CITY OF YORK COUNCIL

Executive **26 November 2015**

Report of the Director of Customer & Business Support Services

Treasury Management Mid Year Review and Prudential Indicators 2015/16

Purpose of the report

1. The Council is required through legislation to provide members with a mid year update on treasury management activities. This report provides an update on activity for the period 1 April 2015 to 31 October 2015.

Recommendations

2. Members are required, in accordance with the Local Government Act 2003 (revised), to:
   - Note the Treasury Management activities to date in 2015/16
   - Note the Prudential Indicators set out at Annex A and note the compliance with all indicators.

Reason: To ensure the continued performance of the Council's Treasury Management function.

Background

3. The Council's Treasury Management function is responsible for the effective management of the Council's investments, cash flows, banking, and money market transactions. It also considers the effective control of the risks associated with those activities and ensures optimum performance within those risk parameters.

Economic Background and Analysis

4. UK Gross Domestic Product growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country. The 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, possibly

being equal to that of the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% year to year) though there was a rebound in quarter 2 to +0.7% (+2.4% year to year). Growth is expected to weaken to about +0.5% in quarter 3 as the economy faces headwinds for exporters from the appreciation of Sterling against the Euro and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme, although the pace of reductions was eased in the May Budget. Despite these headwinds, the Bank of England August Inflation Report had included a forecast for growth to remain around 2.4 to 2.8% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth. However, since the report was issued, the Purchasing Manager's Index, (PMI), for services on 5 October would indicate a further decline in the growth rate to only +0.3% in Q4, which would be the lowest rate since the end of 2012. In addition, worldwide economic statistics and UK consumer and business confidence have distinctly weakened so it would therefore not be a surprise if the next Inflation Report in November were to cut those forecasts in August.

5. The August Bank of England Inflation Report forecast was notably subdued in respect of inflation which was forecast to barely get back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to soon rejoin the world oil market after the impending lifting of sanctions, there could be several more months of low inflation still to come, especially as world commodity prices have generally been depressed by the Chinese economic downturn.

6. There are therefore considerable risks around whether inflation will rise in the near future as strongly as had previously been expected; this will make it more difficult for the central banks of both the US and the UK to raise rates as soon as was being forecast until recently, especially given the recent major concerns around the slowdown in Chinese growth, the knock on impact on the earnings of emerging countries from falling oil and commodity prices, and the volatility we have seen in equity and bond markets in 2015 so far, which could potentially spill over to impact the real economies rather than just financial markets.

7. Capita Asset Services undertook its last review of interest rate forecasts in mid August after the Bank of England's Inflation Report. Later in August, 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 so caused PWLB rates to fall below the forecasts for quarter 4 2015. However, there is much volatility in rates as news ebbs and flows in negative or positive ways and news in September in respect of Volkswagen, and other corporates, has compounded downward pressure on equity prices. This latest forecast includes an increase in Bank Rate in quarter 2 of 2016.

8. Table 1 is Capita's Asset Services Interest Rate forecast for both the bank rate and long term Public Works Loans Board borrowing rates (PWLB – the Debt Management Office subsidiary lending to Local Authorities at preferential rates note all figures are percentages):

	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18
Bank Rate	0.5	0.5	0.75	0.75	1.00	1.00	1.25	1.50	1.50	1.75	1.75
5 Yr PWLB rate	2.40	2.50	2.60	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50
10 Yr PWLB rate	3.00	3.20	3.30	3.40	3.50	3.70	3.80	3.90	4.00	4.10	4.20
25 Yr PWLB rate	3.60	3.80	3.90	4.00	4.10	4.20	4.30	4.40	4.50	4.60	4.60
50 Yr PWLB rate	3.60	3.80	3.90	4.00	4.10	4.20	4.30	4.40	4.50	4.60	4.60

Table 1: Capita Asset Services Interest Rate Forecast (%)

