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BODY:	**AUDIT & GOVERNANCE COMMITTEE**
DATE:	**30 November 2016**
SUBJECT:	**Treasury Management Mid-year Review Report**
REPORT OF:	**Chief Finance Officer**
Ward(s):	All
Purpose:	To provide Members with a mid year review of treasury management activity.
Contact:	Janet Martin, Senior Accountant Telephone Number 01323 415983.
Recommendations:	Members are asked to note the contents of this report.

1.0 Introduction

1.1 Treasury Management is 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.

1.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management was adopted by Cabinet on 3 February 2016 and requires regular reports to this committee on the Treasury Management activities undertaken.

1.3 This mid year report 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;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2016/17;
- A review of the Council's borrowing strategy for 2016/17;
- A review of any debt rescheduling undertaken during 2016/17;
- A review of compliance with Treasury and Prudential Limits for 2016/17.

2.0 Economic Update

2.1 During most of 2015, the economy 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 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.

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 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 stoking core inflationary price pressures within the UK economy.

2.2 Capita's Interest rate forecast as at 15 November is shown in the table below.

	NOW	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
BANK RATE	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.75	0.75
3 month LIBID	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.40	0.50	0.60	0.70	0.80	0.90
6 month LIBID	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.50	0.60	0.70	0.80	0.90	1.00
12 month LIBID	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.80	0.80	0.90	1.00	1.10	1.20	1.30	1.40
5 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.70
25 yr PWLB	3.00	2.90	2.90	2.90	2.90	3.00	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.30	3.40
50 yr PWLB	2.70	2.70	2.70	2.70	2.70	2.80	2.80	2.80	2.90	2.90	3.00	3.00	3.10	3.10	3.20

Capita Asset Services undertook a review of its interest rate forecasts after the US Elections. The above forecast shows Base Rate is predicted to remain at 0.25% for some time with a first increase in June 2019, to 0.50%, and then further increase to 0.75% at the end of 2019. Mark Carney, Governor of the Bank of England, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The Monetary Policy Committee (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.

3.0 Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by Cabinet on 3 February 2016. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity.

There are no policy changes to the TMSS.

3.2 The Council aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

3.3 There is still uncertainty and volatility in the financial and banking market globally. In this context, it is considered that the strategy approved on 3 February 2016 is still fit for purpose in the current economic climate.

4.0 The Council's Capital Position (Prudential Indicators)

4.1 Prudential Indicator for Capital Expenditure

The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2016/17 Original Estimate £000	Position as at 30.9.16 £000	2016/17 Revised Estimate £000
General Fund	12,822	3,817	27,325
HRA	7,712	1,232	10,679
Total	**20,534**	**5,049**	**38,004**

4.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2016/17 Original Estimate £000	2016/17 Revised Estimate £000
Total spend	**20,534**	**38,004**
Financed by:		
Capital receipts	4,018	8,949
Capital grants	8,930	9,859
Capital reserves	275	7,177
Revenue	4,112	720
Total financing	**17,335**	**26,705**
Borrowing need	**3,199**	**11,299**

The increase in the revised estimated capital spend in 2016/17 is mainly due to:

- Re-profiling of previously approved schemes (£6.9m);

- New schemes approved relating to Joint Transformation Project (JTP) Eastbourne Housing Investment Co Ltd loan, Fishermen's Green, Devonshire Collective (6.6m);
- Additional grant funding for DFGs and Coastal Protection (£1.1m)
- Changes to the HEDP schemes (£2.9m)

4.3 **Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary.**

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

	2016/17 Original Estimate £m	2016/17 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	34.9	42.1
CFR – housing	43.1	42.7
Total CFR	78.0	84.8
Net movement in CFR	1.9	9.7
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	77.2	
Serco Paisa Loans	0.8	
Total debt 31 March	78.0	

The revised estimate has been increased from the original forecast Capital Financing Requirement due to the increased borrowing for JTP, EHIC Loan, Fishermen's Green and changes to the Housing Development schemes.

4.4 **Limits to Borrowing Activity**

One key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net 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 2016/17 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.

	2016/17 Original Estimate £m	Position As at 30.9.16 £m	2016/17 Revised Estimate £m
Gross borrowing	55.2	62.1	62.1
Serco Paisa Loans	0.8	0.9	0.8
Less investments	-	(10.0)	-
Net borrowing	56.0	53.0	62.9
CFR (year end position)	78.0	78.0	84.8

No difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. 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	2016/17 Original Indicator	Current Position
Borrowing	92.2	62.1
Other long term liabilities	0.8	0.9
Total	93.0	63.0

5.0 Investment Portfolio 2016/17

5.1 Investment rates available in the market continue at a historical low point. The average level of temporary funds available for investment purposes in the first six months of 2016/17 was £12.1m arising from the timing of precept payments, receipt of grants and progress on the capital programme.

5.2 A full list of investments held as at 30 September 2016 is shown in the table below. All investments are with British Banks and Building Societies:

Counterparty	Term	£000	Rate of Return %
Santander	On Call	5,000	0.55
Nationwide BS	Fixed Term 10/6-9/12	2,000	0.71
Nationwide BS	Fixed Term 1/7-30/12	1,000	0.57
Tameside MBC	Fixed Term 26/8-24/11	2,000	0.25
Total		**10,000**	

The above figures exclude the balance held on the Council’s current accounts with Lloyds Bank of £4.378,000 at a rate of 0.15%

Approved limits within the Annual Investment Strategy were not breached during the first six months of 2016/17.

