Crawley Borough Council

Report to Overview and Scrutiny Commission
19 November 2018

Report to Cabinet
21 November 2018

Treasury Management Mid-Year Review 2018/2019

Report of the Head of Corporate Finance (FIN/457)

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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 2018/2019.

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 2018/2019;

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 mid-year 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, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

4.2 The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. Link do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Link also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

4.3 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.

5. Annual Investment Strategy

5.1 The Treasury Management Strategy Statement (TMSS) for 2018/19, which includes the Annual Investment Strategy, was approved by this Council on 21 February 2018. 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 2018/19

7.1 The Council held £127.7m of investments as at 30 September 2018 (£118.6m at 31 March 2018).

Investments	31 March 2018 £'000	30 September 2018 £'000	Rate/ Return	Average Life yrs
Local Authorities	81,170	83,670	0.88%	0.53
UK Banks	7,642	8,358	0.75%	0.22
UK Building Societies	1,500	0		
Money Market Funds	5,190	3,130	0.86%	0.00
Overseas Banks	21,507	27.182	0.80%	0.29
Corporate Bonds	1,597	5,386	1.07%	0.43
Total	**118,606**	**127,727**	**0.86%**	**0.44**

A full list of investments held as at 30th September 2018 is in appendix 2.

7.2 In addition to the treasury investments in 7.1 above, the Council also has £21.3m 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 Corporate Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19.

7.4 Investment performance for the financial year to date as at 30 September 2018:

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day LIBID + 0.2%	0.44%	0.79%	£516,431

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 2018/2019.

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 2018/2019 – Cabinet, 7 February 2018 [report FIN/433 refers]
Quarterly Budget Monitoring 2018/2019 Quarter 2 – Cabinet, 21 November 2018 [report FIN/456 refers]
Budget and Council Tax for 2018/19 - Cabinet, 8 February 2017 [report FIN/434 refers]
"Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes", 2017 Edition - Chartered Institute of Public Finance and Accountancy
"The Prudential Code for Capital Finance in Local Authorities", 2017 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. The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.) 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. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

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 the next 12 months, 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.

EU. Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

USA. President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, but also an upturn in inflationary pressures. With inflation moving towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

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.

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.

Detailed holdings at 30 September 2018 **APPENDIX 2**

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
AUSTRALIA BANKS									
Commonwealth Bank of Australia	2475	16/04/2018	07/12/2018	68	0.916%	0.925	0.925	10.000	AA-
UK BANKS									
Lloyds Bank plc	20		01/10/2018	1	0.650%	0.090			
	2479	10/05/2018	09/12/2018	70	0.821%	1.268	1.358	10.000	A+
National Westminster Bank Plc	2487	27/06/2018	02/01/2019	94	0.780%	2.000	2.000	15.000	A-
Standard Chartered Bank	2491	29/06/2018	02/01/2019	94	0.750%	3.000	3.000	10.000	A+
Sumitomo Mitsui Banking Corporation	2483	29/05/2018	29/11/2018	60	0.680%	2.000	2.000	10.000	A
CANADA BANKS									
Toronto Dominion Bank	2502	17/09/2018	17/09/2019	352	0.950%	2.000	2.000	10.000	AA-
CORPORATE BONDS									
BMW Finance NV	2478	03/05/2018	14/12/2018	75	0.854%	1.585	1.585	2.000	A+
BP Capital Markets	2494	01/08/2018	10/12/2018	71	1.080%	1.806	1.806	2.000	A
GE Capital UK Funding	2495	08/08/2018	31/07/2019	304	1.225%	1.995	1.995	2.000	A+
FRANCE BANKS									
Credit Industriel et Commercial	2481	18/05/2018	19/11/2018	50	0.750%	2.000	2.000	10.000	A+
GERMANY BANKS									
Landesbank Hessen-Thueringen Giroze	2450	03/11/2017	02/11/2018	33	0.700%	2.000			
	2488	26/06/2018	25/06/2019	268	0.780%	1.500	3.500	10.000	A
LOCAL AUTHORITIES									
Blackpool BC	2451	24/11/2017	23/11/2018	54	0.600%	4.000	4.000	15.000	AA
Conwy County Borough Council	2485	01/06/2018	03/12/2018	64	0.620%	5.000	5.000	15.000	AA
Dumfries & Galloway Council	59	01/12/2017	02/12/2019	428	0.900%	5.000	5.000	15.000	AA
Kingston-Upon-Hull City Council	36	02/12/2013	02/12/2021	1159	2.750%	5.000	5.000	15.000	AA
Merthyr Tydfil County BC	2484	25/05/2018	26/11/2018	57	0.650%	3.000	3.000	15.000	AA
Newcastle City Council	58	01/02/2018	03/02/2020	491	1.000%	5.000	5.000	15.000	AA
Northamptonshire County Council	2456	01/03/2018	28/02/2019	151	0.700%	5.000	5.000	15.000	AA
North Tyneside MDC	2447	02/10/2017	01/10/2018	1	0.560%	3.170			
	2457	21/12/2017	20/12/2018	81	0.750%	3.000	6.170	15.000	AA
North Wales Fire Authority	2498	31/08/2018	28/02/2019	151	0.850%	3.000	3.000	15.000	AA
Peterborough City Council	57	27/11/2017	27/11/2019	423	0.900%	5.000	5.000	15.000	AA
City of Salford MDC	2501	13/09/2018	13/03/2019	164	0.850%	2.000	2.000	15.000	AA

