Agenda Item No:	**9**	
Committee:	Council	
Date:	17 December 2015	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2015/16	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2015/16.

2 Key issues

- The Treasury Management Mid-Year Review 2015/16 as considered by Cabinet on 17 December 2015 and by Corporate Governance Committee on 1 December 2015 is attached.
- The report highlights all the key activities carried out within the Treasury Management function during the first six months of 2015/16. All activities have been conducted in accordance with the approved strategy and policies.
- Prudential indicators for, the Capital Financing Requirement (CFR), gross borrowing and the capital position have been revised.
- Changes to the credit methodology to reflect changes to the regulatory regime and to ensure consistent approach across the main rating agencies.
- 2015/16 continues to be a challenging year and the report highlights the success in maximising investment income whilst ensuring the security and liquidity of the Council's investments.

3 Recommendations

It is recommended that:-

- Members note the report.

It is recommended by Cabinet and Corporate Governance Committee that:-

- The increase in the CFR, gross borrowing and the capital prudential indicators (paragraph 4) be approved.
- Changes to credit methodology (paragraph 5) be approved.

Agenda Item No:	**6**	
Committee:	Corporate Governance Committee	
Date:	1 December 2015	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2015/16	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2015/16.

2 Key issues

- The Council has operated within its Treasury Management Strategy Statement (TMSS), Annual Investment Strategy, treasury limits and prudential indicators set by Council for the first six months of 2015/16.
- Prudential indicators for, the Capital Financing Requirement (CFR), gross borrowing and the capital position have been revised.
- There are considerable risks around whether inflation will rise in the near future as strongly as had previously been expected; this will impact on central banks and their ability to raise the bank rate.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/15) currently attracting excessive premiums it is not financially advantageous for the Council to comply with the Gross borrowing and Capital Financing Prudential Indicator in 2015/16.
- Investment income received for the first six months of 2015/16 is £87k (£102k to the end of October). The 2015/16 budgeted outturn of £170k is projected to be achieved.
- Overall interest rate achieved from investments for the first six months of 2015/16 was 0.72% (average across 91 District Councils which submitted information to Capita was 0.68%).
- Changes to the creditworthy methodology to reflect changes to the regulatory regime and to ensure a consistent approach across the main rating agencies.

3 Recommendations

It is recommended that:-

- Members note the report.

It is recommended to Council that:-

- The increase in the CFR, gross borrowing and the capital prudential indicators (paragraph 4) be approved.
- Changes to credit methodology (paragraph 5) be approved.

Wards Affected	All
Portfolio Holder(s)	Councillor Chris Seaton, Portfolio Holder for Finance
Report Originator(s)	Rob Bridge, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Rob Bridge, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper (s)	Capita Asset Services template Cabinet Report 26 February 2015 General Fund Budget 2015/16 and Capital Programme 2015/18

Report:

1 Introduction

3.1 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."

3.2 The Council complies with the requirements of The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (revised 2011).

3.3 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by 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.
- 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.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies (including Mid-year Review Report) to a specific named body. For this Council the delegated body is Corporate Governance Committee.

3.4 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 six months of 2015/16;
- a review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- the Council's capital position;
- a review of the Council's investment portfolio for 2015/16;
- a report of the Council's borrowing strategy for 2015/16;
- a report of debt rescheduling during 2015/16;
- a review of compliance with Treasury and Prudential Limits for 2015/16.

2 Economic Update

2.1 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.

2.2 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 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.

2.3 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 rejoin 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.

2.4 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 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.

2.5 The European Central Bank announced a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government debt of selected Eurozone countries. This programme started in March and will run to September 2016. This seems to have already had a beneficial impact in improving confidence.

2.6 Late on 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 Public Works Loan Board (PWLB) rates to fall.

2.7 Prospects for interest rates and borrowings over the medium term are shown below.

Capita Asset Services Interest Rate View											
	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Capita Asset Services View	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB Rate	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%
10yr PWLB View	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%
25yr PWLB View	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%
50yr PWLB Rate	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%

3 Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by Council on 26 February 2015. Changes to the TMSS since February are an increase in the Capital Financing Requirement (CFR), gross borrowing and capital prudential indicators detailed in paragraph *4* and amendments to the methodology used to support the Council's creditworthiness policy, detailed in paragraph 5.

4 The Council's Capital Position

4.1 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 limits in place for borrowing activity.

4.2 This table shows the revised estimates for capital expenditure and financing of the capital programme and the changes since the budget was approved.

Capital Programme	**2015/16 Original Estimate £000**	**2015/16 Revised Estimate £000**
Forecast Capital Expenditure	**2,684**	**3,014**
Financed by:		
Capital Receipts	335	660
Capital Grants	510	830
Capital Reserves	1,839	1,524
Total Financing	**2,684**	**3,014**

4.3 The main changes to the capital programme approved in February 2015, is the inclusion of open space improvements in three of the market towns. In addition, Cabinet have agreed to support investment in technology as part of the Council's Chanel Shift Project, contribute towards the replacement of Category 2 defective Parish street lights and increase funding for the improvements to the footbridge in High Street, March. These projects, except the footbridge, *are* fully funded from external grants and reserve*s* and ha*ve* no impact on uncommitted capital resources available. The remaining changes relate to reprofiling of expenditure and capital resources between years.

4.4 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; this is termed the Operational Boundary.

Prudential Indicators	**2015/16 Original Estimate £000**	**2015/16 Revised Estimate £000**
Capital Financing Requirement	520	804
External Debt / Operational Boundary		
Borrowing	10,000	10,000
Other Long Term Liabilities Finance Leases	2,000	2,000
Total Debt 31 March	**12,000**	**12,000**

4.5 The Council's revised estimate for CFR is £284k higher than the original estimate. This reflects the decision to lease new vehicles and equipment. Whilst this increases the CFR and therefore the Council's borrowing requirement, this type of lease includes a borrowing facility so the Council is not required to separately borrow to fund these leases. The Council has made provision to repay this lease liability in the General Fund revenue budget.

4.6 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its gross debt, does not, except in the short term, exceed the total CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the 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 of need which will be adhered to if this proves prudent.

Limits to Borrowing Activity	**2015/16 Original Estimate £000**	**2015/16 Revised Estimate £000**
Gross Borrowing	7,800	7,800
Plus Other Long Term Liabilities Finance Leases	514	812
Gross Borrowing	**8,314**	**8,612**
Capital Financing Requirement	520	804

4.7 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/2015) currently attracting excessive premiums (£2.8m at the time of writing this report) if it were prematurely repaid, it is not financially advantageous for the Council to fully comply with this prudential indicator. This has been the case since the housing stock transfer in 2007 and has been acknowledged and approved by Council since then. In addition, the Council's external auditors have also acknowledged this situation and have not raised any issues with our strategy.

4.8 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 for 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 Estimate £000	2015/16 Revised Estimate £000
Borrowing	15,000	15,000
Plus Other Long Term Liabilities Finance Leases	2,000	2,000
Total Borrowing	**17,000**	**17,000**

4.9 The Corporate Director & Chief Finance Officer reports that no difficulties are envisaged for the current year in complying with the above prudential indicators.

5 Investment Portfolio

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. As set out in section 2, 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.

5.2 The Council held investments of £25.85m as at the 30 September 2015 (£18.30m at 31 March 2015) and the investment portfolio yield for the first 6 months of the year is 0.72%. Based on 91 District Councils which provided Capita with information, the average rate of return as at 30 September 2015 was 0.68%.

5.3 The Chief Finance Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2015/16. The Council has achieved investment income of £87k to 30 September 2015 (£102k to end of October). The 2015/16 budgeted outturn of £170k is projected to be achieved.

5.4 The Council's current investment counterparty criteria selection was approved in the TMSS in February 2015 and is meeting the requirement of the treasury management function to date.

5.5 The Council's creditworthiness policy is based on a sophisticated modelling approach supported by Capita Asset Services (the Council's treasury management advisors), the basis of which utilises credit ratings from the three credit ratings agencies Fitch, Moody's and Standard & Poor's. This credit rating information is supported by additional information including Credit Default Swaps (CDS) and other market information.

5.6 It has been necessary to make changes to the methodology as a result of the main rating agencies (Fitch, Moody's and Standard & Poor's) having through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level.

5.7 In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases these factors have netted each other off to leave underlying ratings either unchanged or little change. A consequence of the new methodologies is that they have also lowered the importance of the Fitch Support and Viability ratings and have seen the Moody's Financial Strength rating withdrawn by the agency.

5.8 In keeping with the agencies new methodologies, the credit assessment of Capita Asset Service model now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used by Standard & Poor's, this has been a change to the use of Fitch and Moody's ratings. It is important to stress that the other key elements to Capita Asset Service model process, the assessment of Rating Watch and Outlook information as well as the Credit Default Swaps (CDS) overlay have not changed.

5.9 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution, merely a reassessment of their methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were before. Rather in the majority of cases this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support.

6 Borrowing Strategy

6.1 No new borrowing has been undertaken in the first six months and none is anticipated during the remainder of this financial year, as stated in the TMSS report approved by Council on 26 February 2015.

7 Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2015/16.