Subject:	**TREASURY MANAGEMENT YEAR-END REPORT**
Meeting and Date:	**Cabinet – 20 September 2016** **Governance – 29 September 2016**
Report of:	**Mike Davis – Director of Finance, Housing and Community**
Portfolio Holder:	**Councillor Mike Connolly – Portfolio Holder for Corporate Resources and Performance**
Decision Type:	**Executive Non-Key Decision**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the financial year ended 31 March 2016 (Q4) and an update of activity to date.
Recommendation:	That the report is received

1. **Summary**

This report covers the outturn for the year ending March 2016, and will also be included in the Governance agenda. The main points to note are that, while we are outperforming the benchmark, interest rates are down, we are working to get the best returns we can, but nonetheless, we are likely to see falling income from interest in the future that will be an additional budget pressure.

As at 31st March 2016, the Council's in-house investment portfolio totalled £32.5m (see Appendix 2). The revised Treasury Management Strategy Statement (TMSS) for 2015/16 was updated and approved at the end of September 2015 and, accordingly, further bank accounts had been opened during Q3 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. In particular, funds were placed with HSBC (£7.5m), Barclays (£5m) and Santander (£5m). This means that higher interest rates can be achieved and this has prevented any further erosion in projected interest receivable since the end of the last quarter (in fact, the final position is slightly better than the forecast of £304k reported at the end of Q3 as detailed below).

Additional cashflow funds remain fairly high (£16.6m at 31st March 2016) and we have reviewed our cashflow needs since the end of Q4 and invested further funds for up to six months (see Appendix 4). 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) at times during the year and during the last quarter in breach of its revised 2015/16 TMSS, but in a low risk, instant access Special Interest Bearing Account (SIBA).

Investment limits have been reviewed for both the Council's operating bank and other highly credit-rated counterparties and increased as part of the 2016/17 TMSS approved at Council on 2nd March 2016 within the MTFP, to deal with higher levels of cash available until key projects formally commence and require funding. Since 1st April 2016 until the date of this report, none of the revised investment limits have been exceeded.

The Council's investment return for the quarter was 0.51%, which outperformed the benchmark[1] by 0.15%. However, while the Council's budgeted investment return for 2015/16 was £333k, performance for the year was £313k, which remains £20k below budget, although this is better than the £29k estimated shortfall reported at the end of 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.

The Council has remained within its Treasury Management guidelines, except as mentioned above, and within the Prudential Code guidelines during the period.

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.

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.

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.

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, deposit limits have been updated for the 2016/17 TMSS to allow increased funds to be held with highly credit-rated banks and institutions, subject to suitable credit criteria, to improve returns in 2016/17, although this will now be offset by the recent impact of the post-Brexit bank base rate reduction.

[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.

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 and will be held until its maturity date of July 2018.

The investment portfolio as at the end of March is attached at Appendix 2. Since the end of the quarter, several deposits have matured and mainly been reinvested with the same banks, except for the £5m Close Bros deposit (0.6% interest rate) which, on maturity, along with £7.2m surplus cashflow funds, were invested with three separate institutions, being: £2.8m with Santander (at 0.9%), £2m with Lloyds (at 0.8%) and £7.4m with Bank of Scotland (at 0.8%). This has effectively increased core cash balances held for investment purposes (pending commencement of key projects) to £42m approx. as shown on Appendix 4. The other deposits maturing and being reinvested with the same institutions were: £3m with Lloyds on 17th June (rate increase 0.75% to 0.8%), £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 0.44%). Additionally, a £1m deposit maturing with Bank of Scotland (at 0.75%) on 9th May was reinvested with Lloyds (at 0.8%). 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 TMSS.

Please note that, following the Brexit vote and the reduction in bank base rate, interest rates are dropping 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.

Cash flow funds decreased from £23.1m at 31st December 2015 to £16.6m at 31st March 2016 (see Appendix 2). This is normal and expected, as there are reduced council tax receipts in February and 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, and a further six-monthly PWLB loan instalment was paid for the 2015/16 year at the end of March. Cashflow funds have increased only slightly from £16.6m at the end of March 2016 to £17.4m at the end of July 2016 (see Appendix 4), which reflects the fact that a further £7.2m cashflow funds have been transferred to longer term deposits as part of the Council's core investment balances, as mentioned above.

4. **Economic Background**

The report attached (Appendix 1) contains information up to the end of March 2016; since then we have received the following update from Capita (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. **New 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 has increased limits with highly credit-rated banks, including with our operating bank, NatWest, which also enables further transfers of funds to longer term investments with better rates of return.

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: The Solicitor to the Council has been consulted in the preparation of this report and has no further comments to make. (HR)

Comment from the Equalities Officer: This report does not specifically highlight any equalities implications however, in discharging their responsibilities members are required to comply with the public sector equality duty as set out in section 149 of the Equality Act 2010 http://www.legislation.gov.uk/ukpga/2010/15 (KM)

Appendices

Appendix 1 – Capita treasury management report for quarter four

Appendix 2 – Investment portfolio as at 31 March 2016

Appendix 3 – Borrowing portfolio as at 31 March 2016

Appendix 4 – Investment portfolio as at 31 July 2016

Background Papers

Medium Term Financial Plan 2015/16 – 2017/18

Contact Officer: Stuart Groom, extension 2072