Subject:	**TREASURY MANAGEMENT QUARTER THREE REPORT 2015/16**
Meeting and Date:	**Governance – 24th March 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 31 December 2015 (Q3) and an update of activity to date.
Recommendation:	That the report is received

1. Summary

As at 31 December 2015, the Council's in-house investment portfolio totalled £32.5m (see Appendix 2). The revised Treasury Management Strategy Statement (TMSS) was updated and approved at the end of September 2015 and, accordingly, we have opened further accounts during Q3 and placed funds with HSBC (£7.5m), Barclays (£5m) and Santander (£5m) in order to deal with the higher level of in-house funds available for investment as a result of funds being returned from Investec on their withdrawal from custodianship arrangements on 30th June 2015. This means that higher interest rates can be achieved and this has prevented any further reduction in projected interest receivable since the end of the last quarter.

Additional cashflow funds remain high (£23m at 31st December 2015) and we will continue to review our cashflow needs, and consider whether further funds can be invested for six to twelve months. However, we need to bear in mind that significant funds sitting in the Dover Regeneration and Economic Development Reserve are earmarked for spending during 2016/17 and 2017/18 as part of the leisure centre and town hall projects. Similarly, more than £3m remains in the Council's bank account awaiting payment requests from Discovery Park, where the Council is acting as the accountable body (intermediary) for "Building Foundations for Growth" grant already received from DCLG. For these reasons, the Council has exceeded the £10m deposit limit with its operating bank (NatWest) in breach of its revised TMSS, but in a low risk, instant access Special Interest Bearing Account (SIBA).

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 remains £29k below budget, as reported at the end of September, but means there has been no further projected erosion of returns during the quarter to December. The shortfall for the year also relates to the on-going pressure on interest rates and the reduction in deposit durations permissible for part-nationalised banks following revisions to credit ratings.

[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.

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

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 longer term investment, following the withdrawal of Investec, formerly the Council's fund managers, from the local authority segregated funds market.

To avoid excessive cashflow funds being held in low-interest bearing overnight and instant access deposit accounts with the Council's operating bank and others, it is proposed to update deposit limits in the 2016/17 TMSS to allow increased funds to be held with highly credit-rated banks and institutions, subject to suitable credit criteria, to further improve returns in 2016/17.

3. Annual investment strategy

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.

The investment portfolio as at the end of December is attached at Appendix 2. Since the end of the quarter, three deposits have matured and been reinvested with the same banks. Two deposits with Nationwide totalling £4m have been reinvested for six months as before, but at a higher rate of return (0.71% vs. 0.66%). One deposit of £2m with Lloyds has been reinvested for six months at 0.75%, which is a lower rate of return than before, when it was invested for twelve months at 1.00%. The shorter duration relates to a change in credit rating following a reduced Government stake in the Lloyds banking group.

Cash flow funds decreased from £39.4m at 30th September 2015 to £23.1m at 31st December 2015 (see Appendix 2), which is mainly due to transferring £17.5m funds to longer term deposits as part of the revised investment portfolio figure of £32.5m, as detailed in (1) above. Cashflow funds have increased slightly from £23.1m at the end of December 2015 to £24.2m at the end of February 2016 (see Appendix 4), but these should reduce once the final PWLB loan instalment is paid for the 2015/16 year (in March) and also bearing in mind the reduced council tax receipts in March (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. These factors should cause a reduction in cash balances by the end of the financial year.

4. Economic background

The report attached contains information up to the end of December 2015; since then we have received the following update from Capita, which they have split between "January 2016" and "February 2016" comments. Please note that their references to quarters are based on *calendar* years:

January - Introduction

Economic data from the UK was mixed in January. The Manufacturing PMI fell to a three-month low of 51.9 in December, falling short of economists' expectations, as factories reported the slowest rate of new orders growth in five months. The Services PMI also fell, but at 55.5 the sector is expanding at a healthy rate and continues to underpin the UK's recovery. However, the Construction PMI picked up from its seven-month low of 55.3 in November to 57.8 in December as commercial building picked up in tandem with the country's resurgent economy. The sum of the disappointing data was that the UK economy ended the year on a slightly weaker note.

GDP

Although the preliminary estimate of UK Q4 GDP revealed a slight improvement in quarterly growth of 0.5%, the year on year rate of 1.9% was the weakest in nearly three years.

Employment

The labour market tightened further to leave unemployment at a near ten year low of 5.1%, in the three months to November. Moreover, the number of people in employment reached a record 31.39 million. Despite the stronger employment figures, wage growth, including bonuses, slowed to 2.0% in November, from 2.4% in the previous month, the lowest rate since February of last year. Conversely, the headline Consumer Prices Index (CPI) rose to an 11 month high of 0.2% year-on-year, surpassing economists' expectations, as increased Christmas transport costs, particularly air fares, outweighed the impact of falling oil prices.

Interest rates

The Bank of England (BoE) left interest rates unchanged at 0.5% as expected, with the Monetary Policy Committee (MPC) members voting 8-1, as Ian McCafferty again voted for a rate increase. The rationale behind the MPC's decision was that the falling oil prices will have a direct impact on British inflation in the coming months and economic growth may well be slower than previously forecast. The MPC did add that declines in oil prices may contribute to economic growth in Britain and other economies.

