AUDIT, GOVERNANCE & STANDARDS COMMITTEE	18 November 2019

Treasury Management Mid-Year Review 2019/20

Final Decision-Maker	Audit, Governance & Standards Committee
Lead Head of Service/Lead Director	Chris Hartgrove – Interim Head of Finance
Lead Officer and Report Author	John Owen – Finance Manager
Classification	Public
Wards affected	All

Executive Summary

This report sets out the activities of the Treasury Management Function for the first 6 months of the 2019/20 financial year in accordance with CIPFA's Code of Practice on Treasury Management in Local Authorities.

This report makes the following recommendations to this Committee:

That:

1. The position of the Treasury Management Strategy as at 30 September 2019 be noted.
2. No amendments to the current procedures are necessary as a result of the review of activities in 2019/20.

Timetable	
Meeting	***Date***
Audit, Governance & Standards Committee	18 November 2019

Treasury Management Mid-Year Review 2019/20

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The Treasury Management Function ensures the safeguard of Council finances and the liquidity of funds when liabilities become due to support the strategic plan objectives.	Interim Head of Finance
Cross Cutting Objectives	The report recommendations supports the achievements of all the cross cutting objectives as stated above.	Interim Head of Finance
Risk Management	Covered in the risk section of this report.	Interim Head of Finance
Financial	This report relates to the financial activities of the council in respect of treasury management and specific financial implications are therefore detailed within the body of the report.	Section 151 Officer & Finance Team
Staffing	None.	Interim Head of Finance
Legal	The legal implications are detailed within the body of the report which is compliant with statutory and legal regulations such as the CIPFA Code of Practice on Treasury Management in Local Authorities.	Team Leader (Corporate Governance), MKLS
Privacy and Data Protection	None	Policy and Information Team
Equalities	The recommendations do not propose a change in service therefore will not require an equalities impact assessment	Equalities and Corporate Policy Officer
Public Health	We recognise that the recommendations will not negatively impact on population health or that of individuals.	Public Health Officer
Crime and Disorder	None	Interim Head of Finance
Procurement	None	Interim Head of Finance Section 151 Officer

2. INTRODUCTION AND BACKGROUND

2.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

2.2 The Authority's treasury management strategy for 2019/20 was approved at Council on 27th February 2019. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Authority's treasury management strategy.

2.3 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

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 the 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, (stewardship 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 to a specific named body. For this Council the delegated body is the Audit, Governance and Standards Committee.

2.4 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 part of the 2019/20 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2019/20;
- A review of the Council's borrowing strategy for 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20.

2.5 Economics and interest rates

2.5.1 The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

2.5.2 As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

2.5.3 With regard to the labour market, despite the contraction in quarterly GDP growth of -0.2% quarter on quarter, (+1.3% year on year), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As 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. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

2.5.4 The Council's treasury advisor, Link Asset Services, has provided the following forecast. This forecast includes the increase in margin over gilt yields of 100bps introduced on 9.10.19.

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

2.5.5 The above forecasts have been based on an assumption that an agreed deal on Brexit is implemented. In the run-up to a General Election, this remains a key assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks and months.

2.5.6 It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019. In its meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That is shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

2.5.7 There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields.

2.6 Treasury Management Strategy Statement and Annual Investment Strategy Update

2.6.1 The Treasury Management Strategy Statement, (TMSS), for 2019/20 was approved by this Council on 28th February 2019. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

2.7 Investment Portfolio

2.7.1 The Council held £27.98m of investments as at 30th September 2019 (£15.0m at 31 March 2019) and the investment portfolio yield for the first 6 months of the year is 0.82%. The Council will aim to achieve optimum return on investments after having satisfied proper levels of security and liquidity. It was agreed to keep investments short term with highly credit rated financial institutions, using the creditworthiness list, information provided by the Council's investment advisors, Link Asset Services, along with information sharing from other local authorities and being mindful of market intelligence. A full list of investments can be found in **Appendix A**.

2.7.2 The Director of Finance and Business Improvement confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2019/20.

2.7.3 The Council's investment return as at 30th September 2019 is £106,000 against a budgeted amount for the year of £150,000. The performance for the year to date is in line with the budget.

2.7.4 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

2.8 Prudential and Treasury Indicators

2.8.1 It is a statutory duty for the Council to determine and keep under review 'Affordable Borrowing Limits.' During the first six months of financial year 2019/20, the Council has operated within the prudential and treasury indicators set out in the Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury indicators can be found in **Appendix B**.

2.9 Borrowing

2.10 The Council's capital financing requirement (CFR) for 2019/20 is £52.6m. 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.

2.11 The Council has yet to enter into the borrowing market and funded all expenditure from its internal balances, due to the fact there has been no need to borrow as at 30th September 2019 and the cost of carry and credit risk would increase.

