**TRAFFORD COUNCIL**

**Report to:** **Accounts & Audit Committee 23 November 2016**
**Executive 19 December 2016**

**Report for:** **Discussion**
**Report of:** **The Executive Member for Finance and the Chief Finance Officer**

**Report Title**

| |
|---|
| **Treasury Management 2016-17 Mid-Year Performance Report** |

**Summary**


This report has been prepared in accordance with the CIPFA Code of Practice and gives a summarised account of the Treasury Management activities and outturn for the first half of the year. The purpose of this report is to provide members with, an update of the world economic headlines for this period, the major debt & investment activities undertaken, revised interest rate and economic forecasts and a benchmarking update.

**Debt Activity:-**

- Net debt interest costs are forecasted to be £0.13m above budget as previously reported in the Revenue Budget Monitoring report,
- At 30 September the Council's external debt was £106.0m.

**Investment Activity:-**

- The annualised investment interest to be generated is forecasted to be in line with budget of £0.77m,
- Rate of Return achieved during the period April to September 2016 was;
  i. short term investments 0.72%, or 0.28% / £(155)k above the comparable performance indicator of the average 7-day **L**ondon **I**nterbank **BID** interest rate and
  ii. long term investments 5.25%,
- At 30 September the Council's level of investments was £102.1m.

**Prudential Indicators:-**

- During the first half of 2016/17 the Council complied with its legislative and regulatory requirements, including compliance with all treasury management prudential indicators.


**Recommendations**

That the Accounts & Audit Committee & Executive be requested to:

1. Note the Treasury Management activities undertaken in the first half of 2016/17.


Contact person for background papers and further information:

Name: Graham Perkins
Extension: 4017 Background papers: None

| | |
|---|---|
| Relationship to Policy Framework/Corporate Priorities | Value for Money |
| Financial | The Council did not encounter any cash flow liquidity difficulties and all investment income was received on time. The projected level of investment income from investments for 2016/17 is £0.77m and this is in-line with budget. Net debt costs are £0.13m above budget due to increase costs on the Council's variable rate loan being incurred as reported in the Revenue Budget Monitoring report. |
| Legal Implications: | Actions being taken are in accordance with legislation, Department of Communities & Local Government (DCLG) Guidance, Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code and Treasury Management Code of Practice. |
| Equality/Diversity Implications | Not applicable |
| Sustainability Implications | Not applicable |
| Staffing/E-Government/Asset Management Implications | Not applicable |
| Risk Management Implications | The monitoring and control of risk underpins all treasury management activities and these factors have been incorporated into the treasury management systems and procedures which are independently tested on a regular basis. The Council's in-house treasury management team continually monitor interest forecasts and actual market interest rate movements to ensure that any exposure to adverse fluctuations in interest rates are minimised and security of capital sums are maintained at all times. |
| Health and Safety Implications | Not applicable |

## 1. BACKGROUND

1.1 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.

1.2 A main feature of this function is to ensure that the Council's day to day cash flow requirements are adequately planned and accounted for with any surplus monies being invested in low risk counterparties providing adequate liquidity initially before considering optimising investment return. An additional role is ensuring the Council's longer term funding requirements arising from its capital programme commitments are also considered which may involve arranging long or short term loans.

1.3 Each year in order to comply with the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code), the Accounts & Audit Committee together with the Executive will receive the following reports:

- annual treasury strategy for the year ahead ( February)
- mid-year update report (November i.e. this report)
- annual report describing the activity undertaken compared to the strategy (June).

1.4 The Treasury Management Strategy for 2016/17 was approved by Council at its meeting on 17 February 2016 and the policies to be adopted for the year remain unchanged.

