Capita Treasury solutions

Treasury Management Update
Quarter Ended 30 June 2017

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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

The UK GDP annual growth rates in each calendar year 2013 – 2016 of 1.9%, 3.1%, 2.2% and 1.8%, have all been the top rate, or near top rate, of any of the G7 countries in every year. It is particularly notable that the UK performance was repeated in 2016, a year in which the Bank of England had forecast in August 2016 that growth would be near to zero in the second half of the year due to the economic shock it expected from the result of the Brexit referendum in June. However, it has had to change its mind and in its February and May 2017 Inflation Reports, the Bank upgraded its forecasts for growth (May Report - 2017 1.9%, 2018 and 2019 1.9%). However over these years, it also expects inflation to accelerate towards nearly 3% as increases in costs as a result of the fall in the value of sterling since the referendum, gradually feeds through into the economy, though it should fall back to 2.2% in 2019. Provided those cost pressures do not feed through into significantly higher domestically generated inflation within the UK, the MPC is expected to 'look through' this one off blip upwards in inflation. Wage inflation, which is a key driver of domestically generated price pressures, is currently subdued. There is, though, a potential risk that the MPC might muster a majority to reverse the emergency 0.25% rate cut before embarking on a progressive trend of increases in Bank Rate at a later time.

GDP growth in the US has been highly volatile in 2016 but overall mediocre, at an average of 1.6% for the year. Quarter 1 in 2017 has also been mediocre at 1.4% but current indications are that growth could rebound strongly in quarter 2. The disappointment so far has been the lack of decisive action from President Trump to make progress with his promised fiscal stimulus package. The Fed has, therefore, started on the upswing in rates now that the economy is at or around "full employment" and inflationary pressures have been building to exceed its 2% target. It has, therefore, raised rates four times, with the last three following quickly on one another in December 2016 and March and June 2017. One or two more increases are expected in 2017 and possibly four in 2018.

Growth in the EU improved in 2016, to 1.7%, after the ECB cut rates into negative territory and embarked on massive quantitative easing during the year. The ECB is now forecasting growth of 1.9% in 2017, 1.8% in 2018 and 1.7% in 2019. It has committed to continuing major monthly quantitative easing purchases of debt instruments, though in April 2017 it reduced the rate from €80bn per month to €60bn, to continue until the end of 2017, in order to stimulate growth and to get inflation up to its 2% target.

There are major concerns about various stresses within the EU; these could even have the potential to call into question the EU project. The Dutch and French elections passed off without creating any waves for the EU but we still have a national election in Germany on 22 October; this is not currently expected to cause any significant change. What could be more problematic is the general election in Austria on 15 October where a major front runner is the Freedom Party which is strongly anti-immigration and anti EU. There is also a risk of a snap general election in Italy before the final end possible date of 20 May 2018. A continuing major stress point is dealing with the unsustainable level of national debt in Greece in the face of implacable opposition from Germany to any further bail out. High levels of unemployment in some EU countries and the free movement of people within the EU, together with the EU's fraught relationship with Turkey in controlling such people movements, are also major stress issues. On top of which the EU also now has to deal with Brexit negotiations with the UK.

China is expected to continue with reasonably strong growth, (by Chinese standards), of 6.5% in 2017. However, medium term risks are increasing. Japan has only achieved 1% growth in 2016 and is struggling to get inflation to move from around 0%, despite massive fiscal stimulus and monetary policy action by the Bank of Japan.

2. Interest Rate Forecast

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

	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%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August 2016 in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. However, since then, growth has been robust until dipping in quarter 1 of 2017 to 0.2%. Also, CPI inflation has risen substantially as a result of the sharp fall in the value of sterling since the referendum. Consequently, Bank Rate has not been cut again, and market concern has switched to whether the MPC could get together a majority to reverse the August emergency 0.25% rate cut before embarking on a progressive trend of increases in Bank Rate at a later time when the economic and political / Brexit situation is more robust to withstand such increases. There is much uncertainty at this time over the slender majority the Conservative Government has, which is dependent on DUP support, and also over what form of Brexit will transpire and how difficult the EU could be in setting terms. There are therefore a multiplicity of ifs and buts at the current time and depending on how things transpire, then this will materially influence MPC decision making as to when Bank Rate will rise.

Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after the Brexit 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 2017/18, which includes the Annual Investment Strategy, was approved by the Council on 9th February 2017. 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 30 June 2017.

The average level of funds available for investment purposes in house during the quarter was **£15.2m**. 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. 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 3 months of the year is 1.06%.

Investments at 30th June 2017

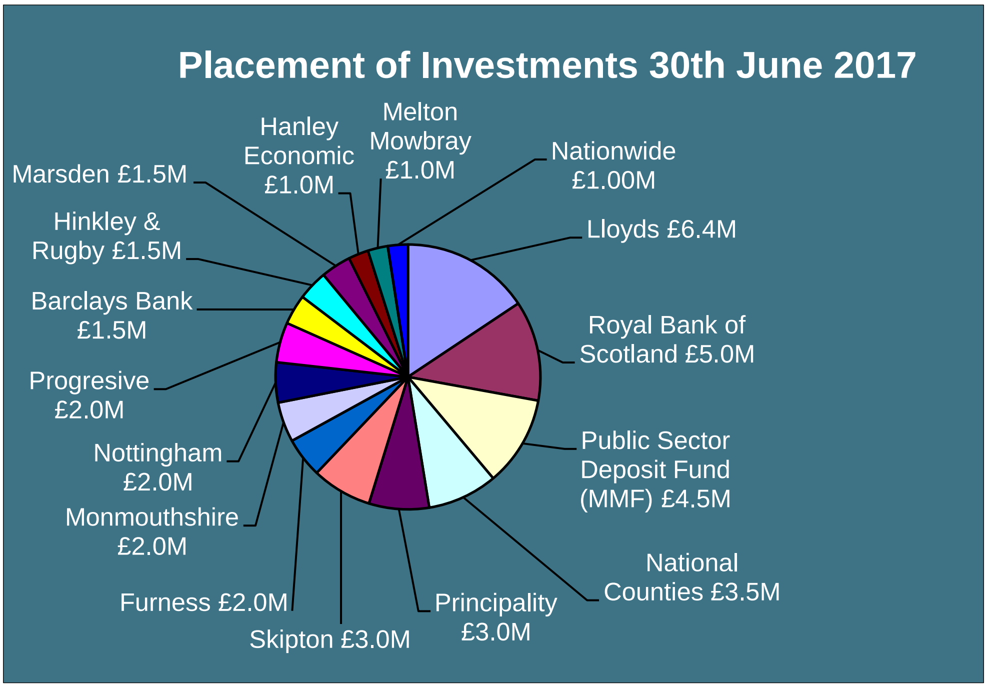
	Amount £	Average Interest Rate %
Managed By NHDC		
Banks	7,900,000	0.61
Money Market Fund	4,500,000	0.30
NHDC To Total	**12,400,000**	**0.57**
Managed by Tradition		
Banks	5,000,000	0.97
Building Societies	23,500,000	1.15
Tradition Total	**28,500,000**	**1.13**
TOTAL	**40,900,000**	**1.09**

In percentage terms, this equates to:

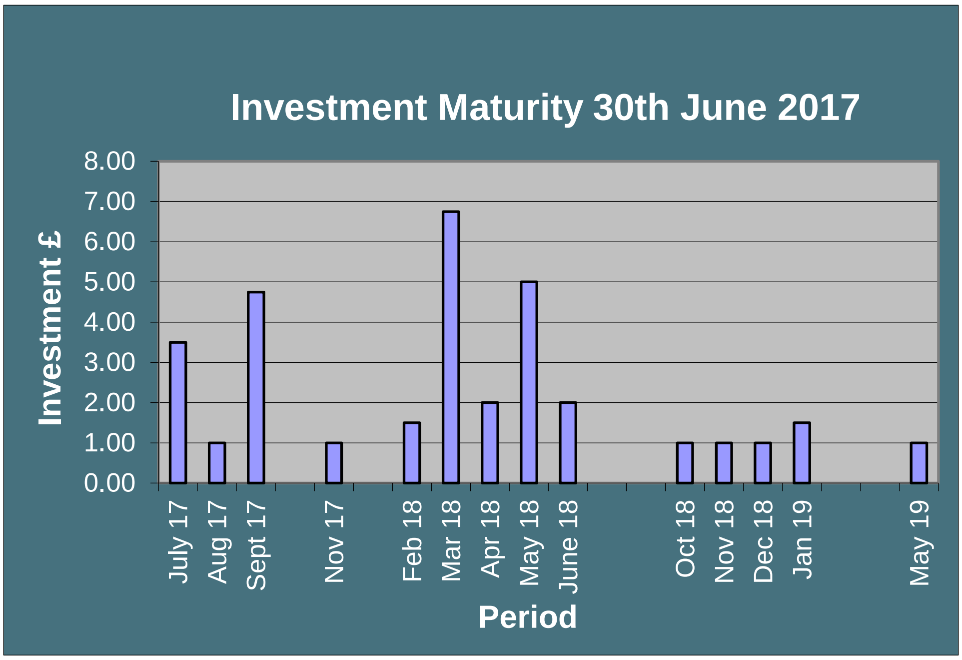
	Percentage
Money Market Funds	11.00
Banks	31.54
Building Societies	57.46

The approved 17/18 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 2017. This is a snapshot in time that demonstrates the diversification of investments.

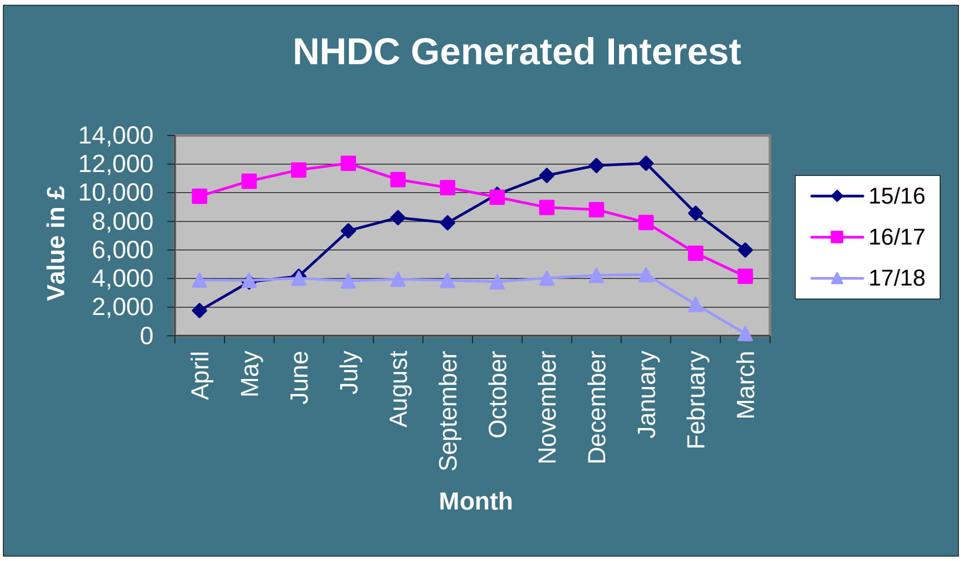


The chart below shows the Council's investment maturity profile. (This does not include the £4.5M held in the Public Sector Deposit Fund Money Market account or £3.4M held in the Lloyds current account which can be called back on any day). Tradition placed six new deals in the first quarter, four of which were for longer than a year. Of these four deals, three were at 1.0% and the fourth at 1.1%.



The Council's Original budgeted investment return for 2017/18 was £0.267M. The projection at the first quarter is £0.327M which is an increase of £0.060M. The increase is mainly due to Tradition deals having been budgeted at 0.7% but renewed at 1.0% and a higher level of investments at the start of they year.

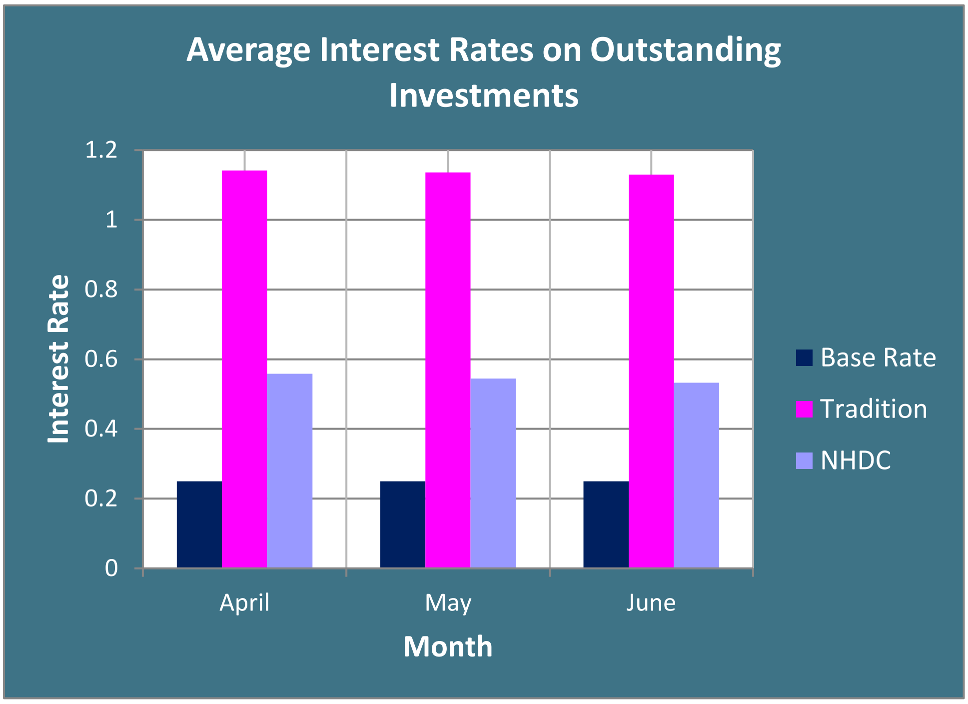
The graph below shows the level of interest expected to be generated from the cash available in-house over the year which is maintained to ensure adequate cash flow. Cash balances have historically reduced over January to March each year as there are less Council tax receipts in February and March.



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	0.33%
Tradition	1.00%

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 for shorter periods are lower than for 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 2017/18.

4. New Borrowing

No borrowing was undertaken during the quarter.

The Council's capital financing requirement (CFR) for 2017/18 is -£16.6m. 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 gives an indication of the rates that the Council could currently borrow at.

PWLB maturity certainty rates quarter ended 30 June 2017

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.80%	1.14%	1.78%	2.53%	2.27%
Date	03/05/2017	15/06/2017	15/06/2017	13/04/2017	13/04/2017
High	1.08%	1.44%	2.08%	2.75%	2.48%
Date	30/06/2017	30/06/2017	30/06/2017	30/06/2017	09/05/2017
Average	0.87%	1.23%	1.89%	2.60%	2.34%

Loans Outstanding at 30 June 2017

	Amount	Average Interest Rate	Cumulative Rate
	£	%	%
Public Works Loans Board	480,387	9.4317	8.5616
Lender Option Borrower Option	0		
	480,387	9.4317	8.5616

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 quarter ended 30 June 2017, 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 30 June 2017

Treasury Indicators	2017/18 Budget £'000	Quarter 1 (Apr - Jun) Actual £'000
Authorised limit for external debt The maximum level of borrowing set by Council which can not be exceeded.	6,000	480
Operational boundary for external debt The limit beyond which external debt is not normally expected to exceed, based on gross external debt	4,000	480
Gross external debt Based on current level of debt, plus an allowance for additional debt if it was required	3,480	480
Investments Level of cash investments, expect actuals to exceed this early in the year as linked to capital spend during the year.	(31,500)	(40,900)
Net borrowing Investments less Gross external debt	(28,020)	(40,420)

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	25	25
12 months to 2 years	16	16
2 years to 5 years	53	53
5 years to 10 years	96	96
10 years to 20 years	40	40
20 years to 30 years	250	250
The budget represents the structuring of borrowing that was in place at the start of the year. No new borrowing has been taken out so the position is still in line with budget.		

Upper limit of fixed interest rates based on net debt At least 70% of investments should be at fixed rates. Currently only the Money Market Fund investment is at a variable rate.	70% - 100%	89.0%
Upper limit of variable interest rates based on net debt See above.	0% - 30%	11.0%

Upper limit for principal sums invested over 364 days Up to 40% of investments (by value) can be for more than one year.	Max 40%	13.4%

Prudential Indicators	2017/18 Budget £'000	Quarter 1 (Apr - Jun) Actual £'000
Capital expenditure The budget is the expected capital expenditure during the year. The actual total is spend to date. Only at the end of the year will actuals get close to the budget.	20,590	1,874
Capital Financing Requirement (CFR) The total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The year end position reflects the budgeted capital spend during the year. A negative total means that there is no borrowing requirement.	(2,286)	(16,642)
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream Net expenditure/ (income) from borrowing and investments, as a % of the Council's net revenue. This is negative as the Council is currently receiving a net income from investments.	-1.60%	-2.08%
Incremental impact of capital investment decisions on Band D Council Tax This reflects the expected impact of the net change in financing costs/ income compared to the previous year. This is represented by the theoretical change in Band D Council Tax that would be required to fund this change.	1.13%	1.13%