Crawley Borough Council

Report to Overview and Scrutiny Commission
27 November 2017

Report to Cabinet
29 November 2017

Treasury Management Mid-Year Review 2017/2018

Report of the Head of Finance, Revenues and Benefits, **FIN/426**

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1. Purpose

1.1 This report provides an update on the Council's Treasury Management Strategy for the two first quarters of 2017/2018

2. Recommendations

2.1 To the Overview and Scrutiny Commission:

That the Commission consider the report and decide what comments, if any, it wishes to submit to the Cabinet.

2.2 To the Cabinet

That the Cabinet is recommended to:

- note the report and the treasury activity for the first two quarters of 2017/2018;

3. Reasons for the Recommendations

3.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, annual and midyear reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

4. Interest rate forecasts

4.1 The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

4.2 The increase to 0.5% at the November MPC meeting raises the question as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

4.3 The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

5. Annual Investment Strategy

5.1 The Treasury Management Strategy Statement (TMSS) for 2017/18, which includes the Annual Investment Strategy, was approved by this Council on 22 February 2017. It sets out the Council's investment priorities as being:

- Security of capital
- Liquidity; and
- Yield.

6. Compliance with Treasury and Prudential Limits

6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved TMSS.

6.2 During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 3.

7. Investment Portfolio 2017/18

7.1 The Council held £137.0m of investments as at 30 September 2017 (£118.2m at 31 March 2017).

Investments	**31 March 2017 £'000**	**30 September 2017 £'000**	**Rate/ Return**	**Average Life yrs**
Local Authorities	51,000	56,000	0.81%	0.60
UK Banks	6,887	19,558	0.50%	0.35
UK Building Societies	3,500	7,000	0.35%	0.32
Money Market Funds	3,290	4,890	0.21%	0.00
Overseas Banks	39,510	42,352	0.49%	0.47
Corporate Bonds	13,996	7,175	0.59%	0.16
Total	**118,183**	**136,975**	**0.61%**	**0.46**

A full list of investments held as at 30th September 2017 is in appendix 2.

7.2 In addition to the treasury investments in 7.1 above, the Council also has £14.12m invested in Investment Properties. These investments are deemed capital expenditure, and as such are an application (spending) of capital resources. As such, these investments are not included in the treasury management indicators, but have been included in the list of investments in appendix 2. There is a further budget of £5.0m to purchase additional investment properties.

7.3 The Head of Finance, Revenues and Benefits confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2017/18.

7.4 Investment performance for the financial year to date as at 30 September 2017:

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day LIBID + 0.2%	0.31%	0.63%	£418,669

The performance above is the return achieved for the half year. This is different from the table in 7.1 as this shows the average rate on the investments actually held on 30 September.

8. Borrowing

8.1 The Council borrowed £260.325m in March 2012 for HRA self-financing. The average borrowing rate is 3.19%. There has been no requirement for further borrowing in 2017/2018.

9. Implications

9.1 The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these. There are no other legal implications arising in this report.

9.2 The financial implications are addressed throughout this report.

9.3 Risks are highlighted throughout this report, but appendix 1 addresses risks in the interest rate forecast, and appendix 3 addresses the risk to security, liquidity and yield of the Council's investment strategy.

10. Background Papers

Treasury Management Strategy for 2017/2018 – Cabinet, 8 February 2017 [report FIN/404 refers]
Quarterly Budget Monitoring 2017/2018 Quarter 2 – Cabinet, 29 November 2017 [report FIN/427 refers]
Budget and Council Tax for 2017/18 - Cabinet, 8 February 2017 [report FIN/401 refers]
"Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes", 2011 Edition - Chartered Institute of Public Finance and Accountancy
"The Prudential Code for Capital Finance in Local Authorities", 2011 Edition - Chartered Institute of Public Finance and Accountancy
DCLG Guidance on Local Government Investments (Second Edition)

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APPENDIX 1

Economic background

UK. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. . The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the 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 75% 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. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised 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. The Bank of England Inflation Reports during 2017 have clearly flagged up that they 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. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling 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 increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. 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 would be inflationary over the next few years.

Following the guidance from the MPC it became likely that the MPC would increase Bank Rate to 0.5% in November, which proved to be the case. The big question after this rise will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

EU. Economic growth in the EU, (the UK's biggest trading partner), has 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 now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% 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 August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

USA. Growth in the American economy has been 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%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with 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 more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

Chinese 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.

Japan is struggling to stimulate consistent significant 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.

Detailed holdings at 30 September 2017 **APPENDIX 2**

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
AUSTRALIA BANKS									
Australia and New Zealand Banking G	2436	17/08/2017	03/08/2018	307	0.400%	0.996	0.996	10.000	AA-
Commonwealth Bank of Australia	2422	24/05/2017	23/05/2018	235	0.520%	5.000			
	2439	01/09/2017	31/08/2018	335	0.500%	2.000	7.000	10.000	AA-
National Australia Bank Ltd	2409	17/01/2017	08/11/2017	39	0.547%	1.808	1.808	10.000	AA-
UK BANKS									
Goldman Sachs International Bank	2391		notice account	182	0.755%	2.000			
	2432	31/07/2017	31/01/2018	123	0.560%	3.500			
	2438	01/09/2017	01/03/2018	152	0.550%	2.000	7.500	10.000	A+
Lloyds Bank plc	20		01/10/2017	1	0.150%	2.057	2.057	10.000	A
The Royal Bank of Scotland plc	2427	28/06/2017	27/06/2018	270	0.660%	2.000			
	2428	04/07/2017	29/06/2018	272	0.613%	3.002	5.002	15.000	BBB+
Sumitomo Mitsui Banking Corporation	2424	02/06/2017	01/12/2017	62	0.360%	3.000			
	2430	17/07/2017	17/01/2018	109	0.370%	2.000	5.000	10.000	A
UK BUILDING SOCIETIES									
Coventry BS	2440	01/09/2017	01/03/2018	152	0.350%	2.000			
	2442	07/09/2017	07/03/2018	158	0.350%	2.000	4.000	10.000	A
Nationwide BS	2421	15/05/2017	15/11/2017	46	0.370%	1.500			
	2435	08/08/2017	08/02/2018	131	0.320%	1.500	3.000	10.000	A+
CANADA BANKS									
Toronto Dominion Bank	2444	18/09/2017	17/09/2018	352	0.510%	2.000	2.000	10.000	AA-
CORPORATE BONDS									
BG Energy Capital plc	2403	14/12/2016	07/12/2017	68	0.591%	1.996	1.996	2.000	A
Daimler AG	2399	05/12/2016	08/11/2017	39	0.703%	2.000	2.000	2.000	A-
Deutsche Bahn Finance BV	54	11/08/2016	30/10/2017	30	0.389%	1.769	1.769	2.000	AA-
Prudential plc	2411	25/01/2017	19/01/2018	111	0.658%	1.410	1.410	2.000	A
DENMARK BANKS									
Danske Bank	2441	05/09/2017	05/03/2018	156	0.282%	2.001	2.001	10.000	A
FRANCE BANKS									
Credit Industriel et Commercial	2437	31/08/2017	28/02/2018	151	0.350%	1.500	1.500	10.000	A+

