REPORT REFERENCE NO.	**RC/20/6**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**13 FEBRUARY 2020**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2019-20 – QUARTER 3**
LEAD OFFICER	**Director of Finance and Resourcing (Treasurer)**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2019-20 (to December 2019) 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 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. Economic growth** in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 back up to +0.4% and quarter 4 expected to come in around zero. Political and Brexit uncertainty have dampened growth in 2019.

2.2 Despite political uncertainty ending with a decisive overall majority for the Conservative government in the December 2019 General Election which clears the way for the UK to leave the EU on 31 January 2020, there is still much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020.

2.3 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. It is unlikely there will be any further action from the MPC until these remaining uncertainties over the likely type of Brexit become clear. If there was a no deal exit, it is likely that Bank Rate would be cut in order to support growth. However, if growth was to flag significantly in any event, the MPC could also cut Bank Rate in 2020.

2.4 The Government has announced some major spending increases and is expected to make further commitments in the spring budget; these will provide some support to growth and will take some pressure off the MPC to act to stimulate growth by either cutting Bank Rate or implementing other monetary policy measures.

2.5 The MPC did have some concerns over the trend in wage inflation, which was on a rising trend and peaked at a new post financial crisis high of 3.9% in June 2019. Since then, however, it has been falling steadily back to 3.5% in October 2019, (3 month average figure, excluding bonuses). Growth in employment picked up again to 24,000 in the three months to October, after a fall in the previous month's figures. However, this is still well below the 2018 average, although the unemployment rate remained at 3.8 percent, its lowest rate since 1975.

2.6 As for CPI inflation itself, this fell to 1.5% in October and November 2019 and is likely to remain between 1.5% and 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 strong wage inflation figure and the 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 2.0%, i.e. a real term 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

2.7 **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 and 2.1% in quarter 3. The strong growth in employment numbers during 2018 has subsided into a weaker trend of growth during 2019, indicating that the economy is cooling, while inflationary pressures have also been weakening. After the Federal Bank (Fed) 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, September and October in order to counter the downturn in the outlook for US and world growth. The Fed is now likely to pause to see how the economy responds during 2020.

2.8 **EUROZONE.** The annual rate of growth has been steadily falling, from 1.8% in 2018 to only 1.1% y/y in quarter 3 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 Eurozone growth, 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.

2.9 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.

2.10 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 Eurozone 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 to start in November at €20bn per month, a relatively small amount. 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.

2.11 **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 appear currently to be having a particularly 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.

2.12 **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.

2.13 **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. Cconcerns are focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during the first ten months of 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. This would impact 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. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been weak which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during 2020 is expected to be weak.

<u>Interest Rate Forecasts</u>

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

Link Asset Services Interest Rate View	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

2.15 The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal. The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside. In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

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; 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 A full list of investments held as at 31 December 2019 are shown in Appendix A.

3.4 £11m of the £38.1m invested at 31 December 2019 was with 'Green' deposits, which represented 28% of our portfolio. These 'Green' deposits meet the agreed Security, Liquidity, Yield (SLY) criteria approved by the Authority, but the funds are used by the counterparty to invest in underlying assets/schemes which deliver environmental/green objectives.

3.5 The average level of funds available for investment purposes during the quarter was £43.209m (£45.904m at the end of Quarter 2 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 3
3 Month LIBID	0.66%	0.85%	£0.080m.

3.6 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 original budgeted investment target of £0.201m by £0.071m. This budget has been rebaselined for the remainder of the financial year to £0.271m.

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 December 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 31 December 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 25.6 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 increased to 3.05%.

