REPORT FOR DECISION

DECISION OF:	**CABINET** **OVERVIEW & SCRUTINY COMMITTEE** **COUNCIL**
DATE:	**26 NOVEMBER 2014** **9 DECEMBER 2014** **10 DECEMBER 2014**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY – MID YEAR REVIEW 2014/15**
REPORT FROM:	**LEADER OF THE COUNCIL &CABINET MEMBER FOR FINANCE**
CONTACT OFFICER:	**STEPHEN KENYON, ASSISTANT DIRECTOR OF RESOURCES (FINANCE AND EFFICIENCY)**
TYPE OF DECISION:	**COUNCIL**
FREEDOM OF INFORMATION/STATUS:	The report is within the public domain
SUMMARY:	This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following: • An economic update for the 2014/15 financial year to 30 September 2014 • A review of the Treasury Management Strategy Statement and Annual Investment Strategy • The Council's capital expenditure (prudential indicators) • A review of the Council's investment portfolio for 2014/15 • A review of the Council's borrowing strategy for 2014/15 • A review of any debt rescheduling undertaken during 2014/15 • A review of compliance with Treasury and Prudential Limits for 2014/15

OPTIONS & RECOMMENDED OPTION	It is recommended that, in accordance with CIPFA's Code of Practice on Treasury Management, the report be noted. That the Counterparty investment limit for Barclays be increased from £10m to £15m to reflect that Barclays will be the Authority's main banker from 2015.

IMPLICATIONS:	
Corporate Aims/Policy Framework:	Do the proposals accord with the Policy Framework? Yes
Statement by the S151 Officer: **Financial Implications and Risk Considerations:**	Treasury Management is an integral part of the Council's financial framework and it is essential that the correct strategy is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.
Statement by Executive Director of Resources and Regulation:	There are no additional resource implications. Treasury management activities so far have produced a projected underspending for the year of £0.5m. This will help to support other areas of the Council's budget that are under pressure from user demand or economic conditions.
Equality/Diversity implications:	No
Considered by Monitoring Officer:	Yes
Wards Affected:	All
Scrutiny Interest:	Overview & Scrutiny Committee

TRACKING/PROCESS **DIRECTOR: STEVE KENYON**

Chief Executive/ Strategic Leadership Team	Cabinet Member/Chair	Ward Members	Partners
Yes	Yes	N/a	N/a
Scrutiny Commission		Committee	Council
Overview & Scrutiny Committee			

1.0 BACKGROUND

1.1 The Council operates a balanced budget, which broadly means that cash raised during the year will meet 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 optimising 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 that the Council can meet its capital spending obligations. 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".

1.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was adopted by this Council on 24 February 2010*.*

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 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 (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.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is: Overview & Scrutiny Committee.

1.3 This report fulfils the requirement to produce a mid-year review.

2.0 ECONOMIC UP-DATE (from Treasury Advisors)

2.1 Economic Performance to date

2.1.1 After 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 growth will continue through 2014 and into 2015. The manufacturing sector has also seen growth though the latest figures indicate a weakening in the future trend rate of growth. For any recovery to become more balanced and sustainable in the longer term, it 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.

2.1.2 Growth has resulted in unemployment falling 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. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still continue, in 2015 and 2016.

2.1.3 There has been a fall in inflation (CPI), reaching 1.5% in May and July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 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 Q1 or 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.

2.1.4 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.

2.1.5 First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded in Q2 to 4.6% (annualised). The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions

2.1.6 The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt). Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

2.1.7 Japan is causing considerable concern as the increase in sales tax in April has suppressed consumer expenditure and growth. In Q2 growth was -1.8% q/q and -7.1% over the previous year. The Government is hoping that this is a temporary blip. As for China, Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has raised fresh concerns. There are also major concerns as to the creditworthiness of much bank lending to corporates and local government during the post 2008 credit expansion period and whether the bursting of a bubble in housing prices is drawing nearer.

2.2 Interest rate Forecasts and Outlook

2.2.1 The Council's treasury advisor, Capita Asset Services, has provided the following 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%

Capita Asset Services undertook a review of its interest rate forecasts on 24th October. During September and October, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, plus fears around Ebola, and an accumulation of dismal growth news in most of the ten largest economies of the world and on the growing risk of deflation in the Eurozone, had caused 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. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2015.

2.2.2 PWLB forecasts are based around a balance of risks. However, there are potential upside risks, especially for longer term PWLB rates, as follows: -

- Further investor confidence that robust world economic growth is 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.

2.2.3 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 economic growth is currently dependent on consumer spending and the 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 partners - the EU and US, 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.
- Recapitalising 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 that the reluctance of western economies 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), 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 of the same environment which led to the 2008 financial crisis.

3.0 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UP-DATE

The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by the Council on 19 February 2014.

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.

4.0 THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

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.

4.1 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	**2014/15 Original Estimate £m**	**2014/15 Revised Estimate £m**
Non-HRA	12.270	15.937
HRA	12.014	13.816
Total	**24.284**	**29.753**

The increase of the revised estimate over the original estimate is due to slippage from 2013/14 of £16.126m offset by estimated project reprofiling to 2015/16 of £10.655m

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

The table shows the Capital Financing Requirement, 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.

	2014/15 Original Estimate £m	2014/15 Revised Estimate £m
Prudential Indicator - Capital Financing Requirement		
CFR – non HRA	125.551	125.104
CFR – HRA existing	40.531	40.531
Housing Reform Settlement	78.253	78.253
Total CFR	**244.335**	**243.888**
Prudential Indicator - External Debt / the Operational Boundary		
Borrowing	244.300	243.900
Other long term liabilities	7.000	7.000
Total	**251.300**	**250.900**

4.3 Limits to Borrowing Activity

4.3.1 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. Gross 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.

