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Crawley Borough Council

Report to Overview and Scrutiny Commission
28 November 2016

Report to Cabinet
30 November 2016

Treasury Management Mid-Year Review 2016/2017

Report of the Head of Finance, Revenues and Benefits, **FIN/396**

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1. Purpose

1.1 This report provides an update on the Council's Treasury Management Strategy for the two first quarters of 2016/2017

2. Recommendations

2.1 To the Overview and Scrutiny Commission:

That the Commission consider the report and decide what comments, if any, it wishes to submit to the Cabinet.

2.2 To the Cabinet

That the Cabinet is recommended to:

a) note the report and the treasury activity for the first two quarters of 2016/2017;
b) recommend to Council the approval of an amendment to the Council's Annual Investment Strategy to include additional investment types to the investment strategy (see sections 5.2 – 5.4)
c) note the breach of investment limits (see section 7.3)

3. Reasons for the Recommendations

3.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, annual and midyear reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

4. Interest rate forecasts

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

4.2 Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% in November this year and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later. Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

4.3 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. However, we have been experiencing exceptional levels of volatility in financial markets which have caused significant swings in PWLB rates. Our PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

5. Annual Investment Strategy

5.1 The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by this Council on 24 February 2016. It sets out the Council's investment priorities as being:

- Security of capital
- Liquidity; and
- Yield.

5.2 It is proposed to amend the Council's Annual Investment Strategy. Cabinet is requested to recommend to Council that the following investments are appended to the 2016/17 Annual Investment Strategy:

	Colour (and long term rating where applicable)	Money Limit	Time Limit
Repurchase agreements	AA	£5m	5 yrs
Housing Associations	AA-	£2m	1 yrs

5.3 Repurchase agreements (repos) are a form of secured lending. A detailed explanation of repos can be found in Appendix 4.

5.4 Loans to Housing Associations can provide a significant pick up in yield when compared to loans to local authorities.

6. Compliance with Treasury and Prudential Limits

6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved TMSS.

6.2 During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 3.

7. Investment Portfolio 2016/17

7.1 The Council held £126.5m of investments as at 30 September 2016 (£118.0m at 31 March 2016).

Investments	31 March 2016 £'000	30 September 2016 £'000	Rate/ Return	Average Life yrs
Local Authorities	32,000	39,000	1.02%	1.10
UK Banks	22,041	17,168	0.79%	0.26
UK Building Societies	9,000	5,500	0.68%	0.36
Money Market Funds	2,340	4,135	0.37%	0.00
Supranational	3,082	-	-	-
Overseas Banks	43,651	52,278	0.69%	0.44
Corporate Bonds	5,849	8,434	1.08%	0.46
Total	**117,963**	**126,515**	**0.91%**	**0.59**

A full list of investments held as at 30th September 2016 is in appendix 2.

7.2 In addition to the treasury investments in 7.1 above, the Council also has £14.12m invested in Investment Properties. These investments are deemed capital expenditure, and as such are an application (spending) of capital resources. As such, these investments are not included in the treasury management indicators, but have been included in the list of investments in appendix 2. There is a further budget of £5.0m to purchase additional investment properties.

7.3 Breach of approved limits
On 9 August 2016, an investment of £2m was placed with Nationwide Building Society for 364 days. The limit in place at the time was 6 months. The error occurred because the credit list was not referred to when placing the deal. The treasury team have been reminded that the correct procedure is to refer to the credit list before accepting an investment. The Head of Finance, Revenues and Benefits considers that the risk to Council is minimal.

7.4 The Head of Finance, Revenues and Benefits confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2016/17 apart from as described in 7.3 above.

7.5 Investment performance for the financial year to date as at 30 September 2016:

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day LIBID + 0.2%	0.48%	0.90%	£561,701

The performance above is the return achieved for the quarter. This is different from the table in 7.1 as this shows the average rate on the investments actually held on 30 September.

8. Borrowing

8.1 The Council borrowed £260.325m in March 2012 for HRA self-financing. The average borrowing rate is 3.19%. There has been no requirement for further borrowing in 2016/2017.

9. Implications

9.1 The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these. There are no other legal implications arising in this report.

9.2 The financial implications are addressed throughout this report.

9.3 Risks are highlighted throughout this report, but appendix 1 addresses risks in the interest rate forecast, and appendix 3 addresses the risk to security, liquidity and yield of the Council's investment strategy.

10. Background Papers

Treasury Management Strategy for 2016/2017 – Cabinet, 10 February 2016 [report FIN/381 refers]
Quarterly Budget Monitoring 2016/2017 Quarter 2 – Cabinet, 30 November 2016 [report FIN/395 refers]
Budget and Council Tax for 2016/17 - Cabinet, 10 February 2016 [report FIN/380 refers]
"Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes", 2011 Edition - Chartered Institute of Public Finance and Accountancy
"The Prudential Code for Capital Finance in Local Authorities", 2011 Edition - Chartered Institute of Public Finance and Accountancy
DCLG Guidance on Local Government Investments (Second Edition)

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APPENDIX 1

Economic background

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year 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. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on November 23.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the MPC is expected to look through a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but slowed to +0.3% (+1.6% y/y) in quarter 2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

Japan is still bogged down in anaemic growth and making little progress on fundamental reform of the economy while Chinese economic growth has been weakening and medium term risks have been increasing.

Detailed holdings at 30 September 2016

APPENDIX 2

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
AUSTRALIA BANKS									
Commonwealth Bank of Australia	2364	01/06/2016	24/05/2017	236	0.985%	5.000	5.000	10.000	AA-
National Australia Bank Ltd	53	02/08/2016	13/01/2017	105	0.645%	5.005	5.005	10.000	AA-
UK BANKS									
Abbey National Treasury	30	04/10/2011	04/10/2016	4	3.300%	2.000	2.000	10.000	A
Goldman Sachs International Bank	2359	25/04/2016	25/10/2016	25	0.780%	2.000			
	2365	02/06/2016	02/12/2016	63	0.765%	2.000			
	2384	01/09/2016	01/03/2017	152	0.605%	2.000	6.000	10.000	A
Lloyds Bank plc	20		01/10/2016	1	0.150%	0.168	0.168	10.000	A
The Royal Bank of Scotland plc	32	27/03/2012	27/03/2017	178	1.376%	5.000	5.000	15.000	BBB+
Sumitomo Mitsui Banking Corporation	2363	25/05/2016	25/11/2016	56	0.720%	4.000	4.000	10.000	A
UK BUILDING SOCIETIES									
Nationwide BS	2358	15/04/2016	17/10/2016	17	0.710%	2.000			
	2362	12/05/2016	14/11/2016	45	0.710%	1.500			
	2379	09/08/2016	08/08/2017	312	0.620%	2.000	5.500	10.000	A
CANADA BANKS									
Toronto Dominion Bank	2337	03/12/2015	01/12/2016	62	0.950%	3.000			
	2381	16/08/2016	16/05/2017	228	0.580%	2.000	5.000	10.000	AA-
CORPORATE BONDS									
Daimler AG	2345	12/01/2016	02/12/2016	63	1.015%	1.914	1.914	2.000	A-
Deutsche Bahn Finance BV	54	11/08/2016	30/10/2017	395	0.389%	1.792	1.792	2.000	AA
Municipality Finance plc	52	04/12/2015	15/12/2016	76	0.801%	2.009	2.009	5.000	AA+
National Grid Gas plc	2376	06/07/2016	07/06/2017	250	0.759%	1.216	1.216	2.000	A-
Places For People Capital Markets	48	15/06/2015	27/12/2016	88	1.402%	0.891			
	2380	16/08/2016	27/12/2016	88	1.228%	0.612	1.503	2.000	A
FRANCE BANKS									
BNP Paribas	2367	17/06/2016	07/12/2016	68	0.875%	1.102	1.102	10.000	A
Credit Industriel et Commercial	2366	15/06/2016	15/12/2016	76	0.710%	2.000			
	2383	31/08/2016	28/02/2017	151	0.490%	2.000	4.000	10.000	A
GERMANY BANKS									
Landesbank Hessen-Thueringen Giroze	2330	02/11/2015	01/11/2016	32	1.020%	3.000			
	2378	01/08/2016	31/07/2017	304	0.600%	2.000	5.000	10.000	A

