/03/2019	26/03/2019	26/03/2019	26/03/2019	26/03/2019	26/03/2019	03/04/2018

5. Housing Revenue Account (HRA) Self-Financing

5.1 Following the implementation of the self-financing initiative, the HRA has continued to be partly funded using the Council's general fund cash reserves. The HRA has paid interest to the general fund for the use of this money.

5.2 The balance of the general fund cash used to fund the HRA averaged £85.17 million over the year and was charged at an average rate of 1.53% based on PWLB three-month variable rates.

6. Capital Expenditure and Borrowing Limits

6.1 Capital expenditure to 31 March 2019 totalled £50.7 million for the General Fund and £25.8 million for the HRA.

6.2 The table below shows the capital expenditure and financing in 2018/19.

	General Fund £m	HRA £m	Total £m
Total Capital Expenditure	50.74	25.82	76.56
Financed by:			
Capital Receipts	6.64	8.42	15.06
Grants and Contributions	10.67	0.30	10.97
Earmarked Reserves	0.28	0.00	0.28
Revenue Contributions	0.14	11.95	12.09
Use of Major Repairs Reserve	0.00	5.15	5.15
Prudential Borrowing	33.01	0.00	33.01
Total Financing	50.74	25.82	76.56

6.3 The impact on the Council's Capital Financing Requirement (CFR) is also shown in the table below:

	General Fund £m	HRA £m	Total £m
Opening CFR 31/03/2018	160.76	210.16	370.92
Prudential Borrowing in 2018/19	33.01	0.00	33.01
Minimum Revenue Provision (MRP)	-0.83	0.00	-0.83
Closing CFR 31/03/2019	192.94	210.16	403.10

6.4 External borrowing was well within the Capital Financing Requirement, Authorised Borrowing Limit and the Operational Boundary.

7. Compliance with Treasury Limits

7.1 During the financial year, the Council operated within the treasury limits. The detailed outturn for Treasury Management Prudential Indicators is shown in **Appendix A**.

7.2 Other non-Treasury related Prudential Indicators are set and monitored as part of the Council's Budget process.

8. The Strategy for 2018/19

- 8.1 The Council strategy allowed investments in the following areas:
- investments in UK and overseas financial institutions with long term credit ratings of A or above;
 - no more than 50% of the portfolio placed with other local authorities meeting the Council's local authority lending criteria;
 - the purchase of government securities on a buy to hold basis with maturity dates of up to two years;
 - no more than £50 million to be invested in corporate bonds or commercial paper with up to one-year maturity in institutions with a UK Government guarantee;
 - no more than £50 million to be invested in European Investment Bank (EIB) bonds with up to one-year maturity;
 - no more than £150 million to be invested with money market funds; and
 - the balance to be deposited with the UK Government Debt Management Office (DMO).
- 8.2 The treasury management strategy for 2018/19, approved by the Council on 7 March 2018, was based on the expectation that the bank base rate would rise twice more from 0.50% up to 1.00% by 2020. The Bank of England increased the base rate to 0.75% in August 2018. Forward guidance indicates that in order to keep anticipated inflation in line the bank rate is expected to rise twice more in the next two years and reach 1.25% by the end of 2020. However, if the UK suffers a disorderly exit from the European Union later in the year, the MPC have said that rates could go up or down, though it is probably more likely to be down in order to support growth.
- 8.3 Taking into account the worldwide economic climate, it was considered appropriate to keep investments short-term and only invest with AAA rated Money Market Funds or UK Government backed institutions, resulting in capital preservation and relatively low returns compared with borrowing rates. This practice was relaxed as part of the 2019/20 strategy to enable the Council to place some limited investments with A rated banks going forward in 2019/20.

