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Cyngor Bwrdeistref Sirol
MERTHYR TUDFUL
MERTHYR TYDFIL
County Borough Council

FULL COUNCIL REPORT

Date Written	16th November 2018
Report Author	Adele Lewis
Service Area	Accountancy
Exempt/Non Exempt	Non Exempt
Committee Date	19th December 2018

To: Mayor, Ladies and Gentlemen

Treasury Management Half Year Review Report 2018/19

1.0 SUMMARY OF THE REPORT

1.1 The Treasury Reports outline the Council's performance for the first six months of 2018/19 in respect of:

- The management of the organisation's cash flows, its banking, money market and capital market transactions.
- The effective control of the risks associated with those activities.
- The pursuit of optimum performance consistent with those risks.

2.0 RECOMMENDATIONS that

2.1 The Treasury Management Half Year Review Report for 2018/19 be received.

3.0 INTRODUCTION AND BACKGROUND

3.1 The Treasury Management Half Year Review Report 2018/19 is attached at Appendix A, for Members' attention. This Report is a requirement of the Chartered Institute for Public Finance and Accountancy's Code of Practice on Treasury Management.

3.2 The Council employs Arlingclose as its Treasury Management consultant to give specialist advice on all Treasury Management matters including borrowing and investment requirements. This advice has been followed in producing the Annual Treasury Report.

4.0 FINANCIAL IMPLICATIONS

4.1 Financial information and performance is included within the body of the report.

5.0 INTEGRATED IMPACT ASSESSMENT

5.1

	Positive Impacts	Negative Impacts	Not Applicable
1. Merthyr Tydfil Well-being Objectives	4 of 4	0 of 4	0 of 4
2. Sustainable Development Principles - How have you considered the five ways of working: • Long term • Prevention • Integration • Collaboration • Involvement	5 of 5	0 of 5	0 of 5
3. Protected Characteristics *(including Welsh Language)*	0 of 10	0 of 10	10 of 10
4. Biodiversity	0 of 1	0 of 1	1 of 1

Summary:

The main positive impacts are that the Treasury Management Policy and Annual Investment strategy supports the Council to achieve its Well-being Objectives through its Treasury Management Activities.

GARETH CHAPMAN
CHIEF EXECUTIVE

COUNCILLOR ANDREW BARRY
CABINET MEMBER FOR GOVERNANCE AND CORPORATE SERVICES

BACKGROUND PAPERS		
Title of Document(s)	**Document(s) Date**	**Document Location**
Prudential Indicators – Council Tax 2018/19	Council 7th March 2018	Accountancy/Intranet Committee Agendas and Minutes
Treasury Management Policy and Annual	Council 7th March 2018	Accountancy/Intranet Committee Agendas and Minutes

Investment Strategy 2018/19 (Included within Medium Term Financial Plan Report 2018-19 to 2021-22)		
Treasury Management 2018/19 Working Papers	April 2018 to September 2018	Accountancy
Does the report contain any issue that may impact the Council's Constitution?		**No**

Consultation has been undertaken with the Corporate Management Team in respect of each proposal(s) and recommendation(s) set out in this report.

Appendix A

MERTHYR TYDFIL COUNTY BOROUGH COUNCIL

TREASURY MANAGEMENT HALF YEAR REVIEW REPORT 2018/19

1.0 Introduction and background

1.1 In March 2010 the Authority adopted he Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

1.2 The Authority's treasury management strategy for 2018/19 was approved at full Council on 7th March 2018.The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested sums and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

1.3 Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter.

1.4 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority will be producing its Capital Strategy later in 2018-19 for approval by full Council.

1.5 The Welsh Government (WG) asked for comments on changes to its Guidance on Minimum Revenue Provision (MRP). These include clarification or changes to terminology and the calculation of MRP.

2.0 External Context

2.1 Appendix 1 outlines an Economic for the first six months of the 2018/19 financial year.

3.0 Treasury Management Summary

3.1 On 31st March 2018, the Authority had net borrowing of £83m arising from its revenue and capital income and expenditure. The Authority's strategy was to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The Treasury management position as at 30th September 2018 and the change during the period is shown in table 1 below

Table1 Treasury Management Summary

Description	31st March 2018 £'000	2018/19 Movement £'000	30th September 2018 £'000	Rate/ Return %
Long term borrowing	60,948	(1,275)	59,673	7.14
Short term borrowing	35,187	3,000	38,187	1.43
Total Borrowing	**96,135**	**1,725**	**97,860**	**4.91**
Long term investments	0	0	0	**0.00**
Short term investments	13,500	(3,500)	10,000	**0.69**
Total Investments	**13,500**	**(3,500)**	**10,000**	**0.69**
Net Borrowing	**82,635**	**5,225**	**87,860**	**5.39**

4.0 Borrowing activity

4.1 At 30th September 2018, the Authority held £98m loans, an increase of £2m to the 31st March 2018 position, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in table 2 below:

Table2 Borrowing Position

Description	31st March 2017/18 £'000	2018/19 Movement £'000	30th September 2018 £'000	Rate/ Return %
Public Works Loan Board	52,135	(1,275)	50,860	7.23
Banks (Lender's Option Borrower's Option Loans)	12,000	0	12,000	4.50
Banks (fixed-term)	0	0	0	0.00
Local authorities (short-term)	32,000	3,000	35,000	0.72
Total Borrowing	**96,135**	**1,725**	**97,860**	**4.57**

4.2 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

4.3 In keeping with these objectives, no new long term borrowing was undertaken, while £1.275m of existing loans were allowed to mature without replacement to the 30th September 2018. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

4.4 With short-term interest rates remaining much lower than long-term rates, the Authority considered it to be more cost effective in the near term to use short-term loans instead.

