Report to	Cabinet	**Item**
	9 December 2015	
Report of	Chief finance officer	6
Subject	Treasury management strategy - mid-year review 2015-16	

Purpose

To advise of the treasury management performance for the first six months of the financial year to 30 September 2015.

Recommendations

To:

a) note the report and the treasury activity; and

b) approve the revised prudential indicators.

Corporate and service priorities

The report helps to meet the corporate priority to provide value for money services.

Financial consequences

The report has no direct financial consequences however it does report on the performance of the council in managing its borrowing and investment resources.

Ward/s: All wards

Cabinet member: Councillor Stonard – Resources and income generation

Contact Officers

Justine Hartley, chief finance officer	01603 212440
Philippa Dransfield, chief accountant	01603 212562

Background documents

None

Background

1. The council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure that this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

2. The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer term cash flow planning to ensure the council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

3. As a consequence 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."

Introduction

4. The council has regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011.

5. The primary requirements of the code, as adopted by the council in its financial regulations, are as follows:

   a) Creation and maintenance of a treasury management policy statement which sets out the policies and objectives of the council's treasury management activities.

   b) Creation and maintenance of treasury management practices which set out the manner in which the council will seek to achieve those policies and objectives.

   c) Approval of an annual treasury management strategy statement (TMSS) - including the annual investment strategy and minimum revenue provision policy - for the year ahead which is reported to the council by the cabinet.

   d) Production of a mid-year review report to the cabinet on the activities of the treasury management operation, and an annual report (stewardship report) to the cabinet for presentation to the council by 30 September of the succeeding financial year.

   e) Delegation of executive decisions for borrowing, investment or financing to the chief finance officer, who is required to act in accordance with CIPFA's code of practice for treasury management in the public services.

6. This mid-year report has been prepared in compliance with the CIPFA code and covers the following:

   - An economic update (Section 3);
   - A review of the council's investment strategy (Section 4);
   - A review of the council's borrowing strategy (Section 5);
   - A review of debt rescheduling (Section 6);
   - A review of the *Treasury management strategy statement* and *Annual investment strategy* (Section 7);
   - The council's capital position (prudential indicators), including a review of compliance with treasury and prudential limits (Section 8);

Economic update

7. UK GDP growth of 3.0% in 2014 was the strongest growth since 2006. However, quarter 1 of 2015 was weak at +0.4% (though there was a rebound in quarter 2 to +0.7%) Growth is expected to weaken marginally to about +0.5% in quarter 3 as the economy faces headwinds for exporters from the appreciation of Sterling against the Euro; 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.

8. Despite these headwinds, the Bank of England is forecasting 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 and CPI inflation hovering at or near to zero over the last quarter.

9. Investment expenditure is also expected to aid this reasonably strong growth. The August Bank of England inflation report forecast was notably subdued with inflation barely getting 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 re-join 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.

10. Therefore there are considerable risks around whether inflation will rise in the near future as strongly as previously expected. This will make it more difficult for the central banks of both the US and the UK to raise rates as soon as had previously been expected, 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.

Outlook for the next six months of 2015-16

11. Capita Asset Services undertook a review of its interest rate forecasts (see appendix 2) on 11 August. Later 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 depressed PWLB rates. However, there is much volatility in rates as news ebbs and flows in negative or positive ways and news in September in respect of Volkswagen, and other corporates, has compounded downward pressure on equity prices. This latest forecast includes a first increase in bank rate in quarter 2 of 2016.

12. The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas. Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

13. The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- Uncertainty around the risk of a UK exit from the EU.
- The ECB severely disappointing financial markets with a programme of asset purchases which proves insufficient to significantly stimulate growth in the EZ.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate in 2015, causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Investment strategy

14. The Treasury Management Strategy Statement (TMSS) for 2015-16, which includes the Annual Investment Strategy, was approved by the council on 17 February 2015. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

15. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

16. The council will also aim to achieve the optimum return (yield) on 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 12 months, with highly

credit rated financial institutions, using Capita Asset Services' suggested creditworthiness approach.

