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REPORT OF:	BILL PALLETT
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TO:	EXECUTIVE
DATE:	12 November 2015
EXECUTIVE MEMBER:	COUNCILLOR G. KNIGHT

KEY DECISION REQUIRED:	NO
WARD (S) AFFECTED:	ALL

SUBJECT:	**HALF YEARLY TREASURY MANAGEMENT REPORT FOR 2015/16**

RECOMMENDATIONS:

Note the Treasury Management Performance for the year to date and the prudential indicators.

REASONS FOR RECOMMENDATIONS:

To comply with the requirements of the regulatory framework for treasury management and meet the Council's reporting requirements.

EXECUTIVE SUMMARY:

The 2015/16 treasury management performance is currently forecast as a net under-recovery of £32,000. This is due to continuing low interest rates and has been partially offset by operational underspends.

The update of the capital programme has not resulted in any changes to the Prudential Indicators, Investment Strategy, Borrowing Strategy or Cash Management Strategy at this time.

The above recommendations are subject to approval by Full Council.

STATUTORY POWERS

1. The Council operates its Treasury Management activity as an integral part of its statutory obligation to effectively manage the Council's finances under the Local Government Act 2003 and associated regulations.
2. The Council's Treasury Management activities are undertaken in accordance with Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management and the Prudential Code for Capital Finance in Local Authorities, and the Government's Investment Regulations.

3. Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid year treasury review, in addition to the Annual Treasury Strategy and Annual Report on Treasury Management Activity required previously.

4. This report meets that requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the Capital Expenditure Plans and the Council's Prudential Indicators.

BACKGROUND

5. The Treasury Management Strategy and PI's were previously reported to the Executive on 29 January 2015.

KEY INFORMATION

Issues

6. The underlying economic environment continues to remain challenging for the Council, particularly in relation to investment counterparty risk (ie which institutions it is "safe" to invest with.) This has led to an approach of maintaining short-term investments with high quality counterparties. The consequences of this approach are that investments are limited to a small group of banks and building societies. The returns on investment continue to be low, though we have taken advantage of a 2 year deal with one of the highest rated banks which will provide a small pick up on this.

Current Treasury Position

7. The following shows the Council's net investment position as at 30 September 2015 and its projected position at 31 March 2016.

	Actual as at 31/3/15 £000	**Average Rate %**	**Current Position as at 30/9/15 £000**	**Estimated Position as at 31/3/16 £000**	**Anticipated Average Rate %**
Fixed Rate Borrowings	**0**	**0**	**0**	**0**	**0**
Variable Rate Borrowings	**0**	**0**	**0**	**0**	**0**
TOTAL BORROWINGS	**0**	**0**	**0**	**0**	**0**
Fixed rate Investments	**(48,000)**	**0.89**	**(48,000)**	**(48,000)**	**1.01**
Variable rate Investments	**0**	**0**	**0**	**0**	**0**
TOTAL INVESTMENTS	**(48,000)**	**0.89**	**(48,000)**	**(48,000)**	**1.01**
Net Investments	**(48,000)**		**(48,000)**	**(48,000)**	

8. It is anticipated that minor borrowing may be needed at the end of the financial year due to cash flow requirements.

9. The following table shows the projected earnings against the treasury budget at 30 September 2015. This shows a projected net under-recovery of £32,000.

Activity	Projection as at 30/9/15 £000	Budget 2015/16 £000	Variance Projected at 31/03/16 £000
Cash Managers – Investment Returns	(433)	(513)	80
Bank Deposit returns	(22)	(18)	(4)
Temporary Lending – Cash Flow Activity	(50)	(30)	(20)
Bank Charges, Borrowing Costs & Operarional Costs	74	98	(24)
Net Interest	(431)	(463)	32

Conditions and Expected Movements in Interest Rates

10. A detailed commentary of the economy and interest rates, as provided by Capita (our treasury advisers), can be found in Annex 1 to this report.

Investment Strategy

11. No changes are proposed to the 2015/16 Investment Strategy. The Investment Strategy for 2016/17 will be reviewed in a separate report later in the year.

Borrowing Strategy

12. The Borrowing Strategy Remains unchanged.

Cash Management Strategy

13. The Cash Management Strategy sets out the Council’s approach to the effective management of the processes handling the inflows and outflows of cash within the Council. Work continues in this area to ensure the efficiency and productivity of these systems and processes.

Prudential Indicators

14. The relevant Prudential Indicators are set out in each of the individual strategy documents. An update on the performance against these indicators is provided below.

15. **Capital Programme –** The Capital Programme has been revised to take account of carry forwards and reprofiling of projects to reflect updated expectations. The following table shows these revisions for 2015/16.

Capital Expenditure	2015/16 Original Budget £000	2015/16 Revised Budget £000	2016/17 Budget £000	2017/18 Budget £000
Waste Management & Recycling Improvements	570	570	20	20
Environment	76	81	104	104
Capital Grants	630	661	630	630
Regeneration	5,380	10,733	3,414	145
Leisure & Culture	2,727	5,257	522	356
Strategic Property	3,508	2,762	5038	563
Organisational Change	0	53	70	0
Rolling Programmes	563	1,153	992	871
Total Capital Programme	**13,454**	**21,270**	**10,790**	**2,689**

16. **Capital Financing –** The table below shows the Capital Financing for the revised programme.

