Policy and Scrutiny

Open Report on behalf of Andrew Crookham, Executive Director - Resources

Report to:	**Overview and Scrutiny Management Board**
Date:	**27 June 2019**
Subject:	**Treasury Management Annual Report 2018/19**

Summary:

This report has been prepared in accordance with the reporting recommendations of the CIPFA Code of Practice 2017 and details the results of the Council's treasury management activities for the financial year 2018/19. The report compares this activity to the Treasury Management Strategy for 2018/19, approved by the Executive Councillor for Finance on 20th March 2018. It will also detail any issues arising in treasury management during this period.

Actions Required:

That the report be noted and any comments to be passed onto the Executive Councillor with responsibilities for Finance.

1. Background

1. Introduction and Background

1.1. Treasury Management relates to the policies, strategies and processes associated with managing the cash and debt of the Council through appropriate borrowing and lending activity. It includes the effective control of the risks associated with the lending and borrowing activity and the pursuit of optimum performance consistent with the risks.

1.2. This Annual Treasury Report will cover the following matters for the year 2018/19:

- Economic overview and interest rate review.
- **Treasury Investments -** Treasury investment policy, risk appetite, treasury activity and return, comparing this with treasury strategy.
- **Long Term Borrowing -** Capital expenditure plans, borrowing requirement and activity, control of interest rate risk, debt rescheduling activity and internal borrowing position, comparing this with treasury strategy.
- Other treasury issues arising during 2018/19.

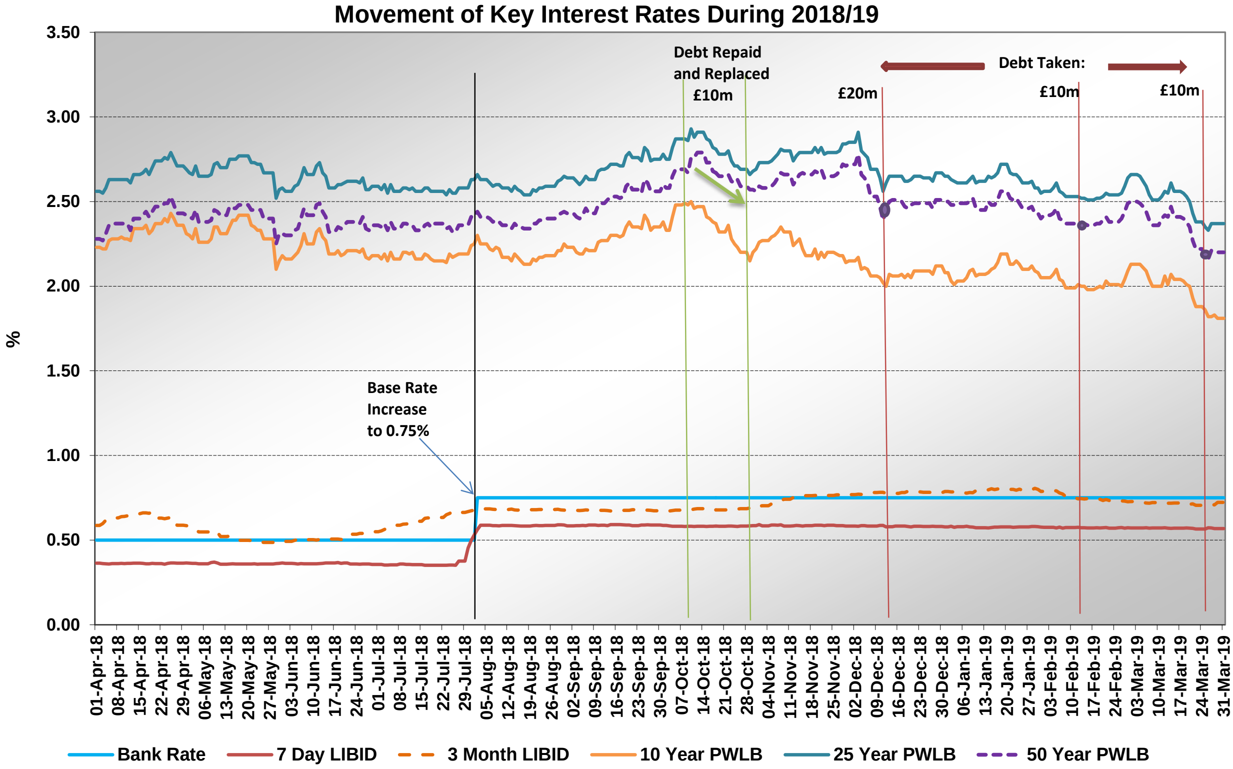
1.3. For reference, a **Key Points Summary** arising from this report has been included in the Conclusion in Section 2 of this report.

