REPORT TO:	**AUDIT COMMITTEE**		
DATE:	27 November 2017		
TITLE:	**MID YEAR REVIEW TREASURY REPORT 2017/2018**		
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 midyear 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 2017/2018 – 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 2017/2018 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 Councils portfolio position as at 30 September 2017 was:

	31 March 2017 Actual £million	30 September 2017 Actual £million
Borrowing	13.00	12.90
Investments	(27.26)	(23.10)
Net Position	**(14.26)**	**(10.20)**

1.4 The Council held **£23.10m** of investments (including temporary cashflow) as at 30 September 2017 and the investment portfolio yield for the first six months of the year is 0.68**%.**

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

Budgeted Interest Receivable	Actual Interest Received
(£158,925)	(£194,127)

1.6 During the first 6 months of 2016/2017 interest on external debt was paid at an average rate of 3.39%.

Budgeted Interest Payable	Actual Interest Paid
£280,000	£198,844

Details of the investment portfolio as at the 30 September 2017 can be found in *Appendix 2*

Details of the borrowing portfolio as at the 30 September 2017 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'

2.2 Investments to date:

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

3. Compliance with Treasury Limits

3.1 During the financial year to September 2017, the Council operated within the treasury limits and prudential indicators set out in the Council's Treasury Policy Statement 2017/2018 and annual Treasury Strategy Statement 2017/2018. 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 £23.10m of investments as at 30 September 2017.
- The Council held £12.90m of external debt as at 30 September 2017.
- During the first six months of the year, no debt rescheduling was undertaken.
- The Executive Director confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2017/2018.
- 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

Interest rates are predicted to rise to 0.5% in November 2017. Additional information 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 2016/2021 approved at Council on 23 February 2017 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

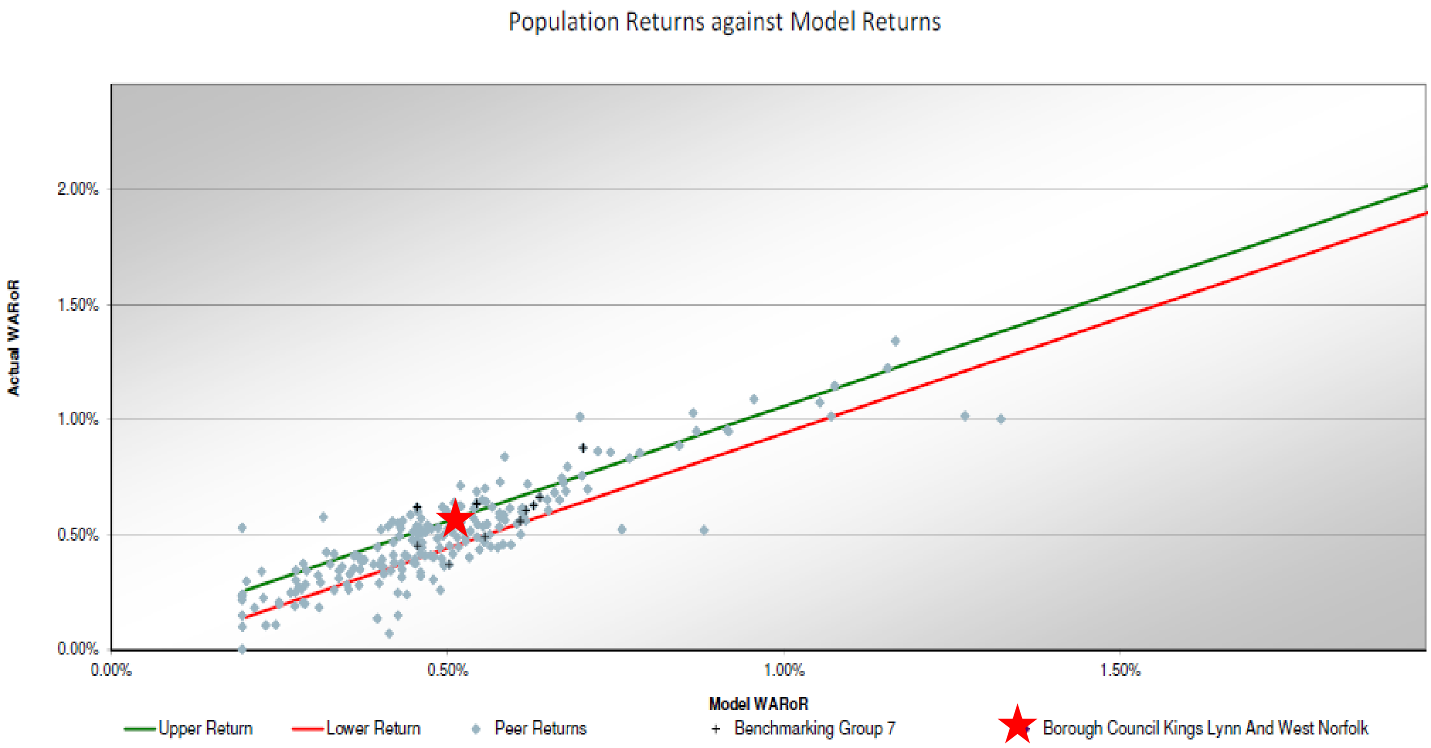
9.1 The Council must set prudential indicators and adopt a Treasury Management Strategy and Annual Investment Strategy.

