AUDIT COMMITTEE – 26 NOVEMBER 2015

PART I – DELEGATED

9. TREASURY MANAGEMENT – 2015/16 MID YEAR REVEIW
(DoF)

1. **Summary**

1.1 This report gives details of the 2015/16 Mid Year Review of the Treasury Management function.

2. **Details**

2.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management 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".

2.2 The Council's 2015/16 Treasury Management Strategy (TMS) as approved by Council on 24 February 2015 (Minute No. CL67/14) is designed to ensure that cash flows are adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity before considering optimising investment return.

2.3 This report considers the UK economy and updates members with the progress on whether the Council is meeting the TMS and the policies contained therein for the first 6 months of 2015/16.

2.4 *The UK Economy for the first 6 months of 2015/16 (1/4/15 – 30/915) by Capita Asset Services (the Council's treasury advisors)*

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. 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.

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.

2.5 *Interest rate forecasts*

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

Month & Year	Bank Rate %
Dec 2015	0.50
Mar 2016	0.50
Jun 2016	0.75
Sep 2016	0.75
Dec 2016	1.00
Mar 2017	1.00
Jun 2017	1.25
Sep 2017	1.50
Dec 2017	1.50
Mar 2018	1.75
Jun 2018	1.75

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.

2.6 *The Council's Capital Position (Prudential Indicators)*

The Council's capital expenditure plans are one of the key drivers of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

The capital expenditure plans are financed in full by capital receipts, grants or capital reserves. Over the next three years there are no planned shortfalls of resources which would result in a funding need (borrowing). The Council is currently debt free; however a major project in South Oxhey is in the planning stage and may require significant funding and involve borrowing funds.

2.7 *Capital Financing Requirement (CFR), External Debt and Operational Boundary*

The CFR and Operational Boundary estimates are shown below:

Prudential Indicator	2015/16 Original Estimate	Current Borrowing Position	2015/16 Revised Estimate
Capital Financing Requirement	£0m	£0m	£0m
External Debt / the Operational Boundary			
Borrowing	£7m	£0m	£7m

2.8 *Limits to Borrowing Activity*

The first key control over the treasury activity is a Performance Indicator (PI) to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

2.9 *The Authorised Limit*

This PI, which is required to be set and revised by Members, controls the overall level of borrowing and represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit For External Debt	2015/16 Original Indicator	Current Borrowing Position	2015/16 Revised Indicator
Borrowing	£9m	£0m	£9m

2.10 *Investment Portfolio 2015/16*

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. As set out in Section 2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. Indeed, the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

The Council held £31.7m of investments as at 30 September 2015 (See table below). This information is reported in the monthly Members Information Bulletin.

Institution	Principal (£)
Lloyds Bank plc	10,600,000
Nat West Bank plc	2,600,000
Total Banks	*13,200,000*
Nationwide Building Society	6,000,000
Principality Building Society	6,000,000
Skipton Building Society	6,500,000
Total Building Societies	*18,500,000*
Total	*31,700,000*

The approved limits within the Annual Investment Strategy were not breached during the first six months of 2015/16.

2.11 *Security*

The Council's maximum security risk benchmark for the current portfolio was set as 0.01% risk of default when compared to the whole portfolio. The benchmarks are an average risk of default measure, and would not constitute an expectation of loss against a particular investment. The benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members.

In line with the TMS, the Council has managed to invest with those institutions who offered the best rate and the investment portfolio is above the overall benchmark during the year to date.

2.12 *Liquidity*

The Council set liquidity facilities/benchmarks to maintain:

- A zero bank overdraft.
- The benefit of instant access to its funds on the general account with Lloyds.

The liquidity arrangements were adequate during the year to date.

2.13 *Yield*

The budget for interest earnt on investments for 2015/16 is £177,000; interest received up to the end of September was £97,310.

The approved benchmark measure of yield is a return of 0.12% above the average bank rate of 0.50%. The returns up to 30 September 2014 averaged 0.64%, against a benchmark rate of 0.62%. The average yield return was higher than the benchmark for the year to date.

Table of Monthly Interest Rates to Date:

Month	Rate Achieved
April	0.65%
May	0.65%
June	0.65%
July	0.63%
August	0.64%
September	0.63%

The Council keeps all investments short term. There are no sums invested for greater than 364 days. Counterparties have been downgraded over the past few years; most investments have been limited to a 6 months period. This has resulted in lower interest rates being achieved.

The current investment counterparty criteria selection approved in the TMS is being met.

2.14 *Credit Ratings*

Fitch and Moody provide the Council with credit ratings for financial institutions,

The credit rating of counterparties is monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly. The Council considers minimum short term ratings as key criteria in the choice of creditworthy investment counterparties. F1+, P-1 and A-1+ are the highest short term credit ratings of Fitch, Moody's and Standard and Poor's respectively. Minimum Short Term Ratings, where given, these must be met, for all categories.

3. **Options/Reasons for Recommendation**

3.1 The recommendation allows members to note the contents of the 2015/16 Mid Year Review of the Treasury Management function.

4. **Policy/Budget Implications**

4.1 The recommendations in this report are within the Council’s agreed policy and budgets.

5. **Financial Implications**

5.1 As continued in the body of the report

6. **Legal Implications**

6.1 There is no requirement to make any amendments to the Treasury Management Strategy at this stage.

7. **Equal Opportunities, Staffing, Environmental, Community Safety, Customer Services Centre Implications and Website Implications**

7.1 None specific.

8. **Risk Management Implications**

8.1 There are no risks associated with the decision Members are being asked to make, i.e. to note this report.

9. Recommendation

9.1 That members note the contents of the 2015/16 Mid Year Review of the Treasury Management function.

Background Papers:

Treasury Management Strategy 2015/16;
UK Economic Forecasts provided by Capita Asset Services;

Report prepared by: Loretta Manhertz (Finance Officer)

Data source: Logotech Treasury Management system

Data checked by: Nigel Pollard (Acting Head of Finance)
Data rating

1	Poor	
2	Sufficient	
3	High	✓