REPORT TO:	**AUDIT COMMITTEE**		
DATE:	12 November 2018		
TITLE:	**MID YEAR REVIEW TREASURY REPORT 2018/2019**		
TYPE OF REPORT:	Review		
PORTFOLIO(S):	Cllr Brian Long		
REPORT AUTHOR:	Toby Cowper		
OPEN/EXEMPT	Open	WILL BE SUBJECT TO A FUTURE CABINET REPORT:	*No*

REPORT SUMMARY/COVER PAGE

PURPOSE OF REPORT/SUMMARY:

Summary

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (2011) and remains fully compliant with its requirements.

One of the primary requirements of the Code is receipt by Council of a Mid-Year Review Report.

The Mid-Year Review Report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- A review of the Treasury Management Strategy;
- The Council's capital expenditure (prudential indicators);
- An economic update for the first six months of 2018/2019 – Appendix 5.

RECOMMENDATIONS:

Audit Committee is asked to review the report and the treasury activity.

REASONS FOR RECOMMENDATIONS:

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (2011) and remains fully compliant with its requirements.

One of the primary requirements of the Code is:

Receipt by Audit Committee of a Mid-Year Review Report.

1. The 2018/2019 Mid-Year Review

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Council's Code of Practice on Treasury Management require that the Audit Committee consider a Mid-Year Review Report.

1.2 During the first 6 months of the year the Council maintained a cautious approach to investment and management of debt.

1.3 The Council's portfolio position as at 30 September 2018 was:

	31 March 2018 Actual £million	30 September 2018 Actual £million
Borrowing	13.80	17.70
Investments	(15.25)	(16.40)
Net Position	**(1.45)**	**1.30**

1.4 The Council held **£16.4m** of investments (including temporary cash flow) as at 30 September 2018 and the investment portfolio yield for the first six months of the year is 1.20**%.**

1.5 Details of the 'Treasury Benchmarking Group' can be found in *Appendix 1,*

Budgeted Interest Receivable	Actual Interest Received
(£168,940)	(£173,984)

1.6 During the first 6 months of 2018/2019 interest on external debt was paid at an average rate of 2.56%.

Budgeted Interest Payable	Actual Interest Paid
£280,000	£195,096

Details of the investment portfolio as at the 30 September 2018 can be found in *Appendix 2*

Details of the borrowing portfolio as at the 30 September 2018 can be found in *Appendix 3*

2. Local Property Investments Fund

2.1 On the 31 January 2017 Cabinet approved the 'Capital and Local Property Investment Fund Strategy 2017-2021. An amendment to this strategy will be going to Cabinet on the 17 October 2018.

2.2 Investments to date:

Property	Capital Expenditure to date	Return achieved
Burnham Market bungalow	£314,000	(TBC)

3. Compliance with Treasury Limits

3.1 During the financial year to September 2018, the Council operated within the treasury limits and prudential indicators set out in the Council's Treasury Policy Statement 2018/2019 and annual Treasury Strategy Statement 2018/2019. The mid-term review of the prudential indicators is shown in *Appendix 4.*

4. Mid-Year Review Summary

- The Treasury Management Strategy Statement is still fit for purpose.
- The Council held £16.40m of investments as at 30 September 2018.
- The Council held £17.70m of external debt as at 30 September 2018.
- During the first six months of the year, no debt rescheduling was undertaken.
- The Deputy Chief Executive confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/2019.
- During the financial year to date the Council has operated within the treasury limits and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

5. Economic update

An economic update provided by Link Asset Services can be found in *Appendix 5*

6. Financial Implications

6.1 The financial implications of the borrowing and investment strategy are reflected in the financing adjustment figure included in the Financial Plan 2017/2022 approved at Council on 22 February 2018 and updated as reported in the Budget Monitoring reports.

7. Risk Management Implications

7.1 There are elements of risk in dealing with the treasury management function although the production and monitoring of such controls as prudential indicators and the treasury management strategy help to reduce the exposure of the Council to the market. The costs and returns on borrowing and investment are in themselves a reflection of risk as seen by the market forces.

8. Policy Implications

8.1 There are no changes in the Treasury Management policy at present.

9. Statutory Considerations

9.1 The Council must set prudential indicators and adopt a Treasury Management Strategy and Annual Investment Strategy.

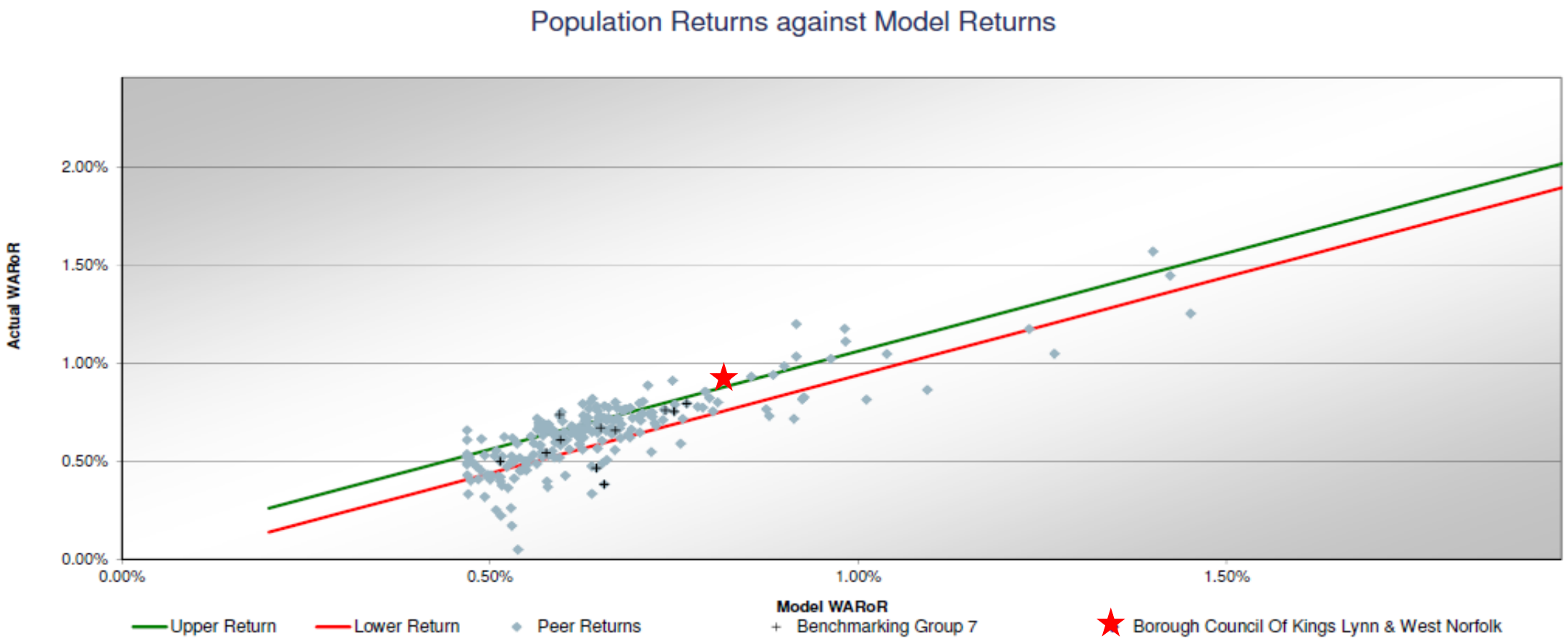
10. Access to Information

The Budget 2017/2022 – The Financial Plan
Capital Programme 2017/2022
Treasury Management Strategy and Annual Investment Strategy 2018/2019
Budget Monitoring reports 2018/2019
Link Asset Services Monthly Investment Analysis Review
Investment Portfolio Benchmarking Analysis June 2018
Capital Strategy 2017/2022
Capital and Local Property Investment Fund Strategy 2017-2021

