

## CABINET

THURSDAY 29<sup>TH</sup> NOVEMBER 2018

### REPORT OF THE PORTFOLIO HOLDER FOR ASSETS AND FINANCE

#### TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2018/19

##### EXEMPT INFORMATION

None

##### PURPOSE

To present to Members the Mid-year Review of the Treasury Management Strategy Statement and Annual Investment Strategy.

##### RECOMMENDATIONS

**That Council be requested to accept the Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2018/19.**

##### EXECUTIVE SUMMARY

This mid-year report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (revised 2017), and covers the following:-

- An economic update for the first six months of 2018/19;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's Capital expenditure as set out in the Capital Strategy, and Prudential Indicators;
- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;
- A review of any debt rescheduling undertaken during 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

The main issues for Members to note are:

1. The Council has complied with the professional codes, statutes and guidance.
2. There are no issues to report regarding non-compliance with the approved prudential indicators.
3. The investment portfolio yield for the first six months of the year is 0.77% (0.52% for the same period in 2017/18) compared to the 3 Month LIBID benchmark rate of 0.61% (0.18% for the same period in 2017/18).

The aim of this report is to inform Members of the treasury and investment management issues to enable all Members to have ownership and understanding when making decisions on Treasury Management matters. In order to facilitate this, training on Treasury Management issues was most recently delivered for Members in February 2018 and will be provided as and when required.

## **RESOURCE IMPLICATIONS**

All financial resource implications are detailed in the body of this report which links to the Council's Medium Term Financial Strategy.

## **LEGAL/RISK IMPLICATIONS BACKGROUND**

Risk is inherent in Treasury Management and as such a risk based approach has been adopted throughout the report with regard to Treasury Management processes.

## **SUSTAINABILITY IMPLICATIONS**

None

## **BACKGROUND INFORMATION**

In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following:-

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- An overview of how the associated risk is managed
- The implications for future financial sustainability

A report setting out our Capital Strategy will be included with the Budget and Medium Term Financial Strategy report presented to Cabinet and Council in February 2019.

The CIPFA Code of Practice on Treasury Management (revised 2017) suggests that Members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This is the second monitoring report for 2018/19 presented to Members this year and therefore ensures the Council is embracing best practice. Cabinet also receives regular monitoring reports as part of the quarterly healthcheck on Treasury Management activities and risks.

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 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 operations. 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 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.”*

## **Introduction**

The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (revised 2017) was adopted by this Council on 27<sup>th</sup> February 2018.

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 Audit and Governance 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 part of the 2018/19 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council’s Capital expenditure as set out in the Capital Strategy, and Prudential Indicators;
- A review of the Council’s investment portfolio for 2018/19;
- A review of the Council’s borrowing strategy for 2018/19;
- A review of any debt rescheduling undertaken during 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

## 1. Economic Update

### 1.1 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 2<sup>nd</sup> 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, 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 Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track.

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.

### 1.2 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.

### 1.3 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.

### 1.4 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.

### 1.5 Japan

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.

### 1.6 Interest Rate Forecasts

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

Link Asset Services Interest Rate View														
	Dec-18	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%	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	0.80%	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	0.90%	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	1.10%	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	2.00%	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%	2.50%	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%	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%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

Link Asset Services do not currently think that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. It is likely that getting parliamentary approval on both sides of the Channel will take well into spring next year. However, in view of the hawkish stance of the MPC this time, they have moved forward their first increase in Bank Rate from August to May 2019. The next increases then occur in February and November 2020 before ending up at 2.0% in February 2022.

Financial markets are now expecting a first increase in February 2019 and then further increases only in February 2020 and then May 2021, to end 21/22 at only 1.50%. PWLB rates, particularly 5 and 10 year rates, have increased slightly in response to the faster pace of Bank Rate increases. Forecasts for average investment earnings beyond the three year time horizon will be heavily dependent on economic and political developments.

#### 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 PWLB rates are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than currently anticipated.
- A resurgence of the **Eurozone sovereign debt crisis**, possibly **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in government spending which the Italian government has refused. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold Italian debt. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and consequently, Italian bond yields have risen sharply – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.

