Agenda Item No:	**8**	
Committee:	Council	
Date:	14 December 2017	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2017/18	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2017/18.

2 Key issues

- The Treasury Management Mid-Year Review 2017/18 as considered by Cabinet on 14 December 2017 and by Corporate Governance Committee on 4 December 2017 is attached.
- The report highlights all the key activities carried out within the Treasury Management function during the first six months of 2017/18. All activities have been conducted in accordance with the approved strategy and policies.
- Prudential indicators for, the Capital Financing Requirement (CFR) and the capital position have been revised.
- 2017/18 continues to be a challenging year and the report highlights the success in maximising investment income whilst ensuring the security and liquidity of the Council's investments.

3 Recommendation

It is recommended that Members note the report.

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Agenda Item No:	8	Fenland CAMBRIDGESHIRE
Committee:	Corporate Governance Committee	
Date:	4 December 2017	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2017/18	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2017/18.

2 Key issues

- The Council has operated within its Treasury Management Strategy Statement (TMSS), Annual Investment Strategy, treasury limits and prudential indicators set by Council for the first six months of 2017/18.
- Prudential indicators for the Capital Financing Requirement (CFR) and the capital position have been revised.
- The latest Monetary Policy Committee decision included forward guidance that they expect to increase the Bank Rate only twice more in the next three years to reach 1.0% by 2020.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/17) currently attracting excessive premiums it is not financially advantageous for the Council to comply with the Gross borrowing and Capital Financing Prudential Indicator in 2017/18.
- Investment income received for the first six months of 2017/18 is £58k (£67k to the end of October). The 2017/18 budgeted outturn of £140k has been revised down to £110k.
- Overall interest rate achieved from investments for the first six months of 2017/18 was 0.42% (average across 114 District Councils which submitted information to Capita was 0.46%).

3 Recommendation

It is recommended that Members note the report.

Wards Affected	All
Portfolio Holder(s)	Councillor Chris Seaton, Portfolio Holder, Finance
Report Originator(s)	Brendan Arnold, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Brendan Arnold, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper (s)	Capita Asset Services template Council Report 23 February 2017 General Fund Budget 2017/18 and Capital Programme 2017/2020

Report:

1 Introduction

1.1 Treasury management is defined as "The management of the local authority's investments and 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."

1.2 The Council complies with the requirements of The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (revised 2011).

1.3 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by full Council 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 covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies (including Mid-year Review Report) to a specific named body. For this Council the delegated body is Corporate Governance Committee.

1.4 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management and covers the following:

- an economic update for the first six months of 2017/18;
- a review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- the Council's capital position;
- a review of the Council's investment portfolio for 2017/18;
- a report of the Council's borrowing strategy for 2017/18;
- a report of debt rescheduling during 2017/18;
- a review of compliance with Treasury and Prudential Limits for 2017/18.

2 Economic Update

2.1 After the UK surprised with strong economic growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.2% (+2.0% y/y), quarter 2 was +0.3% (+1.7% y/y) and quarter 3 was +0.4% (+1.6% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

2.2 While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee, (MPC), meeting of 14 September 2017 managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting MPC. (Inflation actually came in at 3.0% in September and is expected to rise slightly in the coming months.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

2.3 At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

2.4 Economic growth in the EU, (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y), 0.6% in quarter 2 (2.3% y/y) and +0.6% in quarter 3 (2.5% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in October inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

2.5 Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.0%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.2%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and three increases since December 2016; and there could be one more rate rise in 2017, which would then lift the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

2.6 Economic growth in China 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 Prospects for interest rates and borrowings over the medium term are shown below.

	Dec-17	Mar-18	Jun-18	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%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

3 Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2017/18 was approved by Council on 23 February 2017 and there are no policy changes to report since. Estimated reductions to both the borrowing and Capital Financing Requirements (CFR) as detailed in paragraph 4 below.

4 The Council's Capital Position

4.1 This part of the report is structured to update:

- the Council’s capital expenditure plans;
- how these plans are being financed;
- the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- compliance with limits in place for borrowing activity.

4.2 This table shows the revised estimates for capital expenditure and financing of the capital programme and the changes since the budget was approved.