Treasury Benchmarking Group **APPENDIX 1**

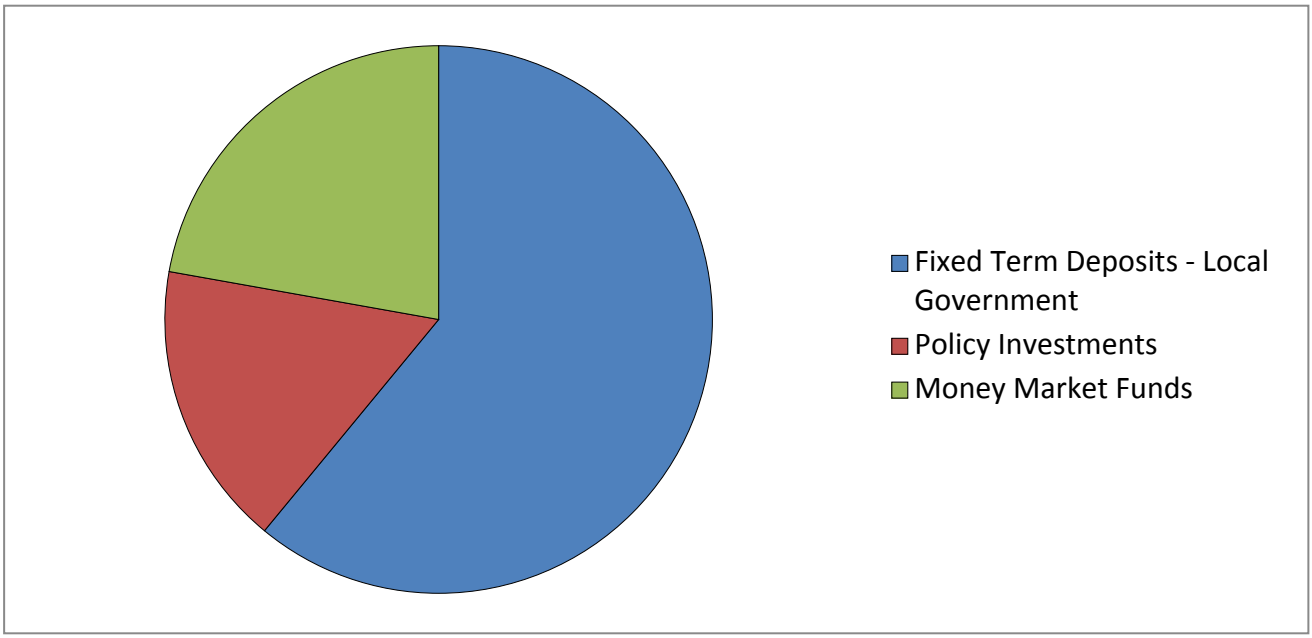
The Council is a member of a Treasury Benchmarking Group, where Link Asset Services clients from neighbouring authorities (including those in Norfolk, Suffolk and Cambridgeshire) meet to discuss treasury instruments relevant to their authority and discuss ideas for borrowing and investments.

All authorities want to try to maximise their returns, whilst maintaining good credit quality and security during the difficult financial climate. In addition to this, percentage rate returns are disclosed at each quarterly meeting.



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
rough Council Of Kings Lynn & West Nor	0.92%	0.82%	0.10%	0.76%	0.88%	Above

Investment Portfolio as at 30 September 2018 **APPENDIX 2**



Institution	Principal £	Start Date	End Date	Rate %	Ratings
BNP (Banque Nationale de Paris) – Money Market Fund*	3,640,000	N/A	N/A	0.68	AAA
Barnsley Metro BC	2,000,000	21/09/2017	21/09/2020	0.92	AA
Dudley Metro BC	3,000,000	04/04/2018	06/04/2020	1.08	AA
Cheshire West and Chester	2,000,000	19/01/2018	20/01/2020	1.00	AA
Northamptonshire CC	3,000,000	23/04/2018	23/10/2020	1.25	AA
Total Investments	**13,640,000**				
Norfolk & Waveney Enterprise Services (LEP)*	2,750,000	Various	30/11/2018	1.80	
Gaywood Community Centre	10,200	20/07/2016	01/08/2021	1.00	
Total Investments other	**2,760,200**				
Total Overall Investments	**16,400,200**			**1.20**	

*MMF – denotes Money Market Fund used for daily cash flow purposes

Borrowing Portfolio as at 30 September 2018 **APPENDIX 3**

Institution	Principal £	Start Date	End Date	Rate
Cambridge and Peterborough Combined Authority	5,000,000	19/06/2018	21/01/2019	0.48%
Total Short Term	**5,000,000**			
Suffolk County Council Local Enterprise Partnership (LEP)	2,500,000	27/03/2014	30/11/2018	1.80%
Barclays	5,000,000	22/03/2007	21/03/2077	3.81%
Barclays	5,000,000	12/04/2007	14/04/2077	3.81%
Public Works Loan Board	200,000	15/09/2009	14/09/2019	2.92%
Total Long Term	**12,700,000**			
Total	**17,700,000**			**2.56%**

Prudential Indicators: **APPENDIX 4**

Net borrowing and the CFR	31 March 2018 Actual £million	30 September 2018 Actual £million
Borrowing	13.80	17.70
Investments	(15.25)	(16.40)
Net Position	**(1.45)**	**1.30**
Capital Financing Requirement	**39.34**	**28.59** (estimate for 2018/2019 year end)

In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2018/2019. This essentially means that the Council is not borrowing to support revenue expenditure. The Council has complied with this prudential indicator.