- **Other minority eurozone governments.** Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy**, this year, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. In October 2018, we have seen a sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

#### **Upside risks to current forecasts for UK gilt yields and PWLB rates**

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

## 2. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved by Council on 27th February 2018.

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.

## 3. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

### 3.1 Prudential Indicator for Capital Expenditure

This table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2018/19 Original Programme	Budget B'fwd from 2017/18	Virements to Programme in Year	Total 2018/19 Budget	Actual Spend @ Period 6	Predicted Outturn	2018/19 Revised Estimate*
	£m	£m	£m	£m	£m	£m	£m
General Fund	10.176	9.105	3.987	23.268	8.908	22.215	23.114
HRA	13.274	18.198	0.250	31.722	6.933	30.867	31.441
<b>Total</b>	<b>23.450</b>	<b>27.303</b>	<b>4.237</b>	<b>54.990</b>	<b>15.841</b>	<b>53.082</b>	<b>54.555</b>

\* Includes potential expenditure slippage into 2019/20

### 3.2 Changes to the Financing of the Capital Programme

The following table draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

<b>Capital Expenditure</b>	<b>2018/19 Capital Programme £m</b>	<b>2018/19 Predicted Outturn £m</b>	<b>2018/19 Budget * £m</b>
Unsupported	1.666	8.364	8.529
Supported	21.784	44.719	46.462
<b>Total spend</b>	<b>23.450</b>	<b>53.082</b>	<b>54.990</b>
Financed by:			
Grants - Disabled Facilities	0.360	0.447	0.447
Coalfields Grant	-	0.042	0.222
Section 106's	0.225	0.274	0.484
GF Receipts	6.302	16.621	16.651
GF Reserve	-	0.086	0.470
Sale of Council House Receipts	0.412	0.480	0.564
HRA Receipts	1.665	1.735	1.735
HLF Assembly Rooms Lottery	0.340	0.576	0.576
Grants - Assembly Rooms (SLGF/Arts Council)	0.654	1.934	1.934
Public Contributions (Assembly Rooms)	0.050	0.050	0.050
HLF/Donation - Castle Mercian Trail	-	0.558	0.558
Other Contributions	0.168	-	-
MRR	5.077	7.608	7.942
HRA 1-4-1 Replacements Receipts	0.528	1.225	1.375
HRA Reserve	3.706	9.493	9.863
HRA Regeneration Fund	2.298	3.592	3.592
<b>Total Financing</b>	<b>21.784</b>	<b>44.719</b>	<b>46.462</b>
<b>Borrowing need</b>	<b>1.666</b>	<b>8.364</b>	<b>8.529</b>

\* includes potential expenditure slippage into 2019/20

### **3.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary**

The following table shows the Capital Financing Requirement (CFR), which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

#### **Prudential Indicator – Capital Financing Requirement**

We are on target to achieve the original forecast Capital Financing Requirement.

## Prudential Indicator – the Operational Boundary for External Debt

	2017/18	2018/19	2018/19	2018/19
	Outturn	Capital Programme	Projected Outturn	Budget *
	£m	£m	£m	£m
CFR – Non Housing	0.885	2.547	1.978	2.143
CFR – Housing	68.041	75.255 <sup>1</sup>	75.255	75.255
Total CFR	68.926	77.802	77.233	77.398
<b>Net movement in CFR</b>	<b>(0.058)</b>	<b>8.876</b>	<b>8.307</b>	<b>8.472</b>
Operational Boundary				
Expected Borrowing	63.060	63.060	63.060	63.060
Other long term liabilities	-	-		-
<b>Total debt 31st March</b>	<b>63.060</b>	<b>63.060</b>	<b>63.060</b>	<b>63.060</b>

<sup>1</sup> Includes re-profiling of planned borrowing of £7.214m from 2017/18

### 3.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2017/18	2018/19	2018/19	2018/19
	Outturn	Original Estimate	Projected Outturn	Budget
	£m	£m	£m	£m
Gross borrowing	63.060	63.060	63.060	63.060
Less investments	60.805	54.198	59.751	59.916
<b>Net borrowing</b>	<b>2.255</b>	<b>8.862</b>	<b>3.309</b>	<b>3.144</b>
<b>CFR (year end position)</b>	<b>68.926</b>	<b>77.802</b>	<b>77.233</b>	<b>77.398</b>

