Ashfield
DISTRICT COUNCIL

Report To:	CABINET	Date:	30TH NOVEMBER 2017
Heading:	TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW 2017/18		
Portfolio Holder:	CLLR JACKIE JAMES – CORPORATE RESOURCES AND FINANCE		
Ward/s:			
Key Decision:	NO		
Subject To Call-In:	NO		

Purpose Of Report

To receive a report on the position of the Council with regard to its Mid Year position against the existing Treasury Management Strategy.

Recommendation(s)

Cabinet are asked to note 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 position and meet the requirements of the Council's Financial Regulations (C.29).

Alternative Options Considered (With Reasons Why Not Adopted)

None.

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 using 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 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 2017/18

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 2017/18 financial year as at 30th September 2017;
- The Council's capital position (prudential indicators);
- The Council's investment portfolio for 2017/18.

There has been no change to the Council's Treasury Management Strategy and Annual Investment Strategy which was agreed by Council on 23rd March 2017. 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 also events overseas. The below provide a brief update on the UK economy and the wider global economy.

UK. After the UK economy surprised many with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 resulted 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 slowing growth has been the sharp increase in inflation, caused by the weakening partly of sterling after the EU referendum, resulting in 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.

Recently there have been encouraging statistics from the manufacturing sector that 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. Growth for quarter 3 at 0.4% (higher than expected).

EU. Economic growth in the EU, (the UK's biggest trading partner), has been lacklustre for several years after the financial crisis despite the European Central Bank (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 ECB 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.

USA. Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 showing growth of only 1.2% but quarter 2 rebounded 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 USA Central Bank (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 interest rate 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.

Chinese 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 is struggling to stimulate consistent significant 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.

Taking all of the above in to account, the MPC increased the bank base rate from 0.25% to 0.5% on the 2nd November 2017.

1.1.2 Interest Rate Forecasts

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

	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00
3 month LIBID	0.40	0.40	0.40	0.40	0.40	0.60	0.60	0.60	0.70	0.90	0.90
6 month LIBID	0.45	0.50	0.50	0.50	0.60	0.80	0.80	0.80	0.90	1.00	1.00
12 month LIBID	0.65	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.10	1.30	1.30
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.10
10 yr PWLB	2.10	2.10	2.20	2.30	2.40	2.40	2.50	2.60	2.60	2.70	2.70
25 yr PWLB	2.70	2.80	2.90	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.40
50 yr PWLB	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10	3.20

The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include the final outcome of the Governments Brexit negotiations with the EU.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- UK economic growth and increases in inflation are weaker than currently anticipated.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases interest rate in the Fed. Funds Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

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. This is based on the November 2017 Capital Programme which is on the same agenda as this report.

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.

	2017/18 Original Estimate £m	**2017/18 Revised Estimate £m**
CFR – non housing	31.726	46.559
CFR – housing	80.081	80.081
Total CFR	111.807	126.640
Net movement in CFR		**+14.833**
Borrowing	75.449	90.449
Other long term liabilities	0	0
Total debt 31 March	**75.449**	**90.449**

The Council's CFR and borrowing have both increased to reflect a further £15m to be spent on Investment Properties as outlined in the updated Capital Strategy & Capital Programme report, subject to approval by Council.

Prudential Indicator 2017/18	***Original £m***	***Revised £m***
Authorised Limit	130	130
Operational Boundary	120	120
Capital Financing Requirement	112	127

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.

The value of Investment Properties is not expected to decrease in value. Therefore, in line with our current MRP strategy, it is proposed not to charge MRP on the property costs as the

borrowing incurred on these properties could be offset by future sale proceeds from the Investment Properties. MRP will continue to be charged on the acquisition costs (Stamp Duty Land Tax, agent fees etc.).

3.1 Investment Portfolio 2017/18

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 very low and in line with the 0.25% Bank Rate which was in effect for the first six months of the financial year.

In total the Council held £20.2m of investments (see tables below) as at 30 September 2017 (£19.1 at 31 March 2017) and the average investment portfolio yield for all investments in the first six months of the year is 0.26%.

Call Deposits

Borrower	Closing Balance £000's
Barclays Bank	119
Bank of Scotland	4,000
Standard Life – Money Market Fund	3,960
Insight – Money Market Fund	1,000
Total	**9,079**

The average interest rate across counterparties for Call deposits is 0.19%.

Term Deposits

Borrower	Closing Balance £000's
Svenska Handelsbanken AB	1,600
Goldman Sachs International Bank	5,000
Thurrock Borough Council	4,500
Total	**11,100**

The average investment return for term deposits i.e. those investments which are made for a period of seven days or more is shown below. The comparison below compares the performance of these investments against the current Bank of England (BoE) base rate.

BoE Base Rate	Council Performance	Investment Interest Earned
0.25%	0.41%	£31,552

The Council's budgeted investment return for 2016/17 is £52k, and performance for the half year to 30th September 2017 is £38k which comprises £32k from term deposits and £6k from call deposits. The estimated full year outturn is £60k.

Glossary of Terms

Call Deposits	Call Deposit Meaning: In deposit terminology, the term Call Deposit refers to a specific type of interest bearing investment account that allows a person to withdraw their money from the account without a penalty.
GDP	Gross Domestic Product This is the monetary value of all the finished goods and services produced by a country within its borders in a specific time period, usually a year.
G7	This is an international organisation established to facilitate economic cooperation among the seven wealthiest developed nations – Canada France Germany Great Britain Italy Japan USA
CPI	Consumer Price Index
LIBID	The London Interbank Bid Rate, that is, the interest rate at which banks bid to take short-term deposits from other banks
RPI	Retail Price Index Both CPI and RPI measure inflation by measuring changes in the price levels of a sample of representative goods and services purchased by households. They use different items and different formulae for the calculations which means that CPI is often lower than RPI.
y/y	Year on year is a method of evaluating two or more measured events to compare the results of one time period with those of a comparable time period on an annualised basis.
MPC	Monetary Policy Committee This is a committee of the Bank of England which decides the official interest rate in the UK (the Bank of England Base Rate) and also directs other monetary policy such as quantitative easing and forward guidance.
PWLB	Public Works Loan Board The PWLB is a statutory body operating within the UK Debt Management Office to lend money from the National Loan Fund to local authorities and to collect the repayments.
QE	Quantitative Easing is an unconventional form of monetary policy where a Central Bank creates new money electronically to buy financial assets, like government bonds. This process aims to directly increase private sector spending in the economy and return inflation to target.

Implications

Corporate Plan:

Legal:
The report ensures compliance with Financial Regulations.

Finance:

This report is effective from 30/11/2017 and has the following financial implications:

Budget Area	Implication
General Fund – Revenue Budget	None.
General Fund – Capital Programme	None.
Housing Revenue Account – Revenue Budget	None.
Housing Revenue Account – Capital Programme	None.

Risk:

Risk	Mitigation
None. Risks associated with borrowing for investment properties is contained within the Capital Strategy Update & Capital Programme report, also on this Agenda.	

Human Resources:
No Human Resources Implications.

Equalities:
No Equalities Implications.

Other Implications:
Not Applicable.

Reason(s) for Urgency (if applicable):
Not Applicable.

Exempt Report:

Not Applicable.

Background Papers
Not Applicable.

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