

**2 November 2015**

**Policy, Finance and Resources Committee**

**Treasury Management Strategy Statement and Annual  
Investment Strategy Mid-year Review Report 2015/16**

**Report of:** *Chris Leslie, Finance Director*

**Wards Affected:** *All*

**This report is:** *Public*

**1. Executive Summary**

- 1.1 The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by this Council on 4 March 2015.
- 1.2 The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a Code of Practice for Treasury Management. The Code suggests that members should be informed of Treasury Management activities at least twice a year.
- 1.3 This report, which covers the first six months of the 2015/16 financial year, therefore ensures this Authority is embracing best practice and meeting the statutory requirements.
- 1.4 The legal status of the Code is derived from regulations issued under the Local Government Act 2003 which require local authorities to “have regard to guidance that the Secretary of State may by regulations specify.” The Code and the CIPFA Prudential Code fall into this category.

**2. Recommendation(s)**

- 2.1 To note the Treasury Management Activity for the period 1 April 2015 to 30 September 2015**

### **3. Introduction and Background**

3.1 The Council follows the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011). The primary requirements of the Code are as follows:

- The creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's Treasury Management Activities.
- The creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- To provide Members with the following reports:
  - a. an Annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead,
  - b. a Mid-year Review Report.
  - c. an Annual Report (stewardship report) covering activities during the previous year.
- The 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.

3.2 This 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 half of the 2015/16 financial year;
- 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 any debt rescheduling undertaken during 2015/16;
- A review of compliance with Treasury and Prudential Limits for 2015/16.

3.3 Key changes to the Treasury and Capital Strategies :

No changes to the 2015/16 Strategies are proposed by this report.

## **4 Context – Economic update**

- 4.1 Whilst the Bank of England is forecasting growth to remain around 2.4 – 2.8% over the next three years, recent forward looking surveys for the services and manufacturing sectors showed a marked slowdown in the rate of growth, reflecting concerns among exporters over the strength of Sterling against the Euro and of weak growth in the EU, China and emerging markets.
- 4.2 In order for the domestic economic recovery to become more balanced and sustainable in the longer term there needs to be a shift away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure.
- 4.3 The overall strong UK growth has resulted in unemployment falling quickly over the last few years. The Chancellor and the Bank of England Monetary Policy Committee (MPC) have been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising above the rate of general inflation in order to ensure that the recovery will be sustainable.
- 4.4 Wage inflation has now risen significantly above Consumer Price Index inflation, the rate of which had slipped back to zero in June and again in August, driven by a fall in oil and commodity prices. The August Bank of England Inflation Report forecasts that inflation will barely get back up to the 2% target within a 2-3 year time horizon. Although year on year average weekly earnings reached 2.9% in the three months to July, the continuing positive output gap and low inflation mean this is unlikely to provoke the MPC to raise the bank rate soon.
- 4.5 There are considerable risks around whether inflation will rise in the near future as strongly as previously expected, which will remove the need for central banks in both the US and the UK to raise rates. Central banks retain the option of additional quantitative easing should domestic growth slow in reaction to the international economy. It is unlikely they will raise rates until they are sure growth is securely embedded.
- 4.6 The forecast for the first increase in Bank Rate has therefore been pushed back from Q1 to Q2 of 2016, with any subsequent increases at a much slower pace and to much lower levels than prevailed before 2008, although any increase will have a lower effect on consumer demand given the reduction in aggregate consumer debt from the levels prevalent before the global financial crisis.
- 4.7 **Interest Rate Forecast**

The Council's treasury advisor, Capita Asset Services, has provided the forecast as outlined in Table 1:

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

Capita Asset Services undertook a review of its interest rate forecasts in early August. Subsequently, fears around the slowdown in China and Japan caused major volatility in equities and bonds and sparked a flight from equities into safe havens like gilts and which depressed PWLB rates. News in September in respect of Volkswagen, and other corporates, has compounded downward pressure on equity prices.

The latest forecast shown above includes a first increase in Bank Rate in quarter 2 of 2016.

