

**Treasury Management Half Yearly Report – 2017/18**

**1. Background**

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate security and liquidity initially before considering optimising investment return (yield).

Accordingly 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.”

The second main function of a treasury management service is the funding of an authority’s capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasions any debt previously drawn may be restructured to meet Council risk or cost objectives.

**2. Introduction**

The treasury management function is carried out in accordance with the Chartered Institute of Public Finance and Accountancy’s (CIPFA) current Code of Practice on Treasury Management (revised November 2011). The original Code was adopted by this Council on 24 February 2010.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council’s treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, and an Annual Report (stewardship report) covering activities during the previous year.
4. The production of a Mid-Year Review Report for scrutiny by Members. For this Council the delegated body to review treasury management and receive the Mid-Year Review Report is the Audit and Risk Committee.
5. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices. For this Council the delegated body is the Cabinet (for implementing) and the Audit and Risk Committee (for monitoring).
6. Delegation by the Council for the execution and administration of treasury management decisions. For this Council this is delegated to the Executive Director (Resources and Support Services).

7. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Finance, Resources and Partnership Scrutiny Committee.

This Mid-Year Review Report to members is intended to provide an update of the treasury management strategy and performance for the period April to September of this financial year. It has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the 2017/18 financial year to 30 September 2017
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's investment portfolio for 2017/18

### **3. Economic Update – as provided by the Council's Treasury Management Advisors, Arlingclose**

Commodity prices fluctuated over the period with oil falling below \$45 a barrel before inching back up to \$58 a barrel. UK Consumer Price Inflation (CPI) index rose with the data print for August showing CPI at 2.9%, its highest since June 2013 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. The new inflation measure CPIH, which includes owner occupiers' housing costs, was at 2.7%.

The unemployment rate fell to 4.3%; it's lowest since May 1975, but the squeeze on consumers intensified as average earnings grew at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar 2017.

The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth. Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months". The Council's treasury advisor Arlingclose is not convinced the UK's economic outlook justifies such a move at this stage, but the Bank's interpretation of the data seems to have shifted.

In the face of a struggling economy and Brexit-related uncertainty, Arlingclose expects the Bank of England to take only a very measured approach to any monetary policy tightening; any increase will be gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy through the Brexit transition.

#### Outlook for the remainder of 2017/18

The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Both consumer and business confidence remain subdued. Household consumption growth, the driver of UK GDP growth, has softened following a contraction in real wages. Savings rates are at an all-time low and real earnings growth (i.e. after inflation) struggles in the face of higher inflation.

The Bank of England's Monetary Policy Committee has changed its rhetoric, implying a rise in Bank Rate in "the coming months". Arlingclose is not convinced the UK's economic outlook justifies such a move at this stage, but the Bank's interpretation of the data seems to have shifted.

This decision is still very data dependant and Arlingclose is, for now, maintaining its central case for Bank Rate at 0.25% whilst introducing near-term upside risks to the forecast as shown below. Arlingclose's central case is for gilt yields to remain broadly stable in the across the medium term, but there may be near term volatility due to shifts in interest rate expectations.

#### **4. Regulatory Updates – as provided by the Council's Treasury Management Advisors, Arlingclose**

##### *MiFID II*

Local authorities are currently treated by regulated financial services firms as professional clients who can "opt down" to be treated as retail clients instead. But from 3rd January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can "opt up" to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional, the Council must have an investment balance of at least £10 million and the person authorised to make investment decisions on behalf of the Council must have at least one year's relevant professional experience. In addition, the firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The main additional protection for retail clients is a duty on the firm to ensure that the investment is "suitable" for the client. It is likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Council has declined to opt down to retail client status in the past as the costs were thought to outweigh the benefits.

The Council does not plan to opt up professional status because it will not hold investment balances of at least £10 million and will not be engaging into borrowing where unnecessary. The Council could borrow in accordance with its Capital Financing Requirement; this could temporarily mean that the Council could opt up to become a professional client (i.e. greater than £10m of investments) but this would introduce increased risk associated with investing public monies. Remaining a retail client may lead to an increased cost and restricted access to some financial products after 3rd January 2018. This is currently being reviewed with the Council's Treasury Management Advisors together with advice from CIPFA and the Local Government Association.

