RYEDALE
DISTRICT
COUNCIL

REPORT TO:	**COUNCIL**
DATE:	**10 DECEMBER 2015**
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 2015/16 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 2015/16;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2015/16;
- A review of compliance with Treasury and Prudential Limits for 2015/16.

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 Capita Asset Services (Sector Treasury Services

Limited) to provide treasury management information and advice.

8.0 REPORT DETAILS

Economic Update

8.1 UK GDP 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% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y). 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 – 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.

8.2 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. 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.

8.3 The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015. While there had been confident expectations during the summer that the Fed. could start increasing rates at its meeting on 17 September, or if not by the end of 2015, the recent downbeat news about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision to pull back from making that start. The nonfarm payrolls figures for September and revised August, issued on 2 October, were disappointingly weak and confirmed concerns that US growth is likely to weaken. This has pushed back expectations of a first rate increase from 2015 into 2016.

8.4 In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to

September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

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

	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 its last review of interest rate forecasts on 11 August shortly after the quarterly Bank of England 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 above 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 a first increase in Bank Rate in quarter 2 of 2016.

Treasury Management Strategy Statement and Annual Investment Strategy Update.

8.6 The Treasury Management Strategy (TMSS) for 2015/16 was approved by this Council on 24 February 2015. 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 24 February 2015 is still fit for purpose in the current economic climate.

Investment Portfolio 2015/16

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	7,160,000
Foreign Banks	1,000,000
Local Authorities	0
Building Societies	1,000,000
Total	9,160,000

8.13 A full list of investments held as at 30 September 2015, compared to Sectors counterparty list and changes to Fitch, Moodys and S&P's credit ratings during the first six months of 2015/16 is shown in annex B and summarised below:

Type of Institution	Investments (£)
UK Clearing Banks	10,020,000
Foreign Banks	2,000,000
Building Societies	2,500,000
Local Authorities	0
Total	14,520,000

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 2015/16 was £15.2m. 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 the progress of 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 0.36%.

	Average Investment (£)	Average Gross Rate of Return	Net Rate of Return	Benchmark Return	Interest Earned (£)
Cash Equivalents	5,730,710	0.34%	n/a	n/a	9,785
Fixed Term Deposits	1,063,542	0.76%	n/a	0.36%	35,993

8.16 The Council's budgeted investment return for 2015/16 is £59k and performance during the financial year to 30 September 2015 is £46k, **which is on target to out perform 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 level of gross borrowing remains at £1.75m, full details can be found at annex B.. Repayments have been made in line with the loan repayment schedule. In order to fulfil the funding requirements of the current Capital Programme the Council still has a borrowing requirement of £320k, however it is unlikely that we will look to borrow the remaining sum in the current financial 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 2015 was £46k, which is in excess of the profiled budget. The cost of borrowing affects the revenue account. Borrowing costs to 30 September 2015 were £30k, which is below the profiled budget.

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

PRUDENTIAL AND TREASURY INDICATORS

Prudential Indicators

	2014/15	2015/16		
	Actual	Original Estimate	Current Position	Revised Estimate
Capital Expenditure	**£1.331m**	**£1.263m**	**£0.442m**	**£2.129m**
Net borrowing requirement	**-£6.897m**	**-£6.380m**	**-£12.770m**	**-£6.700m**
Capital Financing Requirement as at 31 March (excl borrowing by finance lease)	**£1.010m**	**£2.029m**	**n/a**	**£2.029m**
Annual change in Capital Financing Requirement	**£1.010m**	**£1.019m**	**n/a**	**£1.019m**

Treasury Management Indicators

	2015/16	
	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	£0.7m
Total	£5.7m	£5.8m

ANNEX B

Investment Portfolio as at 30 September 2015

Investment by Institution	Investment £	Duration of Investment	Latest Capita Duration Band Rating	Sovereignty Rating
UK Clearing Banks				
National Westminster Bank	2,520,000	On Call	12 Months	AA+
Bank of Scotland	1,500,000	12 Months	6 Months	AA+
Bank of Scotland	1,000,000	12 Months	6 Months	AA+
Nationwide B.S.	1,500,000	6 Months	6 Months	AA+
Barclays Bank	1,000,000	6 Months	6 Months	AA+
CIC	1,000,000	6 Months	6 Months	AA
Santander	1,000,000	95 Days Notice	6 Months	AA+
Santander	1,500,000	95 Days Notice	6 Months	AA+
Nationwide B.S.	1,000,000	6 Months	6 Months	AA+
CIC	1,000,000	5.5 Months	6 Months	AA
Barclays Bank	1,500,000	5.5 Months	6 Months	AA+
Grand Total	**14,520,000**			

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.

Borrowing Schedule as at 30 September 2015

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£1.00m	Maturity	3.69%	50 years
PWLB	£0.75m	EIP	2.99%	19 years