Report To:	**CABINET**	**Date:**	**26 NOVEMBER 2018**
Heading:	**TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW 2018/19**		
Portfolio Holder:	**COUNCILLOR ROBERT SEARS-PICCAVEY – CABINET MEMBER (INWARD)**		
Ward/s:	**NO**		
Key Decision:	**NO**		
Subject to Call-In:	**NO**		

Purpose of Report

Cabinet are asked to note the mid-year position in respect of the treasury activity and performance against the prudential indicators.

Recommendation(s)

Cabinet:

1. Notes the change from existing Constant Net Asset Value (CNAV) Money Market Funds to Low Volatility Net Asset Value (LVNAV) Money Market Funds and;

2. Notes the mid-year position in respect of the treasury activity and performance against the prudential indicators.

Reasons for Recommendation(s)

To make Members aware of the current Treasury Management performance position and meet the requirements of the Council's Financial Regulations (C.30).

Alternative Options Considered

There is a requirement to report on Treasury Management performance during the year in accordance with Financial Regulations.

Detailed Information

Overview

The Council aims to operate 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.

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 commitments. This management of longer term cash may involve arranging long or short term loans, or the use of longer term cash flow surpluses, and on occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly treasury management is defined as:

"The management of the local authority's borrowing, 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."

TREASURY MANAGEMENT – MID YEAR REPORT 2018/19

1. Introduction

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 2018/19 financial year as at 30th September 2018;
- The Council's capital position (prudential indicators);
- The Council's investment portfolio for 2018/19.

There has yet been no change to the Council's Treasury Management Strategy and Annual Investment Strategy which was agreed by Council on 1st March 2018. Further information with regards to the Minimum Revenue Provision (MRP) can be found on section 2.1.2 of this report.

Due to the technical terms / abbreviations within this report, a glossary has been provided at the end of the report.

1.1 Economics and interest rates

1.1.1 Economics update

The United Kingdom (UK) is part of a global economy and as a result it is not only affected by events at home but events overseas. The below provide a brief update on the UK economy and the wider global economy.

UK. 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 MPC 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 (e.g. food and energy), 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 MPC has indicated that the 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 MPC 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, 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 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.

1.1.2 Interest Rate Forecasts

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%

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 MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC 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. We do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC 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.

2.1 The Council's Capital Position (Prudential Indicators)

2.1.1 Prudential Indicators

The Council's revised estimate position is shown in the table below.

Any changes to borrowing in the Capital Programme affect the Capital Financing Requirement (CFR). The CFR represents the Council's underlying need to borrow for capital expenditure.

	2018/19 Original Estimate £m	**2018/19 Revised Estimate (Adjusted for slippage) £m**
CFR – non housing	37.076	52.601
CFR – housing	80.081	80.081
Total CFR	117.157	132.682
Net movement in CFR		**+15.525**
Borrowing	74.748	79.748
Other long term liabilities	0	0
Total debt 31 March	**74.748**	**79.748**

The 2018/19 CFR Revised Estimate includes the approval of £6m for the Kirkby Leisure Centre and £10m for Investment properties as well as slippage brought forward on schemes from 2017/18.

Prudential Indicator 2018/19	**Original £m**	**Revised (Adjusted for slippage) £m**
Authorised Limit	130	130
Operational Boundary	120	120
Capital Financing Requirement	118	133

2.1.2 Minimum Revenue Provision

Minimum Revenue Provision (MRP) is a statutory charge to the General Fund to allow for the repayment of debt. MRP is calculated by dividing the amount borrowed either internally or externally by the expected life of that asset. E.g. if an asset is purchased for £100k and is expected to last 10 years then an MRP charge of £10k per annum (£100k/10) will be made each year until the total cumulative MRP charge equals the amount borrowed.

No changes are currently requested to the MRP policy. An updated MRP policy will be included in the next version of the Treasury Management Strategy early in 2019.

3.1 Investment Portfolio 2018/19

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. As set out in Section 1.1.2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are still very low and in line with the 0.75% Bank Rate which was in effect since 2nd August 2018.

In total the Council held £2.2m of call deposit investments (see tables below) as at 30 September 2018 (£8.1m at 31 March 2018) and the average investment portfolio yield for all investments in the first six months of the year is low at 0.42% due to low interest rates.

Call Deposits

Borrower	Closing Balance at 30/09/18 £000's
Barclays Bank	53
Aberdeen Liquidity – Money Market Fund	900
Insight – Money Market Fund	1,250
Total	**2,203**

The average interest rate across counterparties for Call deposits is 0.40%.

Term Deposits

As at 31st March 2018 the Council did have £4.5m term deposits with Thurrock Council. However, the Council did not have any term deposits at the end of September 2018. It did have term deposits both at the beginning and during the first six months of the financial year. The comparison below compares the performance of these term deposit investments against the current Bank of England (BoE) base rate.

BoE Base Rate As at 2nd August 2018	Council Performance	Investment Interest Earned £000's
0.75% (avg 0.58%)	0.42%	£16k

The bank base rate increased by 0.25% to 0.75% on 2nd August 2018. Most of the Council's investment income to date was received before the base rate increase. The Council's budgeted investment return for 2018/19 is £13k, and performance for the half year to 30th September 2018 is £22k which comprises £16k from term deposits and £6k from call deposits. The estimated full year outturn is £35k. (£22k above budget).

4.1 Money Market Funds

The Council currently has Constant Net Asset Value (CNAV) Money Market Funds (MMF). In order to make these more resilient to future financial crises the European Parliament has agreed that these should be modified to become Low Volatility Net Asset Value (LVNAV) Money Market Funds. The value of a CNAV MMF remains the same e.g. you purchase £100 MMF shares you will receive £100 when you sell these. The difference with Low Volatility Net Asset Value (LVNAV) shares is that you may no longer get £100 when you sell £100 MMF shares. It is unlikely that there will be a change in the price of the MMF shares between price paid and monies received when shares are sold.

5.1 Investment Properties

The Council spent £14.981m on Investment Properties in 2017/18. These are expected to generate £1.101m rental income in 2018/19. This will result in a gross yield of 7.35%.

In 2018/19 to date the Council has purchased a further investment property for £4.334m which is expected to generate annual rental income of £0.287m. Which represents a gross yield of 6.62%.

The combined expenditure for all Investment Properties to date is £19.315m. These are expected to generate total income £1.357m which will result in a gross yield of 7.19%.

Implications

Corporate Plan: Effective treasury management and investment in properties is providing an income stream to support delivery of the key services within the Corporate Plan.

Legal:
Requirement to adhere to the CIPFA Prudential Code. Ensures compliance with Financial Regulations.

Finance:

Budget Area	Implication
General Fund – Revenue Budget	The General Fund investment income is expected to be £22k greater than budget.
General Fund – Capital Programme	No significant implications.
Housing Revenue Account – Revenue Budget	No significant implications.
Housing Revenue Account – Capital Programme	No significant implications.

Risk:

Risk	Mitigation
Risk that the investment properties become void or fall in value.	Spread of assets within the portfolio and a reserve to cushion any void periods.

Human Resources:
Not Applicable

Equalities:
Not Applicable

Other Implications:
Not Applicable

Reason(s) for Urgency
Not Applicable

Reason(s) for Exemption
Not Applicable

Background Papers
Link Asset Services -Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2018/19

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