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Crawley Borough Council

Report to Overview and Scrutiny Commission
30 November 2015

Report to Cabinet
2 December 2015

Treasury Management Mid-Year Review 2015/2016

Report of the Head of Finance, Revenues and Benefits (FIN/376)

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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 2015/2016

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 2015/2016;
b) recommend to Full Council the approval of an amendment to the Council's Annual Investment Strategy to include an ethical investment policy (see section 5.3).

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-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%

4.2 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).

4.3 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.

5. Annual Investment Strategy

5.1 The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by this Council on 25 February 2015. It sets out the Council's investment priorities as being:

- Security of capital
- Liquidity; and
- Yield.

5.2 The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. Investment rates available in the market have been broadly stable during the first half of the year and have continued at historically low levels as a result of the ultra-low base rate. Full details of the investments held by the Council at 30 September 2015 can be found in Appendix 2.

5.3 It is proposed to amend the Council's Annual Investment Strategy to include an ethical investment policy. Cabinet is requested to recommend to Council that the following policy is appended to the 2015/16 Annual Investment Strategy:

Ethical Investment Policy

The Council will not undertake direct investment or borrowing activities with organisations whose core activities include:

- Armaments – weapon systems
- Gambling
- Pornography
- Tobacco
- Pay-day loans

In order to comply with treasury management guidance, the Council's investments will prioritise security, liquidity and yield in that order. The Ethical Investment Policy thereby becomes a fourth consideration in the decision making process.

5.4 The core activities in the Ethical Investment Policy above has been chosen after careful consideration of the Policy direction of the administration, the officer time in implementing the policy, the cost of external resources, and the timeliness of investment decisions.

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 2015/16

7.1 The Council held £117.7m of investments as at 30 September 2015 (£112.4m at 31 March 2015).

Investments	31 March 2015 £'000	30 September 2015 £'000	Rate/ Return	Average Life yrs
UK Government	-	1,995	0.48%	0.17
Local Authorities	51,500	27,500	1.23%	1.32
UK Banks	21,213	26,309	1.08%	0.51
UK Building Societies	15,000	12,000	0.60%	0.18
Money Market Funds	5,935	4,050	0.49%	0.00
Supranational	3,109	-	-	-
Overseas Banks	7,007	32,031	0.70%	0.45
Corporate Bonds	8,592	13,816	0.84%	0.26
Total	**112,356**	**117,701**	**0.91%**	**0.59**

A full list of investments held as at 30th September 2015 is in appendix 2.

7.2 In addition to the treasury investments in 8.1 above, the Council also has £6.21m 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 £8.8m to purchase additional investment properties.

7.3 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 2015/16.

7.4 Investment performance for the financial year to date as at 30 September 2015:

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day LIBID + 0.2%	0.56%	0.92%	£579,871

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 2015/2016.

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 2015/2016 – Cabinet, 11 February 2015 [report FIN/355 refers]
Quarterly Budget Monitoring 2015/2016 Quarter 2 – Cabinet, 2 December 2015 [report FIN/373 refers]
Budget and Council Tax for 2015/16 - Cabinet, 11 February 2015 [report FIN/356 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 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 re-join 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%.

APPENDIX 2

Detailed holdings at 30 September 2015

	Total	Limit	Rating
<u>UK Government</u>	£2.00m	unlimited	AA+
<u>Local Authorities</u>			
Kingston Upon Hull City Council	£5.00m	£15.00m	AA+
Lancashire County Council	£8.00m	£15.00m	AA+
Newtownabbey Borough Council	£1.50m	£15.00m	AA+
North Lanarkshire Council	£4.00m	£15.00m	AA+
Peterborough City Council	£4.00m	£15.00m	AA+
Thurrock Council	£3.00m	£15.00m	AA+
Staffordshire Moorlands Borough Council	£2.00m	£15.00m	AA+
<u>UK Banks</u>			
Bank of Scotland plc	£2.00m	£10.00m	A+
Close Brothers	£4.50m	£10.00m	A
Lloyds Bank	£1.81m	£10.00m	A+
Royal Bank of Scotland	£5.00m	£15.00m	BBB+
Santander UK Plc	£2.00m	£10.00m	A
Standard Chartered Bank	£9.00m	£10.00m	AA-
Sumitomo Mitsui Banking Corp	£2.00m	£10.00m	A-
<u>UK Building Societies</u>			
Coventry Building Society	£2.00m	£10.00m	A
Nationwide Building Society	£7.00m	£10.00m	A
Yorkshire Building Society	£3.00m	£10.00m	A-
<u>Money Market Funds</u>			
Standard Life Investments	£4.05m	£15.00m	AAA
<u>Overseas Banks</u>			
Credit Suisse	£3.50m	£10.00m	A
DBS Bank	£7.00m	£10.00m	AA-
Landesbank	£5.00m	£10.00m	A-
Oversea Chinese Banking Corporation	£5.00m	£10.00m	AA-
Skandinaviska Enskilda Banken	£5.00m	£10.00m	A+
Svenska Handelsbanken	£0.03m	£10.00m	AA-
United Overseas Bank	£6.50m	£10.00m	AA-
<u>Corporate Bonds</u>			
Commonwealth Bank of Australia	£3.10m	£10.00m	AA-
Danska Bank	£2.07m	£10.00m	A
Nordea Bank	£1.45m	£10.00m	AA-
Places for People Capital	£0.92m	£2.00m	A
Prudential plc	£1.06m	£2.00m	A+
United Utilities Water	£1.73m	£2.00m	A-
Volkswagen International	£1.36m	£2.00m	A

Westpac Banking Corporation	£2.12m	£10.00m	AA-
	£117.70m		
Investment Properties	£6.21m		
	£123.91m		

Prudential and Treasury Indicators as at 30th September 2015 — APPENDIX 3

Treasury Indicators	2015/16 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	117,701

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%	13.8%
10 years to 20 years	0% - 80%	66.5%
20 years to 30 years	0% - 25%	19.7%
30 years to 40 years	0% - 10%	0%
40 years to 50 years	0% - 10%	0%

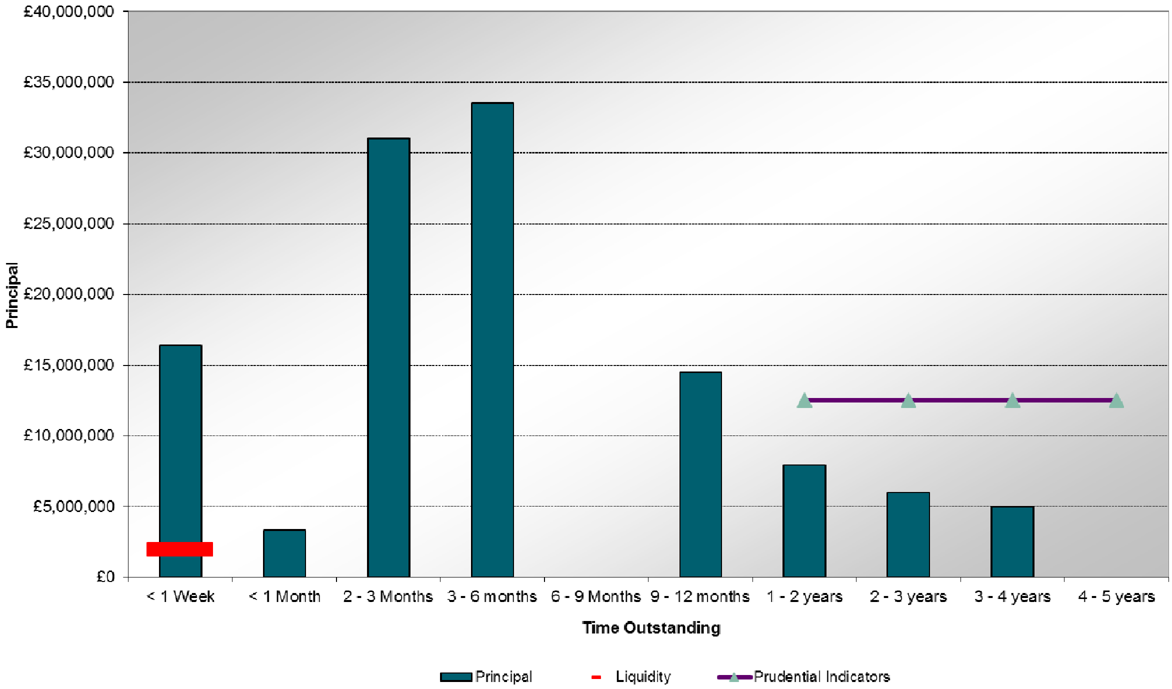
Upper limit of fixed interest rates based on:		
- Debt only	270,325	260,325
- Investments only	140,000	108,311
Upper limit of variable interest rates based on:		
- Debt only	10,000	0
- Investments only	40,000	9,390

Weighted average life of investments	Avg. 1.20 years Max 1.50 years	0.59
Short term deposits (<1 week's notice)	2,000	16,390
Upper limit for principal sums invested over 364 days	50,000	18,922

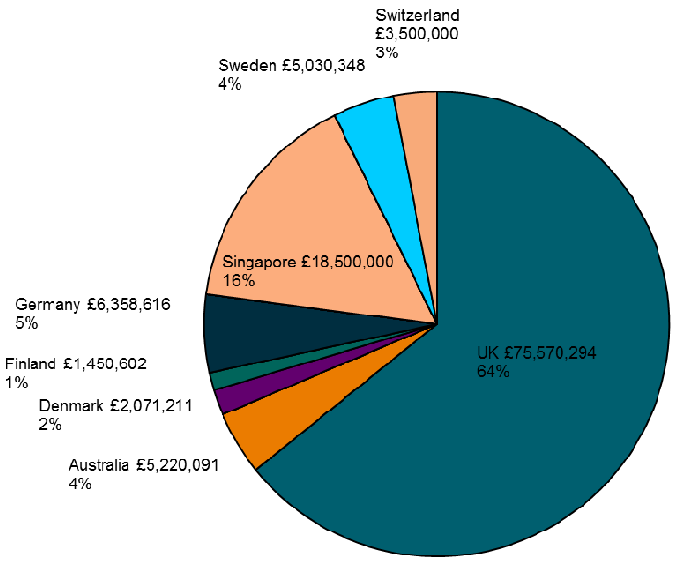
Prudential Indicators	2015/16 Strategy £'000	Quarter 2 Forecast £'000
General Fund		
Capital expenditure	22,989	14,594
Capital Financing Requirement (CFR)	(330)	(207)
Annual change in CFR	0	0
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	-7.68%	-8.17%
HRA		
Capital expenditure	21,349	29,364
Capital Financing Requirement (CFR)	260,273	260,147
Annual change in CFR	0	0
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream	17.31%	16.97%

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