

Treasury solutions

Treasury Management Update
Quarter Ended 31ST December 2014
North Hertfordshire District Council

Contents

1. Economic Background	3
2. Interest Rate Forecast.....	4
3. Annual Investment Strategy	5
4. New Borrowing	10
5. Debt Rescheduling	11
6. Compliance with Treasury and Prudential Limits.....	11
7. Other	12

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Treasury Management Update

Quarter Ended 31st December 2014

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

1. Economic Background

- After strong UK GDP growth in 2013 at an annual rate 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.
- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.
- The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently predicted that the first increase in the Fed. rate will occur by the middle of 2015.

- The Eurozone is facing an increasing threat from deflation. In November the inflation rate fell to 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth and is currently expected to embark on quantitative easing early in 2015 to counter this threat of deflation and to stimulate growth.

2. Interest Rate Forecast

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
5yr PWLB rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%

Capita Asset Services undertook a review of its interest rate forecasts on 5 January 2015 after a proliferation of fears in financial markets around the plunge in the price of oil had caused a flight from equities into bonds and from exposure to the debt and equities of emerging market oil producing countries to safe havens in western countries. These flows were compounded by further fears that Greece could be heading towards an exit from the Euro after the general election on January 25 and financial flows generated by the increasing likelihood that the ECB would soon be starting on full blown quantitative easing (QE) purchase of Eurozone government debt. In addition, there has been a sharp increase in confidence that the US will start increasing the Fed. rate by the middle of 2015 due to the stunning surge in GDP growth in quarters 2 and 3 of 2014. This indicated that the US is now headed towards making a full recovery from the financial crisis of 2008.

The result of the combination of the above factors is that we have seen bond yields plunging to phenomenally low levels, especially in long term yields. These falls are unsustainable in the longer term but just how quickly these falls will unwind is hard to predict. In addition, positive or negative developments on the world political scene could have a major impact in either keeping yields low or prompting them to recover back up again. We also have a UK general election coming up in May 2015; it is very hard to predict what its likely result will be and the consequent impact on the UK economy, and how financial markets will react to those developments.

This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 2 of 2015 to quarter 4 of 2015 as a result of the sharp fall in inflation due to the fall in the price of oil and the cooling of the rate of GDP growth in the UK, albeit, that growth will remain strong by UK standards, but not as strong as was previously forecast. 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 currently increasing marginally as a result of wage inflation now running slightly above the depressed rate of CPI inflation, though some consumers will not have seen that benefit come through for them. In addition, whatever party or coalition wins power in the next general election, will be faced with having to implement further major cuts in expenditure and / or increases in taxation in order to eradicate the annual public sector net borrowing deficit.

3. Annual Investment Strategy

The North Hertfordshire District Council Treasury Management Strategy Statement (TMSS) for 2014/15, which includes the Annual Investment Strategy, was approved by the Council on 13 February 2014. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in higher rates in periods up to 24 months.

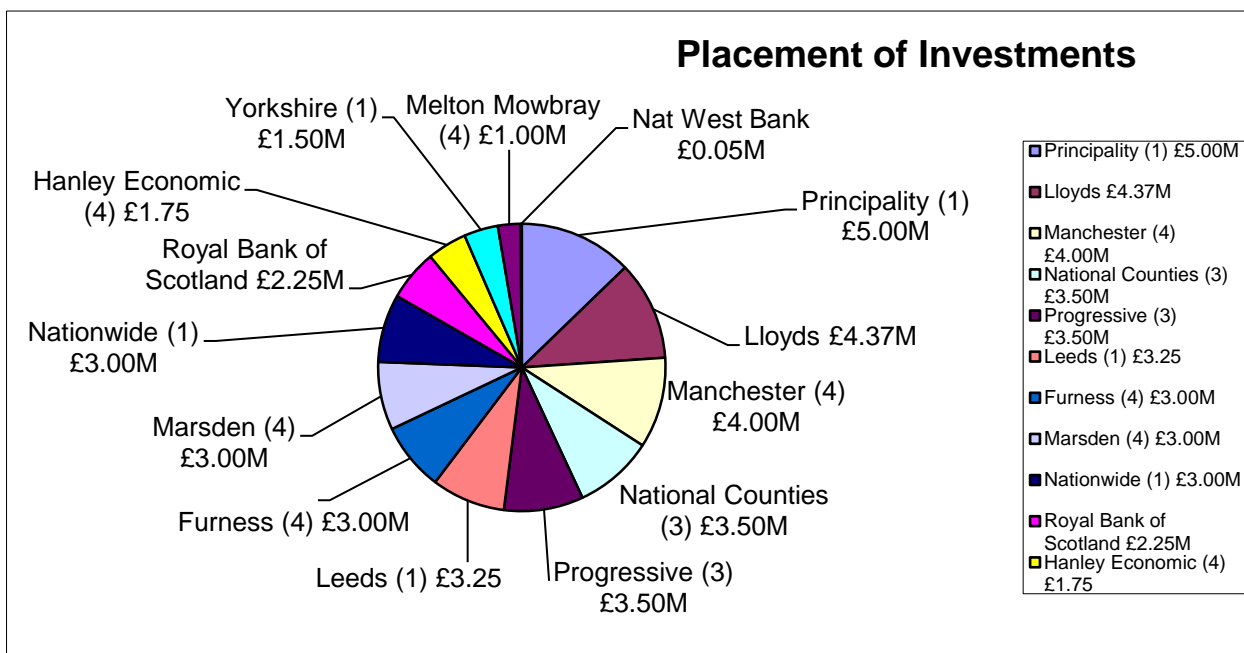
Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the ultra-low Bank Rate and other extraordinary measures such as the Funding for Lending Scheme. The average level of funds available for investment purposes in house during the quarter was £5.6m. 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 progress on the Capital Programme. On the 31st December the Council held £36.5m core cash balances with Sterling and Tradition for investment purposes (i.e. funds available for more than one year). The investment portfolio yield for the first nine months of the year is 1.2%.

Investments as at 31 December 2014

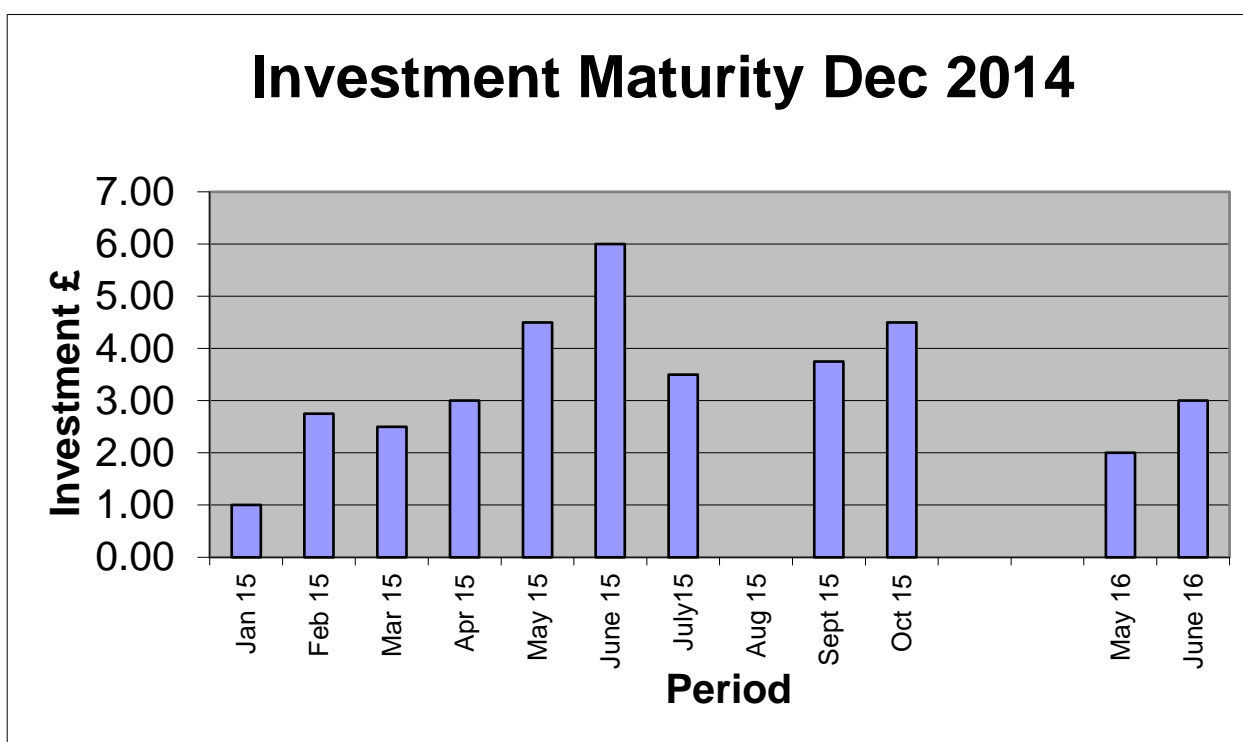
	Amount	Average
	£	Interest Rate %
Managed By NHDC		
Lloyds Bank	2,618,468	0.40
Nat West Bank	50,000	0.25
NHDC To Total	2,668,468	0.34
Managed by Sterling		
Banks	0	
Building Societies	16,500,000	1.18
Sterling Total	16,500,000	1.18
Managed by Tradition		
Banks	4,000,000	2.40
Building Societies	16,000,000	1.31
Tradition Total	20,000,000	1.67
TOTAL	39,168,468	1.48

