OVERVIEW AND SCRUTINY ITEM, FOR CONSIDERATION PRIOR TO FULL COUNCIL

RYEDALE
DISTRICT
COUNCIL

REPORT TO:	**COUNCIL**
DATE:	**14 DECEMBER 2017**
REPORT OF THE:	**FINANCE MANAGER (s151)** **PETER JOHNSON**
TITLE OF REPORT:	**TREASURY MANAGEMENT MID-YEAR REVIEW**
WARDS AFFECTED:	**ALL**

EXECUTIVE SUMMARY

1.0 PURPOSE OF REPORT

1.1 To report on the treasury management activities to date for the financial year 2017/18 in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code).

2.0 RECOMMENDATIONS

2.1 It is recommended that:
(i) Members receive this report; and
(ii) The mid-year performance of the in-house managed funds to date is noted.

3.0 REASON FOR RECOMMENDATIONS

3.1 The Council has adopted the Code. A provision of the Code is that a mid-year review report must be made to the Full Council relating to the treasury activities of the current year.

4.0 SIGNIFICANT RISKS

4.1 There are significant risks when investing public funds especially with unknown institutions. However, by the adoption of the CIPFA Code and a prudent investment strategy these are minimised. The employment of Treasury Advisors also helps reduce the risk.

REPORT

5.0 BACKGROUND AND INTRODUCTION

5.1 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 ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

5.2 The second major function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide towards whether the Council has a borrowing need, 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.

5.3 Treasury management in this context is defined as:
"The management of the local authority'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."

5.4 The CIPFA Code of Practice on Treasury Management 2009 was adopted by this Council on 22 February 2010 and this Council fully complies with its requirements.

5.5 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 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, which in this Council is the Overview and Scrutiny Committee.

5.6 This mid-year report has been prepared in compliance with CIPFA's Code of Practice 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;
- A review of the Council's investment portfolio for 2017/18;
- A review of compliance with Treasury and Prudential Limits for 2017/18.

6.0 POLICY CONTEXT

6.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in Local Authorities and this report complies with the requirements under this Code.

7.0 CONSULTATION

7.1 The Council uses the services of Capita Asset Services (Sector Treasury Services

Limited) to provide treasury management information and advice.

8.0 REPORT DETAILS

Economic Update

8.1 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.

8.2 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 warning 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 meeting MPC. 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.

8.3 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.

8.4 Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

8.5 Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

8.6 *The Council's treasury advisor, Capita Asset Services, has provided the following forecast:*

	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%

Capita Asset Services undertook its last review of interest rate forecasts on 9 August 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. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

Treasury Management Strategy Statement and Annual Investment Strategy Update.

8.7 The Treasury Management Strategy (TMSS) for 2017/18 was approved by this Council on 21 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. Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity

8.8 The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (maximum loan period of 12 months) and only invest with highly credit rated financial institutions, using Sector's suggested creditworthiness approach, including sovereign rating and credit default swap (CDS) overlay information provided by Sector.

8.9 Investments during the first six months of the year have been in line with the strategy and there have been no deviations from the strategy.

8.10 As outlined above, there is still some uncertainty and volatility in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 21 February 2017 is still fit for purpose in the current economic climate.

Investment Portfolio 2017/18

8.11 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

8.12 As set out earlier in the report, it is a very difficult investment market in terms of earning the level of interest rate commonly seen in previous decades as rates are very low and in line with the 0.25% Bank Rate.

8.13 The Council's investment position at the beginning of the financial year was as follows:

Type of Institution	Investments (£)
UK Clearing Banks	10,713,305
Foreign Banks	5,000,000
Building Societies	2,900,000
Total	18,613,305

8.14 A full list of investments held as at 30 September 2017, compared to Sectors counterparty list and changes to Fitch, Moodys and S&P's credit ratings during the first six months of 2017/18 is shown in annex B and summarised below:

Type of Institution	Investments (£)
UK Clearing Banks	13,238,619
Foreign Banks	6,000,000
Building Societies	2,000,000
Total	21,238,619

8.15 As illustrated in the economic background section above, investment rates available in the market are at a historical low point. The average level of funds available for investment purposes in the first six months of 2017/18 was £20.7m. These funds were available on a temporary basis and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and the progress of the capital programme.

