OVERVIEW AND SCRUTINY ITEM, FOR CONSIDERATION PRIOR TO FULL COUNCIL

RYEDALE
DISTRICT
COUNCIL

REPORT TO:	**COUNCIL**
DATE:	**8 DECEMBER 2016**
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 2016/17 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 2016/17;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2016/17;
- A review of compliance with Treasury and Prudential Limits for 2016/17.

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 strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. 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 business surveys, 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.

8.2 The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% 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%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on November 23. 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 and, in addition, 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. However, the MPC is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

8.3 The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

8.4 In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but slowed to +0.3% (+1.6% y/y) in quarter 2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

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

	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%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC 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 above 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. Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

Treasury Management Strategy Statement and Annual Investment Strategy Update.

8.6 The Treasury Management Strategy (TMSS) for 2016/17 was approved by this Council on 23 February 2016. 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 23 February 2016 is still fit for purpose in the current economic climate.

Investment Portfolio 2016/17

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 0.25% 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	2,000,000
Building Societies	2,500,000
Total	11,660,000

8.13 A full list of investments held as at 30 September 2016, compared to Sectors counterparty list and changes to Fitch, Moodys and S&P's credit ratings during the first six months of 2016/17 is shown in annex B and summarised below:

Type of Institution	Investments (£)
UK Clearing Banks	12,845,057
Foreign Banks	3,000,000
Building Societies	2,500,000
Total	18,345,057

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 2016/17 was £16.8m. 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 0.28%.

	Average Investment (£)	Average Gross Rate of Return	Net Rate of Return	Benchmark Return	Interest Earned (£)
Cash Equivalents	5,591,530	0.26%	n/a	n/a	6,951
Fixed Term Deposits	1,160,644	0.70%	n/a	0.28%	40,788

8.16 The Council's budgeted investment return for 2016/17 is £65k and performance during the financial year to 30 September 2016 is £48k, **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 2016 was £48k, which is in excess of the profiled budget. The cost of borrowing affects the revenue account. Borrowing costs to 30 September 2016 were £29k, 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

ANNEX A

PRUDENTIAL AND TREASURY INDICATORS

Prudential Indicators

	2015/16	2016/17		
	Actual	Original Estimate	Current Position	Revised Estimate
Capital Expenditure	**£1.076m**	**£1.295m**	**£0.120m**	**£2.220m**
Net borrowing requirement	**-£9.339m**	**-£6.700m**	**-£16.595m**	**-£7.020m**
Capital Financing Requirement as at 31 March (excl borrowing by finance lease)	**£2.351m**	**£2.764m**	**n/a**	**£2.764m**
Annual change in Capital Financing Requirement	**£0.825m**	**£1.238m**	**n/a**	**£1.238m**

Treasury Management Indicators

	2016/17	
	Original Limits	Revised Estimate
Authorised Limit for external debt -		
Borrowing	£10.0m	£10.0m
Other long term liabilities	£1.0m	£1.0m
Total	£11.0m	£11.0m
Operational Boundary for external debt -		
Borrowing	£5.0m	£5.0m
Other long term liabilities	£0.8m	£0.8m
Total	£5.8m	£5.8m

Investment Portfolio as at 30 September 2016

Investment by Institution	Investment £	Duration of Investment	Latest Capita Duration Band Rating	Sovereignty Rating
UK Clearing Banks				
Lloyds Bank	5,245,057	On Call	6 Months	AA
Nationwide B.S.	1,500,000	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
Bank of Scotland	1,500,000	3 Months	6 Months	AA
CIC	1,000,000	6 Months	6 Months	AA
Barclays Bank	1,000,000	6 Months	6 Months	AA
Nationwide B.S.	1,000,000	6 Months	6 Months	AA
DBS Bank Ltd	1,000,000	9 Months	12 Months	AAA
CIC	1,000,000	6 Months	6 Months	AA
Lloyds Bank	1,500,000	6 Months	6 Months	AA
Barclays Bank	1,100,000	6 Months	6 Months	AA
Grand Total	**18,345,057**			

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

Borrowing Schedule as at 30 September 2016

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