Report to:	**Audit Committee**
Date:	**10th January 2017**
Title:	**Treasury Management Mid-Year Review**
Portfolio Area:	**Support Services – Cllr C Edmonds**
Wards Affected:	**ALL**
Relevant Scrutiny Committee:	

Urgent Decision:	**N**	Approval and clearance obtained:	**Y**

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Recommendations:

1. That the report is noted.

1. Executive summary

The Council is on course to meet its budget target of £45,321. To date, the Council has outperformed the industry benchmark by 0.25%. The Council has achieved a rate of return of 0.53%, against the 7 day LIBID bid rate (LIBID) of 0.28%.

2. 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. The Council is currently has a £2.1 million loan with the Public Works Loan Board.

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."

The Council's Finance Procedure Rules require that a report be taken to the Executive three times a year on Treasury Management. The specific reporting requirements are:

- An annual treasury strategy in advance of the year (Audit Committee 15/03/2016 – AC32)
- A mid-year (minimum) treasury update report (This report)
- An annual review following the end of the year describing the activity compared to the strategy (Audit Committee 27/09/2016)

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 (i.e. Treasury Management Strategy Statement (TMSS), annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

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.

Interest Rate Forecast
The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

(Please note that these forecasts were produced in September 2016 and since then the forecasts have been revised by Capita Asset Services. Bank base rate is now not expected to reduce to 0.1%, but instead to remain at 0.25% until Summer 2019 when it is predicted the Bank base rate will rise to 0.5%).

	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%

Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by the Council on 05/04/16 – CM61 (and Audit Committee 15/03/2016 – AC32). It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

The Council will also aim to achieve the optimum return (yield) on its 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 periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

Treasury Position at 30 September 2016

	As at 31/03/2016		**As at 30/09/2016**	
Investment Type	**Principal £**	**Interest %**	**Principal £**	**Interest %**
Short Fixed	4,000,000	0.69	8,000,000	0.57
Money Market Funds	3,875,000	0.48	1,950,000	0.37
Total	**7,875,000**	**0.59**	**9,950,000**	**0.53**

The Council's Investments mid way through the year are always higher than at the end of the year (at 31st March) due to the cashflow advantage that the Council benefits from part way through the year.

This is, in part, due to the timing differences between the Council collecting council tax income and paying this over to major precepting authorities such as Devon County Council, the Police and the Fire Authority

The following is a list of our fixed investments at 30 September 2016:

Counterparty	**Fixed to**	**£**	**Interest Rate**
Barclays Bank plc	15/03/2017	3,000,000	0.43%
Nationwide BS	06/10/2016	2,000,000	0.42%
Lloyds TSB Bank Plc	17/10/2016	3,000,000	0.80%

Performance Assessment

The Council's budget for investment interest is £45,321 for 2016/17. Performance to date is on target to meet this budget.

To date, the Council has outperformed the industry benchmark by 0.25%. The Council has achieved a rate of return of 0.53%, against the 7 day LIBID bid rate (LIBID) of 0.28%. Industry performance is judged and monitored by reference to a standard benchmark; this is the 7 day London Interbank Bid Rate (LIBID). The average weighted LIBID rate at the end of September was 0.28% which is 0.25% lower than our average return of 0.53% @30/09/16.

The reason the Council is exceeding this benchmark is due to the use of fixed term investments that where made before the Bank of England dropped the base rate so when they are renewed the return will be lower. A discussion with Members of the different options available was part of the agenda for the Financial Principles workshop with Members on 5 December 2016.

The Treasury Management Strategy is risk averse with no investments allowed for a period of more than a year and very high credit rating are required together with a limit of £3m per counterparty. This has resulted in only a small number of institutions in which we can invest (see Appendix A).

Compliance with Treasury Limits and Prudential Indicators

During the financial year the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement. The Council's Prudential Indicators for 2016/17 are detailed and shown in Appendix B.

3. Outcomes/outputs

In the last 18 months the interest achieved has been above the industry benchmark due to better use of fixed term investments. Now that rates have dropped not risen we are forecasting to come on budget in 2016/17 but unless we update our TM strategy 2017/18 investment returns could be below 2015/16 & 2016/17 figures

4. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	Statutory powers are provided by the Local Government Act 1972 Section 151 and the Local Government Act 2003

Financial	Y	2016-17 Budget for investment income is £45,321 and the Council is currently forecasting to reach this. Consideration of the Annual Treasury Report forms an essential component of the Council's systems for public accountability. It also provides a platform for future investment planning
Risk	Y	The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation. The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines. The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and the Executive.
Comprehensive Impact Assessment Implications		
Equality and Diversity	N	N/A
Safeguarding	N	N/A
Community Safety, Crime and Disorder	N	N/A
Health, Safety and Wellbeing	N	N/A
Other implications	N	None

Supporting Information

Appendices:

Appendix A – Lending list as at 31 March 2016
Appendix B – Prudential and Treasury Indicators 2016/17

Background Papers:

Annual treasury strategy in advance of the year (Audit 15/03/16 – AC32)
Annual review following the end of the year describing the activity compared to the strategy (27/09/16 – Item 7)

Approval and clearance of report

Process checklist	**Completed**
Portfolio Holder briefed	**Yes**
SLT Rep briefed	**Yes**
Relevant Exec Director sign off (draft)	**Yes**
Data protection issues considered	**Yes**
If exempt information, public (part 1) report also drafted. (Cabinet/Scrutiny)	**N/A**

APPENDIX A

West Devon Borough Council lending list as at 31 March 2016.

Barclays Bank Plc
HSBC Bank plc
Lloyds Banking Group Plc: • Bank of Scotland plc • Lloyds Bank plc
Nationwide Building Society
Royal Bank of Scotland Group Plc: • The Royal Bank of Scotland plc • National Westminster Bank plc
Government UK Debt Management Facility
Local Authorities (as defined under Section 23 of the Local Government Act 2003)
AAA rated Money Market Funds

APPENDIX B

PRUDENTIAL INDICATORS

THE CAPITAL PRUDENTIAL INDICATORS

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Capital Expenditure.

This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual £000	Actual £000	Estimate £000	Estimate £000	Estimate £000
Total	**473**	**300**	**720**	**701**	**701**

The table below summarises the above capital expenditure plans and how these plans are being financed. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual £000	Actual £000	Estimate £000	Estimate £000	Estimate £000
Total	**473**	**300**	**720**	**701**	**701**
Financed by:					
Capital receipts	259	32	0	0	0
Capital grants	186	244	402	402	402
Reserves	28	24	0	0	0
New Homes Bonus	0	0	318	299	299
Net financing need for the year	**Nil**	**Nil**	**Nil**	**Nil**	**Nil**

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). It is essentially a measure of the Council's underlying need to borrow if the figure is greater than zero.

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual £000	**Actual £000**	**Estimate £000**	**Estimate £000**	**Estimate £000**
Capital Financing Requirement (CFR)					
Total CFR	1,799	1,757	1,715	1,673	1,631
Movement in CFR	-42	-42	-42	-42	-42
Movement in CFR represented by:					
Net Financing need for the year	0	0	0	0	0
Less MRP and other financing movements	-42	-42	-42	-42	-42
Net borrowing requirement	0	0	0	0	0

Minimum Revenue Provision (MRP)

The Minimum Revenue Provision is calculated at £42,000 per year. This is the Council's borrowing of £2.1 million divided by the life of the asset of 50 years.

Debt Rescheduling

The Council has one PWLB loan of £2.1 million which matures in 2053; this is at a rate of 4.55%.
The Council has not undertaken any debt rescheduling during the first six months of 2016/17 and there are no current opportunities for debt rescheduling.

AFFORDABILITY PRUDENTIAL INDICATORS

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the receipt of net investment income against the net revenue stream. It is calculated by dividing investment income and interest received by the Council's Net Budget.

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	**Actual**	**Estimate**	**Estimate**	**Estimate**
Ratio of net investment income to net revenue stream. (Surplus)	1.2%	1.2%	1.3%	1.3%	1.2%

Estimates of the incremental impact of capital investment decisions on council tax

This indicator calculates the notional cost of the impact of lost investment income on the Council Tax, from spending capital resources. The Council is not undertaking any borrowing to fund its Capital Programme at present.

Incremental impact of capital investment decisions on the band D council tax (Notional cost as explained above)

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Actual	Estimate	Estimate	Estimate
	£	£	£	£	£
Future incremental impact of capital investment decisions on the band D Council tax (Notional cost)	0.03	0.01	0.06	0.13	0.18

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

The Operational Boundary – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	2015/16	2016/17	2017/18	2018/19
	£	£	£	£
Borrowing	3,000,000	3,000,000	3,000,000	3,000,000
Other long term liabilities	-	-	-	-
Total	3,000,000	3,000,000	3,000,000	3,000,000

Operational Boundary	2015/16	2016/17	2016/17	2016/17
	Actual	Estimate	Current Position	Revised Position
	£	£	£	£
Prudential Indicator – Capital Financing Requirement				
CFR	1,757,000	1,715,000		1,715,000
Prudential Indicator – External Debt/ The Operational Boundary				
Total Debt 31 March 2016	2,100,000	2,100,000	2,100,000	2,100,000

The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

Authorised limit	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£	**£**	**£**	**£**
Borrowing	6,000,000	6,000,000	6,000,000	6,000,000
Other long term liabilities	-	-	-	-
Total	6,000,000	6,000,000	6,000,000	6,000,000

West Devon Borough Council's current level of external borrowing is £2.1 million.