Agenda Item No:	**9**	
Committee:	Council	
Date:	15 December 2016	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2016/17	

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 2016/17.

2 Key issues

- The Treasury Management Mid-Year Review 2016/17 as considered by Cabinet on 15 December 2016 and by Corporate Governance Committee on 6 December 2016 is attached.
- The report highlights all the key activities carried out within the Treasury Management function during the first six months of 2016/17. All activities have been conducted in accordance with the approved strategy and policies.
- Prudential indicators for, the Capital Financing Requirement (CFR) and the capital position have been revised, alongside changes to the borrowing strategy.
- 2016/17 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 and the borrowing strategy be approved.

Agenda Item No:	6	
Committee:	Corporate Governance Committee	
Date:	6 December 2016	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2016/17	

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 2016/17.

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 2016/17.
- Prudential indicators for, the Capital Financing Requirement (CFR) and the capital position have been revised alongside changes to the borrowing strategy.
- The latest Monetary Policy Committee decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/16) currently attracting excessive premiums it is not financially advantageous for the Council to comply with the Gross borrowing and Capital Financing Prudential Indicator in 2016/17.
- Investment income received for the first six months of 2016/17 is £83k (£96k to the end of October). The 2016/17 budgeted outturn of £170k has been revised down to £160k.
- Overall interest rate achieved from investments for the first six months of 2016/17 was 0.64% (average across 90 District Councils which submitted information to Capita was 0.64%).

3 Recommendations

It is recommended that:-

- Members note the report.

It is recommended to Council that:-

- The increase in the CFR and the borrowing strategy 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 Council Report 25 February 2016 General Fund Budget 2016/17 and Capital Programme 2016/19

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 2016/17;
- 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 2016/17;
- a report of the Council’s borrowing strategy for 2016/17;
- a report of debt rescheduling during 2016/17;
- a review of compliance with Treasury and Prudential Limits for 2016/17.

2 Economic Update

2.1 UK GDP growth rates in 2013, 2014 and 2015 were 2.2%, 2.9% and 1.8% respectively and were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for Q3 was a pleasant surprise, which confounded the downbeat forecast by the Bank of England in August of only +0.1%. During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro and weak growth in the EU, China and emerging markets and from the dampening effect of the Government's continuing austerity programme.

2.2 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. Subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

2.3 The Monetary Policy Committee (MPC) meeting on 4th August addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

2.4 The MPC meeting on 3rd November left Bank Rate unchanged at 0.25% and other monetary policy measures also unchanged. This was in line with market expectations, which was a major change from the previous quarterly Inflation Report MPC meeting, which had given a strong steer in its forward guidance that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank.

2.5 The latest MPC decision included a forward view the Bank Rate could go either up or down depending on how economic data evolves in the coming months. The Chancellor has said he will do 'whatever is needed' to promote growth, there are two main options he can follow, fiscal policy e.g. cut taxes, increase investment allowances for businesses and/or increase Government expenditure on infrastructure, housing etc. The other key factor is inflation where the MPC aims for a target for CPI of 2.0%. Peak forecasts for inflation range between 2.3% to 2.7% during 2017, this increase was largely due to the effect of the sharp fall in the value of sterling since the referendum.

2.6 The US economy has been growing strongly in Q3 at 2.9% (on an annualised basis) after only 1.4% in Q2. The election does not appear likely to have much impact on the Federal Reserve (Fed) in terms of holding back further on increasing the Federal Funds Rate. The next rate rise is still widely expected to occur in December 2016. If the Trump package of policies is implemented there is likely to be an increase in inflationary pressures, which could mean that the pace of further Fed. Rate increases will be quicker and stronger than formerly expected.

2.7 In the Eurozone the European Central Bank has commenced significant quantitative easing programmes and progressive cuts to its deposit facility rate. These measures have struggled to make an impact in boosting economic growth and in stimulating inflation to rise from around zero towards the target of 2%. 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 their economies and economic growth.

