TRAFFORD BOROUGH COUNCIL

Report to: **Executive 16 November 2015**
Accounts & Audit Committee 25 November 2015

Report for: **Discussion**
Report of: **The Executive Member for Finance and the Director of Finance**

Report Title

Treasury Management 2015-16 Mid-Year Performance Report

Summary

In accordance with the CIPFA Code of Practice adopted by the Council, this report provides an update on the progress of the treasury management activities undertaken for the first half of 2015/16.

- **Debt Activity:-**

No new borrowings to finance the capital programme were taken and due to unfavourable market conditions no debt restructuring exercises were undertaken. At 30 September the Council's external debt was £94.7m.

- **Investment Activity:-**

The priorities when undertaking any Council investment continues to be security, liquidity and then rate of return and during the first half of 2015/16 the annualised investment rate of return from proactive cash flow management was 0.71%, which was 0.36% or £(184)k above the comparable performance indicator of the average 7-day **L**ondon **I**nterbank **BID** interest rate. As a result of income being received ahead of actual spend, and £5m being placed in the Church Commissioners Local Authority Property Fund, the forecasted level for investment interest to be generated in the year is currently expected to total £0.7m exceeding the budget by £0.2m. At 30 September the Council's level of investments was £101.2m.

- **Prudential Indicators:-**

During the first half of 2015/16 the Council complied with its legislative and regulatory requirements, including compliance with all treasury management prudential indicators.

Recommendations

That the Accounts & Audit Committee & Executive be requested to:

1. Note the Treasury Management activities undertaken in the first half of 2015/16.

Contact person for background papers and further information:

Name: Graham Perkins
Extension: 4017

Background papers: None

Relationship to Policy Framework/Corporate Priorities	Value for Money
Financial	The Council did not encounter any cash flow liquidity difficulties and all investment income was received on time. The projected level of investment income from investments for 2015/16 is £0.7m and exceeds budget by £0.2m. Debt interest payable remains in-line with budget at £5.8m.
Legal Implications:	Any legal implications are as set out in the report.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Resource Implications e.g. Staffing / ICT / Assets	Not applicable
Risk Management Implications	The monitoring and control of risk underpins all treasury management activities and these factors have been incorporated into the treasury management systems and procedures which are independently tested on a regular basis. The Council's in-house treasury management team continually monitor to ensure that the main risks associated with this function of adverse or unforeseen fluctuations in interest rates are avoided and security of capital sums are maintained at all times.
Health & Wellbeing Implications	Not applicable
Health and Safety Implications	Not applicable

1. BACKGROUND

1.1 The treasury management operation ensures that the Council's day to day cash flow requirements are adequately planned and accounted for with any surplus monies beinginvested in low risk counterparties. In addition to the day to day cash flow activities, theCouncil's longer term funding requirements arising from its capital programme are alsoconsidered and this may involve arranging long or short term loans.

1.2 Treasury management is defined as:

> The management of the local authority's investments and cash flows, its banking, moneymarket and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.

1.3 Each year in order to comply with the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code), the Accounts & Audit Committee together with the Executive will receive the following reports:

- annual treasury strategy for the year ahead (February)
- mid-year update report (November i.e. this report)
- annual report describing the activity undertaken compared to the strategy (June).

1.4 The Treasury Management Strategy for 2015/16 was approved by Council at its meeting on 18 February 2015 and the policies to be adopted for the year remain unchanged.

1.5 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- Economic Update (section 2)
- Treasury Position (section 3)
- Debt Activity (section 4)
- Investment Activity (section 5)
- Risk Benchmarking (section 6)
- Prudential and Performance Indicators (section 7)
- Recommendations (section 8)

2. ECONOMIC UPDATE

2.1 The main economic headlines arising from the first half of 2015/16 are outlined below and a forecast of the main indicators for 2016 are provided at Appendix B for reference:

UK

- Gross Domestic Product (GDP) in 2014 grew at an annual rate of 2.9%, the strongest rate since 2006 and of any G7 country and forecasters currently predict the 2015 growth rate to be a leading rate in the G7 again at 2.2%. Growth is expected to slow marginally during the 2nd half of 2015 as pressures for exporters mount as a result of:

    - the appreciation of Sterling against the Euro,
    - weak growth in the UK's main trading partners and
    - the lingering impact of the Government's austerity measures which are aimed at improving the country's financial position.

