Subject:	**TREASURY MANAGEMENT QUARTER TWO REPORT 2015/16**
Meeting and Date:	**Governance – 3rd December 2015**
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 September 2015 (Q2) and an update of activity to date.
Recommendation:	That the report is received

1. Summary

As at 30 September 2015, the Council's in-house investment portfolio totalled £16.9m (see Appendix 2). This includes some of the funds returned from Investec following their withdrawal from the segregated fund market, although the majority of the returned funds are sitting in overnight cash balances, of which £5m has been placed with Barclays since 30th September, and it is proposed to transfer a further £7.5m from NatWest to a fixed term deposit with HSBC once the account opening procedures are completed to improve investment yields. The Treasury Management Strategy Statement (TMSS) has been updated and approved since quarter one in order to deal with the higher level of in-house funds available for investment as a result of the changes.

It is expected that we will increase the sum regarded as "investment portfolio" (as opposed to cashflow funds), from the previous level, which was £22m approx., to over £30m as part of reviewing our cashflow needs following the return of the funds from Investec. Some of this increase may, in fact, 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.

The Council's investment return for the quarter was 0.50%, which outperformed the benchmark[1] by 0.14%. However, while the Council's budgeted investment return for 2015/16 is £333k, performance for the year is estimated to be £304k, which is £29k below budget. This is mostly due to the on-going pressure on interest rates and the reduction in deposit durations permissible for part-nationalised banks following revisions to credit ratings.

The Council has remained within Prudential Code guidelines during the period.

[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.

2. Introduction and Background

Council adopted the 2015/16 Treasury Management Strategy Statement (TMSS) on 4 March 2015 as part of the 2015/16 Budget and Medium Term Financial Plan.

The 2015/16 Treasury Management Strategy was revised and approved by Council on 30th September 2015 to allow for the transfer of additional funds held in-house by DDC for investment following the withdrawal of Investec, formerly the Council's fund managers, from the local authority segregated funds market.

While sums are currently held in low-interest bearing overnight and instant access deposit accounts with the Council's operating bank and others, it is proposed to open new longer term accounts at better rates following update of the TMSS, subject to suitable credit criteria (e.g. £5m has been placed with Barclays for six months on 2nd October 2015).

3. Annual investment strategy

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

The investment portfolio as at the end of September is attached at Appendix 2. Since the end of the quarter, £5 million previously held in an overnight account with Barclays has been transferred, on 2nd October, to a six-month fixed term deposit with Barclays at a rate of 0.69%, and £1 million Bank of Scotland deposit maturing on 9th November has been reinvested for six months at a rate of 0.75%. We are in the process of opening an account with HSBC to place further funds, currently in our operating bank's overnight (SIBA) account at low interest rates, in order to spread risk and earn higher returns.

Cash flow funds increased from £35.4m at 30 June 2015 to £39.4m at 30 September (see Appendix 2), which is partly due to an increase in right-to-buy housing sales in the last quarter. Additionally, there is an increased inflow of Council Tax receipts, generally paid over 10 months from April to January, while preceptors on the Collection Fund are paid their shares of Council Tax income evenly over the year which causes some building of cash balances until February/March. The cash flow funds have dropped since 30 September 2015, to £33.1m by 31 October 2015 (see Appendix 4), but this mainly relates to the transfer of £5m funds to a fixed term deposit with Barclays and therefore shown within investment portfolio instead.

4. Economic background

The report attached contains information up to the end of September 2015; since then we have received the following update from Capita (please note that their reference to quarters is based on *calendar* years):

Introduction

October kicked off with Volkswagen reporting its first quarterly loss for at least 15 years after its performance was materially undermined by provisions to cover the potential costs of its emissions scandal. Elsewhere, China's economy showed little sign of improvement, with official figures revealing it grew 3% less (on an annual basis) than in the previous three decades. Meanwhile, the Bank of England's

Monetary Policy Committee (MPC) provided no surprises once again, with an 8-1 vote from members in favour of no change in the level of policy support.

The excess supply of oil continues to linger, affecting global economies and markets. With North Sea oil production struggling with the crashing prices, the UK oil sector is predicted to lose a further 10,000 jobs, alongside the 5,500 already made redundant. The surplus supply has sent oil prices plummeting over the past year, with the international benchmark Brent crude falling from over $100 a barrel in July 2014, to trade around the $50-mark today. Credit ratings agency, S&P, gloomily suggested that prices may remain low even longer than expected with a "more prolonged recovery".

