

Treasury solutions

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2015-16

English Authorities

1 Background

The Council operates 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 operations. 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. This council does not currently have borrowing requirements due to the capital receipts previously classed as "set-aside".

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."

2 Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was adopted by this Council on 12 February 2015.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Finance, Audit and Risk Committee:

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 first part of the 2015/16 financial year;
- 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.

3 Economic update

UK. 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. However, since the report was issued, the Purchasing Manager's Index, (PMI), for services on 5 October would indicate a further decline in the growth rate to only +0.3% in Q4, which would be the lowest rate since the end of 2012. 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 re-join 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.

USA. The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015. While there had been confident expectations during the summer that the Fed. could start increasing rates at its meeting on 17 September, or if not by the end of 2015, the recent downbeat news about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision to pull back from making that start. The nonfarm payrolls figures for September and revised August, issued on 2 October, were disappointingly weak and confirmed concerns that US growth is likely to weaken. This has pushed back expectations of a first rate increase from 2015 into 2016.

EZ. In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to

boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

3.2 Interest rate forecasts

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

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PVLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PVLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PVLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PVLB rate	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 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 PVLB 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.

Despite market turbulence since late August causing a sharp downturn in PVLB rates, the overall trend in the longer term will be for gilt yields and PVLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

The disappointing US nonfarm payrolls figures and UK PMI services figures at the beginning of October have served to reinforce a trend of increasing concerns that growth is likely to be significantly weaker than had previously been expected. This, therefore, has markedly increased concerns, both in the US and UK, that growth is only being achieved by monetary policy being highly aggressive with central rates at near zero and huge QE in place. In turn, this is also causing an increasing debate as to how realistic it will be for central banks to start on reversing such aggressive monetary policy until such time as strong growth rates are more firmly established and confidence increases that inflation is going to get back to around 2% within a 2-3 year time horizon. Market expectations in October for the first Bank Rate increase have therefore shifted back sharply into the second half of 2016.

Downside risks to current forecasts for UK gilt yields and PVLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.

- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

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

- Uncertainty around the risk of a UK exit from the EU.
- The ECB severely disappointing financial markets with a programme of asset purchases which proves insufficient to significantly stimulate growth in the EZ.
- The commencement by the US Federal Reserve 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.

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by this Council on 12 February 2015.

- There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5 The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure as approved in the first quarter Capital Budget Monitoring Report.

Capital Expenditure by Service	2015/16 Original Estimate £	Current Position £	2015/16 Revised Estimate £
Advances & Cash Incentives	598,000	0	598,000
Asset Management	1,973,800	46,984	1,973,800
CCTV	12,300	0	12,300
Community Services	376,700	60,003	376,700
Computer Software & Equipment	396,500	20,268	460,500
Corporate Items	95,000	0	95,000
Growth Fund Project	547,600	0	547,600
Leisure Facilities	4,751,400	290,281	4,521,200
Museum & Arts	1,477,900	685,824	1,615,900
Parking	1,208,300	112,747	1,208,300
Renovation & Reinstatement Grant Expenditure	805,000	218,661	805,000
Town Centre Enhancement	141,200	0	141,200
Total capital expenditure	12,383,700	1,434,768	12,355,500

5.2 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 finance arrangements of this capital expenditure.

Capital Expenditure	2015/16 Original Estimate £	Current Position £	2015/16 Revised Estimate £
Total capital expenditure	12,383,700	1,434,768	12,355,500
Financed by:			
Capital receipts	4,227,800	884,066	4,144,800
Capital grants	893,800	173,283	893,800
Other Capital Contributions	1,350,800	17,037	1,290,800
Revenue Contributions	92,300	0	92,300
S106 Funding	487,700	170,389	461,700
Total financing	7,052,400	1,244,775	6,883,400
Net Financing Need	5,331,300	189,993	5,472,100

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), 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, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

The Capital Financing Requirement will remain negative during the year.