The pie chart below shows the spread of investment balances as at 31 Dec 2014. The figures shown are in millions whilst the figure in brackets denotes the value of the building societies total assets:

- (1) Building Societies with Assets over £4.5bn
- (2) Building Societies with Assets between £2.5bn - £4.5bn
- (3) Building Societies with Assets between £1.0bn - £2.5bn
- (4) Building Societies with Assets between £0.3bn - £1.0bn

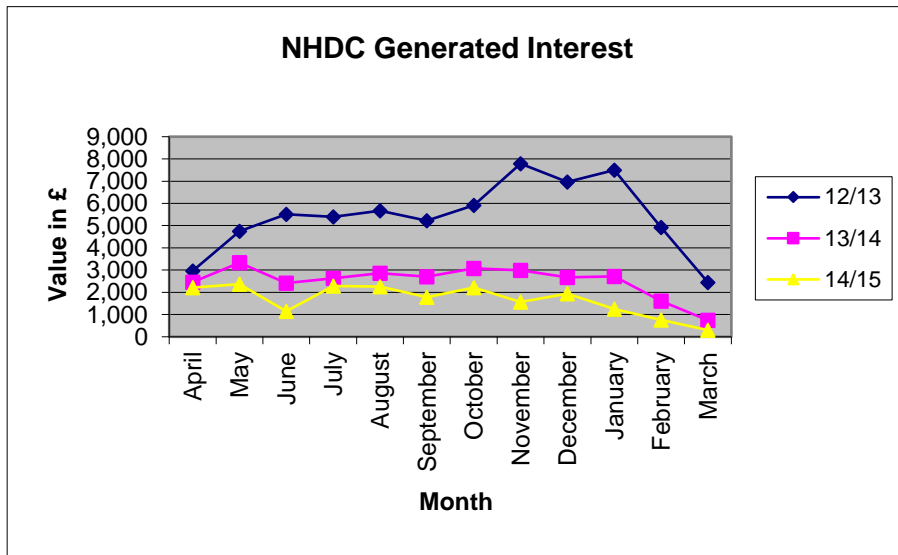


The chart below shows the Council's investment maturity profile. (This does not include the £0.050M held in the Nat West Liquidity account or £2.62M of the £4.37M Lloyds total held in the Lloyds current account which can be called back on any day). One new deal in the third quarter was placed for longer than a year. This was with Furness Building Society for 579 days with an interest rate of 1.5%. As investments mature with the Cash Managers during the final quarter of the year, the length of the deal will depend on our need to fund capital expenditure. Investments may be kept short to cover any short fall in cashflow towards the end of the financial year.



