REPORT REFERENCE NO.	**RC/18/14**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**5 SEPTEMBER 2018**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2018-19 – QUARTER 1**
LEAD OFFICER	**DIRECTOR OF FINANCE (TREASURER)**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2018-19 (to June 2018) be noted.***
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a Code of Practice for Treasury Management. The Code suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Authority is embracing Best Practice in accordance with CIPFA's Code of Practice.
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Investments held as at 30 June 2018.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) as approved at the meeting of the Fire & Rescue Authority held on the 16 February 2018 – Minute DSFRA/64c refers.

1. INTRODUCTION

1.1 The Treasury Management Strategy for Devon and Somerset Fire & Rescue Authority has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in Public Services Code of Practice (the Code) and the CIPFA Prudential Code. The Code recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report, therefore, ensures this Authority is implementing best practice in accordance with the Code and includes:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities;
- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives;
- The receipt by the full Authority 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;
- The delegation by the authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

"The management of the local authority's 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. "

1.3 The preparation of this report demonstrates that the Authority is implementing best practice in accordance with the code.

2. ECONOMIC BACKGROUND

2.1 **UK.** Growth in 2017 was disappointingly weak in the first half of the year but picked up to 0.5% in quarter 3 and 0.4% in quarter 4. Growth in quarter 1 of 2018 was again disappointing, although on the first revision the rate improved from 0.1 to 0.2% to allay fears that the economy may have started a prolonged period of very weak growth. Initial indications in quarter 2 are that growth may have picked up speed to around 0.4%. The main reason for weak growth during 2017 and 2018 has been that inflation has been exceeding pay growth until recently. This means that that there has been negative growth in consumer disposable income when consumer expenditure is the biggest driver of the services sector which accounts for about 75% of GDP. The manufacturing sector was the bright spot in the economy in 2017 in terms of strong growth but quarter 1 was the weakest quarter for one and a half years and forward indicators do not suggest a return to strong growth is likely.

2.2 During January and February, financial markets were viewing a Bank Rate increase at the May Monetary Policy Committee (MPC) meeting as likely to be a near certainty after strong growth in the second half of 2017. However, the ensuing weeks before the meeting saw opinion turn right around. The MPC did not disappoint by leaving rates unchanged due to concerns as to whether the weak growth in quarter 1 was indicative of the start of a prolonged slow down or just a temporary blip, to which bad weather had been just one contributor. Since May, opinion again turned to suggest that an August Bank Rate increase was back on the cards and indeed the bank rate was increased on 2 August 2018 from 0.50 to 0.75%.

2.3 However, there remains much uncertainty around the Brexit negotiations, consumer spending levels and business investment, so it is still far too early to be confident about how strong growth and inflationary pressures will be over the next two years, and therefore the pace of any rate increases.

2.4 **EU.** A recovery to strong growth in 2016 and 2017 looks as if it will weaken somewhat going forward. Despite providing massive monetary stimulus, the European Central Bank (ECB) has been struggling to get inflation up to its 2% target. However, in April the headline Eurozone rate jumped up from 1.4% to 1.9% although the core inflation rate was still subdued in rising from 0.7% to 1.1%. At its June meeting, the ECB announced it would halve its monthly quantitative easing purchases from €30bn to €15bn, and then end all purchases after December. It is unlikely to make a start on increasing interest rates until late in 2019.

2.5 **USA.** Growth in the American economy was volatile in 2015, 2016 and 2017 during each year, with quarter 1 being particularly weak. The annual rate of GDP growth for 2017 was 2.3%. Quarter 1 in 2018 came in at 2.0%, down from 2.9% in the previous quarter. The Trump $1.5 trillion income tax cut package coming into effect in January 2018, is likely to boost growth to the Trump administration's 3% target. However, it is also likely to boost inflation at a time when spare capacity in the economy is minimal and unemployment, in particular, has fallen to the lowest level for 17 years, reaching 3.8% in May. The Federal Bank (the Fed) has started on an upswing in rates with seven increases since the first one in December 2015, the latest one being in June 2018 to lift the central rate to 1.75 – 2.00%. There could be a further two or more increases in 2018. In October 2017. The Fed became the first major western central bank to make a start on unwinding quantitative easing by phasing in a gradual reduction in respect of reinvesting maturing debt.

2.6 **Chinese economic growth** has been weakening over successive years, despite repeated rounds of central bank stimulus and 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.