4.3.2 The Assistant Director of Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

4.3.3 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	2014/15 Original Indicator £m	2014/15 Revised Indicator £m
Borrowing	279.300	278.900
Other long term liabilities	7.000	7.000
Total	**286.300**	**285.900**

5.0 INVESTMENT PORTFOLIO 2014/15

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 and in line with the 0.5% Bank Rate. Indeed, the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the 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 £59.1m of investments as at 30 September 2014 (£45.0m at 31 March 2014) and the investment portfolio yield for the first six months of the year is 0.62% against Capita's suggested investment earnings rate for returns on investments placed, for periods up to three months in 2014/15, of 0.42%.

5.3 The investments held as at 30 September were:-

Type of Investment	£ Million
Call Investments (Cash equivalents)	12.8
Fixed Investments (Short term investments)	46.3
Total	**59.1**

5.4 The Assistant Director of Resources confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2014/15.

5.5 The Council's budgeted investment return for 2014/15 is £0.5m, and performance for the year to date is in line with the budget.

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

5.7 The Council is currently changing it's transactional banking from the Co-operative Bank to Barclays Bank. The Council's current counterparty investment limit for Barclays is £10m. It is requested that this be increased to £15m to reflect that Barclays will now be the Authority's main banker. This is purely a precautionary measure, as overnight balances will be cleared as near to nil as possible.

5.8 The Cabinet have recently approved a "Property Investment Strategy" which aims to increase investment income by investing in property rather than investing with financial institutions where returns are low at present. Additional borrowing may need to be undertaken to finance property acquisitions; each investment will be subject to a robust business case and also non-financial factors (e.g. ethical stance) will be considered.

6.0 BORROWING

6.1 The Council's capital financing requirement (CFR) for 2014/15 is £242.9m. 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 £210.9m and has utilised £32m of cash flow funds in lieu of borrowing. 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 prevail.

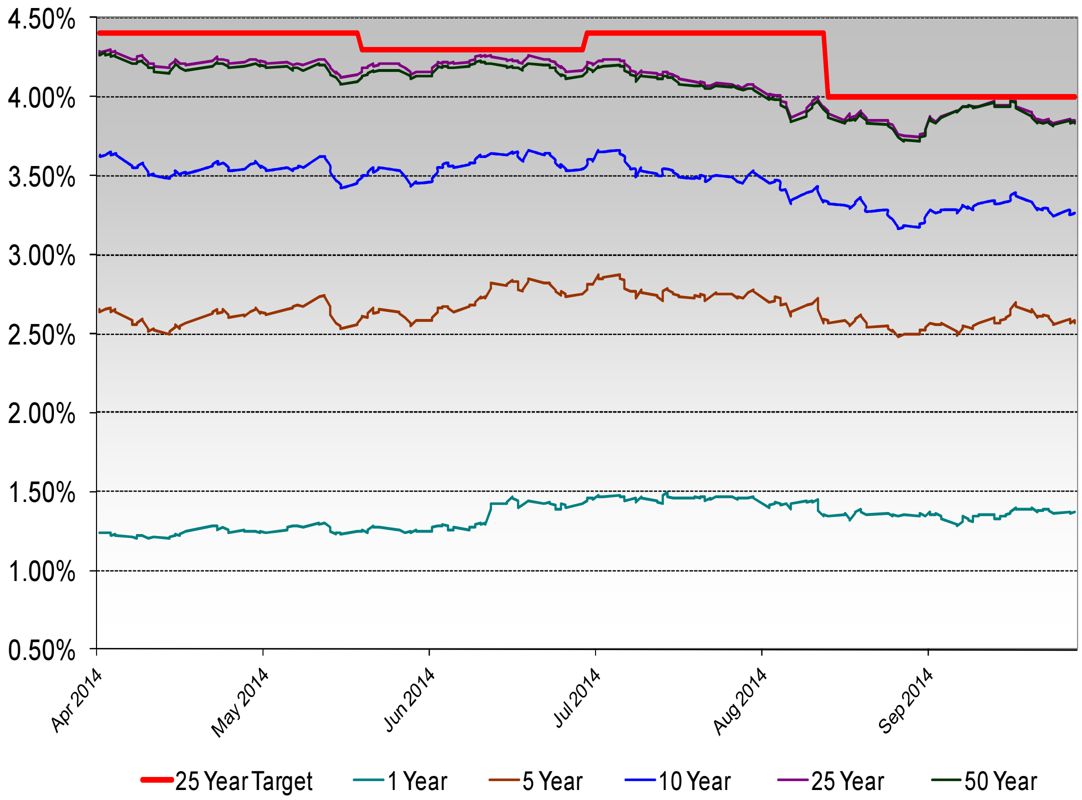
		30th Sept 2014		
		Principal		Avg.
		£000	£000	Rate
Fixed rate funding				
	PWLB Bury	146,362		
	PWLB Airport	4,078		
	Market Bury	57,500	207,940	
Variable rate funding				
	PWLB Bury	0		
	Market Bury	0	0	
Temporary Loans / Bonds		3,003	3,003	
Total Debt			**210,943**	**3.96%**
Total Investments			**59,100**	**0.62%**

6.2 Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR), new temporary external borrowing of £3m was undertaken from the market:

Lender	Rate	Amount	Start Date	End Date
Police Authority	0.40	3m	07/07/2014	31/03/2015

It is anticipated that no further borrowing will be undertaken during this financial year.

6.3 The graph below shows the movement in PWLB certainty rates for the first six months of the year to 30.09.14:



7.0 DEBT RESCHEDULING

7.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2014/15.

Councillor Mike Connolly
Leader of the Council and Cabinet Member for Finance

List of Background Papers:-

None

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