The Council's budgeted investment return for 2014/15 as reported at the 2nd quarter was £0.492M. The projection at the third quarter is £0.485M which is in line with the original budget of £0.484M. The reduction is due in part to reinvesting short term £3.5M of maturing investments to fund capital spend.

The graph below shows the level of interest expected to be generated from the cash available in-house over the year which is maintained to ensure adequate cashflow. Cash balances have historically reduced over January to March each year as there were no Council tax receipts in February and March. Receipts are now spread more evenly as many residents are choosing to pay council tax over 12 months.

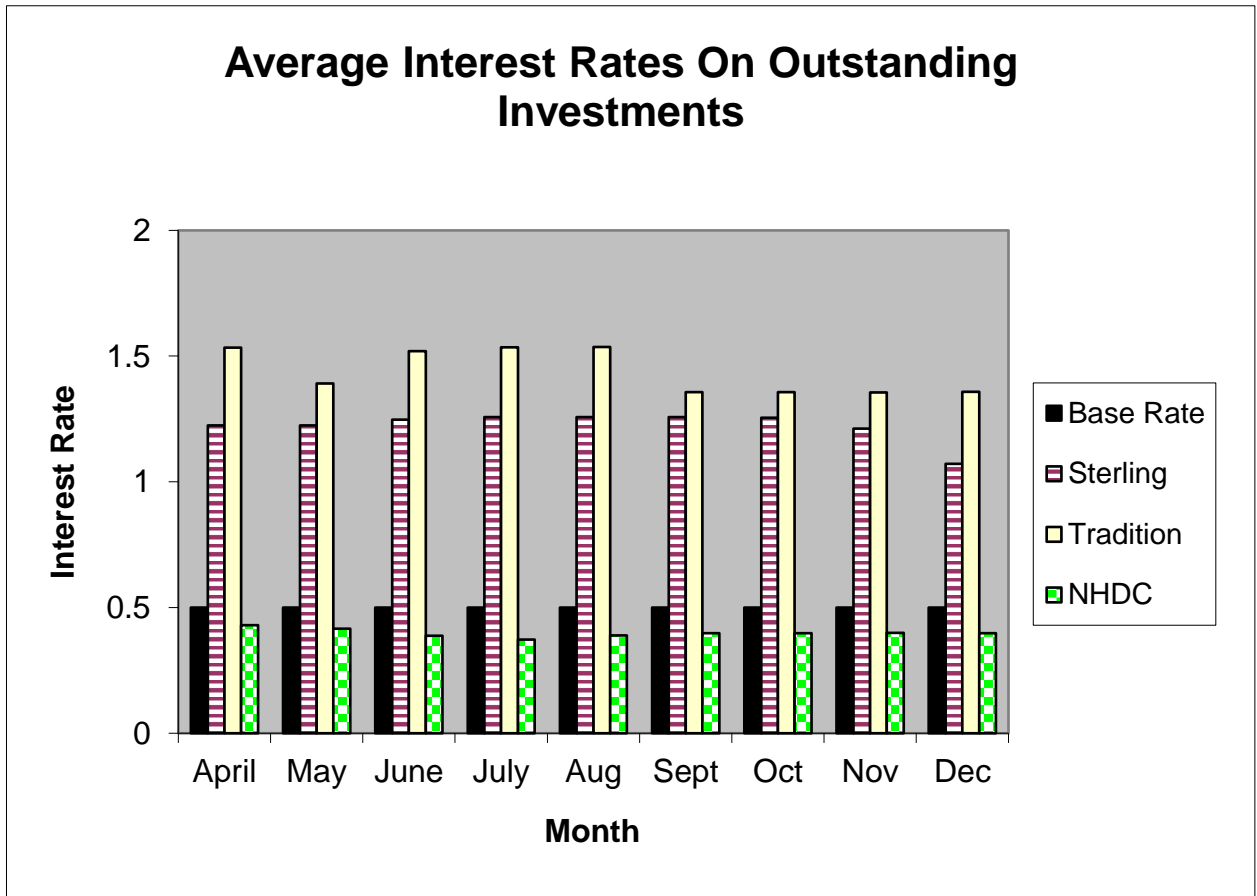


The table below shows the average rates achieved on investments made during the third quarter.