2.7 **Japan** The best economic run (of positive growth for eight quarters) since the 1980s came to an end in quarter 1 with a contraction of -0.6% blamed on weak exports. However, it is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus, with inflation falling to only 0.4% in May. It is also making little progress on fundamental reform of the economy.

Interest Rate Forecasts

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

	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%
10yr PWLB View	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%

2.9 Link Asset Services undertook its last review of interest rate forecasts on 11 May 2018 after the quarterly Bank of England Inflation Report and MPC meeting at which the MPC kept Bank Rate unchanged at 0.50%. The MPC Minutes indicated they wanted to see whether the slowdown in growth in quarter 1 had been a temporary blip or a potential first sign of a prolonged period of weak growth.

2.10 The overall balance of risks to economic recovery in the UK is probably even. However, given the uncertainties around Brexit in particular, but also other uncertainties, there is a wide diversity of possible outcomes for the strength of economic growth and inflation, and the corresponding speed with which Bank Rate could go up.

3. TREASURY MANAGEMENT STRATEGY STATEMENT

ANNUAL INVESTMENT STRATEGY

3.1 The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement (TMSS) was approved by the Authority on the 16 February 2018. It outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity
- Yield

3.2 The Authority 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 a significant proportion of investments short term. This will not only cover short term cash flow needs but will also seek out value available in significantly higher rates in periods up to 12 months with highly credit rated financial institutions using the Link suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Link.

3.3 A full list of investments held as at 30 June 2018 are shown in Appendix A.

3.4 The average level of funds available for investment purposes during the quarter was £36.284m (£40.497m at the end of 2017/18). These funds were available on a temporary basis and the level of funds was dependent on the level of reserves, timing of precept payments, receipt of grants and progress on the Capital Programme.

Benchmark	Benchmark Return	Authority Performance	Investment interest to Quarter 1
3 Month LIBID	0.53%	0.71%	(£0.021)m.

3.5 As illustrated, the Authority outperformed the 3 month LIBID benchmark by 0.18bp. It is currently anticipated that the actual investment return for the whole of 2018-19 will match the Authority's budgeted investment target of £201k.

BORROWING STRATEGY

Prudential Indicators:

3.6 It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's' approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

3.7 A full list of the approved limits (as amended) are included in the Financial Performance Report 2018-19, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to June 2018 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

3.8 The Authority has not taken any external loans since June 2012 and has been using cash resources to meet any capital expenditure. The amount of outstanding external borrowing as at 30 June 2018 was £25.631m, forecast to reduce to £25.584m by the end of the financial year as a result of standard loan repayments. All of this debt is at fixed rate with the remaining principal having an average rate of 4.10% and average life of 25.5 years.

Loan Rescheduling

3.9 No debt rescheduling was undertaken during the quarter. The Authority will continue to work closely with our treasury advisors to explore any opportunities to repay existing loans, however current Public Works Loan Board early repayment rates mean there is no financial benefit in undertaking premature loan repayment at this time.

