2015/16 MID YEAR TREASURY MANAGEMENT REVIEW

1 SUMMARY

1.1 The purpose of this report is to provide an update of the Council's Treasury Management activity for the period 1 April 2015 to 30 September 2015 in accordance with the Council's Treasury Management Policy and good practice in treasury management.

1.2 It is recommended that the Treasury Management Task & Finish Group notes the Council's treasury activities for the period ending 30 September 2015 and provide comments on the information presented in this report, before it is presented for approval by Full Council on 15 December 2015.

2 INTRODUCTION

2.1 The Council has adopted the Code of Practice on Treasury Management and a requirement of this is to produce a mid-year review looking at the Authority's performance in line with the strategy agreed by Council in February 2015.

2.2 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the Treasury Management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

2.3 The second main function of the Treasury Management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending liabilities.

Accordingly, treasury management is defined as: 'The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks'.

2.4 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 2015/16 financial year to 30 September 2015;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2015/16;
- A review of the Council's borrowing strategy for 2015/16;
- A review of compliance with Treasury and Prudential Limits for 2015/16.

2.5 The Council employs treasury advisors, Capita Treasury Services Ltd. (Capita), formerly known as Sector Treasury Services Ltd., to provide advice on its Treasury Management strategy and analysis of the economy and expectations for interest rates.

3 KEY MOVEMENT/CHANGES TO THE CAPITAL AND TREASURY STRATEGIES

3.1 There are no changes to the Treasury Management Strategy (TMS) to report. However, with some institutions starting to re-establish themselves and credit rates starting to improve, it is felt useful to clarify part of the TMS to Members.

3.2 The credit worthiness policy in the TMS provides limits and duration of investments dependent on the colour status of an institution. The limits increase with the strength of the counterparty either in duration or the amount to be placed. For a counterparty in one of the higher colour bandings, any limit in the colour bandings below it can also be applied. The limits and durations are as follows:-

Capita Colour Coding	Maximum Duration	Maximum Investment
No Colour	Not to be used	-
Green	100 days	£6m
Red	6 months 100 days	£3m £6m
Orange	1 year 6 months 100 days	£1m £3m £6m
Blue	1 year	£4m
Purple	2 years 100 days	£3m £6m

Prudential Indicator for Capital Expenditure

3.3 This table shows the forecasted outturn for capital expenditure as at 30 September 2015 and the changes since the Capital Programme was agreed in July 2015, as well as the indicative financing for the programme.

Capital Expenditure	2015/16 Original Estimate £'000s	2015/16 Revised Estimate £'000s	2015/16 Latest & End of Year Forecast £'000s
Total	3,737	4,008	3,670
Financed by:			
Prudential Borrowing	1,709	1,726	-
Funded Internally	-	-	1,607
Capital Receipts	1,878	1,763	1,613
Grants	150	519	450

Changes to the Prudential Indicators for the Capital Financing Requirement and the Operational Boundary

3.4 The original capital programme outlined in January 2015 showed a requirement for net new borrowing of £1.709m in the current financial year. However, with the current forecast and internally identified resources it is anticipated that this will reduce to £1.607m and an internal, rather than external, borrowing opportunity will be explored.

3.5 Net external borrowing should not, except in the short term, exceed the total of Capital Financing Requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2015/16 and next two financial years. The Council has no external borrowing and the capital financing requirement is expected to increase as per the table below.

£000s	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
CFR	687	2,294	2,850	3,116
Movement in CFR	-	1,607	556	266

3.6 The anticipated borrowing position as indicated above will mean a Minimum Revenue Provision charge (MRP) will be made to repay the borrowing and interest costs to the respected service areas.

3.7 There are no changes to the authorised and operational limits (upper limit beyond which external debt is prohibited) which is outlined in the Treasury Management Strategy and can only be revised by Full Council.

Economic performance to date

3.8 During the quarter ended 30 September 2015:-

- **The economic recovery lost some pace;**
  Growth in the UK Gross Domestic Product (GDP) of 3.0% in 2014 was the strongest growth since 2006. Quarter 1 of 2015 was weak at +0.4% quarter 2 to +0.7%. The Bank of England is forecasting growth to remain around 2.4 – 2.8% over the next three years.

- **Wage growth picked up further in response to labour market tightening;**
  This overall strong growth has resulted in unemployment falling quickly over the last few years and now encouraging in 2015 to see wage inflation rising significantly above the Consumer Prices Index (CPI).