8.4 The following table shows how the portfolio was invested at 31 March 2019:

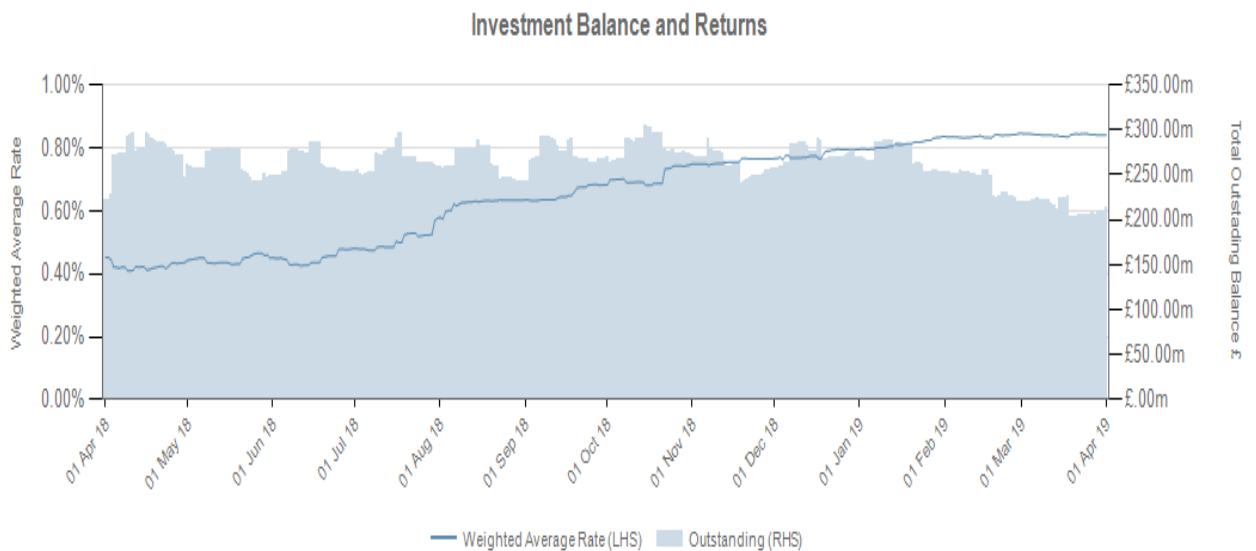
Counterparty Name	Investment Type	Amount £M	Percentage of Total Investment
DMO	Fixed Deposit	0.00	0.00%
Treasury Bills	Fixed Rate Bond	55.10	26.20%
Other Local Authorities	Fixed Deposit	83.00	39.48%
Royal Bank of Scotland	Call Account	1.88	0.89%
Money Market Funds	MMF	70.30	33.43%
Total		210.28	100.00%

This breakdown reflects the decision to keep the Council’s deposits with the local authorities, Money Market Funds and the UK Government during the year. The credit ratings shown in the Appendix are those in force at the end of the financial year and the limits shown are calculated using these ratings and the limits agreed in the 2018/19 Strategy.