New Borrowing

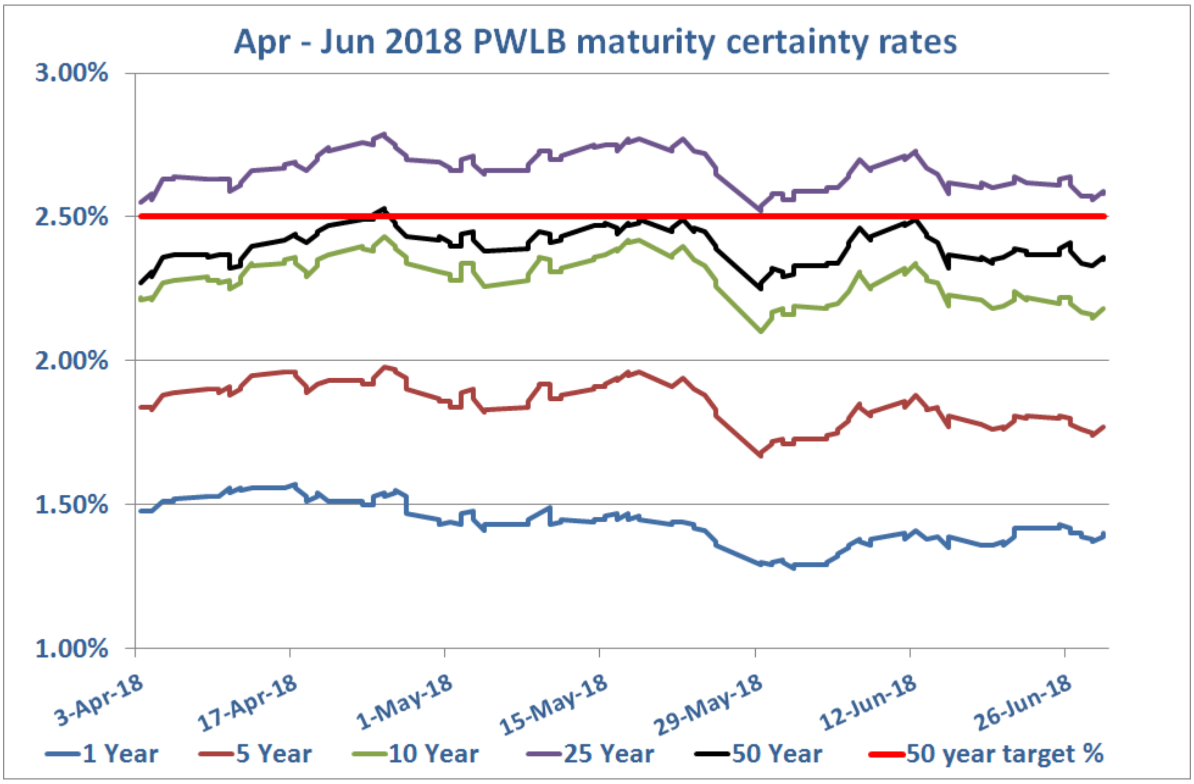
3.10 PWLB rates have not been on any consistent trend in this quarter. During the quarter, the 50 year PWLB target (certainty) rate for new long term borrowing was marginally reduced to 2.40%.

3.11 No new borrowing was undertaken during the quarter and none is planned during 2018-19 as a result of the Authority's adopted financial strategy to utilise revenue funds (revenue budget and reserves) to finance capital investment needs for the medium term.

PWL rates quarter ended 30 June 2018

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.28%	1.67%	2.10%	2.52%	2.25%
Date	01/06/2018	29/05/2018	29/05/2018	29/05/2018	29/05/2018
High	1.57%	1.98%	2.43%	2.79%	2.53%
Date	17/04/2018	25/04/2018	25/04/2018	25/04/2018	25/04/2018
Average	1.44%	1.86%	2.29%	2.66%	2.40%

3.12 Borrowing rates for this quarter are shown below.



<u>Borrowing in Advance of Need</u>

3.13 The Authority has not borrowed in advance of need during this quarter.

4. SUMMARY AND RECOMMENDATION

4.1 In compliance with the requirements of the Chartered Institute of Public Finance and Accountancy Code of Practice of Treasury Management, this report provides the Committee with the first quarter report on treasury management activities for 2018-19 to June 2018. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken so far, with priority being given to liquidity and security over yield. Whilst investment returns are recovering as a result of the increase in interest rates, the Authority is still anticipating that investment returns will meet the budgeted target, as rates were forecast to rise when the budget was set.

AMY WEBB
Director of Finance & Treasurer

APPENDIX A TO REPORT RC/18/14

Counterparty	Maximum to be invested	Amount Invested	Call or Term	Period invested	Interest rate(s)
	£m	£m			
Bank of Scotland	7.000	2.100	T	12 mths	0.85%
		3.400	T	12 mths	0.90%
		1.500	T	12 mths	0.90%
Barclays Bank	8.000	3.000	T	12 mths	0.55%
		3.000	T	6 mths	0.81%
Barclays FIBCA		0.001	C	Instant Access	Variable
Goldman Sachs	7.000	5.000	T	6 mths	0.73%
		2.000	T	6 mths	0.80%
Highland Council	5.000	3.000	T	6 mths	0.75%
Lloyds Bank	2.000	2.000	T	12 mths	0.90%
Santander	7.000	1.000	T	6 mths	0.58%
		1.000	T	6 mths	0.63%
		1.000	T	6 mths	0.84%
		1.000	T	6 mths	0.68%
Standard Life	6.000	0.968	C	Instant Access	Variable
Sumitomo Mitsui	7.000	2.000	T	6 mths	0.58%
Total amount Invested		**31.969**			