CITY OF YORK COUNCIL

Executive **24 November 2016**

Report of the Director of Customer & Corporate Services

Treasury Management Mid Year Review and Prudential Indicators 2016/17

Summary

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 2016 to 30 September 2016.

Recommendations

2. Members are required, in accordance with the Local Government Act 2003 (revised), to:
   - Note the Treasury Management activities to date in 2016/17
   - 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 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 GDP growth rates in 2013 of 2.2% and 2.9% in 2014 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 had 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, plus 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 though 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.

5. The Bank of England meeting on the 4th August addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.5% to 0.25%. The 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%.

6. The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year. The post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years.

Interest Rate Forecast

7. Capita Asset Services undertook a quarterly review of its interest rate forecasts after the meeting of 4th August 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 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.

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 (note all figures are percentages):

	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	0.25
5 Yr PWLB rate	1.00	1.00	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.30
10 Yr PWLB rate	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80
25 Yr PWLB rate	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60
50 Yr PWLB rate	2.10	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.40

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

Annual Investment Strategy Update

9. The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by Council on 25 February 2016. There are no policy changes to the TMSS and the details in this report do not amend the TMSS.

10. 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

11. 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

12. The average level of cash balances available for investment purposes in the first 6 months of 2016/17 was £106.306m (£100.629m for the same 6 month period in 15/16). 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 depending on cash flow movement.

13. The average level of cash balances has increased compared to a year ago due to a number of factors. These include the receipt of grant funding in advance of the associated profiled spend and delays to a number of capital schemes.

14. This allows the Council to continue 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 the potential to secure long term funding is kept under review to ensure this remains the most effective use of cash balances, given long term rates are currently at attractive levels.

15. Investment return (calculated as the amount of interest earned against the average cash balance for the period) during the first six months of 2016/17 is shown in table 2:

	2015/16 (full year)	2016/17 (part year to date)
Average CYC Rate of Return	0.55	0.56
Benchmarks		
Bank of England Base Rate	0.50	0.25
Average 7 Day LIBID	0.37	0.28
Average 1 Month LIBID	0.39	0.30

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

16. The average rate of return achieved to date in 2016/17 is broadly comparable to 2015/16. This has been helped by a higher than expected average balance allowing more cash to be placed in fixed term investments yielding a better rate of return.

17. However, as set out earlier in this report, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates continue to be very low. Given the current financial environment, and continued uncertainty following the Brexit vote, investment returns are likely to remain low and we therefore expect a reduction in the second half of the year as financial markets adjust investment rates to take account of the Bank Rate cut to 0.25%.

18. Figure 1 shows the interest rates available on the market based on LIBID rates between 7 days and 1 year and also the rate of return that the Council has achieved for the first six months of 2016/17. It shows that favourable / competitive interest rates have been obtained for investments whilst ensuring the required liquidity and security of funds for the Council.