Capital Financing	2015/16 Original	2015/16 Revised	2016/17 Budget	2017/18 Budget
Total Capital Expenditure	**13,454**	**21,270**	**10,790**	**2,689**
Capital Receipts Reserve	7,627	13,836	9,213	1,739
Capital Grants	4,344	4,412	882	404
CIL / S106	1,379	2,418	195	46
New Homes Bonus	104	104	0	0
Contributions from Revenue	0	500	500	500
Total Financing	**13,454**	**21,270**	**10,790**	**2,689**
Borrowing Need (or Capital Financing Requirement)	**0**	**0**	**0**	**0**
Net Investments (see table in paragraph 7)	**(48,000)**	**(48,000)**	**(39,000)**	**(37,500)**

17. **Capital Financing Requirement –** It is not anticipated that there will be any need to undertake long term borrowing in 2015/16, which will result in a Capital Financing Requirement (CFR) of zero. In addition, there will be no requirement to make a Minimum Revenue Provision (MRP) toward the repayment of borrowing in 2015/16.

18. There is also a requirement to ensure that total borrowing, net of any investments, does not, except in the short-term, exceed the total of the CFR for 2015/16 and the next 2 years. Since projected investment levels are greater than projected borrowing levels the Council complies with this.

19. **Borrowing Limits –** The Council sets limits on borrowing activity. These remain unchanged from the Treasury Strategy 2015/16 which revised the limits to take into account the potential for longer-term borrowing in the future.

	2014/15 Actual £000	2015/16 Proposed £000	2016/17 Budget £000	2017/18 Budget £000
Authorised Limit for External Debt	25,000	35,000	35,000	35,000
Operational Boundary for External Debt	15,000	25,000	25,000	25,000
Upper limit for fixed rate exposure	100%	100%	100%	100%
Upper limit for variable rate exposure	0%	0%	0%	0%

OPTIONS

20. The Executive has two options open to it.

    Option 1 – accept and note the contents of the report.

    Option 2 – accept the report, but ask Officers to provide more detail on some specific issues contained in the report.

21. The Executive is asked to approve Option 1.

LEGAL IMPLICATIONS

22. There are no direct legal implications arising from this report.

FINANCIAL IMPLICATIONS

23. There are no direct financial implications arising from this report.
24. The implications arising from treasury management activity have been taken into account in the budget and are reported through regular financial monitoring.

EQUALITIES IMPLICATIONS

25. There are no equality issues that need to be considered as part of this report.

CONSULTATION

26. There is no consultation required in this report. However this report will act as a starting point for discussions, later in the year, with the Treasury Member Panel regarding the Treasury Strategy 2016/17.

POLICY FRAMEWORK

27. This report is submitted in accordance with the Council's Treasury Management Policy.

Background Papers:

None.

Economic Background

- UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, possibly being equal to that of the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y). 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 and 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. However, the Purchasing Manager's Index, (PMI), for services issued on 5 October would indicate an even lower growth rate of around +0.3%, in quarter 4, which would be the lowest growth rate since the end of 2012.
- Despite these headwinds, the Bank of England August Inflation Report had included a forecast for 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 at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth. Since then, worldwide economic statistics have been distinctly weak so it would not be a surprise if the next Inflation Report in November were to cut those forecasts.
- 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 rejoin 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.
- There are therefore 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.
- The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015. While there had been confident expectations during the summer that

the Fed. could start increasing rates at its meeting on 17 September, or if not by the end of 2015, the recent downbeat news about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision to pull back from making that start. The nonfarm payrolls figures for September and revised August, issued on 2 October, were disappointingly weak and confirmed concerns that US growth is likely to weaken. This has pushed back expectations of a first rate increase from 2015 to 2016. However, there are increasing concerns, both in the US and UK, that the growth rates currently being achieved are only being achieved with monetary policy being highly aggressive with central rates at near zero and huge QE in place. This is causing an increasing debate as to how realistic it will be for central banks to start on reversing such aggressive monetary policy until such time as strong growth rates are more firmly established and confidence increases that inflation is going to get back to around 2% within a 2-3 year time horizon. In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Interest Rate Forecast

The Council's treasury advisor, Capita Asset Services, has provided the following 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%
5yr PWLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

Capita Asset Services undertook a review of its interest rate forecasts on 11 August after the August Bank of England Inflation Report. This latest forecast includes no change in the timing of the first increase in Bank Rate as being quarter 2 of 2016. With CPI inflation now likely to be at or near zero for most of 2015, it is difficult for the MPC to make a start on increasing Bank Rate when the Inflation Report forecast was also notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. Despite average weekly earnings ticking up to 2.9% y/y in the three months ending in July, (as announced in mid-September), this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate soon as labour productivity growth meant that net labour unit costs are still only rising by about 1% y/y. The significant appreciation of Sterling against the Euro in 2015 has also acted as a dampening to UK growth while sharp volatility in financial markets since the Inflation Report has depressed equity prices, raised bond prices and lowered bond yields (and PWLB rates).

The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only just starting a significant recovery as a result of recent increases in the rate of wage inflation, though some consumers will not have seen that benefit come through for them.