| | |
|---|---|
| **Subject:** | **TREASURY MANAGEMENT QUARTER ONE REPORT 2016/17** |
| **Meeting and Date:** | **Governance – 29th September 2016** |
| **Report of:** | **Mike Davis – Director of Finance, Housing & Community** |
| **Portfolio Holder:** | **Councillor Mike Connolly – Portfolio Holder for Corporate Resources and Performance** |
| **Decision Type:** | **Non-Key Decision** |
| **Classification:** | **Unrestricted** |
| **Purpose of the report:** | To provide details of the Council's treasury management for the quarter ended 30 June 2016 (Q1) and an update of activity to date. |
| **Recommendation:** | That the report is received |

1. **Summary**

The Council has remained within its Treasury Management and Prudential Code guidelines during the period.

The Council's investment return for the quarter was 0.59%, which outperformed the benchmark[1] by 0.23% although this return is expected to reduce slightly by the year-end as interest rates on new and rolled over deposits come down. However, the Council's budgeted investment return for 2016/17 is £329k, and performance for the full year is estimated to be on budget. This takes into account expected reductions in interest rates on assumed rollover of term deposits on maturity, but not any further reduction in the bank base rate or the need to use reserves to fund capital projects, which could impact performance by the end of year.

2. **Introduction and Background**

CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2009: it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code.

Council adopted the 2016/17 Treasury Management Strategy (TMS) on 2nd March 2016 as part of the 2016/17 Budget and Medium Term Financial Plan. The Treasury Management Strategy (TMS) for 2016/17 was approved by Council as part of its MTFP on 2nd March 2016. An update of the TMS will be considered by Cabinet and Council on 20th and 28th September respectively.

In order to comply with the CIPFA code referred to above a brief summary is provided below and Appendix 1 contains a full report from the Council's Treasury Management Advisers, Capita.

[1] The "benchmark" is the interest rate against which performance is assessed. DDC use the London Inter-Bank Bid Rate or LIBID, as its benchmark.

Members are asked to note that in order to minimise the resource requirements in producing this report, Capita's report has been taken verbatim. Capita generally use a more journalistic style than is used by our officers, but in order to avoid changing the meaning or sense of Capita's work, this has not been edited out.

As at 30th June 2016, the Council's investment portfolio totalled £42m (see Appendix 2). This is a higher level than prior years, which is partly due to a review of cashflow requirements and also the return of funds last year from Investec, our former external investment managers, following their withdrawal from the segregated funds market. This leaves the majority of our investment portfolio to be managed in-house. However, some of this may be shorter term, as significant funds sitting in the Dover Regeneration and Economic Development Reserve are earmarked for spending during 2016/17 and 2017/18 on a new leisure centre and town hall refurbishment (subject to project approvals).

The post-Brexit reduction in bank base rate, the on-going pressure on interest rates generally, and the reduction in deposit durations permissible for part nationalised banks following reductions in the Government's stakes in them, continue to place pressure on returns from banks and building societies. However, keeping funds with such highly credit-rated institutions for the currently recommended maximum six-month deposit durations remains a low risk strategy that maintains security of capital as far as possible in the uncertain post-Brexit economic climate.

3. **Annual investment strategy**

The investment portfolio, as at the end of June, is attached at Appendix 2. Core balances for investment are £42m approx. Since the end of the quarter, three deposits have matured and been reinvested with the same banks and building societies, being: £1m with Nationwide on 4th July (rate decrease 0.71% to 0.55%), £2m with Lloyds on 29th July (rate increase 0.75% to 0.8%), and £3m with Nationwide on 24th August (rate decrease 0.71% to 0.40%). A further £3m was transferred from short term cash and placed with Nationwide on 1st August (at 0.47%), which may be used to increase core balances for investment to £45m, depending on capital requirements. Shorter permissible durations relating to a change in credit ratings following a reduced Government stake in the Lloyds banking group has reduced the prospect for higher returns, as one-year deposits with them fall outside the credit criteria within the TMS.

Additionally, following the Brexit vote and the reduction in bank base rate, interest rates have dropped with all institutions. There is some expectation of a further base rate cut and some institutions may price this in, leading to further reductions in rates offered and pressure on investment income for 2016/17 and beyond.

The Gilt holding of £1.9 million transferred to King and Shaxson following Investec's withdrawal from the segregated funds market will be held until its maturity date of July 2018.