The Council's Capital Position and Associated Prudential Indicators

The capital programme 2018/2019 was updated for rephasing and amendments as part of the closedown of the accounts 2017/2018. The updated estimates were approved by Council on 25 June 2018 and are shown in the table below. The capital programme 2018/2019 has been revised as reported in the Monthly Monitoring reports.

Capital Expenditure **Service Head**	**Capital Programme 2018/2019 (Cabinet 25 June 2018)**	**Expenditure as at 30 September 2018**
	£'000	**£'000**
Major Projects	37,063	7,687
Central and Community Services	2,997	715
Commercial Services	3,804	793
Environment and Planning	8	0
Finance Services	119	47
Total Capital Programme	**48,871**	**9,242**

Budget Related Prudential Indicators – Revised	2018/2019 revised estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Capital Expenditure Approved at Cabinet 25 June 2018	43,847	25,935	5,467	3,076
Ratio of financing costs to net revenue stream (Equals net treasury cost ie cost of borrowing less the income from investments divided by the total of Government grant and total council tax).	4.28%	4.43%	4.67%	4.46%
Capital Financing Requirement (CFR) as at 31 March this reflects the Council's underlying need to borrow for capital purposes	28,588	13,481	10,930	10,501

Authorised / Operational Limit for external debt	2018/19 £'000	2019/20 estimate £'000	2020/21 estimate £'000	2021/22 estimate £'000
Authorised Limit for external debt	36,000	25,000	25,000	23,000
Operational Boundary for external debt	31,000	20,000	20,000	18,000

- The Authorised Limit represents the maximum limit beyond which borrowing is prohibited, and needs to be set and revised by Members.

- The Operational Boundary for External Debt is a working practice limit that is set lower than the Authorised Limit. In effect the authorised limit includes a degree of contingency in case of circumstances arising that take the limit above the operational limit.

Interest Rate Exposures (Limit on fixed and variable rate borrowing)	2018/2019 Upper %	2019/2020 Upper %	2020/2021 Upper %	2021/2022 Upper %
Limits on fixed interest rates based on net debt	100%	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%	40%

Maturity Structure of fixed interest rate borrowing	Lower	Upper	Portfolio Position as at 30 September 2018
Under 12 months	0%	100%	29.38%
12 months to 2 years	0%	100%	14.12%
2 years to 5 years	0%	100%	0%
5 years to 10 years	0%	100%	0%
10 years and above	0%	100%	56.50%

APPENDIX 5

Economic and interest rate update – Provided by Link Asset Services as at October 2018

UK. The first half of 2018/19 has seen UK **economic growth** post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase **Bank Rate** on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of **inflationary pressures**, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

As for the **labour market,** unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.) Given 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. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, but also an upturn in inflationary pressures. With inflation moving towards 3%, the Fed

increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

EUROZONE. Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

Interest rate forecasts

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a

medium term forecast. We do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. This is likely to lead to friction with the EU when setting the target for the fiscal deficit in the national budget. Unsurprisingly, investors have taken a dim view of this and so Italian bond yields have been rising.
- Austria, the Czech Republic and Hungary now form a strongly anti-immigration bloc within the EU while Italy, this year, has also elected a strongly anti-immigration government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position as a result of the rise of the anti-immigration AfD party. To compound this, the result of the Swedish general election in September 2018 has left an anti-immigration party potentially holding the balance of power in forming a coalition government. The challenges from these political developments could put considerable pressure on the cohesion of the EU and could spill over into impacting the euro, EU financial policy and financial markets.
- The imposition of trade tariffs by President Trump could negatively impact world growth. President Trump's specific actions against Turkey pose a particular risk to its economy which could, in turn, negatively impact Spanish and French banks which have significant exposures to loans to Turkey.
- Weak capitalisation of some European banks.
- Rising interest rates in the US could negatively impact emerging countries which have borrowed heavily in dollar denominated debt, so causing an investor flight to safe havens e.g. UK gilts.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- President Trump's fiscal plans to stimulate economic expansion causing a significant increase in inflation in the US and causing further sell offs of government bonds in major western countries.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.