Renfrewshire Council

To: **Finance Resources and Customer Services Policy Board**

On: **14 November 2018**

Report by: **Director of Finance and Resources**

Heading: **Treasury Management Mid-year Review 2018-2019**

1. Summary

1.1 This mid-year report has been prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services Code of Practice (revised November 2009) which was adopted by Council on 3 March 2010. The report covers the following:

- an economic update for the first six months of 2018-2019;
- a review of the Treasury Management Strategy Statement 2018-2019, incorporating the annual investment strategy;
- a review of the Council's investment portfolio for 2018-2019;
- a review of the Council's borrowing strategy for 2018-2019; and
- a review of compliance with treasury management indicators for 2018-2019.

2. Recommendations

2.1 It is recommended that Members note the treasury management activity for the period 1 April 2018 to 19 October 2018.

3. Economic update

3.1 External economic review for the period April to October 2018

The following paragraphs outline a review of the economy over the first half of 2018-2019.

3.2 UK Consumer Price Inflation (CPI) for August rose to 2.7% for the 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.

3.3. The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 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 Bank Rate to 0.75%.

3.4. The escalating trade war between the US 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.

3.5 The 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.

3.6 **Financial markets:** 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 UK, German and US 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 LIBID rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

3.7 **Credit background:** 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 ringfencing. 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 S&P and to Aa3 from A1 by Moody's.

3.8 Ring-fencing of the big four UK banks, which requires the larger UK banks to separate their core retail banking activity from the rest of their business is almost complete. Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc, 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.

4. Regulatory update

4.1 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.

4.2 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. A Capital Strategy is being developed for approval by full Council early in 2019.

5 Outlook for the remainder of 2018/19

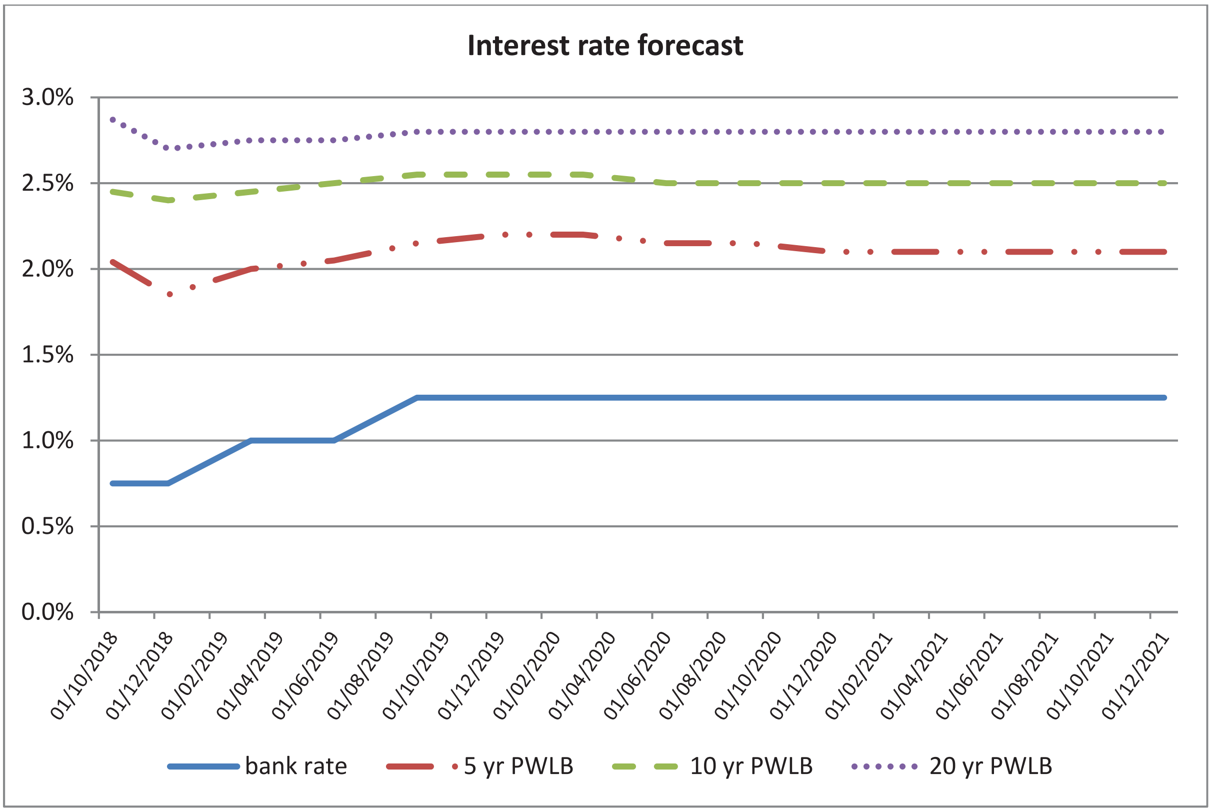
5.1 Having raised policy rates in August 2018 to 0.75%, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon.