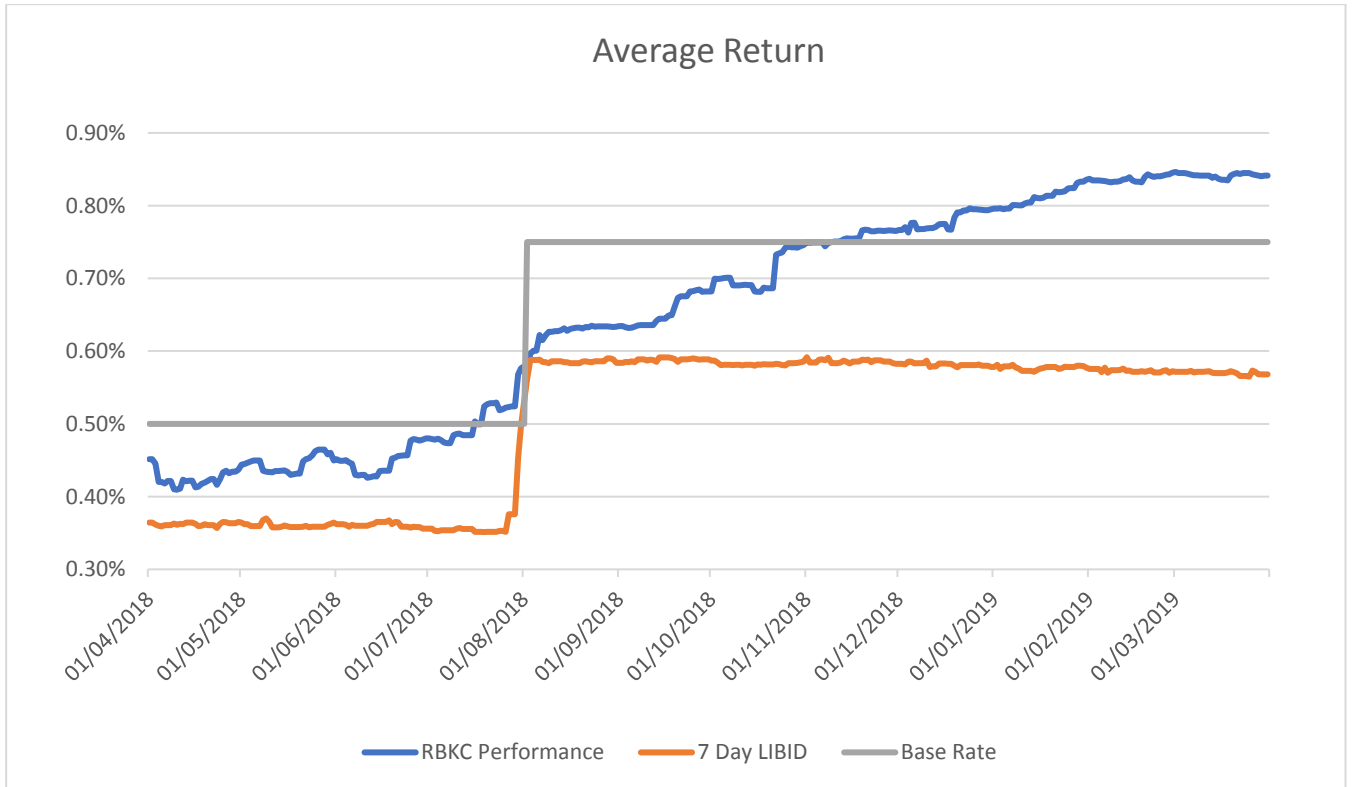
9. Investment Outturn for 2018/19

9.1 The investments outstanding at 31 March 2019 amounted to £210.28 million invested in short-term deposits. This compares with £222.94 million short-term investments at 1 April 2018.

9.2 The investments outstanding during the year together with the average return are shown in the following diagram:



9.3 The average return achieved on investments managed internally for the year 2018/19 was 0.65% compared with the average 7-day money market rate (uncompounded) of 0.51%. The Bank of England base rate was increased from 0.50% to 0.75% with effect from 2 August 2018. The Council follows a low risk strategy and does not seek potential higher returns which would increase counterparty risk. The following graph show the weekly average return on investments held compared with the base rate and the Benchmark 7-day London Interbank Bid (LIBID) rate:



9.4 The following table shows the average balances of short-term deposits that were placed during the year, and the range of interest rates achieved on the deposits compared to the average 7-day rate:

Period	Average Balance	Weighted Average Rate	Average 7 Day Rate
Quarter 1	267.34	0.44%	0.36%
Quarter 2	268.06	0.59%	0.51%
Quarter 3	272.47	0.75%	0.58%
Quarter 4	243.28	0.83%	0.57%

10. Future Changes

- 10.1 The Council's financial environment remains challenging and officers have begun undertaking a more detailed review of the Council's treasury management strategy to investigate whether the Council may be able to improve its treasury returns through exploring additional investment opportunities.

FOR INFORMATION

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Executive Director of Resources and Assets

Background papers: CIPFA Code of Practice on Treasury Management for the Public Sector
CLG Guidance on Local Government Investments

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**RBKC – TREASURY MANAGEMENT PRUDENTIAL INDICATORS
2018-19**

Indicator	Approved Limit £m	Actual Debt £m	No. of days Limit Exceeded
Authorised Limit ¹	281.00	218.84	None
Operational Boundary ²	267.00	218.84	None
Capital Financing Requirement (CFR)	445.64	403.10	None
Interest Rate Exposure	Lower Limit	Upper Limit	Actual at 31 March 2019
Fixed Rate Debt	50% of total debt	100% of total debt	100% total debt
Variable Rate Debt	0	50% of total debt	0
Maturity Structure of Borrowing	Lower Limit	Upper Limit	Actual at 31 March 2019
Under 1 year	0%	10%	2%
1 year to 2 years	0%	10%	5%
2 years to 5 years	5%	30%	11%
5 years to 10 years	10%	50%	12%
Over 10 years	30%	85%	70%

¹ The Authorised Limit is the maximum requirement for borrowing taking into account maturing debt, capital programme financing requirements and the ability to borrow in advance of need for up to two years ahead.

