COUNCIL – 23RD JANUARY 2017

Report of the Cabinet

ITEM 6.2 TREASURY MANAGEMENT UPDATE – MID-YEAR REVIEW FOR THE SIX MONTHS ENDING 30TH SEPTEMBER 2016

Purpose of Report

This report reviews the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first six months of 2016/17.

Recommendation

That the mid-year review of the Treasury Management Strategy Statement, Prudential Borrowing and Treasury Indicators plus the Annual Investment Strategy as shown in Part B of the report of the Head of Finance and Property Services, attached as an Annex, be noted.

Reason

To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the Revised CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement, that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Treasury Management Strategy Statement, Prudential and Treasury Indicators and Annual Investment Strategy must be approved by Council each year and reviewed half yearly. This review is set out in Part B of the report of the Head of Finance and Property Services, attached as an Annex. The Strategy for the year was approved by Council on 29th February 2016.

At its meeting on 17th November 2016, Cabinet considered a report of the Head of Finance and Property Services, attached as an Annex to this report, setting out the the mid-year review of the Treasury Management Strategy Statement, Prudential Borrowing and Treasury Indicators plus the Annual Investment Strategy.

Cabinet resolved *'That it be recommended to Council to note the mid-year review of the Treasury Management Strategy Statement, Prudential Borrowing and Treasury Indicators, plus the Annual Investment Strategy, as shown in Part B of the report of the Head of Finance and Property Services, filed with these minutes.'*

The reason for the recommendation was *'To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the Revised CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement, that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.'*

Implementation Timetable including Future Decisions and Scrutiny

If approved by Council, this decision will have immediate effect.

Financial Implications

There are no further financial implications other than those set out in the report submitted to Cabinet (attached as an Annex).

Risk Management

There are no further risks other than those set out in the report submitted to Cabinet (attached as an Annex).

Key Decision:	No
Background Papers:	None
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CABINET – 17TH NOVEMBER 2016

Report of the Head of Finance & Property Services

Lead Member: Councillor Tom Barkley

Part A

ITEM 12 TREASURY MANAGEMENT UPDATE – MID-YEAR REVIEW FOR THE 6 MONTHS ENDING 30TH SEPTEMBER 2016

Purpose of Report

This report reviews the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first 6 months of 2016/17.

Recommendation

That it be recommended to the Council to note this mid-year review of the Treasury Management Strategy Statement, Prudential Borrowing and Treasury Indicators plus the Annual Investment Strategy as shown in Part B.

Reason

To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the Revised CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement, that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Treasury Management Strategy Statement, Prudential & Treasury Indicators and Annual Investment Strategy must be approved by Council each year and reviewed half yearly. This review is set out in the attached report as Part B. The Strategy for the year was approved by the Council on 29th February 2016 (minute ref: 84.4).

Implementation Timetable including Future Decisions and Scrutiny

This report will be available for Overview Scrutiny Group on 14th November 2016, should they wish to consider it, and for the Audit Committee on 29th November 2016.

Report Implications

The following implications have been identified for this report.

Financial Implications

There are no direct financial implications arising from this report.

Risk Management

There are no direct risks arising from the recommendation in this report. Risks associated with the Treasury Policy etc in general are included in Part B.

Key Decision:	No
Background Papers:	None
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Part B

Treasury Management Update – Half Year Ending 30th September 2016

1. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly. This report therefore ensures the Council is implementing best practice in accordance with the Code.

Economic Background

2. This section does not comprehensively cover the last six months' economic outcomes as these are sufficiently covered in the media. However, some brief highlights and a forward look are set out:

    - UK GDP growth rates in 2013 (2.2%) and 2014 (2.9%) were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries.

    - During most of 2015, the economy faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the EU, China and emerging markets. It was also affected by the dampening effect of the Government's continuing austerity programme.

    - The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys. It is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

    - The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access (i.e. without tariffs) to the EU single market.

    - The Bank of England meeting on 4th August 2016 addressed this expected slowdown through a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Bank Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%.

    - Mr. Carney also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on 23rd November 2016.

    - The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started to rise during 2016 as the

falls in the price of oil and food twelve months ago fall out of the calculation during this year. In addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is considered likely to result in a 3% increase in CPI over a time period of 3-4 years.

- However, the MPC is expected to look past a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

- The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Federal Reserve embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and the Brexit vote, have caused a delay in the timing of the second increase, which is now strongly expected in December this year.

- In the Eurozone, the European Central Bank (ECB) commenced a massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month in March 2016. This was originally intended to run to September 2016 but was extended to March 2017 at the ECB December 2015 meeting.

- At its December and March meetings the ECB progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn.