Cash flow funds have remained steady from 31st March (£16.6m) to 30th June (£16.4m) - see Appendix 2, and have increased a little since then to £17.4m at the end of July 2016 - see Appendix 4.

4. **Economic background**

The report attached (Appendix 1) contains information up to the end of June 2016; since then we have received the following update from Capita, which was also included in the Q4 report for 2015/16 (please note that their reference to quarters is based on *calendar* years). Please also note that the last section of this update on Interest Rates has been edited from a separate "Updated Interest Rate Forecast" report issued by Capita on 9th August 2016, which can be made available in full on request:

***Introduction***

*In a surprising turn, the UK voted to leave the European Union, prompting policy makers to preserve growth rates. The Bank of England (BoE) cut the bank rate for the first time since 2009 to 0.25%, as the Monetary Policy Committee (MPC) voted unanimously in favour of a cut. It also expanded its Quantitative Easing (QE) programme by £60bn to £435bn. However, three policymakers voted against the expansion. In addition, the BoE unveiled two new schemes: one to buy £10bn of high grade corporate bonds and the "Term Funding Scheme". This could be worth up to £100bn and is aimed at ensuring banks keep lending into the real economy even after rates have been cut.*

*The August Inflation Report showed the BoE leaving its growth forecasts unchanged at 2% for 2016 but lowering its forecast for 2017 significantly to 0.8% from the previous estimate of 2.3%. July retail sales showed that British shoppers and British businesses had very different perceptions on the outlook of the British economy following the Brexit vote, as shoppers continue to spend whilst businesses continue to delay investment spending and hiring. Nevertheless, it is expected that sentiments will converge in the medium term as the full effects of Brexit are translated into harder data.*

*Across the pond the US is expected to increase interest rates in the upcoming months, with the general consensus being late this year or early next year. Nevertheless, recent speeches by members of Federal Reserve have had a hawkish tone, increasing the possibility of an earlier hike than anticipated.*

***Inflation and Bank Base Rate***

*UK headline CPI increased by 0.6% year on year for July, relative to last month, beating the general consensus of a 0.5% gain. Figures from the ONS revealed that the depreciation in the pound led to an increase in the costs of imports for manufacturers, as the Producer Prices Index (PPI) also registered an increase. The main price rises came from the cost of imported food materials and the price of imported metals. Inflation forecasts were revised up sharply due to the fall in sterling and is now forecasted to hit its 2% target in 2017 and rise further to 2.4% in 2018 and 2019.*

*As mentioned, the UK reduced the bank rate to 0.25% and expanded the quantitative easing process, with further stimulus and rate cuts still on the table for later this year. Analysts are expecting the Bank of England to make full use of the monetary policy tools at its mandate, should the economy show signs of deterioration.*

***Europe***

*As far as the European Union goes, the Brexit fears have not materialised as recent data indicated that the Eurozone has shrugged off the Brexit vote. The purchasing managers indices, which typically serve as a reliable indicator of economic growth, increased in August at a level which is consistent with the economy realising a third quarter growth rate of 0.3-0.4%. Nevertheless, growth remains subdued and unemployment remains high, and there is little room to cut rates without dropping into negative territory as the bank rate remains firmly at 0%.*

*The migration crisis has also placed a strain on inter-European relationships, with many EU countries closing their borders and refusing to relocate incoming refugees. The EU-Turkey deal to stem the flow of migrants crossing into Europe is also rapidly falling apart and widespread terrorism poses a threat to foreign investment.*

***UK Public Finances***

*The UK public finance release showed that the government achieved a surplus below the forecast this July, thus leaving Britain's newly appointed chancellor, Phillip Hammond with little room to use fiscal measures to stimulate the post-referendum economy whilst simultaneously reducing Britain's deficit. Figures revealed that the £1bn surplus was primarily driven by a rise in tax receipts which were 3.4% higher in comparison to last year, yet still below the forecast surplus of £1.2bn for the month. The public finances took a serious hit in a month which is typically meant to be lucrative for public funds as businesses usually settle their tax bills. All eyes will be on the chancellor later this year when he delivers the autumn statement, with a thinned down set of measures expected.*

***Employment***

*There were fears that the Brexit vote would lead to widespread job losses in the immediate aftermath. However these fears were not realised, as the number of people claiming jobseeker's allowance in July fell by 8600 to 763,600, well below the 9500 rise predicted by the market. The UK unemployment rate remained stable at 4.9%, whilst average weekly earnings excluding bonuses rose 2.3% over the same period. Nevertheless, labour market indicators tend to lag behind the wider economy and thus we may have to wait some time before the post-referendum labour market effects are translated into hard data.*

***US Data***

*The US job market shone once again in July following on from June's stellar performance. 255,000 jobs were added in July, considerably higher than the 180,000 forecast by the market. The figure was viewed by some as positive indicator that the Fed may hike interest rates later this year. Nevertheless, weak global growth, political uncertainty with the upcoming presidential elections in November and recent disappointing PMI and core inflation data may still be weighing on the mind of Federal lawmakers. The futures markets are currently pricing in a 16% chance of a rate hike in September, which has increased in recent weeks due to hawkish statements by speeches from several Fed members. The likelihood of a hike before the end of the year still hovers around a probability of 50%.*

*Investors will look towards the Jackson Hole symposium where Federal Reserve chair Janet Yellen will deliver a speech, hoping to gain an indication of the timing of a* *rate hike. In terms of the buoyant labour market, market participants will shift their focus to the August data which will be released in September, ahead of the next Federal Open Market Committee (FOMC) meeting. Another stronger than expected increase in labour markets will mark the third consecutive month where the payroll figures exceeded the general consensus and will be hard to ignore for the Fed.*

***Interest Rates***

*Forward guidance that a further cut to near zero (0.10%?), is likely – probably November 2016 quarterly inflation report meeting, if data comes in as forecast, but Carney has dismissed the ideas of negative rates and helicopter money.*

*Considerable variety of views as to whether these latest measures will have much direct impact on the economy; but they are likely to have an indirect effect by impacting on perceptions and boosting confidence that the Bank is taking action and doing as much as possible - so this WILL help sentiment.*

*Our tentative forecast is for increases in Bank Rate in May 2018 to 0.25% and to 0.50% May 2019; but these will very much depend on how strongly, and how soon, the UK economy makes a gradual recovery, and so start a process of very gradual increases in Bank Rate over a prolonged period.*

| **BANK RATE** | **Est. now** | **Est. previously** |
|---|---|---|
| Q3 2016 | 0.25% | 0.25% |
| Q1 2017 | 0.10% | 0.25% |
| Q1 2018 | 0.10% | 0.25% |
| Q1 2019 | 0.25% | 0.50% |

5. **Net Borrowing**

The Council's borrowing portfolio is attached at Appendix 3. No new borrowing was undertaken during the quarter.

Cabinet and Council (20th and 28th September respectively) will consider changes to the TMS required to increase borrowing limits to enable the borrowing to support the Dover Leisure Centre project to be undertaken, subject to project approval. Detail of the borrowing will be advised to Members as part of the quarterly update reports when it is undertaken.

6. **Debt Rescheduling**

At this time it is not of benefit to the Council to consider rescheduling of its long-term debt, as advised by Capita.

7. **Compliance with Treasury and Prudential Limits**

The Council has operated within the treasury limits and Prudential Indicators and in compliance with the Council's Treasury Management Practices.

As mentioned, an update of the TMS will be considered by Cabinet and Council on 20th and 28th September respectively. This includes a footnote about 'term deposit durations' which was omitted from the original TMS for 2016/17, which gives a small degree of flexibility around weekend and bank holiday dates while remaining within the spirit of the intended duration limits. It states: For the purposes of the table above, in order to keep within the intended spirit of the maximum investment period, 6 months means “up to 186 days” and 1 year means “up to 370 days”.

8. **Corporate Implications**

Comment from the Section 151 Officer: Finance have no further comments to make. (SG)

Comment from the Senior Solicitor to the Council:

Comment from the Equalities Officer:

## Appendices

Appendix 1 – Capita treasury management report for quarter one

Appendix 2 – Investment portfolio as at 30 June 2016

Appendix 3 – Borrowing portfolio as at 30 June 2016

Appendix 4 – Investment portfolio as at 31 July 2016

**Background Papers**

Medium Term Financial Plan 2016/17 – 2019/20

**Contact Officer: Stuart Groom, extension 2072**

Date: 30th August 2016