ITEM NO	

REPORT TO EXECUTIVE

DATE	**14 November 2017**
PORTFOLIO	**Resources and Performance Management**
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2017/18 Treasury Management Mid-Year Report

PURPOSE

1. • To report treasury management activity for the period 01/04/17 to 30/09/17.

RECOMMENDATION

2. The Executive is requested to;

- Note the Treasury Management activities undertaken during the period 1 April to 30 September 2017, and;

Recommend that Full Council;

- Endorse the mid-year update on Treasury Management Strategy for 2017/18 in compliance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.
- Approve the increase in the limit for deposits in Goldman Sachs International Bank from £2m to £4m as per the revised counterparty list at Appendix 3 .
- Approve the option to invest in a property fund as discussed in paragraph 9, to a maximum limit of £2m.

REASONS FOR RECOMMENDATION

3.
- To inform members of the treasury management activity in the first half of 2017/18 and to fulfil statutory and regulatory requirements.
- To enable the Council to increase the limit that can be deposited with Goldman Sachs to £4m in line with other UK banks.
- To enable the Council to invest in a property fund in order to obtain potential higher rates of return.

SUMMARY OF KEY POINTS

4. **Background**

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

The second main function of the treasury management service is to ensure 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 commitments. This management of longer term cash may involve arranging long or short term loans, or using cash flow surpluses, and, on occasions any current debt may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

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

The monitoring requirements for treasury were set out in the report which included both the Treasury Management Strategy Statement for 2017/18 and the Prudential and Treasury Indicators for 2017/18 – 2019/20, approved by Full Council on the 22 February 2017.

5. **Introduction**

The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management 2011 was adopted by this Council on the 23 February 2012.

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 the Scrutiny Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first six months of 2017/18;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure;
- A review of the Council's investment portfolio for 2017/18;
- A review of the Council's borrowing strategy for 2017/18;
- A review of any debt rescheduling undertaken during 2017/18;
- A review of compliance with Treasury and Prudential Limits for 2017/18.

6. **<u>Economic Update (Provided by Capita Asset Services)</u>**

Economic performance to date – After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warnings that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September MPC meeting. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

It therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

Interest Rate Forecast

Capita Asset Services undertook its last review of interest rate forecasts on 9 August (see below) after the quarterly Bank of England Inflation Report. There was no change in MPC policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate “over the coming months”. It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. An increase in the short-term however is not currently reflected in the table below.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

7. **Treasury Management Strategy Statement update**

The Treasury Management Statement (TMSS) for 2017/18, which includes the Annual Investment Strategy, was approved by this Council on 22 February 2017.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

8. **The Council’s Capital Position**

The table below shows the financing of the Original Capital Budget approved by Full Council on the 22 February 2017 and the latest Revised Capital Budget. Nearly all of this increase is due to in year budget monitoring adjustments, which included £1.2m slippage from 2016/17.

Capital	**2017/18 Original Estimate £'000**	**2017/18 Revised Estimate £'000**
Total Budget	**12,028**	**15,349**
Financed by:		
Capital receipts	2,008	2,178
Capital grants	4,620	6,123
Revenue	1,378	3,150
Total financing	**8,006**	**11,451**
Borrowing need	**4,022**	**3,898**

9. **Investment Portfolio 2017/18**

Investment rates available in the market have also continued at historically low levels. The average daily level of funds deposited during the financial year to date, is £11.4m, compared with £14.3m for the same period in 2016/17. The actual value of funds deposited on the 30 September was £11.856m. These funds have been available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

There were 5 investments carried forward from 2016/17 totalling £14.1m, of which £9.1m was with our bank HSBC, £2m in fixed term deposits with Bank Of Scotland, £2m in fixed term deposits with Goldman Sachs and £1m in notice accounts with Santander.

There have been 4 new investments made during the period 1 April 2017 to 30 September 2017 totalling £8m, as well as a daily average of £5.6m being invested with HSBC's deposit account, earning between 0.10% and 0.15% interest.

