For Publication

Bedfordshire Fire and Rescue Authority
Corporate Service Policy and Challenge Group
29 November 2017
Item No. 8

REPORT AUTHORS: **CHIEF FIRE OFFICER AND TREASURER**

SUBJECT: **TREASURY MANAGEMENT – MID-YEAR REVIEW REPORT TO 30 SEPTEMBER 2017**

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Background Papers:

Treasury Management Strategy 2017/18, as detailed in the Budget Book 2017/18.

Implications (tick ✓):

LEGAL		FINANCIAL	✓
HUMAN RESOURCES		EQUALITY IMPACT	
ENVIRONMENTAL		POLICY	
ORGANISATIONAL RISK		CORE BRIEF	
		OTHER (please specify)	

Any implications affecting this report are noted at the end of the report.

PURPOSE:

To provide an update on the Authority's Treasury Management to 30 September 2017.

RECOMMENDATION:

That the Corporate Services Policy and Challenge Group consider the report.

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1. Introduction

1.1 Since 1 April 2006, the management of the Fire and Rescue Authority's (FRA) Treasury operations has been undertaken by the Authority's Finance staff. Treasury management activities are undertaken with the objective of maximising return/minimising cost, consistent with minimising risk. When investing, the over-riding principle is the maintenance of the capital sum.

In order to support this function, the Authority also employs Link Asset Services (was Capita Asset Services) to provide independent, professional treasury advice.

1.2 The FRA's banking facilities are also arranged and monitored by the Finance staff.

1.3 The FRA adopted the Code of Practice for Treasury Management in the Public Services published by the Chartered Institute of Public Finance and Accountancy (CIPFA), introduced in April 2004 and revised in November 2011. One of the requirements of the CIPFA Code is for there to be regular reports on Treasury Management to be presented to the appropriate 'committee'. This is the mid-year Review Report for 2017/18 to 30 September 2017.

1.4 The Policy and Challenge Group is asked to note the report, as there are no changes requested to the Prudential Indicators, approval is not required by the FRA.

2. Treasury Management Reports

2.1 This 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 Statement and Annual Investment Strategy;
- The Authority's capital expenditure (prudential indicators);
- A review of the Authority's investment portfolio for 2017/18;
- A review of the Authority's borrowing strategy for 2017/18;
- A review of any debt rescheduling undertaken (if applicable) during 2017/18;
- A review of compliance with Treasury and Prudential Limits for 2017/18; and
- An economic update for the first six months of 2017/18.

3. Treasury Management Training

3.1 The Responsible Officer (the Section 151 Officer) must ensure that Group/FRA Members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

3.2 Training was again provided to Members by our Treasury Advisor's, Link Asset Services on 4 July 2017 as part of the Members Training Day.

4. Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy Update

There are no policy changes to the TMSS, the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5. Borrowing/Investment Strategy for 2017/18

5.1 It was anticipated at the beginning of 2017/18 that the Authority would have surplus funds available for short-term investment, either within its Special Interest Bearing Account (SIBA) at its bankers or through the money market. As at the 30th September 2017 the SIBA account is paying a rate of 0.01%.

5.2 The Authority's call-account with Barclays Bank has been used to a minimum during 2017/18 as the rate remains at 0%.

5.3 This Authority had also placed surplus funds into a 120-Day Interest account with Santander at a rate of 0.80%. However, this rate decreased to 0.70% as of 1 June.

5.4 This Authority had also placed surplus funds into a 180-Day Interest account with Santander at a rate of 0.90%. However, this rate decreased to 0.80% as of 1 June.

5.5 The Authority has re-invested funds with two foreign banks, Qatar National Bank and Goldman Sachs, during the first half of 2017/18, still via our Treasury Agents, Link Asset Services. The Qatar National Bank investment is a fixed term investment for one year at a rate of 0.84% and will mature in April 2018 (£2.5M). The Goldman Sachs Bank investments are fixed term investments for six months at a rate of 0.58% and 0.55%. Goldman Sachs investments will mature in January (£3M) and February (2M) 2018.

5.6 During the second half of 2017/18 this Authority will be considering using Money Market Funds for short-term investments. Operators use the credit ratings agencies which lay down investment restrictions to enable the funds to maintain its AAA status. Money Market Funds may also be governed by the Institutional Money Market Fund Association (IMMFA) which is a voluntary code of practice issued in 1992 by a trade body for Money Market Funds. This ensures all members offer a consistently high quality product by promoting best practice, transparency of fund values and a standardised format for published data.

5.7 Borrowing has not been undertaken in 2017/18 to finance the Capital Programme. The funding for the 2017/18 Capital Programme was through Grant and revenue contributions.

6. Interest Rate Movements During 2017/18

6.1 Bank base rate was 0.25% at the beginning of the year and still remained the same as of 30 September 2017. This report covers the first six months of the financial year. However, as an update, the bank base rate increase by 0.25% to 0.5% on 2nd November 2017.

6.2 Interest rates applicable to temporary investments were short-term money market rates. These investments were fixed for a set period (between one month and one year), at a greater interest rate than bank base rate. During the first six months of 2017/18, four investments reached maturity, new investments were then placed, one in April of £2.5M, one in May for £0.5M one in July for £3M, and another in August for £2M. When placing these, a number of factors were considered, including cashflow, security, return etc in order to meet our Policies and at the same time get the best return.

7. Investment/Borrowing Operations

7.1 **Investments:**

Surplus cash is invested on a temporary basis through the money market. Levels of investment have varied from £8.5M at the start of 2017/18 to £10M as at 30th September 2017. In the year 2017/18 to 30 September 2017, £26,460 interest has been generated through these investments and through the local SIBA account and Santander Accounts. Interest on PWLB borrowings totals of £210,817 was paid on 2nd October but was for the period up to end of September. This will give a net interest paid position of £184,357 as at 2 October 2017.

7.2 The FRA's budgeted investment return (interest receivable) for 2017/18 is £75,400.

7.3 **Long-Term Borrowing:**

No debt rescheduling was undertaken during the first six months of 2017/18.

7.4 **Borrowing and Investments Outstanding:**

	Temporary Investments £000s	**Long-Term Borrowing £000s**
Outstanding at 1 April 2017	8,500	9,987
Raised	8,000	0
Repaid	(6,500)	0
Outstanding at 30 September 2017	**10,000**	**9,987**

8. Prudential Indicators

8.1 Under the prudential code the following Treasury Management indicators were set for 2017/18:

Authorised Limit for external debt	£12.0M
Operational Boundary	£10.1M
Limits for fixed interest rate exposure:	
Upper limit	£312,000
Limits for variable interest rate exposure:	
Upper limit	£104,000

8.2 Neither the authorised limit nor the operational boundary has been exceeded during the year compared to the limits as at 1 April 2017. Actual interest rate exposure was as below:

Fixed interest rate exposure	£36,871
Variable interest rate exposure	£36,871

8.3 All the Prudential Indicators have been summarised for Members benefit in Appendix ‘A’.

9. Performance Measurement

9.1 The success of cash flow management, and hence the Fire Authority's temporary investment and borrowing activity, is measured by comparing the actual rates of interest achieved and borne against a benchmark of the average Local Authority 7 Day Rate.

9.2 For the period ending 30 September 2017, the average interest rate achieved from temporary investments, the SIBA Account, and Santander Accounts was 0.59%, higher than the average Local Authority 7 Day Rate over the same period of 0.11%.

9.3 At a recent meeting with our Treasury Consultants, Link Asset Services, it was commented that our Treasury Team had produced a very good average investment rate despite the current economic climate, resulting in limited counterparty flexibility.

10. General Economic Conditions

10.1 In brief, the first six months of this financial year has seen:

- Inflation – Target Inflation (CPI) was at 2.30% on 1 April 2017 and at 2.90% by 30 September 2017 (0.60% change). Headline Inflation (RPI) was at 3.1% on 1 April 2017 and at 3.9% by 30 September 2017 (0.80% change).

10.2 **Economic Update:**

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.

****Since the writing of this report the MPC have increased the Bank Rate of 0.5% as from 2nd November***.

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.

11. Economic Forecast – (November Link Asset Services update)

The Authority's Treasury Advisers, Link Asset Services, have provided the following forecast:

	End Q4 2017	End Q1 2018	End Q2 2018	End Q3 2018	End Q4 2018	End Q1 2019	End Q2 2019	End Q3 2019
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%
10yr PWLB rate	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%
25yr PWLB rate	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
50yr PWLB rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%

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Prudential Indicator	2017/18 Indicator £000	Up to 30 September 2017 Actual £000
Capital Financing Requirement (CFR)	10,393	N/A at mid year
Gross borrowing	9,987	9,987
Investments as at 1/4/17 and 30/09/17	8,500	10,000
Net borrowing	87	184*
Authorised limit for external debt	12,000	11,956
Operational boundary for external debt	10,100	10,056
Limit of fixed interest rates based on net debt	312	166
Limit of variable interest rates based on net debt	104	55
Principal sums invested > 365 days	0	0
Maturity structure of borrowing:	**Forecast**	**Actual**
Under 12 months	0%	0%
12 months to 2 years	0%	0%
2 years to 5 years	0%	0%
5 years to 10 years	0%	0%
10 years and above	100%	100%

*Note:

This figure is a result of cashflow timing. We are not expecting to have a Net Borrowing surplus as at 31 March 2018.