² The Operational Boundary is the expected normal upper requirement for borrowing in the year.

APPENDIX B

RBKC – AUTHORISED INVESTMENTS – ACTUAL USAGE 2018-19

	Credit Rating as at 31 st March 2019 (see below for definitions)			Limit £m	Peak Exposure £m	Year End Exposure £m
	Long Term	Short Term	Support			
UK GOVERNMENT						
Debt Management Account Deposit Facility	AA	N/A	N/A	Unlimited	135.20	0.00
Treasury Bills	AA	N/A	N/A	Unlimited	81.58	55.10
UK GOVERNMENT TOTAL						55.10
LOCAL AUTHORITIES						
Cheshire East Council				10.00	5.00	0.00
Conwy County Borough Council				10.00	5.00	0.00
Darlington Borough Council				10.00	5.00	5.00
Denbighshire County Council				10.00	8.00	8.00
Doncaster Metropolitan Borough Council				10.00	10.00	10.00
Dumfries and Galloway Council				10.00	5.00	0.00
Fife Council				10.00	5.00	0.00
Highland Council				10.00	5.00	5.00
Kingston upon Hull City Council				10.00	5.00	5.00

Leeds City Council				10.00	10.00	0.00
Lincolnshire County Council				10.00	0.06	0.00
London Borough of Barking and Dagenham				10.00	5.00	5.00
London Borough of Croydon				10.00	10.00	10.00
London Borough of Southwark				10.00	10.00	10.00
London Borough of Waltham Forest				10.00	5.00	5.00
North Lanarkshire Council				10.00	10.00	0.00
North Tyneside Metropolitan Borough Council				10.00	5.00	0.00
Plymouth City Council				10.00	10.00	0.00
Reading Borough Council				10.00	10.00	0.00
Rhondda Cynon Taff County Borough Council				10.00	10.00	10.00
Rotherham Metropolitan Borough Council				10.00	5.00	5.00
South Ayresshire Council				10.00	10.00	5.00
Stockport Metropolitan Borough Council				10.00	10.00	0.00
Swindon Borough Council				10.00	5.00	0.00
LOCAL AUTHORITIES TOTAL						83.00
MONEY MARKET FUNDS						
Federated Prime Rate Sterling Liquidity Fund	AAA			30.00	30.00	30.00

JP Morgan Sterling Liquidity Institutional Distributing Fund	AAA			30.00	28.90	10.10
Morgan Stanley Sterling Liquidity Institutional Fund	AAA			30.00	30.00	29.90
Blackrock ICS Institutional Sterling Liquidity Fund	AAA			30.00	30.00	0.30
MONEY MARKET FUNDS TOTAL						70.30
UK BANKS – Partially Nationalised						
Royal Bank of Scotland	BBB+	F2	1	£10m	3.63	1.88
UK BANKS TOTAL						1.88
TOTAL INVESTED						210.28

CREDIT RATING DEFINITIONS:

Fitch	Moody's	S&P	Definition
Long Term			
AAA	Aaa	AAA	Highest credit quality. 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
AA+ AA AA-	Aa1 Aa2 Aa3	AA+ AA AA-	Very high credit quality. 'AA' ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	A1 A2 A3	A+ A A-	High credit quality. 'A' ratings denote expectations of low credit risk. The capacity for payments of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
BBB	Baa	BBB	Good credit quality. 'BBB' ratings indicate that there are currently expectations of low credit risk. The capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category.

Short Term			
F1+ F1	P1 P1	A1+ A1	Highest credit quality. Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
F2	P2	A2	Good credit quality. A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.
F3	P3	A3	Fair credit quality. The capacity for timely payment of financial commitments is adequate; however, near term adverse changes could result in a reduction to non investment grade.
Support			
1	n/a	n/a	A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum long-term rating floor of 'A-'.
2	n/a	n/a	A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum long-term rating floor of 'BBB-'.
3	n/a	n/a	A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum long-term rating floor of 'BB-'.

