ANNEX C

TREASURY MANAGEMENT POSITION 2015/16 – QUARTER 3

1.0 LEGISLATIVE REQUIREMENT:

1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, Annual and Mid-year reports, as well as quarterly updates). This report therefore ensures this Council is implementing best practice in accordance with the Code.

1.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This quarter 3 report therefore updates Members on the current treasury management position

1.3 The Council's capital expenditure plans at quarter 3 continue to be financed by either external grants or contributions, capital receipts received in the year or capital reserves. The changes in the capital expenditure plans as detailed in the main body of the report are not financed by borrowing and therefore there is no affect on the Council's underlying need to borrow.

1.4 The council undertook no borrowing at Quarter 3 2015/16 and remained debt free. This is expected to be the position at 31 March 2016.

1.5 The capital financing requirement, which is the amount of borrowing required to support the capital expenditure programme, is set at £35,000,000. This is due to the Council's approval to invest in Broadacres Housing Association, which is classed as capital expenditure. In 2015/16, £10,000,000 will be invested but this will be financed from the Council's reserves and no long term borrowing will occur. All other capital expenditure as detailed in the paragraphs above is supported from grants, contributions and reserves. The following table shows the treasury management position as at 31 December 2015:-

	31 Dec 15 £000's	Rate %
Capital Financing Requirement	35,000	-
Borrowing	0	0.0
Investments	24,660	0.61

Table 1: Borrowing and Investment position at 31 December 2015

1.6 The table shows that changes in the capital expenditure programme only affects the treasury management position through the surplus funds that are available to the Council to invest, to earn investment income.

2.0 THE ECONOMY, INTEREST RATES AND TREASURY MANAGEMENT STRATEGY:

2.1 The economic background and interest rate forecast, which sets the environment in which the Council's treasury management operates, is attached at Annex D.

3.0 ANNUAL INVESTMENT STRATEGY 2015/16 – Quarter 3:

3.1 **Investment Policy** – the Council's investment policy is governed by the Department for Communities and Local Government guidance, which was implemented in the Treasury Management Strategy Statement (TMSS) for 2015/16, and includes the Annual Investment Strategy approved by Cabinet on 10 February 2015. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield

3.2 The Council's priority is security of its surplus funds when investing with financial institutions. However the Council will always aim to achieve the optimum return (yield) on investments in line with its risk appetite and which is commensurate with proper levels of liquidity and security. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months. Investment are placed with highly credit rated financial institutions, using the Council's treasury Management advisers – Capita Asset Services - suggested creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Capita Asset Services.

3.3 **Investments held by the Council** – As set out in Annex D, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low for the foreseeable future.

3.4 The average level of funds available for investment purposes during quarter 3 – 31 December 2015 - was £31,862,145. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council held core cash balances of £23,400,000 at Quarter 3 and £1,260,000 cash flow movement balances. Total investment balance at 31 December 2015 was £24,660,000. The first payments to Broadacres Housing Association have been made during Quarter 3 out of the Council's reserves, therefore the funds available for investments relating to Treasury Management have reduced, this will continue in Quarter 4.

3.5

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.36%	0.40%	£46,198
3 month	0.44%	0.81%	£100,784

Table 2: Investment performance for quarter 3 – latest information 31 December 2015

3.6 The table shows that the Council monitors its core cash against 3 month LIBID – London Inter Bank Investment Rates – and its cash flow investments against the 7 day rate. The Council outperformed the 3 month benchmark by 0.37% and the 7 day benchmark by 0.04%.

3.7 The Council's budgeted investment return for 2015/16 was approved at £139,510 at Quarter 1. However at quarter 3, the estimate of interest to be earned during the year has been revised to £170,390. Further detail is available in the 2015/16 quarter 3 Revenue Monitoring Report.

4.0 BORROWING 2014/15 – Quarter 3

4.1 The following borrowing information is provided to ensure Members are updated with the interest rates available for borrowing and are kept informed with regards to the current position. Capita Asset Services – the Council's treasury management advisor – target PWLB rate for new long term borrowing for quarter 4 2015/16 has decreased from the original estimate in February 2014 for 25 years by 0.4% to 3.60%, and for 5 years has decreased by 0.4% to 2.30%.

4.2 As outlined below, the general trend in PWLB rates has been an increase in interest rates during the first quarter followed by a fall during the second quarter: in the third quarter rates have been volatile with no overall direction. The 50 year PWLB target (certainty) rate for new long term borrowing, for the quarter ending 31st December, fell slightly during the quarter from 3.60% to 3.50% after the November Bank of England Inflation report.

4.2 The table below shows the Public Works Loans Board interest rates which were available for loans during quarter 3 of 2014/15. The Public Works Loans Board is the mechanism by which the Government allows local authorities to borrow at slightly lower interest rates than are available to other institutions. Certainty rates, as detailed in the table, are interest rates available to local authorities if they inform the Government of their borrowing requirements at the beginning of the financial year and are 0.02% (or 20 basis points) below Public Works Loans Board rates. This was introduced by the Government in October 2012.

	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	1.17%	1.90%	2.55%	3.28%	3.10%
Date	23/10/2015	15/10/2015	05/10/2014	02/10/2015	03/12/2015
High	1.33%	2.33%	2.88%	3.57%	3.43%
Date	09/11/2015	09/11/2015	09/11/2015	09/11/2015	09/11/2015
Average	1.23%	2.05%	2.69%	3.41%	3.27%

Table 3: Public Works Loan Board (PWLB) certainty rates, quarter ended 31 December 2015

4.3 **Treasury Borrowing** – the Council remains debt free and undertook no external borrowing for cash flow purposes or capital financing purposes in the first nine months of 2015/16.

4.4 **Rescheduling of Borrowing** – the Council has no debt and therefore undertook no rescheduling of debt during 2015/16.

4.5 **Repayment of borrowing** – the Council has no external loans and therefore no repayments were necessary.

5.0 COMPLIANCE WITH PRUDENTIAL AND TREASURY INDICATORS:

5.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) were approved in the Treasury Management Strategy Statement by Council on 24 February 2015 and are in compliance with the Council's Treasury Management Practices.

5.2 During the financial year to date the Council has operated within the Treasury and Prudential Indicators approved which are attached at Annex E.

5.3 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31 December 2015.

ANNEX D

Economic Update

1.1 ECONOMIC BACKGROUND

UK Gross Domestic Product (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. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before falling back to +0.4% (+2.1% y/y) in quarter 3. Growth is expected to improve to about +0.6% in quarter 4 but 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 November autumn statement.

Despite these headwinds, the Bank of England November Inflation Report included a forecast for growth over the three years of 2015, 2016 and 2017 to be around 2.7%, 2.5% and 2.6% respectively, although statistics since then would indicate that an actual outturn for 2015 is more likely to be around 2.2%. Nevertheless, this is still moderately strong growth which is being 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 November 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 Bank of England to make a start on raising Bank Rate as soon as had been expected in early 2015, especially given the subsequent 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 during 2015, which could potentially spill over to impact the real economies rather than just financial markets.

The American economy 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 before easing back to +2.0% in quarter 3. While there had been confident expectations during the summer that the Fed. could start increasing rates at its meeting on 17 September, downbeat news during the summer 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. The nonfarm payrolls figures for September and revised August, issued on 2 October, were also disappointingly weak. However, since then concerns on both the domestic and international scene have abated and so the Fed made its long anticipated start in raising rates at its December meeting.

In the Eurozone, the European Central Bank (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 Euro Zone countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. At the European Central Bank's (ECB's) December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. Gross Domestic Product growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the European Central Bank's lack of more decisive action in December and it is likely that it will need to boost its Quantitative Easing programme if it is to succeed in significantly improving growth in the Euro Zone and getting inflation up from the current level of around zero to its target of 2%.

1.2 INTEREST RATE FORECAST

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

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
5yr PWLB rate	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
10yr PWLB rate	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
25yr PWLB rate	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
50yr PWLB rate	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%

Capita Asset Services undertook a review of its interest rate forecasts on 9 November 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 and into early 2016, it is currently very difficult for the MPC to make a start on increasing Bank Rate. In addition, 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 excluding bonuses hitting 2.5% in quarter 3, this has subsided to 1.9% and is unlikely to provide ammunition for the MPC to take action to raise Bank Rate soon as labour productivity growth would mean that net labour unit costs are still only rising by less than 1% y/y. The significant appreciation of Sterling against the Euro in 2015 has also acted to dampen UK growth while volatility in financial markets since the Inflation Report has resulted in volatility in equity and bond prices and bond yields (and therefore PWLB rates). But CPI inflation will start sharply increasing around mid-year 2016, once initial falls in fuel and commodity prices fall out of the 12 month calculation of inflation; this will cause the MPC to take a much keener interest in the forecasts for inflation over their 2-3 year time horizon from about mid-year.

The Governor of the Bank of England, 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 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.

ANNEX 'E'

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy Statement by Cabinet on 10 February 2015

The main purpose of the indicators is to control how much a Council needs to borrow. In 2015/16, the Council will invest in a loan to Broadacres of £10,000,000. In the Strategy, the agreement was to invest with Broadacres £35,000,000 by either using surplus funds or borrowing from the Public Works Loan Board. Therefore in the table below, the Original Budget Prudential Indicators are calculated on the Council borrowing £35,000,000 from the Public Works Loan Board (PWLB) but at Quarter 3 it shows that no borrowing will occur as the £10,000,000 will be provided to Broadacres Housing Association by using surplus funds for the investment.
The capital Financing Requirement has therefore been reduced to £10,000,000.

1. PRUDENTIAL INDICATORS	2015/16	2015/16
Extract from budget and rent setting report	**Original Budget**	**Actual Q3**
	£'000	**£'000**
Capital Expenditure	37,937	14,237
Ratio of financing costs to net revenue stream	Nil	Nil
Net borrowing requirement General Fund		
brought forward 1 April	Nil	Nil
carried forward 31 March	Nil	Nil
in year borrowing requirement	35,000	0
Capital Financing Requirement 31 March 2015	35,000	10,000
Incremental impact of capital investment decisions	£	£
Increase in Council Tax (band D) per annum	£0.00	£0.00

2. TREASURY MANAGEMENT INDICATORS	2015/156	2015/15
6	**original**	**actual**
	£'000	**£'000**
Authorised Limit for external debt -		
borrowing	£40,000	£40,000
other long term liabilities	£1,000	£1,000
TOTAL	£41,000	£41,000
Operational Boundary for external debt -		
borrowing	£39,000	£39,000
other long term liabilities	£600	£600
TOTAL	£39,600	£39,600

Actual external debt	£0	£0
Upper Limit on fixed interest rates based on net debt	108%	108%
Upper Limit on variable interest rates based on net debt	-8%	-8%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£9,000	£9,000

Maturity structure of fixed rate borrowing during 2014/15	upper limit	lower limit
under 12 months	0%	100%
12 months and within 24 months	0%	100%
24 months and within 5 years	0%	100%
5 years and within 10 years	0%	100%
10 years and above	0%	100%

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