US Data

Across the Atlantic, the first reading of US Q4 GDP added to the gloom, showing a sharp slowdown as the economy grew by an annualised 0.7%, compared to 2.0% in Q3. The considerable fall was attributed to weak global demand pressuring exports, not helped by a strengthening dollar, and a surplus of inventories. On a more positive note, US job growth was particularly strong, with the economy adding 292,000 to non-farm payrolls in December. Nonetheless, the rate of unemployment was unchanged at its seven and a half year low of 5%. The Federal Reserve kept interest rates at 0.25-0.5% as expected at its January meeting but pointed towards global equities performance as reflection of growing fears of a sudden global economic slowdown. Despite the robust US Labour market data, economists believe that low inflation and financial market turmoil could persuade the Fed not to deliver a previously expected second hike in March.

Eurozone Data

Eurozone unemployment fell slightly from 10.6% to 10.5% in November; the lowest level in more than four years. The German economy recorded the lowest rate of unemployment at 4.5%, whilst Spain and Greece continued to experience the highest levels at 21.4% and 24.6% respectively. The European Central Bank stuck to the status quo as anticipated, keeping its deposit rate at -0.3% and the main refinancing rate at 0.05%.

February - Introduction

February saw the continuation of the turbulent market conditions that had been in place through the prior month, with the additional domestic concern of an EU referendum for participants to contend with. Data releases from here and further afield added to market concerns about the global economic outlook, leading most investors and commentators to pare back any rising interest rate expectations.

Despite the tepid nature of data releases towards the end of Q4, the services PMI activity survey provided evidence that the economic recovery began 2016 on a somewhat stronger note. The headline figure saw a slight nudge, from 55.5 to 55.6 in January. However, with uncertainty remaining ahead of the EU referendum, coupled with firms' concerns over a global economic slowdown, caution regarding the outlook remained fully entrenched. Despite these positive readings, the manufacturing activity survey revealed the index slumped to a near three-year low of 50.8 in February, from the preceding month's 52.9. Furthermore, the construction PMI also stood at its weakest in ten months, with the figure coming in at 54.2, from 55.0 in January.

Employment

On a less gloomy note for the UK, employment reached its highest peak in the three months to December 2015, as recorded by the ONS. Of the UK population, 74.1% were logged to have been employed, providing some positive sentiment in the economy's near-term outlook. In spite of this, an expected fall in unemployment failed to take place in December, with the unemployment rate sticking at 5.1%, the same level as in the three months between September and November.

Interest Rates

This month's "Super Thursday" announcements revealed any prospects for an early rate rise remains remote, following a 9-0 vote in favour of leaving rates at its record low of 0.5%, evidently illustrating that low inflation has clearly tied the MPC's hands. This outcome from the MPC resulted in Sterling falling by over a percent against the Euro.

GDP

With the weakening global economy taking its toll on the UK, the Bank of England (BoE) has steered to cutting its growth forecasts, with GDP predicted to come in at 2.2% this year, from a previously anticipated 2.5%. A further key point outlined in the Inflation Report suggested inflation will remain below 1% for all of 2016, and is only expected to reach its 2% target by the first quarter of 2018.

Petrol prices looked to be the biggest contributor to the annual inflation rate inching up to a 12-month high in January, as suggested by data from the ONS. Nevertheless, CPI rising to 0.3% in January from December's 0.2%, still indicated that price pressures were benign. Beliefs still linger regarding CPI inflation gradually heading back towards its target if and when the impact of tumbling commodity prices begins to take a back seat.

US Data

US non-farm payroll numbers came in worse than anticipated, leading equity markets, including those in London, to fall. With international news agency, Reuters, predicting an increase of 190,000 people in jobs for January, markets were disappointed when the actual figure recorded a gain of only 151,000. Despite this substandard number, the unemployment rate continued to fall, to 4.9% from 5% in December, nearing an eight-year low. Alongside this, average hourly earnings rose 2.5% year-on-year in January, exceeding forecasts of a 2.2% increase. Further US data encompassed the slight appreciation of the Dollar after GDP for Q4 was unexpectedly revised upwards. The second estimate saw growth hit 1% annualised in the final quarter of the year, up from the 0.7% initial estimate.

UK Data

In contrast, the second estimate of UK GDP for Q4 revealed no change, with the growth levels remaining at 0.5% q/q and 1.9% y/y, in line with expectations. Following several months of market uncertainty and turmoil, investors took some comfort from these confirmed positive readings. Consumer spending revealed a 0.7% increase in the last quarter of 2015, aiding towards offsetting the decline in exports and the biggest drop in business investment in nearly two years. Conversely, the ONS reported that Britain's total trade deficit widened to £10.35bn in Q4, from £8.58bn in the previous quarter. This provides further evidence that international trade is likely to have dragged on economic growth, and consequently suggesting that the UK appears to be losing ground over recent decades with respect to the trade deficit.

The UK recorded the largest January public finances surplus since 2008, of £11.2bn. Nonetheless, expectations of a £12.65bn surplus were missed, indicating little to no scope to loosen the country's fiscal stance in the Budget next month. Alongside this, the odds still remain loaded against Chancellor George Osborne meeting the fiscal targets of £73.5bn for the 2015/16 budget deficit.

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. A further update of the TMSS for 2016/17 seeks to increase limits with highly credit-rated banks, including with our operating bank, NatWest, but also to enable further transfers of 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 31 December 2015

Appendix 3 – Borrowing portfolio as at 31 December 2015

Appendix 4 – Investment portfolio as at 29 February 2016

Background Papers

Medium Term Financial Plan 2015/16 – 2017/18

Contact Officer: Stuart Groom, extension 2072