10. Access to Information

The Budget 2016/2021 – The Financial Plan
Capital Programme 2016/2021
Treasury Management Strategy and Annual Investment Strategy 2017/2018
Budget Monitoring reports 2017/2018
Capita Asset Services Monthly Investment Analysis Review
Investment Portfolio Benchmarking Analysis September 2017
Capital Strategy 2016/2021
Capital and Local Property Investment Fund Strategy 2017-2021

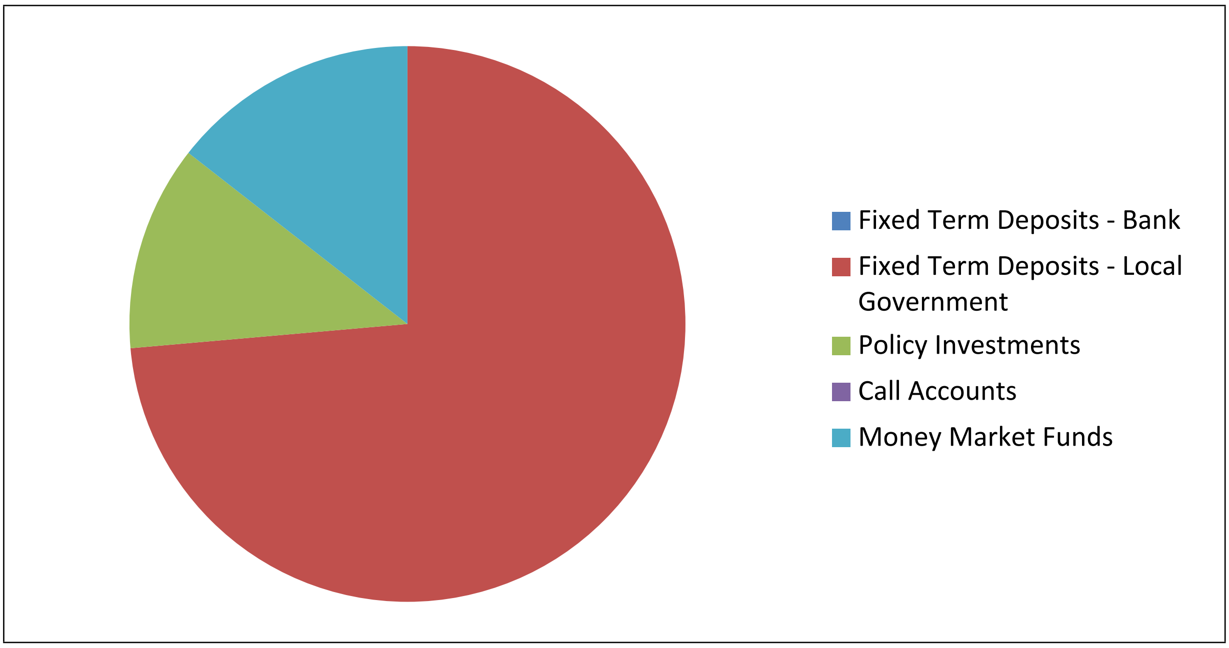
The Council is a member of a Treasury Benchmarking Group, where Capita Treasury clients from neighbouring authorities (including those in Norfolk, Suffolk and Cambridgeshire) meet to discuss treasury instruments relevant to their authority and discuss ideas for borrowing and investments.

