Policy Committee – 3 November 2015

Treasury Management Mid-year Report 2015/16

Report of the Strategic Manager – Financial Services (S151 Officer)

Ward(s) affected: All

1. **Purpose of Report**

1.1 To update Members on the treasury activity undertaken in the first six months of the year in the context of current and forecast economic climates.

2. **Recommendations**

Members are recommended to:

2.1 Note the Treasury Management Mid-year Report for 2015/16.

3. **Introduction**

3.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was adopted by this Council on 27th March 2012. In this context it is the management of the Council's cash flows, its banking and its capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. This Council complies with the Code requirements.

3.2 The Council's Treasury Management Strategy Statement (TMSS), was approved by Council on 24 February 2015. The council is also required to produce a Mid-Year Report and an Annual Report.

3.3 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 2015/16 financial year;
- A forecast of future interest rates;
- A review of the Treasury Management Strategy Statement;
- A review of the Council's investment portfolio for 2015/16 and counterparty criteria;
- A review of the Council's borrowing strategy for 2015/16;
- A review of any debt rescheduling undertaken during 2015/16;
- A review of compliance with Treasury and Prudential Limits for 2015/16.
- A summary of the Council's prudential indicators at Appendix A.

4. The Economy

4.1 UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, possibly being equal to that of the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y).

4.2 The Bank of England August Inflation Report had included a forecast for growth to remain around 2.4-2.8% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth. Since then, worldwide economic statistics have been distinctly weak so it would not be a surprise if the next Inflation Report in November were to cut those forecasts

4.3 The August Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to re-join the world oil market when sanctions are lifted, there could still be several more months of low inflation.

4.4 There are considerable risks around whether inflation will rise in the near future as strongly as previously expected; this will make it more difficult for the central banks of both the US and the UK to raise rates as soon as had previously been expected, especially given the recent major concerns around the slowdown in Chinese growth, and the knock on impact on the earnings of emerging countries. The volatility we have seen in equity and bond markets in 2015 so far, which could potentially spill over to impact the real economies rather than just financial markets.

4.5 The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015. While there had been confident expectations during the summer that the Fed. could start increasing rates at its meeting on 17 September, or if not by the end of 2015, the recent downbeat news about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision to pull back from making that start.

4.6 Expectations of a first rate increase have been put back from 2015 to 2016. However, there are increasing concerns, both in the US and UK, that the growth rates currently being achieved are only being achieved with monetary policy being highly aggressive with central rates at near zero and huge Quantitative Easing in place. This is causing an increasing debate as to how realistic it will be for central banks to start on reversing such aggressive monetary policy until such time as strong growth rates are more firmly established and confidence increases that inflation is going to get back to around 2% within 2-3 years.

4.7 In the Eurozone, the ECB undertook a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. The recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

5. Interest Rate Forecast

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

	Dec 15 %	Mar 16 %	Jun 16 %	Sep 16 %	Dec 16 %	Mar 17 %	Jun 17 %	Sept-Dec 17 %	Mar-Jun 18 %
Bank rate	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.50**	**1.75**
5 Year PWLB rate	**2.40**	**2.50**	**2.60**	**2.80**	**2.90**	**3.00**	**3.10**	**3.25**	**3.45**
10 Year PWLB rate	**3.00**	**3.20**	**3.30**	**3.40**	**3.50**	**3.70**	**3.80**	**3.95**	**4.15**
25 Year PWLB rate	**3.60**	**3.80**	**3.90**	**4.00**	**4.10**	**4.20**	**4.30**	**4.45**	**4.60**
50 Year PWLB rate	**3.60**	**3.80**	**3.90**	**4.00**	**4.10**	**4.20**	**4.30**	**4.45**	**4.60**

5.2 Capita Asset Services undertook a review of its interest rate forecasts on 11 August, after the Bank of England's Inflation Report. This latest forecast includes no change in the timing of the first increase in Bank Rate in quarter 2 of 2016. With CPI inflation likely to be at or near zero for the rest of 2015, it is difficult for the MPC to make a start on increasing Bank Rate when the report forecast was notably subdued with inflation barely getting back up to the target of 2% within a 2-3 year time horizon.