1.4. For further reference, a list of abbreviations used throughout this report is shown in **Appendix A**.

2. Economic Overview and Interest Rate Review 2018/19

2.1. At the time of setting the Strategy in March 2018, short term bank rate was expected to rise to 0.75% by the end of the year and long term rates were forecast to rise by around 0.30% by the end of the year.

2.2. The graph below shows that Base Rate was increased to 0.75% on 2nd August 2018 and has remained at that level since, in line with the forecast. Long term rates peaked mid-year, then started to fall when the impact of non-delivery of the Brexit withdrawal plan started to take hold. Long term rates ended the year below their starting level, especially in the 10 year period. The Council took advantage of this movement by securing new borrowing at the lower levels during the year as indicated on the graph.



2.3. **Growth** in the first half of 2018/19 picked up to a particularly strong annual rate of 1.4% (September 2018), prompting the MPC to raise Bank Rate on 2nd August 2018 from 0.50% to 0.75%. The UK was the third fastest growing country in the G7 at this time.

2.4. However, uncertainties over Brexit have weakened growth in the second half of the year and the MPC is unlikely to take any further action on Rates until these uncertainties clear, despite having concerns over the trend in

wage inflation, which peaked to a new high of 3.5% in December 2018. A disorderly exit of the EU is likely to see Bank Rate cut to support growth.

2.5. **CPI Inflation** fell over 2018/19 to a level of 1.8%/1.9% in January 2019 /February 2019. The latest Bank of England inflation forecast however does see CPI inflation remaining marginally above the MPC's target of 2% over the next 2/3 year time horizon. The rise in wage inflation and the fall in CPI inflation do however give the consumer more spending power which is likely to feed through into support to the overall rate of economic growth in coming months.

2.6. **Brexit** is at an impasse, the Conservative minority government having so far been unable to muster a majority in the Commons over its Brexit deal. A deadline for a new supported deal has now been set at 31st October 2019 by the EU, but no majority likely in the Commons for any form of Brexit deal at present has led to the resignation of Prime Minister May, effective 7th June 2019. The chances of the next Prime Minster being a hard Brexiteer, another referendum or a general election in 2019 have all increased, with potential of a loosening of monetary policy, rising gilt yields, a weaker pound and higher inflation. The uncertainty continues.

2.7. **USA**: The annual rate for US growth was 2.9% in 2018 following massive easing of fiscal policy. Strong growth in employment numbers led to a rise in wage inflation which hit 3.4% in February 2019, whilst at the same time CPI inflation overall fell over the year to 1.5%. The last increase in Fed Rate to 2.50% was made in December 2018, the 4th increase in the year, but the next direction is expected to be downward with rates expected to be 0.50% lower by the end of 2020. President Trump continues to unsettle markets with his extreme tariff policy, targeting China and Mexico in particular.

2.8. **EUROZONE**: The annual rate of growth in the EU was 1.8% in 2018 but is expected to fall to around half this rate in 2019. Any rate increases are therefore unlikely until at least the end of 2019. The ECB ended its QE programme in December 2018. However the downturn in growth, together with falling inflation has prompted the ECB to take new measures to stimulate growth, including providing cheap borrowing to its banks with incentives to encourage bank lending. Rates are expected to not change throughout 2019. (0% refinancing, 0.4% deposit rate).

2.9. **CHINA**: Economic growth has been weak despite central bank stimulus. Excess industrial capacity and the stock of unsold property still exists, as well as non-performing loans in the banking and credit systems.

2.10. **JAPAN**: Is making little progress on fundamental reform of the economy, with little GDP growth and very low inflation, despite huge monetary and fiscal stimulus.

2.11. **WORLD GROWTH**: Equity markets are currently concerned about the synchronised general weakening of growth in the major economies of the world.

3. Treasury Investments 2018/19

Treasury Investment Policy

3.1. The Council's treasury investment policy, governed by the MHCLG investment guidance, is implemented in the Council's Annual Investment Strategy for Treasury Investments 2018/19. This was approved by the Executive Councillor for Finance on 23rd March 2018, after being scrutinised by the Overview & Scrutiny Management Board on 1st March 2018.

3.2. The policy sets out the Council's approach for choosing authorised investment counterparties with appropriate limits (amount & maturity) that meet the risk appetite set by the Council. This selection is based on credit ratings issued by the three main credit rating agencies, supplemented by additional market data such as rating outlooks, credit default swaps and bank share prices. The Council's treasury advisors, Link Asset Services (LAS), provide the Council this data in the form of a creditworthiness matrix of suggested counterparties and limits, which the Council follows. **Appendix B** shows the Council's Authorised Lending List at 31 March 2019, based on this creditworthiness approach, together with a key explaining the credit rating scores.

