BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 4**

Resources Committee **21 October 2015**

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 18 March 2015.

2 Executive Summary

This report combines the actual performance and investments held as at 30 September 2015 with an overall outline 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 2015

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

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 2015-16 was approved by Council on 18 March 2015. 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, at the present time 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. However these do need to be monitored carefully.

6.4 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 £3.5m with the domestic Banks and £25m with domestic building societies.

6.5 The average level of funds available for investment purposes in the first half of 2015-16, as reported above, was £28.5m. 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

2015-16 Performance to date

6.6 Appendix 1 shows a detailed list of the investments held at 30 September 2015.

6.7 These totalled £28,500,000 which includes £3,500,000 in call accounts, with estimated interest receivable for the first 6 months amounting to £115k. The average rate of return for the first six month period is 0.84%, compared to the average three months LIBID (London Interbank Bid Rate) interest rate for the same period of 0.33%.

6.8 The estimated interest receivable for the year is £237k, based on an average annual interest rate of 0.84%, the 2015-16 budget was set at £324k assuming an average rate of return of 1.20%, therefore anticipated performance for the year is approximately £87k below budget and the pressure on the budget for Investment income will be reported as part of the Revenue Monitoring for the year.

6.9 It has come to light that in the first 6 months of 2015-16, there has been one breach of the Annual Investment Strategy, of £1m over limit for 5 months with a main building society. As building societies are already recognised as an acceptable risk, outside of the treasury management consultants standard advice, the level of risk this breach poses is minimal. However, following this a review has been undertaken and internal control and procedures have been amended in order to mitigate this risk.

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

6.11 Other than the issues discussed in 6.10, 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.

6.12 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.

6.13 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 2015-16

Appendix 1

Summary if Investments as at 30 September 2015					
Loans Investment Number	Borrower	Interest Rate %	Period of Loan	Value of Investment £	Required for
I 3338	Progressive Building Society	1.00	364	2,000,000	Housing Benefits
I 3341	Skipton Building Society	0.96	364	2,000,000	NNDR/ Precepts
I 3342	National Counties Building Society	1.05	364	1,000,000	Housing Benefits
I 3343	Leeds Building Society	0.81	364	3,000,000	NNDR/ Precepts
I 3346	Nottingham Building Society	0.95	364	2,000,000	Housing Benefits
I 3347	Principality Building Society	0.88	364	1,000,000	Investment
I 3348	Skipton Building Society	0.97	364	1,000,000	NNDR/ Precepts
I 3349	Nottingham Building Society	0.97	364	1,000,000	Investment
I 3350	Progressive Building Society	1.00	364	1,000,000	NNDR/ Precepts
I 3352	Nationwide Building Society	0.90	364	2,000,000	Housing Benefits
I 3353	Nationwide Building Society	0.66	185	1,000,000	NNDR/ Precepts
I 3354	Newcastle Building Society	0.98	364	1,000,000	NNDR/ Precepts
I 3356	National Counties Building Society	1.10	364	2,000,000	Investment
I 3357	Newcastle Building Society	1.00	364	2,000,000	Housing Benefits
I 3358	Principality Building Society	0.86	274	2,000,000	NNDR/ Precepts
I 3359	Nottingham Building Society	1.03	364	1,000,000	NNDR/ Precepts
I 3302	Royal Bank of Scotland	0.25	CALL	1,000,000	Cashflow
I 3351	Bank of Scotland	0.40	CALL	2,500,000	Cashflow
	Total			28,500,000	

Appendix 2

Summary of Economic Background and Outlook

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.

Despite these headwinds, the Bank of England is forecasting 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.

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 rejoin 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 has 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. This has led to a reappraisal of the likelihood of any increase occurring in 2015 with early 2016 now being widely regarded as being more likely.

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%.

Interest Rate Forecast

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%

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).

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.