Annual Investment Strategy

9. Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by Council on 26 February 2015. There are no policy changes to the TMSS and the details in this report do not amend the TMSS. The Council's Annual Investment Strategy, which is incorporated in the Strategy, outlines the Council's investment priorities as follows:
   - security of capital
   - liquidity
   - yield

10. The Council continues to aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity and the Councils risk appetite.

Investment Portfolio

11. Investment rates available in the market have continued at historical low levels. The average level of cash balances available for investment purposes in the 6 months of 2015/16 was £100.629m (£73.160m for the same 6 month period in 14/15). The level of cash balances available is largely dependent on the timing of the Council's cash flow as a result of precept payments, receipt of grants, receipt of developers contributions, borrowing for capital purposes, payments to its suppliers of goods and services and spend progress on the Capital Programme. These funds are therefore only available on a temporary basis dependant on cash flow movement.

12. The average level of cash balances has increased compared to a year ago due to a number of factors. These include the receipt of developers contributions in advance of the associated profiled spend and receipt of funding from NHS England.

13. This increase allows the Council to use cash balances instead of taking long term debt to finance the Councils capital programme. This strategy remains a prudent one as investment rates continue to be lower than borrowing rates when viewed on a short term projection but consideration is being given to securing long term funding currently as long term rates are at attractive levels.

14. Investment return (calculated as the amount of interest earned against the average cash balance for the period) during the first six months of 2015/16 is shown in table 2:

	2014/15 (full year)	**2015/16 (part year to date)**
CYC Rate of return	0.52%	0.52%
Benchmarks		
Bank of England Base Rate	0.50	0.50
7 Day LIBID	0.35	0.38
1 Month LIBID	0.37	0.40

Table 2: CYCs investment rate of return performance vs. benchmarks

15. The average rate of return is broadly comparable to 2014/15 reflective of the continued uncertainty regarding the rate of growth in both the Eurozone and UK and the continued uncertainty over the Eurozone sovereign debt positions.

16. Figure 1 shows the interest rates available on the market between 7 days and 1 year and also the rate of return that the Council has achieved for the first six months of 2015/16. It shows that favourable / competitive interest rates have been obtained for investments whilst ensuring the required liquidity and security of funds for the Council.

