OVERVIEW AND SCRUTINY ITEM, FOR CONSIDERATION PRIOR TO FULL COUNCIL

RYEDALE
DISTRICT
COUNCIL

REPORT TO:	**COUNCIL**
DATE:	**18 DECEMBER 2014**
REPORT OF THE:	**FINANCE MANAGER (s151)** **PETER JOHNSON**
TITLE OF REPORT:	**TREASURY MANAGEMENT MID-YEAR REVIEW**
WARDS AFFECTED:	**ALL**

EXECUTIVE SUMMARY

1.0 PURPOSE OF REPORT

1.1 To report on the treasury management activities to date for the financial year 2014/15 in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code).

2.0 RECOMMENDATIONS

2.1 It is recommended that:

(i) Members receive this report; and
(ii) The mid-year performance of the in-house managed funds to date is noted.

3.0 REASON FOR RECOMMENDATIONS

3.1 The Council has adopted the Code. A provision of the Code is that a mid-year review report must be made to the Full Council relating to the treasury activities of the current year.

4.0 SIGNIFICANT RISKS

4.1 There are significant risks when investing public funds especially with unknown institutions. However, by the adoption of the CIPFA Code and a prudent investment strategy these are minimised. The employment of Treasury Advisors also helps reduce the risk.

REPORT

5.0 BACKGROUND AND INTRODUCTION

5.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

5.2 The second major function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide towards whether the Council has a borrowing need, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short term loans or using longer term cash flow surpluses.

5.3 Treasury management in this context 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."

5.4 The CIPFA Code of Practice on Treasury Management 2009 was adopted by this Council on 22 February 2010 and this Council fully complies with its requirements.

5.5 The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual Treasury Management Strategy Statement (including the Annual Investment Strategy and Minimum Revenue Provision Policy) for the year ahead, a Mid-Year Review Report and an Annual Report covering activities during the previous year.
4. 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.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body, which in this Council is the Overview and Scrutiny Committee.

5.6 This mid-year report has been prepared in compliance with CIPFA's Code of Practice and covers the following:

- An economic update for the first six months of 2014/15;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2014/15;
- A review of compliance with Treasury and Prudential Limits for 2014/15.

6.0 POLICY CONTEXT

6.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in Local Authorities and this report complies with the requirements under this Code.

7.0 CONSULTATION

7.1 The Council uses the services of Sector Treasury Services Limited to provide treasury management information and advice.

8.0 REPORT DETAILS

Economic Update

8.1 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 appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also 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. This overall strong growth has 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 are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. 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.

8.2 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May and July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q1 or Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

8.3 In September, the Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $15bn and are expected to stop in October 2014, providing strong economic growth continues. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in Q2 to 4.6% (annualised). The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions.

8.4 The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt). Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

8.5 The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	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	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%
10yr PWLB rate	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%
25yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%
50yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%

Capita Asset Services 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.

Treasury Management Strategy Statement and Annual Investment Strategy Update.

8.6 The Treasury Management Strategy (TMSS) for 2014/15 was approved by this Council on 25 February 2014. There are no policy changes to the TMSS, the details in this report update the position in the light of the updated economic position and budgetary changes already approved. Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity

8.7 The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (maximum loan period of 12 months) and only invest with highly credit rated financial institutions, using Sector's suggested creditworthiness approach, including sovereign rating and credit default swap (CDS) overlay information provided by Sector.

8.8 Investments during the first six months of the year have been in line with the strategy and there have been no deviations from the strategy.

8.9 As outlined above, there is still some uncertainty and volatility in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 25 February 2014 is still fit for purpose in the current economic climate.

Investment Portfolio 2014/15

8.10 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.

8.11 As set out earlier in the report, it is a very difficult investment market in terms of earning the level of interest rate commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate.

8.12 The Council's investment position at the beginning of the financial year was as follows:

Type of Institution	Investments (£)
UK Clearing Banks	4,910,000
Local Authorities	0
Building Societies	0
Total	4,910,000

8.13 A full list of investments held as at 30 September 2014, compared to Sectors counterparty list and changes to Fitch, Moodys and S&P's credit ratings during the first six months of 2014/15 is shown in annex B and summarised below:

Type of Institution	Investments (£)
UK Clearing Banks	10,660,000
Foreign Banks	0
Building Societies	0
Local Authorities	0
Total	10,660,000

8.14 As illustrated in the economic background section above, investment rates available in the market are at a historical low point. The average level of funds available for investment purposes in the first six months of 2014/15 was £10.9m. These funds were available on a temporary basis and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

8.15 The table below compares the investment portfolio yield for the first six months of the year against a benchmark of the average 7 day LIBID rate of 0.35%.

	Average Investment (£)	**Average Gross Rate of Return**	**Net Rate of Return**	**Benchmark Return**	**Interest Earned (£)**
Cash Equivalents	6,026,667	0.50%	n/a	n/a	15,118
Fixed Term Deposits	817,500	0.76%	n/a	0.35%	18,447

8.16 The Council's budgeted investment return for 2014/15 is £68k and performance during the financial year to 30 September 2014 is £34k, **which is on target to achieve the budget.**

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

Compliance with Treasury and Prudential Limits

8.18 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy Statement (TMSS).

8.19 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's TMSS and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in annex A.

8.20 The Council currently has no long-term borrowing, however it is likely that borrowing will take place in this financial year before forecast increases in PWLB rates. There have been no temporary borrowing transactions in the year.

9.0 IMPLICATIONS

9.1 The following implications have been identified:

a) Financial
The results of the investment strategy affect the funding of the capital programme. The investment income return to 30 September 2014 was £34k, which is in line with the budgeted return.

b) Legal
There are no additional legal implications within this report.

c) Other (Equalities, Staffing, Planning, Health & Safety, Environmental, Crime & Disorder)
There are no additional implications within this report.

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Background Papers:
None

Background Papers are available for inspection at:
N/a

ANNEX A

PRUDENTIAL AND TREASURY INDICATORS

Prudential Indicators

	2013/14	2014/15

	Actual	Original Estimate	Current Position	Revised Estimate
Capital Expenditure	**£3.331m**	**£1.375m**	**£1.007m**	**£2.405m**
Net borrowing requirement	**-£4.708m**	**-£2.334m**	**-£10.406m**	**-£2.317m**
Capital Financing Requirement as at 31 March	**£0.254m**	**£2.616m**	**n/a**	**£2.633m**
Annual change in Capital Financing Requirement	**-£0.041m**	**£1.524m**	**n/a**	**£2.379m**

Treasury Management Indicators

	2014/15	
	Original Limits	**Revised Estimate**
Authorised Limit for external debt -		
Borrowing	£20.0m	£20.0m
Other long term liabilities	£1.0m	£1.0m
Total	£21.0m	£21.0m
Operational Boundary for external debt -		
Borrowing	£5.0m	£5.0m
Other long term liabilities	£0.7m	£0.8m
Total	£5.7m	£5.8m

ANNEX B

Investment Portfolio as at 30 September 2014

Investment by Institution	Investment £	Duration of Investment	Latest Sector Duration Band Rating	Sovereignty Rating
UK Clearing Banks				
National Westminster Bank	5,660,000	On Call	12 Months	AA+
Bank of Scotland	1,000,000	12 Months	12 Months	AA+
Bank of Scotland	1,000,000	12 Months	12 Months	AA+
Bank of Scotland	500,000	6 Months	12 Months	AA+
National Westminster Bank	1,000,000	95 Day Notice	12 Months	AA+
Bank of Scotland	500,000	6 Months	12 Months	AA+
National Westminster Bank	1,000,000	60 Day Notice	12 Months	AA+
Grand Total	**10,660,000**			

Fitch and Moodys Sovereignty Rating for the UK is AA+ while S&P's is AAA.
All the above borrowers met the required credit rating at the time of investment.