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
GERMANY BANKS									
Landesbank Hessen-Thueringen Giroze	2392	01/11/2016	31/10/2017	31	0.660%	3.000			
	2426	27/06/2017	26/06/2018	269	0.480%	1.500			
	2431	31/07/2017	31/01/2018	123	0.310%	2.000	6.500	10.000	A
LOCAL AUTHORITIES									
Dundee City Council	2401	15/12/2016	14/12/2017	75	0.450%	3.000	3.000	15.000	AA
East Dunbartonshire Council	2397	24/11/2016	23/11/2017	54	0.420%	2.000	2.000	15.000	AA
Glasgow City Council	2393	05/12/2016	04/12/2017	65	0.410%	5.000	5.000	15.000	AA
Kingston-Upon-Hull City Council	36	02/12/2013	02/12/2021	1524	2.750%	5.000	5.000	15.000	AA
London Borough of Enfield	2396	28/11/2016	27/11/2017	58	0.440%	5.000	5.000	15.000	AA
Mid Suffolk District Council	2419	27/04/2017	27/10/2017	27	0.450%	5.000	5.000	15.000	AA
Newcastle City Council	2412	03/04/2017	29/03/2018	180	0.500%	3.000	3.000	15.000	AA
North Tyneside MDC	2402	13/12/2016	12/12/2017	73	0.480%	3.000	3.000	15.000	AA
Peterborough City Council	33	11/03/2013	12/03/2018	163	1.750%	4.000	4.000	15.000	AA
Slough Borough Council	2413	20/02/2017	19/02/2018	142	0.600%	2.000	2.000	15.000	AA
Staffordshire Moorlands District Co	42	03/11/2014	03/11/2017	34	1.600%	2.000	2.000	15.000	AA
Stockport MBC	2415	03/04/2017	29/03/2018	180	0.580%	6.000	6.000	15.000	AA
Telford & Wrekin Council	2418	13/04/2017	19/10/2017	19	0.430%	4.000	4.000	15.000	AA
Thurrock Borough Council	2405	06/01/2017	05/01/2018	97	0.450%	2.000			
	2408	06/01/2017	05/01/2018	97	0.450%	2.000	4.000	15.000	AA
Warrington Borough Council	2398	29/11/2016	28/11/2017	59	0.450%	3.000	3.000	15.000	AA
MONEY MARKET FUNDS									
Standard Life Investments LF	4		01/10/2017	1	0.203%	2.890	2.890	6.000	AAA
Federated Prime Rate Cash Man	1		01/10/2017	1	0.209%	2.000	2.000	6.000	AAA
NETHERLANDS BANKS									
Rabobank Group	2390	13/10/2016	12/10/2017	12	0.600%	2.500			
	2404	15/12/2016	01/11/2017	32	0.604%	1.517			
	2406	05/01/2017	01/11/2017	32	0.559%	0.520			
	2407	05/01/2017	04/01/2018	96	0.490%	2.500	7.037	10.000	AA-
SINGAPORE BANKS									
DBS Bank Ltd	2423	26/05/2017	26/02/2018	149	0.450%	5.000	5.000	10.000	AA-
United Overseas Bank Ltd	2429	11/07/2017	11/01/2018	103	0.350%	2.500	2.500	10.000	AA-
SWEDEN BANKS									
Svenska Handelsbanken	17		01/10/2017	1	0.100%	0.010	0.010	10.000	AA

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
SWITZERLAND BANKS									
UBS AG	2420	15/05/2017	11/04/2018	193	0.573%	2.000			
	2434	02/08/2017	21/06/2018	264	0.492%	1.001			
	2443	12/09/2017	11/09/2018	346	0.480%	3.000	6.000	10.000	AA-
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				172			**136.975**		
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Investment Properties							14.124		

							151.099		

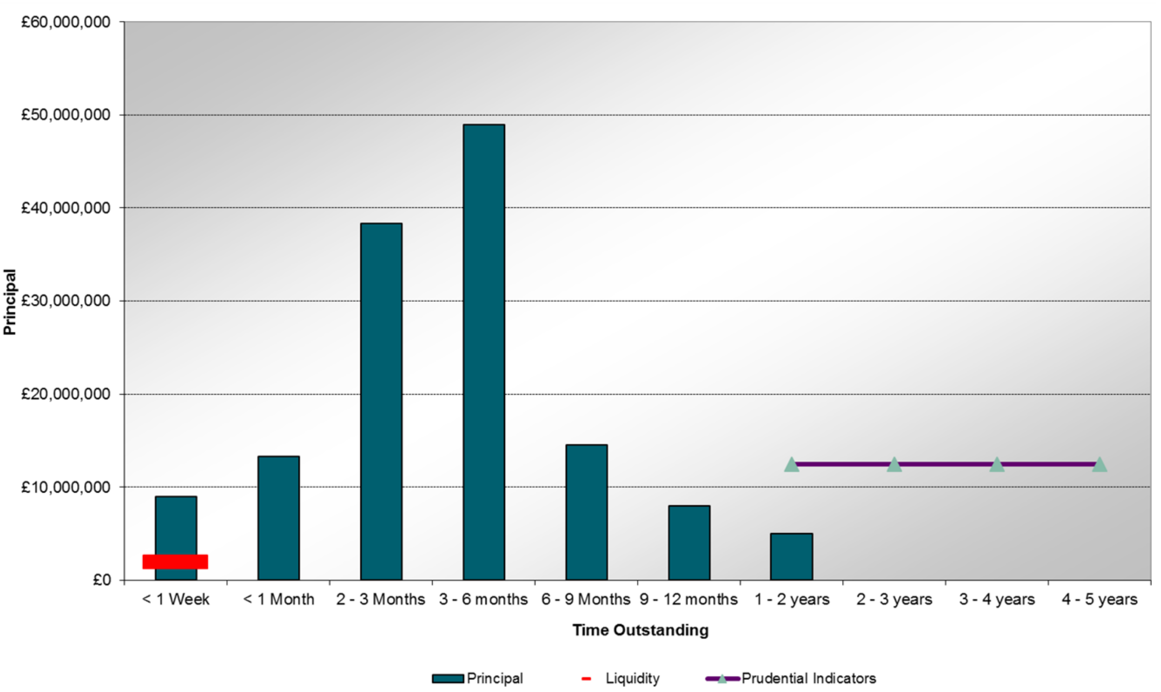
Prudential and Treasury Indicators as at 30th September 2017 APPENDIX 3