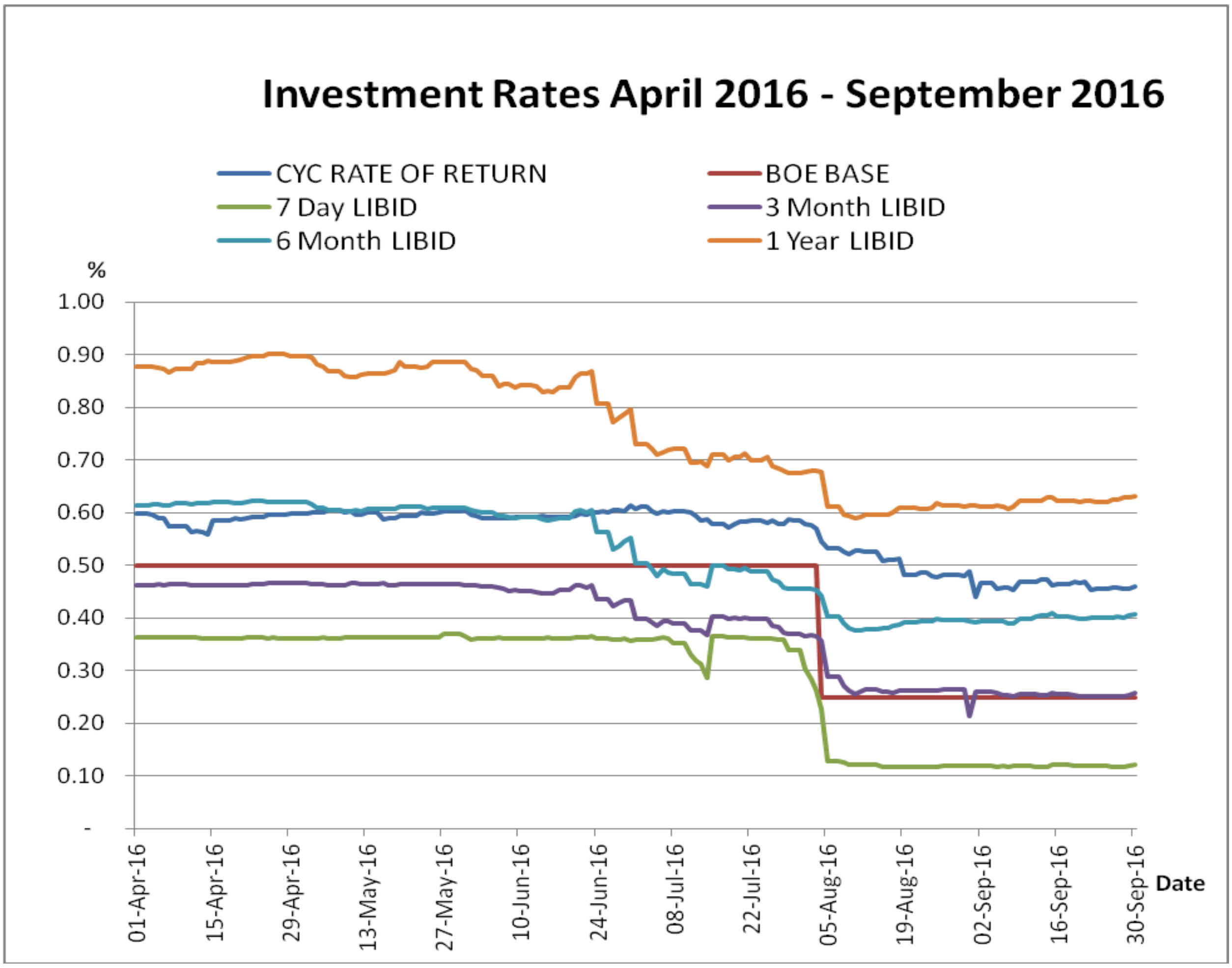

Figure 1 CYC Investments vs Money Market Rates

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

20. All of the money market funds have an AAA credit rating, the notice call accounts are all AA or A rated and the fixed terms investments are A+ or A rated.

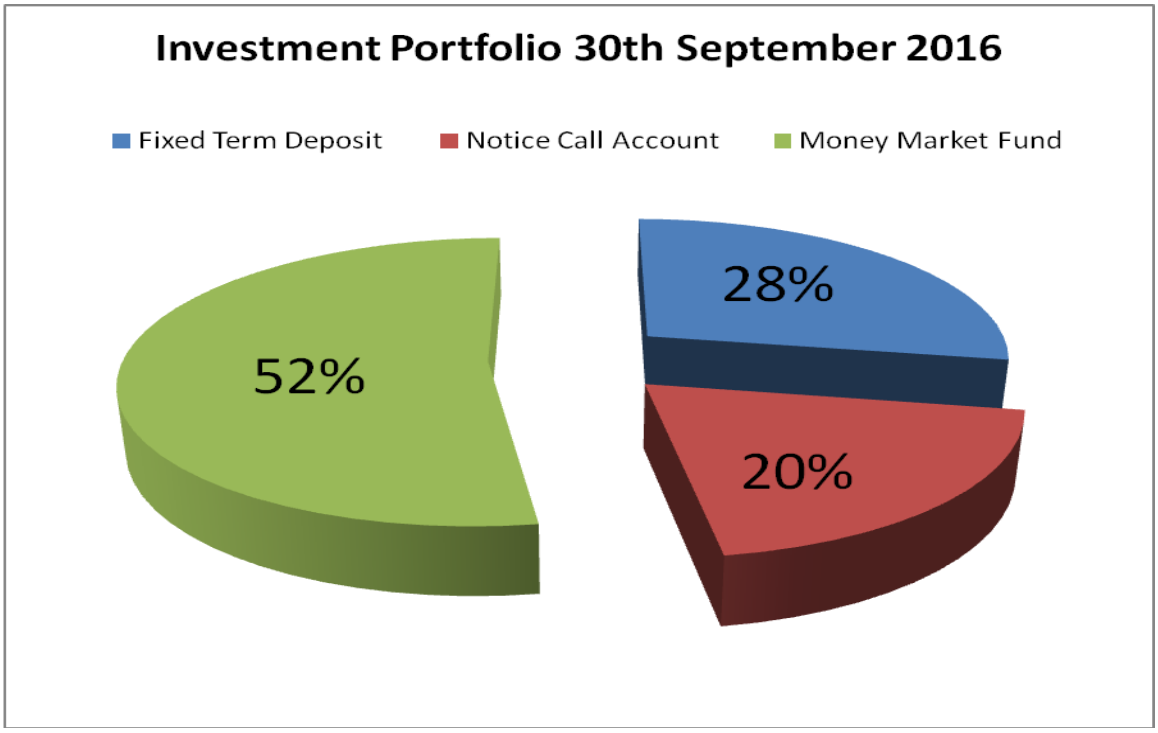

Figure 2 Investment Portfolio by type at 30th September 2016

Borrowing Portfolio

21. 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.

22. 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.

23. Under regulation, the Council can borrow in advance of need and 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.

24. 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.

25. Although no new borrowing has been undertaken during 2016/17 the finance team continues to closely monitor the opportunities that arise and receive daily updates from Capita Asset Services in respect of borrowing timings and amounts.

26. The Councils long-term borrowing started the year at a level of £267.115m. On 10th August 2016 a £5m PWLB loan was repaid taking the Councils long-term borrowing figure to £262.115m. The Housing Revenue Account settlement debt amounts is 46% of the borrowing portfolio (£121.550m) and the General Fund debt is 54% (£140.565m). On 5th November 2016 a £2.00m PWLB loan will be repaid taking the Councils long-term borrowing figure to £260.115m.

27. Figure 3 illustrates the 2016/17 maturity profile of the Council's debt portfolio at 30th September 2016. The maturity profile shows that there is no large concentration of loan maturity in any one year, thereby spreading the interest rate risk dependency.

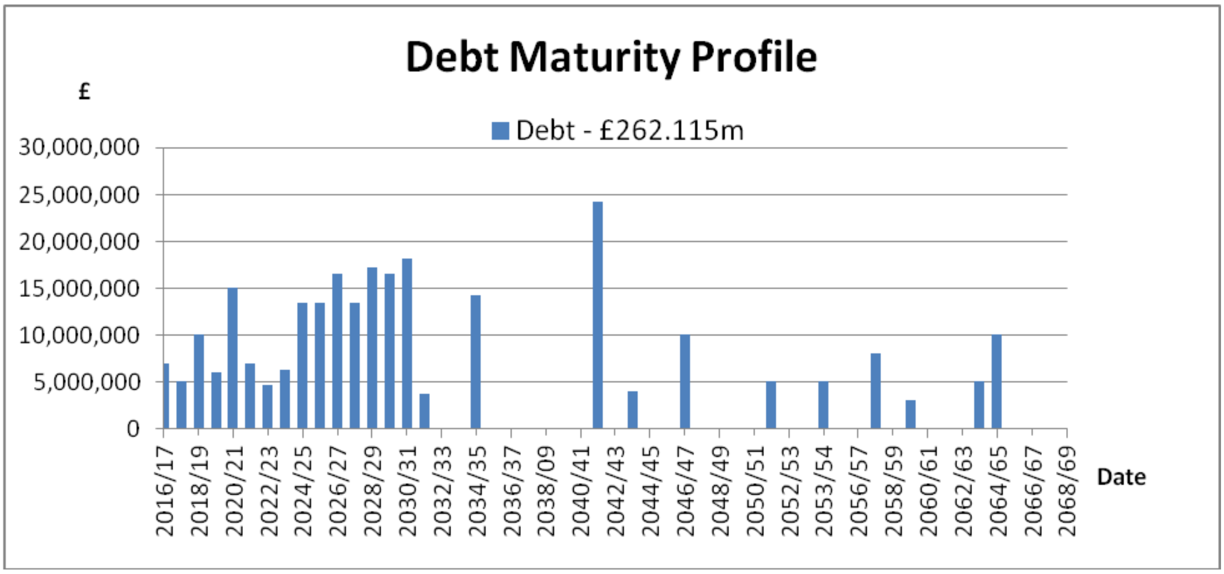

Figure 3 – Debt Maturity Profile 16/17 up to 30th September 2016

28. Table 3 shows PWLB Certainty borrowing rates available for selected loan durations. There have been fluctuations in the rates with an average trend downwards to 30th September 2016. This has been most pronounced and is highlighted in the longer dated loans that all have spreads of over 1.00%. As a point of reference in the same period last year we saw similar spreads but slightly higher, with the 5 year spread particularly higher over 1.00%.

	PWLB Certainty borrowing rates by duration of loan				
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Yr High	1.20%	1.88%	2.56%	3.29%	3.08%
Yr Low	0.81%	0.99%	1.46%	2.09%	1.87%
Yr Avg	0.99%	1.39%	1.97%	2.69%	2.46%
Spread	0.39%	0.89%	1.10%	1.20%	1.21%

Table 3 – PWLB Borrowing Rates (%) – to 30th September 2016

Compliance with Prudential Indicators

29. The Prudential Indicators for 2016/17 included in the Treasury Management Strategy Statement are based on the requirements of the Council's capital programme and approved at Budget Council on 25 February 2016.

30. 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 2016/17 to date the Council has operated within the treasury limits and Prudential Indicators set out.

Consultation and Options

31. The report shows the six month position of the treasury management portfolio in 2016/17. 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 Asset Services. It is a statutory requirement to provide the information detailed in the report.

Council Plan

32. 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 implications

33. The financial implications are in the body of the 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.

Other Implications

35. There are no crime and disorder, information technology, property, equalities, human resources or other implications as a result of this report.

Risk Management

36. 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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<tr><td colspan="4">Wards Affected: All</td><td></td></tr>
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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 2016/17