3.3. **Note**: The treasury investment policy relates to treasury investments only. The policy relating to non-treasury investments, held for service or commercial reasons is covered in the Council's Capital Strategy.

Treasury Investment Risk Appetite

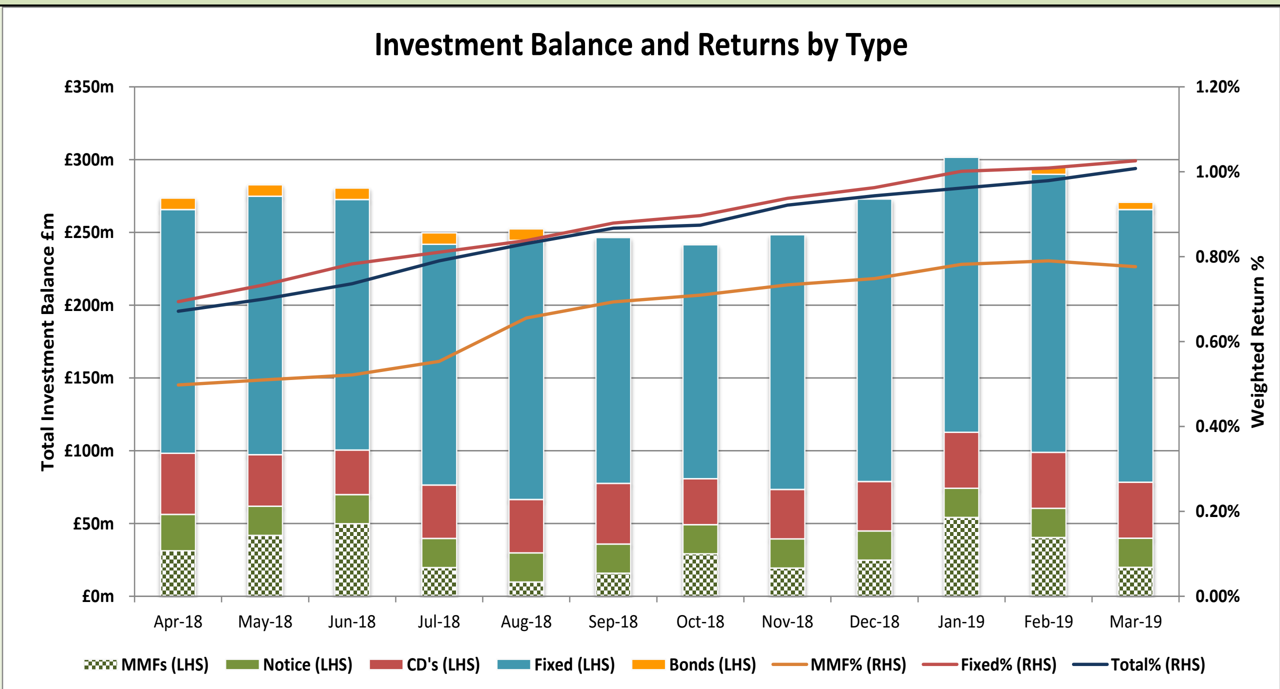
3.4. The Council prioritises the **security of capital** and the **liquidity of investments**, over and above the **return** achieved on its treasury investments and hence the risk appetite set for its treasury investments is **low.**

3.5. As such, in addition to LAS's credit methodology, the Council also maintains a minimum limit of **A+ Long Term Rating (two out of three agencies)** for all its Counterparties, excluding part-nationalised UK banks and a **minimum limit AA- Sovereign Rating, (two out of three agencies)** for any Country in which a Counterparty is based to ensure investments are only placed with highly credit rated financial institutions and hence the return achieved is commensurate with this level of risk taken.