1.5 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- Economic Update (section 2)
- Treasury Position (section 3)
- Debt Activity (section 4)
- Investment Activity (section 5)
- Risk Benchmarking (section 6)
- Prudential and Performance Indicators (section 7)
- Recommendations (section 8)

## 2. ECONOMIC UPDATE

2.1 During the first half of 2016/17, the main economic headlines arising are outlined below with a forecast of the main indicators for 2017, highlighted at Appendix B for reference:

**UK**

- Gross Domestic Product (GDP) continues to remain positive with quarters 1 and 2 recording annualised growth of 2.0% y/y & 2.1% y/y respectively although this has slowed from the 2014 rate of 2.9% and 2015 of 1.8%.
- Economy continues to be of the world's strongest,

- Following the outcome of the Brexit referendum vote in June, businesses were reporting a downturn in confidence, however recent surveys are now reporting this not to be the case,
- Bank of England in response to the Monetary Policy Committee meeting on 4 August announced a rescue package to address the impact of the Brexit result which included reducing its bank rate from 0.50% to 0.25% and increasing quantitative easing from £375bn to £435bn,
- The monthly unemployment rate remains static at 4.9% period ending August 2016 compared to 5.0% for April 2016,
- Consumer Price Index (CPI) for the first half of 2016/17 has risen from 0.3% (April) to 1.0% (September) and this is in response to rising prices for clothing, overnight hotel stays and fuel. A further factor to this increase has been the fall in the value of sterling by 10% following the Brexit referendum and it is currently forecast that CPI could rise to 3% in the next 3 to 4 years, exceeding the Government's 2% target,

**U.S**.

- GDP continues to grow in 2016 with the recorded annualised movements for quarters 1 & 2 being 0.8% and 1.4% respectively, down from the 2015 position of 2.4%,
- Following the move in December 2015 by the Federal bank to move interest rates from 0.25% to 0.50% markets were expecting further increases in 2016 however these have been delayed due to weakness in the international markets with the next increase now expected in December 2016,
- The 3 month unemployment rate remained steady at 4.9% for the 3 months ending September 2016 which was the same level as that reported for the previous quarter,
- CPI was 0.2% for period ending August 2016,
- **Eurozone**
- In March 2015, the European Central Bank (ECB) commenced its massive euro quantitative easing (QE) programme purchasing high credit quality government and other Eurozone debt instruments at a rate of 60bn euro per month. This programme was expected to run until September 2016 however this date has now been extended to March 2017 with the monthly limit being increased from 60bn to 80bn euros,
- E.C.B. reduced its deposit facility rate to -0.4% and the main refinancing rate from 0.05% to 0% in March 2016,
- GDP grew by 0.6% in quarter 1 2016 (1.7% y/y) falling slightly to 0.3% (1.6% y/y) for quarter 2,
- The latest CPI figures show inflation currently remaining very sluggish at 0.29% for September 2016,

- The 3 month unemployment rate continues to remain static at 10.1% for the 3 months ending August with marginal change for the previous quarter;
- Italian constitutional referendum in December 2016, French Presidential election April / May 2017 & German Federal general election in August to October 2017 all of which could have a huge bearing on the future direction the Eurozone follows.

**Other Countries**

- Japan's economy appears to have stalled with weak growth being reported,
- China's economy continues to slow down with the outlook for its medium term growth prospects giving cause for concern.

2.2 The Council's treasury management advisors Capita, provide interest rate forecasts periodically through-out the year and the table below outlines the latest situation taking into consideration the above economic conditions:

| | 2016-17 Original Forecast % | 2016-17 Revised Forecast % | 2017-18 Revised Forecast % | 2018-19 Revised Forecast % |
|---|---|---|---|---|
| Bank Rate | 0.63 | 0.28 | 0.10 | 0.25 |
| Investment Rates | | | | |
| 3 month | 0.70 | 0.33 | 0.20 | 0.38 |
| 1 Year | 1.15 | 0.66 | 0.65 | 0.78 |
| PWLB Loan Rates | | | | |
| 5 Year | 2.25 | 1.17 | 1.10 | 1.20 |
| 25 Year | 3.55 | 2.51 | 2.40 | 2.50 |

2.3 It is widely expected the M.P.C. will cut the Bank of England's Bank Rate again to 0.10% before the year end and the above forecast reflects this with the first increase forecasted to occur in May 2018, back up to 0.25% with the further increase to 0.50% a year later. With regards to gilt yields and PWLB rates, these are only set to rise marginally from their current levels.