#### **4.8 Treasury Management Strategy Statement & Annual Investment Strategy**

The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by the Council on 4 March 2015. In line with CLG investment guidance it sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

Credit rating information is supplied by Capita Asset Services on all active counterparties that comply with the criteria shown below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. The criteria for providing a pool of high quality investment counterparties with the time and monetary limits for institutions on the Council's counterparty list are summarised in Table 2:

<b>Table 2: Counterparty minimum criteria</b>			
	<b>Fitch Long Term Rating (or equivalent)</b>	<b>Money Limit</b>	<b>Time Limit</b>
<b>Banks 1 Higher Quality:</b> Abbey National Treasury Services Citibank International Plc Close Brothers Limited Credit Suisse International Goldman Sacks International Bank HSBC Bank plc MBNA Bank plc MBNA Europe Bank Santander UK Plc Standard Chartered Bank UBS Ltd	F1, A	£3m	1yr
<b>Banks 2 Part Nationalised:</b> Bank of Scotland plc Lloyds Bank Royal Bank of Scotland National Westminster Bank	N/A	£5m £3m £10m £3m	1yr 1yr 1yr 1yr
<b>UK Building Societies:</b> Nationwide Building Society Coventry Building Society	A	£5m	1yr
<b>Banks 3 Council's Banker</b>  Lloyds Bank	N/A	£3m	1 day
Debt Management Account Deposit Facility (DMADF)	AAA	Unlimited	6mths
Local Authorities	N/A	£5m	1yr
Money Market Funds	AAA	£3m	1yr

Additional requirements under the Code require the Council to supplement credit rating information.

Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

### **Investment Portfolio 2015/16**

- 4.9 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. The investment market remains very difficult in terms of earning the level of interest rates commonly seen in previous decades as rates remain low.

4.10 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 higher rates in periods up to 12 months, with highly credit rated financial institutions.

4.11 The Council held £16.3m of investments as at 30 September 2015 (£8.8m at 31 March 2015). During the period 1 April to 30 September 2015, the Council placed the following investments:

<b>Table 3: Investments held as at 30 September 2015</b>				
<b>Date invested</b>	<b>Date to be repaid</b>	<b>Invested in</b>	<b>Investment amount £</b>	<b>Interest rate %</b>
02/09/2015	Call	Royal Bank of Scotland	322,000	0.25
29/09/2015	Call	Bank of Scotland	2,000,000	0.4
<b>Total call deposits</b>			<b>2,322,000</b>	
01/04/2015	04/01/2016	Nationwide Building Society	1,000,000	0.79
01/04/2015	01/02/2016	Nationwide Building Society	2,000,000	0.82
15/04/2015	15/01/2016	Nationwide Building Society	1,000,000	0.79
30/06/2015	31/12/2015	Santander	2,000,000	0.69
01/07/2015	04/01/2016	Santander	1,000,000	0.69
31/07/2015	29/02/2016	Lancashire County Council	2,000,000	0.45
07/08/2015	08/02/2016	Newcastle City Council	2,000,000	0.35
11/08/2015	11/02/2016	Coventry Building Society	1,000,000	0.6
01/09/2015	01/03/2016	Nationwide Building Society	2,000,000	0.66
<b>Total fixed term deposits</b>			<b>14,000,000</b>	
<b>TOTAL INVESTMENTS</b>			<b>16,322,000</b>	

4.12 Surplus funds were held in call accounts held with Bank of Scotland and the Royal Bank of Scotland for cash flow purposes.

4.13 The Section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2015/16.

### **Investment Income**

4.14 The Council's budgeted investment return for 2015/16 is £60,000. Actual income received to date is around £20,769 below the profiled budget, due to the timing of interest receipts. At this stage the forecast year end position for investment income is still as per budget.

<b>Table 4: Investment income earned as at 30 September 2015</b>				
<b>Original estimate £</b>	<b>Actual at 30 Sept £</b>	<b>% earned at 30 Sept</b>	<b>Estimated outturn £</b>	<b>Outturn variance £</b>
60,000	9,231	15%	60,000	0

## Borrowing

- 4.15 During the period 1 April to 30 September 2015, no new external borrowing was undertaken. Details of all loans held by the Council as at 30 September 2015 are shown in Table 5 below:

<b>Table 5: Debt held as at 30 September 2015</b>					
<b>Repayment date</b>	<b>Period of loan (yrs)</b>	<b>Type of loan</b>	<b>Fixed / variable</b>	<b>Interest rate</b>	<b>Amount outstanding £'000</b>
<b>PWLB LOANS:</b>					
28/03/2017	5	Maturity	Fixed	1.240%	5,000
28/03/2022	10	Maturity	Fixed	2.400%	5,000
28/03/2027	15	Maturity	Fixed	3.010%	10,000
08/01/2028	25	Maturity	Fixed	4.875%	400
28/03/2032	20	Maturity	Fixed	3.300%	15,000
28/03/2037	25	Maturity	Fixed	3.440%	15,000
28/03/2042	30	Maturity	Fixed	3.500%	14,166
24/02/2055	60	Maturity	Fixed	8.875%	800
30/04/2055	60	Maturity	Fixed	8.875%	800
<b>TOTAL</b>					<b>66,166</b>

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

### The Council's Capital Position (Prudential Indicators)

- 4.16 This part of the report provides an update on:
- The Council's capital expenditure plans;
  - How these plans are being financed;
  - The impact of any changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
  - Compliance with the limits in place for borrowing activity.
- 4.17 The Council undertakes capital expenditure on long-term assets. These activities may either be:
- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
  - If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.
- 4.18 Table 6 below shows the actual capital expenditure together with the expected financing:

<b>Table 6: Capital expenditure</b>					
	<b>2015/16 Original estimate £m</b>	<b>Current budget £m</b>	<b>Current spend 30 Sept £m</b>	<b>At 30 Sept %</b>	<b>2015/16 est outturn £m</b>
Non HRA	5.096	8.470	0.480	5.7%	3.150
HRA	4.535	6.121	0.989	16.2%	4.437
<b>Total expenditure</b>	<b>9.631</b>	<b>14.591</b>	<b>1.469</b>	<b>10.1%</b>	<b>7.587</b>
Financed by:					
Capital receipts, grants and contributions	7.146	14.591	1.469	10.1%	7.587
<b>Total financing</b>	<b>7.146</b>	<b>14.591</b>	<b>1.469</b>		<b>7.587</b>
Borrowing for HRA	2.485	0	0		0

**The Authorised Limit** - is the “affordable borrowing limit” required by Section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level.

**The Operational Boundary** – the Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

<b>Table 7: Prudential Indicators - Affordability</b>		
	<b>2015/16 Original est £m</b>	<b>2015/16 Revised est £m</b>
<b>Authorised Limit</b>	<b>90.0</b>	<b>90.0</b>
<b>Operational Boundary</b>	<b>87.0</b>	<b>87.0</b>

Table 8 shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period.

<b>Table 8: Capital Financing Requirement / External Debt</b>		
	<b>2015/16 Original est £m</b>	<b>2015/16 Revised est £m</b>
CFR non-HRA	11.490	7.441
CFR HRA	69.847	68.847
<b>Total CFR</b>	<b>81.337</b>	<b>76.288</b>
Borrowing	69.772	66.166
Other long term liabilities	0.013	0.013
<b>Total debt at 31 March</b>	<b>69.785</b>	<b>66.179</b>
<b>Under/(over) borrowing</b>	<b>11.552</b>	<b>10.109</b>

The Council's projected capital financing requirement (CFR) for 2015/16 is £76.3m. 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).

## **Summary**

- 4.19 In compliance with the requirements of the CIPFA Code of Practice of Treasury Management, this report provides Members with an in-year report of the treasury management activities for 2015/16 to date. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken so far, with priority being given to security and liquidity over yield.
- 4.20 Whilst investment returns are still low as a consequence of prevailing low interest rates, the Authority is anticipating that investment returns will meet those originally budgeted. The Council maintains a positive Capital Financing Requirement and any funding issues associated with this position will be managed in accordance with the approved Treasury Management Strategy Statement (TMSS).

## **5 Reasons for Recommendation**

- 5.1 This report meets the requirements of the CIPFA Code of Practice of Treasury Management.

## **6 Consultation**

- 6.1 None.

## **7 References to Corporate Plan**

- 7.1 Sound financial management underpins all of the priorities within the Corporate Plan.

## **8 Implications**

### **Financial Implications**

**Name & Title:** Ramesh Prashar, Financial Services Manager

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- 8.1 The financial implications are outlined in the report.

### **Legal Implications**

**Name & Title:** Chris Potter, Monitoring Officer

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- 8.2 There are no direct legal implications arising from this report.

**9 Background Papers** (include their location and identify whether any are exempt or protected by copyright)

9.1 4 March 2015 Treasury Management Strategy Statement 2015/16.

**10 Appendices to this report**

None

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