##### *CIPFA Consultation on Prudential and Treasury Management Codes*

In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes and after reviewing responses launched a further consultation on changes to the codes in August with a deadline for responses of 30th September 2017.

The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital

programme and treasury management. The prudential indicators for capital expenditure and the authorised borrowing limit would be included in this report but other indicators may be delegated to another committee. There are plans to drop certain prudential indicators, however local indicators are recommended for ring fenced funds (including the HRA) and for group accounts. Other proposed changes include applying the principles of the Code to subsidiaries.

Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of “investments” as well as loans made or shares brought for service purposes. Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee rather than needing approval of full Council. There are also plans to drop or alter some of the current treasury management indicators.

CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year.

The Department of Communities and Local Government (DCLG) and CIPFA wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical. It is understood that DCLG will be revising its Investment Guidance (and its MRP guidance) for local authorities in England; however there have been no discussions with the devolved administrations yet.

## **5. Treasury Management Strategy Statement and Annual Investment Strategy Update**

The Treasury Management Strategy Statement (TMSS) for 2017/18 was approved by Full Council on 22 February 2017. The Council’s Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council’s investment priorities as follows:

- Security of Capital
- Liquidity

The Council 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 investments short term, and only invest with highly credit rated financial institutions using the Arlingclose suggested creditworthiness matrices. Currently investments are only being made with UK financial institutions.

Investments during the first six months of the 2017/18 financial year have been in line with the strategy, and there have been no deviations from the strategy.

As outlined in Section 4 above, there is considerable uncertainty in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 22 February 2017 is still fit for purpose in the current economic climate.

## **6. Investment Portfolio 2017/18**

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 3, 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 and in line with the 0.25% Bank Rate. 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, investment returns are likely to remain low.

The Council held no investments as at 30 September 2017 (£3.4m at 31 March 2017), however £1.7m was held in the Lloyds Current Account. Funds available for investment purposes can vary between nothing and £4million due to fluctuations in cash inflows and outflows during each month. Large cash inflows include council tax & business rate direct debits and the Housing Benefit subsidy from the Department for Work and Pensions. Large cash outflows include payment of the precepts to Staffordshire County Council, the Fire Authority and the Police, payment of salaries and payment of business rates to Central Government and the Staffordshire Business Rate pool.

The investment portfolio yield for the first six months of the year is 0.39% against a target of 0.25%. The Council's budgeted investment return for 2017/18 is £49,000 (£24,500 for first 2 quarters). As at the end of the first 2 quarters of 2017/18 £4,800 of interest has been earned. Despite a greater return in terms of interest rates, fewer funds have been available for investment during this period; this is expected to be the case during the rest of 2017/18.

## **7. Borrowing Position 2017/18**

The only borrowing envisaged by the 2017/18 Treasury Management Strategy is temporary borrowing to cover short-term cash flow deficits. In fact no borrowing has taken place for the first half of the financial year.

However, it was resolved at the meeting of the Council that took place on 7 September 2016, due to the delay in capital receipts; prudential borrowing will most likely be required towards the end of the 2016/17 financial year. However, this is now expected to happen towards the back end of 2017/18.

## **8. Prudential Indicators 2017/18**

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2017/18 Treasury Management Strategy. Consequently, there is no intention to revise any of the indicators for the remainder of the year.

## Annex A

### Treasury Management – Glossary of Terms

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.
- **CPI** – a measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.
- **CPIH** – a measure of how much prices are rising that, unlike CPI, takes into account owner-occupiers' housing costs and council tax.
- **GDP** – Gross Domestic Product is the market value of all officially recognised final goods and services produced within a country in a given period of time.
- **Liquidity** – relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.
- **MiFID II** – The European Union (EU) published the final text of the second Markets in Financial Instruments Directive (MiFID II) in May 2014, aiming to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection. The new rules come into effect on 3rd January 2018.
- **MPC** – interest rates are set by the Bank of England's Monetary Policy Committee. The MPC sets an interest rate it judges will enable the inflation target to be met