The Council has an approved list of counterparties which governs treasury management investment activity. This list is a restricted list taking into consideration the credit rating of the institution concerned and there are also limits on the amount which can be invested with any particular institution from a particular sector e.g. building society, bank etc. and also any group of institutions within an overall banking group. As part of the daily operations of the treasury management dealings, in consultation with guidance from Capita Asset Services and the money market brokers, decisions are taken by the Head of Finance temporarily suspending/revising operations with individual counterparties. The latest deposit counterparties list was approved by the Full Council on 22 February 2017.

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

It is now proposed to increase the limit for deposits with Goldman Sachs to £4m in line with the current limit for the other UK based banks. Appendix 3 shows the revised counterparties list.

Appendix 1 shows the maximum amount invested with any of the counter parties at any one time during the period 1 April 2017 to 30 September 2017. The maximum limit per counterparty is shown in brackets. None of the limits were breached.

Appendix 2 provides Members with an analysis of the Council's total short-term deposits during the period 1 April 2017 to 30 September 2017, as well as comparing this to the total deposits placed on a daily basis throughout the 2016/17 financial year.

Property Funds

Officers have identified the potential for attractive returns for long-term investments in funds that have a wide portfolio of managed propery assets, used for rental investment returns and capital growth.

Over 100 Local Authorities invest in various commercial property funds where returns are higher than deposits in banking institutions, and where there is an opportunity for growth over the medium to long-term. Evidence suggests that returns of more than 4% can be achieved, although there is a requirement for a long-term investment (minimum of 5 years) to make it worthwhile and offset any initial set up costs.

There is a small risk that the principal invested may reduce in value (as well as increase in value), however historical evidence shows that this is unlikely and the fund managers are experts in mitigating that risk.

Approval is sought to give officers the option to invest a maximum of £2m in total in a property fund, subject to a rigourous appraisal and selection process being undertaken using the expertise and experience of our advisors, Capita. The small cost of the appraisal process is to be met from the Council's Invest to Save budget.

10. **Borrowing**

Below is a summary of the Council's external indebtedness, as at 1 April 2017, and as at 30 September 2017.

Borrowing	1 Apr 17 £'000	30 Sept 17 £'000	Change Apr – Sept £'000
Public Works Loan Board	20,587	22,087	1,500
Temporary Market Loans	29	12	(17)
Total	**20,616**	**22,099**	**1483**

PWLB Loans – There is one loan of £1m due to be repaid on 31 March 2018.

Temporary Market Loans – The Edward Stocks Massey Fund withdrew £17k in July 2017.

11. **Debt Rescheduling**

There have been no debt rescheduling opportunities in the current economic climate and consequent structure of interest rates. Therefore, no debt rescheduling was undertaken during the first six months of 2017/18.

12. **Compliance with Treasury & Prudential Limits**

It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy Statement.

During the financial year to date the Council's treasury management activities operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement in compliance with the Council's Treasury Management Practices.

An extract of the Prudential and Treasury Indicators are shown in Appendix 4.

13. **Interest Payable on External Borrowing / Interest Receivable**

Provision is made in the revenue budget to meet the net interest payable on external borrowing. The figure in the original budget for 2017/18 was set at £905,850.

Under the second round of revenue monitoring this budget will be revised down to £887,927 as a result of reducing the budget requirement for PWLB interest paid in the year.

The total interest receivable on temporary deposits for the period 1 April 2017 to 30 September 2017 amounted to £21,847 compared with a revised budget for the year of £42,500 and is therefore forecast to be achieved.

FINANCIAL IMPLICATIONS AND BUDGET PROVISION

14. None arising as a direct result of this report.

POLICY IMPLICATIONS

15. Compliance with the revised CIPFA Code of Practice on Treasury Management.

DETAILS OF CONSULTATION

16. None.

BACKGROUND PAPERS

17. None.

FURTHER INFORMATION	
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