17. The council held £74.7m of investments as at 30 September 2015 (£67.25m at 31 March 2015), the average investments held for the six months to 30 September 2014 was £76.1m (£72.4m in the same period last year).[1]

18. The following table shows the movement in investments for the first six months of the year.

Investments £'000	**Actual 1 April 2015**	**Movement**		**Transfers**	**Actual 30 September 2015**
		Invested	**Matured**		
Long term					
Banks	3,000	-	-	-	3,000
Short term					
Banks	15,000	7,000	(10,700)	-	11,300
Building societies	28,000	22,950	(12,700)	-	38,250
Local authority	5,000	-	(5,000)	-	-
Cash equivalents[2]					
Banks	10,000	64,661	(64,661)	-	10,000
Building societies	6,250	190,000	(184,100)	-	12,150
Total	**67,250**	**284,611**	**(277,161)**	**-**	**74,700**

19. The council's investment return for the first six months of 2015-16 is £307,575 which is £61,175 lower the amount budgeted for the period of £368,750 – officers are investigating other forms of investment to improve this performance.

20. The council is part of a benchmarking group across Norfolk, Suffolk and Cambridgeshire; the table in Appendix 3 shows the performance of the council's investments compared to the other councils (whom have been made anonymous).

21. The chief financial officer confirms that all investment transactions undertaken during the first six months of 2015-16 were within the approved limits in the *Annual investment strategy*.

---

[1] The increase in investment balances is due to capital receipts of £5.0m, LGSS costs not having been invoiced therefore not paid £3.2m and timing issues on the capital programme.
[2] Cash equivalents are those monies that are invested for 3 months or less at inception

22. The current investment counterparty criteria selection the TMSS is meeting the requirement of the treasury management function.

Borrowing strategy

23. The council's capital financing requirement (CFR) for 2015-16 is £232,728. 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. The table below shows the council has borrowings of £224,535 and has utilised cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

24. Appendix 1 shows the movement in interest rates during the six months, across all maturity bands. Appendix 2 sets out predicted interest rates going forward. However, due to the overall financial position no new external borrowing was undertaken. No further borrowing is expected to be undertaken during the remainder of this financial year.

25. The council's debt position is shown in the following table:

Borrowing **£'000**	**TMSS**	**Actual 1 April 2015**	**Actual 30 September 2015**
Long term			
Public works loan board	227,767	218,917	217,607
Money market	5,000	5,000	5,000
3% stock (perpetually irredeemable)	499	499	499
Corporate bonds and external mortgages	74	74	74
Finance leases	1,189	1,355	1,355
Total	**234,529**	**225,845**	**224,535**

Debt rescheduling

26. No debt rescheduling was undertaken during the first six months of 2015-16

Treasury Management Strategy Statement and Annual Investment Strategy update

27. The TMSS for 2015-16 was approved by the council on 17 February 2015 There are no proposed policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Prudential indicator 2015-16 £'000	Original per TMSS	Revised
Authorised limit	275,565	261,075
Operational boundary	235,565	225,845
Capital financing requirement	248,795	232,728

28. The council's operational boundary relates to the level of external debt that is expected in the future. In the council's case this is £11.7m below the capital financing requirement, which is the underlying need to borrow for a capital purpose. The difference relates to internal borrowing, or the use of cash balances in lieu of borrowing. This is an operational policy to reduce the loss arising from borrowing and investing at a lower interest rate, saving approximately 3.5% - 3.75% in interest costs had the monies been borrowed. It has the added benefit of reducing investment counterparty risk. This position is being carefully monitored to ensure a low risk position is maintained in the future.

The council's capital position (prudential indicators) including a review of compliance with treasury and prudential limits

29. 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 the limits in place for borrowing activity.

Prudential indicator for capital expenditure

30. This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the budget.

Capital expenditure by service £'000	2015-16 Original estimate	2015-16 Revised estimate
Non-HRA HRA	21,615 44,326	21,646 42,888
Total	**65,941**	**64,534**

Changes to the financing of the capital programme

31. The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital expenditure £'000	2015-16 Original estimate	2015-16 Revised estimate
Total spend	**65,745**	**64,534**
Financed by: Capital receipts Capital grants Capital reserves Revenue	 4,673 7,847 13,189 25,235	 6,055 7,954 13,189 25,235
Total financing	**50,944**	**52,433**
Borrowing need	**14,997**	**12,101**

Changes to the prudential indicators for the capital financing requirement, external debt and the operational boundary

32. The tables below show the CFR, which is the underlying external need to incur borrowing for a capital purpose, and the expected debt position over the period, termed the operational boundary.