- These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

<u>Interest Rate Forecast</u>

3. The Council's treasury advisor, Capita Asset Services (CAS), has provided the following forecast:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.30%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

4. Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting on 4th August 2016 cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% in November this year and a first increase in May 2018 to 0.25%, but no further increase to 0.50% until a year later. Mr. Carney has repeatedly stated that increases in Bank Rate will be slow and gradual when 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.

Annual Investment Strategy

5. The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by Council on 29th February 2016. It sets out the Council's investment priorities as being:

   • Security of capital;
   • Liquidity; and
   • Yield.

6. The Council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using the Council's creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information. In addition, the Annual Investment Strategy allows the Council to invest with other Local Authorities for a maximum of 2 years.

7. Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the 6 months ending 30th September 2016.

8. It is currently 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 0.25% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis together with other risks, which could impact on the creditworthiness of banks, prompts a low risk strategy. Given this risk environment, investment returns are likely to remain low.

9. The average level of funds available for investment purposes during the half year was £38.2m. The majority of these funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

10. In line with the Treasury Management Policy, the approved limits have been reviewed and amended during the first 6 months of 2016/17 to reflect available investment monies and market conditions.

11. During the 6 months to 30th September 2016, the Council's interest rate earned was 0.72% against a benchmark of 3 month London Interbank Bid Rate (LIBID) of 0.38%. This measure is used as a comparator because it allows comparisons with our benchmarking group and matches the weighted average time period of our current investments. Although the return rate is low, our performance can still be considered to be good as we exceeded the target rate by 0.34%. The actual interest received was £141k, which is 53% of the annual budget of £265k so we performed above target in both percentage and actual returns for the six months.

New Borrowing

12. No new borrowing was undertaken during the half year and neither has the council borrowed in advance of need during the 6 months ended 30th September 2016. Similarly, no debt rescheduling was undertaken during the half year.

Compliance with Treasury and Prudential Limits

13. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved TMSS.
14. During the financial year to date, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 1.

Appendices

Appendix 1: Prudential and Treasury Indicators as at 30th September 2016
Appendix 2: Investment Portfolio – Investments held as at 30th September 2016

APPENDIX 1:

Prudential and Treasury Indicators as at 30th September 2016

Treasury Indicators	2016-17 Budget £'000	30/09/16 Actual £'000
Authorised limit for external debt	96,000	81,190
Operational boundary for external debt	81,190	81,190
Gross external debt	81,190	81,190
Investments	24,214	44,330
Net borrowing	56,976	36,860
Maturity structure of fixed rate borrowing - upper and lower limits	**Upper Limits**	**Actual**
Under 12 months	5%	0%
12 months to 2 years	10%	0%
2 years to 5 years	20%	0%
5 years to 10 years	30%	3%
10 years to 20 years	35%	30%
20 years to 30 years	50%	42%
30 years to 40 years	15%	12%
40 years and above	20%	13%

Prudential Indicators	2016/17 Budget £'000	30/09/16 Actual £'000
Capital expenditure – General Fund	5,896	983
Capital expenditure – HRA	7,341	1,101
Capital Financing Requirement (CFR) – GF	0	0
Capital Financing Requirement (CFR) – HRA	81,173	81,173
Annual change in CFR	0	0
In year external borrowing requirement	0	0
Ratio of financing costs to net revenue stream - GF	-0.11%	-0.11%
Ratio of financing costs to net revenue stream - HRA	12.07%	12.07%

Prudential Indicators	2016/17 Budget £'000	30/09/16 Actual £'000
Incremental impact of capital investment decisions:-		
Increase in council tax (band change) per annum.	0%	0%
Increase in average housing rent per week	0%	0%

APPENDIX 2:

Investment Portfolio

Investments held as at 30th September 2016

Institution	Maturity Date	Interest Rate %	Principal £'000
Bank of Scotland	01/12/2016	0.80	1,000
Bank of Scotland	02/03/2017	0.65	6,000
Nationwide Building Society	25/10/2016	0.71	2,000
Nationwide Building Society	27/10/2016	0.71	3,000
Nationwide Building Society	15/02/2017	0.40	2,000
Warrington Borough Council	23/02/2018	0.90	2,000
Santander	180 Day Notice	0.90	8,000
Goldman Sachs International Bank	65 Day Notice	0.58	2,000
Goldman Sachs International Bank	65 Day Notice	0.46	2,000
Barclays Bank Plc	95 Day Notice	0.45	7,000
Federated MMF	2 Day Notice	0.71	2,000
Federated MMF	1 Day Notice	0.37	5,000
Standard Life MMF	1 Day Notice	0.34	2,330
Total			**44,330**