2.4 The Council's stance when undertaking or considering any money market transactions will continue to be as that adopted in previous years and to take a cautious approach in line with the current and forecasted economic position outlined above.

## 3. TREASURY POSITION

3.1 The Council's investment and debt position at the beginning and midway through the current financial year were as follows:

| | 31 March 2016 | | 30 September 2016 | |
|---|---|---|---|---|
| | **Principal £m** | **Interest Rate %** | **Principal £m** | **Interest Rate %** |
| **DEBT** | | | | |
| **Fixed rate:** | | | | |
| PWLB –fixed rate | 47.2 | 6.11 | 47.0 | 6.06 |
| PWLB – variable rate | 0.0 | 0.00 | 0.0 | 0.00 |
| Market – fixed rate (i) | 6.0 | 3.68 | 24.0 | 4.19 |
| Market – variable rate | 51.0 | 5.73 | 35.0 | 6.44 |
| **Total debt** | **104.2** | **5.79** | **106.0** | **5.78** |
| | | | | |
| **INVESTMENTS** | | | | |
| - Fixed rate | 39.3 | 0.97 | 66.2 | 0.82 |
| - Variable rate | 37.7 | 0.52 | 31.3 | 0.38 |
| - Other – CCLA | 4.8 | 4.77 | 4.6 | 4.88 |
| **Total Investments** | **81.8** | **0.98** | **102.1** | **0.87** |
| **NET POSITION- DEBT / (INVESTMENT)** (ii) | **22.4** | | **3.9** | |

Note: (i) Reflects Barclays market loans converting to fixed rate effective July 16 & includes £3m of interest free Salix loans
(ii) Net position = Total debt less Total Investments

3.2 When reviewing the above table, it is important to note that investment levels do fluctuate daily, reflecting timing issues arising from monies received ahead of spend which are available on a temporary basis.

## 4. DEBT ACTIVITY

4.1 The Council, as at 31 March 2016, was under borrowed by £30.6m, as a result of the total Capital Financing Requirement (CFR), the underlying need to borrow for capital purposes, of £134.8m being higher than its actual level of external debt of £104.2m.

4.2 During 2016/17 the Council's (CFR) position, is forecasted to increase by £7.9m from its closing position as at 31 March 2016 of £134.8m to £142.7m by 31 March 2017 reflecting the difference between the level of new capital expenditure financed by borrowing, £11.0m less the statutory Minimum Revenue Provision £(3.1)m (the amount set aside from revenue for the repayment of debt).

4.3 The Council's position of being under borrowed by £30.6m reflects decisions taken previously to apply its own funds (cash supporting reserves & balances) to fund its capital borrowing requirement rather than taking on any new debt due to the high "cost of carry" i.e. the difference between long-term debt interest rates and short-term investment interest rates.

4.4 This course of action continues to be widely adopted by Local Authorities and it is currently forecast to continue as both short (Investment) and long (debt) term interest rates have reduced to historically low levels, as highlighted in the table at paragraph 2.2, following the outcome of the June Brexit referendum result and subsequent action in August by the Monetary Policy Committee to (a) reduce bank rate from 0.50% to 0.25% and (b) increase the level of support given to markets from £375bn to £435bn.,

4.5 This situation will continue to be monitored closely and any new borrowing opportunities which permit new loans to be taken to assist finance the Council's capital Investment programme without placing any additional financial burden on the revenue budget will be pursued.

4.6 The table at paragraph 3.1 highlights that the level of external debt has increased from £104.2m at 31 March 2016 to £106.0m at 30 September 2016, a net increase of £1.8m. This increase reflects a further £2m (£1m was received in 2015/16) of the £3.8m Salix loan which is to be used on the Council's Street Lighting Replacement Programme, being received at an interest rate of 0% with the remaining balance of £0.8m expected before the end of 2016/17. Maturing debt of £(0.2)m was repaid to the PWLB.