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
Southampton City Council	2446	02/10/2017	01/10/2018	1	0.550%	5.000	5.000	15.000	AA
Stockport MBC	2462	29/03/2018	28/03/2019	179	0.850%	6.000	6.000	15.000	AA
Swindon BC	2500	07/09/2018	07/03/2019	158	0.850%	3.000	3.000	15.000	AA
Thurrock Borough Council	2458	05/01/2018	04/01/2019	96	0.700%	4.000			
	2489	01/08/2018	31/07/2019	304	0.750%	5.000			
	2492	03/07/2018	02/07/2019	275	0.750%	5.000	14.000	15.000	AA
Walsall Council	2459	31/01/2018	30/01/2019	122	0.700%	2.500	2.500	15.000	AA
Woking Borough Council	2497	07/09/2018	14/02/2019	137	0.880%	5.000	5.000	15.000	AA
MONEY MARKET FUNDS									
Standard Life Investments LF	4		01/10/2018	1	0.669%	0.570	0.570	6.000	AAA
Federated Prime Rate Cash Man	1		01/10/2018	1	0.702%	2.560	2.560	6.000	AAA
NETHERLANDS BANKS									
Rabobank Group	2474	04/04/2018	04/10/2018	4	0.830%	2.000			
	2496	20/08/2018	20/02/2019	143	0.840%	2.500	4.500	10.000	AA-
SINGAPORE BANKS									
DBS Bank Ltd	2477	30/04/2018	31/10/2018	31	0.830%	5.000			
	2499	31/08/2018	28/02/2019	151	0.930%	2.000	7.000	10.000	AA-
SWEDEN BANKS									
Svenska Handelsbanken	2486	07/06/2018	18/01/2019	110	0.671%	3.004			
	2490	29/06/2018	18/01/2019	110	0.742%	1.254	4.258	10.000	AA-
Nordea Bank AB	2493	05/07/2018	07/01/2019	99	0.700%	3.000	3.000	10.000	AA-
				162			**127.727**		
Investment Properties							21.322		
							149.049		

Prudential and Treasury Indicators as at 30th September 2018 APPENDIX 3

Treasury Indicators	2018/19 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	61,872	127,727

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% - 20%	8.8%
5 years to 10 years	0% - 40%	28.4%
10 years to 20 years	0% - 65%	62.7%
20 years to 30 years	0% - 15%	0%
30 years to 40 years	0% - 10%	0%
40 years to 50 years	0% - 10%	0%

