AGENDA ITEM 9

Policy Committee –13 December 2016

Treasury Management Mid-year Report 2016/17

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

Lead Member – Finance: Councillor Mulligan

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 2016/17.

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 16th February 2016. 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 2016/17 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 2016/17 and counterparty criteria;
- A review of the Council's borrowing strategy for 2016/17;
- A review of any debt rescheduling undertaken during 2016/17;
- A review of compliance with Treasury and Prudential Limits for 2016/17.
- A summary of the Council's prudential indicators at Appendix A.

4. The Economy

4.1 Following strong UK GDP growth rates in 2013 (2.2%) and 2014 (2.9%), 2015 was disappointing at only 1.8%, although it remained one of the leading rates among the G7 countries.

Growth in quarter 1 of 2016 (Jan-Mar) was less than the previous quarter measuring +0.4%, but bounced back in quarter 2 to +.0.7% (2.1% y/y).

The referendum vote for Britain to leave the European Union delivered an immediate shock fall in confidence indicators and business surveys, but subsequent surveys have shown a sharp recovery. Though it is generally expected that growth will be weak through the second half of the year, the anticipated flat-lining appears to have been avoided.

4.2 The Bank of England meeting on 4th August addressed this expected slowdown in growth by a package of measures including the cut in Bank Rate from 0.50% to 0.25%, and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end.

4.3 The August Inflation Report also forecast a sharp rise in inflation to around 2.4% in 2018 and 2019.
CPI has started to rise as the falls in oil and food prices of twelve months ago drop out of the calculation. At the end of September CPI had risen by 1.0% since September 2015.
The post-referendum 10% fall in the value of sterling is likely to result in a 3% increase in CPI over the next 3 to 4 years. However, the MPC is expected to treat this as a one-off blip, and not react, in order to support economic growth, especially if pay increases remain subdued and pose little danger of fueling price rises by increased consumer spending.

4.4 Following the referendum result, the new Chancellor, Phillip Hammond, announced that the target for achieving a budget surplus by 2020 will be eased in the Autumn Statement on November 23rd.

4.5 The American economy has made a disappointing start to 2016 with growth of only +0.8%, but this improved in quarter 2 to +1.5% which is still a bit lackluster.
However, forward indicators are pointing towards a pickup in growth in the rest of the year.
The Federal Reserve announced a first increase in bank rate in December 2015, but the anticipated additional increases have been put on hold as a result of Britain's decision to exit from the EU.
The next increase is unlikely to occur before December this year.

4.6 In the Eurozone, the massive €1.1 trillion programme of quantitative easing, which began in March 2015 and was intended to end in September 2016, has been extended to March 2017.

At its December 2015 and March 2016 meetings the European Central Bank progressively cut its deposit facility rate to -0.4% and its main re-financing rate from 0.50% to zero. Also at the March meeting it increased its monthly asset purchases to €80bn.

These measures have not made significant impact on boosting the zone's economic growth, nor in helping inflation to rise from zero towards its target of 2%. Growth rose by only 0.6% in quarter 1 and by only 0.8% in quarter 2.

This has prompted many forecasters to comment, in the same vein as

Mark Carney, that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support economic growth.

4.7 In the Far East, Japan is still bogged down in anaemic growth and making little progress on fundamental reform of the economy, while Chinese economic growth has been weakening and medium term risks have been increasing.

5. Interest Rate Forecast

5.1 Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting on 4th August, and included in its forecast a further cut in base rate of 0.10% in November. However, the MPC, at its meeting on 3rd November, held the rate at 0.25%.

In November Capita Asset Services revised its forecast and now predicts rates to be as shown in the following table:

	NOW	Dec-16	Mar-17	Jun-17	Sep-17	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	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.75	0.75
3 month LIBID	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.40	0.50	0.60	0.70	0.80	0.90
6 month LIBID	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.50	0.60	0.70	0.80	0.90	1.00
12 month LIBID	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.80	0.80	0.90	1.00	1.10	1.20	1.30	1.40
5 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.70
25 yr PWLB	3.00	2.90	2.90	2.90	2.90	3.00	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.30	3.40
50 yr PWLB	2.70	2.70	2.70	2.70	2.70	2.80	2.80	2.80	2.90	2.90	3.00	3.00	3.10	3.10	3.20

Mark Carney has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities. However, we have been experiencing exceptional levels of volatility in financial markets which have caused significant swings in PWLB rates. Capita's PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

5.2 The overall balance of risks to economic recovery in the UK remains to the downside as the following lists indicate:

Potential downside risks include:

- Monetary policy action reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some major developed economies, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Weak capitalisation of some European banks.

- A resurgence of the Eurozone sovereign debt crisis.
- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a further flight to safe havens (bonds).
- 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.

Potential upside risks 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 than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

6. Annual Investment Strategy

The Annual Investment Strategy for 2016/17 was approved by the Council on 16th February 2016 as part of the TMSS, and an early review undertaken in April resulted in an amendment to the minimum asset holding of counterparties to £1bn to bring it in line with Treasury Management Practices Schedule 1 – Management of Risk.

No further changes to the strategy are required.

