CAPITA

Asset Services

Capita Treasury solutions

Treasury Management Update

Quarter Ended 31 December 2016

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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

APPENDIX 1: Prudential and Treasury Indicators as at 31December 2016 12

Treasury Management Update

Quarter Ended 31 December 2016

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

UK GDP growth rate 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 has been fairly robust at +0.6% q/q, +2.2% y/y in quarter 3 of 2016 to confound the pessimistic forecasts by the Bank of England in August and by other forecasters, which expected to see near zero growth during 2016 after the referendum. Prior to the referendum, the UK economy had been facing headwinds for exporters from the appreciation of sterling against the Euro plus weak growth in the EU, China and emerging markets, and 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, there was then a sharp recovery in confidence and business surveys and the fall in the value of sterling has had a positive effect in boosting manufacturing in the UK due to improved competitiveness in world markets.

The Bank of England meeting on 4th August addressed its forecast of a slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report cut the forecast for growth in 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. While the MPC was prepared to cut Bank Rate again by the end of 2016, Carney also warned that the Bank could not do all the heavy lifting and suggested that the Government would 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 would be eased in the Autumn Statement on November 23 and which he duly delivered.

The robust growth in quarter 3 of +0.6%, plus forward indicating business surveys also being very positive on growth, caused the MPC in November to pull back from another cut in Bank Rate. The November Inflation Report also included a forecast for inflation to rise to around 2.7% in 2018 and 2019, well above its 2% target, due to a sharp rise in the cost of imports as a result of the sharp fall in the value of sterling after the referendum. However, the MPC is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Growth in quarter 1 of 2016 of +0.8% on an annualised basis, and quarter 2 at +1.4%, was disappointing. However, quarter 3 came in very strongly at +3.5% and forward indicators are pointing towards robust growth in 2017, especially if Trump's expansionary plans are put into effect.

The Fed embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, caused a delay in the timing of the second increase of +0.25% until this December's meeting. Three or four further increases are now expected in both 2017 and 2018.

In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December 2015 and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March 2006 meeting, it also increased its monthly asset purchases to €80bn. In December 2016, it extended its QE programme; monthly purchases at €80bn will continue to March 2017 and then continue at €60bn until December 2017. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 3 2016 (1.7% y/y) but forward surveys are, at last, positive about a modest upturn to growth while inflation has also started to increase significantly. There have been many comments from forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

Japan has struggled for many years to boost anaemic growth despite massive fiscal and monetary stimulus, but quarter 3 came in at +2.7% y/y. Chinese economic growth has been weakening and medium term risks have been increasing.

2. Interest Rate Forecast

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

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling after early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by the Council on 11 February 2016. 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.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31 December 2016.

Investment rates available in the market were broadly stable during the first half of the quarter but then took a slight downward path in the second half concluding with a significant drop after the referendum on a sharp rise in expectations of an imminent cut in Bank Rate and "lower for longer" expectations thereafter.

The average level of funds available for investment purposes in house during the quarter was £20.6m. 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. The Council holds £28.5m core cash balances for investment purposes (i.e. funds available for more than one year). The investment portfolio yield for the first 9 months of the year is 0.89%.

Investments at 31st December 2016

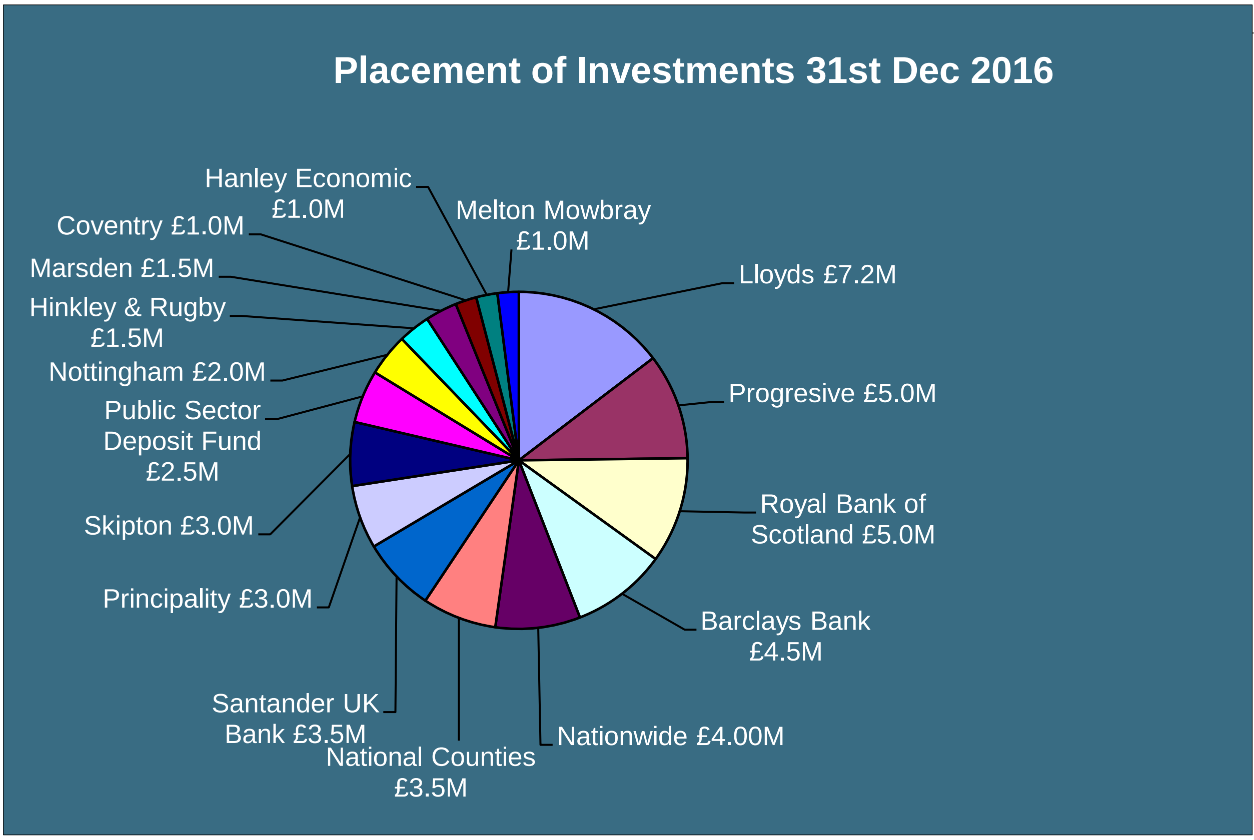
	Amount £	Average Interest Rate %
Managed By NHDC		
Banks	12,200,000	0.69
Building Societies	6,000,000	0.27
Money Market Fund	2,500,000	0.37
NHDC To Total	**20,700,000**	**0.58**
Managed by Tradition		
Banks	8,000,000	1.32
Building Societies	20,500,000	1.19
Tradition Total	**28,500,000**	**1.22**
TOTAL	**49,200,000**	**1.12**

In percentage terms, this equates to:

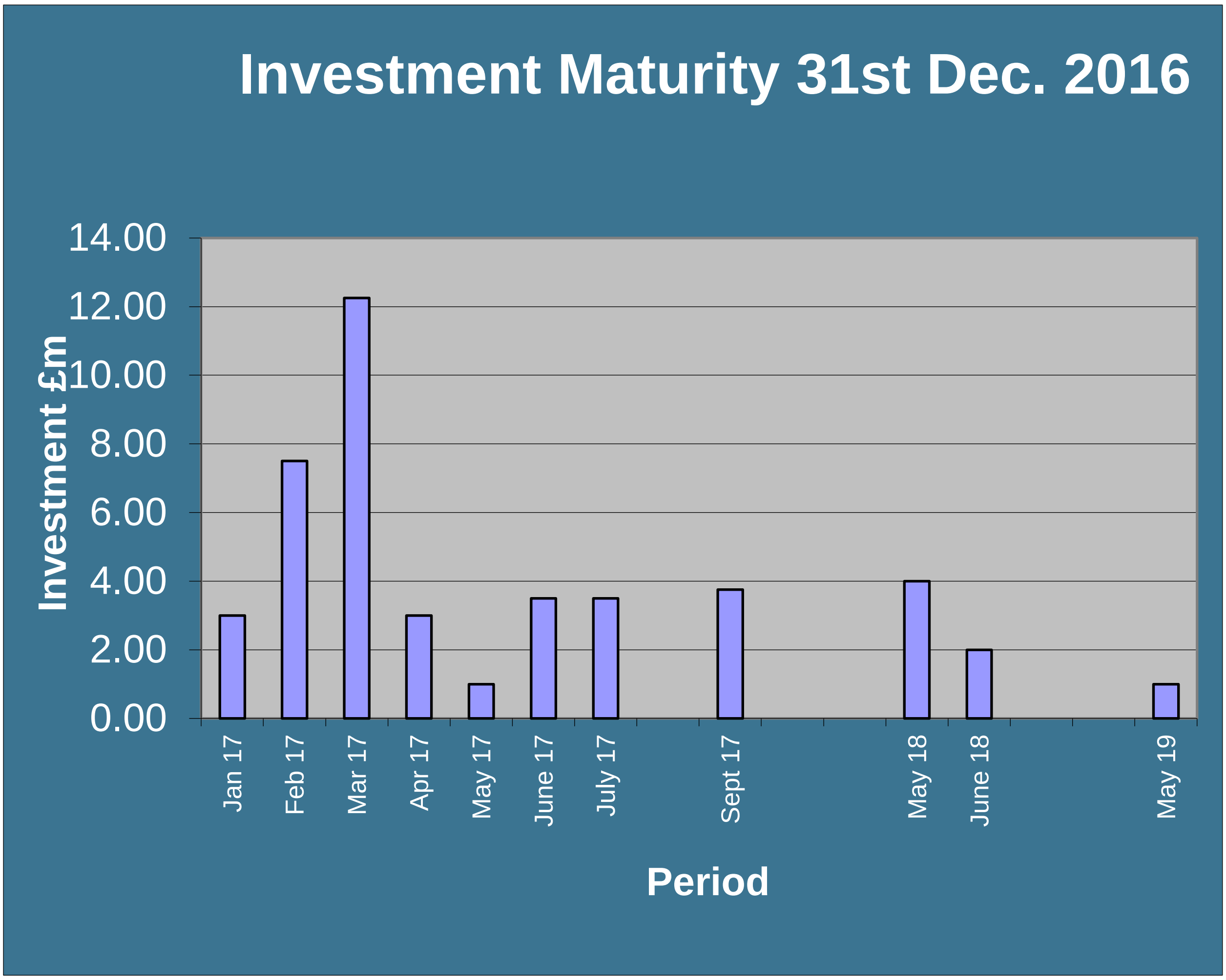
	Percentage
Money Market Funds	5.08
Banks	41.06
Building Societies	53.86

The approved 16/17 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 31 December 2016. This is a snapshot in time that demonstrates the diversification of investments.

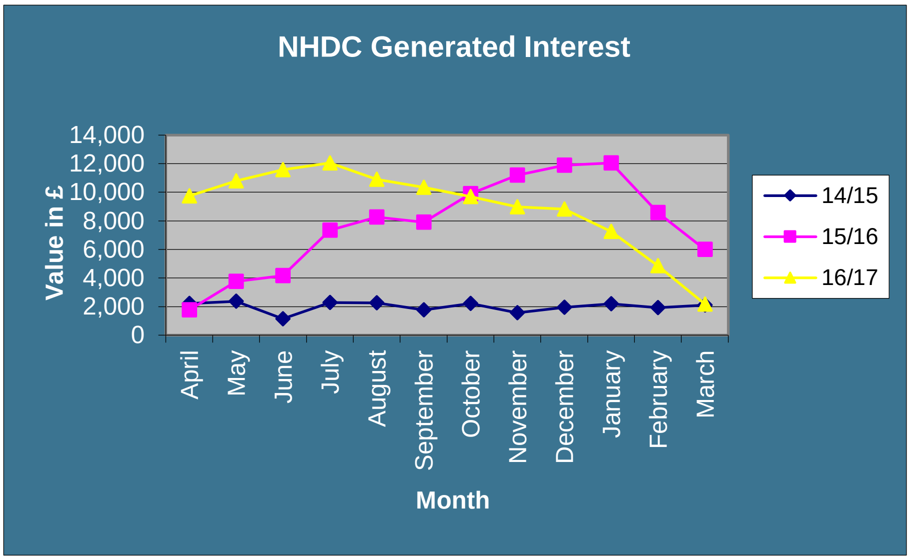


The chart below shows the Council's investment maturity profile. (This does not include the £2.5M held in the Public Sector Deposit Fund Money Market account or £2.2M held in the Lloyds current account which can be called back on any day). No new deals were placed by Tradition in the third quarter.



The Council's Original budgeted investment return for 2016/17 was £0.372M. The projection at the second quarter was £0.427M, this has now increased by a further £0.013M to £0.440M. The increase on the Original budget is mainly due to the three long term deals placed by Tradition and in house investments being placed for longer periods.

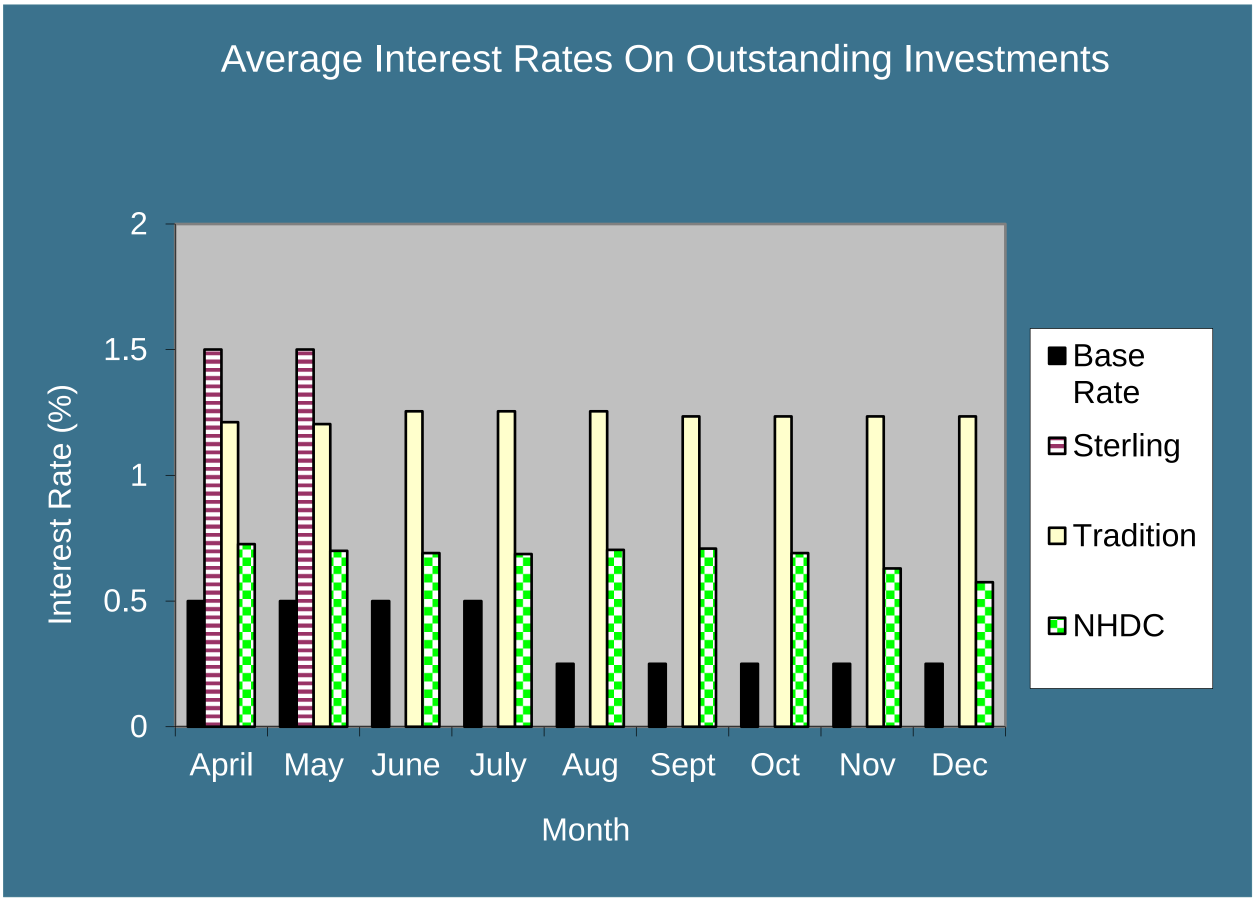
The graph below shows the level of interest expected to be generated from the cash available in-house over the year which is maintained to ensure adequate cash flow. Cash balances have historically reduced over January to March each year as there were no Council tax receipts in February and March. The reduction of the Bank Rate in August from 0.5% to 0.25% has adversely affected the amount of interest generated in the later half of the year.



The table below shows the average rates achieved on investments made during the third quarter. Tradition did not have any deals maturing in the quarter so no new deals were made.

	Ave Interest Rate on Deals made in the 3rd Qrt
NHDC	0.36%
Tradition	N/A

The graph below shows the average rate of interest on outstanding investments at 31st 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 2016/17.

4. New Borrowing

No borrowing was undertaken during the quarter.

The Council's capital financing requirement (CFR) for 2016/17 is -£18.8m. 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.

PWLB certainty rates quarter ended 31 December 2016

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.76%	1.04%	1.56%	2.32%	2.15%
Date	28/12/2016	03/10/2016	03/10/2016	03/10/2016	04/10/2016
High	0.99%	1.58%	2.34%	2.97%	2.72%
Date	26/10/2016	14/11/2016	12/12/2016	12/12/2016	12/12/2016
Average	0.88%	1.40%	2.09%	2.74%	2.51%

Loans Outstanding at 31 December 2016

	Amount	Average Interest Rate	Cumulative Rate
	£	%	%
Public Works Loans Board	497,145	9.325	8.85
Lender Option Borrower Option	0		
	497,145	9.325	8.85

The Lender Option Borrower Option (LOBO) loan was repaid in November. This loan had an interest rate of 10.125%.

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 31 December 2016

Treasury Indicators	2016/17 Budget £'000	Quarter 3 (Oct-Dec) Actual £'000
Authorised limit for external debt	7,000	479
Operational boundary for external debt	5,000	479
Gross external debt	3,515	479
Investments	(34,000)	49,200
Net borrowing	(30,485)	(48,721)
Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	1,035	1,035
12 months to 2 years	25	25
2 years to 5 years	51	51
5 years to 10 years	79	79
10 years and above	325	325
Upper limit of fixed interest rates based on net debt *2	70% - 100%	91.9%
Upper limit of variable interest rates based on net debt *2	0% - 30%	8.1%
Upper limit for principal sums invested over 364 days	Max 40%	14.2%

Prudential Indicators	2016/17 Budget £'000	Quarter 3 (Oct-Dec) Actual £'000
Capital expenditure	18,158	3,226

Capital Financing Requirement (CFR)	(18,827)	(18,827)
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	-1.89	-2.45
Incremental impact of capital investment decisions on Band D Council Tax	0.46%	0.46%

The change in the ratio of financing costs to net revenue stream is mainly due to the increase in investment interest.