The Executive Director Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

<b>Authorised Limit for External Debt</b>	<b>2018/19 Original Indicator</b>	<b>Current Position</b>	<b>2018/19 Revised Indicator</b>
Borrowing	84.954	84.954	84.954
<b>Total</b>	<b>84.954</b>	<b>84.954</b>	<b>84.954</b>

#### **4. 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 shown by forecasts in Section 1, 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 current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short-term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

The Council held £66.51m of investments as at 30<sup>th</sup> September 2018 (£60.77m at 31<sup>st</sup> March 2018 – excluding impaired investments) and the investment portfolio yield for the first six months of the year is 0.77% against a benchmark of the 3 months LIBID of 0.61%. A full list of treasury investments held as at 30<sup>th</sup> September 2018 is detailed in **APPENDIX 1**.

The Executive Director Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19.

The Council's budgeted investment return for 2018/19 is £176k, and performance for the year is projected to be £300k above budget, due to actual interest rates being achieved above the amount budgeted of 0.50% and additional funds available to invest (due to increased capital slippage). The Council is also projected to receive an additional £109k in respect of property fund interest and dividends, due to investments in property funds being made earlier than budgeted.

#### **CIPFA Benchmarking Club**

The Council is a member of the CIPFA Treasury Management Benchmarking Club which is a means to assess our performance over the year against other members. Our average return for In House Investments for the period April 2017 to March 2018 was 0.54% compared to the group average of 0.64% (information from CIPFA Benchmarking Report 2017/18). This is considered to be a reasonable result in light of the current financial climate, our lower levels of deposits/funds and shorter investment time-lines due to Banking sector uncertainty, when compared to other Authorities.

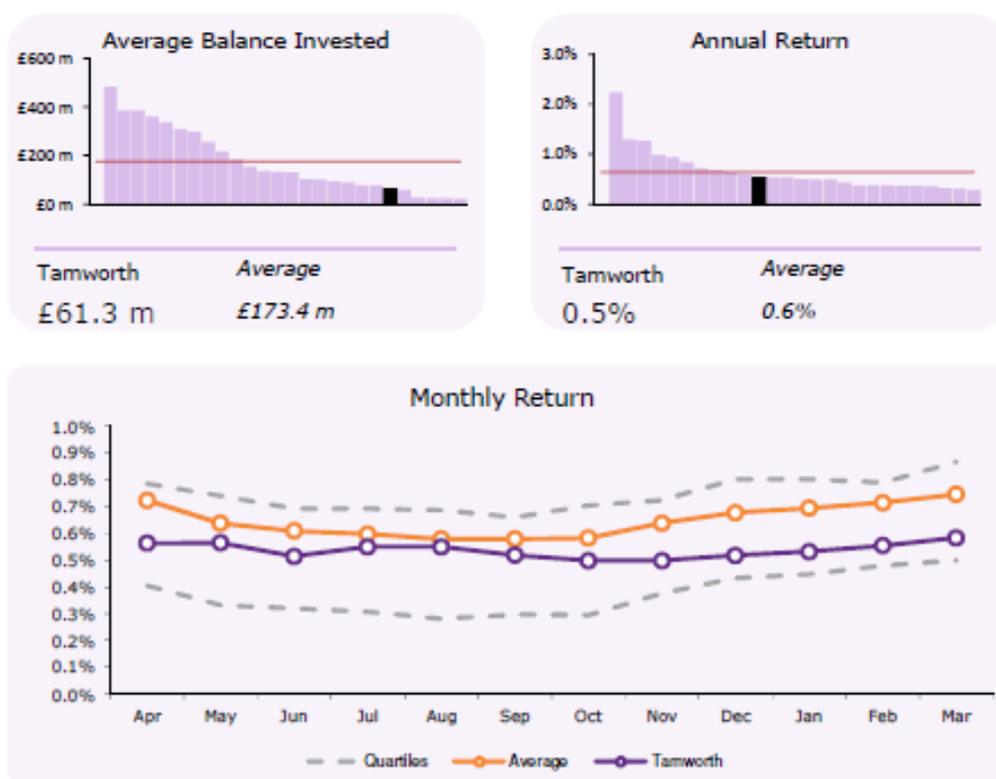
This can be analysed further into the following categories:

Category	Average Balance Invested		Average Annual Return Received	
	Tamworth Borough Council	CIPFA Benchmarking Club	Tamworth Borough Council	CIPFA Benchmarking Club
Fixed Investments (up to 30 days)	-	1.5	-	0.7
Fixed Investments (between 31 and 90 days)	-	5.1	-	0.5
Fixed Investments (between 91 and 364 days)	30.9	69.2	0.5	0.6
Fixed Investments (between 1 year and 3 years)	0.8	37.8	0.9	1.0
Fixed Investments (over 3 years)	-	1.7	-	3.5
Callable and Structured Deposits	-	24.5	-	1.7
Notice Accounts	14.4	31.1	0.7	0.4
Money Market Funds (Constant Net Asset Value)	8.5	33.1	0.3	0.3
Money Market Funds (Variable Net Asset Value)	-	21.6	-	0.7
DMADF	-	1.4	-	0.2
CDs, Gilts and Bonds	6.7	53.0	0.6	1.8
<b>Average of all investments (Managed in House)</b>	<b>61.3</b>	<b>173.4</b>	<b>0.5</b>	<b>0.6</b>

The data above and graphs below display that despite the Council being a small investor in the markets, in the main performance is only marginally lower in those areas where both the Council and other member authorities invest.

The main variances arise from longer term fixed investments (in excess of 1 year) and instruments that the council do not currently get involved with i.e. Callable and Structured Deposits which are longer term deposits which (in line with our use of the Link Asset Services methodology and our approved specified limits in our Treasury Management strategy) are currently prohibited for Tamworth Borough Council and affirms our 'low appetite for risk' in the continuing unsettled markets.

### Combined In-House Investments (excl. impaired investments)



Monthly Return (April 17 - March 18)													
	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March	Year
Balance £'m	53.0	51.4	52.9	56.1	56.0	63.6	67.3	67.9	67.9	69.5	67.2	63.0	61.3
Interest £'k	24.5	24.7	22.3	26.2	26.1	27.1	28.5	27.8	29.8	31.4	28.6	31.2	328.2
Return	0.56%	0.56%	0.51%	0.55%	0.55%	0.52%	0.50%	0.50%	0.52%	0.53%	0.55%	0.58%	0.54%
Upper Quartile	0.79%	0.74%	0.69%	0.69%	0.69%	0.66%	0.70%	0.72%	0.80%	0.80%	0.79%	0.87%	0.74%
Average	0.72%	0.64%	0.61%	0.60%	0.58%	0.58%	0.58%	0.64%	0.68%	0.69%	0.71%	0.75%	0.64%
Lower Quartile	0.41%	0.33%	0.32%	0.31%	0.28%	0.30%	0.29%	0.38%	0.43%	0.45%	0.48%	0.50%	0.37%
% Diff from Avg	-0.2%	-0.1%	-0.1%	0.0%	0.0%	-0.1%	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.1%

### Investment Counterparty Criteria

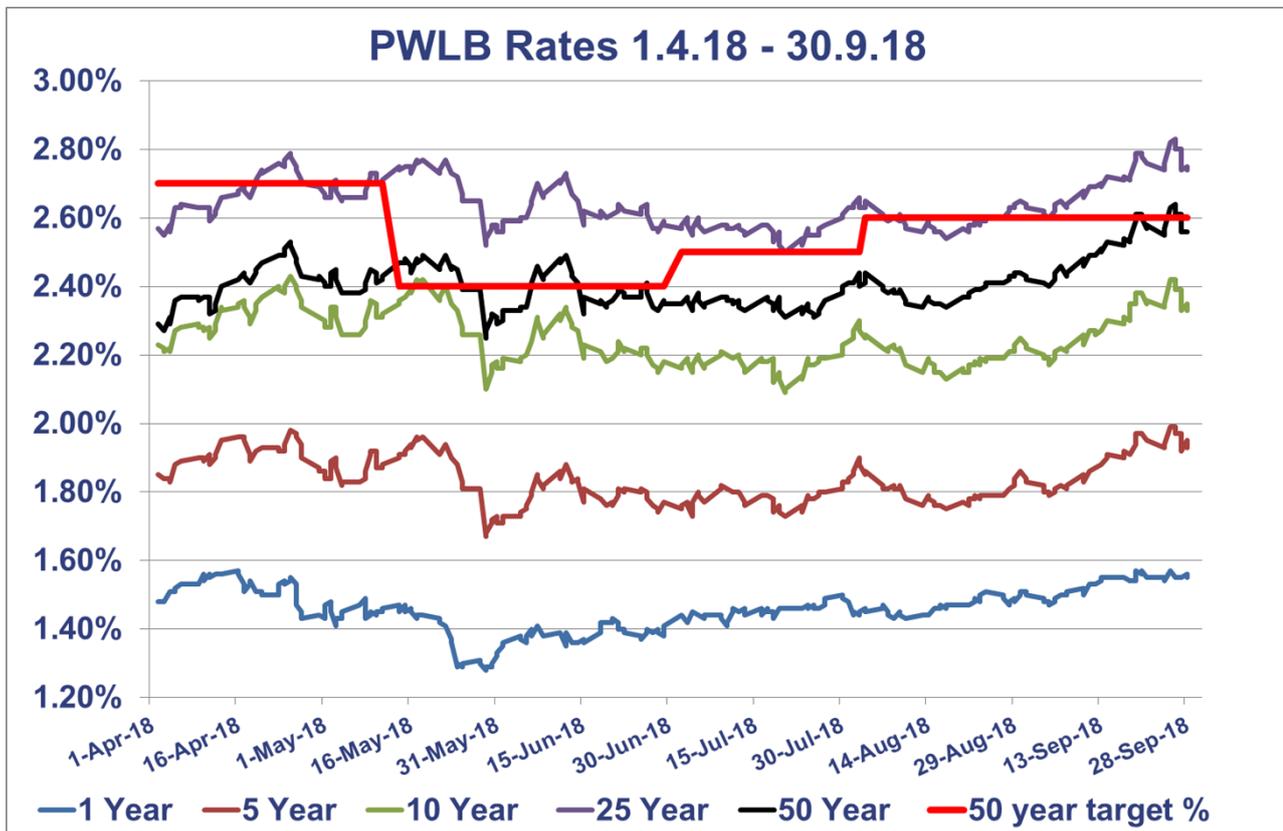
The current investment counterparty criteria selection approved in the TMSS and as approved by Council on 27th February 2018 will meet the requirement of the Treasury Management function.

## 5. Borrowing

The Council's estimated revised capital financing requirement (CFR) for 2018/19 is £77.233m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 3.4 shows the Council has estimated borrowings of £63.060m and has utilised £14.173m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

It is not anticipated that any additional borrowing will be undertaken during 2018/19.

The table and graph below show the movement in PWLB (Certainty Rates) for the first six months of the year to date:



	1 Year	5 Year	10 Year	25 Year	50 Year
3.4.18	1.48%	1.84%	2.22%	2.55%	2.27%
30.9.18	1.55%	1.93%	2.33%	2.74%	2.56%
Low	1.28%	1.67%	2.09%	2.50%	2.25%
Date	01/06/2018	29/05/2018	20/07/2018	20/07/2018	29/05/2018
High	1.57%	1.99%	2.43%	2.83%	2.64%
Date	17/04/2018	25/09/2018	25/04/2018	25/09/2018	25/09/2018
Average	1.46%	1.84%	2.25%	2.64%	2.41%

## **6. Debt Rescheduling**

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

## **7. UK Banks – Ring Fencing**

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

## **8. IFRS9 accounting standard**

This accounting standard came into effect from 1<sup>st</sup> April 2018. It means that the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact onto the Surplus or Deficit on the Provision of Services, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but more specialist types of investments, (e.g. pooled funds, third party loans, commercial investments), are likely to be impacted.