- The 3 month unemployment average continues its downward trend falling to 5.4% for the 3 months ending August 2015 compared to 5.6% for the previous quarter;

- Consumer Price Index (CPI) has for most of the year been close to 0% with the reported rate for September being -0.10%. It is anticipated that several more months of low inflation are expected to be incurred resulting from the continuing fall in the price of oil, Iran re-joining the world oil market after the lifting of sanctions and world commodity prices generally being depressed as a result of the Chinese economic downturn. Despite this the Bank of England forecast CPI to reach the Government's 2% target within 2 to 3 years.

- Monetary Policy Committee (MPC) maintained both the Bank Rate at 0.5% and the level of quantitative easing at £375bn. The forecast for the first increase in Bank Rate has been pushed back from Quarter1 to Quarter2 2016 with increases after that being at a much slower pace and to much lower levels than previously encountered.

<u>U.S</u>.

- GDP continues to grow in 2015 with the recorded annualised movements for the 3 quarters ending September 2015 being 0.6%, 3.9% & 1.5% respectively.

- Markets were expecting the Federal Reserve to raise interest rates during the summer however this has now been put back to the end of 2015 or early 2016 as a result of the slow-down in the world economy, particularly in China and emerging countries.

- The October 2015 rate of unemployment remained unchanged from that reported in September at 5.1%.

- CPI was 0.0% for period ending September 2015.

<u>Eurozone</u>

- In January 2015, the European Central Bank (ECB) announced details of a massive quantitative easing (QE) programme which was to commence in March 2015 with monthly 60bn euro purchases of high credit quality government and other debt of selected Eurozone countries taking place. This programme, which is expected to run until September 2016 costing 1.1trillion euros, is already having a positive effect in helping recover consumer and business confidence.

- GDP grew by 0.5% in quarter 1 2015 falling slightly to 0.4% for quarter 2 however the slowdown in the Chinese economy has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in improving growth.

- The latest CPI figures show inflation currently running at -0.1% for September 2015.
- In July, Greece finally relented to EU demands to implement a major programme of austerity enabling a €86bn third bailout package to be agreed however during this latest round of negotiations, huge damage was done to both the Greek banking system and its economy. A surprise general election was carried out in September resulting in the existing Syriza government retaining power to implement austerity measures though major doubts still remain as to whether the size of cuts and degree of reforms required can be fully implemented in order to prevent a Greek exit from the euro.
- Unemployment remains high at 10.8% as reported in September 2015.

China

- In October 2015, manufacturing contracted for the third month in succession.
- GDP continues to grow however at 6.9% for 2015, this is the weakest it has been since the financial crisis began in 2008.
- Interest rates have been cut five times already since the start of 2015 from 5.6% to 4.35% as the Government tries to move its economy away from being export led to a more consumer and service driven one.

2.2 Interest rate forecasts are provided by the Council's treasury management advisors Capita and the table below outlines the latest situation taking into consideration the above economic conditions:

	2015-16 Original Forecast %	2015-16 Revised Forecast %	2016-17 Revised Forecast %	2017-18 Revised Forecast %
Bank Rate	0.63	0.50	0.90	1.50
Investment Rates				
3 month	0.70	0.55	1.05	1.65
1 Year	1.20	1.05	1.50	2.15
PWLB Loan Rates				
5 Year	2.40	2.35	2.80	3.25
25 Year	3.75	3.55	4.05	4.45

2.3 As a result of the current and forecasted economic position as outlined above, the Council's stance when undertaking or considering any money market transactions will continue to be as that adopted in previous years and to take a cautious approach.

3. TREASURY POSITION

3.1 The Council's debt and investment position at the beginning and midway through the current financial year was as follows:

	31 March 2015			30 September 2015		
	Principal £m	Total £m	Interest Rate %	Principal £m	Total £m	Interest Rate %
DEBT						
Fixed rate:						
- PWLB	39.0			38.7		
- Market	5.0	44.0	6.67	5.0	43.7	6.65
Variable rate:						
- PWLB	0.0			0.0		
- Market	51.0	51.0	5.50	51.0	51.0	5.46
Total debt		**95.0**	**6.05**		**94.7**	**6.01**
INVESTMENTS						
- Fixed rate	39.9			68.3		
- Variable rate	37.7			27.9		
- Other - CCLA	0.0			5.0		
Total Investments		**77.6**	**0.71**		**101.2**	**0.92**
NET ACTUAL DEBT		**17.4**			**(6.5)**	

Net actual debt = Total debt less Total Investments

3.2 When reviewing the table above, it is important to note that the investment figures do fluctuate daily, reflecting funds which are available on a temporary basis as a result of timing issues arising from such aspects as precept payments, receipt of grants and progress on the capital programme.

