Appendix A

Cabinet **16 December 2015**

Report of the Cabinet Member for Finance, Performance and Customer Services

Treasury Management Mid Year Review and Prudential Indicators 2014/15

Summary

1. This Council is required through regulations issued under Part 1 of the Local Government Act 2003 and the revised 2011 (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management (as revised) to provide members with a mid year update on treasury management activities.

2. This report therefore ensures the Council is undertaking and reporting its treasury activities in accordance with the Code. It also provides updates on the Treasury Management activities for the period 1 April 2014 to October 2014 (where possible) and reviews:

   - An economic update for the 2014/15 financial year to October 2014;
   - 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 2014/15;
   - A review of the Council's borrowing strategy for 2014/15;
   - A review of any debt rescheduling undertaken during 2014/15;
   - A review of compliance with Treasury and Prudential Limits for 2014/15.

Background

3. The Council's Treasury Management function is responsible for the effective management of the Council's investments, cash flows, its banking, money market and capital transactions; the

effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Economic Background and Analysis

4. The Council's treasury management activities have operated within the following economic background:

   a) After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), it appeared very likely that strong growth would continue through 2014 and into 2015 as forward surveys for the services and construction sectors, were very encouraging and business investment looked to be strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance.

   b) This overall strong growth had resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters were expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016.

   c) Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

d) However following the International Monetary Funds (IMF) slashing of its growth forecast for the Eurozone, October marked a period of significant instability in the financial markets. Investor confidence was rocked by an announcement from the IMF that growth may never again reach its pre-crisis peak and this was confounded by poor German manufacturing data. This was then compounded as Greek government bond yields soared on the back of political instability and uncertainty regarding their intentions towards their EU and IMF bailout packages. The concerns regarding the state of the Eurozone proved contagious though as worries about Chinese economic growth and poor US retail sales knocked confidence in the global economic outlook. Although there was a great deal of volatility in the markets during this short period, there was a significant rebound shortly afterwards. Importantly, the UK came off relatively unscathed by the events and arguably strong news regarding UK unemployment and real wages slipped under the radar

5. Capita Asset Services– the Council's treasury management advisers – undertook a review of its interest rate forecasts in mid August, after the Bank of England's Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts and depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2015. 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):

	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17	Jun 17
Bank Rate	0.5	0.5	0.5	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.5	1.75
5 Yr	2.5	2.5	2.7	2.7	2.8	2.9	3.0	3.1	3.2	3.3	3.4	3.5

PWLB												
10 Yr PWLB	3.0	3.2	3.4	3.5	3.6	3.7	3.8	3.9	4.0	4.1	4.1	4.1
25 Yr PWLB	3.7	3.9	4.0	4.1	4.3	4.4	4.5	4.6	4.7	4.7	4.8	4.8
50 Yr PWLB	3.7	3.9	4.	4.1	4.3	4.4	4.5	4.6	4.7	4.7	4.8	4.8

Table 1: Capita Asset Services – Treasury Management Advisers – Interest Rate Forecast (%)

Annual Investment Strategy

6. Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Council on 27 February 2014. There are no policy changes to the TMSS; 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

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

7. Investments are only placed with high credit rating financial institutions using the creditworthiness matrices described in the Treasury Management Strategy, which includes sovereign credit ratings from the rating agencies, individual institution credit ratings from the respective credit ratings agencies and the credit default swap (CDS) overlay information provided by Capita were appropriate.

8. During the period under review, the continued risk averse approach in light of continued credit caution (the continued Eurozone sovereign debt crisis) made it appropriate to keep investments short term with a maximum duration of 1 year for financial institutions. This limit applies to all entities in which the Council places funds.

9. Investments held during the first six months of 2014/15 were in accordance with Capita's creditworthiness matrices and changes

to Fitch and Moody's credit ratings. All investments were made in accordance with the Council's approved credit criteria limits contained in the Annual Investment Strategy.

Investment Portfolio

10. 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 2014/15 was £73.160m (£63.661m for the same 6 month period in 13/14). 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 available on a temporary basis dependant on cash flow movement.

11. The average level of cash balances has increased compared to a year ago due to the receipt of developers contributions in advance of the associated profiled spend. This is balanced off to an extent by the use of cash balances instead of taking long term debt to finance the Council's 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.

12. Investment return (calculated as the amount of interest earned against the average cash balance for the period) during the first six months of 2014/15 is shown in table 3:

	2013/14 (full year)	**2014/15 (part year to date)**
CYC Rate of return	0.48%	0.52%
Benchmarks		
Bank of England Base Rate	0.50%	0.50%
7 Day LIBID	0.35%	0.35%
30 Day LIBID	0.39%	0.44%

Table 3: CYCs investment rate of return performance vs. benchmarks

13. The average rate of return is broadly comparable to 2013/14 reflective of the continued uncertainty regarding the rate of growth in both the Eurozone and UK and the continue uncertainty over the Eurozone sovereign debt positions.

14. 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 2014/15. It shows that favourable / competitive interest rates have been obtained for investments whilst ensuring the required liquidity and security of funds for the Council.

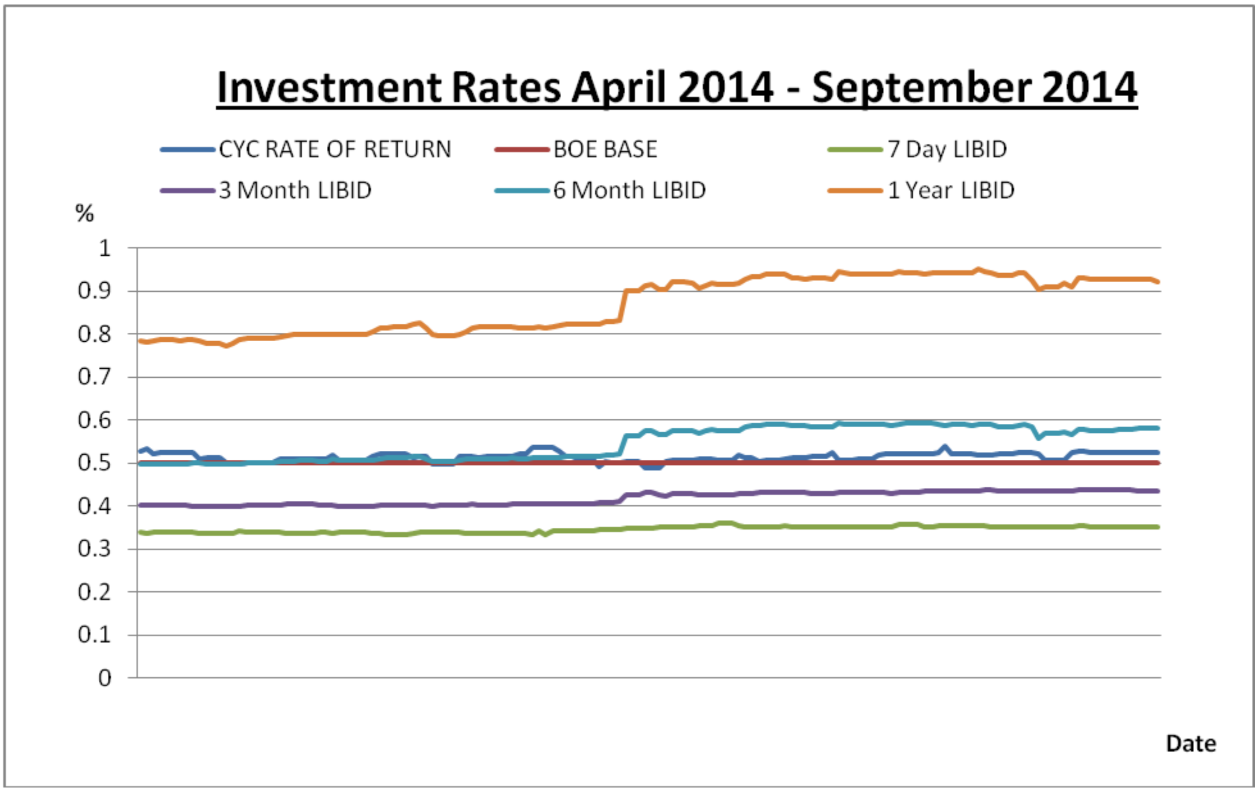

Figure 1 CYC Investments vs Money Market Rates

15. Figure 2 shows the investments portfolio by type split deposits in short term call accounts, fixed term investments and money market funds (MMFs). All of the MMFs are have an AAA credit rating, the call accounts are all A or AA- rated and the fixed terms investments are A rated.

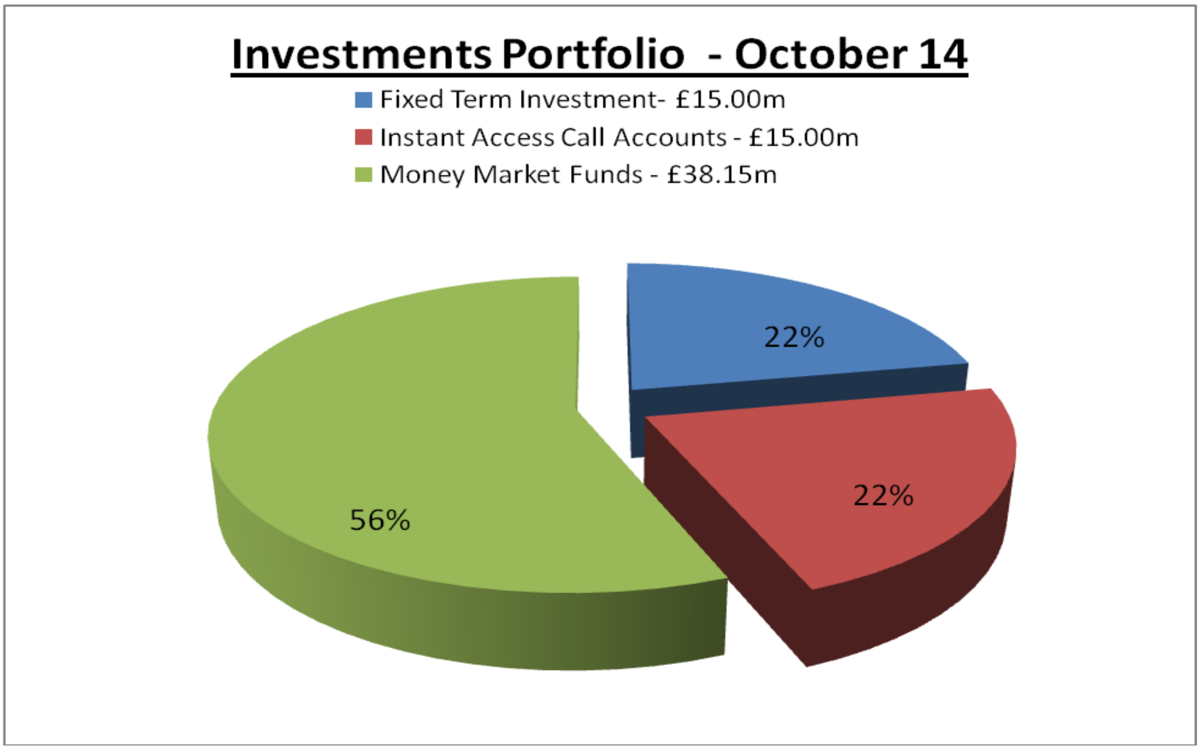

Figure 2 Investment Portfolio by type at October 2014

Borrowing Portfolio

16. 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.

17. The level of borrowing taken by the Council is determined by the Capital Finance Requirement (the Council's underlying need to borrow for capital expenditure purposes). Borrowing needs to be affordable, sustainable and prudent and the treasury management budget supports the borrowing finance costs in the longer term.

18. 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.

19. 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 instead, decreasing the level of surplus funds being available for

investment. 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.

20. Although the treasury management function has not taken any new borrowing during 2014/15 it continues to closely monitor the borrowing environment for opportunities that arise and receive daily updates from Capita services in respect of borrowing timings and amounts. Long term borrowing rates (that is interest rates payable on debt over 10 years) are at comparably low values offering good opportunities to secure long term funding for the Council. Consideration is currently being given to the suitable periods for new borrowing and it is expected that new loans will be taken before the end of the calendar year should rates continue to hold at current levels.

21. The Council's long-term borrowing started the year at a level of £258.615m. A single Public Works Loans Board (PWLB) loan to the value of £4.5m became due for repayment in this financial year. No new borrowing has been taken in the 1st 7 months of 2014/15. The HRA amounts to 55% of the borrowing portfolio at £139.944m and the GF is 45% with borrowing at £114.171m, a current total of £254.115m. Table 4 shows the Council's opening borrowing position, movements and current position for debt split by fund:

	General Fund	**Housing Rev Acc**	**Total**	**Interest Rate**
	£m	**£m**	**£m**	**%**
Opening Debt April 14	**118.671**	**139.944**	**258.615**	**3.76**
Repaid	(4.500)	0.000	(4.500)	3.910
New	0.000	0.000	0.000	0.00
Closing Debt Sept 14	**114.171**	**139.944**	**254.115**	**3.75**

Table 4 – CYCs current debt position October 14

22. Figure 3 illustrates the 2014/15 maturity profile of the Council's debt portfolio to Mid October 2014 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.

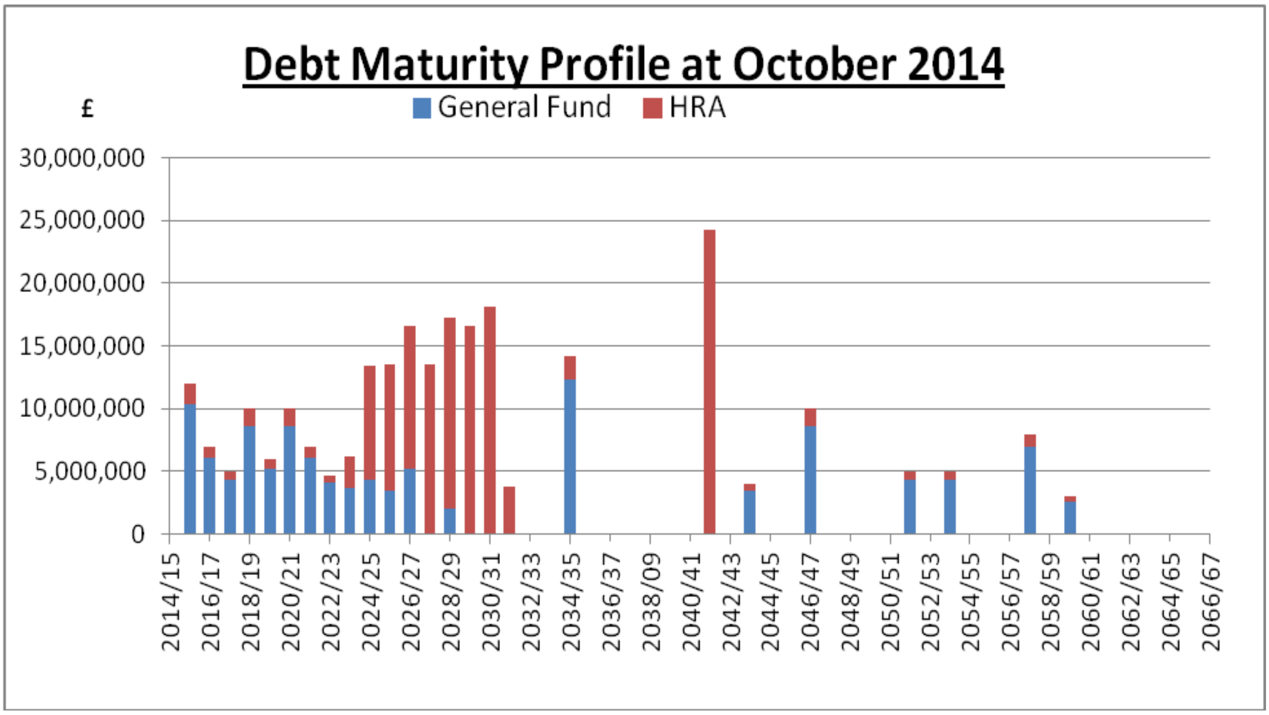

Figure 3 – Debt Maturity Profile 14/15

23. As ever there is volatility in the borrowing markets (PWLB in the main) reflective of the needs of investors and such continued fluctuations over the coming months may present opportunities for borrowing at advantageous levels as set out above.

24. Table 4 shows there has been significantly fluctuations to the end of September 14. This is highlighted in the longer dates that all have spreads of over 0.5%, however as a point of reference, for the same period last year the spread in similar periods was 1.0%. Table 4 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	1.48%	2.86%	3.66%	4.29%	4.26%
Yr Low	1.20%	2.48%	3.16%	3.75%	3.73%
Yr Avg	1.34%	2.65%	3.53%	4.10%	4.17%

Spread	0.28%	0.38%	0.50%	0.54%	0.53%

Table 4 – PWLB Borrowing Rates (%) – to 30 September 14

Compliance with Prudential Indicators

25. The Prudential Indicators for 2014/15, included in the Treasury Management Strategy Statement are based on the requirements of the Council's capital programme and approved at Budget Council on 27 February 2014.

26. 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 2014/15 to date the Council has operated within the treasury limits and Prudential Indicators set out.

Consultation and Options

27. The report shows the six month position of the treasury management portfolio in 2014/15. 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 - the Council's Treasury Management advisors. It is a statutory requirement to provide the information detailed in the report.

Analysis

28. The report is a statutory requirement and as such there are no specific options to analyse.

Council Plan

29. The Council Plan has five priorities which all require a budget to achieve. The treasury management function aims to achieve the optimum return on investments commensurate with the proper levels of security, and endeavours to minimise the interest payable by the Council on its debt structure. It thereby contributes to all Council Plan priorities.

Financial

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

Human Resources Implications

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

Equalities

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

Legal Implications

33. 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

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

Information Technology Implications

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

Property Implications

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

Risk Management

37. 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.

Recommendations

38. Members are required, in accordance with the Local Government Act 2003 (revised), to:
- Note the Treasury Management activities to date in 2014/15
- 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.

Contact Details

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	Report Approved	√	**Date**	22/10/14
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 2014/15