ANNEX C

TREASURY MANAGEMENT POSITION 2018/19 – QUARTER 3

1.0 LEGISLATIVE REQUIREMENT:

1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, Annual and Mid-year reports, as well as quarterly updates). This report therefore ensures this Council is implementing best practice in accordance with the Code.

1.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This Quarter 3 report therefore updates Members on the current treasury management position and is presented to Cabinet and also Audit, Governance and Standards Committee.

1.3 The Council's treasury management position is based on its requirement to fund the capital programme and it's operational cash flow need. The Council looks to balance the requirement to borrow from external sources with the surplus funds that are available.

1.4 The Council's capital expenditure plans at Quarter 3 are financed by external grants or contributions, capital receipts received in the year, capital reserves or borrowing.

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

1.6 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.

1.7 The following table shows the treasury management position as at 31 December 2018:-

	31 Dec 18 £000's	**Rate %**
Capital Financing Requirement	36,200	
Borrowing	1,200	1.05
Investments	7,940	0.61

Table 1: Borrowing and Investment position at 30 June 2018

1.8 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.

1.9 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code. A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the Authority at a much higher level than can be attained by treasury investments. The Council will provide a report for 2019/20, detailed elsewhere on this agenda, on the overall capital strategy and show how the new cash resources of the Authority are apportioned between treasury and non-treasury investments.

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 3:

3.1 **Investment Policy** - The Treasury Management Strategy Statement (TMSS) for 2018/19 which includes the Annual Investments Strategy, was approved by the Council on 27 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. Investments are placed with highly credit rated financial institutions, using the Council's treasury management advisers – Link Asset Services - suggested creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link Asset Services.

3.3 **Investments held by the Council** – The Council held £7,940,000 of investments as at 31 December 2018 and the investment portfolio yield for the 9 months of the year is 0.61%.

3.4 The average level of funds available for investment purposes during Quarter 3 – 31 December 2018 - was £7,174,655. 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 £7,940,000 cash flow movement balances on 31 December 2018 due to the numerous capital projects that are currently ongoing within the Council.

3.5

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.58%	0.61%	£32,711

Table 2: Investment performance for Quarter 3 at 31 December 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 0.03%.

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 investment 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 – QUARTER 3

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 Public Works Loan Board (PWLB) rates have not been on any consistent trend in this quarter. During Quarter 1, the 50 year Public Works Loan Board target (certainty) rate for new long term borrowing was marginally reduced to 2.40%. the council set is overall borrowing target arte at 3.10% at the beginning of the financial year, to cover all rates periods from 0 to 50 years.

4.3 The table below shows the Public Works Loans Board interest rates which were available for loans during Quarter 3 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. Longer term Public Works Loans Board rates have fallen towards the end of the period while 5 and 10 year rates have fallen during most of the period.

	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
1 Oct 2018	1.59%	1.97%	2.38%	2.78%	2.60%
31 Dec 2018	1.53%	1.70%	2.08%	2.65%	2.50%
Low	1.47%	1.63%	2.00%	2.56%	2.39%
Date	19/11/2018	12/12/2018	12/12/2018	11/12/2018	11/12/2018
High	1.64%	2.07%	2.50%	2.93%	2.79%
Date	10/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018
Average	1.54%	1.81%	2.22%	2.75%	2.61%

Table 3: Public Works Loan Board (PWLB) certainty rates, quarter ended 31 December 2018

4.4 **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 (PWLB) at a rate of 1.05% over 5 years. The Council did not undertake any new borrowing during Quarter 3, 2018/19.

4.5 It is anticipated that further borrowing will be required in Quarter 4 of 2018/19 to support the overall Capital Programme; this could be either short or long term borrowing depending on the interest rates available.

4.6 **Rescheduling of Borrowing**: the Council had no debt that could be rescheduled in Quarter 3 of 2018/19 under the regulations.

4.7 **Repayment of Borrowing**: the Council did not have any borrowing to repay during Quarter 3 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 to date in 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 31 December 2018.

ANNEX D

Economic Update

1.1 ECONOMIC BACKGROUND:

United Kingdom. After weak **economic growth** of only 0.1% in quarter one, growth picked up to 0.4% in quarter 2 and to 0.6% in quarter 3. However, uncertainties over Brexit look likely to cause growth to have weakened again in quarter four. After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the Monetary Policy Committee until the uncertainties over Brexit clear. In the event of a disorderly exit, the Monetary Policy Committee have said that rates could go up or down, though it is probably much more likely to be down so as to support growth. Nevertheless, the Monetary Policy Committee does have concerns over the trend in **wage inflation** which peaked at a new post financial crisis high of 3.3%, (excluding bonuses), in the three months to October. The main issue causing this is a lack of suitably skilled people due to the continuing increase in total employment and unemployment being near to 43 year lows. Correspondingly, the total level of vacancies has risen to new highs.

As for **Consumer Price Index inflation** itself, this has been on a falling trend, reaching 2.3% in November. However, in the November Bank of England Inflation Report, the latest forecast for inflation over the two year time horizon was raised to being marginally above the Monetary Policy Committee's target of 2%, indicating a slight build up in inflationary pressures.

The rise in wage inflation and fall in Consumer Price Index inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures in now around 1%, i.e. a real terms increase. 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.

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, our 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 2019, 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 in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the strong rate of growth; this rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5% in quarter 3. The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.1% in November, However, Consumer Price Index inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed increased rates another 0.25% in December to between 2.25% and 2.50%,

this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

EUROZONE. Growth fell in quarter 3 to 0.2% from 0.4% in quarter 2 but this is likely to be a one off blip caused primarily by a one off fall in car production. The European Central Bank forecast growth in 2018 to be 1.9% falling to 1.7% in 2020. The European Central Bank ended its programme of quantitative easing purchases of debt in December, which now means that the central banks in the US, UK and EU have all now ended the phase of post financial crisis expansion of liquidity supporting world financial markets.

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.

1.2 INTEREST RATE FORECAST:

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

Link Asset Services Interest Rate View	Mar-19	Jun-19	Sep-19	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%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

Table 4: Interest Rate Forecasts

After the August increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the Monetary Policy Committee has since then put any further action on hold, probably until such time as the fog of Brexit clears and there is some degree of certainty of what the UK will be heading into. It is particularly unlikely that the MPC would increase Bank Rate in February 2019 ahead of the deadline in March for Brexit, if no agreement on Brexit has been reached by then. ***The above forecast, and other comments in this***

report, are based on a central assumption that there is an agreement on a reasonable form of Brexit. In that case, then Link Asset Services think that the Monetary Policy Committee could return to increasing Bank Rate in May 2019 but then hold fire again until February 2020. However, this is obviously based on making huge assumptions which could be confounded. In the event of a disorderly Brexit, then cuts in Bank Rate could well be the next move.

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 Public Works Loan Board rates, are probably also even and are broadly dependent on how strong Gross Domestic Product growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.