Treasury Investment Activity 2018/19

3.6. The Council's treasury investment position and activity during 2018/19 is shown as follows:

INVESTMENT PORTFOLIO	31.3.18 £m	Annual Return %	31.3.19 £m	Annual Return %
Treasury Investments:				
Money Market Liquidity Funds	17.740	0.29%	20.000	0.67%
Fixed Deposits, Notice, CD's & Bonds	239.958	0.58%	250.827	0.88%
Total Treasury Investments	**257.698**	**0.54%**	**270.827**	**0.84%**



Maturity Structure	31.3.2018		31.3.2019	
Weighted Average Maturity (WAM)	**167 Days**		**144 Days**	
Liquidity	£17.740m	6.88%	£20.000m	7.38%
< 1 Month	£20.000m	7.76%	£20.000m	7.38%
1-3 Months	£68.725m	26.67%	£92.050m	33.99%
3-6 Months	£54.688m	21.22%	£51.000m	18.83%
6-9 Months	£34.950m	13.56%	£52.500m	19.39%
9-12 Months	£46.595m	18.08%	£25.277m	9.33%
1-2 Years	£15.000m	5.82%	£10.000m	3.69%
Total	**£257.698m**	**100.00%**	**£270.827m**	**100.00%**

3.7. The investment balances shown above are made up of general and earmarked reserves, Pension Fund Cash (£10.5m at 31st March 2019), income received but not yet used/spent and general movement of working capital.

3.8. The average value of investments during 2018/19 was £270m, and the graph shown above shows how this balance fluctuated per month over the year. The graph also shows how these funds were invested by type of investment, split between investments held for liquidity (Money Market Funds and Notice Accounts) as opposed to fixed term investments held for return. All investments made were in line with the strategy and the Council had no liquidity difficulties during the year, being supported by temporary borrowing of £65m taken when required during the year to cover liquidity shortfalls at an average cost of 0.60%, below money market fund yield levels. This was in line with strategy and as an alternative to drawing on higher yielding Notice Accounts. No temporary borrowing remained outstanding at 31st March 2019.

3.9. In light of expectation for the increase in rates being delayed due to Brexit, several 1 and 2 year investments were made during the year to lock into higher rates above benchmark levels. The table above shows the maturity profile of the investments made in light of this strategy and the weighted average maturity of the investment portfolio of 144 days at 31st March 2019 slightly reduced from the year before.

3.10. A full list of the investments held at 31st March 2019, compared to Link's creditworthiness list, and changes to credit rating of counterparties during March 2019 are shown in **Appendix C**.

Treasury Investment Return and Benchmarking Results

3.11. The table below shows the Council's annualised return for 2018/19 based on the above activity against the benchmark return for internal investments (weighted 7 day LIBID and 3 month LIBID market rates to reflect low risk appetite taken), compared to the previous year, and also the actual versus budgets investment income earned as a result. The significant underspend in both the Capital and Revenue budgets in 2018/19 was also a contributory factor to the surplus investment income achieved over that budgeted, shown below.

	2017/18	2018/19
Annualised Investment Return	0.54%	0.84%
Annualised Benchmark Rate	0.28%	0.66%
Outperformance	**0.29%**	**0.18%**
Total Investment Income	£1.18m	£2.01m
Budgeted Investment Income	£1.00m	£1.00m
Surplus Investment Income	**£0.18m**	**£1.01m**

3.12. The table shows that the level of return has increased from the previous year and this is also reflected in the graph at 3.5 where the return of MMFs, fixed investments and the total investment portfolio are shown by the relevant lines, highlighting the upward movement in short term rates as the year progressed.

3.13. The level of return achieved directly correlates with the level of risk taken with investments. To demonstrate this, **Appendix D** shows the performance of a variety of major asset classes over several years ranked by riskier assets first (risk to capital loss). The Council has set its risk appetite at the bottom of this spectrum, Money Market Funds held for liquidity being the lowest return.

3.14. The Council's investment return was also benchmarked against analysis as at 31/3/2019, provided by LAS, which comprised a mixture of 9 other authorities in the East Midlands area and 14 English Counties. The results of this benchmarking are detailed below.

Link Benchmarking – Position at 31/3/2019			
	LCC	Benchmark Group(9)	English Counties (14)
31st March Return %	1.01%	0.87%	0.92%
Risk Banding	0.89% -1.01%	0.77% - 0.89%	0.80% -0.91%
Risk Weighted Score (Duration/Credit Quality)	3.12	2.91	2.70
WAM (days)	144	71	72

3.15. The benchmarking results show that the Council is above par with the investment returns achieved by its LAS comparators in 2018/19, mainly as a result of having a longer WAM (duration of investments). This is a good result given the low risk nature of the Counterparties allowed on the Authorities Lending List (restricted to a Long Term minimum rating of A+), which does not apply to other comparators. LAS calculates a risk banding return that should be achievable for the level of risk being taken on investments and the Council is at the top of this banding.

4. Long Term Borrowing 2018/19

Capital Expenditure Plans and Borrowing Requirement 2018/19

4.1. The Council's capital expenditure plans are the key driver of treasury management activity, as it sets the long term borrowing requirement plans for the Council.

