

**BODY:** **AUDIT & GOVERNANCE COMMITTEE**  
**DATE:** **2 December 2015**  
**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 4 February 2015 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 2015/16;
  - 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 2015/16;
  - A review of the Council's borrowing strategy for 2015/16;
  - A review of any debt rescheduling undertaken during 2015/16;
  - A review of compliance with Treasury and Prudential Limits for 2015/16.

## **2.0 Economic Update**

- 2.1 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% year on year) though there was a rebound in quarter 2 to +0.7% (+2.4% year on year). Growth is expected to weaken marginally 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.

The Bank of England August Inflation Report 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. Since then, worldwide economic statistics have been distinctly weak so it would not be a surprise if the next Inflation Report in November were to cut those forecasts.

The August Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon

There are therefore considerable risks around whether inflation will rise in the near future as strongly as previously expected; this will make it more difficult for the central banks of both the US and the UK to raise rates as soon as had previously been expected, 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.

2.2 Capita's Interest rate forecast is shown in the table below.

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
<b>Bank rate</b>	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
<b>5yr PWLB rate</b>	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
<b>10yr PWLB rate</b>	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
<b>25yr PWLB rate</b>	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
<b>50yr PWLB rate</b>	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 a review of its interest rate forecasts on 11 August after the August Bank of England Inflation Report. This latest forecast includes no change in the timing of the first increase in Bank Rate as being quarter 2 of 2016. With CPI inflation now likely to be at or near zero for most of 2015, it is difficult for the MPC to make a start on increasing Bank Rate when the Inflation Report forecast was also

notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. Despite average weekly earnings ticking up to 2.9% year on year in the three months ending in July, (as announced in mid-September), this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate soon as labour productivity growth meant that net labour unit costs are still only rising by about 1% year on year. The significant appreciation of Sterling against the Euro in 2015 has also acted as a dampening to UK growth while sharp volatility in financial markets since the Inflation Report has depressed equity prices, raised bond prices and lowered bond yields (and PWLB rates).

The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only just starting a significant recovery as a result of recent increases in the rate of wage inflation, though some consumers will not have seen that benefit come through for them.

### **3.0 Treasury Management Strategy Statement and Annual Investment Strategy Update**

3.1 The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by Cabinet on 4 February 2015. 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 4 February 2015 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.

<b>Capital Expenditure</b>	<b>2015/16 Original Estimate £000</b>	<b>Position as at 30.9.15 £000</b>	<b>2015/16 Revised Estimate £000</b>
General Fund	16,548	4,492	22,921
HRA	9,669	4,150	10,238
<b>Total</b>	<b>26,217</b>	<b>8,642</b>	<b>33,159</b>

#### 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.

<b>Capital Expenditure</b>	<b>2015/16 Original Estimate £000</b>	<b>2015/16 Revised Estimate £000</b>
<b>Total spend</b>	<b>26,217</b>	<b>33,159</b>
Financed by:		
Capital receipts	4,319	4,428
Capital grants	11,049	12,155
Capital reserves	5,264	5,489
Revenue	834	884
<b>Total financing</b>	<b>21,466</b>	<b>22,956</b>
<b>Borrowing need</b>	<b>4,751</b>	<b>10,203</b>

The increase in the revised estimated capital spend in 2015/16 is mainly due to:

- Re-profiling of previously approved schemes;
- new schemes approved relating to Pier Grant and Coastal Communities Grant;
- Eastbourne Housing Investment Co Ltd loan;
- Devonshire Park Project.

#### 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.

	2015/16 Original Estimate £m	2015/16 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	28.5	33.7
CFR – housing	42.9	43.3
Total CFR	71.4	77.0
Net movement in CFR	3.3	8.8
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	70.4	76.0
Serco Paisa Loans	1.0	1.0
Total debt 31 March	71.4	77.0

The revised estimate has been increased from the original forecast Capital Financing Requirement due to the increased borrowing for Devonshire Project, Sovereign Harbour Innovation Mall, re-profiling of the Investment in Council 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 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.