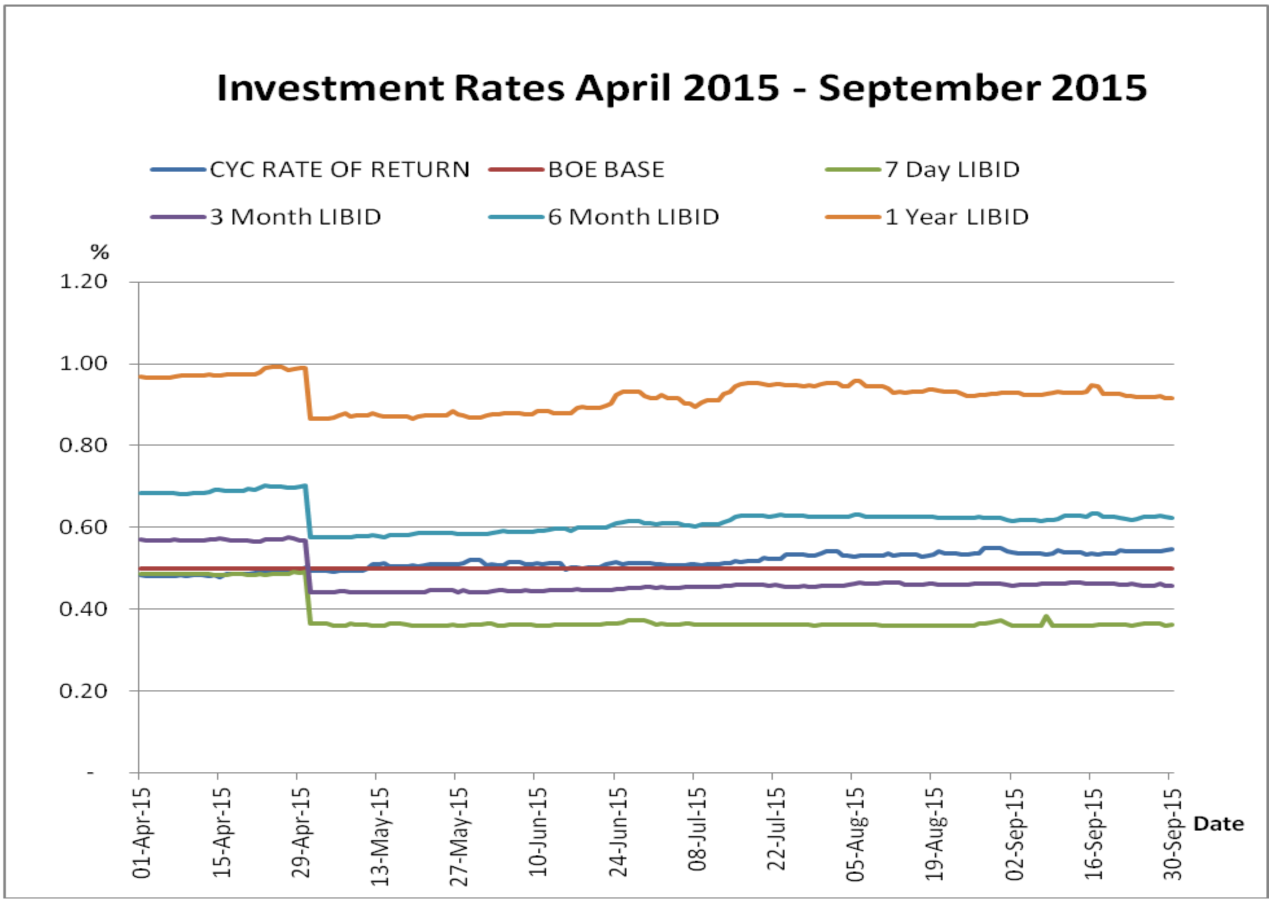

Figure 1 CYC Investments vs Money Market Rates

17. Figure 2 shows the investments portfolio split by deposits in short term call accounts, fixed term investments and money market funds (MMFs).

18. All of the MMFs have an AAA credit rating, the call accounts are all AA-, A+ or A rated and the fixed terms investments are A+ or A rated.

