Report to	Cabinet	**Item**
	14 December 2016	
Report of	Chief finance officer	7
Subject	Treasury management strategy statement and annual investment strategy Mid-year review report 2016-17	

Purpose

This report sets out the treasury management performance for the first six months of the financial year to 30 September 2016

Recommendations

To note the report and the treasury activity and the revised forecasts of outturn compared to the approved prudential indicators.

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 business liaison

Contact Officers

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1. Background

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.

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."

2. Introduction

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

The primary requirements of the code are as follows:

1. Creation and maintenance of a treasury management policy statement which sets out the policies and objectives of the council's treasury management activities.
2. Creation and maintenance of treasury management practices which set out the manner in which the council will seek to achieve those policies and objectives.
3. Receipt by the 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.
4. 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.

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 (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);

3. Economic update

Economic forecasting remains difficult with so many external influences weighing on the UK. Forecasts will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

The overall balance of risks to economic recovery in the UK remains to the downside.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that are highly correlated to geo-political, sovereign debt crisis and emerging market developments.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by central banks reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some major developed economies, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.

- Major national polls:
    - US presidential election 8.11.16;
    - Italian constitutional referendum 4.12.16;
    - Spain has held two inconclusive general elections and is still unable to form a workable government with a coalition holding a majority of seats; if this impasse continues beyond 31 October, a third general election will have to be held – currently tentatively scheduled for 25.12.16
    - Dutch general election 15.3.17;
    - French presidential election April/May 2017;
    - French National Assembly election June 2017;

- German Federal election August – October 2017.

- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

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

- UK inflation rising to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate 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.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).
  - 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

4. Investment strategy

The treasury management strategy statement (TMSS) for 2016/17, which includes the annual investment strategy, was approved by the council on 23 February 2016. 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.

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.

The council held £73.44m of investments as at 30 September 2016 (£58.3m at 31 March 2016), the average investments held for the six months to 30 September 2016 was £57.1m (£76.1m in the same period last year).

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

		Balance at 1-Apr-16	Invested	Matured	Transfer from Long Term to Short Term during 6 months	Balance at 30-Sep-16
Long Term						
Bank		3,000,000.00			(3,000,000.00)	-
		3,000,000.00			**(3,000,000.00)**	**-**
Short term						
Bank		10,000,000.00	13,000,000.00	(6,000,000.00)	3,000,000.00	20,000,000.00
Building Society		25,000,000.00	30,250,000.00	(14,250,000.00)		41,000,000.00
		35,000,000.00	**43,250,000.00**	**(20,250,000.00)**	**3,000,000.00**	**61,000,000.00**
Cash Equivalents						
Bank		10,000,000.00	50,540,000.00	(52,150,000.00)		8,390,000.00
Building Society		2,300,000.00	168,815,000.00	(167,065,000.00)		4,050,000.00
Local Authority		8,000,000.00		(8,000,000.00)		-
		20,300,000.00	**219,355,000.00**	**(227,215,000.00)**	**-**	**12,440,000.00**
		58,300,000.00	**262,605,000.00**	**(247,465,000.00)**	**-**	**73,440,000.00**

The council's investment return for the first six months of 2016/17 is £234,005 which is £115,993 lower the amount budgeted for the period of £349,998. This is partly due to the lowering of the Bank of England rate by 0.25% in June 2016 which caused all counterparties to decrease their rate of return (by more than the drop in BoE rate) – officers are investigating other forms of investment to improve this performance.

The council is part of a benchmarking group across Norfolk, Suffolk & Cambridgeshire; the table in Appendix 2 shows the performance of the council's investments compared to the other councils (whom have been made anonymous).

The Chief Finance Officer confirms that all investment transactions undertaken during the first six months of 2016/17 were within the approved limits in the annual investment strategy.

