BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 5**

Resources Committee **2 November 2016**

Report of the Head of Finance

2016-17 MID YEAR REPORT ON TREASURY MANAGEMENT

1 Purpose of Report

This report aims to keep members informed of treasury management activity, in line with the Treasury Management Strategy Statement (TMSS) which was approved by this committee on 23 March 2016.

2 Executive Summary

2.1 This report combines the actual performance and investments held as at 30 September 2016 with an overall out line of expected performance for the remainder of the financial year.

2.2 It also includes as an appendix an update on the current UK economy and the forecast for interest rates going forwards. The market and economy are key factors in the level of returns that can be expected from investments and this information should help members understand the wider economic picture and its influences over the rate of return achieved.

3 Appendices

Appendix 1 - Summary of investment transactions at 30 September 2016

Appendix 2 – Summary of economic background and interest forecast

4. **Proposed action: The resources committee is invited to RESOLVE to:**

4.1 **Note the Mid-Year Report on Treasury Management.**

4.2 **Authorise officer to undertake due diligence and investigate the use of Property Funds and report back to a future committee with their findings.**

5. Background

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management and the Council's treasury management policy requires periodic reports on the routine activity of the treasury management function and operations to be reported to committee, which includes a mid-year update report. This report fulfils that requirement.

6 Discussion

Annual Investment Strategy:

6.1 The Treasury Management Strategy Statement (TMSS) for 2016-17 was approved by Council on 23 March 2016. The council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the council's investment priorities as follows:

- Security of capital
- Liquidity of investments

6.2 The council also aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity.

6.3 The council has historically invested mainly in building societies, which do not necessarily have high credit ratings as defined by the recognised credit rating agencies e.g. Fitch and Moody's. However, at the present time building societies are continuing to provide better rates of return, with a good history of credit, so the credit risk of investing with them is considered acceptable within the parameters outlined in the TMSS. However these do need to be monitored carefully.

6.4 The Treasury Management Strategy allows for up to £25m (if we exclude our current banking provider) to be invested in named domestic banks and £32m in named domestic building societies. Wellingborough's portfolio of investments currently comprises of £4.1m with the domestic banks and £20m with domestic building societies.

6.5 As illustrated in the economic background in Appendix 2, investment rates available in the market are still historically low.

6.6 The average level of funds available for investment purposes in the first half of 2016-17, as reported above, was £24.1m. Many of these funds were non-reserve backed working capital balances and as such were temporary in nature. The level of funds was dependent on the timing of precept and NNDR payments, as well as the receipt of various grants. Progress on the capital programme also influenced the level of funds available for investment purposes

2016-17 Performance to date

6.7 Appendix 1 shows a detailed list of the investments held at 30 September 2016. These totalled £24,110,000 which includes £1,610,000 in call accounts, with estimated interest receivable for the first 6 months amounting to £108k.

6.8 The profiling and the maturity of these investment are summarised in the following charts:

Chart 1:

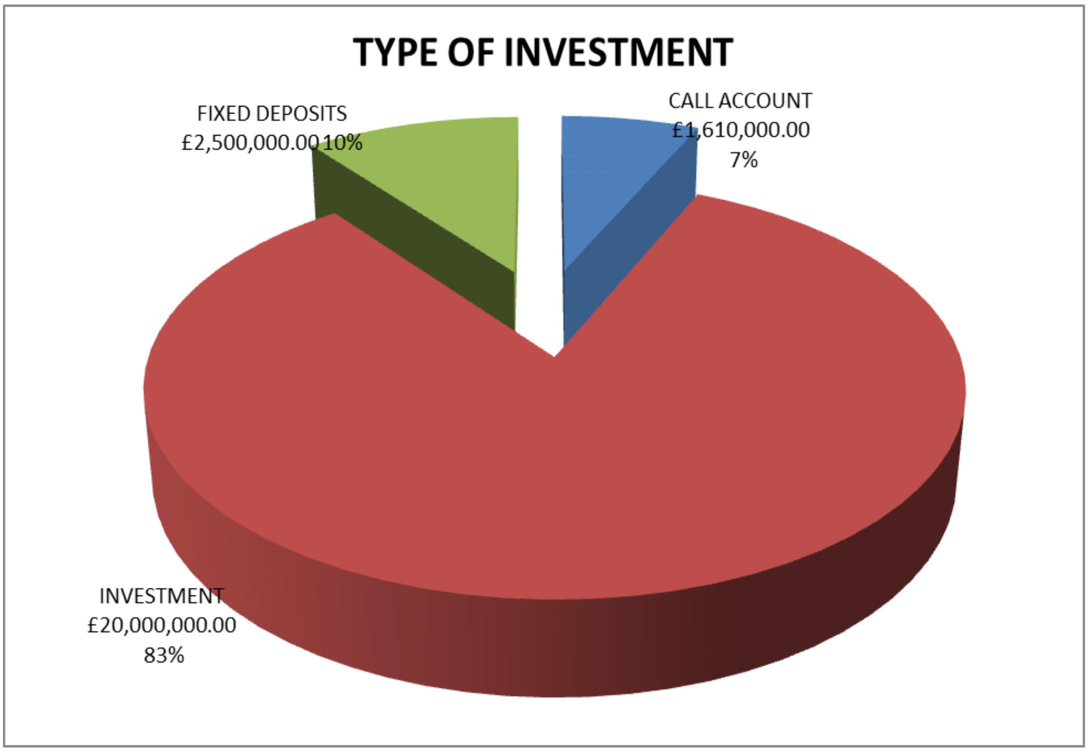
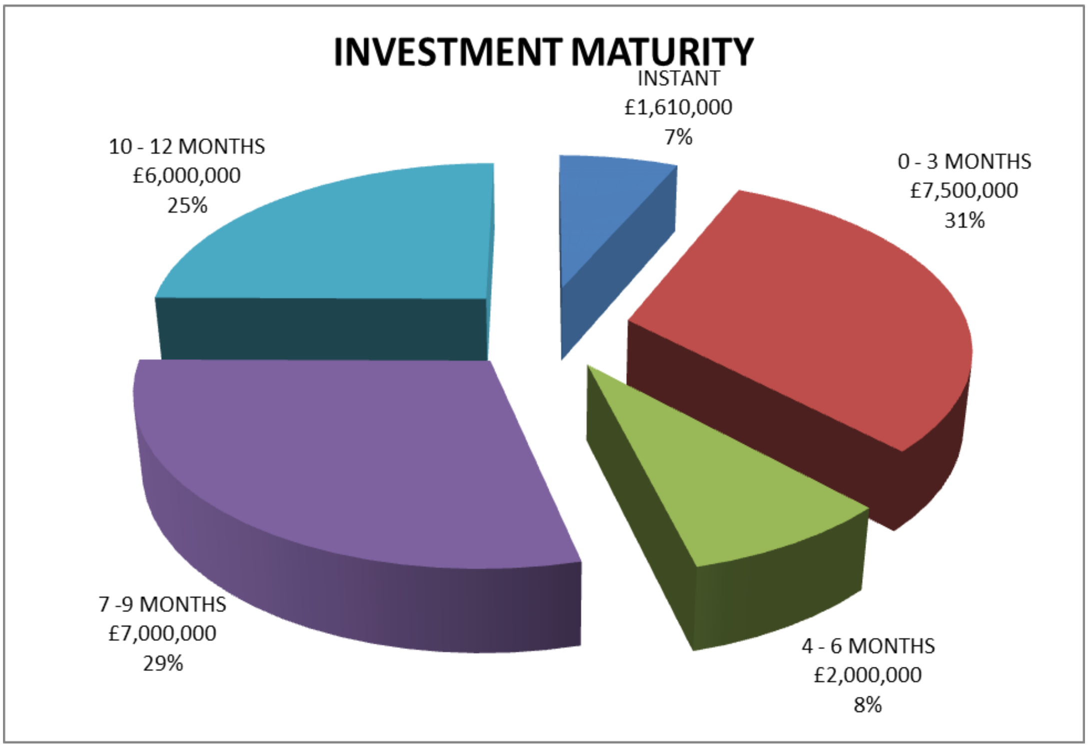


Chart 2:



6.9 The average rate of return for the first six month period is 0.88%, compared to the average three months LIBID (London Interbank Bid Rate) interest rate for the same period of 0.36%.

6.10 The estimated interest receivable for the year is £208k, based on an average annual interest rate of 0.89%, the 2016-17 budget was set at £237k assuming an average rate of return of 0.95%, therefore anticipated performance for the year is approximately £29k below budget and the pressure on the budget for investment income will be reported as part of the revenue monitoring for the year.

6.11 Capita, the council's treasury management advisers have provided an overview of the current economic climate and this is provided at Appendix 2, as it helps to set the scene within which the council's treasury management function operates.

6.12 Future interest rates are predicted to reduce again later in the year, as detailed in appendix 2, and are not anticipated to increase before 2018. Iit is therefore advised that we keep our investment returns projections for revenue estimate purposes low and the budget for the coming years will be amended to reflect the new forecasts.

6.13 The council has complied fully with the requirements of its approved Treasury Management Strategy during the period including use of approved counterparties and investment limits.

7 Investment in Property Funds

7.1 Due to the reduced interest return the council is anticipating it will receive on its investment portfolio, consideration has been given to how to diversify the portfolio in order to achieve a greater return.

7.2 Property Funds are a form of investment, comprising a portfolio of commercial properties to achieve investment returns through rental income and capital growth. However, the value of such investments may fall as well as rise. There may also be restrictions on redemption of the investment. This type of investment is regarded as a 5 to 7 year minimum timeframe.

7.3 The use of these instruments can be deemed capital expenditure, and as such would be an application (spending) of capital resources.

7.4 Officers are proposing to undertake further due diligence and investigation on this type of investment, which will be reported back to committee for consideration and recommendation on next steps.

8 Legal Powers

Local Government Act 2003.

9 Financial and Value For Money Implications

As stated in the report.

10 Risk Analysis

Nature of risk	**Consequences if realised**	**Likelihood of occurrence**	**Control measures**
Fall in interest rates	Reduced income	High	Maintaining as high an average interest rate as possible through a mix of short and longer term fixed and variable rate investments.
Less funds available for investment	Reduced income	Medium	Regular budget monitoring, allowing for remedial action to be taken.
Loss of capital	Reduced funds available for both capital and revenue purposes	Low	Financial ratings of counterparties and limits on amounts invested. Reviews of Council's lending policies.

11 Implications for Resources

No direct implications for staffing or property.

12 Implications for Stronger and Safer Communities

No direct implications.

13 Implications for Equalities

No direct implications.

14 Author and Contact Officer

S Knowles, Principal Finance Manager

H Essom, Technical Accountant

15 Consultees

L Elliott, Head of Finance

16 Background Papers

Treasury Management Strategy statement 2016-17

Appendix 1

Summary of Investments as at 30 September 2016					
Loans Investment Number	Borrower	Interest Rate %	Period of Loan	Value of Investment £	Maturity Date
I 3365	Santander Building Society - 31 day notice	0.40	31	1,000,000	13/10/2016
I 3382	Santander Building Society - 31 day notice	0.40	31	1,000,000	27/10/2016
I 3360	Progressive Building Society	1.03	364	2,000,000	28/10/2016
I 3366	Santander Building Society - 60 day notice	0.50	60	500,000	31/10/2016
I 3361	Nationwide Building Society	0.90	364	1,000,000	07/11/2016
I 3362	Skipton Building Society	1.02	364	2,000,000	09/12/2016
I 3363	National Counties Building Society	1.10	364	1,000,000	03/01/2017
I 3369	Nottingham Building Society	1.02	364	1,000,000	31/03/2017
I 3370	Principality Building Society	1.05	364	1,000,000	06/04/2017
I 3372	Nottingham Building Society	1.02	185	1,000,000	11/04/2017
I 3373	Nationwide Building Society	0.95	364	2,000,000	02/05/2017
I 3375	Principality Building Society	1.05	364	2,000,000	13/06/2017
I 3377	Newcastle Building Society	1.15	364	1,000,000	06/07/2017
I 3378	National Counties Building Society	1.03	364	2,000,000	26/07/2017
I 3379	Newcastle Building Society	1.15	364	2,000,000	03/08/2017
I 3371	Progressive Building Society	1.00	364	1,000,000	05/04/2017
I 3384	Nottingham Building Society	0.71	364	1,000,000	13/09/2017
I 3374	Bank of Scotland	0.15	CALL	750,000	CALL
I 3380	Bank of Scotland	0.15	CALL	760,000	CALL
I 3381	Bank of Scotland	0.15	CALL	100,000	CALL
	Total			24,110,000	

Appendix 2

Summary of Economic Background and Outlook

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 thorough 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.

Interest Rate Forecast

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%

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.