Appendix 1

Treasury Management Half Yearly Report – 2018/19

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 December 2017). The original Code was adopted by this Council on 24 February 2010. The Code requires the Council to approve treasury management semi-annual and annual reports.

This Half Yearly 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 2018/19 financial year to 30 September 2018
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council’s investment portfolio for 2018/19

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

UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year, above the consensus forecast and that of the Bank of England’s in its August Inflation Report, as the effects of sterling’s large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages.

However real wages (i.e. adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.

The rebound in quarterly Gross Domestic Product (GDP) growth in quarter 2 to 0.4% appeared to overturn the weakness in quarter 1 which was largely due to weather-related factors. However, the detail showed much of quarter 2 GDP growth was attributed to an increase in inventories. Year on year GDP growth at 1.2% also remains below trend. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking the Bank Rate to 0.75%.

The escalating trade war between the United States and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just to China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019.

The European Union (EU) Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29th March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

Gilt yields displayed marked volatility during the period, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven United Kingdom, German and United States government bonds. Over the period, despite the volatility, the bet change in gilt yields was small. The 5-year benchmark gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%. The increase in Bank Rate resulted in higher in money markets rates. 1-month, 3-month and 12-month rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

The ringfencing of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and Royal Bank of Scotland/Natwest Bank plc – is complete, the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018.

There were a few credit rating changes during the period. Moody's downgraded Barclays Bank plc's long-term rating to A2 from A1 and NatWest Markets plc to Baa2 from A3 on its view of the credit metrics of the entities post ring-fencing. Upgrades to long-term ratings included those for Royal Bank of Scotland plc, NatWest Bank and Ulster Bank to A2 from A3 by Moody's and to A- from BBB+ by both Fitch and Standard & Poor's (S&P). Lloyds Bank plc and Bank of Scotland plc were upgraded to A+ from A by Standard and Poor's and to Aa3 from A1 by Moody's.

Our treasury advisor Arlingclose will henceforth provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in.

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

CIPFA Updates

Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. In England the Ministry of Housing, Communities and Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018.

The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority will be producing its Capital Strategy later in 2018/19 for approval by full Council.

5. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved by Full Council on 21 February 2018. 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 2018/19 financial year have been in line with the strategy, and there have been no deviations from the strategy.

As outlined in Section 3 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 21 February 2018 is still fit for purpose in the current economic climate.

6. Investment Portfolio 2018/19

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 0.75% Bank Rate. Given this environment, investment returns are likely to remain low.

The Council held investments of £3.45m as at 30 September 2018; £2.75m was held in the Council's notice account with Santander, while the remaining £0.7m was held in the

Lloyds Current Account. In comparison only £0.5m was held as at 31 March 2018, entirely within the Council's Lloyds Current Account. These investments are in line with Arlingclose's recommended maximum deposit duration (6 months each).

Funds available for investment purposes can vary between nothing and around £7million 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 0.44%, in line with the target of 0.40%. The Council's budgeted investment return for 2018/19 is £49,000 (£24,500 for first 2 quarters). As at the end of the first 2 quarters of 2018/19 £9,950 of interest has been earned. Despite a slightly 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 2018/19.

7. Borrowing Position 2018/19

The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The only borrowing envisaged by the 2018/19 Treasury Management Strategy is temporary borrowing to cover short-term cash flow deficits. As at 31st March 2018 the Council had temporary borrowing of £2.5m, this covered the final two weeks of 2017/18 and was repaid on the first working day of 2018/19. During the first six months of 2018/19 no borrowing has taken place.

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 almost certainly expected to happen towards the back end of 2018/19.

8. Prudential Indicators 2018/19

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2018/19 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.

- **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.

- **MHCLG** – the Ministry of Housing, Communities and Local Government is the UK Government department for housing, communities and local government in England. Known previously as Department for Communities and Local Government (DCLG), it was renamed to add Housing to its title and changed to a ministry in January 2018.

- **Bail-in** – This is an alternative to the bail-out of a failing bank where investors take a loss rather than governments and taxpayers.