Subject:	**TREASURY MANAGEMENT QUARTER TWO REPORT 2017/18**
Meeting and Date:	**Governance – 7th December 2017** **Council – 31st January 2018**
Report of:	**Mike Davis – Director of Finance, Housing & Community**
Portfolio Holder:	**Councillor Mike Connolly – Portfolio Holder for Corporate Resources and Performance**
Decision Type:	**Non-Executive**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 30th September 2017 (Q2) and an update of activity to date.
Recommendation:	That the report is received

1. **Summary**

1.1 The Council's investment return for the six-month period to September was 0.53%, which outperformed the benchmark[1] by 0.32%. Actual interest and dividends income to the end of September was £188k, which is a favourable variance compared with the year-to-date (YTD) budget of £153k. The Council's projected investment return for 2017/18 is £398k, which is £93k better than the original budget estimate of £305k. This improvement is due to the estimated dividend from new investments in the CCLA Property Fund, with an actual dividend received for the quarter of £60k.

1.2 As of 1st April 2017, the Council has appointed Arlingclose Limited as its treasury advisors, and they have proposed various investment options that would help to improve returns and spread risk. At the Investment Advisory Group on 4th October the group considered the pooled investment funds suggested by Arlingclose. It was proposed to deposit up to £28m into a number of these funds to improve income. £6m has already been placed in the CCLA property fund, with a return of 4.57%.

1.3 However, a new International Financial Reporting Standard (IFRS9) is about to be implemented, which could force us to charge unrealised gains or losses on the capital value of such funds to the General Fund revenue budget each year, even if we propose to hold the funds for a longer period of time and avoid selling if the capital value is lower than the price paid. It is often normal to pay a premium on purchasing such funds, as with the CCLA Property Fund, to take account of stamp duty and other costs but, over time, the capital value is expected to rise, based on past trends, so that capital losses are unlikely in the longer term. However, we currently recognise the dividend returns, paid each year, and credit these returns to our budget. We are awaiting further guidance from CIPFA as to whether there will be any statutory override for local authorities and will brief members again prior to going ahead, setting out any options to mitigate the impact of potential unrealised losses.

[1] The "benchmark" is the interest rate against which performance is assessed. DDC use the London Inter-Bank Bid Rate or LIBID, as its benchmark.

1.4 The forecast return of £398k for the full financial year does not currently allow for additional income from further investments in pooled funds, other than the £6m already invested in the CCLA property fund.

1.5 The Council remained within its Treasury Management and Prudential Code guidelines during the period.

2. Introduction and Background

2.1 CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2011; it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code.

2.2 Council adopted the 2017/18 Treasury Management Strategy (TMS) on 1st March 2017 as part of the 2017/18 Budget and Medium Term Financial Plan.

2.3 In order to comply with the CIPFA code referred to above, a brief summary is provided below, and Appendix 1 contains a full report from the Council's Treasury Management Advisors, Arlingclose.

2.4 Members are asked to note that in order to minimise the resource requirements in producing this report, Arlingclose's report has been taken verbatim. Treasury advisors generally use a more journalistic style than is used by our officers, but in order to avoid changing the meaning or sense of Arlingclose's work, this has not been edited out.

2.5 As at 30th September 2017, the Council's investment portfolio totalled £57.8m (see Appendix 2). However, some of this is shorter term, as significant funds sitting in the Dover Regeneration and Economic Development Reserve are earmarked for spending during 2017/18 and 2018/19 on the new Dover leisure centre and other approved capital projects. After these approved commitments, there should be £20m - £25m underlying core funds available for longer term investment, while the remainder of funds will need to be kept in shorter term instruments and bank accounts for cash-flow requirements and future capital projects (subject to project appraisals).