Prudential indicator – capital financing requirement £'000	**2015-16 Original estimate**	**2015-16 Revised estimate**
CFR – non housing	39,159	26,128
CFR – housing	298,637	206,600
Total CFR	248,795	232,728
Net movement in CFR		**(16,067)**

Prudential indicator – external debt / the operational boundary £'000	**2015-16 Original estimate**	**2015-16 revised year end estimate**
Borrowing	233,803	222,607
Other long term liabilities*	1,762	1,847
Total debt 31 March	**235,565**	**224,454**

* Includes on balance sheet finance leases

Limits to borrowing activity

33. The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose*. External borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2015-16 and 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.

Borrowing limit **£'000**	**2015-16** **Original estimate**	**2015-16** **Revised estimate**
Gross borrowing Plus other long term liabilities*	233,803 1,762	223,917 1,928
Gross borrowing	**235,565**	**225,845**
CFR* (year end position)	**247,719**	**232,728**

* Includes on balance sheet finance leases

34. The chief finance officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

35. 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 of 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 **£'000**	**2015-16** **Original indicator**	**2015-16** **Revised indicator**
Borrowing Other long term liabilities*	273,803 1,762	259,147 1,928
Total	**275,565**	**261,075**

* Includes on balance sheet finance leases

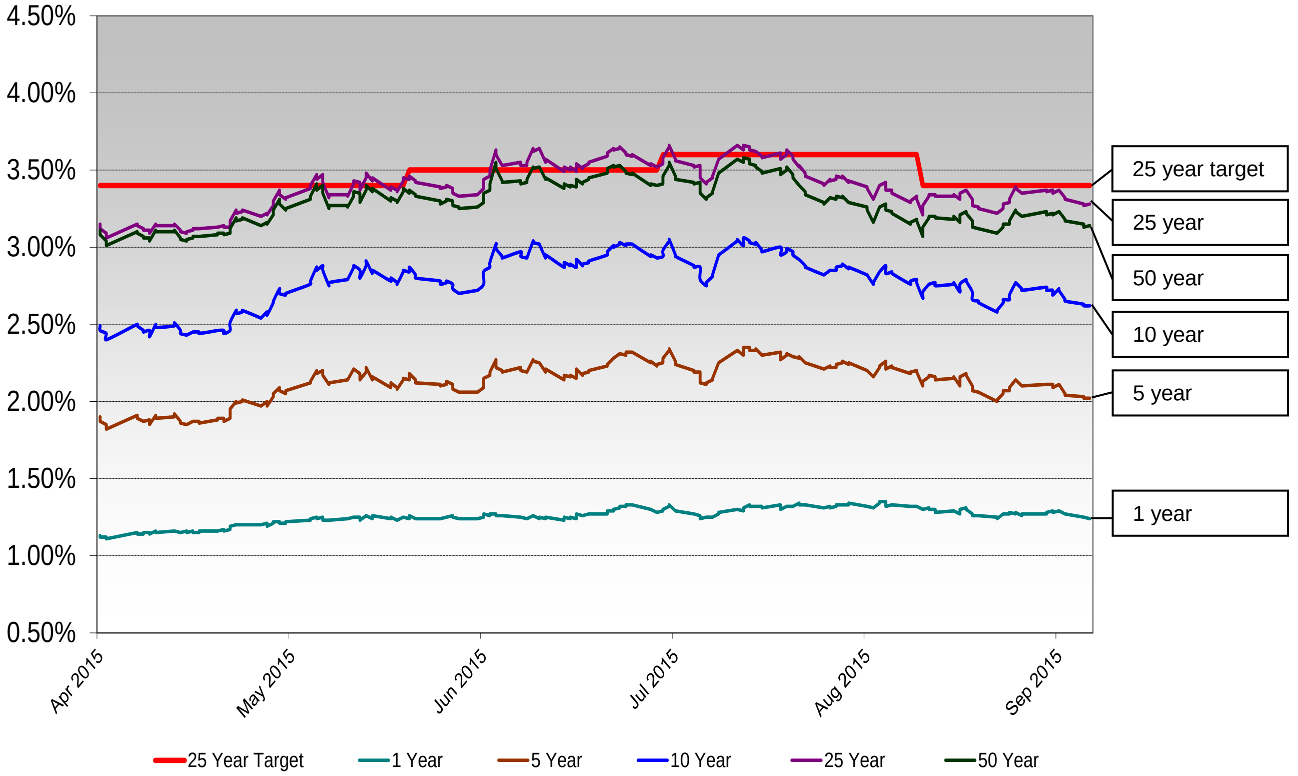
Integrated impact assessment	NORWICH City Council
The IIA should assess **the impact of the recommendation** being made by the report Detailed guidance to help with completing the assessment can be found here. Delete this row after completion	
Report author to complete	
Committee:	Cabinet
Committee date:	9 December 2015
Head of service:	Justine Hartley
Report subject:	Treasury management mid year review
Date assessed:	
Description:	