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

5. <u>Borrowing strategy</u>

The council's approved capital financing requirement (CFR) for 2016/17 is £279.265m The forecast year end position is a CFR of £239.162m 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 £216.869m and has utilised cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

Appendix 1 sets out predicted interest rates for the next two years. However, due to the overall financial position no new external borrowing has been undertaken in the year to date and nor is any new borrowing 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 1 April 2016**	**Actual 30 September 2016**
Long Term			
Public Works Loan Board	248,107	213,857	210,107
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	1,099	1,189	1,189
Total	**254,779**	**220,619**	**216,869**

6. Debt rescheduling

No debt rescheduling was undertaken during the first six months of 2016/17

7. Treasury management strategy statement and annual investment strategy update

The TMSS for 2016/17 was approved by this council on 23 February 2016 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 2016/17 £'000	**Original per TMSS**	**Revised**
Authorised Limit	294,779	260,989
Operational Boundary	254,779	225,845
Capital Financing Requirement	279,265	239,162

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 £13.317m 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.

8. <u>The council's capital position (prudential indicators) including a review of compliance with treasury and prudential limits</u>

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

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	2016/17	2016/17
£'000	Original	Revised
	Estimate	Estimate
Non-HRA	35,164	23,574
HRA	47,340	35,506
Total	**82,504**	**59,080**

Changes to the financing of the capital programme

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	2016/17	2016/17		
£'000	Original	Revised		
	Estimate	Estimate		
		GF	HRA	Total
Total spend	82,504	23,574	35,506	59,080
Financed by:				
Capital receipts	11,682	2,237	9,472	11,709
Capital grants	8,812	7,315	730	8,045
Capital reserves	2,423	210	840	1,050
Revenue	26,104	-	26,104	26,104
Total financing	49,021	9,762	37,146	46,908
Borrowing need	33,483	13,812	(1,640)	12,172

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

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	2016/17	2016/17
£'000	Original	Revised
	Estimate	Estimate
CFR – non housing	62,869	32,683
CFR – housing	216,396	206,480
Total CFR	279,265	239,162
Net movement in CFR		**(40,103)**

Prudential Indicator – External Debt / the Operational Boundary	2016/17	2016/17
£'000	Original	Revised Year End
	Estimate	Estimate
Borrowing	253,107	226,029
Other long term liabilities*	1,672	1,762
Total debt 31 March	**254,779**	**227,791**

* Includes on balance sheet finance leases

Limits to borrowing activity

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 2016/17 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	**2016/17**	**2016/17**
£'000	**Original**	**Revised**
	Estimate	**Estimate**
Gross borrowing	253,107	223,917
Plus other long term liabilities*	1,672	1,762
Gross borrowing	**254,779**	**225,679**
CFR* (year end position)	**279,265**	**239,162**

* *Includes on balance sheet finance leases*

The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

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	**2016/17**	**2016/17**
£'000	**Original**	**Revised**
	Estimate	**Estimate**
Borrowing	293,107	263,917
Other long term liabilities*	1,672	1,762
Total	**294,779**	**265,679**

* *Includes on balance sheet finance leases*

Appendix 1: Treasury Management Adviser's (Capita's) interest rate forecast

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

Appendix 2: Benchmarked Performance

The table below shows that the rate of return being achieved by the Council and the bench-marking group and details average risk and longest time to maturity. The figures in brackets are those at 31 March 2016. Where there is ‘n/a’ in the brackets this means that the members joined after 1 April 2016 so there are no 31 March 2016 figures.

Council	WARoR	WA Risk	WAM	WA Tot. time
Norwich	0.84% (0.85%)	6.3 (5.2)	126 (126)	281 (274)
A	0.84 % (1.07%)	2.9 (3.2)	203(240)	343 (503)
B	0.58% (0.60%)	2.2 (3.4)	71 (60)	105 (91)
C	0.56% (0.81%)	3.8 (4.1)	73 (205)	147 (326)
D	0.70% (0.90%)	3.5 (5.5)	136 (84)	253 (232)
E	0.83% (0.98%)	4.0 (5.4)	45 (41)	117 (261)
F	0.92% (0.92%)	5.8 (5.7)	194 (169)	293 (301)
G	0.85% (0.84%)	5.6 (5.7)	142 (179)	272 (267)
H	0.79% 0.84%)	5.6 (5.7)	108 (116)	239 (275)
I	0.76% (n/a)	5.0 (n/a)	166 (n/a)	268 (n/a)
J	0.56% (n/a)	5.0 (n/a)	54 (n/a)	160 (n/a)