Prudential Indicator – the Operational Boundary for external debt

	2015/16 Original Estimate £	Current Position £	2015/16 Revised Estimate £
Prudential Indicator – Capital Financing Requirement			
Total CFR	-20,193,924	-20,193,924	-20,193,924
Net movement in CFR	0	0	0
Prudential Indicator – the Operational Boundary for external debt			
Operational Boundary	6,000,000	6,000,000	6,000,000
Borrowing			
PWLB	572,154	540,605	515,276
LOBO	1,000,000	1,000,000	1,000,000
Total debt	1,572,154	1,540,605	1,515,276
Within Operational Boundary	4,427,846	4,459,395	4,484,724

The Operational Boundary was set to ensure there is sufficient headroom to allow for any temporary borrowing that may be required during the year.

5.4 Limits to Borrowing Activity

The first 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. 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 but this will not be required in 2015/16.

The Director of Finance reports that 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	2015/16 Revised Indicator
Authorised Limit	8,000,000	8,000,000	8,000,000
Borrowing	1,572,154	1,540,605	1,515,276

6 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 3, 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. The continuing potential for a re-emergence of a 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 £33.0m of core investments with Sterling and Tradition as at 30 September 2015 and the investment portfolio yield for the first six months of the year including in-house deals is 0.9%.

The average level of funds available for investment purposes in house during the quarter was £17.2M. 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. At the 30 September the Council held £33.0M core cash balances for investment purposes (i.e. funds available for more than one year). This will reduce to £28.5M during the year as £4.5M of Sterling investments mature in October and will be retained in-house to fund the capital programme.

Investments as at 30 Sept 2015

	Amount £	Average Interest Rate %
Managed By NHDC		
Banks	7,850,000	0.65
Building Societies	7,000,000	0.60
Money Market Fund	25,000	0.55
NHDC Total	14,875,000	0.62
Managed by Sterling		
Banks		
Building Societies	5,500,000	1.43
Sterling Total	5,500,000	1.43
Managed by Tradition		
Banks	8,000,000	1.17
Building Societies	19,500,000	1.51
Tradition Total	27,500,000	1.38
TOTAL	47,875,000	1.31

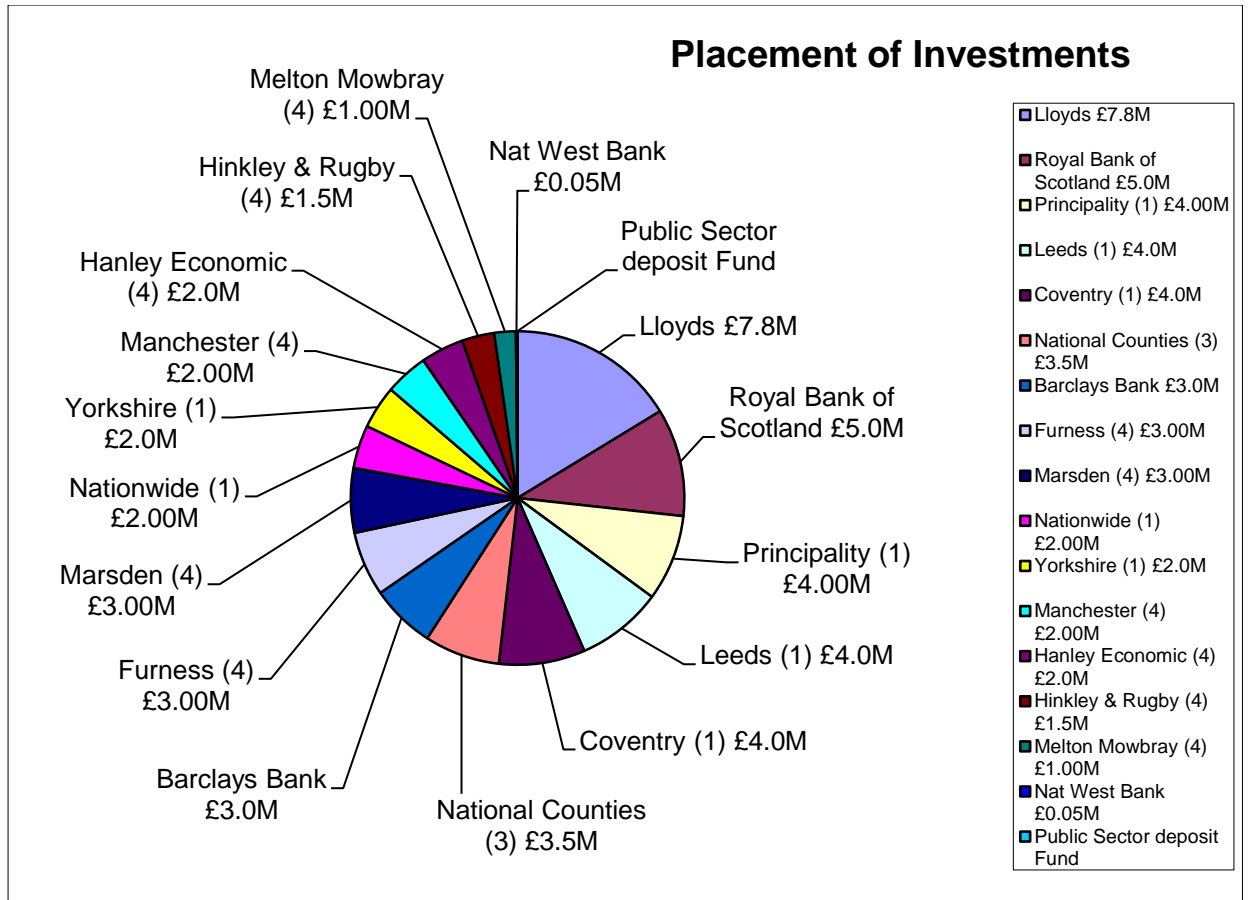
In percentage terms, this equates to:

	Percentage
Money Market Funds	0.05
Banks	33.11
Building Societies	66.84

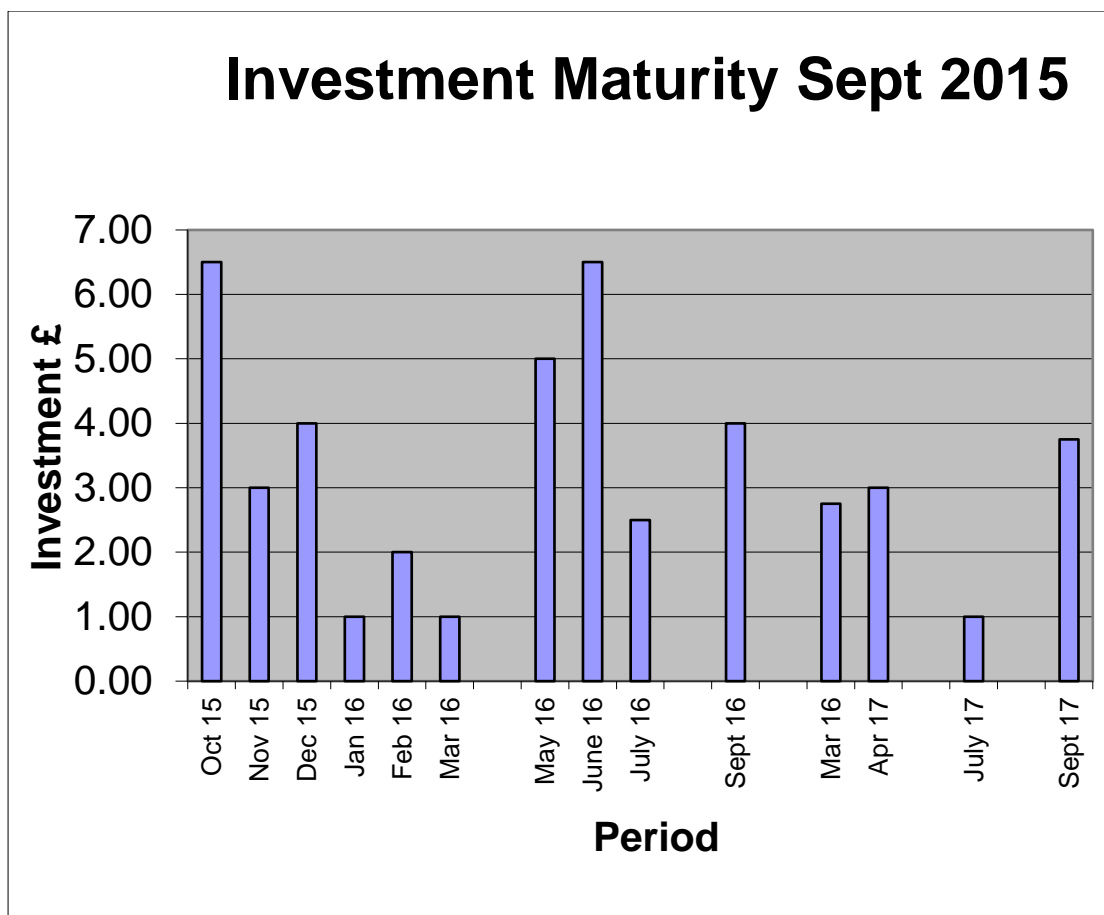
The approved 15/16 strategy is that no more than 75% of investments should be placed with Building Societies.

The pie chart below shows the spread of investment balances as at 30 September 2015. 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



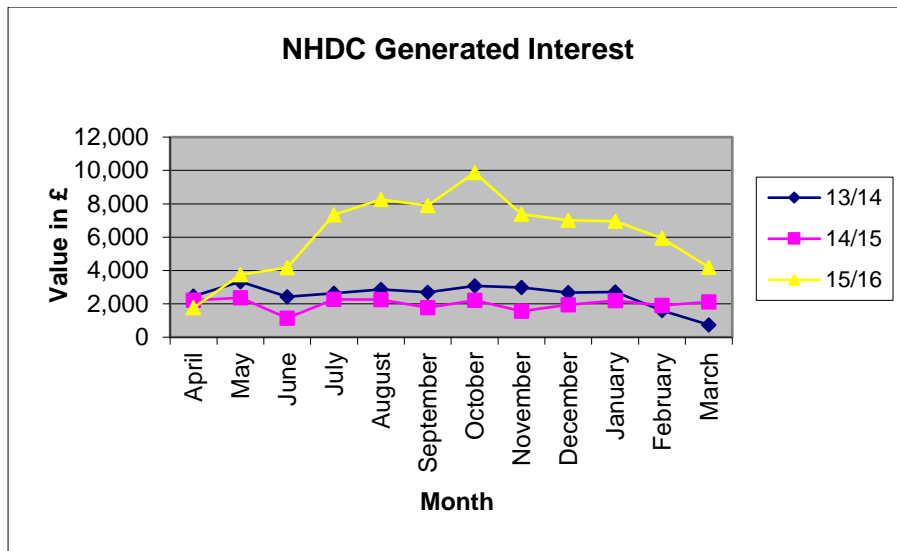
The chart below shows the Council's investment maturity profile. (This does not include the £0.025M held in the Public Sector Deposit Fund Money Market account, £0.050M held in the Nat West Liquidity account or £1.8M held in the Lloyds current account which can be called back on any day). Three new deals in the second quarter were placed for longer than a year. These totalled £4.75M and were all two year deals.



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

The Council's budgeted investment return for 2015/16 was £0.364M. The projection at the first quarter increased the budget to £0.413M. The projection at the second quarter is £0.431M an increase of £0.018M. The increase is mainly due to in house investments being placed for longer periods. This was possible as the level of balances increased in June when asset disposal income was received.

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.

