Policy Committee – 18th November 2014

Treasury Management Mid-year Report 2014/15

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 2014/15.

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.

3.2 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 Policy Committee.

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 2014/15 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 2014/15 and counterparty criteria;
- A review of the Council's borrowing strategy for 2014/15;
- A review of any debt rescheduling undertaken during 2014/15;
- A review of compliance with Treasury and Prudential Limits for 2014/15.

4. The Economy

4.1 After strong UK GDP quarter on quarter growth throughout the period from April 2013 to June 2014, it appears very likely that this trend will continue through the rest of 2014 and into 2015 as forward surveys for the services and construction sectors are very encouraging, and business investment is also strongly recovering. The manufacturing sector has also been encouraging, though the latest figures indicate a weakening in the future trend rate of growth.

4.2 However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods.

4.3 This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, the limit at which it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance and is looking at a much wider range of indicators in order to form a view on how much slack there is in the economy and how quickly the slack is being used up.

4.4 The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. In order to support increases in pay rates there also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008.

4.5 Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

4.6 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.2% in September the lowest rate since 2009. This confirmed forward indications that inflation was likely to fall further in 2014 to possibly near to 1% from its 1.5% in August. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in repayments at a time when inflationary pressures are also weak.

4.7 A first increase in Bank Rate is expected in Q1 or Q2 2015 and increases after that are expected to be at a slow pace and stay below the levels that prevailed before 2008.

4.8 The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

5. Interest Rate Forecast

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

	Sept 14 %	**Dec 14 %**	**Mar 15 %**	**Jun 15 %**	**Sept 15 %**	**Dec 15 %**	**Mar-Jun 16 %**	**Sept-Dec 16 %**	**Mar-Jun 17 %**
Bank rate	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.63**	**2.00**
5 Year PWLB rate	**2.70**	**2.70**	**2.80**	**2.90**	**3.00**	**3.00**	**3.15**	**3.35**	**3.50**
10 Year PWLB rate	**3.40**	**3.50**	**3.60**	**3.70**	**3.80**	**3.90**	**4.05**	**4.15**	**4.30**
25 Year PWLB rate	**4.00**	**4.10**	**4.20**	**4.30**	**4.40**	**4.50**	**4.65**	**4.80**	**4.90**
50 Year PWLB rate	**4.00**	**4.10**	**4.20**	**4.30**	**4.40**	**4.50**	**4.65**	**4.80**	**4.90**

5.2 Capita Asset Services undertook a review of its interest rate forecasts in mid August, after the Bank of England's Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts which depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2015.

5.3 There are also increasing concerns that the reluctance of western economies to raise interest rates significantly for some years, plus the huge QE measures which remain in place (and may be added to by the ECB in the near future), has created potentially unstable flows of liquidity searching for yield and therefore heightened the potential for an increase in risks in order to get higher returns. This is a return of the same environment which led to the 2008 financial crisis.

6. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by the Council on 11th February 2014, 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 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 indicated in section 4 above, 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 0.5% Bank Rate. Indeed, the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

7.2 The Council held £11.5m of investments as at 30 September 2014 (£7.3m at 31 March 2014) and a current account balance of £0.23m. The details are shown at Appendix A.

7.3 Returns on investment have been slightly above benchmark rates as shown in the table below. However the Council budgeted for returns based on a rate of 0.54% and currently the average rate is forecast to be 0.46%.

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned £
Up to 7 day	0.35%	0.37%	11,710
1 month	0.37%	0.40%	340
3 month	0.42%	0.46%	3,390
6 month	0.55%	0.58%	32
12 month	0.88%	n/a	0

7.4 Additionally, the Council's investment income was boosted by a discount of £13,000 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 £28,470 at 30 September.

7.5 The Council's budgeted investment return for 2014/15 is £19,410 based on an average return of 0.54% on average balances of £6.7m. The forecast outturn for the year is £55,000 due to cash balances 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 2014/15.

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. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts", and although this process may commence during this financial year the actual timing of the changes is still subject to discussion.

8.3 Discussions with the Council's treasury management advisors Capita Treasury Services' have indicated that the Council's current investment criteria is restrictive and that this is adding risk to the portfolio. They have suggested that the Counterparties, duration of investment and limits are reviewed to offer a greater spread of investments thereby reducing risk and enhancing returns.

8.4 The Council's Treasury officers will therefore 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 2014/15 is £5.883m after utilising £0.311m 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	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
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

9.5 It is anticipated that further borrowing will not be undertaken during this financial year.

10. Debt Rescheduling

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: Investments at 30 September

APPENDIX A

Investments at 30 September 2014

Counterparty	Date of Investment	Date of Maturity	Value £	Interest Rate	Interest Due or Forecast £
Fixed term:					
Furness BS	01/04/2014	01/10/2014	500,000	0.55%	1,380
National Counties BS	01/04/2014	01/10/2014	500,000	0.65%	1,630
Newcastle BS	01/04/2014	01/10/2014	500,000	0.60%	1,500
Coventry BS	04/07/2014	06/10/2014	500,000	0.44%	570
Barclays Bank	02/05/2014	03/11/2014	1,000,000	0.55%	2,790
Nationwide BS	01/08/2014	03/11/2014	1,000,000	0.50%	1,290
Cumberland BS	13/08/2014	13/11/2014	1,000,000	0.45%	1,130
Coventry BS	02/06/2014	02/12/2014	500,000	0.58%	1,450
Cambridge BS	02/06/2014	02/12/2014	500,000	0.51%	1,280
National Counties BS	02/07/2014	02/01/2015	500,000	0.65%	1,640
Money Market Funds:					
Goldman Sachs	n/a	n/a	900,000	0.36%	1,750
SWIP	n/a	n/a	500,000	0.29%	950
Blackrock	n/a	n/a	600,000	0.32%	1,100
Insight	n/a	n/a	1,000,000	0.41%	1,380
Ignis Sterling Liquidity Fund	n/a	n/a	1,000,000	0.35%	1,740
Call Accounts:					
Santander	n/a	n/a	500,150	0.40%	1,670
Bank of Scotland	n/a	n/a	501,855	0.40%	1,800
Lloyds Bank Current Account	n/a	n/a	230,237	0.40%	1,200
Total Investments at 30 September			11,732,242		