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, and 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 £16.5m of investments as at 30 September 2016 (£11.7m at 31 March 2016 and £13.3m at 30 September 2015).
The current account balance at 30 September was £1.175m (£0.272 at 31 March 2016 and £0.284 at 30 September 2015) . A full list is included at Appendix B.

7.3 Returns on investments in the first half year have been greater than anticipated due to higher available principal, and securing higher rates of interest before the cut in bank rate on 4th August.
The table below shows the detail:

	Average Principal (£)	Average Rate of Return (%)	Interest (£)
Forecast for twelve months	7,878,000	0.76	59,876
Achieved in six months	13,630,000	0.64	43,620

Additionally, the Council's investment income has been boosted by a discount of £14,730 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 £58,350 at 30 September.
The revised forecast outturn for the year is in the region of £100,000, 67% over budget.

7.4 It is anticipated that investments held at 31 March 2017 will total £14m, but with lower rates continuing over the next three years, yields are forecast to average around £70,000 p.a. at an average rate of 0.5%.

8. Investment Counterparty Criteria

8.1 The current investment counterparty criteria selection approved in the TMSS (as amended) is meeting the requirement of the treasury management function for 2016/17.

8.2 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.

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

9. The Council's Capital Position

9.1 The Council's capital spending plans, and the financing of them, remains unchanged.

10. Borrowing

10.1 The Council's capital financing requirement (CFR) for 2016/17 is £5.676m after utilising £0.321m of funds set aside as the Minimum Revenue Provision.

10.2 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

10.3 The following table shows the Council's 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

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

11. Debt Rescheduling

11.1 Early repayment of debt when current interest rate is below the debt's coupon rate results in the payment of a premium over and above the value of debt being repaid. This is because the lender can only re-lend the principal at a lower interest rate. Therefore no debt rescheduling was undertaken in the first six months, and is unlikely to occur in this financial year.

12. Implications

12.1 **Financial and Value for Money Implications**

There are no financial implications associated with this report.

12.2 Legal implications

There are no legal implications attached to this report.

12.3 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.

12.4 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.

12.5 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.

13. Consultations with Others

None

14. Access to Information : Background Documents

Working papers held in Financial Services.

15. Author of the Report

Mary Kennedy, Finance Officer
Tel: 01756 706282
Email: mkennedy@cravendc.gov.uk

16. Appendices

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

APPENDIX A

Treasury Indicators	**2016/17 Budget**	**2016/17 Mid-Year Actual**
Authorised Limit for External Debt	£12.75m	£12.75m
Operational Boundary for External Debt	£10.5m	£10.5m
Gross External Debt	£5.988m	£5.988m
Investments	£7.78m	£16.5m
Net Investments	£1.792m	£10.512m
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	£1.913m	£0.390m
Capital Financing Requirement	£5.676m	£5.355m
Annual Change in CFR	£0.162m	(£0.321)m
In Year Borrowing Requirement	£0.482m	nil
Ratio of Financing Costs to net Revenue Stream*	5.73%	5.41%

APPENDIX B

Investments at 30 September 2016

Counterparty	Date of Investment	Date of Maturity	Value £	Interest Rate	Interest Accountable in 2016/17 £
Fixed term:					
Newcastle BS	01/04/2016	03/10/2016	500,000	0.80%	2,030
Progressive BS	01/04/2016	03/10/2016	1,000,000	0.70%	3,550
Cumberland BS	01/07/2016	03/01/2017	1,000,000	0.55%	2,800
Bank of Scotland	15/04/2016	16/01/2017	1,000,000	0.90%	6,810
Lloyds Bank	19/07/2016	16/01/2017	500,000	0.80%	2,040
Commonwealth Bank of Australia	03/02/2016	01/02/2017	1,000,000	0.78%	6,540
Principality BS	03/05/2016	03/02/2017	1,000,000	0.85%	6,430
Newcastle BS	15/02/2016	13/02/2017	500,000	1.15%	5,010
Nottingham BS	15/02/2016	13/02/2017	500,000	1.01%	4,400
Nottingham BS	15/02/2016	01/07/2016	500,000	0.75%	2,820
Barclays Bank	02/09/2016	02/03/2017	1,000,000	0.41%	2,030
National Counties BS	07/09/2016	06/09/2017	1,000,000	0.78%	4,380
Skipton BS	02/09/2016	02/03/2017	1,000,000	0.49%	2,430
West Bromwich BS	30/09/2016	29/09/2017	1,000,000	0.75%	3,760
Notice Accounts:					
Santander 95-day	01/04/2016	31/08/2016	1,000,000	0.90%	3,800
Santander 95-day	01/09/2016	31/03/2017		0.65%	3,780
Santander 95-day	15/07/2016	31/08/2016	500,000	0.90%	600
Santander 95-day	01/09/2016	31/03/2017		0.65%	1,890
Money Market Funds:					
Aberdeen	n/a	n/a	500,000	0.33%	3,200
Aviva	n/a	n/a	1,000,000	0.31%	3,810
Insight	n/a	n/a	1,000,000	0.35%	5,580
Legal & General	n/a	n/a	1,000,000	0.35%	5,78
Total Investments at 30 September			**16,500,000**		
Call Accounts:					
Lloyds Bank Current Account	n/a	n/a	1,175,000	0.40%	3,000