Report to	Cabinet	**Item**
	10 December 2014	
Report of	Chief finance officer	11
Subject	Treasury management strategy statement and annual investment strategy mid-year review 2014-15	

Purpose

This report sets out the Treasury Management performance for the first six months of the financial year to 30 September 2014.

Recommendations

To:

1) Note the report and the treasury activity; and

2) Approve the revised prudential indicators.

Corporate and service priorities

The report helps to meet the corporate priority "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 Waters – deputy leader and resources

Contact Officers

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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 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.

   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

3. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011 was adopted by this council on 22 March 2011.

4. The primary requirements of the code 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) Receipt by the full council of an annual Treasury Management Strategy Statement (TMSS) - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

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

   a) An economic update (paragraphs 6 to 11);

   b) A review of the council's investment portfolio (paragraphs 12 to 18);

   c) A review of the council's borrowing strategy (paragraphs 19 to 20);

   d) A review of debt rescheduling (paragraph 21);

   e) A review of the Treasury Management Strategy Statement and Annual Investment Strategy (paragraphs 22 to 23);

   f) The council's capital position (prudential indicators), including a review of compliance with Treasury and Prudential Limits (paragraphs 24 to 30).

Economic update

Economic performance to date

6. After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1, 0.9% in Q2 and a first estimate of 0.7% in Q3 2014 (annual rate 3.1% in Q3), it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance.

7. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be an improvement in labour productivity to support increases in pay rates.

8. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

9. Also encouraging has been the sharp fall in inflation (CPI), reaching 1.2% in September, the lowest rate since 2009. Forward indications are that inflation is likely

to fall further in 2014 to possibly 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

10. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

Outlook for the next six months of 2014/15

11. Economic forecasting remains difficult. However, there are potential upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates, as follows: -

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds and into equities.

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Downside risks currently include:

- The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe.

- Fears generated by the potential impact of Ebola around the world

- UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.

- A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014.

- Weak growth or recession in the UK’s main trading partner - the EU, inhibiting economic recovery in the UK.

- A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.

- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.

- Recapitalisation of European banks requiring more government financial support.

- Lack of support by populaces in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.

- Italy: the political situation has improved but it remains to be seen whether the new government is able to deliver the austerity programme required and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.

- France: after being elected on an anti austerity platform, President Hollande has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme. Major overdue reforms of employment practices and an increase in competiveness are also urgently required to lift the economy out of stagnation.

- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.

- Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.

- There are also increasing concerns at the reluctance of western central banks to raise interest rates significantly for some years, plus the huge QE measures which remain in place (and may be added to by the ECB in the near future). This has created potentially unstable flows of liquidity searching for yield and, therefore, heightened the potential for an increase in risks in order to get higher returns. This is a return to a similar environment to the one which led to the 2008 financial crisis.

Investment strategy

12. The Treasury Management Strategy Statement (TMSS) for 2014/15, which includes the Annual Investment Strategy, was approved by the Council on 18 February 2014. It sets out the council's investment priorities as being:

    - Security of capital;
    - Liquidity; and
    - Yield

    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.

13. 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.

14. The council held £70.9m of investments as at 30 September 2014 (£64.0m at 31 March 2014), the average investments held for the six months to 30 September 2014 was £72.4m.[1]

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

Investments £'000	TMSS	Actual 31 March 2014	Movement		Transfers	Actual 30 September 2014
			Invested	Matured		
Long term						
Banks		-	3,000	-	-	3,000
Local authorities		3,000	-	-	(3,000)	-
Short term						
Banks		34,500	6,000	(17,000)	3,000	26,500
Building societies		16,500	11,000	(11,500)	-	16,000
Cash equivalents[2]						
Banks		10,000	30,045	30,045	-	10,000
Building societies		-	284,680	(269,280)	-	15,400
Total	**25,000**	**64,000**	**334,725**	**(327,825)**	**-**	**70,900**

15. The council's investment return for the first six months of 2014/15 is £390,070 which is £65,920 above the amount budgeted for the period of £324,150.

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

17. The chief financial officer confirms that all investment transactions undertaken during the first six months of 2014/15 were within the approved limits in the annual investment strategy.

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

Borrowing 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

19. The council's capital financing requirement (CFR) for 2014/15 is £236.812m. 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 £225.920m and has utilised cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

20. 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.

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

Borrowing **£'000**	**TMSS**	**Actual 31 March and 30 September 2014**
Long term		
Public works loan board	218,917	218,917
Money market	5,000	5,000
3% Stock (perpetually irredeemable)	499	499
corporate bonds and external mortgages	74	74
Finance leases	1,429	1,430
Total	**225,919**	**225,920**

Debt rescheduling

21. No debt rescheduling was undertaken during the first six months of 2014/15.

Treasury management strategy statement and annual investment strategy update

22. The TMSS for 2014/15 was approved by this council on 18 February 2014 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 2014/15 **£'000**	**Original per TMSS**	**Revised**
Authorised limit	285,844	264,781
Operational boundary	245,845	224,781
Capital financing requirement	253,886	236,812

23. 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 approximately £12m 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

24. 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

25. 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	2014/15 Original Estimate	2014/15 Revised Estimate
Non-HRA	29,311	13,555
HRA	42,551	44,420
Total	**71,862**	**57,975**

Changes to the financing of the capital programme

26. 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	2014/15 Original Estimate	2014/15 Revised Estimate
Total spend	**71,862**	**57,975**
Financed by:		
Capital receipts	7,218	10,203
Capital grants	9,753	5,793
Capital reserves	16,923	16,611
Revenue	19,885	19,883
Total financing	**53,778**	**52,490**
Borrowing need	**18,084**	**5,485**

Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

27. 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	**2014/15 Original Estimate**	**2014/15 Revised Estimate**
CFR – non housing	42,319	25,492
CFR – housing	211,567	211,319
Total CFR	253,886	236,812
Net movement in CFR		**(17,074)**

Prudential Indicator – External Debt / the Operational Boundary £'000	**2014/15 Original Estimate**	**2014/15 Revised Estimate**
Borrowing	243,917	224,782
Other long term liabilities*	1,927	1,430
Total debt 31 March	**244,844**	**226,212**

* On balance sheet finance leases

Limits to Borrowing Activity

28. 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 2014/15 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**	**2014/15** **Original** **Estimate**	**2014/15** **Revised** **Estimate**
Gross borrowing Plus other long term liabilities*	243,917 1,927	224,782 1,430
Gross borrowing	**244,844**	**226,212**
CFR* (year end position)	**253,886**	**236,812**

** Includes on balance sheet finance leases*

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

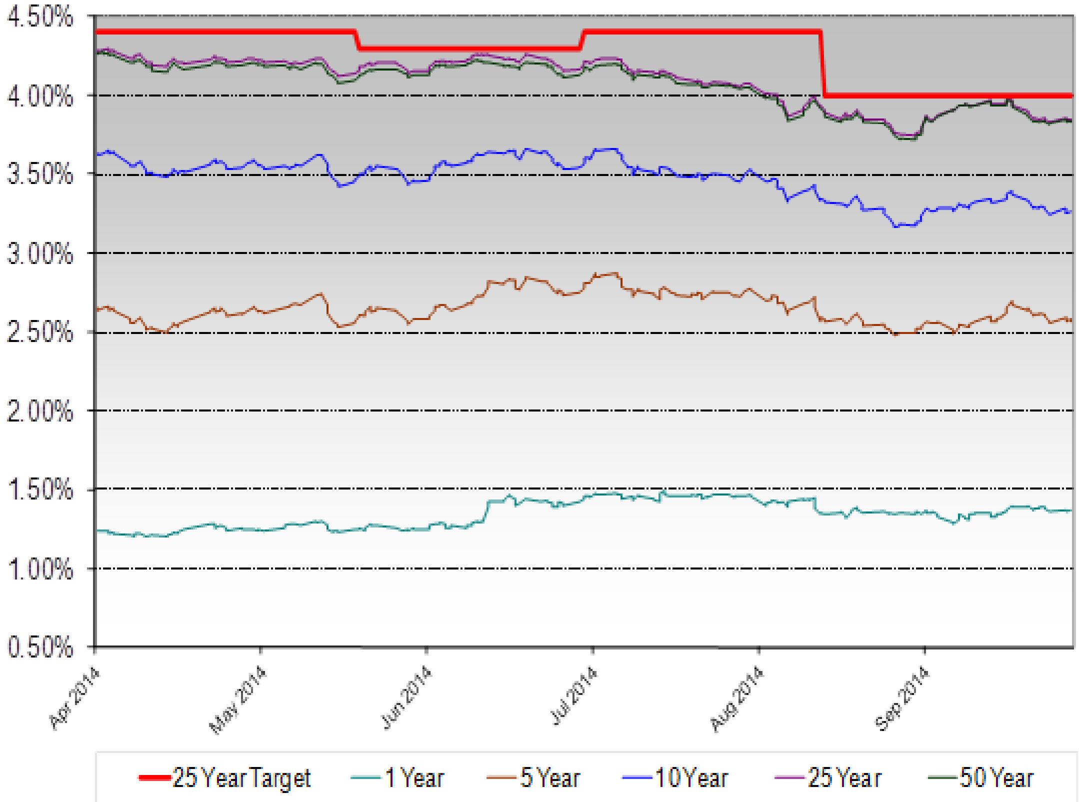
30. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by members. It reflects the level of borrowing which, while not desired, could be afforded in the short 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**	**2014/15** **Original** **Indicator**	**2014/15** **Revised** **Indicator**
Borrowing Other long term liabilities*	283,917 1,928	263,351 1,430
Total	**285,844**	**264,781**

** Includes on balance sheet finance leases*

APPENDIX 1

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-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
5yr PWLB rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10yr PWLB rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%

Benchmarked performance

APPENDIX 3

The table below shows that the rate of return being achieved by the council is highest of the benchmarking 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 2014, there are two new members of the benching marking group for 2014/15, therefore N/A appears in brackets for these councils.

Council	WARoR	WA Risk	WAM	WA Tot. time
Norwich	1.07% (1.09%)	4.9 (4.8)	143 (147)	420 (425)
A	0.93% (0.85%)	2.8 (3.4)	245 (139)	340 (208)
B	0.52% (N/A)	2.8(N/A)	51(N/A)	57 (N/A)
C	0.68% (0.69%)	3.9 (3.9)	110 (145)	197 (185)
D	0.78% (0.87%)	4.2 (3.9)	93 (46)	169 (260)
E	0.90% (N/A)	4.2 (N/A)	107 (N/A)	291 (N/A)
F	0.78% (0.94%)	4.3 (3.9)	111 (103)	206 (296)
G	0.62% (0.65%)	3.4 (4.4)	92 (142)	200 (180)
H	0.81% (0.71%)	3.8 (4.5)	97 (102)	205 (127)

WARoR – Weighted average rate of return. This is the average annualised rate of return weighted by the principle amount in each rate

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 5 years

2 Up to 2 years

3 Up to 1 year

4 Up to 6 months

5 Up to 3 months

6 0 months

A number of 4.9 means between 6 months to a year

WAM – Weighted average time to maturity. This is the average time, in days, until the portfolio matures, weighted by the principle amount

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

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:	10 Decmeber 2014
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 & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☒	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues