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**South Cambridgeshire** District Council

11 December 2019

To: Chairman – Councillor Tony Mason
Vice-Chairman – Councillor Nick Sample
Members of the Audit and Corporate Governance Committee – Councillors John Batchelor, Brian Milnes, Peter Topping, Heather Williams and Eileen Wilson

Quorum: 3

Substitutes: Councillors Nick Wright, Bunty Waters, Tom Bygott, Grenville Chamberlain, Clare Delderfield and Dawn Percival

Dear Councillor

You are invited to attend the next meeting of **AUDIT AND CORPORATE GOVERNANCE COMMITTEE**, which will be held in **SWANSLEY A - SOUTH CAMBRIDGESHIRE HALL** at South Cambridgeshire Hall on **THURSDAY, 19 DECEMBER 2019** at **9.30 a.m.**

Members are respectfully reminded that when substituting on committees, subcommittees, and outside or joint bodies, Democratic Services must be advised of the substitution ***in advance of*** the meeting. It is not possible to accept a substitute once the meeting has started. Council Standing Order 4.3 refers.

Yours faithfully
**Liz Watts**
Chief Executive

**The Council is committed to improving, for all members of the community, access to its agendas and minutes. We try to take all circumstances into account but, if you have any specific needs, please let us know, and we will do what we can to help you.**

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## AGENDA

| | | PAGES |
|---|---|---|
| **1.** | **Apologies for Absence**<br>To receive Apologies for Absence from Committee members. | |
| **2.** | **Declarations of Interest** | |
| **3.** | **Minutes of Previous Meeting**<br>To confirm the minutes of the meeting held on 24 September 2019 as a correct record. | **1 - 6** |
| | **REPORTS** | |
| **4.** | **Treasury Management - Annual Report 2018/19** | **7 - 20** |

| | | |
|---|---|---|
| **5.** | **Mid-year 2019/2020 Treasury Management Report** | **21 - 36** |
| **6.** | **Final Accounts Update 2017/18 - Ernst & Young's Report (Report to Follow)**<br>To consider the report (to follow) of the external auditors on the audit of the 2017/18 financial statements. | |
| **7.** | **Final Account 2017/18 Update - Council's Report** | **37 - 40** |

**INFORMATION ITEMS**

**8. Matters of Topical Interest**

**9. Date of Next Meeting**

The next meeting has been scheduled Tuesday 24 March 2020 at 9:30am in the Swansley Room.

# GUIDANCE NOTES FOR VISITORS TO SOUTH CAMBRIDGESHIRE HALL

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**Disturbance by Public**

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# Agenda Item 3

**SOUTH CAMBRIDGESHIRE DISTRICT COUNCIL**

Minutes of a meeting of the Audit and Corporate Governance Committee held on Tuesday, 24 September 2019 at 9.30 a.m.

| | | |
|---|---|---|
| PRESENT: | Councillor Tony Mason – Chairman<br>Councillor Nick Sample – Vice-Chairman | |
| Councillors: | John Batchelor | Peter Topping |
| | Heather Williams | Eileen Wilson |
| Officers: | Patrick Adams | Senior Democratic Services Officer |
| | Suzy Brandes | Principal Accountant (General Fund & Projects) |
| | Peter Maddock | Head of Finance |
| | Rory McKenna | Deputy Head of Legal Practice |
| Auditors: | Suresh Patel | Ernst & Young |
| | Jonathan Tully | Head of Shared Internal Audit |

Councillor John Williams was in attendance, by invitation.

**1. APOLOGIES FOR ABSENCE**

Apologies for Absence were received from Councillor Brian Milnes.

**2. DECLARATIONS OF INTEREST**

Councillor John Batchelor declared a non-pecuniary interest as an unpaid Director of Ermine Street Housing Limited.

**3. MINUTES OF PREVIOUS MEETING**

The minutes of the meeting held on 30 July 2019 were agreed as a correct record subject to the amendment of the end of the paragraph under the heading “Honest reporting” in minute 4 to read:
“Councillor Heather Williams suggested that the Committee should be concentrating more on the future than making political points regarding the past. Councillors Eileen Wilson stated it was necessary to examine the past to inform the future. Both councillors expressed an interest in sitting on the Task and Finish Group.”

**4. INTERNAL AUDIT UPDATE**

The Head of Shared Internal Audit presented this report, which updated the Committee on the work of Internal Audit between April and September 2019.

**Audit of HRA – Voids and lettings**
It was noted that this audit in progress was on a sensitive issue that generated

much local interest. There were no significant issues to report.

**Audit service assessed by the Public Sector Internal Audit Standards**
It was noted that in 2018 CIPFA had assessed the Council to the Public Sector Internal Audit Standards (PSIAS) and ruled that we Generally Conform with these standards, which was the highest rating that could have been awarded.

**Programme assurance**
The Head of Shared Internal Audit explained that the actions relating to programme assurance were being addressed. The implementation of Council Anywhere would greatly assist this.

The Committee **NOTED** the report.

## 5. ANNUAL REVIEW OF THE RISK MANAGEMENT STRATEGY

The Principal Accountant (General Fund and Projects) presented this report, which invited the Committee to conduct its annual review of the Risk Management Strategy. It was noted that the Strategy had been approved by the Executive Management Team.

**Risk appetite**
It was suggested that the Council's baseline of risk before taking action was too low at £50,000 for the authority to take advantage of investment opportunities. It was explained that this baseline figure did not apply to investments and the authority evaluated risks when making decisions on possible investments. The Committee recommended that the Risk Management Strategy include a figure in paragraph 3.3 that could be universally applied.

**Risk Management Process - Paragraph 6.1.3**
The Committee recommended to EMT that paragraph 6.1.3 of the Risk Management Process be re-written as it did not make grammatical sense.

The Committee **AGREED** the revised Risk Management Strategy, with the above amendments.

## 6. POSSIBLE APPOINTMENT OF INDEPENDENT MEMBERS

The Head of Finance presented this report, which invited the Committee to consider whether to appoint an independent person to its membership. It was noted that an appointment would have to be agreed by Council.

Members of the Committee made the following points:

- It was unclear what additional benefit an independent members could bring to the Committee.
- The Council would find it difficult to attract a person of suitable calibre for this position.
- It was unlikely that the allowance that would be offered for the position would prove much of an incentive.

The Committee resolved not to recommend the appointment of an independent member at this time, but to review this issue annually.

## 7. UPDATE ON THE 2017/18 ACCOUNTS - ORAL UPDATE

The Chairman brought this matter forward to item 4 on the agenda.

**Capacity of External Auditors**
Suresh Patel from Ernst & Young acknowledged the Council's frustration regarding the 2017/18 accounts. He assured the Committee that Ernst & Young had recently recruited a number of new staff to ensure that the company delivered the expected quality of service. It was understood that some of the new staff would require training. He noted that the Council had expressed concerns to the Public Sector Accounts Authority and he reported that these concerns had been passed to Ernst & Young.

**Resolving queries**
Suresh Patel reported that visits by Ernst & Young in early August had resulted in queries that had not been responded to in a timely way. This had led to further delays. The external auditors now planned to visit the Council in early November and all being well will complete the audit of the 2017/18 accounts by the end of November. It was noted that significant adjustments had been made and the group accounts needed to be prepared.

In response to questioning, Suresh Patel explained that it was impossible to know how many additional queries the external auditors would raise on the 2017/18 accounts.

The Head of Finance explained that the outstanding queries had been resolved and the group accounts would not take long to complete. He also reported that the significant adjustment was a favourable one for the Council and had been made to the 2017/18 accounts. He also acknowledged that there had been some communication issues with Ernst & Young. The Council had employed temporary staff to assist with this process.

**Identifying errors**
Following a brief discussion the Committee acknowledged that the External Auditors could not be expected to uncover all errors in the accounts. It was noted that the External Auditors have a minimum figure to define what is considered a material concern.

**Actions**
It was noted that at its previous meeting the Committee had asked Ernst & Young to provide the details of the necessary work required to sign off the 2017/18 accounts with an explanatory comment and a rating on current status of each relevant factor. Suresh Patel was reminded that he had previously agreed to provide the Committee with an effective audit toolkit and training on the investment strategy.

The Head of Finance agreed to ascertain when the next housing re-evaluation was

taking place.

**Update on the 2018/19 and 2019/20 Accounts**
Suresh Patel explained that that aim was to complete the audit of the 2018/19 accounts by the end of January and then start work on the 2019/20 accounts to have them completed by the June deadline. It was noted that the 2018/19 accounts required a starting balance from the 2017/18 accounts and that Ernst & Young had not carried out any preparatory work on either the 2018/19 accounts or the 2019/20 accounts. The Head of Finance considered the end of February 2020 to be a more realistic target for the signing off of the 2018/19 accounts than January 2020.