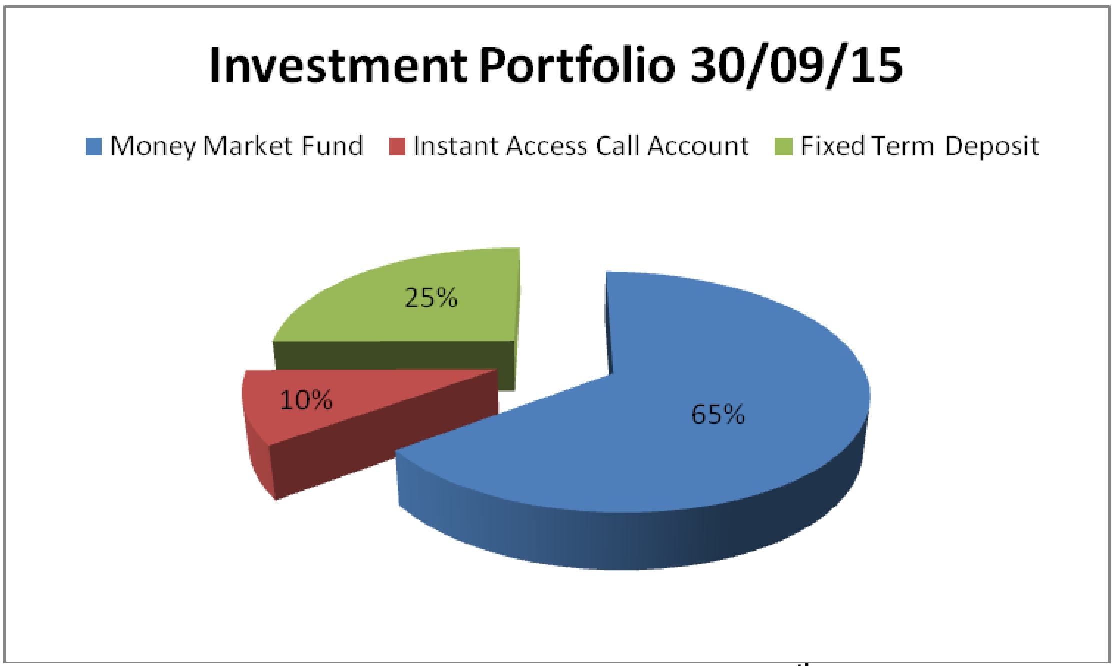

Figure 2 Investment Portfolio by type at 30th September 2015

Borrowing Portfolio

19. The Council undertakes long term borrowing in accordance with the investment requirements of the capital programme and all borrowing is therefore secured for the purpose of its asset base.

20. The level of borrowing taken by the Council is determined by the Capital Financing Requirement (the Councils underlying need to borrow for capital expenditure purposes). Borrowing needs to be affordable, sustainable and prudent.

21. Under regulation, the Council can borrow in advance of need in line with its future borrowing requirements in accordance with the Capital Financing Requirement. Markets are therefore constantly monitored and analysed to ensure that advantage is taken of favourable rates and the increased borrowing requirement is not as dependant on interest rates in any one year.

22. On the reverse side, the Council's level of borrowing can also be below the Capital Financing Requirement. This would mean that instead of increasing the Council's level of borrowing, surplus funds held for investment purposes would be utilised. In the current interest rate environment where investment rates on holding investments are significantly below borrowing rates consideration is given to the value of taking borrowing or whether it is better for the council to keep investment balances lower.

23. Although the treasury management function has not taken any new borrowing during 2015/16 it continues to closely monitor the borrowing environment for opportunities that arise and receives daily updates from Capita services in respect of borrowing timings and amounts.

24. The Council's long-term borrowing started the year at a level of £269.115m. The HRA amounts to 52% of the borrowing portfolio at £140.344m and the GF is 48% with borrowing at £128.771m, a current total of £269.115m.

25. Figure 3 illustrates the 2015/16 maturity profile of the Council's debt portfolio to 30th September 2015 split by general fund and HRA. The maturity profile shows that there is no large concentration of loan maturity in any one year, thereby spreading the interest rate risk dependency.