4.7 The majority of the Council's loans are held at fixed rates of interest however the Council has 1 loan which is subject to quarterly interest rate fixings using a recognised market indicator and as a consequence of the current economic climate this has resulted in a higher level of interest being paid during 2016/17; this is forecast to be £0.13m above budget and has been previously reported in the Revenue Budget Monitoring report.

4.8 Debt rescheduling opportunities have been limited due to the high breakage penalty (premium) costs which would need to be incurred and therefore during the first half of the year no debt restructuring has been undertaken however the situation will continue to be monitored for the remainder of the year.

4.9 The Council has 7 market loans totalling £59m, 2 of which are with Barclays bank at a value of £16m which were subject to interest rate reviews every 6 months by the bank. In July the Council received a letter from Barclays informing it that the bank had now waivered its right to review future interest rates and that the loans had been converted into fixed rate loans at the current interest rate levels at no cost to the Council. All other conditions of the loans remain the same. As a result of this action any sensitivity to market movements has been removed thereby enabling the Council to forecast with more certainty its ongoing debt costs.

4.10 During the first half of the year the Council had no liquidity difficulties as a result of proactive cash flow management thereby avoiding the need for any temporary borrowing to be undertaken.

## 5. INVESTMENT ACTIVITY

5.1 In accordance with the Code of Conduct, the Council's priorities when placing any temporary surplus funds with any approved institution remains as adopted in previous years which is security of capital, liquidity and then an appropriate level of return consistent with its risk appetite.

5.2 All investments placed with any of the Council's approved institutions and which matured during the first half of the financial year, were repaid on time without any difficulties and the list of institutions in which the Council invests continues to be kept under review. For reference during the first half of the year no institutions were added to or deleted from the Council's approved list.

5.3 The movement in the Council's temporary investments as at 31 March 2016 compared to 30 September 2016 is shown below for reference:

| Sector | 31 March 2016 £m | 30 September 2016 £m |
|---|---|---|
| UK Banks | 21.1 | 27.5 |
| UK Building Societies | 2.2 | 8.7 |
| Money Market Funds | 36.7 | 31.3 |
| Non UK Banks | 12.0 | 30.0 |
| Local Authority | 5.0 | 0.0 |
| Other - CCLA | 4.8 | 4.6 |
| **Total** | **81.8** | **102.1** |

The maturity structure of the investment portfolio was as follows:

| Period | 31 March 2016 £m | 30 September 2016 £m |
|---|---|---|
| Instant Access | 37.7 | 31.3 |
| Up to 3 Months | 5.5 | 13.8 |
| 3 to 6 Months | 16.7 | 25.8 |
| 6 to 9 Months | 9.5 | 2.5 |
| 9 to 12 months | 7.6 | 24.1 |
| Over 1 year | 4.8 | 4.6 |
| **Total** | **81.8** | **102.1** |

5.4 Throughout the first half of the year, a total of 104 short term temporary investments were undertaken by the Council's in house treasury management team in an environment of historically low interest rates. The table below details the results of these activities, which clearly illustrates the Council outperforming the 7day LIBID benchmark, a recognised market performance indicator, by 0.28% on its short term investments whilst ensuring that all risk was kept to a minimum during this period.

| Average level of short term Investments (ex CCLA) 1 April to 30 Sept £m | Average interest rate earned % | Average 7 day LIBID rate % | Additional interest earned against 7 day LIBID £k |
|---|---|---|---|
| 104.0 | 0.72 | 0.28 | 155 |

5.5 In September 2015, the Council invested £5m in the Local Authority Property Investment fund, managed by the Church Commissioners Local Authority, (CCLA), enabling 1,643,872 units in the fund to be purchased. This fund is only available to Local Authorities and the objective of it is to generate long-term growth in the original amount invested whilst generating returns in the form of annual dividends by investing in commercial property throughout the UK.

