

REPORT REFERENCE NO.	RC/19/18
MEETING	RESOURCES COMMITTEE
DATE OF MEETING	21 NOVEMBER 2019
SUBJECT OF REPORT	TREASURY MANAGEMENT PERFORMANCE 2019-20 – QUARTER 2
LEAD OFFICER	Director of Finance and Resourcing (Treasurer)
RECOMMENDATIONS	<i>That the performance in relation to the treasury management activities of the Authority for 2019-20 (to September 2019) 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 2019.
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 19 February 2019 – Minute DSFRA/36c 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 only tepid annual **economic growth** of 1.4% in 2018, growth in quarter 1 was unexpectedly strong at 0.5%. However, this was boosted by stock building ahead of the original March Brexit deadline so quarter 2 was expected to be slightly negative and duly came in at -0.2% q/q, +1.3% y/y. After the Monetary Policy Committee (MPC) raised **Bank Rate** from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a no deal exit, it is likely that Bank Rate would be cut in order 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 3.9% in June before edging back to 3.8% in July, (excluding bonuses). Growth in employment fell to only 31,000 in the three months to July, well below the 2018 average, while the unemployment rate remained at 3.8 percent, its lowest rate since 1975.

- 2.2. As for **CPI inflation** itself, this fell to 1.7% in August and is likely to remain close to 2% over the next two years. If there was a no deal Brexit though, it could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound. 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 the two figures is now around 2.1%, 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. **Brexit.** The Conservative minority government is now led by a new Prime Minister in Boris Johnson, who has spoken strongly of being adamant that the UK will leave the EU on 31 October, even if there is no deal. However, his proroguing of Parliament was overturned by the Supreme Court and Parliament carried a bill to delay Brexit until 31 January 2020 if there is no deal by 31 October. MPs have now voted to hold a general election scheduled for the 12th December 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. **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 rate of growth to 2.9% for 2018, just below his target of 3%. Growth in quarter 1 of 2019 was a strong 3.1% but growth fell back to 2.0% in quarter 2. The strong growth in employment numbers during 2018 has reversed into a falling trend during 2019, indicating that the economy is cooling, while inflationary pressures are also weakening. After the Federal Bank increased rates by 0.25% in December 2018 to between 2.25% and 2.50%, it has taken decisive action to reverse monetary policy by cutting rates by 0.25% in each of July and September in order to counter the downturn in the outlook for US and world growth. There are expectations that it could cut again in December.
- 2.5. **EUROZONE (EZ).** The annual rate of growth for 2018 was 1.8% but is expected to fall to possibly around half that rate in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of Targeted Longer-Term Refinancing Options (TLTROs); this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and unsurprisingly, the ECB stated that governments will need to help stimulate growth by fiscal policy.

- 2.6. **CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. The trade war with the US does not currently appear to be having a significant impact on growth. Major progress still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs 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.
- 2.8. **WORLD GROWTH.** The trade war between the US and China on tariffs is a major concern to financial markets and is depressing worldwide growth, as any downturn in China will spill over into impacting countries supplying raw materials to China. Concerns are focused on the synchronised general weakening of growth in the major economies of the world compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns have resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks.

Interest Rate Forecasts

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

Link Asset Services Interest Rate View										
	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	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

- 2.10. The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture. The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

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 19 February 2019. 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 September 2019 are shown in Appendix A.
- 3.4. The average level of funds available for investment purposes during the quarter was £45.904m (£37.486m at the end of Quarter 1 2019/20). 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	0.66%	0.85%	£0.098m.

- 3.5. As illustrated, the Authority outperformed the 3 month LIBID benchmark by 0.19bp. It is anticipated that the actual investment return for the whole of 2019-20 will surpass the Authority's budgeted investment target of £0.201m by £0.071m.
- 3.6. Finance officers have been prioritising liquidity of funds in the lead up to a potential No Deal Brexit which may have a short term detrimental impact on returns.

Borrowing Strategy

Prudential Indicators:

- 3.7. 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.
- 3.8. A full list of the approved limits (as amended) are included in the Financial Performance Report 2019-20, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to September 2019 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

- 3.9. 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 2019 was £25.491m, forecast to reduce to £25.444m 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 4.23% and average life of 25.8 years.

Loan Rescheduling

- 3.10. 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.