5.3 Investment performance against benchmark was as follows:

Benchmark	Benchmark Return	Council Performance	Interest Earnings
7 day	0.28%	0.53%	£32,300

5.4 The authority outperformed the benchmark by 0.25%. The budgeted investment return for 2016/17 is £50,000. Performance for the year to date is above target, but the second half of the year will see a reduction in interest income as temporary investments are utilised in place of borrowing. The continuous use of internal balances is in line with the Council's strategy and reduces the amount of interest paid on loans.

5.5 **Investment Counterparty criteria**
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

6.0 Borrowing

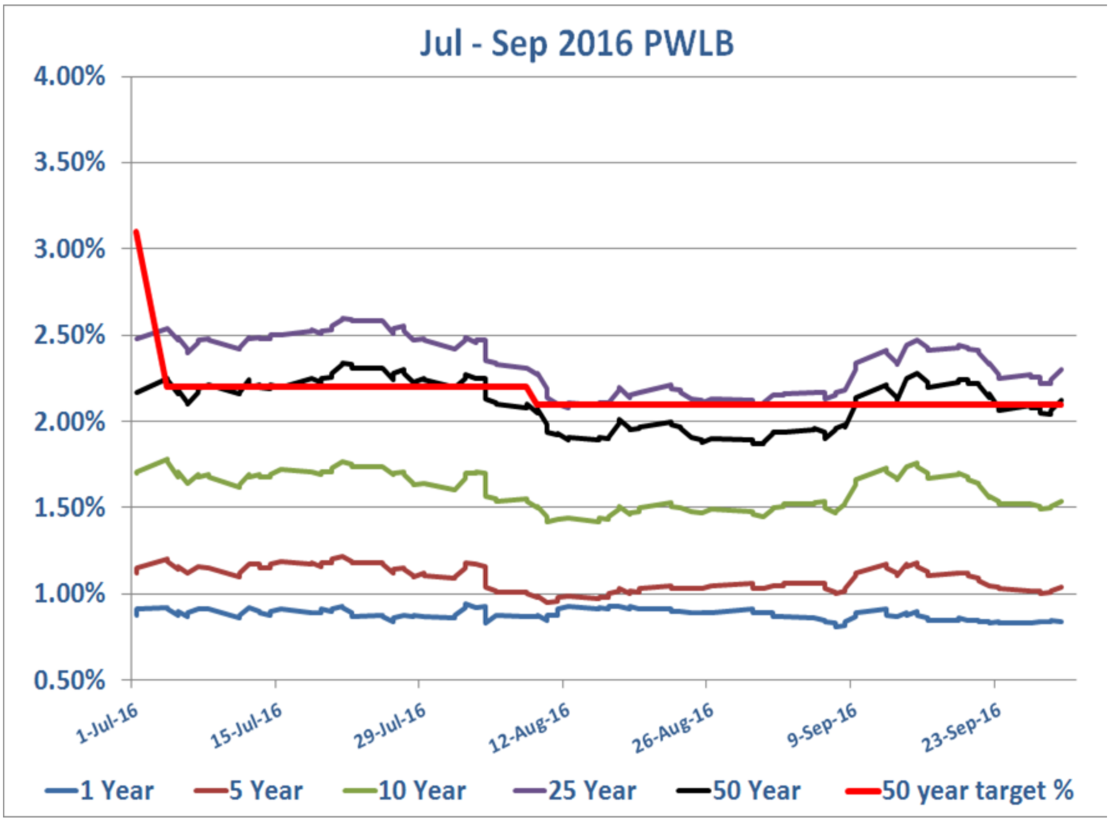
6.1 The following new loans were drawn down:

Lender	Amount £m	Interest Rate %	Start Date	Repayment Date
PWLB	2.0	2.87	07-Apr-16	24-Mar-66
PWLB	2.0	2.86	16-May-16	24-Mar-63
PWLB	2.0	2.78	03-Jun-16	24-Sep-60
PWLB	2.0	2.68	10-Jun-16	24-Mar-64
PWLB	2.0	2.49	20-Jun-16	24-Mar-59
PWLB	2.0	1.92	15-Aug-16	24-Sep-59
Total	**12.0**			

No loans were repaid during the during the first 6 months of the year.

6.2 The Council's revised estimated capital financing requirement (CFR) for 2016/17 is £84.8m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table above at 4.4 shows the Council has net borrowings of £63.0m and has utilised £25.0m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

6.3 The graph below shows the movement in PWLB rates for July to September 2016.



7.0 Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2016/17.

8.0 Compliance with Treasury and Prudential Limits

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

8.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

9.0 Consultation

9.1 None.

10.0 <u>Resource Implications</u>

10.1 None

Janet Martin
Senior Accountant

Background Papers:

The Background Papers used in compiling this report were as follows:

- CIPFA Treasury Management in the Public Services code of Practice (the Code)
- TMSS Policy
- Annual Investment Strategy

To inspect or obtain copies of background papers please refer to the contact officer listed above.