5.6 This investment was undertaken in September 2015 on the understanding that funds would be placed with CCLA for a minimum period of 5 years enabling capital growth to be generated following the deduction of entry costs totalling £0.3m has been taken into account and nothing has changed this position.

5.7 The Council's original investment placed with CCLA was £5m which as at 31 March 2016 was worth £4.8m however due to adverse market movements following the Brexit referendum result in June, the valuation of the Council's units had fallen to £4.6m as at 30 September. Market uncertainty regarding how the UK commercial property will react following both Brexit and the US presidential elections, makes it extremely difficult to forecast when the value of the Council units will reach its initial input value of £5m however the level of dividends received are currently forecasted to continue their strong levels as a result of high rental returns being achieved. For reference the annualised level of return generated for the first half of 2016/17 was 5.25% and it is expected to continue around this level for the forthcoming 12 months.

5.8 Due to a higher level of return achieved earlier in the first half of the year and higher temporary balances being available to be invested resulting from monies being received ahead of spend requirements, it is currently forecasted that the level of investment interest which will be generated from all of the Council's investments during 2016/17 will be in-line with that budgeted of £0.77m.

5.9 As highlighted in Section 2, it is currently a challenging market environment for earning a respectable level of interest as rates are very low and in line with the current 0.25% Bank Rate. With this in mind, together with the continuing potential for a re-emergence of a Eurozone sovereign debt crisis and other risks which could impact on the creditworthiness of banks, a low risk strategy will continue to be adopted. Given this risk environment, investment returns are likely to remain low.

5.10 A breakdown of the Council's investments, as at 30 September 2016 is provided at Appendix A for reference.

## 6. RISK BENCHMARKING

6.1 In accordance with the Code of Practice and CLG Investment Guidance, appropriate security and liquidity benchmarks are used by Officers to monitor the current and future potential risk conditions and undertake any corrective action to the operational strategy if required.

6.2 These benchmarks are simple guides to maximum risk (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria.

6.3 During the first half of 2016/17 the Chief Finance Officer can confirm that no benchmarks, which were set in the Strategy report in February 2016, were breached as shown from the information below;

- **Security** – This table shows the benchmark for the Council's investment portfolio for each individual year and reflects the level of potential default when compared to the historic default rates.

| | 1 year | 2 years | 3 years |
|---|---|---|---|
| **Original maximum default rate** | **0.077%** | **0.056%** | **0.077%** |
| **Position at 30.09.16** | **0.016%** | **0.00%** | **0.00%** |

- **Liquidity** – In respect of this the Council set liquidity facilities/benchmarks of:

  Liquid short term deposits of at least £15m available within 1 week notice and Weighted Average Life (WAL) benchmark expected to be 6 months, with a maximum of 3 years.

  *For the first half of 2016/17 the above liquidity arrangements were complied with and at 30 September 2016 the WAL of its investments was 4.2 months.*

- **Yield** - The local measure of the yield benchmark is to achieve a return above the 7 day LIBID rate.

  *For the first half year of 2016/17 the investment interest return averaged 0.72%, against a 7 day LIBID rate of 0.28%.*

- **Origin** – This stipulated that no more than 40% of the Council's total investments to be directly placed with non-UK counterparties at any time.

  *For the first half of 2016/17 the maximum level was 32%.*

## 7. PRUDENTIAL AND PERFORMANCE INDICATORS

7.1 In accordance with CLG Guidance, the CIPFA prudential Code and the CIPFA Code of Practice on Treasury Management, the Council has in place a number of prudential indicators ensuring that the Council's capital expenditure plans and borrowing remain robust, prudent and sustainable.

7.2 These indicators were originally set in February 2016 for the forthcoming year and are monitored on a monthly basis. During the first half of 2016/17 it can be reported that no breaches occurred.