4.2. The Council is required by regulation to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities 2017 (referred to as the 'Prudential Code') when assessing the affordability, prudence and sustainability of its capital investment plans. It does this by setting a series of **Prudential Indicators** that ensure and demonstrate the Council's capital expenditure plans remain affordable, prudent and sustainable.

4.3. **Appendix E** shows a summary of the actual Prudential Indicators for 2018/19, compared to those estimated and approved by Full Council at its meeting on 23rd February 2018, along with the Council Budget 2018/19. It can be confirmed that no Prudential Indicators were breached during 2018/19.

4.4. Extracted from these Prudential Indicators, shown in the table below, is the Council's **net capital expenditure** for 2018/19 and the resulting **borrowing requirement** for 2018/19 (the element of this expenditure which is not to be financed straight away from cash resource or grants, hence to be financed at a future date by borrowing). Plans were revised during 2018/19 from that agreed by Full Council and both actual spending and borrowing requirement was under budget for the year.

	Original Budget at 1/4/2018 £m	Final Budget at 31/3/2019 £m	Actual at 31/3/2019 £m	Underspend £m
Net Capital Expenditure Programme 2018/19	84.676	93.681	**43.574**	50.108
Borrowing Requirement 2018/19	84.076	70.080	**19.972**	50.108

Capital Financing Requirement, Borrowing Strategy and Control of Interest Rate Risk 2018/19

4.5. **The Capital Financing Requirement** (CFR) is another Prudential Indicator shown in Appendix E. It is a measure of the amount of capital expenditure that the Council has already spent that has yet to be funded from cash resources or the Council's total indebtedness or **need to borrow for capital financing purposes**. Credit arrangements (finance leases and PFI) are also included in the CFR as they have the same practical impact as borrowing. The CFR is increased each year by the **new borrowing / credit arrangement** requirement, as highlighted in the table above, and reduced each year by the **Minimum Revenue Provision (MRP)**, a provision the Council has to set aside to repay its debt each year.

4.6. In fulfilling the underlying need to borrow to finance its capital expenditure plans, the Council has flexibility when it takes external borrowing to ensure borrowing is taken at a time when interest rates are at their lowest (thereby controlling interest rate risk) and to minimise cost of carry (where borrowing costs exceed investment return, until utilised by capital expenditure). The Council utilises its own internal cash resource to finance borrowing requirement not taken externally and this is known as **Internal Borrowing**.

4.7. A benefit of internal borrowing is the reduction of Counterparty risk as a reduced cash balance leads to reduced investments made and in times when investment returns are low this is a prudent strategy. Cash resource is depleted by internal borrowing and therefore there is an ultimate limit as to how much internal borrowing can be done before cash resource is put at risk. The Council tries to maintain the **level of internal borrowing at 15% of CFR** in order to maintain a suitable level of cash resource.

4.8. Another Prudential Limit states that external borrowing should not exceed the CFR two years hence in order to ensure that borrowing remains prudent and affordable and not undertaken for revenue purposes. Appendix E shows that the Council has maintained this limit.

4.9. The table below shows the final CFR position for 2018/19 and how this is split between External and Internal Borrowing.

CFR 2018/19		£m	£m	%
Opening CFR Balance at 1.4.2018			554.638	
Net Capital Expenditure 2018/19		43.574		
Financed by Cash Resource:	Grants	(13.624)		
	Capital Receipts	(3.368)		
	Reserves	(1.634)		
	Revenue	(4.976)		
Add: Borrowing Requirement 2018/19			19.972	
Less: Minimum Revenue Provision 2018/19			(18.126)	
Closing CFR Balance at 31.3.2019			**556.484**	**100.0%**
Represented By:				
External Borrowing (Including Credit Arrangements)			**476.267**	**85.6%**
Internal Borrowing			**80.217**	**14.4%**

External Borrowing Activity 2018/19

4.10. The Strategy for 2018/19 stated that new external borrowing would be undertaken in all periods with the aim of achieving an even spread of maturity profile and keeping an increase in the average cost of the Council's debt to a minimum. Borrowing would be undertaken at a time appropriate to coincide with an identified dip in borrowing rates available.