2.12 It is predicted that the Council will borrow before the end of the financial year. Given the recent increase in rates charged by the PWLB, the Council would investigate a range of possible sources of borrowing in terms of finance and risk.

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3. AVAILABLE OPTIONS

3.1 The Audit, Governance and Standard Committee agrees that no amendments to the current procedures are necessary as a result of a review of activities of the first 6 months of 2019/20.

3.2 The Audit, Governance and Standard Committee proposes changes to the current procedures as a result of a review of activities with the first 6 months of 2019/20.

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4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

4.1 The Audit, Governance and Standard Committee agrees that no amendments to the current procedures are necessary as a result of a review of activities of the first 6 months of 2019/20 as there are no justifications to make any changes.

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5. RISK

5.1 Detailed risk management policies are included within the Treasury Management Practices to which the Council adheres to. A brief description of these risks along with the Council's actions to mitigate these risks are as follows:

- **Liquidity Risk** - Liquidity risk is the risk that cash not be available when it is required. The Council has sufficient standby facilities to ensure that there is always sufficient liquidity to deal with unexpected occurrences. The Council also has an overdraft facility with Lloyds Bank of £500,000 plus the option of short term borrowing.

- **Interest Rate Risk** - Interest rate risk is the risk that unexpected changes in interest rates expose the Council to greater costs or a shortfall in income than have been budgeted for. The Council will seek to minimise this risk by seeking expert advice on forecasts of interest rates from treasury management consultants and agreeing with them its strategy for the coming year for the investment and debt portfolios. It will also determine appropriate limits and trigger points which are set out in the annual Treasury Management Strategy Statement .

- **Exchange Rate Risk** - Exchange rate risk is the risk that unexpected changes in exchange rates expose the Council to greater costs or a shortfall in income than have been budgeted for. The Council has a minimal exposure to exchange rate risk as it has no powers to enter into loans or investments in foreign currency for treasury management purposes.

- **Inflation Risk** - Inflation risk is the risk that unexpected changes in inflation expose the Council to greater costs or a shortfall in income than have been budgeted for. Inflation both current and projected will form part of the debt and investment decision-making criteria both within the strategy and operational considerations

- **Credit and Counterparty Risk** - Credit and counter-party risk is the risk of failure by a third party to meet its contractual obligations under an investment, loan or other commitment, especially one due to deterioration in its creditworthiness, which causes the Council an unexpected burden on its capital or revenue resources. Treasury management staff will add or delete counterparties to/from the approved counterparty list in line with the policy on criteria for selection of counterparties. Due to volatility of the financial market, Treasury Management staff will use information from various sources, eg brokers, Treasury Management Consultants and other local Authority experience to determine the credit worthiness of an institution and to decide if funds are at risk and agree best course of action with Director of Finance & Business Improvement.

- **Refinancing Risk** - Refinancing risk is the risk that when loans or other forms of capital financing mature, that they cannot be refinanced where necessary on terms that reflect the assumptions made in formulating revenue and capital budgets. The Council is currently debt-free, however it will soon be looking to borrow to fund its capital programme in the coming years. In considering the affordability of its capital plans, the Council will consider all the resources currently available/estimated for the future together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the two following years and the impact these will have on council tax. It will also take into account affordability in the longer term beyond this three year period.

- **Legal and Regulatory Risk** - Legal and regulatory risk is the risk that either the Council, or a third party which it is dealing with in its treasury management activities, acts outside of its legal powers or regulatory requirements and as a result the Council incurs loss. The treasury management activities of the Council shall comply fully with legal statute, guidance, Codes of Practice and the regulations of the Council. The Authority will provide written evidence of its powers and authorities to any counterparty that requests us to do so. Counterparties will also provide their details to the Authority as a matter of course.

- **Fraud, Error and Corruption Risk** - Fraud, error and corruption risk is the risk that the Council may fail to employ adequate systems, procedures and other arrangements which identify and prevent losses through such occurrences. The Council will seek to ensure an adequate division of responsibilities and maintenance at all times of an adequate level of internal checks which minimises such risks along with maintaining records of all treasury management transactions so that there is a full audit trail and evidence of the appropriate checks being carried out. Delegated members of staff have the responsibility for the treasury management function for the Council and the Director of Finance & Business Improvement authorises who these are. The Council also has a Fidelity Guarantee insurance policy with Zurich Insurance which covers against loss of cash through fraud or dishonesty of employees.

6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

6.1 None.

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7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

7.1 The Audit, Governance and Standards Committee agree that no amendments to current procedures of the Treasury Management function are necessary, there will be no further action.

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8. REPORT APPENDICES

8.1 The following documents are to be published with this report and form part of the report:

- Appendix A: List of Council Investments as at 30th September 2019
- Appendix B: Prudential and Treasury Indicators

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9. BACKGROUND PAPERS

9.1 None