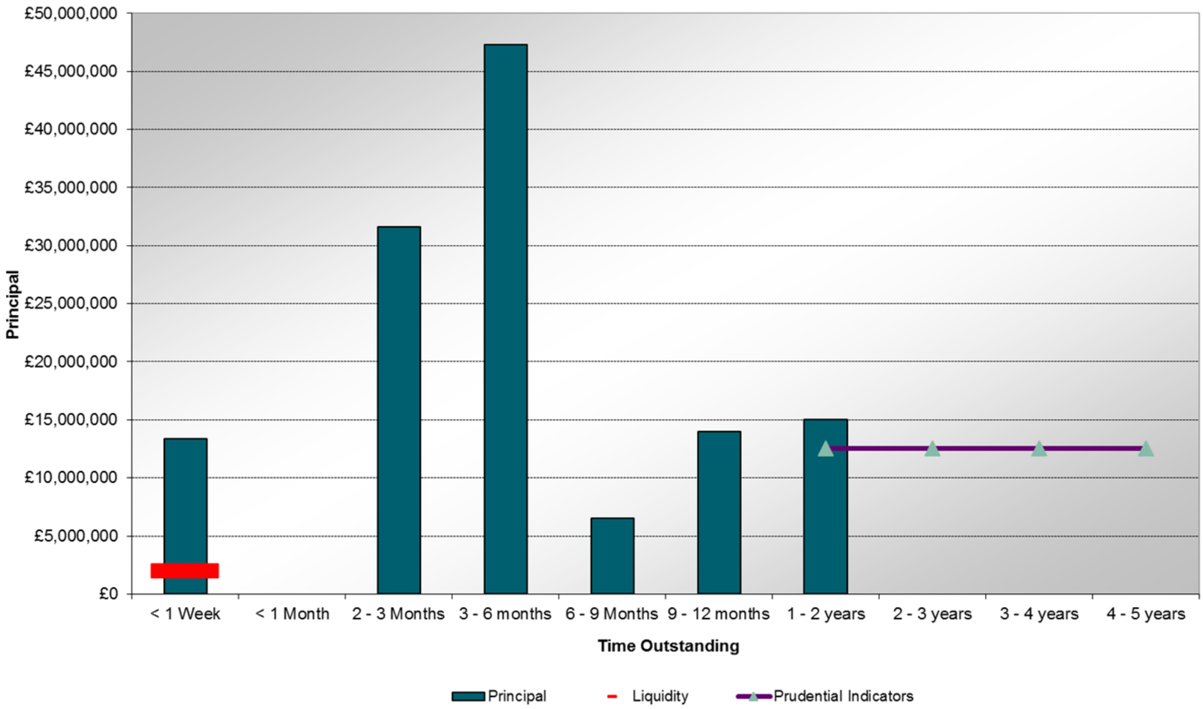
Upper limit of fixed interest rates based on:		
- Debt only	270,325	260,325
- Investments only	140,000	124,506
Upper limit of variable interest rates based on:		
- Debt only	10,000	0
- Investments only	40,000	3,220

Weighted average life of investments	Avg. 0.70 years Max 1.20 years	0.44
Short term deposits (<1 week's notice)	2,000	13,390
Upper limit for principal sums invested over 364 days	50,000	15,000

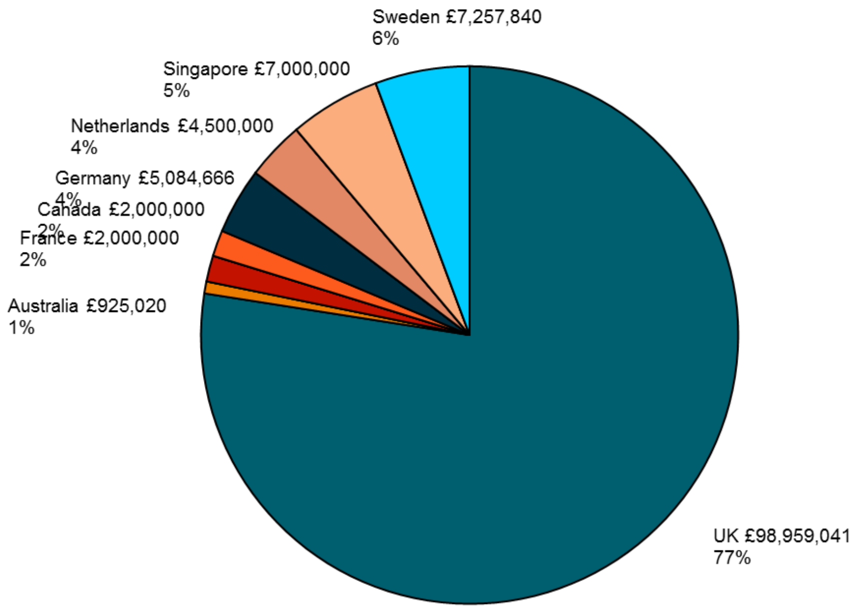
Prudential Indicators	2018/19 Strategy £'000	Quarter 2 Forecast £'000
General Fund		
Capital expenditure	18,515	14,594
Capital Financing Requirement (CFR)	0	0
Annual change in CFR	0	0
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	-6.01%	-7.50%
HRA		
Capital expenditure	53,829	39,815
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	16.86%	17.29%

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