4.11. The Council's actual borrowing position as at 31st March 2019 and activity during 2018/19, is detailed in the table below:

Borrowing Activity 2018/19	Market Debt (LOBO) £m	PWLB Debt £m	Total £m	% Cost
Opening Balance at 1.4.2018	30.000	431.391	461.391	4.088%
New Borrowing in 2018/19	0.000	40.000	40.000	2.365%
Borrowing Matured/Repaid in 2018/19	0.000	(35.497)	(35.497)	
Debt Rescheduling:- Borrowing Repaid in 2018/19 Borrowing Replaced in 2018/19	(10.000) 0.000	0.000 10.000	(10.000) 10.000	3.800% 2.580%
Closing Balance at 31.3.2019	**20.000**	**445.894**	**465.894**	**3.965%**
Authorised Limit For External Debt 2018/19			**651.751**	

4.12. The table above shows that a total of £40m of new external borrowing was taken during the year from the PWLB at an average cost of 2.365%. This borrowing was taken in the 45 to 50 year range. In line with the strategy, the graph in 2.2 shows that this borrowing was taken at times during the year where interest rates were at their lowest and in periods to fill gaps in the long term borrowing maturity profile.

4.13. **Appendix F** shows this maturity profile at 31st March 2019, including the variability effect of the £20m LOBO debt held. The graph shows that no debt maturing in any one year exceeds 10.28% of the total debt portfolio.

4.14. The table also shows that a £10m Market Loan (a LOBO loan from Royal Bank of Scotland) was repaid early and replaced by a £10m maturity loan from the PWLB for the equivalent loan outstanding period of 42 years during the year, the timing of which can also be seen in the graph in 2.2. This debt rescheduling resulted in a reduction of the Council's borrowing cost by 0.03%, which equates to a net £1.324m saving over the life of the replacement loan or £31.5k per annum.

4.15. The balance of remaining LOBO's at 31st March 2019 was £20m after this restructuring, all held with BAE Systems Pension Fund. This is well within the limit set in the Strategy of 10% of total external debt (equating to £46.6m). A limit is set on this type of borrowing to limit the amount of variability within the debt portfolio for debt repayment.

4.16. Total long term debt outstanding at 31st March 2019 of £465.894m is well within the Council's Authorised Limit for External Debt of £651.751m. This is the Council's statutory 'Affordable Borrowing Limit' as per the Local Government Act 2003, which should not be breached and is also another Prudential Indicator.

External Borrowing Cost and Benchmarking Position

4.17. The table below shows the interest cost of the Council's total external debt and that of new borrowing taken in the year. This is benchmarked against the average cost of debt that was available from the PWLB in the year. Again significant underspend of the capital programme in 2018/19 accounts for the saving in interest cost, as well as the reduction in the overall interest cost of the borrowing portfolio.

	2017/18		2018/19	
	% Cost	£m	% Cost	£m
Long Term Borrowing Outstanding at 31st March.	-	461.391	-	465.894
Actual Interest Cost of External Debt	4.088%	19.002	3.965%	18.380
Budgeted Cost of External Debt	-	19.968	-	20.281
Underspend		**0.966**		**1.901**
New Borrowing Taken and Average Cost	-	0.000	2.365%	40.000
Benchmark Cost of Borrowing Available in Year (50 Year PWLB)	2.410%	-	2.470%	-
Outperformance	**-**	**-**	**0.11%**	**0.044**

Internal Borrowing Activity 2018/19

4.18. The borrowing requirement (CFR) not taken externally is known as 'internal borrowing' and this utilises the internal balances of the Council to finance the capital spend. The level of Internal borrowing is adjusted for amounts carried forward along with any capital programme underspends each year and also for adjustment to borrowing taken for any voluntary repayment of debt or excess borrowing taken for maturing debt in excess of MRP level. The balance of internal borrowing at 31st March 2019 stood at £80.217m and the table below shows how this balance has been derived since 2011/12.

	Original Borrowing Requirement £m	Carry Forward £m	Outturn Borrowing Requirement £m	Adjustment for Voluntary or Maturing Debt £m	Actual External Borrowing Taken £m	Internal Borrowing Balance £m
2011/12	73.145	(25.651)	47.494	(14.690)	(17.345)	**15.459**
2012/13	97.685	(13.833)	83.852	(15.366)	(12.000)	**56.486**
2013/14	53.197	(7.032)	46.165	(20.138)	0	**26.028**
2014/15	35.300	(18.312)	16.988	(10.404)	(20.000)	**(13.417)**
2015/16	70.761	(50.092)	20.669	(9.012)	(30.000)	**(18.343)**
2016/17	50.353	(34.579)	15.774	(0.644)	(12.000)	**3.130**
2017/18	36.548	(21.946)	14.602	(1.794)	0	**12.808**
2018/19	70.080	(50.108)	19.972	18.143	(40.049)	**(1.934)**
Total			**265.516**	**(53.905)**	**(131.394)**	**80.217**

The £50.108m carry forward of internal borrowing for 2018/19 will be carried forward to 2019/20, along with the Capital Programme and Borrowing Requirement underspends. The Council will take external borrowing in 2019/20, after adjusting for debt repayments and underspends to ensure internal borrowing remains around 15% of CFR in order that sufficient cash balance is maintained.

