Ashfield
DISTRICT COUNCIL

Report To:	CABINET	**Date:**	24th November 2016
Heading:	TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW 2016/17		
Portfolio Holder:	CORPORATE SERVICES		
Ward/s:	N/A		
Key Decision:	NO		
Subject To Call-In:	NO		

Purpose Of Report

To receive a report on the position of the Council with regard to its Mid-Year position against the existing Treasury Management Strategy.

Recommendation(s)

Cabinet are asked to note the mid-year position in respect of the treasury activity and performance against the prudential indicators.

Reasons For Recommendation(s)

To make Members aware of the current position and meet the requirements of the Council's Financial Regulations (C.29).

Alternative Options Considered (With Reasons Why Not Adopted)

None as reporting is a requirement of Financial Regulations

Detailed Information

Overview

The Council aims to operate a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending commitments. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly treasury management 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."

TREASURY MANAGEMENT – MID-YEAR REPORT 2016/17

5.1 Introduction

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the 2016/17 financial year as at 30th September 2016;
- The Council's capital position (prudential indicators);
- The Council's investment portfolio for 2016/17.

There has been no change to the Council's Treasury Management Strategy and Annual Investment Strategy which was agreed by Council on 14th April 2016.

Due to the technical terms / abbreviations within this report, a glossary has been provided at the end of the report.

5.2 Economic update

5.2.1 UK Economy

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 exporters suffered from the appreciation during the year of sterling against the Euro, and weak growth in the European Union, 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.

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.

5.2.2 Interest Rate Forecasts

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 Monetary Policy Committee (MPC) meeting of 4th August to 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.

The overall longer run trend is for gilt yields and Public Works Loans Board (PWLB) rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities. However, there have been exceptional levels of volatility in the financial markets which have caused significant swings in PWLB rates. Capita PWLB rate forecasts are based on the Certainty Rate (minus 20 basis points) which has been accessible to most authorities since 1st November 2012.

The overall balance of risks to economic recovery in the UK remains to the downside. Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some major developed economies, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Weak capitalisation of some European banks.
- A resurgence of the Eurozone sovereign debt crisis.
- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the US Federal Reserve rate (Fed.) increases, causing a further flight to safe havens (bonds).
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

5.3 The Council's Capital Position (Prudential Indicators)

The Council's revised estimate position is shown in the table below. This is based on the November 2016 Capital Programme which is on the same agenda as this report.

Any changes to borrowing in the Capital Programme affect the Capital Financing Requirement (CFR). The CFR represents the Council's underlying need to borrow for capital expenditure.

	2016/17 Original Estimate £m	**2016/17 Revised Estimate £m**
CFR – non housing	20.739	20.841
CFR – housing	80.081	80.081
Total CFR	100.820	100.922
Net movement in CFR		**+0.101**
Borrowing	75.449	75.449
Other long term liabilities	0	0
Total debt 31 March	**75.449**	**75.449**

In terms of the revised estimate there has been an increase in the CFR mainly due to the inclusion in 2016/17 of the Vehicle Tracker Scheme in the revised Capital Programme.

The Council's CFR is within the Operational Boundary and the Authorised Limit outlined in the strategy.

Prudential Indicator 2016/17	***Original £m***	***Revised Prudential Indicator £m***
Authorised Limit	120	120
Operational Boundary	110	110
Capital Financing Requirement	101	101

5.4 Investment Portfolio 2016/17

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 5.2, 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 0.25% Bank Rate.

The Council held £21.0m of investments as at 30 September 2016 (£15.2m at 31 March 2016) and the investment portfolio yield for the first six months of the year is 0.41%.

The average investment return for term deposits i.e. those investments which are made for a period of seven days or more is shown below. The Council has a number of investments ranging from two weeks to one year. The comparison below compares the performance of these investments against the current Bank of England (BoE) base rate.

BoE Base Rate	Council Performance	Investment Interest Earned
0.25	0.60	£44,989

The Council's budgeted investment return for 2016/17 is £105k, and performance for the half year to 30th September 2016 is £60k which comprises £45k from term deposits and £15k from call deposits. The estimated full year outturn is £100k which is likely be slightly below budget due mainly to the fall in base rates from 0.5% to 0.25% in August 2016.

Glossary of Terms

GDP *Gross Domestic Product*
This is the monetary value of all the finished goods and services produced by a country within its borders in a specific time period, usually a year.

G7 G7 Countries
This is an international organisation established to facilitate economic cooperation among the seven wealthiest developed nations –Canada, France, Germany, Great Britain, Italy, Japan, USA.

CPI *Consumer Price Index*

RPI *Retail Price Index*

Both CPI and RPI measure inflation by measuring changes in the price levels of a sample of representative goods and services purchased by households. They use different items and different formulae for the calculations which means that CPI is often lower than RPI.

y/y *Year on year*

Year on year is a method of evaluating two or more measured events to compare the results of one time period with those of a comparable time period on an annualised basis.

MPC *Monetary Policy Committee*

This is a committee of the Bank of England which decides the official interest rate in the UK (the Bank of England Base Rate) and also directs other monetary policy such as quantitative easing and forward guidance.

PWLB *Public Works Loan Board*

The PWLB is a statutory body operating within the UK Debt Management Office to lend money from the National Loan Fund to local authorities and to collect the repayments.

Fed. *The Federal Reserve System*

The Federal Reserve System, often referred to as the Federal Reserve or simply "the Fed," is the central bank of the United States. It was created by the US Congress to provide the nation with a safer, more flexible, and more stable monetary and financial system.

Gilt A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. The term “gilt” or “gilt-edged security” is a reference to the primary characteristic of gilts as an investment: their security. This is a reflection of the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.

Equity An instrument that signifies an ownership position, or equity, in a corporation, and represents a claim on its proportionate share in the corporation's assets and profits.

<u>Implications</u>

Corporate Plan:

The Council’s treasury management activities provide support to fund priorities in the Corporate Plan.

Legal:

The report ensures compliance with Financial Regulations.

Finance:

This report relates to the period 1st April 2016 to 30th September 2016 and has the following financial implications:

Budget Area	Implication
General Fund – Revenue Budget	None- Reporting only
General Fund – Capital Programme	None – Reporting only
Housing Revenue Account – Revenue Budget	None – Reporting only
Housing Revenue Account – Capital Programme	None – Reporting only

Human Resources / Equality and Diversity:

There are no Human Resource & Equality & Diversity implications associated with this report.

Other Implications:

None

Reason(s) for Urgency (if applicable):

N/A

Background Papers

None

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