Subject:	**TREASURY MANAGEMENT YEAR END REPORT 2017/18**
Meeting and Date:	**Governance – 30 July 2018** **Cabinet – 10 September 2018** **Council – 31 October 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-Key Decision**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the financial year ended 31 March 2018 (Q4) and an update of activity to date.
Recommendation:	That the report is received

1. Summary

1.1 This report covers the outturn for the year ending March 2018. The main points to note are that, while we are outperforming the benchmark, interest rates are low, and we are working to get the best returns we can but, nonetheless, we are likely to see reduced income from bank and other short-term deposits in the future that will be an additional budget pressure. To mitigate this, we have appointed new treasury advisers, Arlingclose Ltd, from 1 April 2017, to explore alternative treasury management options.

1.2 As at 31 March 2018, the Council's investment portfolio totalled £43.4m (see Appendix 2). Additionally, cashflow funds were lower than anticipated (£3.1m at 31 March 2018) due to normal year end cashflow fluctuations. Cashflow funds have since increased (to £9.5m at 30 June 2018).

1.3 The Council has remained within its Treasury Management guidelines. The Council has complied with the Prudential Code guidelines during the period.

1.4 The Council's investment return for the year was 0.84%, which outperformed the benchmark1 by 0.25%. The Council's budgeted investment return for 2017/18 was £305k, and performance for the year was £525k, which is a favourable variance of £220k. This is due to investing in long-term pooled investment funds that generate a much better rate of return than call accounts and money market funds.

1.5 During the last quarter of 2017/18, £8 million was invested with Payden and Rygel. This was in addition to £18m invested in other pooled funds during the previous quarters, following the recommendations of our treasury advisers, which were considered at the Investment Advisory Group on 4 October 2017. Accordingly, £6m

[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.

was invested in the CCLA property fund, £6 million was invested in Colombia Threadneedle's strategic bond fund, and £6 million was invested in Investec's diversified income fund (all funds forecast to generate annual returns exceeding 4%).

1.6 A new International Financial Reporting Standard (IFRS9), due to be implemented from 2018/19, 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. In the meantime, to reduce the potential impact of this on the General Fund, the 2018/19 budget proposes setting aside £2m in the Dover Regeneration and Economic Development Reserve as a prudent provision for any unexpected potential fluctuations in the capital value of investments.

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 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 advisers, Arlingclose Ltd.

2.3 Members are asked to note that in order to minimise the resource requirements in producing this report, Arlingclose's report has been taken verbatim with regards to their explanation of the economic background. Generally, treasury advisers 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.

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

3. Annual Investment Strategy

3.1 The investment portfolio, as at the end of March 2018, is attached at Appendix 2. Total balances held for investment and cash-flow purposes were £46.5m, rising to £48m at the end of June (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 The Gilt holding of £1.9 million remains with King and Shaxson and will be held until its maturity date of 22 July 2018, at which point it is proposed to reinvest it in a pooled investment fund.

3.3 Since the end of the quarter, three deposits have matured. The £7.5m Birmingham City Council deposit that matured on 27 April 2018 has been rolled over for a further three months until 27 July at a rate of 0.70%. The £3m with Mid Suffolk District Council has also been rolled over for a further three months until 15 August at a rate of 0.55%. The £5m deposit with Suffolk County Council was returned to cash flow on maturity.

3.4 Cash flow funds decreased from £13m at 31 December 2017 to £3.1m at 31 March 2018 (see Appendix 2). This is normal and expected, as there are reduced council tax receipts in February and March (generally paid over 10 months from April to January), while preceptors on the Collection Fund are paid their shares of Council Tax income evenly over the year. There was also a further six-monthly PWLB loan instalment of £2.35m paid for the 2017/18 year at the end of March 2018. Cashflow funds have increased from £3.1m at the end of March 2018 to £9.5m at the end of June 2018 (see Appendix 4).

4. Economic Background

4.1 The report attached (Appendix 1) contains information up to the end of March 2018; since then we have received the following update from Arlingclose. Please note that any of their references to quarters are based on *calendar* years:

Introduction

4.2 The anticipated May 2018 interest rate rise did not materialise. It is now widely expected to happen at the next MPC meeting in August. UK economic data continues to remain positive although there is still some uncertainty with how Brexit will impact this.

UK Data

4.3 The MPC minutes supported Arlingclose's view that the MPC will seek to raise the Bank Rate in the short term. While the majority of the Committee voted to maintain Bank Rate at 0.5% as expected, the unexpected vote for a rate hike by the Bank's chief economist increased the probability of a near term rate rise.

4.4 The projected outlook for the UK economy, however, means that monetary tightening in the current environment could be a potential policy error.

4.5 The MPC has a definite bias towards tighter monetary policy. While policy makers are wary of domestic inflationary pressures over the next two years, Arlingclose believe that MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and that 2) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise.

4.6 The current soft UK economic environment prompted the MPC not to tighten policy in May. The economic data since then has been mixed, but suggests that GDP growth will recover somewhat in Q2 2018 after the weak expansion in Q1. The MPC appears to be focused on data sets that support monetary tightening, at the expense of others that show a less healthy economic environment.

4.7 As noted previously, the Bank has moved the goalposts around both the forecast horizon and supply capacity of the UK economy in order to justify monetary tightening even in a below-trend economic environment.

4.8 Our 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.

4.9 The initial estimate of GDP growth in Q1 was 0.1%, since revised to 0.2%. The estimate is lower than predicted in February and the Bank of England believes the adverse weather conditions prevalent in February and March resulted in the weaker growth. The MPC expect GDP growth to be around 1.75% for the year.

4.10 CPI inflation fell to 2.5% in March and has fallen further to 2.4% in June. CPI inflations is anticipated to fall back to target quicker than expected.

4.11 Wage growth and domestic cost pressures are rising gradually as was expected. The rate at which productivity levels are expected to grow is projected to remain well below pre-crisis rate and the UK economy has very limited degree of slack.

Bank Base Rate

4.12 Arlingclose expects the Bank of England will raise the base rate once in 2018 and twice in 2019.

BANK RATE	
Q2 2018	0.50%
Q3 2018	0.75%
Q4 2018	0.75%
Q1 2019	1.00%

5. New Borrowing

5.1 The Council's borrowing portfolio is attached at Appendix 3. No new external borrowing was taken out in 17/18 as internal borrowing has been used to fund capital expenditure in the short term.

6. Debt Rescheduling

6.1 At this time it is not of benefit to the Council to consider rescheduling any of its long-term debt.

7. Compliance with Treasury and Prudential Limits

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

Appendices

Appendix 1 – Arlingclose treasury management outturn report for 2017/18

Appendix 2 – Investment portfolio as at 31 March 2018

Appendix 3 – Borrowing portfolio as at 31 March 2018

Appendix 4 – Investment portfolio as at 30 June 2018

Background Papers

Medium Term Financial Plan 2017/18 – 2020/21

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