**Task and Finish Group**
The Chairman explained that the Task and Finish Group would meet in early October and early November to monitor the progress being made on the signing off of the 2017/18 accounts. It was agreed that a representative from the PSAA should be invited to the next meeting in early October. It was hoped that the letter of engagement sent to the PSAA could be found. It was noted that the PSAA had appointed Ernst & Young for the Eastern Region and 98% of local authorities had accepted the external auditors appointed by the PSAA. The PSAA had explained that the only alternative the Council had was to appoint one of the other external auditors who had been awarded a regional contract, but the PSAA had warned that they too were experiencing the same capacity issues as Ernst & Young.

The Head of Finance explained that the PSAA were hosting a Local Quality Audit Forum on 25 November and he promised to circulate the details.

## 8. OMBUDSMAN: ANNUAL REVIEW LETTER 2018-19

The Committee requested that in future the information from the Ombudsman be accompanied by some explanatory text. It was noted that the letter from the Ombudsman had been addressed to the previous Chief Executive.

## 9. MATTERS OF TOPICAL INTEREST

**Tracking Action Points made by the Committee**
The Head of Shared Internal Audit presented an action list to the Committee. This was well received and it was agreed that all the Committee members should be sent an electronic copy.

Concerns were expressed regarding the Council’s current phone system, which needed to be replaced.

It was agreed that this should become a standing item at every meeting.

**Liaising with the Scrutiny and Overview Committee**
Councillor Heather Williams explained that the Task and Finish Group had recommended that the Committee liaise with the Scrutiny and Overview Committee to ensure that there was no duplication of effort.

**Regulation of Investigatory Powers Act (RIPA)**
The Deputy Head of Legal reported that the Council had not used the RIPA during the last quarter.

## 10. DATE OF NEXT MEETING

It was noted that the next meeting of the Committee would be held on Tuesday 26 November at 9:30am.

The next meeting of the Auditing of Accounts Task and Finish Group would be held in early October. It was agreed that a representative of the PSAA should be invited to attend. The Chairman agreed to contact the PSAA and then inform the Committee of the subsequent meeting date. The following meeting of the Task and Finish Group was scheduled for Thursday 14 November at 3pm. It was agreed that Suresh Patel from Ernst & Young should be invited to attend this meeting.

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**The Meeting ended at 11.35 a.m.**

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# Agenda Item 4

South Cambridgeshire District Council

| | | |
|---|---|---|
| **REPORT TO:** | Audit & Governance | 19 December 2019 |
| **LEAD CABINET MEMBER:** | Councillor John Williams,<br>Lead Cabinet Member for Finance | |
| **LEAD OFFICER:** | Peter Maddock, Head of Finance | |

# Treasury Management – Annual Report 2018/2019

## Executive Summary

1. This report outlines the Treasury Management activities in the financial year 2018/2019 and invites the Audit and Governance Committee to note the Treasury Management performance and approve the report.

## Key Decision

2. This is not a key decision as there are no resource implications directly arising from the report at this stage.

## Recommendations

3. **That Audit and Governance Committee is requested to consider the report, to seek any clarification and, if satisfied, approve the Treasury Management Annual Report.**

## Reasons for Recommendations

4. To consider a report on Treasury Management activities during the financial year 2018/2019.

## Details

Treasury Portfolio 2018/2019: Summary Position

5. The summary position as at 31 March 2019 (with comparable data for 31 March 2018) is shown below:

| | 31 March 2018 | | 31 March 2019 | |
|---|---|---|---|---|
| **Borrowing** | **£000** | **Rate %** | **£000** | **Rate %** |
| PWLB | 205,123 | 3.51 | 205,123 | 3.51 |
| LOBO - Market | Nil | | Nil | |
| Local Authority | Nil | | 3,000 | 0.80 |
| Other Long Term Liabilities | Nil | | Nil | |
| **Total Debt** | **205,123** | | **208,123** | |
| Investments | **(81,431)** | | **(97,658)** | |
| **Net Borrowing/(Investment)** | **123,692** | | **110,465** | |

Investments

6. Investments are categorised into long and short term (i.e. less than 365 days). £37.8 million had less than one year to maturity as at 31 March 2019 and are, therefore, classified as short term. The remaining balance held of £59.9 million is classified as a long term investment. The increase in Long Term Investments reflects the increased allocation to South Cambs Limited and loan to Cambridge Leisure and Ice Centre during the year. A summary of the investments held is shown below:

| | Balance 01/04/18 | New Investments | Maturities/ Sales | Interest Accrued | Balance 31/03/19 |
|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 |
| **Investment Counterparty** | | | | | |
| Short Term: | | | | | |
| Clearing Banks | 20,500 | 22,500 | (29,000) | 105.3 | 14,000 |
| Other Banks | 5,000 | 4,000 | (5,000) | 27.4 | 4,000 |
| Building Societies | 8,000 | 28,500 | (33,500) | 16.4 | 3,000 |
| Housing Associations | 5,000 | 5,000 | (5,000) | 47.4 | 5,000 |
| Local Authorities | 4,000 | 47,400 | (46,900) | 24.1 | 4,500 |
| Money Market Funds | 3,425 | 223,590 | (219,840) | 3.5 | 7,175 |
| Call Account | Nil | 30,750 | (30,675) | 0.2 | 75 |
| | | | | | |
| Long Term: | | | | | |
| CLIC (Ice Rink Loan) | Nil | 1,255 | | 8 | 1,255 |
| South Cambs Ltd | 35,506 | 23,147 | | 802.7 | 58,653 |
| | | | | | |
| **Total Investments** | **81,431** | | | | **97,658** |
| | | | | | |
| **Increase/(Decrease) in Investments** | | | | | **16,227** |

7. The UK Bank Rate was increased in August 2018 to 0.75%. This benefited the Council's liquid holdings over the remaining 7 months of the year and added value in the short term Local Authority Market. Short term money market rates are still, however, at very low levels with average 3 month LIBID in 2018/2019 being 0.68%, 6 month LIBID 0.79% and 1 year LIBID 0.94%. These rates correlate to the anticipated return to be achieved in relation to all of the investments over the durations quoted. The Council's actual return of 2.35% shows the effect of the portfolio's long term duration set out above.

8. The Council followed the approach adopted in 2018/2019 Treasury Management Strategy Statement, together with the advice from the appointed Treasury Management Advisers. Due to higher balances than forecast further loans were made to South Cambs Ltd without taking on significant borrowing. This enabled a further £16.2 million to be invested across asset classes during 2018/2019 with £3 million borrowed during January to meet cash flow requirements.

9. The table below lists the £30.5 million held in fixed term investments as at 31 March 2019. These investments include deposits with other local authorities and registered providers:

| | Amount | Interest | Total | Term | Rate | Maturity Date |
|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | Days | % | |
| **Counterparty** | | | | | | |
| Barclays | 1,000 | 9.364 | 1,009 | 364 | 0.94 | 31/07/2019 |
| Lloyds | 1,000 | 9.973 | 1,010 | 364 | 1.00 | 23/05/2019 |
| Lloyds | 2,000 | 19.945 | 2,020 | 364 | 1.00 | 31/05/2019 |
| Lloyds | 1,000 | 9.973 | 1,010 | 364 | 1.00 | 23/07/2019 |
| Lloyds | 1,000 | 9.973 | 1,010 | 364 | 1.00 | 29/07/2019 |
| Lloyds | 1,000 | 10.471 | 1,010 | 364 | 1.05 | 23/09/2019 |
| Santander | 2,000 | 20.145 | 2,020 | 364 | 1.01 | 10/04/2019 |
| Santander | 1,500 | 14.211 | 1,514 | 364 | 0.95 | 30/04/2019 |
| Santander | 1,500 | 14.211 | 1,514 | 364 | 0.95 | 07/05/2019 |
| Santander | 1,000 | 12.466 | 1,012 | 364 | 1.25 | 31/10/2019 |
| Santander | 1,000 | 12.363 | 1,012 | 361 | 1.25 | 29/11/2019 |
| Close Brothers | 2,000 | 22.748 | 2,023 | 361 | 1.15 | 23/07/2019 |
| Close Brothers | 1,000 | 10.759 | 1,011 | 357 | 1.10 | 11/09/2019 |
| Close Brothers | 1,000 | 10.819 | 1,011 | 359 | 1.10 | 11/09/2019 |
| Yorkshire Building Society | 2,000 | 15.912 | 2,016 | 363 | 0.80 | 27/06/2019 |
| Yorkshire Building Society | 1,000 | 10.471 | 1,010 | 364 | 1.05 | 31/10/2019 |
| Places for People | 1,000 | 12.466 | 1,012 | 364 | 1.25 | 29/05/2019 |
| Places for People | 2,500 | 31.164 | 2,531 | 364 | 1.25 | 02/07/2019 |
| Places for People | 1,500 | 18.699 | 1,519 | 364 | 1.25 | 08/07/2019 |
| Lancashire CC | 2,000 | 19.726 | 2,020 | 360 | 1.00 | 30/09/2019 |
| Bury MBC | 2,500 | 24.726 | 2,525 | 361 | 1.00 | 30/08/2019 |
| | | | | | | |
| **Total** | 30,500 | | | | | |

10. The remaining £7.25 million of short term investment balances were held in money market funds and the Council's Call account for liquidity purposes.

11. Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy, as set out in its Treasury Management Strategy Statement for 2018/2019, which defined "high credit quality" organisations as those having a long-term credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

12. All new investments are undertaken in accordance with advice from the Council's Treasury Management Adviser. A list of investment counterparties used during 2018/2019 is listed in **Appendix A**.

Borrowing

13. At 31 March 2019 the Council had external borrowing of £208.123 million.

| | Balance 01/04/2018 | Maturing Debt | Reclassified Debt | New Debt | Balance 31/03/2019 |
|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 |
| **Borrowing** | | | | | |
| Short Term Borrowing | Nil | | | 3,000 | 3,000 |
| Long Term Borrowing | 205,123 | | | | 205,123 |
| **Total Borrowing** | **205,123** | | | **3,000** | **208,123** |
| Other Long Term Liabilities | | | | | |
| **Total External Debt** | **205,123** | | | | **208,123** |

14. £205,123 million of the total relates to borrowing from the Public Works Loan Board (PWLB). The PWLB loans were obtained for Housing Revenue Account purposes as part of the HRA Self-Financing in 2012. These loans are fixed interest maturity loans having an average term to maturity of approximately 27 years and bearing interest at an average rate of 3.51%.

15. The Council also held £3 million of borrowing from two Local Authorities which was taken for cash flow purposes during January 2019.

Cash Management

16. In keeping with the MHCLG's Guidance on Investments, the Council maintained a sufficient level of liquidity averaging £7.5 million through the use of Money Market Funds and call accounts.

17. Internal Treasury Management includes the management of the Council's bank account balances. The aim is for all cleared funds to be deposited in interest bearing accounts or time deposits.

Outturn Budget Monitoring

18. Council, at its meeting on 22 February 2018, approved a net budget for interest payable and investment income in 2018/2019 of £1.702 million. Higher than forecast investment balances in the year contributed to an increase in interest receivable and lower than forecast capital expenditure in 2017/2018 resulted in lower MRP cost. MRP is not applied to lending to South Cambs Ltd. The budget is compared to the final outturn position in the table below:

| | Budget 2018/2019 | Outturn 2018/2019 | Variance |
|---|---|---|---|
| | £000 | £000 | £000 |
| **Expenditure Description** | | | |
| Interest Payable - PWLB & Short Term Loans | 7,257.8 | 7,220 | (37.8) |
| Contribution to/(from) Reserves/Provision | (443) | 5,813 | 6,256 |
| Minimum Revenue Provision | 176 | 87 | (89) |
| Interest Receivable | (1,702) | (2,300) | (598) |
| **Net Expenditure** | **5,288.8** | **10,820** | **5,531.2** |

19. Interest Payable was less than forecast because no long term borrowing was required to support the Capital Strategy and the use of short term borrowings to manage cash flow. The increase in Interest Receivable was due to higher balances than forecast, particularly with South Cambs Ltd following Council's approval to increase the Capital Strategy limit for South Cambs Ltd in 2018/2019.

Benchmarking

20. Benchmarking data is also provided by the Council's Treasury Management Adviser. Investment return rates for the year to 31 March 2019 (excluding lending to South Cambs Ltd) are reported on a quarterly basis and were better than the client average and can be compared as follows:

| | Investment Returns | |
|---|---|---|
| **Quarter Ending** | **SCDC** | **Client Average** |
| 30 June 2018 | 0.79% | 0.69% |
| 30 September 2018 | 0.89% | 0.78% |
| 31 December 2018 | 0.90% | 0.83% |
| 31 March 2019 | 1.01% | 0.88% |

21. Benchmarking data on average weighted credit scores of the Council's counterparties (based in information held by the Council's Treasury Management Adviser) is set out in the table below and illustrates the Council's credit risk position in relation to other Councils:

| | Weighted Average Credit Risk | |
|---|---|---|
| **Quarter Ending** | **SCDC** | **Comparators** |
| 31 March 2018 | 4.69 | 3.39 |
| 30 June 2018 | 4.54 | 3.36 |
| 30 September 2018 | 3.93 | 3.33 |
| 31 December 2018 | 3.86 | 3.31 |
| 31 March 2019 | 3.82 | 3.23 |

22. The benchmarking shows that the Council's portfolio has been invested in counterparties with a higher risk than the comparator group over the duration of the year. This benchmark can only compare funds with credit ratings. Whilst it shows the Council has underperformed its comparator group, and been comparatively higher risk than other Councils, it does show the Council has achieved higher returns than the comparator group and the risk level has fallen over the year.

Treasury Management Strategy for 2018/2019

(a) Interest Rates and Investments

23. The Treasury Management Strategy for 2018/2019 was prepared in the context of an expected low interest rate policy with Bank of England Base Rate predicted to move from 0.50% to 0.75% during the year. The Base Rate was subsequently raised to 0.75% in August 2018. Volatility in the financial markets has continued to affect the Council's holdings.

24. The Council continued its policy of minimising risk by investing in Fixed Deposits only with highly rated Banks and Building Societies, Local Authority Counterparties and Registered Providers and using Money Market Funds and Bank Call Accounts to manage liquidity. This policy coupled with using pooled fund investments (suitably diversified) to maximise interest return on an element of the Council's portfolio has enabled the Council to reduce the cost of Capital Financing.

(b) Borrowing

25. The 2018/2019 borrowing strategy was based upon obtaining new PWLB loans of £16.9 million to fund the capital programme. Careful management of cash flows and short term borrowing enabled the Council to fund the capital programme without entering into long term borrowing. Council did borrow £17 million of short term Local Authority loans for operational liquidity during the year, and £3 million of this was outstanding as at 31st March 2019.

26. During 2018/2019 there was a requirement for short term external borrowing of £3 million. Unfinanced capital expenditure was met from internal cash borrowing. This is inclusive of additional loans to the value of £23.1 million made to South Cambs Limited and £1.3 million made to Cambridge Leisure & Ice Centre from cash balances. These loans are recognised as capital expenditure in the year increasing the Council's underlying need to borrow (the Capital Financing Requirement).

| | **Actual**<br>**2017/18**<br>**£'000** | **Original Budget**<br>**2018/19**<br>**£'000** | **Actual**<br>**2018/19**<br>**£'000** |
|---|---|---|---|
| **Capital Financing Requirement (CFR) as at 1st April** | | | |
| - General Fund | 20,938 | 43,410 | 42,087 |
| - HRA | 204,429 | 204,429 | 204,429 |
| **Total** | **225,367** | **247,838** | **246,516** |
| **Change in the CFR** | 21,621 | 22,471 | 25,009 |
| **Minimum Revenue Provision** | -472 | -176 | -87 |
| **Capital Financing Requirement (CFR) as at 31 March** | **246,516** | **270,133** | **271,438** |

Economy

27. The Council's Treasury Management Advisers have provided a summary of the economy during 2018/2019, and related performance, and this is included at **Appendix B**.

Compliance with Performance Indicators

28. During the financial year the Council operated within the treasury limits and prudential indicators approved by Full Council on 22 February 2018.

29. Performance against prudential indicators in 2018/2019 was as follows:

**(1) Acceptance of the CIPFA Treasury Management Code of Practice (National Indicator)**

This indicator demonstrates that the Council adopted the principles of best practice. The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in January 2012. The Council adopted the CIPFA Treasury Management Code & Guidance Notes as part of its Treasury Management Policy and Strategy which was considered and approved at its meeting on 22 February 2018.