Treasury Indicators	2017/18 Strategy £'000	30 September Actual £'000
Authorised limit for external debt	270,325	260,325
Operational boundary for external debt	260,325	260,325
Investments	83,110	136,975
Maturity structure of fixed rate borrowing - upper and lower limits:		
Under 12 months	0% - 10%	0%
12 months to 2 years	0% - 10%	0%
2 years to 5 years	0% - 10%	0%
5 years to 10 years	0% - 30%	24.5%
10 years to 20 years	0% - 80%	68.8%
20 years to 30 years	0% - 15%	6.7%
30 years to 40 years	0% - 10%	0%
40 years to 50 years	0% - 10%	0%
Upper limit of fixed interest rates based on:		
- Debt only	270,325	260,325
- Investments only	140,000	130,018
Upper limit of variable interest rates based on:		
- Debt only	10,000	0
- Investments only	40,000	6,957
Weighted average life of investments	Avg. 0.70 years Max 1.20 years	0.47
Short term deposits (<1 week's notice)	2,000	6,957
Upper limit for principal sums invested over 364 days	50,000	5,000

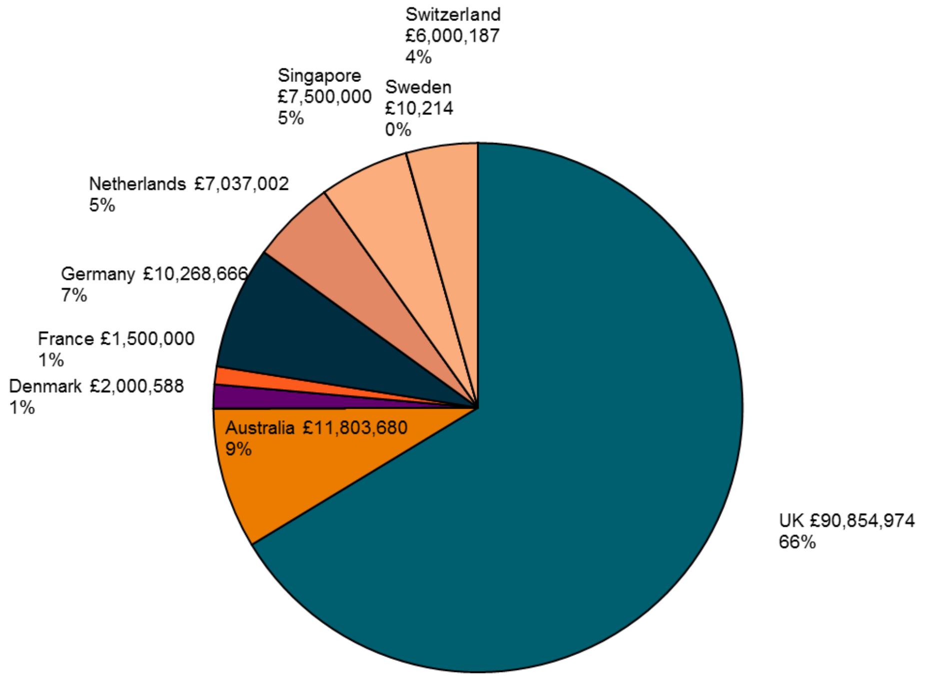
Prudential Indicators	2017/18 Strategy £'000	Quarter 2 Forecast £'000
General Fund		
Capital expenditure	13,901	7,591
Capital Financing Requirement (CFR)	0	0
Annual change in CFR	0	0
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	-4.51%	-6.91%
HRA		
Capital expenditure	37,468	23,820
Capital Financing Requirement (CFR)	260,325	260,325
Annual change in CFR	0	0
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	17.59%	17.60%

Incremental impact of capital investment decisions:-		
a) Increase in council tax (band change) per annum.	Nil	Nil
b) Increase in average housing rent per week.	Nil	Nil

Compliance with Liquidity and Prudential Indicator Limits



Country Limits



Sector Diversification