5.2 The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that

(a) ultra-low interest rates can result in other economic problems and

(b) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise and cuts are required.

5.3 The Council's Treasury Advisers are Arlingclose Ltd and their central case is for Bank Rate to rise twice in 2019. The risks are weighted to the downside. The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average.



5.4 The view is that the UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

6 Review of the Treasury Management Strategy Statement 2018-2019 (incorporating annual investment strategy) as at 19 October 2018

6.1 The Treasury Management Strategy Statement for 2018-2019 was approved by Council on 2 March 2018. The Council's annual investment strategy, which is incorporated in the Treasury Management Strategy Statement, sets out the Council's investment priorities as follows:

- the security of capital and
- the liquidity of its investments.

6.2 The Council also aims to achieve the optimum returns on its investments commensurate with the proper levels of security and liquidity. Investments and borrowing during the first six months of the year have been in line with the strategy and there have been no changes to the policies set out in the Treasury Management Strategy Statement 2018-2019. The details in this report update the position in light of the updated economic position and budgetary changes already approved.

7 Review of borrowing and investments over the period 1 April 2018 to 19 October 2018

7.1 The Council's net borrowing position as at 19 October 2018 is shown in Appendix 1.

7.2 During the period 1 April 2018 to 19 October 2018 the Council's total external borrowings have decreased by £2.9 million to £225.21 million, due to the scheduled repayments of PWLB debt.

7.3 During the period 1 April 2018 to 19 October 2018, temporary investments have increased from £112.01 million to £167.65 million. The increase in investments is after financing the £2.9 million of debt repayment and reflects:

- the re-profiling of elements of the current capital programme;
- the "front-loading" (that is, more income being received in the early part of the year) of revenue support grant income and non-domestic rates pool receipts.

7.4 The Director of Finance and Resources confirms that, during the period 1 April 2018 to 19 October 2018, the approved limits set out within the annual investment strategy sections of the Treasury Management Strategy Statement 2018-2019 were complied with. The Council only invested with institutions listed in the Council's approved lending list. Similarly, only permitted investment vehicles were used, mainly call accounts, fixed term deposits and money market funds.

7.5 In accordance with CIPFA's Treasury Management in the Public Services Code of Practice, 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.

7.6 The table below shows the average interest rate achieved by the Council on its temporary investments during the period 1 April 2018 to 19 October 2018. The table also shows for comparison the benchmark comparator, which is the average 7-day LIBID rate (uncompounded). (The 7-day LIBID rate is the London Interbank Bid Rate, being the rate at which a bank is willing to borrow from other banks, for borrowings of a maturity of seven days.)

Interest rates achieved on investments	Average value of investments	Actual rate of return	Benchmark return
Internally managed investments	£145.10m	0.611%	0.43%

7.7 **Debt rescheduling**

Debt rescheduling opportunities have been limited in the current economic climate and it is not anticipated that this is likely to change over the short to medium term. However, in conjunction with the Council's treasury advisors, the service will remain alert to any opportunities which may arise.

8 Review of compliance with treasury management indicators for 2018-2019

8.1 During the period 1 April 2018 to 19 October 2018 the Council complied with the approved treasury management indicators as set out in the Treasury Management Strategy Statement 2018-2019. These indicators relate to:

- interest rate exposures: the upper limit on the proportion of investments which are exposed to fixed interest rates and the upper limit on the proportion of investments which are exposed to variable interest rates;
- the maturity structure of borrowing: the lower and upper limits on the proportion of investments which fall into each maturity band.

8.2 In addition to the treasury management indicators referred to at 6.1, there are two *prudential* indicators (as set out in the Prudential Framework for Capital Finance 2016-2018 and Treasury Management Strategy Statement 2017-2018, approved by Council on 1 March 2018) which are of particular relevance to the Council's treasury management strategy:

- operational boundary for external debt;
- authorised limit for external debt.

8.3 During the period 1 April 2018 to 19 October 2018 the Council operated within the operational boundary for external debt, and within the authorised limit for external debt. These indicators, along with the Council's actual external debt, are shown in Appendix 2.

Implications of the Report

1. **Financial** – As described in the report. The Treasury Management Strategy Statement and treasury management indicators assist in providing assurance that the Council's treasury management activities and longer term plans are affordable, prudent and sustainable.

2. **HR & Organisational Development** – none

3. **Community Planning** – none

4. **Legal** – none

5. **Property/Assets** – none

6. **Information Technology** – none

7. **Equality & Human Rights** – Recommendations contained within this report have been assessed in relation to their impact on equalities and human rights. No negative impacts on equality groups or potential for infringement of individuals' human rights have been identified arising from the recommendations contained in the report because it is for noting only. If required following implementation, the actual impact of the recommendations and the mitigating actions will be reviewed and monitored, and the results of the assessment will be published on the Council's website.

8. **Health & Safety** – none

9. **Procurement** – none

10. **Risk** – The Treasury Management Strategy Statement and treasury management indicators provide a framework to take forward the Council's treasury activities in the context of the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. This mid-year review report demonstrates that the treasury management activities carried out during the period 1 April 2018 to 19 October 2018 have been consistent with the Treasury Management Strategy Statement 2018-2019 and have complied with the treasury management indicators set out in the Strategy Statement

11. **Privacy Impact** – none

12. **COSLA Policy position** - none

List of Background Papers
None

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Appendix 1

Borrowing and investment position as at 19 October 2018

	balance at 01-Apr-18	new borrowing in 2018-2019	principal repayments	debt restructuring	net cash movements	balance at 19-Oct-18
Long term borrowings						
PWLB - fixed	175,197,092.97	-	(2,899,704.80)	-	-	172,297,388.17
PWLB - variable	-	-	-	-	-	-
Market loans	52,916,000.00	-	-	-	-	52,916,000.00
	228,113,092.97	-	(2,899,704.80)	-	-	225,213,388.17
Short term borrowings						
Temporary loans	-	-	-	-	-	-
	-	-	-	-	-	-
Total external borrowings	228,113,092.97	-	(2,899,704.80)	-	-	225,213,388.17
Investments						
Fixed term deposits	98,000,000.00	-	-	-	26,000,000.00	124,000,000.00
Notice accounts	0.00	-	-	-	0.00	0.00
Call accounts	2,424,000.00	-	-	-	12,576,000.00	15,000,000.00
Money market funds	11,590,000.00	-	-	-	17,060,000.00	28,650,000.00
Total investments	112,014,000.00	-	-	-	55,636,000.00	167,650,000.00
Net borrowing	116,099,092.97	-	(2,899,704.80)	-	55,636,000.00	57,563,388.17

Appendix 2

Treasury Management Indicators as at 19 October 2018

	2018-2019 estimate	2018-2019 probable	2019-2020 estimate	2020-2021 estimate
Authorised limit for external debt	£430m	£384m	£512m	£573m
Operational boundary for external debt	£413m	£348m	£490m	£550m
Actual external debt at 19 October 2018	n/a	£302.39m	n/a	n/a
Upper limit for fixed interest rate exposure (borrowing) expressed as percentage of total net outstanding principal	100%	n/a	100%	100%
Upper limit for variable interest rate exposure (borrowing) expressed as percentage of total net outstanding principal	25%	n/a	25%	25%

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	new borrowing in 2018-2019		total of all borrowing	
	value	maturity structure	upper limit	actual at 19 Oct 2018
Maturity structure of fixed rate borrowing				
under 12 months	0	0%	15%	0.28%
12 months and within 24 months	0	0%	15%	1.47%
24 months and within 5 years	0	0%	45%	1.75%
5 years and within 10 years	0	0%	50%	4.82%
10 years and above	0	0%	100%	91.68%