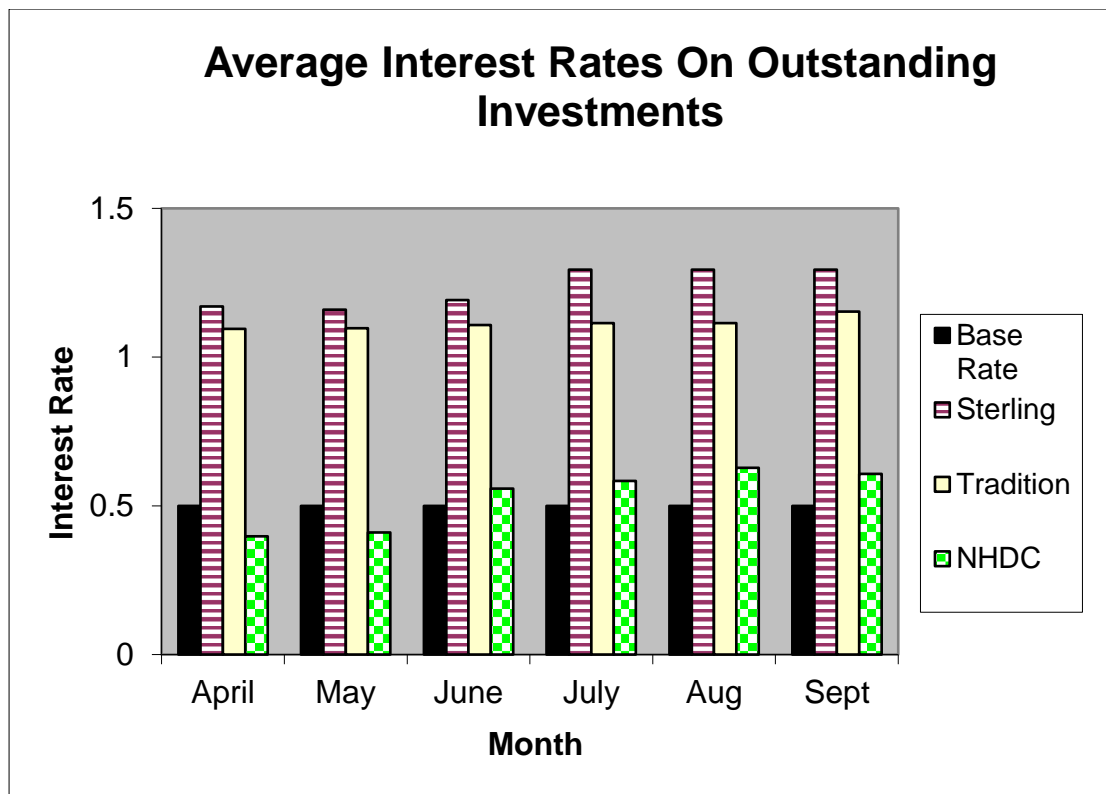


The spike in June / July resulted when income was received from an asset disposal. The expected level of in house balance is expected to increase in October when funds mature that were placed by Sterling. These will remain in house to be invested short term to fund capital expenditure.

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

	Ave Interest Rate on Deals made in the 2nd Qrt
NHDC	0.58
Tradition	1.37

Base rate started the year at 0.5% and remained constant through out the first six months. The graph below shows the average rate of interest on outstanding investments at 30th September.



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.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function but will be reviewed when setting next year's TMSS

7 Borrowing

The Council's capital financing requirement (CFR) for 2015/16 is -£20.2m. 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.

Loans Outstanding as at 30 September 2015

	Amount	Average Interest Rate	Cumulative Rate
	£	%	%
Public Works Loans Board	540,605	9.06	8.85
Lender Option Borrower Option	1,000,000	10.125	10.1
Temporary Loans 364 Days and Under	0	0	0
	<u>1,540,605</u>	<u>9.7509</u>	<u>8.545</u>

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 six months of the year to date:

PWLB certainty rates 1 April 2015 to 30th September 2015

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.11%	1.82%	2.40%	3.06%	3.01%
Date	02/04/2015	02/04/2015	02/04/2015	02/04/2015	02/04/2015
High	1.35%	2.35%	3.06%	3.66%	3.58%
Date	05/08/2015	14/07/2015	14/07/2015	02/07/2015	14/07/2015
Average	1.26%	2.12%	2.76%	3.39%	3.29%

8 Debt Rescheduling

No debt rescheduling was undertaken during the first six months of 2015/16. At present it is not financially beneficial to repay debt early.

**APPENDIX 1: Prudential and Treasury Indicators
as at 30th Sept 2015**

Treasury Indicators	2015/16 Budget £'000	Quarter 2 (Apr-Sept) Actual £'000
Authorised limit for external debt	8,000	1,515
Operational boundary for external debt	6,000	1,515
Gross external debt	4,572	1,515
Investments	(36,250)	(47,875)
Net borrowing	(31,678)	(46,360)

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	57	57
12 months to 2 years	1,035	1,035
2 years to 5 years	58	58
5 years to 10 years	97	97
10 years and above	325	325
Upper limit of fixed interest rates based on net debt *2	70% - 100%	93.7%
Upper limit of variable interest rates based on net debt *2	0% - 30%	6.3%
Upper limit for principal sums invested over 364 days	Max 40%	22%

Prudential Indicators	2015/16 Budget £'000	Quarter 1 (Apr-Jun) Actual £'000
Capital expenditure *	12,354	1,435
Capital Financing Requirement (CFR) *	(20,194)	(20,194)
In year borrowing requirement	0	0

