

REPORT REFERENCE NO.	RC/18/17
MEETING	RESOURCES COMMITTEE
DATE OF MEETING	15 NOVEMBER 2018
SUBJECT OF REPORT	TREASURY MANAGEMENT PERFORMANCE 2018-19 – QUARTER 2
LEAD OFFICER	DIRECTOR OF FINANCE (TREASURER)
RECOMMENDATIONS	<i>That the performance in relation to the treasury management activities of the Authority for 2018-19 (to September 2018) be noted.</i>
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 September 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.** 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, 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. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

- 2.2. 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.
- 2.3. 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.
- 2.4. **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.
- 2.5. **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 Federal Bank 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 Federal Bank in the second half of 2019.
- 2.6. **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.
- 2.7. **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.

Interest Rate Forecasts

- 2.8. The Authority's treasury advisor, Link Asset Services, has provided the following forecast and commentary in paragraphs 2.9 to 2.10:

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%

- 2.9. The flow of generally positive economic statistics since the last quarter 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 or 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 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.
- 2.10. 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.

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; and
 - 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. The average level of funds available for investment purposes during the quarter was £45.041m (£36.284m at the end of Q.1). 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 2
3 Month LIBID	0.61%	0.86%	£0.043m.

- 3.4. As illustrated, the Authority outperformed the 3 month LIBID benchmark by 0.25bp. It is currently anticipated that the actual investment return for the whole of 2018-19 will exceed the Authority's budgeted investment target by £77k. A full list of investments held as at 30 September 2018 are shown in Appendix A.

Borrowing Strategy

Prudential Indicators:

- 3.5. 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.
- 3.6. A full list of the approved limits 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 September 2018 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

- 3.7. 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 September 2018 was £25.584m, forecast to reduce to £25.537m 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

- 3.8. 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 (PWLB) early repayment rates mean there is no financial benefit in undertaking premature loan repayment at this time.

New Borrowing

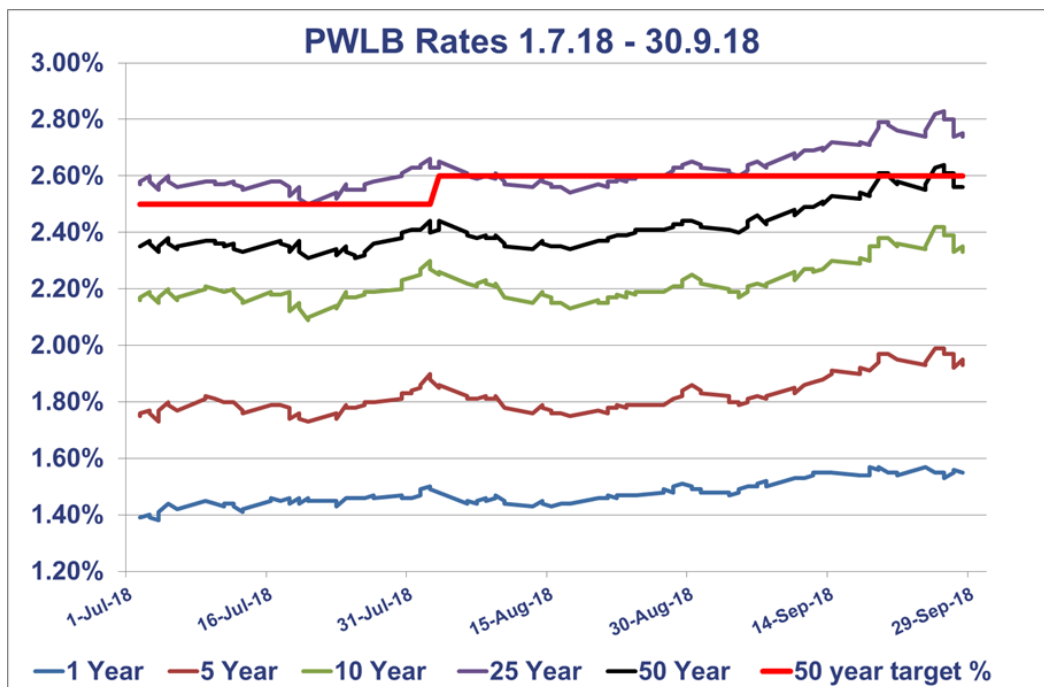
- 3.9. PWLB rates have not been on any consistent trend in this quarter. During the quarter, the 50 year PWLB target (certainty) rate for new long term borrowing was marginally reduced to 2.40%.

3.10. 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 and reserve funds to finance capital investment needs for the medium term.

PWLB rates quarter ended 30 September 2018

	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%

3.11. Borrowing rates for this quarter are shown below.



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

4. CONCLUSION

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 September 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. Now that investment returns are recovering from historic lows as a result of the increase in interest rates, the Authority is anticipating that investment returns will exceed the budgeted target due to strong performance of the portfolio; the 2018-19 budget was set assuming higher interest rates throughout the year.

AMY WEBB

Director of Finance (Treasurer)

APPENDIX A TO REPORT RC/18/17

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	6 mths	0.81%
		2.000	T	6 mths	0.78%
		3.000	T	6 mths	0.82%
Barclays FIBCA		0.001	C	Instant Access	Variable
Blackrock	5.000	0.500	C	Instant Access	Variable
Coventry	4.000	3.100	T	6 mths	0.79%
Goldman Sachs	7.000	2.000	T	6 mths	0.80%
		5.000	T	6 mths	0.91%
Lloyds Bank	2.000	2.000	T	12 mths	0.90%
Santander	7.000	1.000	T	6 mths	0.84%
		1.000	T	6 mths	0.68%
		3.000	T	12 mths	0.94%
		1.000	T	6 mths	0.88%
		1.000	T	6 mths	0.86%
Standard Life	6.000	0.805	C	Instant Access	Variable
Sumitomo Mitsui	7.000	5.000	T	12 mths	0.85%
		2.000	T	6 mths	0.82%
Thurrock Borough Council	5.000	3.500	T	12 mths	0.97%
Total amount Invested		45.906			