GDP

Britain's economic growth fell by more than expected in the third quarter of 2015, with figures revealing that the economy grew 0.5% between July and September, in contrast to the 0.7% growth in the second quarter. This missed economists' expectations of 0.6% growth, while the annual return of 2.3% was also shy of forecasted levels. Despite accounting for a small portion of overall output, the 2.2% shrinking of the construction sector hit GDP the hardest. Contrastingly, industrial output benefited from a bounce in oil production, mainly due to fewer maintenance shutdowns than in previous years. While the slowing of the recovery is only expected to be temporary, the data underlined market expectations that monetary policy tightening will not commence anytime soon.

Interest Rates

The MPC held UK interest rates at the record low of 0.5%, following an 8-1 vote in favour of keeping rates unchanged. This marks the 79th consecutive month without a change to rates. Following August and September's actions, Ian McCafferty, once more, voted for a modest 0.25% increase in the Bank Rate.

US Data

US economic growth also slowed sharply in the third quarter of this year as a result of businesses scaling back investment. GDP grew by 1.5% from July to September, down from 3.9% in the second quarter. This was modestly below economists' expectations of 1.6% growth for the period.

At the conclusion of its two day meeting, the Federal Reserve announced that it will keep interest rates at their record low of 0-0.25%. However, the accompanying statement did suggest that a hike is still a possibility in the final meeting of the year, in mid-December. This wrong-footed markets and saw US equities give up some of their recent gains, which also affected markets further afield.

Retail Sales

Domestic retail sales rose at the fastest monthly rate since December 2013 in September, predominantly boosted by falling store prices and promotions related to the Rugby World Cup. The Office for National Statistics (ONS) revealed retail sales had climbed up by 1.9% on the month, far higher than economists' forecasts for a 0.3% rise, suggesting hosting the Rugby World Cup provided a timely uplift to sales and helped the industry set a solid platform ahead of the essential Christmas period.

Inflation

For the second time this year, inflation in Britain has dipped below zero, easing pressure on the MPC to raise interest rates from their record low. ONS figures revealed that the Consumer Prices Index (CPI) dropped from zero in August to -0.1% in September, mainly dragged by cheaper fuel prices and a less-than-expected rise in clothing prices. Despite this, Mark Carney reassured Britons that the UK is not headed for a scenario of widespread price falls becoming entrenched, and to enjoy low inflation while it lasts. This fall in CPI has boosted household budgets as wages continue to rise faster than underlying prices.

Employment

UK unemployment slipped to its lowest level since mid-2008 between June and August with the number of people out of work standing at 1.77 million. This, however, was surpassed by the slight slowdown in average earnings, with pay excluding bonuses increasing by 2.8%, compared to a 2.9% rise in the period to July. Policymakers at BoE have stated that wage growth and unemployment will be key deciders for when it is eventually decided to hike interest rates. The data, therefore, saw some market participants push back further on their expectations for when rate-setters will begin to hike.

Mortgage Lending

In the year to September, mortgage approvals leaped 24%, figures by the BBA showed, suggesting buyers are racing to secure mortgages in fear that interest rates will hike soon. Despite this, British banks approved the fewest mortgages last month since May. With surveys continuing to indicate a shortage of new homes for sale, this is likely to increase the upward pressure on house prices, which the UK Chief Economist of Capital Economics, expects to increase by approximately 8% next year.

5. **Net Borrowing**

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

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 Prudential Indicators in compliance with the Council's Treasury Management Practices, but has exceeded the level of permissible deposit with its own operating bank, NatWest, albeit in a low risk instant-access overnight deposit account. As mentioned above, it has been necessary to revise the Treasury Management Strategy Statement for 2015/16 to provide sufficient scope to spread the investment risk across a sufficiently wide number of banks and institutions, which was approved by Council on 30th September 2015. We are in the process of opening accounts with further highly credit-rated banks following the

revision of the TMSS in order to lower the levels of cash with our operating bank, and transfer funds to longer term investments with better rates of return.

Appendices

Appendix 1 – Capita treasury management report for quarter two

Appendix 2 – Investment portfolio as at 30 September 2015

Appendix 3 – Borrowing portfolio as at 30 September 2015

Appendix 4 – Investment portfolio as at 31 October 2015

Background Papers

Medium Term Financial Plan 2014/15 – 2016/17

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