Report of the Cabinet Member for Finance & Strategy

Council – 15 December 2016

TREASURY MANAGEMENT - MID YEAR REVIEW REPORT 2016/17

Purpose:	To receive and note the Treasury Management Mid Year Review Report 2016/17
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FOR INFORMATION	

1 Background

1.1 This report is presented in line with the recommendations contained within the The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management which requires a mid term review of TM operations to be presented to Council

2 Introduction

2.1 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. " A glossary of terms is at Appendix 1.

2.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council in February 2010.

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 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 the Improvement and Budget Performance Panel

This Mid-year Review Report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2016/17
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's investment portfolio for 2016/17
- A review of the Council's borrowing strategy for 2016/17
- A review of any debt rescheduling undertaken during 2016/17
- A review of compliance with Treasury and Prudential Limits for 2016/17

3 Economic Update

3.1 The preliminary estimate of UK Q2 GDP showed reasonably strong growth as the economy grew 0.7% quarter-on-quarter, compared to 0.4% in Q1; with annual growth running at a healthy 2.2%. However, the UK economic outlook changed significantly on 23rd June 2016. Growth forecasts had already been downgraded as the EU membership referendum loomed, dampening business investment. The surprise result of the referendum, and the subsequent political turmoil, prompted a sharp decline in household, business and investor sentiment. The repercussions of this plunge in sentiment on economic growth were judged by the Bank of England to be severe, prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy. The minutes of the August meeting also suggested that many members of the Committee supported a further cut in Bank Rate to near-zero levels (the Bank, however, does not appear keen to follow peers into negative rate territory) and more QE should the economic outlook worsen.

3.2 In response to the Bank of England's policy announcement, money market rates and bond yields declined to new record lows. Since the onset of the financial crisis over eight years ago, the rate outlook has progressed from ‘lower for longer’ to ‘even lower for even longer’ to the current ‘even lower for the indeterminable future’.

3.3 Whilst the economic growth consequences of BREXIT remain speculative, there is uniformity in expectations that uncertainty over the UK’s future trade relations with the EU and the rest of the world will weigh on economic activity and business investment, dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment. These effects will dampen economic growth through the second half of 2016 and into 2017.

3.4 Inflation is expected to pick up due to a rise in import prices, reducing real wage growth and real investment returns. The August Quarterly Inflation Report from the Bank of England forecasts a rise in CPI to 0.9% by the end of 2016, and thereafter a rise closer to the Bank’s 2% target over the coming year, as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies. The rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes.

3.5 Following the referendum result gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future.

3.6 The yield on the 10-year gilt fell from 1.37% on 23rd June to a low of 0.52% in August, a quarter of what it was at the start of 2016. The 10-year gilt yield has since risen to 0.69% at the end of September. The yield on 2 and 3 year gilts briefly dipped into negative territory intra-day on 10th August to -0.1% as prices were driven higher by the Bank of England’s bond repurchase programme. However both yields have since recovered to 0.07% and 0.08% respectively.

3.7 The fall in gilt yields was reflected in the fall in the Public Works Loan Board (PWLB) borrowing rates.The most noticeable fall in money market rates was for very short-dated periods (overnight to 1-month) where rates fell to between 0.1% and 0.2%.London Interbank Bid (LIBID) rates supplied by the British Bankers’ Association show that there was barely any movement in rates before the base rate reduction and accompanying MPC actions. Rates have since followed base rate down across all periods, and rates paid by banks to Local Authorities have been volatile and non-uniform, being based on individual institutions’ wholesale funding requirements at the time. The appointed advisors’ (Capita’s) forecast of rates is outlined at Appendix 2.

4 Review of the Treasury Management Strategy Statement and Investment Strategy

4.1 The Treasury Management Strategy Statement for 2016/17 was approved by Council in February 2016. The Council’s Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement, outlines the Council’s investment priorities as follows:

- Security of capital
- Liquidity

And then

- Yield

4.2 The Council shall aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered only appropriate to invest with highly credit rated financial institutions, using our advisor's suggested creditworthiness approach, including sovereign credit rating and credit default swap (CDS) overlay information.

4.3 Borrowing rates and available investment interest rates have remained low during the first six months of 2016/17. Opportunities for undertaking some external borrowing was taken in June 2016 (details below 6)
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4.4 As outlined in Section 3 above, there is still considerable uncertainty and volatility in financial and banking markets, both globally and in the UK following Brexit.. In this context, it is considered that the strategy approved in February 2016 is still appropriate in the current economic climate but will be reviewed in formulating the strategy for 2017/18 as funding for capital and cashflow requirements dictate.

5 Review of Investment Portfolio 2016/17

5.1 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.

A full list of internally managed investments held as at 30th September 2016, is shown in Appendix 3. To 30th September 2016, the portfolio has returned 0.43% against a 7 day benchmark rate of 0.28%.

6 Review of Borrowing Strategy

6.1 As outlined in the Treasury Management Strategy 2016/17, it was planned to use internal funds to finance capital borrowing requirements in 2016/17 unless there were opportunities to externally borrow advantageously. The benefits of this strategy are twofold i.e.

- The risk of borrower(counterparty) default is reduced
- There is a reduced cost of carry (borrowing rates v investment rates)

6.2 Notwithstanding the above, as outlined in 4, there was some degree of volatility ahead of the Brexit referendum where borrowing rates offered some long term value where the Authority took the opportunity to undertake the following borrowing in June 2016:

£5m for 9 years @ 2.00%
£5m for 10 years @ 2.11%

£5m for 46 years @ 2.47%
£5m for 47 years @ 2.47%

6.3 External debt as at 30th September 2016 is £423m at an average rate of 4.98% with a budgeted capital financing requirement of £502m

7 Review of Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling has been undertaken in 2016/17 to date.

8 Review of Compliance with Treasury & Prudential Limits

8.1 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 outlined in the approved Treasury Management Strategy Statement.

8.2 During the financial year to date the Council has operated within the Treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. Compliance with the Prudential and Treasury Indicators are shown in Appendix 4.

9 Financial Implications

9.1 The financial implications associated with this report have been reported at Council in February 2016 in the Revenue and Capital Budget Report 2016/17.

10 Legal Implications

10.1 There are no legal implications associated with this report

11 Equality and Engagement Implications

11.1 An EIA Screening has been completed and confirmed that there are no equality or engagement implications arising directly from the report

Background papers: The revised CIPFA Treasury Management Code of Practice 2009

The revised CIPFA Prudential Code for Capital Finance in Local Authorities 2009

Appendices

Appendix 1 – Glossary of terms
Appendix 2 –Interest Rate forecast
Appendix 3 – Schedule of investments
Appendix 4 - Prudential Indicators

Appendix 1

Treasury Management – Glossary of Terms

Annualised Rate of Return	Represents the average return which was achieved each year.
Authorised Limit	The authorised limit must be set to establish the outer boundary of the local authority's borrowing based on a realistic assessment of risks. The authorised limit is not a limit that a Council will expect to borrow up to on a regular basis. It is crucial that it is not treated as an upper limit for borrowing for capital expenditure alone since it must also encompass borrowing for temporary purposes. It is the expected maximum borrowing need, with some headroom for unexpected requirements.
Bank Rate	The Official Bank rate paid on commercial bank reserves i.e. reserves placed by commercial banks with the Bank of England as part of the Bank's operations to reduce volatility in short term interest rates in the money markets.
Base Rate	Minimum lending rate of a bank or financial institution in the UK.
Borrowing	In the Code, borrowing refers to external borrowing. Borrowing is defined as both:- • Borrowing repayable with a period in excess of 12months • Borrowing repayable on demand or within 12months
Capital Expenditure	The definition of capital expenditure starts with all those items which can be capitalised in accordance with the Statement of Recommended Practice (SORP). To this must be added any items that have/will be capitalised in accordance with legislation that otherwise would not be capitalised. Prudential indicators for current and future years are calculated in a manner consistent with this definition.
Capital Financing Charges	These are the net costs of financing capital i.e. interest and principal, premia less interest discounts received.
Capital Financing Requirement	The Capital Financing Requirement is capital expenditure, which needs to financed from borrowing. It is essentially a measure of the Council's underlying

	borrowing need.
CIPFA	The Chartered Institute of Public Finance and Accountancy. One of the leading professional accountancy bodies in the UK and the only one which specialises in the public services.
Counterparty	The organisations responsible for repaying the Council's investment upon maturity and for making interest payments.
CPI (Consumer Price Index)	The consumer price index (CPI) is a measure of the average price of consumer goods and services purchased by households. It is one of several price indices calculated by national statistical agencies. The percent change in the CPI is a measure of inflation.
Credit Rating	This is a scoring system that lenders use to determine how credit worthy borrowers are. The Credit Rating components are as follows: 1. The AAA ratings through to C/D are long-term rating definitions and generally cover maturities of up to five years, with the emphasis on the ongoing stability of the institution's prospective financial condition. AAA are the most highly rated, C/D are the lowest. This Council does not invest with institutions lower than AA - for investments over 364 days 2. F1/A1/P1 are short-term rating definitions used by Moody's, S&P and Fitch Ratings for banks and building societies based on their individual opinion on an institution's capacity to repay punctually its short-term debt obligations (which do not exceed one year). This Council does not invest with institutions lower than F1/A1/P1 for investments under 364 days.
Debt	For the purposes of the Code, debt refers to the sum of borrowing (see above) and other long-term liabilities (see below). It should be noted that the term borrowing used in the Act includes both borrowing as defined for the balance sheet and other long terms liabilities defined as credit arrangements through legislation.
Debt Management Office (DMO)	Government Agency responsible for the issuance of government borrowing and lending.

De- leveraging	Paying back borrowed sums of money
Discounts	Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount. This is calculated on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.
Financing Costs	The financing costs are an estimate of the aggregate of the following:- • Interest payable with respect to borrowing • Interest payable under other long-term liabilities • Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount to be met from government grants and local taxpayers (premiums and discounts) • Interest earned and investment income • Amounts required in respect of the minimum revenue provision plus any additional voluntary contributions plus any other amounts for depreciation/impairment that are charged to the amount to be met from government grants and local taxpayers
Financial Reporting Statements (FRSs)	These are standards set by governing bodies on how the financial statements should look.
Gilts	Gilts are bonds issued by the UK government. The term is of British origin, and refers to the securities certificates issued by the Bank of England, which had a gilt (or gilded) edge.
Investments	Investments are the aggregate of:- • Long term investments • Short term investments (within current assets) • Cash and bank balances including overdrawn balances
IMF	International Monetary Fund
Leverage	Borrowed sums of money
LOBO (Lender's Option/	Money Market instruments that have a fixed initial term (typically one to ten year) and then move to an

Borrower's Option)	arrangement whereby the lender can decide at pre-determined intervals to adjust the rate on the loan. At this stage the borrower has the option to repay the loan.
London Inter-Bank Bid Rate (LIBID)	The interest rate at which major banks in London are willing to borrow (bid for) funds from each other.
Managed Funds	In-House Fund Management Surplus cash can be managed either by external fund managers or by the Council's staff in-house. The in-house funds are invested in fixed deposits through the money markets. Externally Managed Funds Fund managers appointed by the Council invest surplus cash in liquid instruments such as bank certificates of deposit and government stocks. The fund managers' specialist knowledge should ensure a greater diversification of investments and higher expected returns
Maturity	The date when an investment is repaid or the period covered by a fixed term investment.
Monetary Policy Committee (MPC)	This is a body set up by the Government in 1997 to set the repo rate (commonly referred to as being base rate). Their primary target (as set by the Government) is to keep inflation within plus or minus 1% of a central target of 2% in two years time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and employment.
Money Market	Consists of financial institutions and deals in money and credit. The term applied to the institutions willing to trade in financial instruments. It is not a physical creation, but an electronic/telephone one.
Net Borrowing	For the purposes of the Code, net borrowing refers to borrowing (see above) net of investments (see above).
Net Revenue Stream	Estimates for net revenue stream for current and future years are the local authority's estimates of the amounts to be met from government grants and local taxpayers.
Operational	This is based on expectations of the maximum

Boundary	external debt of the authority according to probable not simply possible – events and being consistent with the maximum level of external debt projected by the estimates. It is not a limit and actual borrowing could vary around this boundary for short periods.
Other Long Term Liabilities	The definition of other long term liabilities is the sum of the amounts in the Council's accounts that are classified as liabilities that are for periods in excess of 12months, other than borrowing (see definition above).
Premature Repayment of Loans (debt restructuring/ rescheduling)	A facility for loans where the Council can repay loans prior to the original maturity date. If the loan repaid has a lower interest rate than the current rate for a loan of the same maturity period the Council can secure a cash discount on the repayment of the original loan. If the loan replaced has a higher rate of interest than the current rate for a loan of the same maturity period, a cash penalty is payable to the lender.
Premia	Where the prevailing current interest rate is lower than the fixed rate of a long term loan, which is being repaid early, the lender can charge the borrower a premium. This is calculated on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.
Prudential Code	The Prudential Code is the largely self regulatory framework outlined by CIPFA for managing/monitoring capital investment in local government.
Public Works Loan Board (PWLB)	A Government agency which provides loans to local authorities. Each year, it issues a circular setting out the basis on which loans will be made available and a quota formula for the amount that can be borrowed. Loans can be either at a fixed rate or on a variable rate basis. They can be repaid on either an annuity, equal instalment of principal or maturity basis. The interest rate charged is linked to the cost at which the Government itself borrows.
Quantitive Easing	Extreme form of monetary policy used to stimulate an economy where interest rates are either at or close to zero. Normally a central bank stimulates the economy by lowering interest rates but when it cannot lower them further it can attempt to seed the system with new money by quantitive easing.

	In practical terms, the central bank purchases financial assets including government debt and corporate bonds from financial institutions using money it has created by increasing its own credit limits in its own bank accounts. Also know as ‘printing money’ although no extra physical cash is created.
Risk	Credit /Counterparty Risk The risk that counterparty defaults on its obligations. Inflation Risk The risk that growth in the Authority’s investment income does not keep pace with the effects of inflation on its expenditure. Interest Rate Risk The risk that changes in rates of interest creates an unexpected or unbudgeted burden on the Council’s finances. Liquidity Risk The risk that cash will not be available when it is needed. Operational Risk The risk of loss through fraud, error, corruption, system failure or other eventualities in treasury management dealings, and failure to maintain effective contingency management arrangements. Refinancing Risk The risk that the Authority is unable to replace its maturing funding arrangements on appropriate terms.
Set Aside Capital Receipts	A proportion of money received by the Council for the sale of fixed assets must be set aside to repay debt.
SORP	Statement of Recommended Practice, published by CIPFA (Local Authority Accounting Body). This sets out guidelines regarding the Council’s financial matters.
Specified/Non Specified investments	Specified investments are sterling denominated investments for less than 364 days as identified in Appendix A in line with statutory investment regulations. Non-specified investments are all other investments identified in Appendix A in line with statutory investment regulations.
Supranational	These are bonds issued by institutions such as the

Bonds	European Investment Bank and World Bank. As with Government bonds (Gilts) they are regarded as the safest bond investments with a high credit rating.
Temporary Borrowing and Investment	Loans which are capable of being repaid within one year. The term of the loans will be negotiated from overnight to 364 days.
Treasury Management	Treasury management has the same definition as in CIPFA's code of Practice of Treasury Management in the Public Services. "The management of the organisation's 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."
Yield Curve	The line resulting from portraying interest rate graphically for a series of periods, e.g. 7days, 1month, 3, 6, 9, and 12months. When longer-term interest rates are higher than short-term rates the yield curve slopes upwards and is described as positive. When the opposite prevails the yield curve is referred to as inverse.

Appendix 2

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.50
3 month LIBID	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.30	0.40	0.50	0.60
6 month LIBID	0.30	0.30	0.30	0.40	0.40	0.50	0.50	0.50	0.60	0.60	0.70
12 month LIBID	0.50	0.50	0.60	0.60	0.70	0.70	0.70	0.80	0.80	0.80	0.90
5 yr PWLB	1.00	1.00	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.30
10 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80
25 yr PWLB	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60
50 yr PWLB	2.10	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.40

Appendix 3

Investments as at 30 September 2016

	£
Bank of Scotland	1,691,471.56
Coventry Building Society	7,000,000.00
Glasgow City Council	1,000,000.00
Gloucester City Council	5,000,000.00
Goldman Sachs International	12,000,000.00
London Borough of Newham	5,000,000.00
Nationwide Building Society	14,000,000.00
Santander Bank	11,000,000.00
UBS AG	6,000,000.00
Total	**62,691,471.56**

APPENDIX 4

Prudential Indicators

Capital Prudential Indicators	2015/16	2016/17
	Outturn	Original Estimate
	£'000	£'000
Capital Expenditure		
GF	47,679	54,863
HRA	114,997	55,000
TOTAL	162,679	109,863
Ratio of financing costs to net revenue stream	%	%
GF	6.69	7.01
HRA	13.33	13.33
Incremental Impact on Council Tax (Band D) or Council House Rent	£	£
GF	81.36	80.91
HRA	0.00	104.64
Capital Financing Requirement	£'000	£'000
GF	328,493	344,735
Credit Arrangements	1,656	1,451
HRA	135,158	154,345
TOTAL	465,307	500,531

Treasury Management Prudential Indicators		
	2015/16	2016/17
	Outturn	Original Estimate
	£'000 or %	£'000 or %
Authorised limit for external debt	402,432	£607,156
Operational boundary for external debt	402,432	£547,156
Upper limit for fixed interest rate exposure	75.65%/ £508,216	100%/ £607,156
Upper limit for variable interest rate exposure	24.35%/ £98,000	40%/ £242,862
Upper limit for total principal sums invested for over 364 days	0	£40,000

Maturity Structure of Fixed Rate Borrowing in 2016/17			
	Upper Limit	**Lower Limit**	**Actual**
Under 12 months	50%	0%	0.71%
12 months and within 24 months	50%	0%	1.42%
24 months and within 5 years	50%	0%	0.71%
5 years and within 10 years	85%	0%	4.52%
10 years and above	95%	15%	92.64%

The treasury management prudential indicators identified above as:

- Upper limit for fixed interest rate exposure
- Upper limit for variable interest rate exposure
- Upper limit for total principal sums invested for over 364 days
- Maturity Structure of fixed rate borrowing in 2016/17

Above figures are as at 30th September 2016. None of the above limits/Prudential Indicators have been breached during the first half of 2016/17.