4.5 The Authority continues to hold £12m of LOBO (Lender's Options Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the period.

5.0 Investment activity

5.1 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. The investment position is shown in table 3 below

Table 3 Investment Position

Description	31st March 2018 £'000	2018/19 Movement £'000	30th September 2018 £'000	Rate/ Return %
Banks	0	0	0	0
Building Societies	10,000	0	10,000	0.69
Government (inc local authorities)	3,500	(3,500)	0	0.00
Total investments	**13,500**	**(1,275)**	**10,000**	**0.69**

5.2 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.0 Performance and Financial Implications

6.1 The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget as shown in table 4 below.

Table 4 Performance

Description	Estimate £'000	Outturn £'000
Public Works Loan Board Loans	3,777	1,919
Lender's Option Borrower's Option Loans	0	271
Short Term Borrowing	280	81
Short Term Investments	(35)	(39)
Total Borrowing	**4,022**	**2,232**

The estimate detailed above is the full year position, the outturn is the position to 30th September 2018. The estimates were calculated on the basis of repaying the Authority's Lender Option Borrower Option Loans (LOBO), variances against budget will now be experienced at year end as the LOBO loans were not repaid at the start of the financial year as reported to Cabinet on 25th July 2018.

7.0 Compliance Report

7.1 The Chief Finance Officer reports that all treasury management activities undertaken during the period complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific debt and investment limits are demonstrated in tables 5 and 6 below.

Table 5 Debt limits

Description	2018/19 Maximum £'000	30.9.18 Actual £'000	2018/19 Operational Boundary £'000	2018/19 Authorised Limit £'000	Complied
Borrowing	99,682	99,682	117,211	128,667	✓

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cashflow, and this is not counted as a compliance failure.

Table 6 Investment Limits

Description	2018/19 Maximum £'000	30.9.18 Actual £'000	2018/19 Limit £'000	Complied
Banks and Building Societies	5,000	5,000	5,000	✓
UK Local Authorities	2,000	0	5,000	✓
UK Government	0	0	As required	✓

8.0 Treasury Management Indicators

8.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

8.1.1 Interest Rate Exposures:

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable interest rate exposures, expressed as the amount of net interest payable was:

Description	30.9.18 Actual £'000	2018/19 Limit £'000	Complied
Upper limit on fixed interest rate exposure	2,210	4,022	✓
Upper limit on variable interest rate exposure	268	201	☒

The estimate detailed above is the full year position, the outturn is the position to 30th September 2018. The estimates were calculated on the basis of repaying the Authority's Lender Option Borrower Option Loans (LOBO), however the Authority's LOBO loans were not repaid at the start of the financial year as reported to Cabinet on 25th July 2018. The result of not repaying the LOBO loans is that the interest payable on these loans will now be reflected as Variable interest rather than fixed.

8.1.2 Maturity structure of Borrowing:

This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

Description	30.9.18 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	6%	7%	0%	✓
12 months and within 24 months	5%	7%	0%	✓
24 months and within 5 years	20%	20%	0%	✓
5 years and within 10 years	18%	17%	0%	☒
10 years and above	51%	51%	0%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

The position to 30th September 2018 is non-compliant for one timescale bracket. The indicator limits have been calculated to the year end position by which time loans will be repaid and will move within the brackets to comply with the final year end position.

8.1.3 Principal Sums invested for Periods longer than 364 days:

The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Description	2018/19	2019/20	2020/21
Principal Sums Invested for Periods Longer than 364 days	0	0	0
Complied	✓	✓	✓

9.0 Outlook for the remainder of 2018/19

9.1 Having raised policy rates in August 2018 to 0.75%, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon.

9.2 The MPC has a definite bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that (a) ultra-low interest rates result in other economic problems, and that (b) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise and cuts are required.

9.3 Arlingclose's central case is for Bank Rate to rise twice in 2019. The risks are weighted to the downside. The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average

	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Ca	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Downside risk	0.00	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

9.4 The 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.

Appendix 1

External Context

Economic background

Oil prices rose by 23% over the six months to around $82/barrel. UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year, above the consensus forecast and that of the Bank of England's in its August *Inflation Report*, as the effects of sterling's large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, it's lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages. However real wages (i.e. adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.

The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year/year GDP growth at 1.2% also remains below trend. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in each of June and September by 0.25% to the current 2%-2.25%. Markets now expect one further rise in 2018.

The escalating trade war between the US and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just to China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019.

The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29th March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

Financial markets

Gilt yields displayed marked volatility during the period, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven UK, German and US government bonds. Over the period, despite the volatility, the bet change in gilt yields was small. The 5-year benchmark gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%. The increase in Bank Rate resulted in higher in money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.56%, 0.70% and 0.95% respectively over the period.