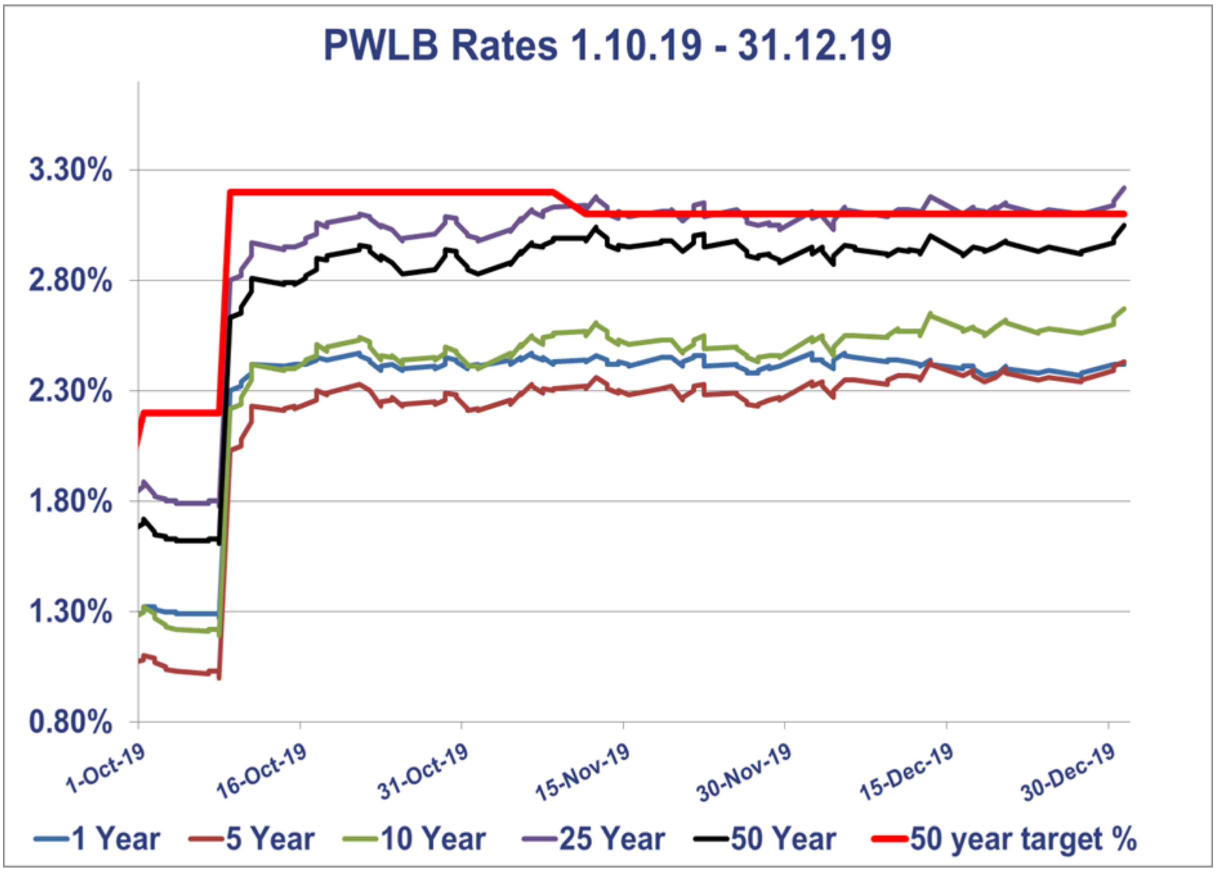
3.12 No new borrowing was undertaken during the quarter and none is planned during 2019-20 as a result of the Authority's adopted financial strategy to utilise revenue funds (revenue budget and reserves) to finance capital investment needs for the medium term.

3.13 On 9 October, the Treasury increased the margin on PWLB rates by 100 bps (1%). Over the last quarter, rates have been on a rising trend. The 50 year PWLB target (certainty) rate for new long term borrowing started the quarter at 2.20% and ended at 3.10%.

PWLB rates quarter ended 31 December 2019

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.43%	2.67%	3.22%	3.05%
Date	21/10/2019	13/12/2019	31/12/2019	31/12/2019	31/12/2019
Average	1.70%	1.64%	1.88%	2.45%	2.31%

3.14 Borrowing rates for this quarter are shown below.



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

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 December 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/20/6

Investments as at 31 December 2019					
Counterparty	**Maximum to be invested**	**Amount Invested**	**Call or Term**	**Period invested**	**Interest rate(s)**
	£m	£m			
Goldman Sachs	7.000	5.000	T	6 mths	0.83%
		2.000	T	12 mths	0.96%
Coventry Building Society	7.000	2.800	T	9 mths	0.85%
		1.200	T	9 mths	0.91%
Thurrock Borough Council	7.000	1.500	T	12 mths	1.09%
Bank Of Scotland	7.000	2.000	T	9 mths	1.05%
		5.000	T	12 mths	1.25%
Standard Chartered Green Desposit	7.000	3.000	T	6 mths	0.85%
Mid & East Antrim Borough Council	7.000	1.500	T	12 mths	0.90%
London Borough of Enfield	7.000	5.000	T	12 mths	0.90%
Barclays 95 Green Deposit	8.000	8.000	C	Variable	Variable
Barclays FIBCA		0.001	C	Variable	Variable
Aberdeen Standard	6.000	1.180	C	Variable	Variable
Total amount Invested		**38.181**			