APPENDIX 1

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review Report 2018/19

1. Background

1.1 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A Capital Strategy for 2019/20 will be taken to the Full Council for approval as part of the suite of papers associated with the budget and treasury operations in February 2019.

1.2 Investment in non-financial investments

On the 2nd February 2018, MHCLG issued revised investment and MRP guidance. This revised guidance was issued too late to be included in our 2018/19 Treasury Management Strategy Statement (TMSS). The implications of the revised guidance on our TMSS are as detailed: -

a. Investment guidance

The MHCLG investment guidance focused particularly on non-financial asset investments. As non-financial assets were excluded from our TMSS report, any changes in this area of investment guidance did not require any changes to our report which deals solely with treasury type investments.

The effective definition of a short-term investment as being repayable ‘within 12 months’ in the 2010 investment guidance, has been removed from the 2018 guidance. A long term investment is therefore now one for in excess of 365 days.

In some circumstances our loan to ECTC may have been considered a non-financial asset investment, this if our only reason for loaning money to the Company was to generate profits. However, this is clearly not the case, with the Company’s objectives including the development of Community Land Trusts and affordable housing across the District as linked with the Council’s Corporate Plan. This means that this is legitimate capital spending and therefore adds to the Council’s Capital Financing Requirement (CFR).

b. MRP guidance

The MHCLG MRP guidance focused particularly on expenditure on purchasing non-financial asset investments. As non-financial assets are not included in our TMSS report, any changes in this area of MRP guidance do not require any changes to our report.

1.3 Treasury Management

The Council operates a balanced budget, which broadly means cash raised during the year, plus planned use of reserves, meets its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council’s capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> “The management of the local authority’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

2. Introduction

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).
The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Resources and Finance Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2018/19 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, and prudential indicators;
- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

3. Economics and interest rates

3.1 Economics update

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 twelve 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.

3.2 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.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement, (TMSS) for 2018/19 was approved at Full Council on 22nd February 2018.

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. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

The below table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure by Service	2018/19 Original Budget £000	Current Position £000	2018/19 Revised Estimate £000
Regulatory Services	2,118.2	488.7	2,380.8
Community Services	75.7	1,507.5	2,023.4
Leisure Centre	1,148.3	610.2	792.1
Resources and Finance	6,330.0	-71.7	302.4
Total capital expenditure	**9,672.2**	**2.534.7**	**5.498.7**

The main changes in the revised estimate when compared to the original budget relate to slippage from 2017/18 £1.691 million, the removal of the costs in relation to the Soham Eastern Gateway, a project which will not now take place during 2018-19, £6.33 million and an overspend on the Leisure Centre, £0.465 million.

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

Capital Expenditure	2018/19 Original Estimate £000	2018/19 Revised Estimate £000
Total capital expenditure	9,672.2	5,498.7
Financed by:		
Capital receipts	411.0	842.1
Capital grants	7,066.3	872.4
CIL / Section 106	546.6	549.1
Revenue	39.0	99.2
Total financing	8,062.9	2,362.8
Borrowing requirement	1,609.3	3,135.9

Other than the changes detailed in 5.1 above, the only change in this section reflects the additional CIL contributions that will be used to assist in funding the costs of the Leisure Centre. The original budget for the Leisure Centre was based on known receipts at that time, but it was always planned that any further receipts received in the intervening period, which could correctly be allocated to the Centre, would be so used.

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

In line with the TMSS, the Council is borrowing for three projects the Leisure Centre, to fund the loan to ECTC and for Waste fleet. The borrowing is planned to be a combination of internal borrowing using our own cash reserves and external borrowing. At this point our own internal reserves remain adequate to cover all of our borrowing requirements and therefore we remain external debt free.