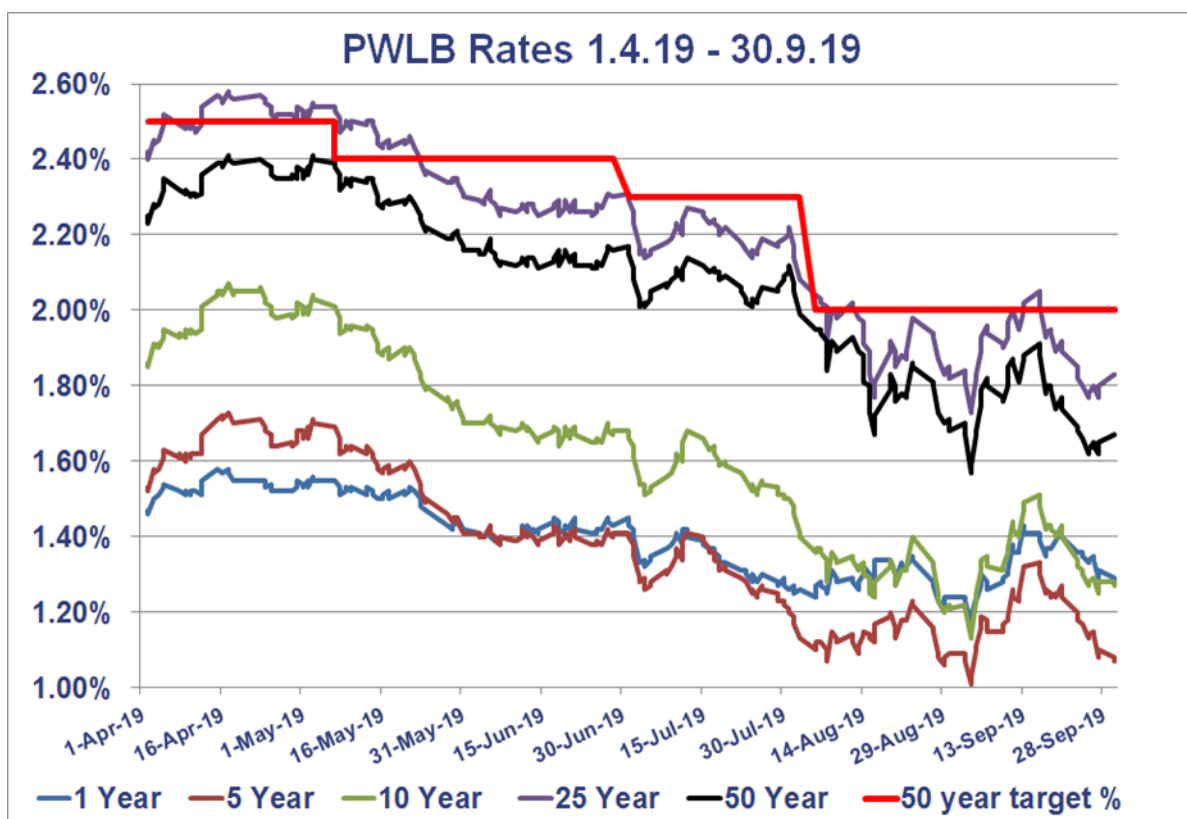
New Borrowing

- 3.11. 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 2.41%.
- 3.12. No new borrowing was undertaken during the quarter and none is planned during 2019-20 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.
- 3.13. On 9 October 2019 the Treasury and PWLB announced an increase in the margin over gilt yields of 100bps on top of the current margin of 80 bps which this authority has paid prior to this date for new borrowing from the PWLB. There was no prior warning that this would happen and it now means that every local authority has to fundamentally reassess how to finance their external borrowing needs and the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing. The Authority has no plans to borrow in the short-medium term, therefore the increase will not affect the funding or affordability of the current capital programme.

PWLB rates quarter ended 30 September 2019

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.01%	1.13%	1.73%	1.57%
Date	03/09/2019	03/09/2019	03/09/2019	03/09/2019	03/09/2019
High	1.58%	1.73%	2.07%	2.58%	2.41%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	17/04/2019
Average	1.40%	1.37%	1.62%	2.20%	2.07%

3.14. Borrowing rates for this quarter are shown below.



Borrowing in Advance of Need

3.15. 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 second quarter report on treasury management activities for 2019-20 to September 2019. 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 and Resourcing (Treasurer)

APPENDIX A TO REPORT RC/19/18

Investments as at 30 September 2019					
Counterparty	Maximum to be invested	Amount Invested	Call or Term	Period invested	Interest rate(s)
	£m	£m			
Santander	7.000	5.000	T	9 mths	0.99%
		1.500	T	12 mths	1.09%
		1.000	T	6 mths	0.93%
Goldman Sachs	7.000	1.500	T	12 mths	0.90%
		5.000	T	6 mths	0.83%
Standard Chartered	7.000	2.000	T	12 mths	0.96%
		2.800	T	6 mths	0.85%
Sumitomi Mitsui	7.000	5.000	T	12 mths	1.25%
Thurock Borough Council	5.000	1.200	T	9 mths	0.91%
		2.000	T	9 mths	1.05%
Eastleigh Borough Council	5.000	5.000	T	12 mths	0.90%
Barclays 95 Green Deposit	8.000	8.000	T	95 Day Notice	0.95%
Barclays FIBCA		0.001	C	Instant Access	Variable
Standard Life	6.000	3.391	C	Instant Access	Variable
Total amount Invested		43.392			