The Ministry of Housing, Communities and Local Government (MHCLG), have recently conducted a consultation on allowing a temporary override to enable English local authorities time to adjust their portfolio of investments. The Government’s response to the consultation was published in November, and this confirms that they will introduce a mandatory statutory override requiring local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from financial year commencing 1 April 2018, and will apply for five years.

## 9. Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports. The Treasury Management Strategy Statement 2018/19 reported to Council in February 2018 set out the Council's approach to investing in property funds, as part of the development of the Commercial Investment Strategy, and utilizing the capital receipt proceeds from the sale of the Golf Course. This approach was endorsed by Members, and since then we have invested £2m in Threadneedle Property Unit Trust and £1.8m in Schroders UK Real Estate Fund. There are no other such changes to report to Members.

### REPORT AUTHOR

Please contact Stefan Garner, Executive Director Finance, extension 242, or Jo Goodfellow, Management Accountant, extension 241.

### LIST OF BACKGROUND PAPERS

<i>Background Papers -</i>	<i>Local Government Act 2003</i>
	<i>CIPFA Code of Practice on Treasury Management in Public Services 2017</i>
	<i>Annual Report on the Treasury Management Service and Actual Prudential Indicators 2017/18 – Council 11<sup>th</sup> September 2018</i>
	<i>Treasury Management Strategy &amp; Prudential Indicators Report 2018/19 - Council 27<sup>th</sup> February 2018</i>
	<i>Budget &amp; Medium Term Financial Strategy 2018/19 - Council 27<sup>th</sup> February 2018</i>
	<i>Financial Healthcheck Period 6, September 2018</i>
	<i>CIPFA Treasury Management Benchmarking Club Report Quarter 2, September 2018</i>

### APPENDICES

#### APPENDIX 1 Current Investment List

## APPENDIX 1

### Investments held as at 30<sup>th</sup> September 2018:

Borrower	Deposit £	Rate %	From	To	Notice
Lloyds Bank	1,000,000	0.90%	30-Nov-17	30-Nov-18	
Lloyds Bank	1,000,000	0.90%	01-Dec-17	30-Nov-18	-
Bank of Scotland	2,000,000	0.85%	03-Jan-18	03-Jan-19	-
Bank of Scotland	2,000,000	0.85%	05-Jan-18	04-Jan-19	-
Lloyds Bank	1,000,000	0.80%	09-Feb-18	08-Feb-19	-
Bank of Scotland	2,000,000	0.85%	12-Feb-18	11-Feb-19	-
Lloyds Bank	2,000,000	0.90%	03-Apr-18	03-Apr-19	-
Lloyds Bank	2,000,000	0.90%	03-Apr-18	03-Apr-19	-
Barclays Bank	2,000,000	0.75%	05-Apr-18	05-Oct-18	-
Royal Bank of Scotland	2,004,563	0.87%	10-Apr-18	27-Nov-18	-
Barclays Bank	2,000,000	0.76%	10-Apr-18	10-Oct-18	-
Coventry BS	2,000,000	0.67%	25-May-18	26-Nov-18	-
National Westminster Bank plc	2,000,593	0.94%	29-Jun-18	28-Jun-19	-
National Westminster Bank plc	4,001,189	0.95%	05-Jul-18	05-Jul-19	-
Barclays Bank	3,000,000	0.81%	12-Sep-18	12-Mar-19	-
Coventry BS	2,000,000	0.79%	12-Sep-18	12-Mar-19	-
Guildford Council	4,000,000	0.85%	13-Sep-18	13-Mar-19	-
Goldman Sachs	10,000,000	0.67%	-	-	180 day
Santander	10,000,000	0.70%	-	-	180 day
MMF - Ignis	508,000	0.62%*	-	-	On call
MMF – PSDF	10,000,000	0.69%*	-	-	On call
<b>Total</b>	<b>66.51</b>	<b>0.77 (avg)</b>			

\* Interest rate fluctuates daily dependant on the funds investment portfolio, rate quoted is approximate 7 day average.

This page is intentionally left blank