4.19. It is worth pointing out that the internal borrowing balance detailed above can be taken externally at any time if investment interest rate yield curves reverse and move higher than long term borrowing rates in the future. This would bring internal borrowing down below 15%.

5. Other Treasury Management Issues

5.1. Capital Strategy 2019/20

The **CIPFA Prudential Code** was revised in 2017 and included the new requirement for Councils to have a **capital strategy** in place by April 2019 which would highlight Councils capital spending plans and objectives, assess their affordability and, where commercial activity or non-treasury investments have been included, highlight the risks of holding these types of investment and how those risks are to be managed. MHCLG also issued **revised statutory guidance on local government investments** in 2018, which came into effect on 1 April 2018 and extended the meaning of "investments" to include these types of commercial and non-treasury investments.

The Council has adhered to this guidance as reflected in its capital strategy for 2019/20, which was presented to this Board for consideration on 31st January 2019 and then to the Executive on 5th February 2019 for recommendation for approval at Full Council, along with the Council's Budget for 2019 /20.

For information, the table below highlights the Council's non-treasury investments in place at 31st March 2019 by investment type.

Type of Investment	Length to Maturity at 31/03/19 Years	Principal O/S at 31/03/19 £,000	Interest Received 2018/19 £,000	Interest Rate %
Loans to Other Bodies (Service Reason) –Valued at Amortised Cost				
Police Loan Debt School Academies Lincs Community Foundation (Soft Loan)	1.0 Various 18.3	52 1,218 270 **1,540**	2.0 58.4 1.4 **61.8**	4.00% Various 0.50%
Loans to LCC Companies & Subsidiaries (Service Reasons) –Valued at Amortised Cost				

Transport Connect – Fixed Loan Transport Connect – Credit Facility	2.5 -	603 79 **682**	23.2 16.6 **39.8**	4.75% 4.75%
Equity Purchase (3rd Parties) (Service Reasons) – Valued at Fair Value				
Investors In Lincoln Shares	-	**294**	**0.0**	-
Commercial Property Investments (Non Service Reasons) –Valued at Fair Value				
County Farms Other non-farm properties	- -	106,971 1,734 **108,705**	2,457.0 68.0 **2,525.0**	- -
Total Non -Treasury Investments		**111,221**	**2,626.60**	

Note: These investments are held for Service or Commercial reasons and hence have a different risk profile than treasury investments and operate under a different investment policy. To manage the level of non-treasury investments undertaken, two new Prudential Indicator Limits have been set for 2019/20 as follows:

- **Limit for Maximum Usable Reserves at Risk from Potential Loss of Investments (Treasury & Non Treasury Investments) – Limit 10%.**

  Actual 2018/19 = 1.59%

- **Income from Non Treasury Investments to Net Service Expenditure – Limit 3%**

  Actual 2018/19 0.61%.

Actual performance for 2018/19 shows that the Council is well below the limits set to control this type of activity.

5.2. International Financial Reporting Standard (IFRS) 9 –Financial Instruments

This accounting standard was effective from 2018/19 and it has had two major impacts to the Council's Financial Statements for 2018/19 as follows:

1) All Investments held by the Council were reclassified and re-measured into the following **new categories**:

- Amortised Cost
- Fair Value through Other Comprehensive Income Account
- Fair Value designation through Other Comprehensive Income Account (Equity Instruments)
- Fair Value Through Profit & Loss

The majority of the Council's investments are valued at amortised cost with no real difference to value on the Balance Sheet. Investments that fall under the Fair Value categories which have to be held on the Balance Sheet at their market value at 31st March include Pooled Investments Funds (including property funds) and Commercial Investments (including equity investments). The Council has minimal exposure to these types of investments at 31st March 2019.

2) In an attempt to recognise the risk involved in holding investments, the standard also requires the **Expected Credit Loss** amount to be calculated and accounted for as a provision upfront of any financial investments held at amortised cost, as opposed to calculation of an impairment figure retrospectively if required. This calculation uses the likely probability of default of the investments held over the next 12 months or the lifetime of the investment if deemed riskier. (Investments to other Local Government bodies are exempt from this calculation).

The following table shows the Expected Credit Loss calculated for investments valued at Amortised Cost at 31st March 2019 and is a proxy for the risk taken by the Council in holding these investments.