Ave Interest Rate on Deals made in the 3rd Qrt

	%
NHDC	0.36
Sterling	1.13
Tradition	0.80

Base rate started the year at 0.5% and remained constant through out the first nine months. The graph below shows the average rate of interest on outstanding investments at 31 December.



As can be seen from the graph, the average rate of interest on outstanding investments for NHDC (cash managed internally) is consistently lower than that of the Cash Managers. This is because the investments made by NHDC during the year are to meet cash flow requirements and are therefore made for short periods. At present, rates in the shorter periods are lower than the longer periods. The Cash Managers have more long term investments and the turnover of investments is small in comparison to NHDC.

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the third quarter of 2014/15.

4. New Borrowing

No new borrowing was undertaken during the quarter.

The Council's capital financing requirement (CFR) for 2014/15 is -£23.3m. 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 CFR is negative as the Council has more cash investments than borrowing. The balance of external and internal borrowing is generally driven by market conditions.

It is anticipated that long term borrowing will not be undertaken during this financial year.

The table below shows the movement in PWLB certainty rates for the first nine months of the year to date:

PWLB certainty rates for the financial year to date at 31st December 2014

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.12%	1.94%	2.54%	3.24%	3.22%
Date	31/12/2014	16/12/2014	16/12/2014	16/12/2014	16/12/2014
High	1.49%	2.87%	3.66%	4.30%	4.28%
Date	16/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.31%	2.51%	3.28%	3.93%	3.91%

Loans Outstanding at 31 December 2014

	Amount	Average Interest Rate	Cumulative Rate
	£	%	%
Public Works Loans Board	611,066	8.6561	8.85
Lender Option Borrower Option	1,000,000	10.125	10.10
	<u>1,611,066</u>	<u>9.5679</u>	<u>8.5356</u>

The total of loan repayments during the year will be £2,057,387. This is made up of two temporary loans of £1.97M (£1.4M taken out over the end of the last financial year and £0.57M taken for one day in April) and PWLB loans.

5. Debt Rescheduling

No debt rescheduling was undertaken during the first nine months of 2014/15. At present it is not financially beneficial to repay debt early.

6. Compliance with Treasury and Prudential Limits

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 included in the approved TMSS.

During the third quarter the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown below.

Treasury Indicators	2014/15 Budget £'000	Quarter 3 Actual £'000
Authorised limit for external debt	8,000	1,611
Operational boundary for external debt	6,000	1,611
Gross external debt	4,659	1,611
Investments	(37,125)	(39,168)
Net borrowing	(32,466)	(37,557)

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	87	87
12 months to 2 years	57	57
2 years to 5 years	1,076	1,076
5 years to 10 years	92	92
10 years and above	347	347

Upper limit of fixed interest rates based on investments	70%-100%	92%
Upper limit of variable interest rates based on investments	0%-30%	8%

Upper limit for principal sums invested over 364 days	20,000 Max	5,000
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Prudential Indicators	2014/15 Budget £'000	Quarter 3 Actual £'000
Capital expenditure *	9,602	3,313
Capital Financing Requirement (CFR) *	(23,340)	(23,340)
In year borrowing requirement	0	0

7. Other

The Council received notice in December that Sterling would be terminating their contract to provide the Council with a Treasury Management service with effect from 31 December 2014. As the funds managed by Sterling reach maturity it is proposed to use some of the funds to increase the amount managed by Tradition with the remainder being managed in house by Officers. Investments totalling £3.5M mature in the final quarter of 2014/15 and will be retained in house to fund Capital spend. This will leave a balance of £13M placed by Sterling. Of this, £8.5M will be allocated to Tradition providing them with a balance of £28.5M with the remaining £4.5M retained in house to fund Capital expenditure in 2015/16.