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
Borough Council Kings Lynn And West Norfolk	0.56%	0.51%	0.05%	0.45%	0.57%	Inline

Investment Portfolio as at 30 September 2017 **APPENDIX 2**



Institution	Principal £	Start Date	End Date	Rate %	Ratings
BNP (Banque Nationale de Paris) – Money Market Fund	3,335,000	N/A	N/A	0.22	AAA
Fife Council	3,000,000	12/11/2015	13/11/2017	0.95	AA
Cheshire West & Chester Council	2,000,000	20/01/2016	19/01/2018	0.99	AA
Moray Council	2,000,000	23/08/2017	23/02/2018	0.30	AA
Great Yarmouth Borough Council	5,000,000	28/03/2017	27/03/2018	0.55	AA
Bury Metro Borough Council	3,000,000	21/04/2016	23/04/2018	1.00	AA
Barnsley metro Borough Council	2,000,000	21/09/2017	21/09/2020	0.92	AA
Total Investments	**20,335,000**			**0.68**	
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	**23,095,200**				

*MMF – denotes Money Market Fund used for daily cashflow purposes

Borrowing Portfolio as at 30 September 2017 **APPENDIX 3**

Institution	Principal £	Start Date	End Date	Rate
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	400,000	15/09/2009	14/09/2019	2.92%
Total	**12,900,000**			**3.39%**

Prudential Indicators: **APPENDIX 4**

Net borrowing and the CFR		
	31 March 2017 Actual £million	**30 September 2017 Actual £million**
Borrowing	13.00	12.90
Investments	(27.26)	(23.10)
Net Position	**(14.26)**	**(10.20)**
Capital Financing Requirement	**27.53**	**44.3** (estimate for 2017/2018 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 2017/2018. 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 2017/2018 was updated for rephasing and amendments as part of the closedown of the accounts 2016/2017. The updated estimates were approved by Council on 27 June 2017 and are shown in the table below. The capital programme 2016/2017 has been revised as reported in the Monthly Monitoring reports.

Capital Expenditure **Service Head**	**Capital Programme 2017/2018 (Cabinet 31 January 2017)** **£'000**	**Revised Capital Programme 2017/2018 (Cabinet 27 June 2017)** **£'000**	**Expenditure as at 30 September 2017** **£'000**
Major Projects	20,238	23,535	6,178
Central and Community Services	1,891	2,515	731
Chief Executive	50	21	0
Commercial Services	1,198	2,805	322
Environment and Planning	0	16	0
Finance Services	0	107	50
Total Capital Programme	**23,377**	**28,999**	**7,281**

Budget Related Prudential Indicators – Revised				
	2017/2018 revised estimate £000	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Capital Expenditure Approved at Cabinet 27 June 2017	28,999	29,266	19,573	4,714
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).	4.1%	3.9%	3.9%	3.9%
Capital Financing Requirement (CFR) as at 31 March this reflects the Council's underlying need to borrow for capital purposes	44,300	33,117	11,488	7,758

Authorised / Operational Limit for external debt				
	2017/2018 estimate £'000	2018/19 estimate £'000	2019/20 estimate £'000	2020/21 estimate £'000
Authorised Limit for external debt	52,000	42,000	19,000	15,000
Operational Boundary for external debt	50,000	40,000	17,000	13,000

- 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)				
	2017/2018 Upper %	2018/2019 Upper %	2019/2020 Upper %	2020/2021 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 2017
Under 12 months	0%	100%	0%
12 months to 2 years	0%	100%	0%
2 years to 5 years	0%	100%	22.4%
5 years to 10 years	0%	100%	0%
10 years and above	0%	100%	77.6%

APPENDIX 5

Economic and interest rate update – Provided by Capita Asset Services as at October 2017

UK. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. . The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.
The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

It therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

EU. Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

USA. Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

Chinese 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 is struggling to stimulate consistent significant 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, Capita Asset Services, has provided the following forecast:

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

Capita Asset Services undertook its last review of interest rate forecasts on 9 August after the quarterly Bank of England Inflation Report. There was no change in MPC policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

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

- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and to get inflation up consistently to around monetary policy target levels.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases in the Fed. Funds Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.