2.8 Economic growth in China has been slowing down and this, in turn has been denting economic growth in emerging market countries dependent on exporting raw materials to China.

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

	Dec-16	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%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	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%	2.30%	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%	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%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

3 Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by Council on 25 February 2016. Since February there has been an increase in the Capital Financing Requirement (CFR), changes to the borrowing strategy and borrowing requirement as detailed at paragraphs 4 and 6 below.

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	**2016/17 Original Estimate £000**	**2016/17 Revised Estimate £000**
Forecast Capital Expenditure	**1,613**	**3,427**
Financed by:		
Capital Receipts	295	465
Capital Grants	499	925
Capital Reserves	819	1,207
Section 106’s	0	63
Total Financing	**1,613**	**2,660**
Borrowing Requirment	**0**	**767**

4.3 The main changes to the capital programme approved in February 2016, is the inclusion of the leisure RE:FIT energy programme (£823k). In addition, Cabinet have agreed to support investment towards the CCTV invest to save proposal and the award of a capital grant to Elm Parish Council through the Rural Capital Grant scheme. The remaining changes relate to reprofiling of expenditure between years including bringing forward from 2017/18 to 2016/17 the purchase of two new refuse vehicles to support implementation of the garden waste project.

4.4 The main changes to the resources statement is increased funding from the Better Care Fund for the agreed delivery of an enhanced Disabled Facilities Programme and use of the capital reserves/internal borrowing to support investment in the leisure RE:FIT energy programme and the purchase of two new refuse vehicles.

4.5 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	**2016/17 Original Estimate £000**	**2016/17 Revised Estimate £000**
Capital Financing Requirement	898	1,588
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**

4.6 The Council's revised estimate for CFR is £690k higher than the original estimate. This reflects the decision to internally borrow to finance the leisure energy programme and to enter into a finance lease for the purchase of two refuse vehicles.

4.7 With respect to the finance lease taken out; this increases the CFR and therefore the Council's borrowing requirement, this type of lease includes a borrowing facility and so the Council is not required to separately borrow to fund these leases.

4.8 The Council has made provision to repay all 'borrowing' liabilities through increased Minimum Revenue Provision (MRP) in the General Fund revenue budget.

4.9 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 2016/17 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	**2016/17 Original Estimate £000**	**2016/17 Revised Estimate £000**
Gross Borrowing	7,800	7,800
Plus Other Long Term Liabilities Finance Leases	861	860
Gross Borrowing	**8,661**	**8,660**
Capital Financing Requirement	898	1,588

4.10 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/2016) currently attracting excessive premiums (£3.135m 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.

4.11 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	**2016/17 Original Estimate £000**	**2016/17 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**

4.12 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. 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 £25.75m as at the 30th September 2016 (£18.55m at 31st March 2016) and the investment portfolio yield for the first 6 months of the year is 0.64%. Based on 90 District Councils which provided Capita with information, the average rate of return as at 30 September 2016 was 0.64%.

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 2016/17. The Council has achieved investment income of £83k to 30th September 2016 (£96k to end of October). The 2016/17 projected outturn of £170k has been revised down to £160k.

5.4 The Council's current investment counterparty criteria selection was approved in the TMSS in February 2016 and is meeting the requirement of the treasury management function to date.

6 Borrowing Strategy

6.1 The Council's CFR for 2016/17 is £1.588m (including finance lease borrowing facilities). 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 balance of external and internal borrowing is generally driven by market conditions.

6.2 During 2016/17 the council has approved the use of £0.823m of cash flows in lieu of borrowing (internal borrowing) to support investment in the RE:FIT leisure energy programme. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

6.3 It is not anticipated there will be any further borrowing undertaken during this financial year other than entering into a lease borrowing facility for the purchase of two refuse vehicles (see paragraph 4.6 above).

7 Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling was undertaken during the first six months of 2016/17.