8.16 The table below compares the investment portfolio yield for the first six months of the year against a benchmark of the average 7 day LIBID rate of 0.11%.

	Average Investment (£)	Average Gross Rate of Return	Net Rate of Return	Benchmark Return	Interest Earned (£)
Cash Equivalents	5,591,530	0.15%	n/a	n/a	4,098
Fixed Term Deposits	1,161,538	0.38%	n/a	0.11%	32,377

8.17 The Council's budgeted investment return for 2017/18 is £65k and performance during the financial year to 30 September 2017 is £36k, **which is on target to out perform the budget.**

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

Compliance with Treasury and Prudential Limits

8.19 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) are outlined in the approved Treasury Management Strategy Statement (TMSS).

8.20 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's TMSS and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in annex A.

8.21 The level of gross borrowing remains at £1.75m, full details can be found at annex B. Repayments have been made in line with the loan repayment schedule. In order to fulfil the funding requirements of the current Capital Programme the Council still has a borrowing requirement of £320k, however it is unlikely that we will look to borrow the remaining sum in the current financial year.

9.0 IMPLICATIONS

9.1 The following implications have been identified:

a) Financial
The results of the investment strategy affect the funding of the capital programme. The investment income return to 30 September 2017 was £36k, which is in excess of the profiled budget. The cost of borrowing affects the revenue account. Borrowing costs to 30 September 2017 were £28k, which is below the profiled budget.

b) Legal
There are no additional legal implications within this report.

c) Other (Equalities, Staffing, Planning, Health & Safety, Environmental, Crime & Disorder)
There are no additional implications within this report.

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Background Papers:
None

Background Papers are available for inspection at:
N/a

ANNEX A

PRUDENTIAL AND TREASURY INDICATORS

Prudential Indicators

	2016/17	2017/18		
	Actual	Original Estimate	Current Position	Revised Estimate
Capital Expenditure	**£0.538m**	**£0.957m**	**£0.105m**	**£2.549m**
Net borrowing requirement	**-£13.731m**	**-£11.187m**	**-£19.489m**	**-£11.187m**
Capital Financing Requirement as at 31 March (excl borrowing by finance lease)	**£2.227m**	**£2.491m**	**n/a**	**£2.491m**
Annual change in Capital Financing Requirement	**-£0.124m**	**£0.264m**	**n/a**	**£0.264m**

Treasury Management Indicators

	2017/18	
	Original Limits	Revised Estimate
Authorised Limit for external debt -		
Borrowing	£10.0m	£10.0m
Other long term liabilities	£1.0m	£1.0m
Total	£11.0m	£11.0m
Operational Boundary for external debt -		
Borrowing	£5.0m	£5.0m
Other long term liabilities	£0.6m	£0.6m
Total	£5.8m	£5.8m

ANNEX B

Investment Portfolio as at 30 September 2017

Investment by Institution	Investment £	Duration of Investment	Latest Capita Duration Band Rating	Sovereignty Rating
UK Clearing Banks				
Lloyds Bank	6,138,619	On Call	6 Months	AA
Nationwide B.S.	1,000,000	6 Months	6 Months	AA
DBS Bank Ltd	1,500,000	9 Months	12 Months	AAA
Lloyds Bank	1,000,000	6 Months	6 Months	AA
DBS Bank Ltd	1,000,000	9 Months	12 Months	AAA
Santander	1,500,000	6 Months	6 Months	AA
CIC	1,000,000	6 Months	6 Months	AA
Santander	1,500,000	6 Months	6 Months	AA
DBS Bank Ltd	1,000,000	9 Months	12 Months	AAA
Nationwide B.S.	1,000,000	6 Months	6 Months	AA
Barclays Bank	1,100,000	5 Months	6 Months	AA
Lloyds Bank	1,500,000	6 Months	6 Months	AA
CIC	1,000,000	6 Months	6 Months	AA
CIC	1,000,000	6 Months	6 Months	AA
Grand Total	**21,238,619**			

Fitch, Moody's and S & P's Sovereignty Rating for the UK is AA.
All the above borrowers met the required credit rating at the time of investment.

Borrowing Schedule as at 30 September 2017

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£1.00m	Maturity	3.69%	50 years
PWLB	£0.75m	EIP	2.99%	19 years