	Impact			
Economic (please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Finance (value for money)	☐	☒	☐	
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	
Equality and diversity (please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Relations between groups (cohesion)	☒	☐	☐	

	Impact			
Eliminating discrimination and harassment	[x]	[ ]	[ ]	
Advancing equality of opportunity	[x]	[ ]	[ ]	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	[x]	[ ]	[ ]	
Natural and built environment	[x]	[ ]	[ ]	
Waste minimisation and resource use	[x]	[ ]	[ ]	
Pollution	[x]	[ ]	[ ]	
Sustainable procurement	[x]	[ ]	[ ]	
Energy and climate change	[x]	[ ]	[ ]	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	[x]	[ ]	[ ]	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues

Movement in PWLB rates for the first six months of the year (to 30.9.14)



APPENDIX 2

Treasury management adviser's (sector's) interest rate forecast

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
BANK RATE	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.50	1.50	1.75	1.75
3 month LIBID	0.60	0.70	0.80	0.90	1.10	1.30	1.40	1.50	1.80	1.90	1.90
6 month LIBID	0.80	0.90	1.00	1.10	1.30	1.50	1.60	1.70	2.00	2.10	2.10
12 month LIBID	1.10	1.20	1.30	1.40	1.60	1.80	1.90	2.00	2.30	2.40	2.40
5 yr PWLB	2.40	2.50	2.60	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50
10 yr PWLB	3.00	3.20	3.30	3.40	3.50	3.70	3.80	3.90	4.00	4.10	4.20
25 yr PWLB	3.60	3.80	3.90	4.00	4.10	4.20	4.30	4.40	4.50	4.60	4.60
50 yr PWLB	3.60	3.80	3.90	4.00	4.10	4.20	4.30	4.40	4.50	4.60	4.60

Benchmarked performance

The table below shows that the rate of return being achieved by the council is highest of the bench marking group and details average risk and longest time to maturity compared to the rest of the benchmarking group. The figures in brackets are those at 31 March 2015.

Council	WARoR[o]	WA Risk[1]	WAM[2]	WA Tot. time[3]
Norwich	0.82% (0.83%)	5.8 (4.7)	140 (173)	275 (329)
A	0.98% (0.90%)	2.9 (2.9)	185 (216)	477 (419)
B	0.58% (0.51%)	3.1 (2.6)	71 (51)	105 (80)
C	0.83% (0.79%)	4.5 (3.2)	150 (203)	287 (281)
D	0.71% (0.75%)	4.6 (3.5)	110 (27)	176 (218)
E	0.89% (0.89%)	4.6 (4.3)	106 (54)	182 (216)
F	0.73% (0.78%)	5.4 (3.9)	110 (114)	222 (217)
G	0.65% (0.68%)	4.4 (3.5)	80 (136)	175 (204)
H	0.74% (0.75%)	4.9 (4.0)	123 (92)	220 (172)

[o]=**WARoR**: Weighted average rate of return. This is the average annualised rate of return weighted by the principle amount in each rate

[1]=**WA risk**: Weighted average risk number. Each institution is assigned a colour to a suggested duration using Sector's credit methodology. The institution is assigned a number based on its colour and an average, weighted using principal amount, of these numbers is calculated.

1: up to five years; 2: up to two years; 3: up to one year; 4: up to six months; 5: up to three months; 6: zero months. A number of 4.9 means between 6 months to a year

[2]=**WAM**: Weighted average time to maturity. This is the average time, in days, until the portfolio matures, weighted by the principle amount

[3]=**WA Tot. Time**: Weighted average total time. This is the average time, in days, that deposits are lent out for, weighted by the principle amount

Comparison of Key Data