CAPITA

Asset Services

Treasury solutions

Treasury Management Update

Quarter Ended 30th June 2015

FAR COMMITTEE (24.9.15)

Contents

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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 of 2.7% and 3.0% in 2014, quarter 1 of 2015 was disappointing at only 0.4%, though subsequent data indicates that this could well be revised up further down the line and also indicates a return to stronger growth in quarter 2. In its May quarterly Inflation Report, the Bank of England reduced its GDP forecast for 2015 from 2.9% to 2.5% and from 2.9% to 2.7% in 2016, while increasing its forecast for 2017 from 2.4% to 2.7%.

Uncertainty around the likely result of the UK general election in May has obviously now evaporated although this has been replaced by some uncertainty around the potential impact on the UK economy of the EU referendum promised by, or in, 2017. In addition, the firm commitment of the Conservative Government to eliminating the deficit within the term of this Parliament will have an impact on GDP growth rates. However, the MPC is fully alert to this and will take that into account, and also the potential spill over effects from the Greek crisis, in making its decisions on the timing of raising Bank Rate.

As for the American economy, confidence has improved markedly in this quarter that the US will start increasing the Fed funds rate by the end of 2015 due to a return to strong economic GDP growth after a disappointing start to the year in quarter 1, (a contraction of 0.2%), after achieving 2.4% growth in 2014.

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, though it remains to be seen whether this will have an enduring effect as strong as the recovery in the US and UK.

2. Interest Rate Forecast

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

	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%	1.50%	1.50%	1.75%
5yr PWLB rate	2.30%	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%
10yr PWLB rate	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%
50yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%

Capita Asset Services undertook a review of its interest rate forecasts after the May Bank of England Inflation Report. The ECB's quantitative easing programme to buy up EZ debt caused an initial widespread rise in bond prices and, correspondingly, a fall in bond yields to phenomenally low levels, including the debt of some European countries plunging into negative yields. Since then, fears about recession in the EZ, and around the risks of deflation, have abated and so there has been an unwinding of this initial phase with bond yields rising back to more normal, though still historically low yields.

This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 1 of 2016 to quarter 2 of 2016 as a result primarily of poor growth in quarter 1, weak wage inflation and the recent sharp fall in inflation due to the fall in the price of oil and the impact of that on core inflation. The UK fell marginally into deflation in April (-0.1%) and figures near zero will prevail for about the next six months until the major fall in oil prices in the latter part of 2014 falls out of the twelve month calculation of CPI inflation. 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. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by the Council on 12 February 2015. 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 its 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 £10.9m. 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. The level of balance was boosted by the land sale at Kimpton. The Council holds £33.0m core cash balances for investment purposes (i.e. funds available for more than one year). The investment portfolio yield for the first 3 months of the year is 0.94%.

Investments at 30th June 2015

	Amount £	Average Interest Rate %
Managed By NHDC		
Banks	7,083,590	0.40
Building Societies	5,000,000	0.64
Local Authority	1,000,000	0.40
Money Market Fund	25,000	0.49
NHDC To Total	**13,108,590**	**0.61**
Managed by Sterling		
Banks	0	
Building Societies	9,000,000	1.31
Sterling Total	**9,000,000**	**1.31**
Managed by Tradition		
Banks	8,000,000	1.06
Building Societies	16,000,000	1.22
Tradition Total	**24,000,000**	**1.16**
TOTAL	**46,108,590**	**1.17**

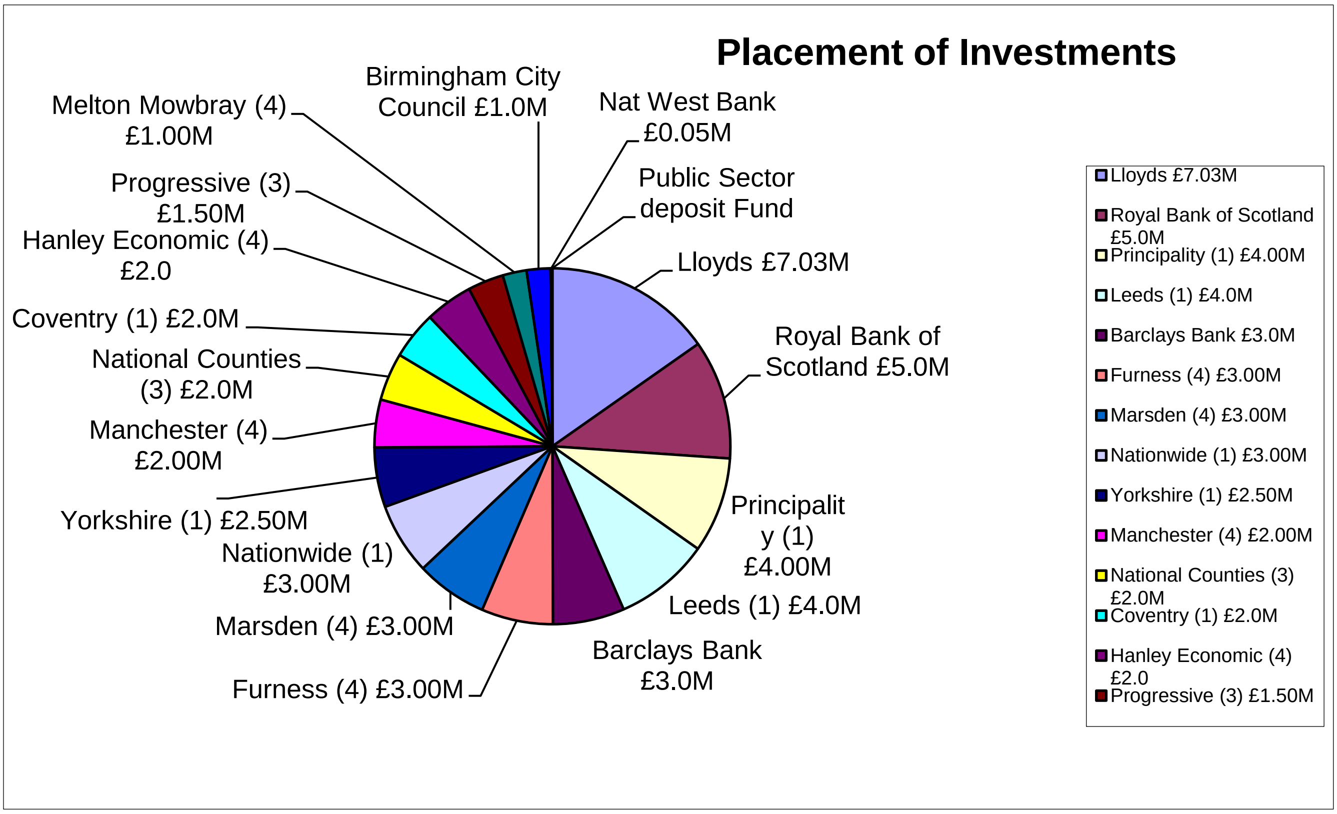
In percentage terms, this equates to:

	Percentage
Money Market Funds	0.05
Other Local Authorities	2.17
Banks	32.71
Building Societies	65.07

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

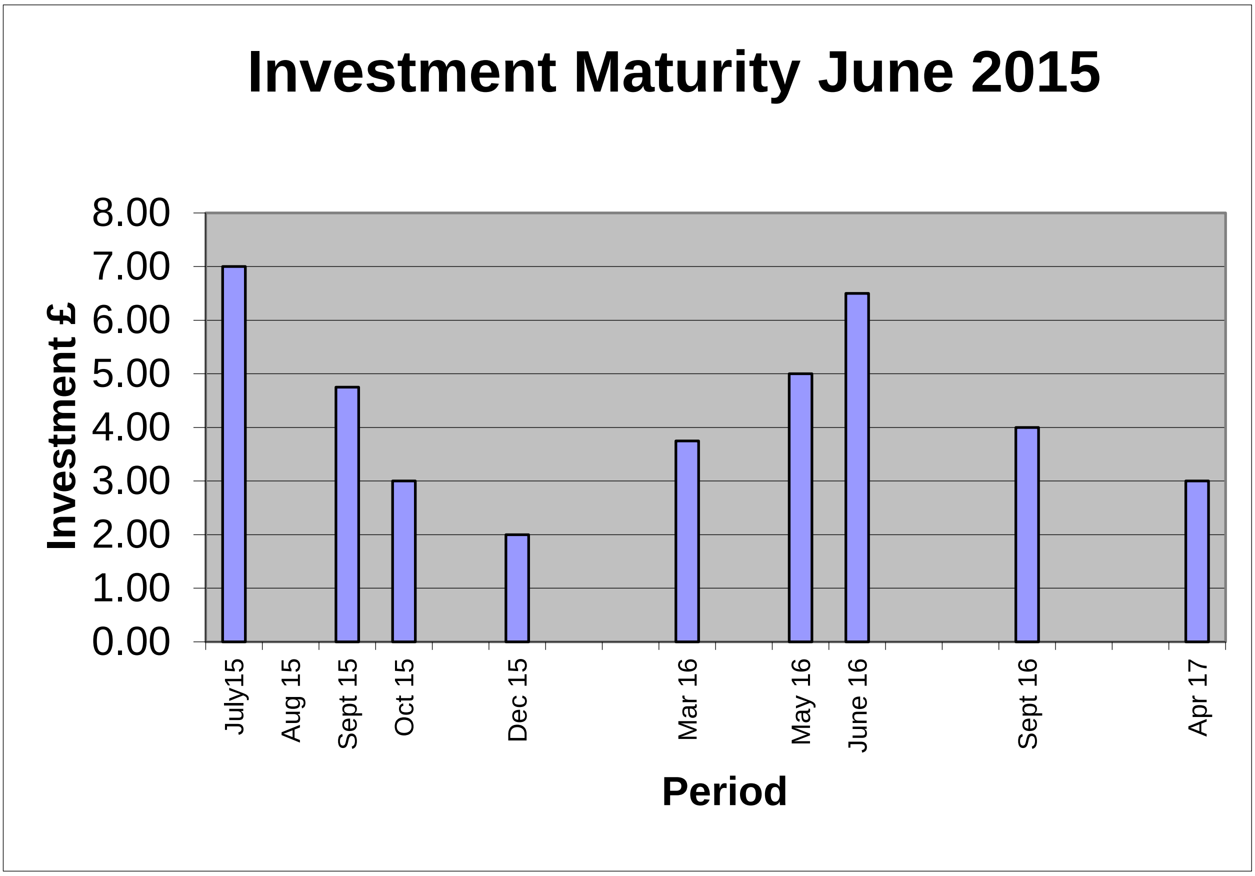
The pie chart below shows the spread of investment balances as at 30 June 2015. The figures shown are in millions whilst the figure in brackets denotes the value of the building societies total assets:

(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



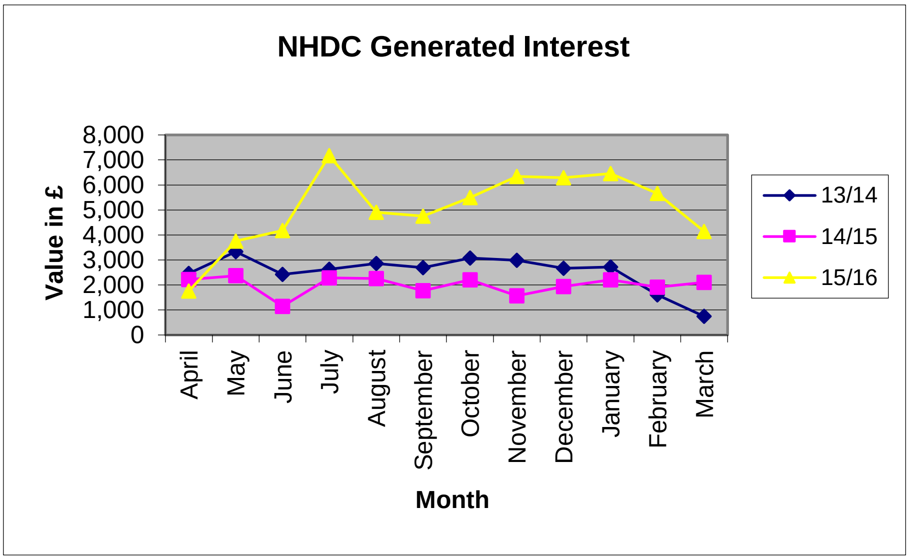
The chart below shows the Council's investment maturity profile. (This does not include the £0.025M held in the Public Sector Deposit Fund Money Market account, £0.050M held in the Nat West Liquidity account or £7.03M held in the Lloyds current account which can be called back on any day). One new deal in the first quarter was placed for longer than a year. This was £4.0M with Leeds Building Society for 457 days with an interest rate of 0.95%.

As investments placed by Sterling mature they have been reinvested by Tradition. During the first quarter, four Sterling deals matured with a total value of £4.0M. A further three deals totalling £3.5M mature in July. This will leave Sterling with a balance of £5.5M until October when four deals mature with a value of £4.5M which will be reinvested in house to fund Capital expenditure. The remaining £1M matures in June 2016 and will be reinvested by Tradition.



The Council's budgeted investment return for 2015/16 was £0.364M. The projection at the first quarter is £0.415M which is an increase of approximately £0.05M. 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.

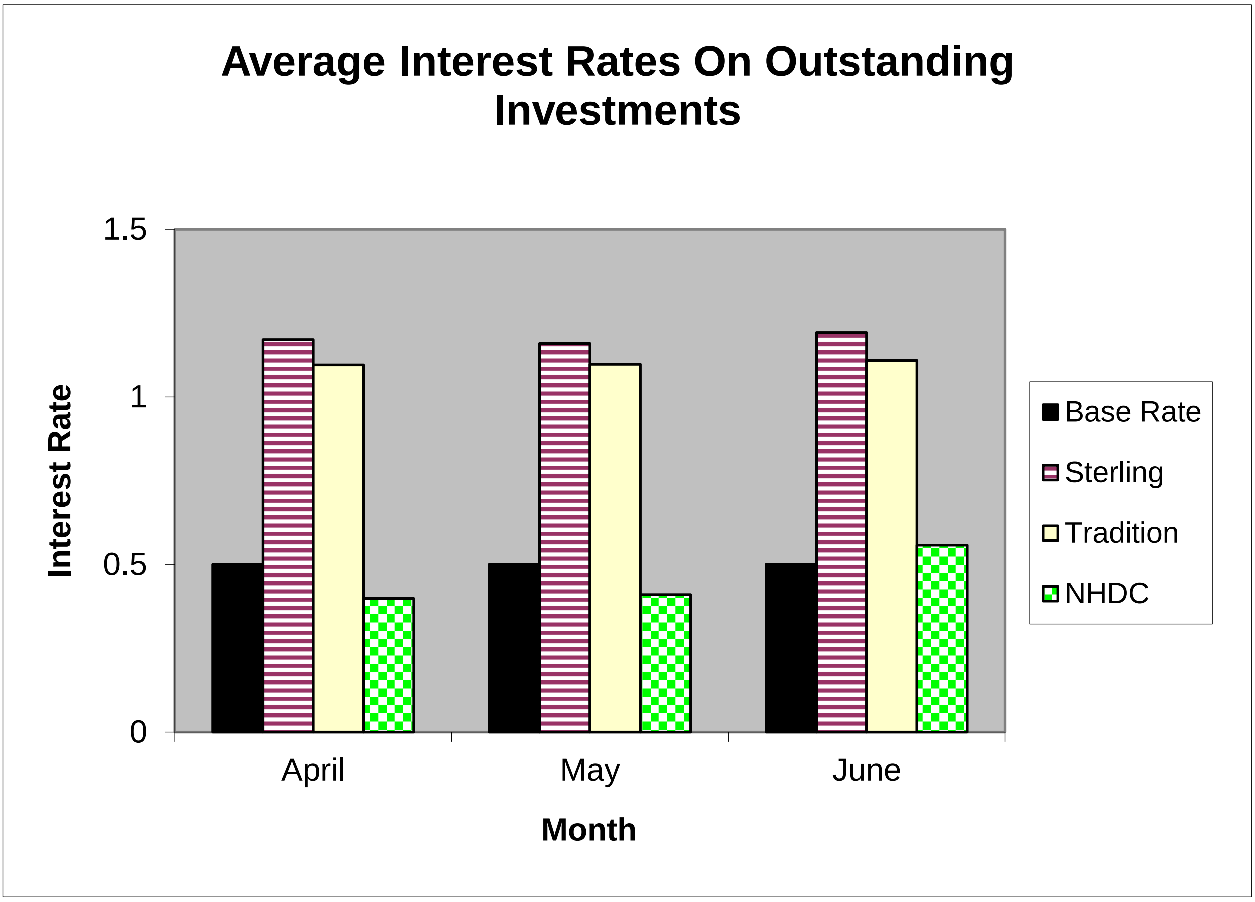


The spike in June / July resulted when income was received from an asset disposal. The expected level of in house balance is expected to increase in October when funds mature that were placed by Sterling. These will remain in house to be invested short term to fund capital expenditure.

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

	Ave Interest Rate on Deals made in the 1st Qrt
	%
NHDC	0.61
Tradition	1.01

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



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 first quarter of 2015/16.

4. New Borrowing

No new borrowing was undertaken during the quarter.

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.

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 three months of the year to date:

PWLB certainty rates, quarter ended 30th June 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	1.33%	2.32%	3.04%	3.65%	3.55%
Date	25/06/2015	25/06/2015	10/06/2015	24/06/2015	04/06/2015
Average	1.23%	2.09%	2.75%	3.37%	3.29%

Loans Outstanding at 30 June 2015

	Amount	Average Interest Rate	Cumulative Rate
	£	%	%
Public Works Loans Board	572,090	8.8723	8.85
Lender Option Borrower Option	1,000,000	10.125	10.10
	1,572,090	9.6691	8.5417

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter.

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 financial year to date 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 in Appendix 1.

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

Treasury Indicators	2015/16 Budget £'000	Quarter 1 (Apr-Jun) Actual £'000
Authorised limit for external debt	8,000	1,572
Operational boundary for external debt	6,000	1,572
Gross external debt	4,572	1,572
Investments	(36,250)	(46,109)
Net borrowing	(31,678)	(44,537)

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%	93.5%
Upper limit of variable interest rates based on net debt *2	0% - 30%	6.5%

Upper limit for principal sums invested over 364 days	Max 40%	21%

Prudential Indicators	2015/16 Budget £'000	Quarter 1 (Apr-Jun) Actual £'000
Capital expenditure *	12,354	592
Capital Financing Requirement (CFR) *	(20,194)	(20,194)
In year borrowing requirement	0	0