**(2) Fixed Interest Rate Exposure and Variable Interest Rate Exposure**

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable interest rate exposures is expressed as the proportion of net principal borrowed.

| Maturity structure of borrowing | Under 12 months | More than 12 months | Under 12 months - Actual | More than 12 months - Actual |
|---|---|---|---|---|
| Upper limit for fixed interest rate exposure | 100% | 100% | 1.44% | 98.66% |
| Upper limit for variable rate exposure | 100% | 0% | 0% | 0% |

**(3) Maturity Structure of Fixed Rate Borrowing**

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

| Fixed Rate Borrowing | | |
|---|---|---|
| Lender | Repayable within | Amount £,000 |
| Local Authorities | <12 Months | 3,000 |
| PWLB | 15 – 20 years | 15,000 |
| PWLB | 20 – 25 years | 50,000 |
| PWLB | 25 – 30 years | 50,000 |
| PWLB | 30 – 35 years | 50,000 |
| PWLB | 35 – 40 years | 50,000 |

The 2011 revision to the CIPFA Treasury Management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment.

**(4) Upper Limit for Total Principal Sums Invested Over 364 Days**

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

The only loans exceeding 364 days are loans made to South Cambs Ltd, a wholly owned subsidiary of the Council, and Cambridge Ice and Leisure Centre (CLIC). Lending to CLIC formed 1.3% of the investment portfolio at 31 March 2018

The limit relates to the maximum amount that can be invested in year. With regard to liquidity, no more than 50% of the total average portfolio held will be invested in instruments over 364 days.

**(5) Credit Risk**

The Council considers security, liquidity and yield, in that order, when making investment decisions. Credit ratings remain an important element of assessing credit risk but they are not a sole feature in the assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength and information on corporate developments and market sentiment towards counterparties. The following key tools are used, either by ourselves or the appointed Treasury Advisers to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals (such as a country's net debt as a percentage of its GDP);
- Corporate developments, news, articles, markets sentiment and momentum.

The only indicators with prescriptive values are credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

**(6) Liquidity Risk**

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

## Implications

30. In the writing of this report, taking into account the financial, legal, staffing, risk management, equality and diversity, climate change, community safety and any other key issues, the following implications have been considered:

**Legal**

31. The Council is required to have regard to the CIPFA Code of Practice for Treasury Management in the Public Services. The Code recommends that an annual post year report on Treasury Management activities is prepared for consideration after each year end.

**Policy**

32. Full Council, at its meeting on 22 February 2018, approved the Council's Treasury Management Policy and Strategy Statements for 2018/2019 and the Strategy was reaffirmed by Audit and Governance Committee, at its meeting on 26/03/2019, following a mid-year review.

**Finance**

33. In 2018/2019 the Council managed a turnover in investments of £356 million (£349 million in 2017/2018) in-house within the Finance Team in the Corporate Directorate. As at 31 March 2019, the Council had funds to the market value of £98.8 million (£83.2 million at 31 March 2018), all managed in-house. These funds include capital balances, reserves and provisions, collection fund monies and monies held on behalf of third parties. The increase was due primarily to higher Grant income and retained business rates.

34. At 31 March 2019 the Council had external borrowing of £208.123 million plus £nil million of leasing liabilities (£205.123 million plus £0.009 million refuse vehicle leasing liabilities at 31 March 2018)

**Risks**

35. There are clearly inherent risks in placing investments both in terms of the security of the capital invested and the level of return from the investment. The approved Treasury Management Strategy 2018/2019 identified the Council's investment priorities as:

    (i) The security of the capital;
    (ii) The liquidity of its investments.

36. The Treasury Management Strategy states that the Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving low investment income.

37. The Council engages an external Treasury Management Adviser to provide appropriate and timely advice on the Council's treasury portfolio (and, in particular, to provide advice on counter-party creditworthiness and investment limits). This appointment is regarded as critical given the investment risks.

**Environmental**

38. There are no direct environmental implications arising from the report.

**Equality and Diversity**

39. In preparing this report, due consideration has been given to the District Council's statutory Equality Duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relations, as set out in Section 149(1) of the Equality Act 2010. A relevance test for equality has determined that the activity has no relevance to South Cambridgeshire District Council's statutory equality duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relation. An equality impact assessment is not needed.

**Effect on Council Priority Areas**

40. Timely and robust consideration of the Council's treasury management activities is vital to ensure that financial performance is in line with expectations.

## Background Papers

Where the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 require documents to be open to inspection by members of the public, they must be available for inspection:

(a) at all reasonable hours at the offices of South Cambridgeshire District Council;
(b) on the Council's website; and
(c) in the case of documents to be available for inspection pursuant to regulation 15, on payment of a reasonable fee required by the Council by the person seeking to inspect the documents at the offices of South Cambridgeshire District Council.

The following documents are relevant to this report:

- Budget Setting Report – Report to Council: 22 February 2018
- Capital Strategy 2019 - 2023 – Report to Council: 22 February 2018
- Treasury Management Strategy – Report to Council: 22 February 2018

## Appendices

A Investment Counterparties 2018/2019

B Treasury Management Adviser – Economic Review 2018/2019

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**Appendix A**

# Investment Counterparties 2018/19

The Council's investment counterparties used during 2018/19 are listed below:

| Category | Counterparty |
|---|---|
| Building Society | Yorkshire BS |
| Building Society | Coventry BS |
| Building Society | Leeds BS |
| Building Society | Skipton BS |
| Clearing Bank | Barclays Bank |
| Clearing Bank | Lloyds Bank |
| Clearing Bank | Santander UK |
| Other Bank | Close Brothers |
| Housing Association | Places for People |
| Local Authority | Lancashire CC |
| Local Authority | Bury MBC |
| Local Authority | London Borough of Havering |
| Local Authority | Wirral MBC |
| Local Authority | Calderdale MBC |
| Local Authority | Norfolk CC |
| Local Authority | Uttlesford DC |
| Local Authority | Stockport MBC |
| Local Authority | Eastleigh BC |
| Local Authority | London Borough of Bexley |
| Local Authority | Middlesbrough BC |
| Local Authority | Elmbridge BC |
| Local Authority | West York's PCC |
| Local Authority | Cornwall Council |
| Local Authority | Southend BC |
| Local Authority | Hull City Council |
| Local Authority | London Borough of Sutton |
| Money Market Fund | Aberdeen Standard Life |
| Money Market Fund | Deutsche Bank |
| Call account | Barclays Bank plc |
| South Cambs Ltd | Ermine Street Housing |
| Other investments | Cambridge Leisure and Ice Centre |

**Appendix B**

# Treasury Management Adviser – Economic Review 2018/2019

## Market Analysis

The major UK landmark event of the year was the inconclusive result of the general election on 8 June. However, this had relatively little impact on financial markets. Brexit negotiations have been a focus of much attention and concern during the year but so far, there has been little significant hold up to making reasonable progress. What has had a significant impact on **investment rates** was a shift in market expectation during the autumn that the MPC was heading in the direction of imminently raising Bank Rate.

The MPC meeting of 14 September did provide a shock to the markets with a sharp increase in tone from the minutes where the MPC considerably hardened their wording in terms of needing to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered on this warning by withdrawing the 0.25% emergency rate cut which had been implemented in August 2016 after the result of the EU referendum. Market debate then moved on as to whether this would be a one and done move for maybe a year by the MPC, or the first of a series of increases in Bank Rate over the next 2-3 years. The MPC minutes from that meeting were viewed as being dovish i.e. there was now little pressure to raise rates by much over that time period. In particular, the GDP growth forecasts were pessimistically weak while there was little evidence of building pressure on wage increases despite remarkably low unemployment.

The MPC forecast that CPI would peak at about 3.1% and chose to look through that breaching of its 2% target as this was a one off result of the devaluation of sterling resulting from the result of the EU referendum. The inflation forecast showed that the MPC expected inflation to come down to near the 2% target over the two to three year time horizon. So this all seemed to add up to cooling expectations of much further action to raise Bank Rate over the next two years. However, GDP growth in the second half of 2017 came in stronger than expected, while in the new year there was evidence that wage increases were starting to rise.

The 8 February MPC meeting minutes therefore revealed a sharp hardening in MPC warnings about a reduction in spare capacity in the economy, weak increases in productivity, higher GDP growth forecasts and a shift of their time horizon to focus on the 18 – 24 month period for seeing inflation come down to 2%. This resulted in a sharp increase in expectations there would be another Bank Rate increase in May 2018 and a bringing forward of the timing of subsequent increases in Bank Rate. Accordingly, LIBID rates from 3 – 12 months increased sharply during the spring quarter.