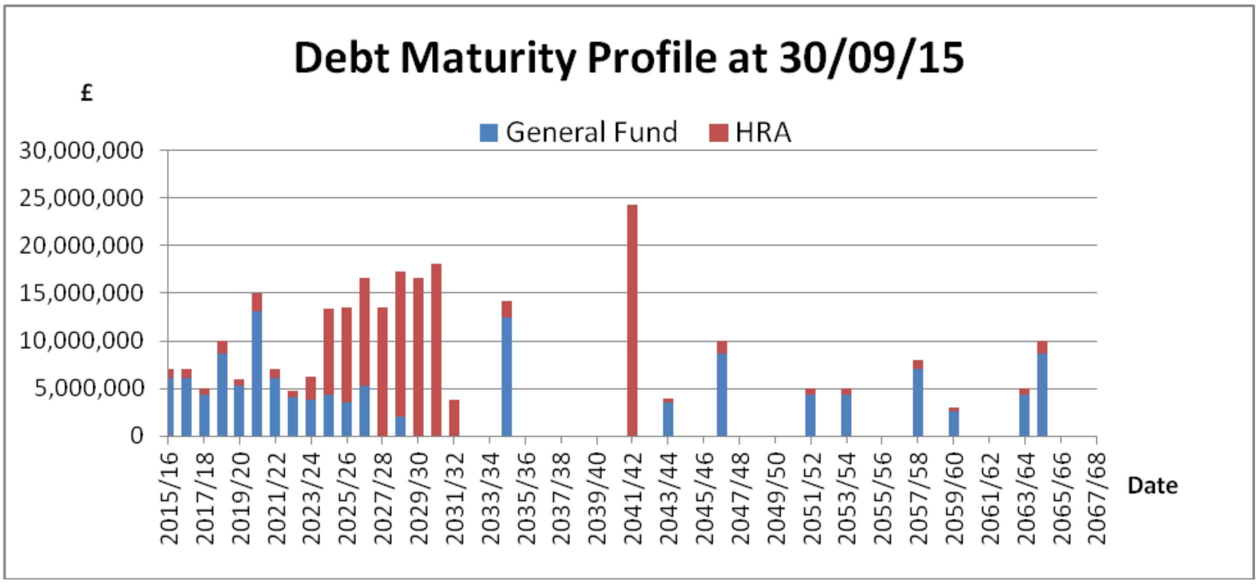

Figure 3 – Debt Maturity Profile 15/16 up to 30th September 2015

26. Table 3 shows that spreads have widened in the first 6 months of the year. The spread is above 1.00%, apart from 1 year duration. As a point of reference, for the same period last year the spread in similar periods was a maximum of 0.54%. Table 3 shows the variations in PWLB borrowing rates over the course of the year to date:

	PWLB borrowing rates by duration of loan				
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Yr High	1.69%	3.19%	3.91%	4.5%	4.48%
Yr Low	1.28%	1.97%	2.42%	3.06%	3.02%
Yr Avg	1.46%	2.58%	3.22%	3.82%	3.77%
Spread	0.41%	1.22%	1.49%	1.44%	1.46%

Table 3 – PWLB Borrowing Rates (%) – to 30th September 2015

Compliance with Prudential Indicators

27. The Prudential Indicators for 2015/16, included in the Treasury Management Strategy Statement are based on the requirements of the Council's capital programme and approved at Budget Council on 26 February 2015.

28. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits" included in the Prudential Indicators. The monitoring of the Prudential Indicators is attached at Annex A. During the financial year 2015/16 to date the Council has operated within the treasury limits and Prudential Indicators set out.

Consultation and Options

29. The report shows the six month position of the treasury management portfolio in 2015/16. The treasury management budget was set in light of the council's expenditure plans and the wider economic market conditions, based on advice from Capita. It is a statutory requirement to provide the information detailed in the report.

Council Plan

30. The treasury management function aims to achieve the optimum return on investments commensurate with the proper levels of security, and to minimise the interest payable by the Council on its debt structure. It thereby contributes to all Council Plan priorities.

Financial

31. The financial implications are in the body of the report.

Human Resources Implications

32. There are no HR implications as a result of this report.

Equalities

33. There are no equalities implications as a result of this report.

Legal Implications

34. Treasury Management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

Crime and Disorder Implications

35. There are no crime and disorder implications as a result of this report.

Information Technology Implications

36. There are no IT implications as a result of this report.

Property Implications

37. There are no property implications as a result of this report.

Risk Management

38. The Treasury Management function is a high-risk area because of the level of large money transactions that take place. As a result of this there are procedures set out for day to day treasury management operations that aim to reduce the risk associated with high volume high value transactions. These are detailed in the Treasury Management Strategy Statement at the start of each financial year.

Contact Details

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	Report Approved	*Y*	**Date**	*12/11/15*
Wards Affected: *All*				
For further information please contact the author of the report				

Specialist Implications**:**
Legal – Not Applicable
Property – Not Applicable
Information Technology – Not Applicable

Annexes
Annex A – Prudential Indicators 2015/16

Glossary of abbreviations used in the report:
BOE – Bank of England
CIPFA – Chartered Institute of Public Finance and Accountancy
CFR – Capital Financing Requirement
CPI - Consumer Price Index
EU – European Union
GDP – Gross Domestic Product
GF – General Fund
HRA – Housing Revenue Account
LIBID – London Interbank Bid Rate
MMF – Money Market Fund
MRA – Major Repairs Allowance
PMI – Purchasing Managers Index
PWLB – Public Works Loans Board
TMSS – Treasury Management Strategy Statement