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| **REPORT REFERENCE NO.** | **RC/19/1** |
| **MEETING** | **RESOURCES COMMITTEE** |
| **DATE OF MEETING** | **7 FEBRUARY 2019** |
| **SUBJECT OF REPORT** | **TREASURY MANAGEMENT PERFORMANCE 2018-19 – QUARTER 3** |
| **LEAD OFFICER** | **Director of Finance** |
| **RECOMMENDATIONS** | ***That the performance in relation to the treasury management activities of the Authority for 2018-19 (to December 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 31 December 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.** After weak economic growth of only 0.1% in quarter one, growth picked up to 0.4% in quarter 2 and to 0.6% in quarter 3. However, uncertainties over Brexit look likely to cause growth to have weakened again in quarter four. After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the Monetary Policy Committee (MPC) until the uncertainties over Brexit clear. In the event of a disorderly exit, the MPC has said that rates could go up or down, though it is probably much more likely to be down so as to support growth.

Nevertheless, the MPC does have concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.3% (excluding bonuses) in the three months to October. The main issue causing this is a lack of suitably skilled people due to the continuing increase in total employment and unemployment being near to 43 year lows. Correspondingly, the total level of vacancies has risen to new highs.

2.2 As for Consumer Price Index (CPI) inflation itself, this has been on a falling trend, reaching 2.3% in November 2018. However, in the November Bank of England Inflation Report, the latest forecast for inflation over the two year time horizon was raised to being marginally above the MPC's target of 2%, indicating a slight build up in inflationary pressures.

The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between to two figures in now around 1%, i.e. a real terms increase. 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.

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 2019, 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 fell in quarter 3 to 0.2% from 0.4% in quarter 2 but this is likely to be a one off blip caused primarily by a one off fall in car production. The European Central Bank (ECB) forecast growth in 2018 to be 1.9% falling to 1.7% in 2020. The ECB ended its programme of quantitative easing purchases of debt in December 2018, which now means that the central banks in the US, UK and EU have all now ended the phase of post financial crisis expansion of liquidity supporting world financial markets.

2.5 **USA.** President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the strong rate of growth; this rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5% in quarter 3. The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.1% in November 2018, however, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019.

The Federal Bank (Fed) increased rates another 0.25% in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

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 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 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% | 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 | 0.90% | 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 | 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 | 1.20% | 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 | 2.10% | 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% | 2.60% | 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% | 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% | 2.80% | 2.90% | 2.90% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% | 3.40% |

2.9 After the August increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the MPC has since then put any further action on hold, probably until such time as the fog of Brexit clears and there is some degree of certainty of what the UK will be heading into. It is particularly unlikely that the MPC would increase Bank Rate in February 2019 ahead of the deadline in March for Brexit, if no agreement on Brexit has been reached by then. The above forecast and other comments in this report are based on a central assumption that there is an agreement on a reasonable form of Brexit. In that case, then we think that the MPC could return to increasing Bank Rate in May 2019 but then hold fire again until February 2020. However, this is obviously based on making huge assumptions which could be confounded. In the event of a disorderly Brexit, then cuts in Bank Rate could well be the next move.

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 £44.272m (£45.041m at the end of Q2). 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 3 |
|---|---|---|---|
| 3 Month LIBID | 0.79% | 0.92% | £0.095m. |

3.4 As illustrated, the Authority outperformed the 3 month LIBID benchmark by 0.13bp. It is currently anticipated that the actual investment return for the whole of 2018-19 will exceed the Authority's budgeted investment target by £80k.

A full list of investments held as at 31 December 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 December 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 31 December 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 4.24% and average life of 25.6 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 early repayment rates mean there is no financial benefit in undertaking premature loan repayment at this time.

New Borrowing

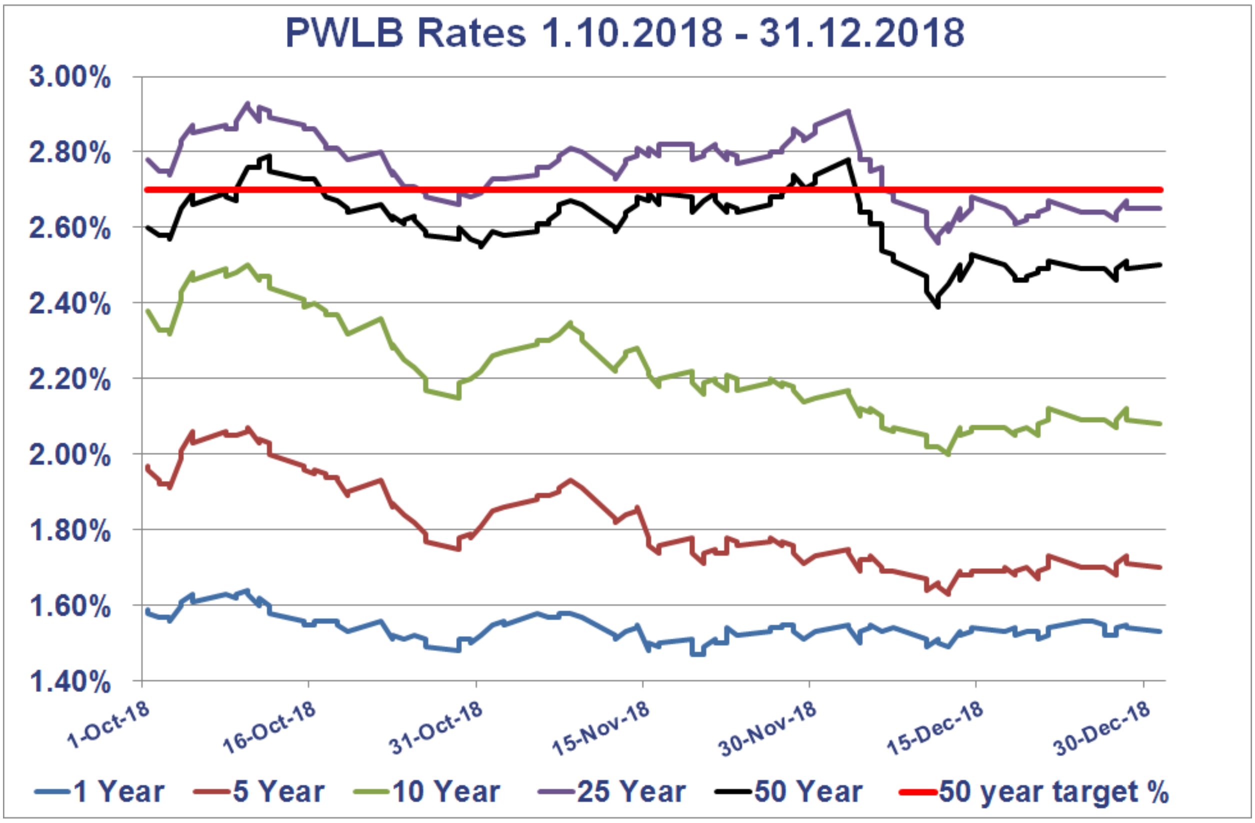
3.9 PWLB rates have not been trading in a narrow range during this period. The 50 year PWLB target (certainty) rate for new long term borrowing varied between 2.40% and 2.70% during this period.

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 31 December 2018**

| | 1 Year | 5 Year | 10 Year | 25 Year | 50 Year | 50 year target |
|---|---|---|---|---|---|---|
| 2-Apr-18 | 1.68% | 1.85% | 2.23% | 2.57% | 2.29% | 2.70% |
| 31-Dec-18 | 1.53% | 1.70% | 2.08% | 2.65% | 2.50% | 2.70% |
| Low | 1.47% | 1.63% | 2.00% | 2.50% | 2.25% | 2.40% |
| Date | 19/11/2018 | 12/12/2018 | 12/12/2018 | 20/07/2018 | 29/05/2018 | - |
| High | 1.77% | 2.07% | 2.50% | 2.93% | 2.79% | 2.70% |
| Date | 16/04/2018 | 10/10/2018 | 10/10/2018 | 10/10/2018 | 12/10/2018 | - |
| Average | 1.62% | 1.83% | 2.24% | 2.68% | 2.48% | 2.59% |

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. 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 December 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**

## APPENDIX A TO REPORT RC/19/1

| Counterparty | Maximum to be invested | Amount Invested | Call or Term | Period invested | Interest rate(s) |
|---|---|---|---|---|---|
| | £m | £m | | | |
| Aberdeen Standard Investment | 5.000 | 0.500 | C | Instant Access | Variable |
| 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 | 2.000 | T | 6 mths | 0.78% |
| | | 3.000 | T | 6 mths | 0.82% |
| Barclays FIBCA | | 0.001 | C | Instant Access | Variable |
| Coventry | 4.000 | 3.100 | T | 6 mths | 0.79% |
| Federated | 5.000 | 0.575 | C | Instant Access | Variable |
| Goldman Sachs | 7.000 | 5.000 | T | 6 mths | 0.91% |
| Santander | 7.000 | 3.000 | T | 12 mths | 0.94% |
| | | 1.000 | T | 6 mths | 0.88% |
| | | 1.000 | T | 6 mths | 0.86% |
| | | 1.000 | T | 6 mths | 0.90% |
| | | 1.000 | T | 6 mths | 1.00% |
| 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** | | **38.676** | | | |