TREASURY MANAGEMENT 2015-16 MID YEAR REVIEW

1 Purpose

1.1 The Authority's Treasury Management Policy requires that a mid year report be brought to scrutiny committee prior to going to Council each year. This report meets the needs of the Prudential Code by ensuring that monitoring of the capital programme and other indicators is carried out.

2 Recommendations/for decision

2.1 To note the performance against the Treasury Management action plan for 2015/16.

2.2 To approve the minimum rating for UK and Foreign banks be set at AA.

2.3 To approve the maximum investment period be increased from one (1) year to three (3) years.

3 Background

3.1 The objectives for the Treasury Management team for 2015/16 were laid out in the Action Plan agreed by Council in April 2015.

3.2 The main activities continue to be:

- To maintain the security of the Council's deposits by only depositing with trusted financial institutions and limiting the size and length of deposit with each organisation.
- To directly manage a range of deposits in order to provide sufficient flexibility to meet day to day operational needs.
- To only undertake new long term borrowing where the business case justifies it.

4 Economic Background

4.1 The underlying economic environment remains difficult for the Council, foremost being the continued challenging concerns over counterparty risk. This challenge encourages the Council to continue maintaining investments short term (less than six months) and with as high a quality counterparties as possible. The downside of such a policy is that investment returns remain low.

4.2 In October the Bank of England elected to keep interest rates at 0.5%, which led forecasters to predict that the earliest rise in interest rates has now moved to June 2016 and then rates will only rise very gradually. The table below is the interest rate view of our advisors, Capita Asset Services.

	Current	March 2016	March 2017	March 2018
	%	%	%	%
Bank Rate	0.50	0.50	1.00	1.75
3 month LIBID	0.60	0.70	1.30	1.90
6 month LIBID	0.80	0.90	1.50	2.10
12 month LIBID	1.10	1.20	1.80	2.40

4.3 As well as the interest rate remaining low, inflation has continued to fall below the Government's 2% target. The headline figure, CPI, fell to 0% in August from 0.1% in July. This was a result of oil prices recording the biggest fall since the start of the year. The Bank of England Governor stated that it was probable that prices would pick up towards the end of the year, and return to 2% early in 2017.

5 Capital Prudential Indicators 2015-16

5.1 This part of the report updates the position on the Council's capital expenditure plans, its financing, the underlying need to borrow and the limits in place for borrowing.

5.2 Below is a summary of the Council's current capital expenditure plans and shows the revised programme against the original.

Capital Expenditure 2015/16	Original - £'000	Revised - £'000
Leisure	645	2,229
Economic Development	0	6,419
Contract Services	0	4,030
Total General Fund	**645**	**12,678**
Disabled Facility Grants	337	337
Enabling Housing Grants	984	1,051
Total	**1,966**	**14,066**

The 2015/16 revised budget for capital expenditure is significantly higher than the 2015/16 original budget. The majority of the increase is the carry forward of the underspend on UCAV, £6.42m and the second phase of the depot alterations, £1.83m. The increase is also due to the Swan Pool Improvement scheme that was agreed after the capital programme was last approved.

The table below summarises how these plans are being financed either from capital, revenue or borrowing resources.

Financing	Original - £'000	Revised - £'000
Capital receipts	1,321	5,418
Capital grants	645	2,229
Capital reserves	0	0
Borrowing	0	6,419
Total	**1,966**	**14,066**

5.3 Another prudential indicator is the Council's Capital Financing Requirement (CFR). This is a measure of the Council's underlying need to borrow. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with assets life. The latest CFR projection is shown below.

CFR	Original - £'000	Revised - £'000
Total CFR	44,985	37,365
External Borrowing	28,418	23,418
Under/(Over) Borrowing	**16,567**	**13,947**

5.4 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new resources (asset sales).

Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2015/16 Original - £'000	2015/16 Revised - £'000
General Fund balance	3,332	3,115
General Fund reserves	27,766	25,835
Revenue provisions	1,816	1,816
Capital receipts	9,609	3,816
Other	1,267	1,267
Total Core Funds	**44,223**	**35,849**

6 Borrowing

6.1 The table shows the actual external debt, split between the various lender types.

	2015/16 Original - £'000	2015/16 Revised - £'000
PWLB	18,500	18,500
Local Authorities	10,000	5,000
Under/(Over) Borrowing	**28,500**	**23,500**

The authority is no longer debt free with loans ranging from 5 to 36 years taken to fund the capital programme. A short term loan is due to be repaid in December 2015.

6.2 The Council is currently maintaining an under-borrowed position. This means that the Council's borrowing need, has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This is considered a prudent strategy as investment returns are low and counterparty risk is relatively high.

6.3 Against this background and the continuing economic uncertainty caution will still be adopted during the remainder of 2015/16, whilst monitoring the interest rates within the financial markets to ensure the best approach is maintained.

7 Investments

7.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

7.2 It is a difficult investment market in terms of earning the level of interest commonly seen in the decades as the rates remain very low and in line with the 0.5% bank rate amd are forecast to remain low over the coming months.

7.3 During the year new regulations has lowered the likelihood of Government (sovereign) support in the event banks get in to trouble in the future. The result of this is that a large number of banks saw the credit rating lowered but this was not as a result of their underlying credit but due to regulatory reform and revision by the credit agencies.

This has had the effect that some of our minimum credit ratings no longer apply, as most banks, both UK and foreign, are no longer AAA rated. It is, therefore, recommended that the minimum rating for UK and Foreign banks be set at AA.

7.4 The strategy currently sets a maximum investment period of 364 days and with the current interest rate regime is sufficient but there may come at time when a particular investment opportunity may arise that would benefit from a longer period. It is recommended that the maximum investment period be increased to three (3) years.

7.5 The Council held £47.25m of investments as at 30 September 2015 spread over the following counter party groups.

Counter Party Sector	Country	£'000
Banks	UK	16,000
Banks - Overseas	Sweden	2,000
Building Societies	UK	23,000
Money Market Funds	UK	6,250
Total		**47,250**

7.6 The table below shows the budgets and income to date for the interest received from all investments, fixed term, variable and MMFs. It is expected that the interest target for the year will be met.

Investment Interest	2015 - Original	Received to 30 September	2015 - Revised
Income – Fixed Term	£215,000	£84,312	£200,000
Income – Variable	£18,000	£16,205	£33,000
Total	**£233,000**	**£100,517**	**£233,000**

7.7 During the year the a couple of 'Notice Accounts' have been opened with Handelsbanken and Santander UK, one a 35 day notice and the other a 95 day notice. These currently offer slightly higher interest rates than the MMFs and some longer term fixed investments so it is hoped that more variable rate interest will be generated.

7.7 No consideration has been made of investing in a property based fund. Although, the returns are currently higher than normal investments, any investment would have to be for a minimum period of five (5) years on order to maximise the return.

8 Reasons for Recommendation

8.1 Under the terms of the Statutory Code of Practice for Treasury Management, the Council is required to receive a mid year report on its Treasury Management performance. This report represents the fulfilment of that requirement.

9 Resource implications

10.1 The authority continues to operate an Interest Equalisation Reserve to smooth out fluctuations in interest rates. Whilst interest rates have remained static over the last few years the reserve has been used to meet the shortfall between the budgeted income and the actual income received.

10.2 The Medium Term Financial Plan also recognises the Council's use of capital and other balances in delivering its plans and the impact that this will have on interest earnings. The plan is, therefore, gradually reducing the Council's reliance on interest earnings over time, so as to manage the remaining balance on the interest equalisation reserve.

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Background Documents	Treasury Management Action Plan 2015/16 CIPFA Prudential Code Statutory Code of Practice for Treasury Management