- **CPI inflation hovered around 0% and poised to turn negative;**
  Consumer Prices Index (CPI) which slipped back to zero in June before rising slightly to +0.1% in July and oil prices taking a fresh downward direction there could be several more months of low inflation still to come.

The August Bank of England Inflation Report forecast inflation barely getting back up to the 2% target within the 2-3 year time horizon.

- **The prospect of a 2015/16 Bank of England base rate hike became extremely unlikely;**
  Major concerns around the slowdown in Chinese growth, the knock on impact on emerging countries from falling oil and commodity prices, and the volatility we have seen in equity and bond markets in 2015 so far it is hardly likely that rates will rise.

Outlook for the last six months of 2015/16

3.9 Risks to current forecasts:-

- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support
- Slow down in the rate of growth for the services and manufacturing sectors given the appreciation of Sterling against the Euro and the slowdown in China and emerging markets; creating headwinds for our exporters of goods.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.

3.10 The Monetary Policy Committee (MPC) revealed recently an increase in caution over UK growth prospects, with this in mind, Capita have updated their interest rate forecast, they now advise that a base rate rise is unlikely until June 2016.

Capita's interest rate forecast has been updated as follows:-

	Sept 2015 Actual %	**Dec 2015 %**	**Mar 2016 %**	**Jun 2016 %**	**Sept 2016 %**	**Dec 2016 %**	**Mar 2017 %**
Interest Rate Forecast February 2015	0.50	0.50	0.50	0.75	0.75	1.00	1.25
Current Forecast	0.50	0.50	0.50	0.75	0.75	1.00	1.00
5 Year PWLB Forecast	2.13	2.30	2.40	2.50	2.60	2.80	2.90
10 Year PWLB Forecast	2.58	2.90	3.00	3.20	3.30	3.40	3.50
25 Year PWLB Forecast	3.30	3.50	3.60	3.80	3.90	4.00	4.10

Treasury Management Strategy Statement and Annual Investment Strategy update

3.11 The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by Council on 24 February 2015. All areas of the TMS including

Prudential Indicators remain the same. No changes to the Capital Indicators have been reported.

Investment Portfolio 2015/16

3.12 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. Given this risk environment, investment returns are likely to remain low.

3.13 The Councils cash flow position is generally such that it has scope to undertake only short term investments of surplus funds. The Council started the year with investments of £3.9m, plus £0.96m in its main current account. The balance of investments held as at 30 September was £4.51m, plus £0.67m in the main current account. The table below summarises the investment transactions that have taken place:-

	Investments £000's	**Current Account £'000's**	**No. of Investments**
Balance on Investments 1 April 2015	3,900	960	3
Investments placed 01/04/15 – 30/09/15	18,800		
Investments realised 01/04/15 – 30/09/15	18,190		
Balance on Investments 30 Sept 2015	4,510	670	2

3.14 The 2 investments comprising the balance of £4.51m were placed with the following counterparties:-

Counterparty	**£000's of Investments**	**% of Investments including current account**
Barclays Bank	10	0.2
Svenska Handlesbanken	4,500	86.9
Lloyds Bank	670	12.9

3.15 The bank base rate has remained at 0.5% since March 2009. In terms of the relative performance of the Council's investment portfolio the target/benchmark investment is 0.5%. Forecast investment return for 2015/16 is £40,000, around £7,000 lower than originally anticipated. The investment rates on offer for short term deposits have remained low during the year primarily as a consequence of general economic conditions.

3.16 The Chief Financial Officer (Section 151 Officer) confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2015/16. A review of the Council's investment strategy will be undertaken in the New Year and strategy considered which seeks to maximise returns on investment.

Investment Counterparty criteria

3.17 The current investment counterparty criteria selection approved in the TMS is meeting the requirement of the treasury management function.

3.18 The financial institutions that the Authority is investing with are monitored on a regular basis in line with the risk document issued by Capita, the treasury advisors.

4 RISK IMPLICATIONS

4.1 There are no new risk management implications arising from the contents of this report. However, Members will be aware of the uncertainty in the financial markets and the economy as a whole and the potential risks that this may have in general. TMS outlines the risks involved in the investments made by the Council and there have been no changes to the assessment of risk.

5 RECOMMENDATION

5.1 It is proposed that the Treasury Management Task and Finish Group **RESOLVES** to:-

(1) Recommend the contents of this Annual Report to Full Council.

(2) Identify any issues on this topic for further consideration and discussion by the group.

Denise Murray

Section 151 Officer

Background Papers:-

None.

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If you would like this report in large print, Braille or another language please contact 01702 318111.