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
LOCAL AUTHORITIES									
Dundee City Council	2357	16/03/2016	16/12/2016	77	0.600%	2.000	2.000	15.000	AA
East Dunbartonshire Council	2335	26/11/2015	24/11/2016	55	0.600%	1.000	1.000	15.000	AA
Fife Council	2348	01/03/2016	03/01/2017	95	0.600%	5.000	5.000	15.000	AA
Kingston-Upon-Hull City Council	36	02/12/2013	02/12/2021	1889	2.750%	5.000	5.000	15.000	AA
Moray Council	2369	04/07/2016	06/01/2017	98	0.480%	2.000	2.000	15.000	AA
North Tyneside MDC	2338	15/12/2015	13/12/2016	74	0.700%	3.000	3.000	15.000	AA
Peterborough City Council	33	11/03/2013	12/03/2018	528	1.750%	4.000	4.000	15.000	AA
City of Salford MDC	2347	10/03/2016	09/03/2017	160	0.650%	2.000			
	2354	11/04/2016	10/04/2017	192	0.650%	2.000			
	2387	27/09/2016	27/03/2017	178	0.350%	1.000	5.000	15.000	AA
Staffordshire Moorlands District Co	42	03/11/2014	03/11/2017	399	1.600%	2.000	2.000	15.000	AA
Thurrock Borough Council	2368	01/07/2016	06/01/2017	98	0.480%	2.000			
	2371	01/07/2016	01/11/2016	32	0.480%	3.000	5.000	15.000	AA
West Dunbartonshire Council	2353	19/04/2016	18/04/2017	200	0.550%	5.000	5.000	15.000	AA
MONEY MARKET FUNDS									
Standard Life Investments LF	4		01/10/2016	1	0.370%	3.985	3.985	6.000	AAA
Federated Prime Rate Cash Man	1		01/10/2016	1	0.368%	0.150	0.150	6.000	AAA
NETHERLANDS BANKS									
ING Bank NV	2377	13/07/2016	23/12/2016	84	0.665%	1.389	1.389	10.000	A
Rabobank Group	2327	15/10/2015	13/10/2016	13	0.730%	3.000			
	2356	10/03/2016	12/12/2016	73	0.740%	2.000	5.000	10.000	A+
SINGAPORE BANKS									
DBS Bank Ltd	2382	26/08/2016	26/05/2017	238	0.450%	5.000	5.000	10.000	AA-
United Overseas Bank Ltd	2360	05/05/2016	07/11/2016	38	0.600%	1.500			
	2375	20/07/2016	20/01/2017	112	0.530%	2.500	4.000	10.000	AA-
SWEDEN BANKS									
Svenska Handelsbanken	17		01/10/2016	1	0.100%	0.010			
	55	12/08/2016	29/08/2017	333	0.554%	0.760			
	56	15/08/2016	29/08/2017	333	0.612%	1.012			
	2370	01/07/2016	03/01/2017	95	0.600%	3.000	4.783	10.000	AA-
Skandinaviska Enskilda Banken	2385	08/09/2016	07/09/2017	342	0.510%	2.000	2.000	10.000	A+
SWITZERLAND BANKS									
UBS AG	2373	05/07/2016	04/07/2017	277	0.685%	3.000			

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
	2386	12/09/2016	11/09/2017	346	0.700%	2.000	5.000	10.000	A+
				--------------			--------------		
				220			**126.514**		
				--------------			--------------		
Investment Properties							14.124		

							140.638		

Prudential and Treasury Indicators as at 30th September 2016 APPENDIX 3

Treasury Indicators	2016/17 Strategy £'000	30 September Actual £'000
Authorised limit for external debt	270,325	260,325
Operational boundary for external debt	260,325	260,325
Investments	96,379	126,514

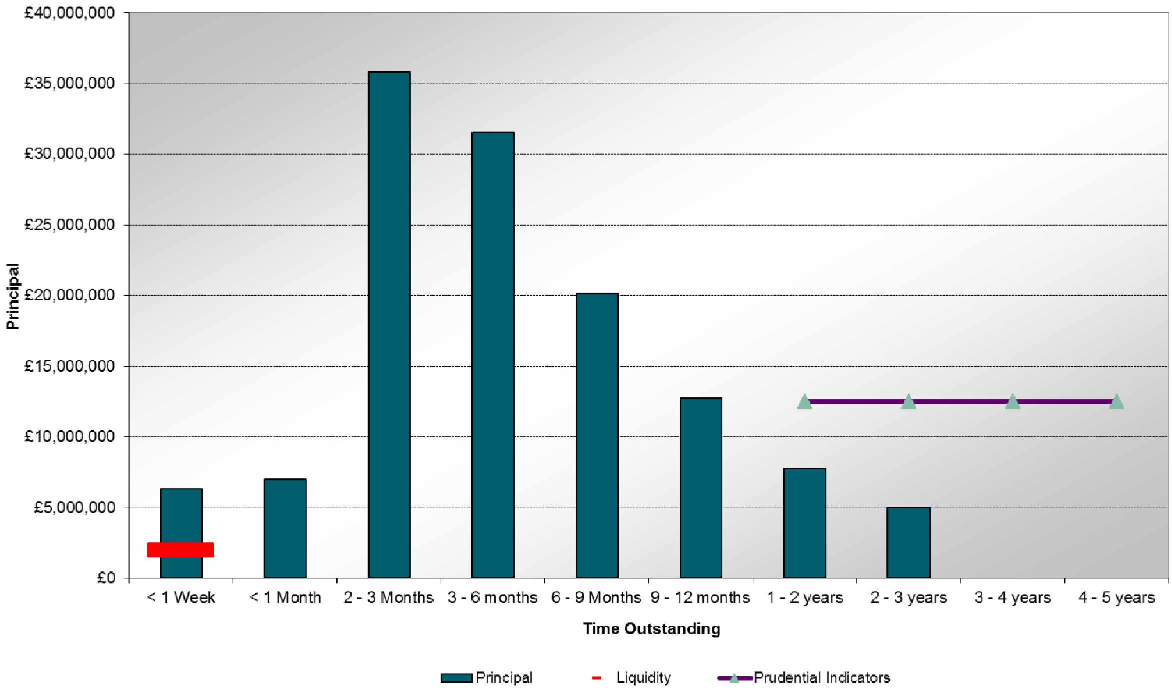
Maturity structure of fixed rate borrowing - upper and lower limits:		
Under 12 months	0% - 10%	0%
12 months to 2 years	0% - 10%	0%
2 years to 5 years	0% - 10%	0%
5 years to 10 years	0% - 20%	18.8%
10 years to 20 years	0% - 80%	68.0%
20 years to 30 years	0% - 25%	13.2%
30 years to 40 years	0% - 10%	0%
40 years to 50 years	0% - 10%	0%

Upper limit of fixed interest rates based on:		
- Debt only	270,325	260,325
- Investments only	140,000	117,201
Upper limit of variable interest rates based on:		
- Debt only	10,000	0
- Investments only	40,000	9,313

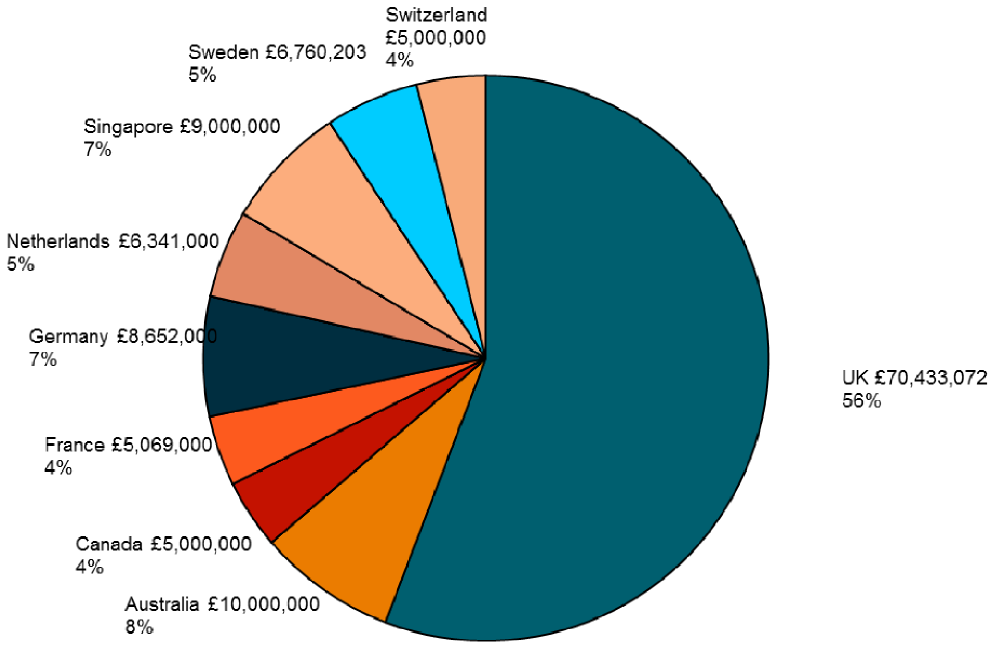
Weighted average life of investments	Avg. 1.20 years Max 1.50 years	0.60
Short term deposits (<1 week's notice)	2,000	16,390
Upper limit for principal sums invested over 364 days	50,000	18,922

Prudential Indicators	2016/17 Strategy £'000	Quarter 2 Forecast £'000
General Fund		
Capital expenditure	23,751	18,810
Capital Financing Requirement (CFR)	(207)	0
Annual change in CFR	0	0
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	-7.50%	-6.73%
HRA		
Capital expenditure	35,837	15,933
Capital Financing Requirement (CFR)	260,147	260,325
Annual change in CFR	0	0
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	17.39%	17.35%
Incremental impact of capital investment decisions:-		
a) Increase in council tax (band change) per annum.	Nil	Nil
b) Increase in average housing rent per week.	Nil	Nil

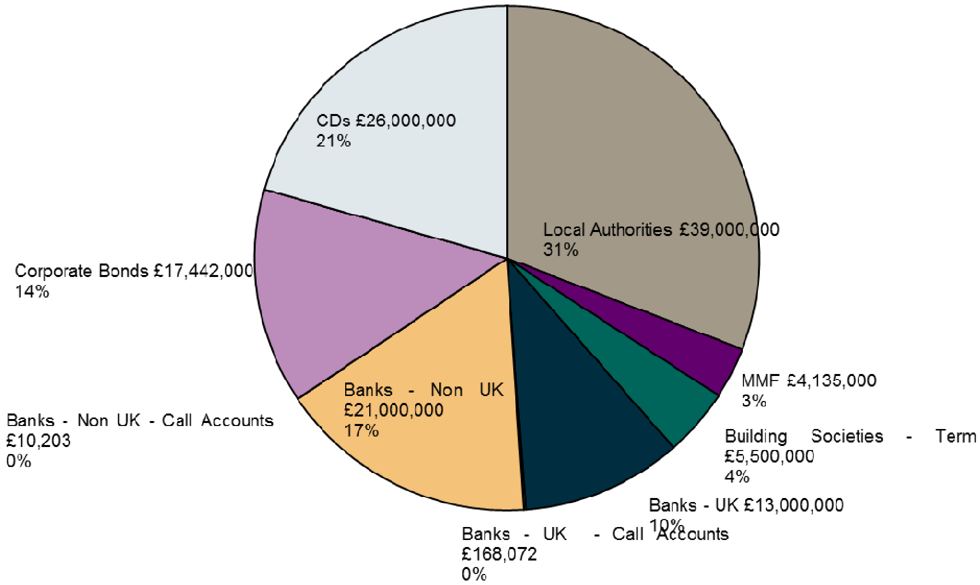
Compliance with Liquidity and Prudential Indicator Limits



Country Limits



Sector Diversification



APPENDIX 4

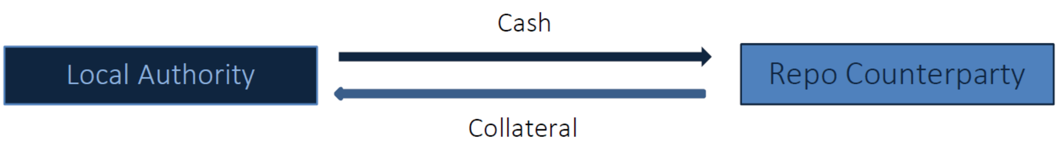
Re-purchase agreements

A re-purchase agreement (Repo) is the sale and re-purchase of securities traded simultaneously – this is an agreement to sell securities and buy them back at a later date at a specified price. The difference between the sale price and re-purchase price is the interest accrued on the cash proceeds – or repo interest. The seller is effectively, using their securities as collateral to borrow cash at a specified rate over a period of time. The buyer of securities is acting as a lender – lending cash and receiving the securities as collateral. The re-purchase price should always be higher than the original sale price.

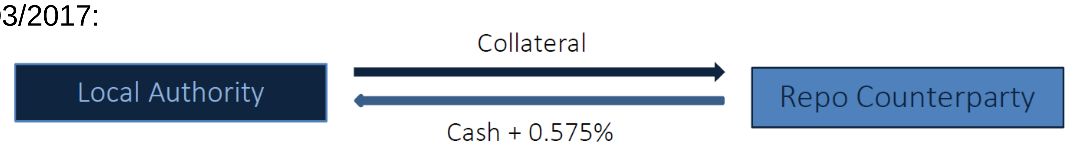
Government bonds are the most common form of collateral for repo – other collateral can be used but the lower the quality of the collateral, the higher the repo rate should be.

<u>For example:</u>
A Local authority lends £3mln to a Repo Counterparty
Start date: 15/12/2016
End Date: 15/03/2017
Repo Rate: 0.575%

15/12/2016:



15/03/2017:



On the end date of the agreement, the lender (in the above case, the LA) would receive their nominal back plus interest. The cash borrower (Repo counterparty) will pay back the nominal plus interest and receive back their collateral.

The broker will monitor the value of the collateral and ensure that they are marked to market. Additional stock will be requested if the securities decrease in value.

If the cash borrower goes in to default, the lender (holding the collateral) can liquidate the collateral assets in the open market and any shortfall can be claimed back from the administrator of the defaulting counterparty.