Treasury Management Update

Quarter Ended 30th June 2015

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 (TMSS, annual and midyear reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code. (Please note that the references to Q1, Q2, Q3 and Q4 in Appendix 1 are based on the *calendar* year, whereas the covering report is based on the financial year so that Q1 is the period ended 30th June 2015).

1. Economic Background

After strong UK GDP growth in 2013 at an annual rate of 2.7% and 3.0% in 2014, quarter 1 of 2015 was disappointing at only 0.4%, though subsequent data indicates that this could well be revised up further down the line and also indicates a return to stronger growth in quarter 2. In its May quarterly Inflation Report, the Bank of England reduced its GDP forecast for 2015 from 2.9% to 2.5% and from 2.9% to 2.7% in 2016, while increasing its forecast for 2017 from 2.4% to 2.7%.

Uncertainty around the likely result of the UK general election in May has obviously now evaporated although this has been replaced by some uncertainty around the potential impact on the UK economy of the EU referendum promised by, or in, 2017. In addition, the firm commitment of the Conservative Government to eliminating the deficit within the term of this Parliament will have an impact on GDP growth rates. However, the MPC is fully alert to this and will take that into account, and also the potential spill over effects from the Greek crisis, in making its decisions on the timing of raising Bank Rate.

As for the American economy, confidence has improved markedly in this quarter that the US will start increasing the Fed funds rate by the end of 2015 due to a return to strong economic GDP growth after a disappointing start to the year in quarter 1, (a contraction of 0.2%), after achieving 2.4% growth in 2014.

In the Eurozone, the ECB, in January 2015 unleashed 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, though it remains to be seen whether this will have an enduring effect as strong as the recovery in the US and UK.

2. Interest Rate Forecast

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

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%
5yr PWLB rate	2.30%	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%
10yr PWLB rate	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%
50yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%

Capita Asset Services undertook a review of its interest rate forecasts after the May Bank of England Inflation Report. The ECB's quantitative easing programme to buy up EZ debt caused an initial widespread rise in bond prices and, correspondingly, a fall in bond yields to phenomenally low levels, including the debt of some European countries plunging into negative yields. Since then, fears about recession in the EZ, and around the risks of deflation, have abated and so there has been an unwinding of this initial phase with bond yields rising back to more normal, though still historically low yields.

This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 1 of 2016 to quarter 2 of 2016 as a result primarily of poor growth in quarter 1, weak wage inflation and the recent sharp fall in inflation due to the fall in the price of oil and the impact of that on core inflation. The UK fell marginally into deflation in April (-0.1%) and figures near zero will prevail for about the next six months until the major fall in oil prices in the latter part of 2014 falls out of the twelve month calculation of CPI inflation. 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.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by the Council on 04/03/2015. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. 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 with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the ultra-low Bank Rate and other extraordinary measures such as the Funding for Lending Scheme. Funds were available on a temporary basis, and 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 holds **£22m** core cash balances for investment purposes (i.e. funds available for more than one year). However, only £16m are shown as portfolio/core balances on Appendix 2 at 30th June, as the majority of funds returned by Investec are being held in short-term call accounts pending review of TMSS and proposed placement with other institutions for longer durations, subject to suitable credit criteria.

Investment performance for quarter ended 30th June 2015

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.36	0.52%	£69k

As illustrated, the Council outperformed the benchmark by 16 bps. However, while the Council's budgeted investment return for 2015/16 is £333k, performance for the year is estimated to be £292k, which is £41k below budget.

4. New Borrowing

The 25 year PWLB target (certainty) rate for new long term borrowing, for the quarter ending 30th June, rose slightly from 3.40% to 3.50% after the May Bank of England Inflation report.

No borrowing was undertaken during the quarter.

PWLB certainty rates, quarter ended 30th June 2015

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.11%	1.82%	2.40%	3.06%	3.01%
Date	02/04/2015	02/04/2015	02/04/2015	02/04/2015	02/04/2015
High	1.33%	2.32%	3.04%	3.65%	3.55%
Date	25/06/2015	25/06/2015	10/06/2015	24/06/2015	04/06/2015
Average	1.23%	2.09%	2.75%	3.37%	3.29%

Borrowing in advance of need

This Council has not borrowed in advance of need during the quarter ended 30th June 2015.

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter.

6. Compliance with Treasury and Prudential Limits

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 TMSS.

During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown below.

7. Other

Investec have withdrawn from the segregated investment fund market and on 30 June 2015 returned the Council's investment of £11m approx. A further £1.9m in Gilts was separately transferred to King and Shaxson to be held until maturity in 2018.

The treasury management strategy is currently being revised to take account of the higher level of in-house funds to be managed by DDC, and it is proposed to update credit criteria and deposit limits to enable further funds to be placed with highly-credit rated institutions, at low risk, to enable higher returns with a view to minimising any further shortfall of investment income against budget in 2015/16.

Prudential and Treasury Indicators as at 30th June 2015

Treasury Indicators	2015/16 Budget £'000	Quarter 1 (Apr-Jun) Actual £'000
Authorised limit for external debt	113,500	113,500
Operational boundary for external debt	108,000	108,000

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	2,086	2,086
12 months to 2 years	3,256	3,256
2 years to 5 years	6,993	6,993
5 years to 10 years	13,232	13,232
10 years and above	64,188	64,188

Prudential Indicators	2015/16 Budget £'000	Quarter 1 (Apr-Jun) Actual £'000
Capital expenditure *	13,693	2,525
Capital Financing Requirement (CFR) *	98,233	92,082