ANNEX C

TREASURY MANAGEMENT POSITION 2018/19 – MID YEAR REVIEW & QUARTER 2 UPDATE

1.0 LEGISLATIVE REQUIREMENT

1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following:-

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how associated risk is managed
- the implications for future financial sustainability

The Capital Strategy report will be published with the 10-Year Capital Programme for 2019/20 in February 2019.

1.2 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.3 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.4 Accordingly, treasury management is defined as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market transactions and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.5 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) was adopted by the Council.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Scrutiny committee:

This mid-year report therefore ensures this Council is implementing best practice in accordance with the code and covers the following:

- An economic update for the first part of the 2018/19 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;
- A review of any debt rescheduling undertaken during 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

1.6 The regulatory environment places responsibility on Members for the review and scrutiny of Treasury Management policy and activities. This Mid-Year report therefore:-

(a) updates Members on the current Treasury Management position

1.7 The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved by this Council on 27 February 2018, there are no policy changes to the TMSS.

1.8 The Council's capital expenditure plans at Quarter 2 are financed by external grants or contributions, capital receipts received in the year, capital reserves or borrowing.

1.9 The Council continues to have an underlying need to borrow for capital purposes and has external borrowing of £1,200,000 which was undertaken in September 2016 from the Public Works Loan Board at a rate of 1.05% over 5 years.

1.10 The capital financing requirement in 2018/19, which is the amount of borrowing required to support the capital expenditure programme, is set at £36,200,000. The capital expenditure of the Council is mainly supported by grants, contributions and reserves. The capital financing requirement refers to the amount of borrowing that could be taken to support the capital expenditure programme.

1.11 The following table shows the treasury management position as at 30 September 2018:-

	30 Sept 18 £000's	**Rate %**
Capital Financing Requirement	36,200	
Borrowing	1,200	1.05
Investments	6,430	0.53

Table 1: Borrowing and Investment position at 30 September 2018

1.12 The table shows that changes in the capital expenditure programme only affects the treasury management position through the surplus funds that are available to the Council to invest, to earn investment income.

2.0 THE ECONOMY, INTEREST RATES AND TREASURY MANAGEMENT STRATEGY:

2.1 The economic background and interest rate forecast, which sets the environment in which the Council's treasury management operates, is attached at Annex D.

3.0 ANNUAL INVESTMENT STRATEGY 2018/19 – QUARTER 2:

3.1 **Investment Policy** – the Council's investment policy is governed by the Department for Communities and Local Government guidance, which was implemented in the Treasury Management Strategy Statement (TMSS) for 2018/19, and includes the Annual Investment Strategy approved by Cabinet on 6 February 2018. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield

3.2 The Council's priority is security of its surplus funds when investing with financial institutions. However the Council will always aim to achieve the optimum return (yield) on investments in line with its risk appetite and which is commensurate with proper levels of liquidity and security. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months. Investment are placed with highly credit rated financial institutions, using the Council's treasury Management advisers – Capita Asset Services - suggested creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Capita Asset Services.

3.3 **Investments held by the Council** – The Council held £6,430,000 of investments as at 30 September 2018 and the investment portfolio yield for the first 6 months of the year is 0.53%.

3.4 The average level of funds available for investment purposes during Quarter 2 – 30 September 2018 - was £6,227,978. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council held £6,430,000 cash flow movement balances on 30 September 2018 due to the numerous capital projects that are currently ongoing within the council.

3.5

Benchmark	Benchmark Return	CouncilPerformance	Investment Interest Earned
7 day	0.44%	0.53	£16,472

Table 2: Investment performance for Quarter 2 at 30 September 2018

3.6 The table shows that the Council monitors its cash flow investments against the 7 day rate. The Council outperformed the 7 day benchmark by 0.09%.

3.7 The Council's budgeted investment return for 2018/19 was approved at £8,000. This was increased by £15,000 in Quarter 1 to £23,000. This was due to the rise in interest rates available to the Council for investment. In Quarter 2 monitoring it has been reported that due to the Bank of England base rate rise in August 2018 the interest rates available to the Council have increased again, resulting in an estimated £12,000 additional income making the budget £35,000. This will be closely monitored throughout the year.