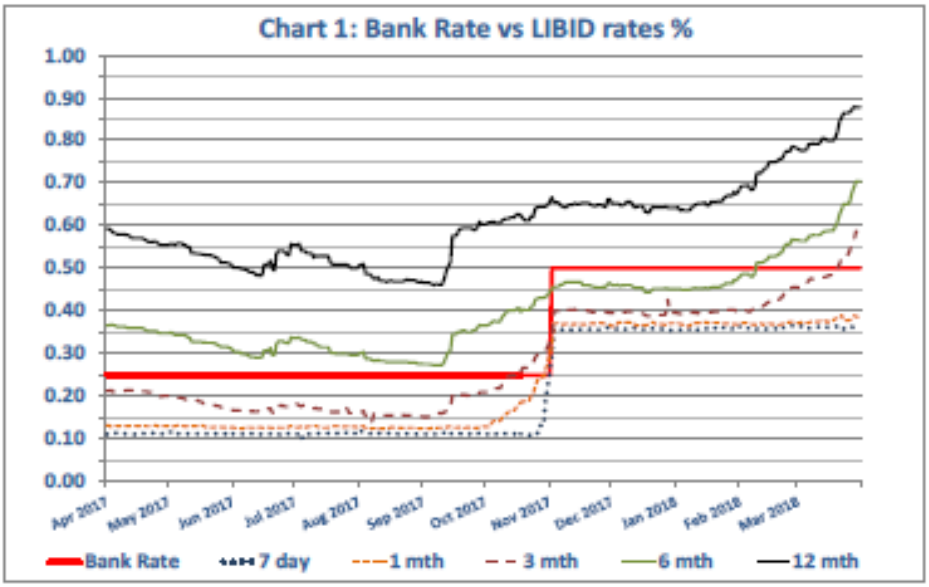
**PWLB borrowing rates** increased correspondingly to these events with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to US treasuries.

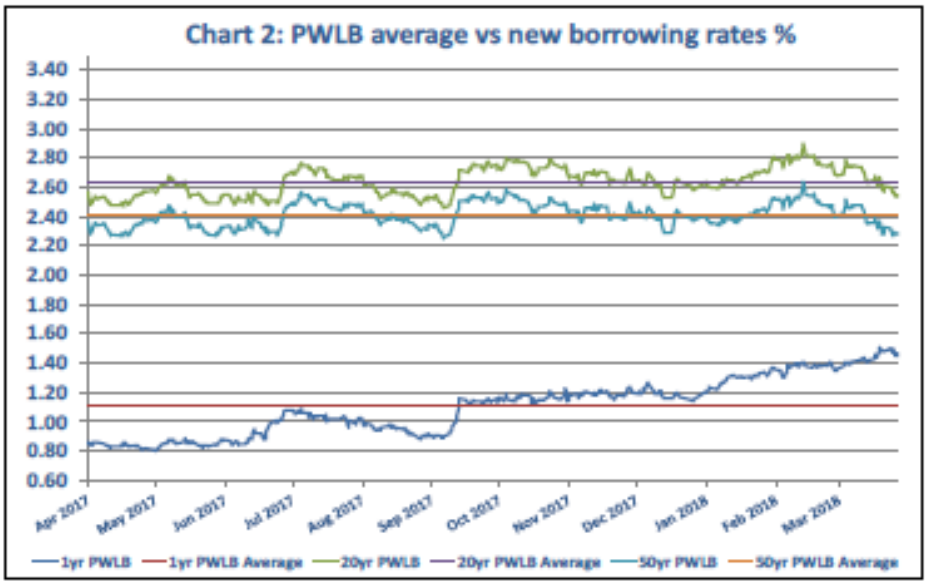
During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases were greater in shorter terms around 5 year, rather than longer term yields.

Another 2-3 increases in the Fed rate are likely in the rest of 2018 as the Fed faces a challenging situation where annual GDP growth increased sharply in 2017 to 2.3% and the Trump fiscal stimulus is likely to increase growth further, consequently increasing inflationary pressures in an economy which is already operating at near full capacity.

The Fed is also the first western central bank to start on an unwinding of quantitative easing by a gradual and phased reduction of reinvesting maturing debt in its portfolio; this commenced in October 2017.

As for **equity markets**, the FTSE 100 hit a new peak near to 7,800 in early January before there was a sharp selloff in a number of stages during the spring, replicating similar developments in US equity markets. The following analysis of the market movements during the financial year to 31st March 2018, along with the supporting graphs, can be used to explain the fluctuations in market rates which affect the fair values.



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South Cambridgeshire District Council

| | | |
|---|---|---|
| **REPORT TO:** | Audit & Governance | 19 December 2019 |
| **LEAD CABINET MEMBER:** | Councillor John Williams,<br>Lead Cabinet Member for Finance | |
| **LEAD OFFICER:** | Peter Maddock, Head of Finance | |

# MID YEAR 2019/2020 TREASURY MANAGEMENT REPORT

## Executive Summary

1. This report outlines the mid-year treasury management report to 30 September 2019, including performance against the approved Prudential Indicators for Treasury Management.

## Key Decision

2. This is not a key decision as there are no resource implications directly arising from the report at this stage.

## Recommendations

3. **That Committee is invited to review the Treasury Management activity and performance for the period to 30 September 2019.**

## Reason for Recommendation

4. To review the Treasury Management activity and performance for the period 1 April 2019 to 30 September 2019.

## Details

Treasury Management Strategy

5. The Council's Treasury Management Strategy and prudential indicators for 2019/2020 was approved by Full Council on 21 February 2019.

6. As part of the Council's Mid-Year Review the Treasury Management Policy Statement and Treasury Management Strategy for 2019-2020 have been reviewed with regard to their compliance to the CIPFA Prudential Code and the CIPFA Treasury Management Code. They have also been reviewed to ensure their appropriateness in light of the Council's current investment and borrowing portfolios, and the ongoing delivery of the Council service objectives. After this review the Treasury Management Policy and Treasury Management Strategy Statement have been found appropriate and there are no changes required.

7. The Council, as a consequence of its activities, has borrowed and invested substantial sums of money and is, therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The

successful identification, monitoring and control of risk is therefore central to the Council's treasury management strategy This report covers the treasury management activity for the period 1 April 2019 to 30 September 2019 and the associated monitoring and risk management.

8. Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Ministry for Housing, Communities & Local Government (MHCLG) published its revised investment Guidance which came into effect from April 2018.

9. The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be an overarching document approved by Full Council. The Council's Capital Strategy was considered by Full Council on 21 February 2019.

Investment Activity

10. As at 30 September 2019, the Council held £107.4 million of invested funds (nominal basis), representing income received in advance of expenditure plus balances and reserves held. The Council's investment balances during 2019/2020 have averaged £102.7million over the year.

11. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield consistent with these principles.

12. The portfolio has been managed throughout 2019 on the basis of there would be an external borrowing requirement for capital expenditure. In the period to 30 September this has been covered by short term borrowing. This has allowed the Council to increase its allocation to higher yielding Ermine Street Housing loans. The remainder of the portfolio has been held in short term liquid money market funds and fixed deposits with other Local Authorities, Banks, Building Societies and a Housing Association.

13. The table below shows the opening balances of investments held at the beginning of the financial year and the movements on each fund up to 30 September 2019:

| **Investment Counterparty** | 01 April 2019 | New | Matured | 30 Sept 2019 |
|---|---|---|---|---|
| **Short Term:** | **£000** | **£000** | **£000** | **£000** |
| Banks – Call/Liquidity Accounts | 75 | 24,250 | (23,935) | 390 |
| AAA Rated Money Market Fund | 7,175 | 120,425 | (121,025) | 6,575 |
| Clearing Banks | 14,000 | 18,000 | (12,000) | 20,000 |
| Other Banks | 4,000 | | (4,000) | 0 |
| UK Local Authorities | 4,500 | 9,200 | (11,700) | 2,000 |
| Building Societies | 3,000 | 9,000 | (5,000) | 7,000 |
| Housing Associations | 5,000 | 5,000 | (5,000) | 5,000 |
| **Total Short Term Investments** | **37,750** | **185,875** | **(182,660)** | **40,965** |

| **Investment Counterparty** | 01 April 2019 | New | Matured | 30 Sept 2019 |
|---|---|---|---|---|
| **Long Term:** | **£000** | **£000** | **£000** | **£000** |

| | | | | |
|---|---|---|---|---|
| South Cambs Ltd | 58,653 | 5,355 | | 64,008 |
| Cambridge Leisure and Ice | 1,255 | 1,145 | | 2,400 |
| **Total Long Term Investments** | **59,908** | **6,500** | | **66,408** |

| | | | | |
|---|---|---|---|---|
| **Total Investments** | **97,658** | | | **107,373** |

14. The upward movement in value of £9.7 million is due to the reasons reflected in paragraph 10.

15. The most significant movements in the portfolio are an increase of £6 million placed with Clearing Banks and a further £5.4 million loaned to Ermine Street Housing. A more detailed analysis of the investment portfolio as at 30 September 2019 is shown at **Appendix A**.

16. Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving low investment income.

17. In order to achieve these objectives, the Council's portfolio is diversified. The majority of the portfolio is invested in fixed deposits where Financial Institutions return 0.98% and Ermine Street Housing returns 3.72%. Liquidity assets typically return 0.73%. This has to 30 September 2019 generated the Council a blended return of 2.65%.

18. This has been achieved whilst maintaining a low level of credit risk. Counterparty credit quality is assessed and monitored with reference to credit ratings (the Council's minimum long-term counterparty rating is [A-] across all major agencies); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. This is shown below.

| | Weighted Average Risk Number | Investment Portfolio | Bail-In Exposure | | Average Balance | Rate of Return |
|---|---|---|---|---|---|---|
| | | £000 | £000 | % | | |
| 30 September 2019 | 4.11 | 104,973 | 34,000 | 32.4 | 40,965 | 0.98% |
| 31 March 2019 | 3.82 | 96,403 | 30,500 | 31.6 | 37,750 | 1.01% |

19. The table also shows how the Council's exposure to Bail in Risk has not significantly changed.

Borrowing Strategy

20. As at 30 September 2019, the Council held £205.123 million of long term debt (principal borrowed, excluding lease liabilities), no change on 31 March 2019. The Council also held £5 million in short term debt that was paid in full on 1 October 2019.

21. Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at

rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained low, and are likely to remain at these levels over the forthcoming two years, the Authority has determined it is more cost effective in the short-term to use internal resources instead of external borrowing.

22. The benefits of internal borrowing are monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Link Asset Services (Treasury Management Advisers) assist the Council with this 'cost of carry' and breakeven analysis.

Borrowing Activity

23. At 31 March 2019 the Council had short term local authority borrowing of £3 million in addition to £205.123 million of PWLB loans for HRA self financing. The table below sets out the movement in the Council's borrowing over the year to date:

| | 01/04/2019 | Maturing Debt | Interest Paid | Lease Payments | CFR Movement | 30/09/2019 |
|---|---|---|---|---|---|---|
| | £000 | £000 | % | £000 | | £000 |
| **Capital Financing Requirement** | 271,438 | | | | 19,500 | 290,938 |
| | | | | | | |
| Short Term Borrowing (a) | 13,000 | 8,000 | 0.80 | 0 | | 5,000 |
| Long Term Borrowing (b) | 205,123 | 0 | 3.51 | 0 | | 205,123 |
| **Total Borrowing (a+b)** | **218,123** | **8,000** | | **0** | | **210,123** |
| Other Long Term Liabilities (c) | 0 | 0 | 0 | 0 | | 0 |
| **Total External Debt (a+b+c)** | **218,123** | **8,000** | **0.80** | **0** | | **210,123** |

24. **PWLB Certainty Rate and Project Rate Update**: Authorities are required to notify MHCLG of any potential future borrowing in order to obtain 'Certainty Rate' (0.20% below the PWLB standard rate) the Council has submitted an application to borrow at this rate until November 2020. There is no penalty if the facility is not used.

25. **Debt Rescheduling**: The premium charge for early repayment of PWLB debt has become very expensive for the loans in the Council's portfolio and, therefore, unattractive for debt rescheduling activity. As a consequence, no rescheduling activity has been undertaken.

26. **Capital Financing Requirement:** The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, developer contributions, revenue contributions, use of earmarked reserves etc.), which has no resultant impact on the Council's borrowing need, or;

- If insufficient financing is available for the investment, or a decision is taken not to apply other resources, the funding of capital expenditure will give rise to a borrowing need.

27. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to

maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

2019/2020 Budget Monitoring

28. The Finance Team monitor and report on the Capital Financing budget on a regular basis. The latest position as at 30 September 2019 is shown in the table below:

| | Current Budget | Forecast Outturn | Forecast Variance |
|---|---|---|---|
| | £000 | £000 | £000 |
| Interest Payments | 406 | 68.8 | (337.2) |
| Minimum Revenue Provision | 594 | 581 | (13) |
| **Total Expenditure** | **1,000** | **649.8** | **(350.2)** |
| Investment Income | (2,004) | (2,689) | (685) |
| Commercial Property Rental Income | (0) | (842) | (842) |
| **Total Income** | **(2,004)** | **(3,531)** | **(1,527)** |
| **Net Budget** | **(1,004)** | **(2,881.2)** | **(1,877.2)** |

29. Interest Payments are forecast to be lower than originally budgeted as the expectation of long term borrowing during the year will not be required, due to higher investment balances.

30. Minimum Revenue Provision shows a small saving of £13,000.

31. Investment Income shows increased income of £0.685 million that is due to the effect of higher balances than forecast, with a significant contribution from Ermine Street Housing.

External Economic Impact on Portfolio

32. The external economic context and market rate data is referenced in the Treasury Advisers report reproduced at **Appendix B.**

33. The Base Rate increase of 0.25% to 0.75% in August 2018 increased the yield available on liquid funds. This increased the return on the Council's Money Market Fund holdings and give an increased return on maturing deposits when reinvested.

Compliance with Performance Indicators

34. The Council has been compliant with the 2019/2020 Prudential Indicators approved by Full Council on 21 February 2019 except where indicated. All exceptions are due to the high levels of investments held in short term money market funds and overnight bank accounts.

35. The Council measures and manages its exposures to treasury management risks using the following indicators:

36. Performance against prudential indicators in 2019/2020 is as follows:

**(1) Interest Rate Exposure**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable interest rate exposures are set out in the table below:

| Maturity structure of borrowing | Under 12 months | More than 12 months | Under 12 months - Actual | More than 12 months - Actual |
|---|---|---|---|---|
| Upper limit for fixed interest rate exposure | 100% | 100% | 2.37% | 97.62% |
| Upper limit for variable rate exposure | 100% | 0% | 0% | 0% |

**(2) Maturity Structure of Borrowing**: The structure of the Council's borrowing is set out below.

| Fixed Rate Borrowing | | |
|---|---|---|
| Lender | Repayable within | Amount £,000 |
| Local Authorities | <12 Months | 5,000 |
| PWLB | 15 – 20 years | 15,000 |
| PWLB | 20 – 25 years | 50,000 |
| PWLB | 25 – 30 years | 50,000 |
| PWLB | 30 – 35 years | 50,000 |
| PWLB | 35 – 40 years | 50,000 |

**(3) Principal Sums Invested for Periods Longer than 364 Days**: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The Council takes in consideration the advice of its Treasury Advisers when determining the duration of investments with financial institutions (excluding Ermine Street Housing and Cambridge Leisure and Ice Centre) The suggested duration for our counterparties are:

| Counterparty | Suggested maximum duration | Actual duration | Total investments £000 |
|---|---|---|---|
| Local Authorities | 5 years | 89 days | 2,000 |
| Lloyds | 12 months | 364 days | 10,000 |
| Santander[1] | 6 months | 364 days | 10,000 |
| Coventry BS | 6 months | 6 months | 4,000 |
| Yorkshire BS[1] | 100 days | 364 days | 3,000 |

[1] The longer duration fixed term deposits with these Counterparties were placed prior to the appointment of our Treasury Advisers.

**(4) Liquidity**: The Council has adopted a voluntary measure of its exposure to liquidity risk by maintaining a minimum £20 million working cash balance (total investment balance less loans to Ermine Street Housing and Cambridge Leisure and Ice). This liquidity is available to meet unexpected payments without additional borrowing.

| Counterparty Type | Amount £000 | % of Portfolio at 30 September |
|---|---|---|
| **Long term (>1yr)** | | |
| Ermine St Housing | 64,008 | 60 |
| CLIC | 2,400 | 2 |
| **Total Long term** | **66,408** | **62** |
| | | |
| **Short term (<365 days)** | | |
| Banks | 20,390 | 19 |
| Building Societies | 7,000 | 7 |
| Housing Assoc. | 5,000 | 5 |
| Local Authorities | 2,000 | 2 |
| Money Market Funds | 6,575 | 5 |
| **Short Term (Working Cash Balance)** | **40,965** | **38** |
| | | |

Outlook for Quarter 4 2019/2020

37. The Council will continue to make acquisitions under the Investment Strategy and make further loans to Ermine Street Housing. The Council will receive minimal receipts from Council Tax and National Non Domestic Rates during February and March and it is forecast that £15 million in short term loans will be required to manage cash flow needs.

38. The view is that the UK economy still faces a challenging outlook as the successor Government, following the General Election, continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

## Implications

39. In the writing of this report, taking into account the financial, legal, staffing, risk management, equality and diversity, climate change, community safety and any other key issues, the following implications have been considered:

**Legal**

40. It is a statutory duty, under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to approve a range of prudential indicators as part of its approval of the General Fund Revenue Budget and Capital Programme.

41. The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end).

**Policy**

42. There are no specific policy implications associated with the recommendations contained in this report. The Chartered Institute of Public Finance & Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (the CIPFA Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities 2017 (as amended) have been used in the preparation of this report.

**Finance**

43. There are no new resource implications associated with the recommendations contained in this report.

**Risks**

44. There are no specific risk implications associated with the recommendations contained in this report.

**Environmental**

45. There are no specific environmental implications associated with the recommendations contained in this report.

**Equality and Diversity**

46. In preparing this report, due consideration has been given to the District Council's statutory Equality Duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relations, as set out in Section 149(1) of the Equality Act 2010. A relevance test for equality has determined that the activity has no relevance to South Cambridgeshire District Council's statutory equality duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relation. An equality impact assessment is not needed.

**Effect on Council Priority Areas**

47. Timely and robust consideration of the Council's treasury management activities is vital to ensure that financial performance is in line with expectations.

## Background Papers

Where the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 require documents to be open to inspection by members of the public, they must be available for inspection:

(a) at all reasonable hours at the offices of South Cambridgeshire District Council;
(b) on the Council's website; and
(c) in the case of documents to be available for inspection pursuant to regulation 15, on payment of a reasonable fee required by the Council by the person seeking to inspect the documents at the offices of South Cambridgeshire District Council.

The following documents are relevant to this report:

- General Fund Medium Term Financial Strategy – Report to Cabinet: 7 November 2018
- Budget Report – Report to Cabinet: 6 February 2019
- Business Plan 2019 - 2024 – Report to Council: 21 February 2019
- Medium Term Financial Strategy and General Fund Budget – Report to Council: 21 February 2019

## Appendices

A Schedule of Investments as at 30 September 2019

B Treasury Management Adviser – External Economic Context and Market Rate Data

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## Appendix A – Schedule of Investments as at 30 September 2019

| | Amount | Interest | Total | Term | Rate | Maturity Date |
|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | Days | % | |
| **Counterparty** | | | | | | |
| Barclays Call Account | 390 | | 390 | Overnight | 0.50 | 01/10/2019 |
| Aberdeen Std Life MMF | 6,575 | | 6,575 | Overnight | 0.73 | 01/10/2019 |
| Yorkshire Building Society | 1,000 | 10.471 | 1,010 | 364 | 1.05 | 31/10/2019 |
| Santander | 1,000 | 12.466 | 1,012 | 364 | 1.25 | 31/10/2019 |
| Santander | 1,000 | 12.363 | 1,012 | 361 | 1.25 | 29/11/2019 |
| Lloyds | 1,000 | 9.727 | 1,010 | 317 | 1.12 | 28/02/2019 |
| Santander | 1,500 | 7.562 | 1,508 | 184 | 1.00 | 31/10/2019 |
| Lloyds | 1,000 | 12.500 | 1,013 | 364 | 1.25 | 30/04/2019 |
| Santander | 3,000 | 13.479 | 3,013 | 164 | 1.00 | 21/10/2019 |
| Places for People | 1,000 | 13.961 | 1,014 | 364 | 1.40 | 27/05/2020 |
| Lloyds | 2,000 | 24.110 | 2,024 | 352 | 1.25 | 20/05/2020 |
| Places for People | 2,500 | 36.151 | 2,536 | 364 | 1.45 | 30/06/2020 |
| Santander | 2,000 | 4.882 | 2,005 | 99 | 0.90 | 10/10/2019 |
| Places for People | 1,500 | 21.690 | 1,522 | 364 | 1.45 | 06/07/2020 |
| Santander | 1,500 | 3.440 | 1,503 | 93 | 0.90 | 10/10/2019 |
| LB of Barking & Dagenham | 2,000 | 3.609 | 2,004 | 89 | 0.74 | 21/10/2019 |
| Lloyds | 1,000 | 10.970 | 1,011 | 364 | 1.10 | 31/07/2020 |
| Lloyds | 2,000 | 5.403 | 2,005 | 116 | 0.85 | 02/12/2019 |
| Coventry Building Society | 2,000 | 5.757 | 2,006 | 133 | 0.79 | 20/12/2019 |
| Coventry Building Society | 1,000 | 4.212 | 1,004 | 183 | 0.84 | 19/02/2020 |
| Coventry Building Society | 1,000 | 4.327 | 1,004 | 188 | 0.84 | 27/02/2020 |
| Lloyds | 1,000 | 10.327 | 1,010 | 359 | 1.05 | 28/08/2020 |
| Lloyds | 1,000 | 3.889 | 1,004 | 169 | 0.84 | 27/02/2020 |
| Yorkshire Building Society | 2,000 | 3.800 | 2,004 | 95 | 0.73 | 20/12/2019 |
| Lloyds | 1,000 | 3.353 | 1,003 | 144 | 0.85 | 14/02/2020 |
| Ermine Street Housing | 61,056 | | | | 3.85 | Various |
| Ermine Street Housing | 2,952 | | | | 1.00 | Various |
| Cambridge Leisure & Ice | 2,400 | | | 25 Years | 4.31 | 31/03/2043 |
| | | | | | | |
| **Total** | 107,373 | | | | | |

**Appendix B – Treasury Management Adviser – External Economic Context and Market Rate Data**

## Economics update

**UK.** This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, in September, his proroguing of Parliament was overturned by the Supreme Court and Parliament carried a bill to delay Brexit until 31 January 2020 if there is no deal by 31 October. MPs also voted down holding a general election before 31 October, though one is likely before the end of 2019. So far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. At the time of writing the whole Brexit situation is highly fluid and could change radically by the day. Given these circumstances and the likelihood of an imminent general election, any interest rate forecasts are subject to material change as the situation evolves. If the UK does soon achieve a deal on Brexit agreed with the EU then it is possible that growth could recover relatively quickly. The MPC could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy.

The first half of 2019/20 has seen UK **economic growth** fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

With regard to the **labour market,** despite the contraction in quarterly GDP growth of -0.2% q/q, (+1.3% y/y), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not

over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.
In the **political arena**, if there is a general election soon, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

**USA.** President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further. The strong growth in employment numbers during 2018 has reversed into a falling trend during 2019, indicating that the economy is cooling, while inflationary pressures are also weakening The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates again in September to 1.75% - 2.00% and is thought likely to cut another 25 bps in December. Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

**EUROZONE.** Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1 and then fell to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of TLTROs; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a resumption of quantitative easing purchases of debt. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and unsurprisingly, the ECB stated that governments will need to help stimulate growth by fiscal policy. On the political front, Austria, Spain and Italy are in the throes of forming coalition governments with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

**CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress also still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. The trade war with the US does not appear currently to have had a

significant effect on GDP growth as some of the impact of tariffs has been offset by falls in the exchange rate and by transhipping exports through other countries, rather than directly to the US.

**JAPAN** - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

**WORLD GROWTH.** The trade war between the US and China is a major concern to financial markets and is depressing worldwide growth, as any downturn in China will spill over into impacting countries supplying raw materials to China. Concerns are focused on the synchronised general weakening of growth in the major economies of the world compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns have resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been sub 50 which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during the rest of this financial year is weak.

## Interest rate forecasts

The Council's treasury advisor, Link Asset Services, has provided the following forecast.
This forecast includes the increase in margin over gilt yields of 100bps introduced on 9.10.19.

| Link Asset Services Interest Rate View | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
| Bank Rate View | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| 3 Month LIBID | 0.70 | 0.70 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 |
| 6 Month LIBID | 0.80 | 0.80 | 0.80 | 0.90 | 1.00 | 1.10 | 1.10 | 1.20 | 1.30 | 1.40 |
| 12 Month LIBID | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 | 1.30 | 1.30 | 1.40 | 1.50 | 1.60 |
| 5yr PWLB Rate | 2.30 | 2.50 | 2.60 | 2.70 | 2.70 | 2.80 | 2.90 | 3.00 | 3.00 | 3.10 |
| 10yr PWLB Rate | 2.60 | 2.80 | 2.90 | 3.00 | 3.00 | 3.10 | 3.20 | 3.30 | 3.30 | 3.40 |
| 25yr PWLB Rate | 3.30 | 3.40 | 3.50 | 3.60 | 3.70 | 3.70 | 3.80 | 3.90 | 4.00 | 4.00 |
| 50yr PWLB Rate | 3.20 | 3.30 | 3.40 | 3.50 | 3.60 | 3.60 | 3.70 | 3.80 | 3.90 | 3.90 |

The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit at some point in time. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.
It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That's shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.
**Bond yields / PWLB rates**. There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that

central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

What we saw during the last half year up to 30 September is a near halving of longer term PWLB rates to completely unprecedented historic low levels. *(See paragraph 7 for comments on the increase in margin over gilt yields of 100bps introduced on 9.10.19.)* There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but due to a correlation between US treasuries and UK gilts, which at various times has been strong but at other times weaker, in the UK. However, forecasting the timing of this and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt fuelled boom which now makes it harder for economies to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

**The balance of risks to the UK**

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

One risk that is both an upside and downside risk is that all central banks are now working in very different economic conditions than before the 2008 financial crash. There has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for eleven years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could, therefore, over or under-do increases in central interest rates.

**Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:**

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on

Italian bonds. Only time will tell whether this new unlikely alliance of two very different parties will endure.

- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor, though more recently concerns have arisen over her health.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Italy, Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks,** for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

**Upside risks to current forecasts for UK gilt yields and PWLB rates**

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

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# Agenda Item 7

South Cambridgeshire District Council

| | | |
|---|---|---|
| **Report To:** | Audit and Governance | 19th December 2019 |
| **Lead Cabinet Member(s):** | Councillor John Williams,<br>Lead Cabinet Member for Finance | |
| **Lead Officer:** | Peter Maddock, Head of Finance | |

**SUBJECT: COMPLETION OF THE 2017/18 AUDIT OF THE ACCOUNTS AND THE PROPOSED TIMESCALES FOR THE AUDIT OF THE 2018/19 ACCOUNTS**

**PURPOSE**

1. To approve the final Statement of Accounts for 2017/18 (to follow) subject to final review and sign off by the Auditors and to note the proposed timetable for the completion of the external audit of 2018/2019 financial statements.

**RECOMMENDATIONS**

2. **To approve the 2017/18 Statement of Accounts (subject to final audit procedures) and to note the proposed timetable for the completion and audit of the 2018/19 Statement of Accounts.**

**REASON FOR RECOMMENDATION**

3. The 2017/18 Accounts audit is now nearing completion and the accounts need to be approved and issued as the final version. The auditors have one or two final things to resolve prior to signing off. Focus will then need to move on to the 2018/19 accounts audit with a view to completing these by the end of March 2020.

**BACKGROUND INFORMATION**

**Introduction**

4. There is a requirement under the Accountancy and Audit Regulations for Council's to present their accounts for the preceding financial year for audit by 31st of May each year and for those accounts to be audited and published by 31st July each year.

**2017/2018 Accounts**

5. With regard to the 2017/18 Accounts these were issued for audit in line with the regulations but had been rushed and had no proper working papers to verify most of the transactions and although the audit commenced in June of 2018 it soon became evident that they were unable to progress the audit further.

6. Since that time there have been a number of attempts to complete the final accounts audit and, for a variety of resource reasons, have had to be paused. The latest attempt to complete the audit commenced on 11th November and although it was expected to take three weeks it has in fact taken rather longer.

7. The 2017/18 accounts audit is now nearing completion and it is fair to say that there were a significant number of errors within the accounts which has necessitated a more detailed audit than would otherwise be the case. Also because of the sporadic nature of the audit a number of different auditors have been involved which has led to duplication for both finance and audit staff. This has been exacerbated by the passage of time in that some of the transactions were carried out over two years ago by different people than are currently having to answer the audit queries and some important detailed knowledge has since been lost.

8. Having said that we can shortly draw a line under the 2017/18 accounts and move on. Whilst the accounts need approving, there is little point in going into any detail as the accounts themselves are so out of date now as to be of little practical use.

**2018/2019 Accounts**

9. Turning to the 2018/19 accounts and given the recent history surrounding accounts preparation, the Team was faced with two choices - either (i) preparing the accounts to the timetable knowing that, in reality, they would be rushed, would still be based on information that was not reliable and indeed on an unaudited starting point or, (ii) preparing and presenting a set of accounts somewhat later with a much better chance of them being able to stand up to audit. The latter course of action was considered the most appropriate and therefore it is proposed to issue the 2018/19 accounts for audit during January when it is expected that they will be complete, with the agreed balance sheet starting point.

10. It was recognised that additional resources would be required to complete the 2018/19 accounts and this has proved quite difficult with a number of possibilities not working out, however a temporary resource has now been secured until May 2020 and the initial signs are very promising.

11. The biggest risk to a completed set of accounts for 2018/19 by the proposed deadline is still the asset register. Setting up the register and agreeing it to the accounts has taken rather longer than expected. Once we are completely happy with the 2017/18 closing position which will not be until the audit for that year is completed, we still need to load the 2018/19 transactions which include Depreciation, Additions and Re-valuations. It is possible that this work may not be completed until after Christmas, which will leave little time for checking and verification before the audit commences. At this stage it is still felt that this is achievable.

12. The other difficulty during January is that getting the accounts ready will clash with 2020/21 budget setting and whilst some staff dealing with the accounts do not get heavily involved with the budget others do including myself. This will need to be a carefully managed to ensure neither process is compromised in any way.

**2019/2020 Accounts**

13. As regards the year due to end on 31st March 2020 it is unlikely that the council will be able to meet the 31st May deadline for presentation of the accounts for audit or the 31st July audit completion deadline. It is also possible that the earlier deadline for audit completion introduced for 2017/18 will be put back to the previous 30th September deadline. The difficulties facing audit teams in 2018/19 when nearly half of local authority accounts audits were not complete by 31st July should not be underestimated and although the audit firms will be planning to complete their local

authority audits by the end of July there must be a significant risk that this will not be achieved. Given the particular difficulties experienced at South Cambs it also makes sense to re-assess the situation early in the new calendar year before making any firm decisions but a later audit commencement than June 2020 would seem the best course of action.

**Summary Position**

14. The 2017/18 accounts audit is nearing completion and it is expected that an unqualified audit opinion will be issued before Christmas.

15. The 2018/19 accounts are partially complete but the Asset Register has still to be completed and reconciled for 2018/19. If this is not achieved by Christmas there is a risk that the accounts will not be ready until well into January and given that this is also a busy period with budget preparation there is a significant risk to the process completing by the end of March as planned.

16. The Finance Team, whilst very committed, has had a number of long term vacancies with delayed recruitment, and also suffers from a shortfall of knowledge and relevant experience and has lacked motivation. Internal and/or external training would help to improve this. Some has already been undertaken but more is needed.

17. It is likely that the Council will not be able to meet the 2019/20 final accounts deadline and a decision on this will need to be made early in the new calendar year.

**OPTIONS**

18. The options around the 2018/19 accounts are that a set of accounts could be presented for external audit at the earliest opportunity after the completion of the 2017/18 audit but there could be limited confidence that the statements were prepared to the required standard; such an approach would essentially leave it to the auditors to find any errors and correct them when they arise but this is, however, bad practice and potentially could lead to additional costs for the Council as more work would be required by the auditors than otherwise. The alternative option, which has now been verbally agreed, is to present a set of accounts toward the end of January with a view to completing the audit by the end of March prior to the auditors focus shifting to the 2019/20 National Health audits which commence in May 2020.

**IMPLICATIONS**

19. In the writing of this report, taking into account the financial, legal, staffing, risk management, equality and diversity, climate change, community safety and any other key issues, the following implications have been considered:

***Policy***

20. Timely closure and audit of the Council's accounts is important to ensure that the financial position of the Council is ascertained as soon as possible after the year end in question. Failure to do so leads to uncertainty and if the true position is not certain when budgets are set this process becomes more difficult.

***Legal***

21. There is a requirement under the Accountancy and Audit Regulations for Council's to present their accounts for the preceding financial year for audit by 31st of May each year and for those accounts to be audited and published by 31st July each year. This however is not a statutory requirement.

***Financial***

22. Timely and robust consideration of the Council's budgets is vital to ensure that financial statements are correctly stated, financial procedures are followed and that the financial position of the Council is effectively managed and monitored.

***Risk***

23. There is a risk that the financial statements are incorrectly stated with consequential impacts.

***Environmental***

24. There are no environmental implications arising directly from the report.

***Equality Analysis***

25. In preparing this report, due consideration has been given to the District Council's statutory Equality Duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relations, as set out in Section 149(1) of the Equality Act 2010. It is considered that the report has no relevance to South Cambridgeshire District Council's statutory equality duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relation. An equality analysis is not needed.

**BACKGROUND PAPERS**

Where the Local Authorities (Executive Arrangements) (Meetings and Access to Information)
England) Regulations 2012 require documents to be open to inspection by members of the
Public, they must be available for inspection:

(a) at all reasonable hours at the offices of South Cambridgeshire District Council;
(b) on the Council's website; and
(c) In the case of documents to be available for inspection pursuant to regulation 15, on payment of a reasonable fee required by the Council by the person seeking to inspect the documents at the offices of South Cambridgeshire District Council.

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