Expected Credit Loss 2018/19	Investment Balance 31/3/19 £,000	Expected Credit Loss 2018/19 £,000	Expected Loss Rate %
Treasury Investments	250,827	33.240	0.013%
Transport Connect – Fixed Loan	603	190.675	31.595%
Transport Connect –Credit Facility	79	20.913	26.472%
Lincs Community Foundation	270	6.884	2.551%
Total Expected Credit Loss		**251.712**	

The table above shows that the majority of the Expected Credit Loss rests with the non-treasury investments, reflecting the higher risk profile taken for these types of investments.

2. Conclusion

Key Points Summary:

- Both short term and long term rates acted in line with the forecast for the first half of the year as Base Rate was increased to 0.75% in early August and long term rates increased gradually in line with growth. Impasse over a Brexit agreement stalled the economy and interest rates in the second half of the year. Long term borrowing rates ended the year lower than they started and no further increases in Base Rate were made or are expected.

- Brexit uncertainties continue to pose a significant risk to economic growth, inflation and interest rates in the UK.
- The Council's risk appetite for its treasury investments is low, as it prioritises security of capital and liquidity over return. The Council has outperformed the benchmark set for this risk level, by 0.18%, which equated to £1.01m in monetary terms. It also outperformed benchmarking comparators whilst having a lower risk profile, primarily by having a longer weighted average maturity of investments.
- Liquidity shortfalls were managed during the year by taking short term borrowing at less than investment rate levels, in line with Strategy.
- The Council adheres to the CIPFA Prudential Code for Capital Finance by setting Prudential Indicators to ensure its capital plans are affordable, prudent and sustainable. All prudential limits have been adhered to with no breaches in 2018/19.
- Both capital expenditure and hence its borrowing requirement for 2018/19 was underspent by £50.1m. This will be carried forward into 2019/20.
- The Council's CFR at 31st March 2019 (or underlying need to finance its capital expenditure plans by borrowing) has been met by a combination of both external and internal borrowing as follows:

External Borrowing	£476.3m	85.6%
Internal Borrowing	£ 80.2m	14.4%
CFR	£556.5m	

- External borrowing of £40m was taken in 2018/19 from PWLB in the 45 to 50 year range at an average cost of 2.365%, below that of the average cost of debt available during the year. This has reduced the total cost of the Councils external debt to 3.965%, equating to £18.4m borrowing interest paid in 2018/19, £1.9m under budget.
- A £10m LOBO loan from RBS was restructured into PWLB debt during the year resulting in a net saving of £1.324m over 42 years.
- Internal borrowing was reduced in 2018/19 by £1.9m after balances brought forward and carried forward, outturn borrowing requirement and external debt taken, leaving the balance of internal borrowing at £80.2m or just under the target level of 15% of the CFR.
- In line with the revised CIPFA Prudential Code, a capital strategy was produced for 2019/20, highlighting the Council's capital spending plans and objectives, assessing affordability of these plans and highlighting the risks of holding commercial and non-treasury investments to meet these plans.
- A total of £111.22m non-treasury investments were held by the Council at 31st March 2019, generating income of £2.6m. Prudential Indicator limits in place for non-treasury investments were no way near being reached in 2018/19. Risk levels were highlighted as being significantly higher for non-treasury related investments.

- New accounting standards have resulted in a reclassification of investments in 2018/19 and expected credit loss provisions being calculated totalling £251.7k.

3. Consultation

a) Have Risks and Impact Analysis been carried out?

Yes

b) Risks and Impact Analysis

Risk & Impact Analysis for Treasury Management forms TMP1 of the Treasury Management Practices, as required by the CIPFA Code of Practice 2017. A Risk Register which details the main risks for Treasury Management has been completed and is reviewed annually. Both the TMPs and the Risk Register are held in the Treasury Files held on IMP at County Offices.

4. Appendices

These are listed below and attached at the back of the report	
Appendix A	Glossary of Abbreviations Used in this Report.
Appendix B	Authorised Lending List at 31st March 2019 and Credit Rating Key.
Appendix C	Investment Analysis Review at 31st March 2019 - Link Asset Services Ltd.
Appendix D	Risk and Reward per Asset Class 2018/19 and Comparative Years.
Appendix E	Prudential Indicators - Actuals Compared to Estimate 2018/19.
Appendix F	LCC Long Term Borrowing Maturity Profile as at 31st March 2019.

5. Background Papers

Document title	Where the document can be viewed
Treasury Management Strategy Statement and Annual Investment Strategy 2018/19 -20/3/2018	Lincolnshire County Council, Resources
Council Budget 2018/19 - 23/2/2018	Lincolnshire County Council, Resources
Capital Strategy 2019/20 - 5/2/2019	Lincolnshire County Council, Resources

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