7.3 To ensure that the in-house treasury management team are offering value for money in the activities undertaken, the Council joined the CIPFA benchmarking club. This facility enabled for comparisons to be undertaken of the treasury management function with 43 other local authorities of various sizes across England, Scotland and Wales and a representation of some of the 2015/16 findings are shown below;

| Topic | Average | TBC |
|---|---|---|
| Capital Financing Requirement (non HRA) as at 31.03.2016 | £323.2m | £134.8m |
| Level of investment (excluding CCLA property fund) at 31 March 2016 | £113.0m | £77.0m |
| Level of borrowings at 31 March 2016 | £258.7m | £104.2m |
| Average annual balance of temporary borrowing | £14.7m | £0.0m |
| Investment Rate of Return (excluding CCLA property fund) on investments | 0.80% | 0.81% |
| Average Consolidated Rate of Interest payable | 4.35% | 6.03% |
| Average rate of interest payable of temporary borrowing | 0.52% | 0.00% |
| Total operating costs of treasury management section per £'m | £0.66k | £0.43k |

7.4 The main findings from the above table are summarised below;

- Level of investment return achieved was above the average whilst keeping any risk to a minimum,
- Consolidated Rate of Interest (average borrowing rate) reflects the level of historic debt taken at rates of interest higher than currently on offer and which are costly to settle early,
- No temporary borrowing undertaken in the year due to effective & proactive cash flow management,
- Operating costs well below the average levels reported reflecting an efficient and effective service provided by the Council's in house treasury team.

7.5 The Council's Audit & Assurance Service, as part of their 2016/17 audit plan, undertook a review of the treasury management process & activities undertaken in 2015/16. The objective of the review was to provide assurance on the operation of the key controls within the treasury management system. For the 10th year in succession a report was issued stating that the treasury management service offered a High Level of Assurance (very good) and there were no recommendations required to be implemented as a result of their audit.

## 8 RECOMMENDATIONS

8.1 That the Accounts & Audit Committee & Executive be requested to;

- Note the Treasury Management activities undertaken in the first half of 2016/17.

**Other Options**

This report has been produced in order to comply with Financial Regulations and relevant legislation and provides an overview of transactions undertaken during the first half of 2016/17.

**Consultation**

Information for the period 1 April 2016 to 30 September 2016 was obtained from Capita, the Council's external consultants.

**Reasons for Recommendation**

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

**Finance Officer Clearance** **…NB……….**

**Legal Officer Clearance** **…MJ………..**

**Director's Signature** **……………….**

**APPENDIX A**

## Breakdown of Investments as at 30 September 2016

| **Counterparty** | **Amount £k** | **Total £k** |
|---|---|---|
| **UK Institutions** | | |
| **Banks** | | |
| Barclays | 5,000 | |
| Close Bros | 2,500 | |
| Goldman Sachs Investment Bank | 5,000 | |
| Lloyds | 10,000 | |
| Santander UK | 5,000 | 27,500 |
| **Building Societies** | | |
| Coventry | 1,200 | |
| Leeds | 2,500 | |
| Nationwide | 5,000 | 8,700 |
| **Money Market Funds** | | |
| Federated | 8,530 | |
| Invesco | 3,100 | |
| Legal & General | 340 | |
| Standard Life | 19,330 | 31,300 |
| **Other** | | |
| Church Commissioners Local Authority | 4,569 | 4,569 |
| **Total UK Institutions** | | **72,069** |
| **Non UK Institutions** | | |
| Commonwealth Bank of Australia | 10,000 | |
| National Bank of Abu Dhabi | 10,000 | |
| Qatar National Bank | 10,000 | 30,000 |
| **Total Non UK Institutions** | | **30,000** |
| **Grand Total** | | **102,069** |

**APPENDIX B**

## Major Economic Forecasts for Calendar Year 2017

| Location | Gross Domestic Product | Unemployment Rate | Consumer Price Index | Bank Rate |
|---|---|---|---|---|
| **UK** | 1.0% | 5.2% | 1.6% | 0.10% |
| **Euro Area** | 1.4% | 9.8% | 1.2% | 0.05% |
| **USA** | 2.1% | 4.7% | 2.0% | 0.75% |
| **China** | 6.2% | 4.3% | 3.0% | 4.10% |

Source of information OECD & Trading Economics