4. DEBT ACTIVITY

4.1 The Council, as at 31 March 2015, was under borrowed by £43.2m, as a result of the total Capital Financing Requirement (CFR) of £138.2m, the underlying need to borrow for capital purposes, being higher than its actual level of external debt of £95.0m. This situation is set to continue for the foreseeable future and is in line with the majority of Local Authorities positions nationwide.

4.2 The Council's under borrowed position reflects previous decisions taken to fund its borrowing requirement from its own funds (cash supporting its reserves & balances) rather than taking on any new debt. This approach reflects the high "cost of carry" i.e. the difference between long-term debt interest rates which as at 30 September 2015 were (3.5% 25yr PWLB rate) and the current average short term investment rate (0.5% 3mth rate). Under these conditions for every £10m borrowed the Council would pay £300k in net interest (Interest payable - £10m x 3.5% = £350k less Interest receivable - £10m x 0.5% = £50k)

4.3 During 2015/16 the Council's (CFR) position, is forecasted to fall by £(2.3)m from its closing position as at 31 March 2015 of £138.2m to £135.9m by 31 March 2016 reflecting the difference between the level of new capital expenditure financed by borrowing compared to the statutory Minimum Revenue Provision (the amount set aside from revenue for the repayment of debt).

4.4 In the current economic climate, debt rescheduling opportunities have been limited due to the high breakage penalty (premium) costs which would need to be incurred. Therefore during the first half of the year no debt restructuring has been undertaken.

5. INVESTMENT ACTIVITY

5.1 In accordance with the Code of Conduct, the Council's priorities when placing any temporary surplus funds with any approved institution remains as that adopted in previous years which are security of capital, liquidity and then to obtain an appropriate level of return consistent with its risk appetite.

5.2 All investments placed with any of the approved institutions and which matured during the first half of the financial year, were repaid on time without any difficulties and the list of institutions in which the Council invests continues to be kept under review. For reference during the first half of the year and as a result of credit rating changes or in the case of the Church Commissioners an addition to the approved policy, the following institutions were added to or deleted from the Council's approved list of institutions:

Institution	Additions	Deletions
UK Banks	Close Brothers, Goldman Sachs Intl. Merrill Lynch Intl. & Morgan Stanley.	The Co-operative
Non UK banks	Abu Dhabi Commercial, ABN Amro, National Australia, Northern Trust Co., UBS Ltd & Danske.	
Building Societies	Coventry & Leeds	
Other	Church Commissioners Local Authority (Property fund)	

5.3 The movement in the Council's temporary investments as at 31 March 2015 compared to 30 September 2015 is shown below for reference:

Sector	31 March 2015 £m	30 September 2015 £m
UK Banks	22.9	37.5
UK Building Societies	5.0	8.3
Money Market Funds	34.7	25.9
Local Authority	9.0	5.0
Non UK Banks	6.0	19.5
Other - CCLA	0.0	5.0
Total	**77.6**	**101.2**

The maturity structure of the investment portfolio was as follows:

Period	31 March 2015 £m	30 September 2015 £m
Instant Access	37.7	28.0
Up to 3 Months	4.0	12.1
3 to 6 Months	9.5	44.1
6 to 9 Months	0.0	5.5
9 to 12 months	21.4	1.5
Over 1 year	5.0	10.0
Total	**77.6**	**101.2**

5.4 During the first half of the year, a total of 172 short term temporary investments were undertaken by the Council's in house treasury management team in an environment of historically low interest rates. The table below details the results of these activities, which clearly illustrates the Council outperforming the 7day LIBID benchmark, a recognised market performance indicator, by 35 basis points whilst ensuring that all risk was kept to a minimum during this period.

Average level of temporary Investments 1 April to 30 Sept £m	Average interest rate earned %	Average 7 day LIBID rate %	Additional interest earned against 7 day LIBID £k
105.6	0.71	0.36	184

5.5 As a consequence of this favourable level of return achieved during the first half of the year, it is currently forecasted that the level of investment interest which will be generated from short term investments during the year will be £0.6m which is £0.1m higher than budget. This level of return is to be achieved despite a slow investment market due to interest rates, as highlighted in Section 2, continuing to be in line with the 0.5% Bank Rate.

5.6 During the first half of the year the Council had no liquidity difficulties as a result of proactive cash flow management thereby avoiding the need for any temporary borrowing to be undertaken.

5.7 Members will recall that during July 2015, approval for a new investment instrument, the Church Commissioners Local Authorities Property Investment Fund, was obtained and that this has now been added to the list of approved instruments which can be used for investment purposes.