Capital Programme	**2017/18 Original Estimate £000**	**2017/18 Revised Estimate £000**
Forecast Capital Expenditure	**1,906**	**2,362**
Financed by:		
Capital Receipts	135	525
Capital Grants	845	983
Capital Reserves	418	758
Section 106's	0	38
Total Financing	**1,398**	**2,304**
Borrowing Requirment	**508**	**58**

4.3 The main changes to the programme since February, is the increase in resources from the Better Care Fund for the agreed delivery of an enhanced Disabled Facilities Grant programme and increased funding from both the use of capital receipts and uncommitted capital reserves to fund the capital programme. The remaining changes relate to reprofiling of expenditure and resources between years.

4.4 The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period; this is termed the Operational Boundary.

Prudential Indicators	**2017/18 Original Estimate £000**	**2017/18 Revised Estimate £000**
Capital Financing Requirement	1,832	821
External Debt / Operational Boundary		
Borrowing	10,000	10,000
Other Long Term Liabilities Finance Leases	2,000	2,000
Total Debt 31 March	**12,000**	**12,000**

4.5 The Council's revised estimate for CFR is £1.011m lower than the original estimate. This results from increased funding from both capital receipts and uncommitted capital reserves to fund the capital programme. In addition, re-profiling of capital expenditure between years.

4.6 The Council has made provision to repay all 'borrowing' liabilities through increased Minimum Revenue Provision (MRP) in the General Fund revenue budget.

4.7 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its gross debt, does not, except in the short term, exceed the total CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

Limits to Borrowing Activity	2017/18 Original Estimate £000	2017/18 Revised Estimate £000
Gross Borrowing	7,800	7,800
Plus Other Long Term Liabilities Finance Leases	860	712
Gross Borrowing	**8,660**	**8,512**
Capital Financing Requirement	1,832	821

4.8 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/2017) currently attracting excessive premiums (£3.110m at the time of writing this report) if it were prematurely repaid, it is not financially advantageous for the Council to fully comply with this prudential indicator. This has been the case since the housing stock transfer in 2007 and has been acknowledged and approved by Council since then. In addition, the Council's external auditors have also acknowledged this situation and have not raised any issues with our strategy.

4.9 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level for borrowing which, while not desired could be afforded in the short term but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit for External Debt	2017/18 Original Estimate £000	2017/18 Revised Estimate £000
Borrowing	15,000	15,000
Plus Other Long Term Liabilities Finance Leases	2,000	2,000
Total Borrowing	**17,000**	**17,000**

4.10 The Corporate Director & Chief Finance Officer reports that no difficulties are envisaged for the current year in complying with the above prudential indicators.

5 Investment Portfolio

5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in section 2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis and its impact on banks prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual, investment returns are likely to remain low.

5.2 The Council held investments of £27.8m as at the 30th September 2017 (£21.3m at 31st March 2017) and the investment portfolio yield for the first 6 months of the year is 0.42%. Based on 114 District Councils which provided Capita with information, the average rate of return to the end of September 2017 was 0.46%.

5.3 The Chief Finance Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2017/18. The Council has achieved investment income of £58k to 30th September 2017 (£67k to end of October). The 2017/18 projected outturn of £140k has been revised down to £110k.

5.4 The Council's current investment counterparty criteria selection was approved in the TMSS in February 2017 and is meeting the requirement of the treasury management function to date.

6 Borrowing Strategy

6.1 The Council's CFR for 2017/18 is £0.923m (including finance lease borrowing facilities). The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

6.2 During 2017/18 the council has approved the use of £0.16m of cash flows in lieu of borrowing (internal borrowing) to support capital investment.

6.3 It is not anticipated there will be any further borrowing undertaken during this financial year.

7 Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling was undertaken during the first six months of 2017/18.

8 Other

8.1 The Chartered Institute of Public Finance and Accountancy, (CIPFA), is currently conducting an exercise to consult local authorities on revising the Treasury Management Code and Cross Sectoral Guidance Notes, and the Prudential Code. CIPFA is aiming to issue the revised codes during November. Officers are monitoring developments and will report to members when the new codes have been agreed and issued and on the likely impact on this Council.

8.2 The EU has now set a deadline of 3 January 2018 for the introduction of regulations under The Markets in Financial Instruments Directive (MIFID) II. These regulations will govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This will have little effect on this authority apart from having to complete forms sent by each institution dealing with this authority.