4.0 BORROWING 2018/19 – MID YEAR REVIEW & QUARTER 2 UPDATE

4.1 The Council has £1,200,000 of long term borrowing with the Public Works Loan Board (PWLB) which is due to be repaid in September 2021.

4.2 The table below shows the Public Works Loans Board interest rates which were available for loans during Quarter 2 of 2018/19. The Public Works Loans Board is the mechanism by which the Government allows local authorities to borrow at slightly lower interest rates than are available to other institutions. Certainty rates, as detailed in the table, are interest rates available to local authorities if they inform the Government of their borrowing requirements and are 0.02% (or 20 basis points) below Public Works Loans Board rates. This was introduced by the Government in October 2012. The Public Work Loans Board rates have not been on any consistent trend during the period.

	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	1.28%	1.67%	2.09%	2.50%	2.25%
Date	01/06/2018	29/05/2018	20/07/2018	20/07/2018	29/05/2018
High	1.57%	1.99%	2.43%	2.83%	2.64%
Date	17/04/2018	25/09/2018	25/04/2018	25/09/2018	25/09/2018
Average	1.46%	1.84%	2.25%	2.64%	2.41%

Table 3: Public Works Loan Board (PWLB) certainty rates, quarter ended 30 September 2018

4.3 **Treasury Borrowing** – Due to the overall financial position and the underlying need to borrow for capital purposes, external borrowing of £1,200,000 was undertaken in September 2016 from the Public Works Loan Board at a rate of 1.05% over 5 years. The Council did not undertake any new borrowing during Quarter 2, 2018/19.

4.4 It is anticipated that further borrowing will be required in Quarter 4 of 2018/19 to support the overall Capital Programme.

4.5 **Rescheduling of Borrowing** – the Council had no debt that could be rescheduled in Quarter 2 of 2018/19 under the regulations.

4.6 **Repayment of Borrowing** – the Council did not have any borrowing to repay during Quarter 2 of 2018/19

5.0 COMPLIANCE WITH PRUDENTIAL AND TREASURY INDICATORS:

5.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) were approved in the Treasury Management Strategy Statement by Council on 27 February 2018 and are in compliance with the Council's Treasury Management Practices. No changes have been made or are required to be made in the first six months of 2018/19 to the Prudential and Treasury Indicators that were set prior to the beginning of the financial year.

5.2 During the financial year to date the Council has operated within the Treasury and Prudential Indicators approved which are attached at Annex E.

5.3 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30 September 2018.

6.0 OTHER

6.1 UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

6.2 IFRS9 accounting standard

This accounting standard came into effect from 1st April 2018. It means that the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact onto the Surplus or Deficit on the Provision of Services, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but more specialist types of investments, (e.g. pooled funds, third party loans, commercial investments), are likely to be impacted. The impact for the Council is likely to be very little in 2018/19.

The Ministry of Housing, Communities and Local Government (MHCLG), are currently conducting a consultation for a temporary override to allow English local authorities time to adjust their portfolio of investments. Members will be updated when the result of this consultation is known.

6.3 Changes in risk appetite

The 2018 CIPFA Capital and Treasury Management Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to members' attention in treasury management update reports.

ANNEX D

Economic Update

United Kingdom. The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some Monetary Policy Committee members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The Monetary Policy Committee has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.)

Given 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. This tends to confirm that the Monetary Policy Committee were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

In the political arena, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, Link Asset Services central position is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, 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.

USA. President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, but also an upturn in inflationary

pressures. With inflation moving towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

EUROZONE. Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

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.

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.

INTEREST RATE FORECAST

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

Table 4: Interest Rate Forecasts

The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the Monetary Policy Committee came to a decision on 2 August 2018 to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the Monetary Policy Committee emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than

before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast.

Link Asset Services do not think that the Monetary Policy Committee will increase Bank Rates in February 2019, ahead of the deadline in March for Brexit. They also feel that the Monetary Policy Committee is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.