5.3 The Governor of the Bank of England has repeatedly stated that increases in Bank Rate will be slow and gradual. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only just starting a significant recovery as a result of recent increases in the rate of wage inflation.

6. Annual Investment Strategy

The Annual Investment Strategy for 2015/16 was approved by the Council on 24th February 2015 as part of the TMSS, and the mid-year review does not indicate that any changes are required to be made to the approved policy.

7. Investment Portfolio

7.1 The Council's TMSS sets out the Council's investment priorities as being: 1) Security of Capital, 2) Liquidity; and 3) Yield.
The Council aims to achieve optimum return. In the current climate it is considered appropriate to keep investments short term to cover cash flow needs, but also seek out value in periods up to 12 months with appropriately credit-rated institutions.

7.2 The Council held £13.330m of investments as at 30 September 2015 (£8.95m at 31 March 2015) and a current account balance of £0.321m. The details are shown at Appendix B.

7.3 Returns on investment have been slightly above benchmark rates as shown in the table below. The Council budgeted for returns based on an average rate of 0.54% and currently the average rate is forecast to be 0.56%.

Benchmark	Benchmark Return %	Council Performance %	Investment Interest Earned £
Up to 7 day	0.36	0.42%	16,360
1 month	0.38	n/a	0
3 month	0.46	0.50%	110
6 month	0.62	0.65%	4,150
12 month	0.93	n/a	0

7.4 Additionally, the Council's investment income has been boosted by a discount of £14,100 on the annual pensions' contribution as a result of making a payment in advance. The total of investment income received from all sources is therefore £34,720 at 30 September.

7.5 The Council's budgeted investment return for 2015/16 is £61,400 based on an average return of 0.54% on average balances of £11.37m. The forecast outturn for the year is £84,140 due to cash balances and yields being higher than forecast.

8. Investment Counterparty Criteria

8.1 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function for 2015/16.

8.2 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. In response to the evolving regulatory regime, the agencies have started to remove these "uplifts". This does not affect the viability of an institution it is just an indicator of the likelihood of sovereign support in the event of an institutions financial failure.

8.3 Based on advice from the Council's Treasury Advisors, since the start of the year the term for some of the Council's investments within the investment portfolio have been lengthened, and this is assisting with returns.

8.4 The Council's Treasury officers will continue to monitor credit reports, and will review the counterparty selection and lending limits criteria.

9. Borrowing

9.1 The Council's capital financing requirement (CFR) for 2015/16 is £5.786m after utilising £0.575m of funds set aside as the Minimum Revenue Provision.

9.2 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. The use of the MRP is a prudent and economic approach in the current climate

9.3 The general trend has been a decrease in interest rates during the six months across longer dated maturity bands, but a rise in the shorter maturities, reflecting in part the expected rise in the Bank rate.

9.4 The following table shows the Councils current borrowing:

Lender	Date of Borrowing	Date of Maturity	Value £	Interest Rate	Interest Paid £
PWLB	01/12/2005	01/02/2031	700,000	4.25%	14,875
PWLB	17/09/2007	01/08/2057	2,000,000	4.55%	45,500
PWLB	17/09/2007	01/08/2057	2,288,110	4.55%	52,055
PWLB	04/11/2013	04/05/2021	500,000	2.89%	7,225
PWLB	04/11/2013	04/05/2023	500,000	3.28%	8,200

9.5 It is anticipated that no further borrowing will be undertaken during this financial year.

10. Debt Rescheduling

10.1 With interest rates at historically low levels no debt rescheduling was undertaken in the first six months.

11. Implications

11.1 Financial and Value for Money Implications

There are no financial implications associated with this report.

11.2 Legal implications

There are no legal implications attached to this report.

11.3 Contribution to Council Priorities

The Treasury Management function does not contribute directly to the Council's Corporate Priorities albeit the delivery of the Treasury Management Strategy supports the Council's budget strategy which in turn is a fundamental element of the Council's service and financial planning approach to achievement of the Council Plan.

11.4 Risk Management

There are no direct risk management implications arising from this report. Regular review provides assurance that treasury management activities are being managed in line with the Treasury Management Strategy.

11.5 Equality Impact Assessment

The Council's Equality Impact Assessment Procedure **has been** followed. An Equality Impact Assessment **has not** been completed on the proposals as completion of **Stage 1- Initial Screening** of the Procedure identified that the proposed policy, strategy, procedure or function **does not have** the potential to cause negative impact or discriminate against different groups in the community based on •age • disability •gender • race/ethnicity • religion or religious belief (faith) •sexual orientation, or • rural isolation.

12. Consultations with Others

None

13. Access to Information : Background Documents

Working papers held in Financial Services.

14. Author of the Report

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15. Appendices

Appendix A: Prudential Indicators at 30 September
Appendix B: Investments at 30 September

APPENDIX A

Treasury Indicators	**2015/16 Budget**	**2015/16 Mid-Year Actual**
Authorised Limit for External Debt	£9.75m	£9.75m
Operational Boundary for External Debt	£7.5m	£5.988m
Gross External Debt	£5.988m	£5.988m
Investments	£8.95m	£13.507m
Net Investments	£2.962m	£7.519m
Maturity Structure of Fixed Rate Borrowing		
Under 12 Months	10%	0
12 Months to 2 Years	15%	0
2 Years to 5 Years	15%	0
5 Years to 10 Years	20%	16.7%
10 Years to 25 Years	40%	11.7%
Over 25 Years	90%	71.6%
Upper limit of fixed interest rates based on net debt	100	100
Upper limit of variable interest rates based on net debt	30	30
Upper limit for principal sums invested over 364 days	0	0
Prudential Indicators		
Capital Expenditure*	£1.328m	£2.937m
Capital Financing Requirement	£5.950	£5.786
Annual Change in CFR*	(51)	256
In Year Borrowing Requirement*	300	575
Ratio of Financing Costs to net Revenue Stream*	2.72	5.73
Incremental impact of capital investment decisions: Increase in council tax per annum	1.71	1.71

* Budget increased for slippage & supplementary estimates

APPENDIX B

Investments at 30 September 2015

Counterparty	Date of Investment	Date of Maturity	Value £	Interest Rate	Interest Received or Forecast £
Fixed term:					
Furness BS	01/04/2015	01/10/2015	500,000	0.60%	1,500
National Counties BS	02/04/2015	05/10/2015	1,000,000	0.70%	3,570
Newcastle BS	13/05/2015	13/11/2015	500,000	0.68%	1,710
Progressive BS	01/04/2015	01/10/2015	500,000	0.65%	1,630
Skipton BS	02/04/2015	02/10/2015	1,000,000	0.70%	3,510
Principality BS	15/04/2015	05/10/2015	1,000,000	0.68%	3,410
Progressive BS	13/05/2015	13/11/2015	500,000	0.68%	1,710
Hanley Economic BS	01/07/2015	04/01/2016	1,000,000	0.70%	3,590
Manchester BS	01/09/2015	07/03/2016	500,000	0.75%	3,860
Bank of Scotland	16/07/2015	15/04/2016	1,000,000	0.80%	5,700
Money Market Funds:					
Goldman Sachs	n/a	n/a	400,000	0.43%	3,440
Aberdeen	n/a	n/a	100,000	0.43%	3,230
Aviva	n/a	n/a	1,000,000	0.44%	3,520
Insight	n/a	n/a	1,000,000	0.43%	4,300
Legal & General	n/a	n/a	1,000,000	0.45%	3,600
Standard Life	n/a	n/a	1,000,000	0.45%	4,500
Call Accounts:					
Santander	n/a	n/a	1,000,000	0.40%	4,000
Bank of Scotland	n/a	n/a	6,990	0.40%	30
Lloyds Bank Current Account	n/a	n/a	321,040	0.40%	3,000
Total Investments at 30 September			13,328,030		