	2015/16 Original Estimate £m	Position As at 30.9.15 £m	2015/16 Revised Estimate £m
Gross borrowing	54.1	46.0	54.1
Serco Paisa Loans	1.0	1.3	1.0
Less investments	-	(5.5)	-
Net borrowing	55.1	41.8	55.1
CFR (year end position)	71.4	71.4	75.6

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	2015/16 Original Indicator	Current Position
Borrowing	85.4	46.0
Other long term liabilities	1.0	1.3
<b>Total</b>	<b>86.4</b>	<b>47.3</b>

## 5.0 Investment Portfolio 2015/16

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 2015/16 was £11.3m 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 2015 is shown in the table below. All investments are with British Banks and Building Societies:

Counterparty	Term	£000	Rate of Return %
Santander	On Call	4,000	0.80
Lloyds Bank	Current account	459	0.40
Nationwide B-Soc	Fixed Term 7/5-6/11/15	1,000	0.66
<b>Total</b>		<b>5,549</b>	

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

5.3 Investment performance against benchmark was as follows:

Benchmark	Benchmark Return	Council Performance	Interest Earnings
7 day	0.35%	0.58%	£32,750

5.4 The authority outperformed the benchmark by 0.23%. The budgeted investment return for 2015/16 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

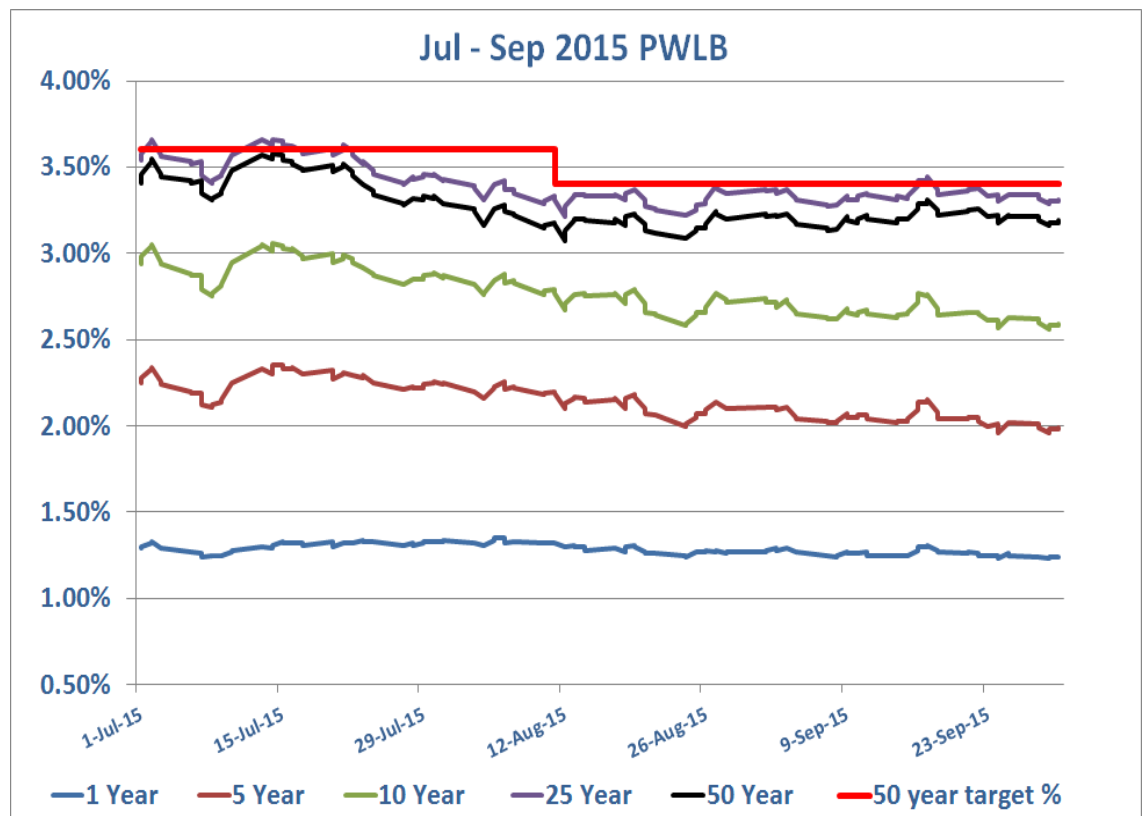
6.1 The following debts were repaid:

Lender	Amount £m	Interest Rate %	Start Date	Repayment Date
PWLB	950,929	10.25	6/8/85	24/9/15
PWLB	266,260	4.875	26/6/00	24/9/15
PWLB	760,743	4.875	27/6/00	24/9/15

No new or temporary borrowing was taken during the first 6 months of the year.

6.2 The Council's revised estimated capital financing requirement (CFR) for 2015/16 is £75.6m. 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 borrowings of £47.3m and has utilised £24.1m 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 2015.



## **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 2015/16.

## **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 Resource Implications**

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.