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

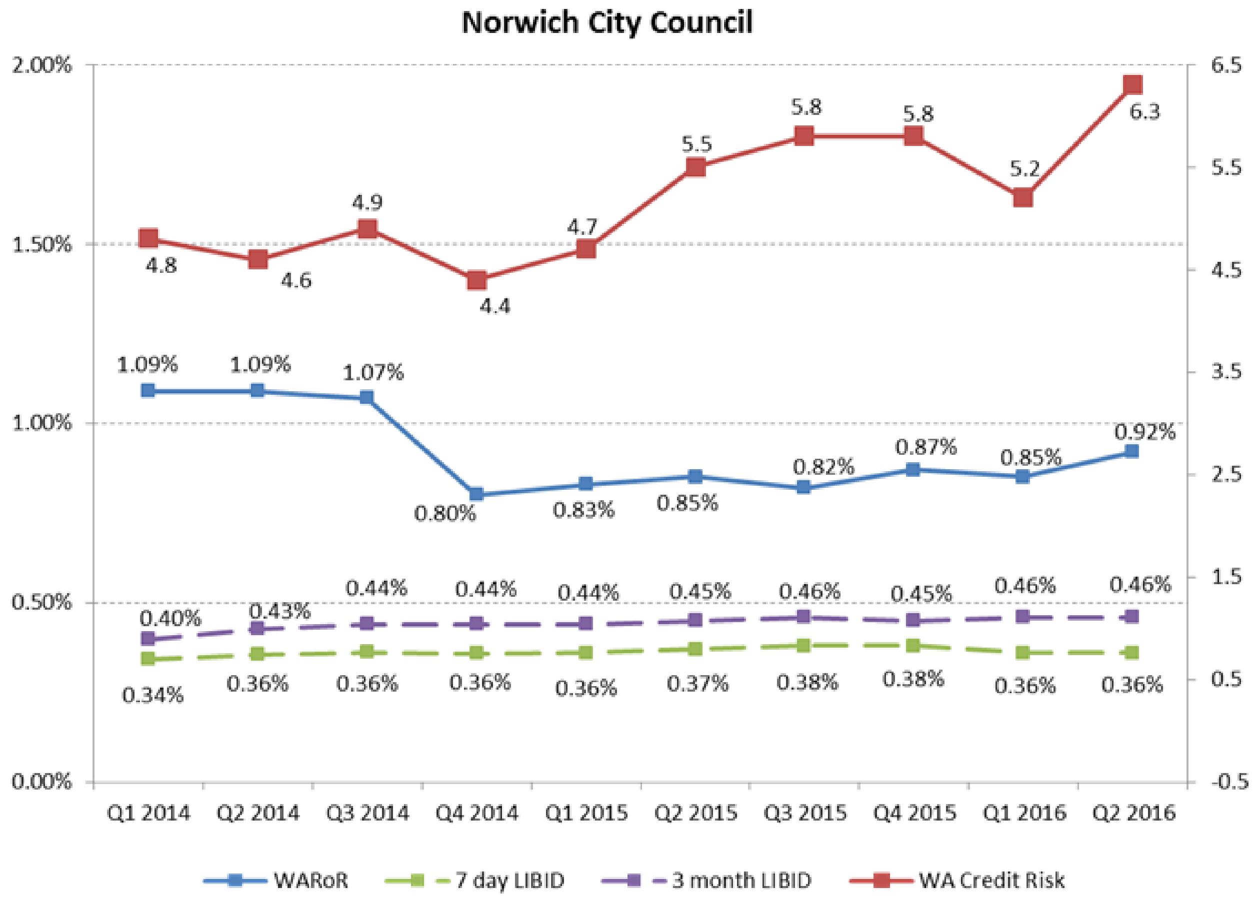
6 0 months

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

Comparison of Key Data



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:	14 December 2016
Head of service:	Justine Hartley
Report subject:	Treasury Management Mid year Review 2016-17
Date assessed:	29/11/2016
Description:	This report sets out the treasury management performance for the first six months of the financial year to 30 September 2016

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The report has no direct financial consequences however it does provide an update on the council's management of its borrowing and investment resources and how performance compares to the indicators approved in the treasury management strategy.
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	☒	☐	☐	

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
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