Prudential Indicator – the Operational Boundary for external debt

	2018/19 Original Estimate £000	2018/19 Revised Estimate £000
CFR – brought forward	14,947	13,523
CFR – new borrowing 2018/19	1,609	3,136
CFR - MRP	-104	-99
Total CFR	**16,452**	**16,560**
Net movement in CFR	**1,505**	**3,037**
External Borrowing	5,000	5,000
Internal Borrowing	11,452	11,560
Total debt (year end position)	**16,452**	**16,560**

In 2018-19, the Council will only be paying MRP on the borrowing associated with the Waste fleet, which amounts to £99,113 as detailed above. No MRP is required to be paid on the Leisure Centre, as this did not open until May 2018, and MRP only falls due in the year following the asset becoming operational, and on the loan to ECTC, as this will be repaid in one lump sum instalment in March 2021.

When the ECTC loan is repaid this will not be used as a capital receipt, but instead used to reduce the Council's Capital Financing Requirement and external debt.

5.4 Limits to External Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years.

	2018/19 Original Estimate £000	2018/19 Revised Estimate £000
External Borrowing	5,000	5,000
Other long term liabilities	0	0
Total debt	5,000	5,000
CFR (year end position)	16,452	16,560

The Finance Manager reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. In approving the TMSS the Council approved an external borrowing limit.

Authorised limit for external debt	2018/19 Original Indicator	2018/19 Revised Indicator
Borrowing	12,000	12,000
Other long term liabilities*	0	0
Total	12,000	12,000

6. Investment Portfolio 2018/19

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in section 3.2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

The Council held £7.954 million of investments as at 30th September 2018 (£4.850 million at 31st March 2018) and the investment portfolio yield for the first six months of the year is £17,916. The average return on investments on this date being 0.62% against a benchmark overnight LIBID (London Inter-Bank Bid Rate) of 0.57%.

The full list of investments at this point are detailed in the table below.

Borrower	Principle	Interest Rate
MMF BlackRock	£5,000,000	0.67%
MMF Insight	£1,550,000	0.61%
MMF Standard Life	£1,025,000	0.62%
NatWest PLC (RFB)	£378,664	0.1%
Total	**£7,953,664**	**0.62%**

The Finance Manager confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19.

The Council's budgeted investment return for the 2018/19 year is £12,100, and performance for the year to date is £17,916 which is significantly above budget.

In addition to this income from investments, the Council is also receiving interest from ECTC on the capital loan provided to the Company. The loan to the Company currently stands at £4,620,000 (out of a total authorised loan of £5,000,000). Interest received on this loan (and the deferred capital receipt for Barton Road – now received) in the first six months of the year was £126,263.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