5.8 The objective of this fund is to generate long-term growth in the original amount invested together with annual returns and since September 2014, the fund which now manages £467m has grown by 120% and includes 123 Local Authorities.

5.9 On 29 September 2015, the Council placed £5m into this fund as a long term investment for a minimum period of 5 years and during this period the performance of the fund will be closely monitored. Annual returns are forecasted to be approximately 4% which for 2015/16 will generate an additional £0.1m in investment interest to that budgeted for.

5.10 A breakdown of the Council's investments, as at 30 September 2015 is provided at Appendix A for reference.

6. RISK BENCHMARKING

6.1 In accordance with the Code of Practice and Department for Communities and Local Government Investment Guidance, appropriate security and liquidity benchmarks are used by Officers to monitor the current and future potential risk conditions and undertake any corrective action to the operational strategy if required.

6.2 These benchmarks are simple guides to maximum risk (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria.

6.3 During the first half of 2015/16 the Director of Finance can confirm that no benchmarks, which were set in the Strategy report in February 2015, were breached as shown from the information below;

- **Security** – This table shows the benchmark for the Council's investment portfolio for each individual year and reflects the level of potential default when compared to the historic default rates.

	1 year	2 years	3 years
Original maximum default rate	**0.09%**	**0.04%**	**0.14%**
Position at 30.09.15	**0.01%**	**0.00%**	**0.00%**

- **Liquidity** – In respect of this the Council set liquidity facilities/benchmarks of:

  Bank overdraft - £0.5m,
  Liquid short term deposits of at least £15m available within 1 week notice and
  Weighted Average Life (WAL) benchmark expected to be 6 months, with a maximum of 3 years.

  For the first half of 2015/16 the above liquidity arrangements were complied with and at 30 September 2015 the WAL of its investments was 3.25 months.

- **Yield** - The local measure of the yield benchmark is to achieve a return above the 7 day LIBID rate.

  For the first half year of 2015/16 the investment interest return averaged 0.71%, against a 7 day LIBID rate of 0.36%.

- **Origin** – This stipulated that no more than 40% of the Council's total investments to be directly placed with non-UK counterparties at any time.

  For the first half of 2015/16 the maximum level was 31%.

7. PRUDENTIAL AND PERFORMANCE INDICATORS

7.1 In accordance with CLG Guidance, the CIPFA prudential Code and the CIPFA Code of Practice on Treasury Management, the Council has in place a number of prudential indicators ensuring that the Council's capital expenditure plans and borrowing remain robust, prudent and sustainable.

7.2 These indicators were originally set in February 2015 for the forthcoming year and are monitored on a monthly basis. During the first half of 2015/16 it can be reported that no breaches occurred.

8 RECOMMENDATIONS

8.1 That the Accounts & Audit Committee & Executive be requested to;

- Note the Treasury Management activities undertaken in the first half of 2015/16.

Other Options

This report has been produced in order to comply with Financial Regulations and relevant legislation and provides an overview of transactions undertaken during the first half of 2015/16.

Consultation

Information for the period 1 April 2015 to 30 September 2015 was obtained from Capita, the Council's external consultants.

Reasons for Recommendation

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

Finance Officer Clearance …ID…………..

Legal Officer Clearance …HK……………

Director's Signature *Appended in hard copy*

APPENDIX A

Breakdown of Investments as at 30 September 2015

Counterparty	**Amount £k**	**Total £k**
UK Institution		
Local Authority		
Greater Manchester Waste Disposal Authority	5,000	5,000
Banks		
Barclays	5,000	
Close Bros	5,000	
Goldman Sachs International	2,500	
Lloyds	20,000	
Santander	5,000	37,500
Building Societies		
Coventry	3,000	
Leeds	2,500	
Nationwide	2,800	8,300
Money Market Funds		
Federated	4,070	
Ignis	14,300	
Legal & General	7,500	25,870
Other		
Church Commissioners Local Authority	5,000	5,000
	Total UK Institutions	**81,670**
Non UK Institutions		
National Bank of Abu Dhabi	9,500	
Development Bank of Singapore	6,000	
Svenska Handelsbanken	2,050	
United Overseas	2,000	19,550
	Total Non UK Institutions	**19,550**
	Grand Total	**101,220**

APPENDIX B

Major Economic Forecasts for Calendar Year 2016

Location	Gross Domestic Product	Unemployment Rate	Consumer Price Index	Bank Rate
UK	2.50%	5.31%	0.35%	0.75%
Euro Area	1.31%	10.33%	-0.54%	0.05%
USA	2.65%	5.58%	1.43%	0.25%
China	10.48%	4.00%	0.43%	3.26%