2.6 Whilst the Council has been reviewing the alternative investment options, any fixed deposits that matured were not reinvested but kept in call accounts until required, apart from the £5m deposit with Suffolk County Council which was rolled over for an extra month and a fixed term deposit of £5m that was made with Telford and Welkin Council at the end of August for three months. This was done due to portfolio balances temporarily reaching £72m.

3. Annual investment strategy

3.1 The investment portfolio, as at the end of September 2017, is attached at Appendix 2. Total balances held for investment and cash-flow purposes were £57.8m, rising to £58.0m at the end of October (see Appendix 4). The increase reflects normal cash-flow fluctuations arising from the timing of 'major preceptor' payments, which are made over twelve months, while the Council Tax receipts that fund them typically come in over the ten months to January and then decline.

3.2 Since the end of the September quarter, the Suffolk County Council deposit has matured and has not been reinvested.

3.3 The Bank of England raised the base rate from 0.25% to 0.5% on the 2nd November and this has resulted in a slight improvement in the returns on the money market funds and NatWest SIBA account.

3.4 All other funds are currently being held in call accounts, and the process of opening new investment fund accounts is progressing, but without yet committing to making further deposits, pending a member briefing on the IFRS9 issues in (1.3) above.

3.5 Cash-flow funds decreased from £18.5m at 30th June 2017 to £16.9m at 30th September 2017 (see Appendix 2), and then increased to £22.3m by the end of October 2017 (see Appendix 4), although this will reduce due to approved capital spend in the coming weeks. The movement in cash-flow funds in the quarter (and since) reflects increases for deposits maturing and not being re-invested in term deposits or longer term instruments, less decreases for the purchase of an investment property (£16m in September) and the second tranche of the investment with CCLA Property Fund (£3m in July).

3.6 The Gilt holding of £1.9 million transferred to King and Shaxson following Investec's withdrawal from the segregated funds market will be held until its maturity date of July 2018

4. Economic background

4.1 The report attached (Appendix 1) contains information up to the end of September 2017; since then we have received an update from Arlingclose, included below. Please note that any of their references to quarters are based on calendar years:

Introduction

4.2 *In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.*

4.3 *Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.*

UK Data

4.4 *The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.*

4.5 *Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.*

4.6 *Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.*

4.7 *Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.*

4.8 *The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.*

US Data

4.9 *The US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.*

Global

4.10 *Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.*

4.11 *Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government.*

4.12 *High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.*

Brexit

4.13 *The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.*

Interest Rates & Financial Indicators

4.14 *The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.*

4.15 *Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.*

Regulatory

4.16 *Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.*

4.17 *The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.*

5. **Net Borrowing**

5.1 The Council's borrowing portfolio is attached at Appendix 3. No new borrowing was undertaken during the quarter.

6. **Debt Rescheduling**

6.1 At this time it is not of benefit to the Council to consider rescheduling of its long-term debt, as advised by Arlingclose.

7. **Compliance with Treasury and Prudential Limits**

7.1 The Council has operated within the treasury limits and Prudential Indicators, and in compliance with the Council's Treasury Management Practices.

8. **Corporate Implications**

8.1 Comment from the Section 151 Officer: Finance have no further comments to make. (SG)

8.2 Comment from the Solicitor to the Council: The Solicitor to the Council has been consulted in the preparation of this report and has no further comments to make.

8.3 Comment from the Equalities Officer: This report does not specifically highlight any equalities implications, however in discharging their responsibilities members are requires to comply with the public sector duty as set out in section 149 of the Equality Act 2010 http://www.legislation.gov.uk/ukpga/2010/15

Appendices

Appendix 1 – Arlingclose Treasury Management Report for Quarter Two

Appendix 2 – Investment portfolio as at 30 September 2017

Appendix 3 – Borrowing portfolio as at 30 September 2017

Appendix 4 – Investment portfolio as at 31 October 2017

Background Papers

Medium Term Financial Plan 2017/18 – 2020/21

Revised 2017/18 Treasury Management Strategy (Council 19th July 2017)

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Date: 24th November 2017