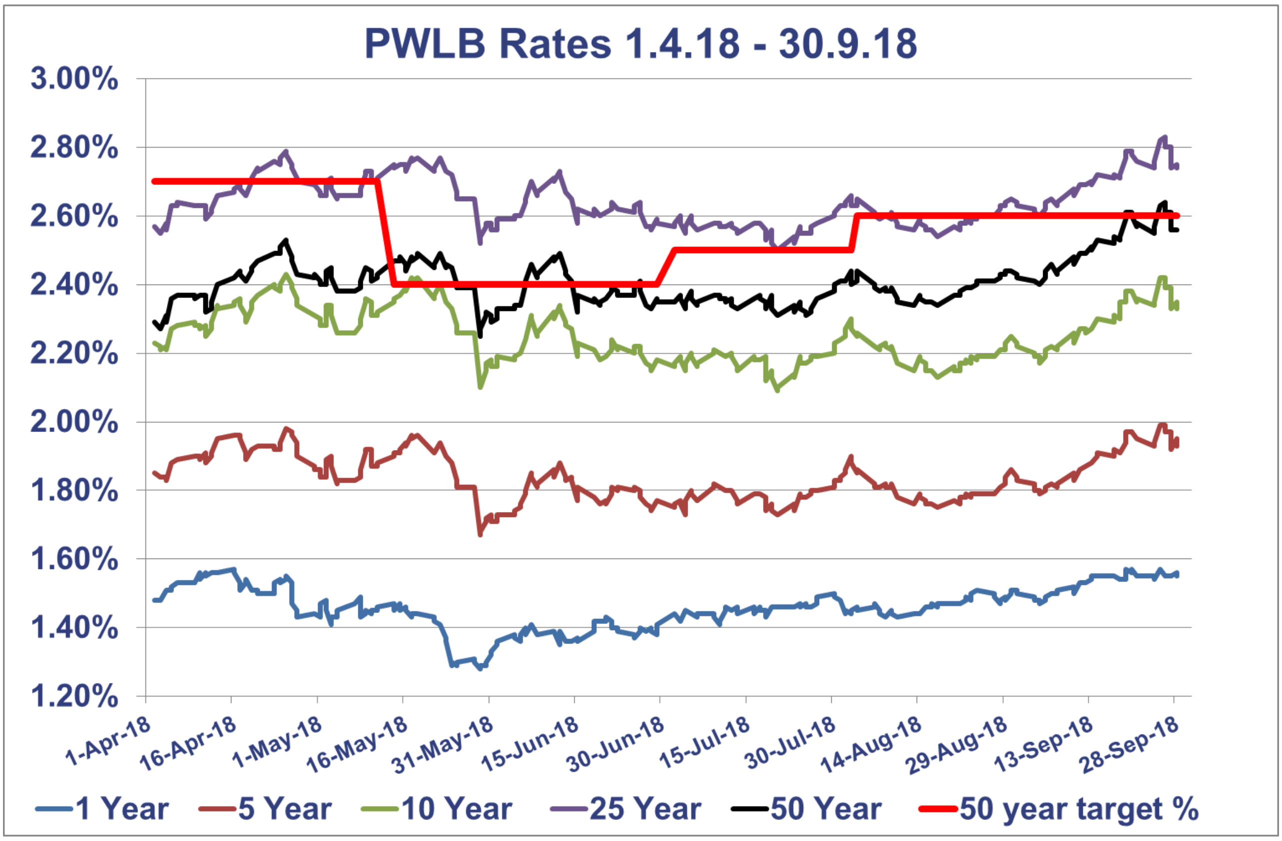
However, the Money Markets Fund sector is now in the final stages of introducing new regulations. These will see existing non-government Constant Asset Value (CNAV) funds converted to Low Volatility Net Asset Value (LVNAV) pricing. This new "title" for these investments is not included in our current TMSS and as such, this needs to be added to the authorised specified investments as detailed on page 25 of the TMSS. It is proposed that the limit for such institutions will be £5 million in line with other Money Market funds.

7. Borrowing

The Council's capital financing requirement (CFR) for 2018/19 is £16.553 million. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions and the availability of internal resources. As detailed in Section 5.3 the Council has up until this point been able to fund all the capital expenditure that makes up if CFR through internal borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

It is anticipated that external borrowing will be undertaken during this financial year, when the Council's internal reserves reduce towards the end of the year. In general terms, Council Tax is mostly collected in the first ten months of the year, while the precepts we pay out are spread more evenly over the year, which means that we tend to have more cash in the early months, which is then reduced in the latter months, when precepts catch up. Currently the expectation remains that we will need to borrow £5 million externally prior to the end of the year.

The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date:



8. Other

1. UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

Our main bank account with the NatWest is within the ring-fence (RFB) element of that bank.

2. IFRS9 accounting standard

This accounting standard came into effect from 1st April 2018. It means that the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact onto the Surplus or Deficit on the Provision of Services, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but more specialist types of investments, (e.g. pooled funds, third party loans, commercial investments), are likely to be impacted. Any impact of this on this Authority are likely to be small.

The Ministry of Housing, Communities and Local Government (MHCLG), are currently conducting a consultation for a temporary override to allow English local authorities time to adjust their portfolio of investments. Members will be updated when the result of this consultation is known.

Not specifically linked to IFRS9, but similar in nature, if at any time it was considered unlikely that the loan to ECTC would not be repaid in March 2021, then we would be required to account for this in the year that it becomes known and charge a MRP into the Council's accounts.

3. Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports.