BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM** **4**

Resources Committee **22 October 2014**

Report of the Head of Finance

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 19 March 2014.

2 Executive Summary

This report combines the actual performance and investments held as at 30 September 2014 with an overall out line of expected performance for the remainder of the financial year.

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 2014

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.**

5. Background

5.1 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 2014-15 was approved by Council on 19 March 2014. 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 previously 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, Building Societies are providing better rates of return, with a good history of credit and as such the credit risk of investing with them is considered acceptable within the parameters outlined in the TMSS but need to be monitored carefully.

6.4 As investments in building societies have matured, they have been placed with domestic banks to mitigate some of the credit risk that having a disproportionate amount of investments held in one sector may have had.

6.5 The Treasury Management Strategy allows for up to £20m (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 £4.5m with the domestic Banks and £23m with domestic building societies.

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

6.7 The average level of funds available for investment purposes in the first half of 2014-15, as reported above, was £27.5m. Many of these funds were non-reserve backed working capital balances and as such were temporary in nature, and the level of funds was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

2014-15 Performance to date

6.8 Appendix 1 shows a detailed list of the investments held at 30 September 2014.

6.9 These totalled £27,500,000, with interest received to-date since 1 April 2014 amounting to £116,213.74 and the average rate of return for the six month period was 0.45%, compared to the average three months LIBID (London Interbank Bid Rate) interest rate for the same period of 0.44%.

6.10 The Council's budgeted investment return for 2014-15 is £321k. However, performance for the year to date is approximately £52k below budget.

6.11 The average interest rate estimated at the 30 September of 0.77% is below the rate assumed in the Medium Term Financial Strategy (1.00%) and as such the pressure on the budget for Investment income has been reported as part of the Revenue Monitoring for the year.

6.12 The interest rate achieved to date includes investments placed some time ago at rates higher than are available now on the market. Therefore, as older investments mature they are being replaced with investments at lower rates of interest.

6.13 The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2014-15.

6.14 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.

6.15 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.

6.16 Given our advisers forecast for base rate it is advised that we keep our investment returns projections for revenue estimate purposes low and as such the budget for the coming years will be amended to reflect the new forecasts.

7 Legal Powers

Local Government Act 2003.

8 Financial and Value For Money Implications

As stated in the report.

9 Risk Analysis

Nature of risk	**Consequences if realised**	**Likelihood of occurrence**	**Control measures**
Fall in interest rates	Reduced income	Medium	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.

10 Implications for Resources

No direct implications for staffing or property.

11 Implications for Stronger and Safer Communities

No direct implications.

12 Implications for Equalities

No direct implications.

13 Author and Contact Officer

H Essom, Technical Accountant

14 Consultees

L Elliott, Head of Finance.

S Knowles, Principal Accountancy Manager

15 Background Papers

Treasury Management Strategy statement 2014-15

Appendix 1

Summary of Investments as at 30 September 2014

Loans Investment Number	Borrower	Interest Rate	Period of Loan	Value of Investment	Required for:
		%		£	
I 3316	Progressive B S	0.90	364D	1,000,000	Housing Benefits
I 3321	National Counties B S	1.11	364D	1,000,000	Investments
I 3322	Progressive B S	0.75	275D	2,000,000	Investment
I 3323	Newcastle B.S.	0.80	273D	2,000,000	NNDR/Housing Benefit
I 3327	Leeds B S	0.61	277D	2,000,000	NNDR Pooling
I 3328	Principality B S	0.71	276D	3,000,000	Investment
I 3329	Skipton B S	0.73	242D	2,000,000	Investment
I 3300	Skipton B S	0.86	335D	1,000,000	Investment
I 3301	Nationwide B S	0.58	187D	1,000,000	Cashflow
I 3332	Nationwide B S	0.67	246D	2,000,000	Investment
I 3333	Principality B S	0.66	217D	2,000,000	NNDR/Housing Benefit
I 3334	Newcastle B S	1.05	364D	1,000,000	NNDR/Salaries
I 3335	National Counties B S	0.95	364D	2,000,000	Investment
I 3336	Nottingham B S	0.68	364D	1,000,000	Cashflow
I 3302	Royal Bank of Scotland	0.25	CALL	1,000,000	Cashflow
I 3324	Bank of Scotland	0.40	CALL	1,500,000	Cashflow
I 3326	Bank of Scotland	0.40	CALL	2,000,000	Cashflow
	Total			27,500,000	

Appendix 2

Summary of Economic Background and Outlook

After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering.

The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate.

The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable.

There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May and July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q1 or Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget -

which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

Interest rate forecasts

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

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%
10yr PWLB rate	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%
25yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%
50yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%

Capita Asset Services undertook a review of its interest rate forecasts in mid August, after the Bank of England's Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts and depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2015.